



OECD Economic Surveys BULGARIA

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OECD Economic Surveys: Bulgaria 2023

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Foreword

This Economic Survey was prepared by Margit Molnar, Michael Abendschein and Zvezdelina Zhelyazkova under the supervision of Sebastian Barnes. Klaus Pedersen and Lutecia Daniel provided research assistance. Nathalie Bienvenu, Gemma Martinez and Karimatou Diallo provided editorial support.

The Survey benefitted from useful comments by Jean-Christophe Dumont, Ben Game, Arijete Idrizi, Thomas Liebig, Marius Luske, Judd Ormsby, Emilia Soldani and Theodora Xenogiani.

On 25 January 2022, the OECD Council decided to open accession discussions with Bulgaria as well as five other countries (Argentina, Brazil, Bulgaria, Croatia, Peru and Romania). On 10 June 2022, the Council at Ministerial Level adopted the Roadmap for the Accession Process of Bulgaria [C/MIN(2022)22/FINAL], setting out the terms, conditions and process for the accession of Bulgaria. In accordance with this Roadmap, 25 OECD technical committees, composed of expert policy-makers from each of the 38 OECD Members, will conduct an in-depth assessment of Bulgaria's legislation, policies and practices against OECD legal instruments and OECD best policies and practices covering multiple areas of government policy, including economic policy but also labour market and social policy, education, and health.

The overarching objective of the OECD accession process is to promote Bulgaria's convergence with OECD standards, best policies and best practices, resulting in better outcomes for OECD Members as well as for Bulgaria and its citizens. Throughout the accession process, the OECD will work closely with Bulgaria to support the adoption of long-lasting reforms for this purpose.

The Economic Survey of Bulgaria was discussed at a meeting of the Economic and Development Review Committee (EDRC) on 7 March 2023 and is published on the responsibility of the Secretary-General of the OECD. The cut-off date for data used in the Survey is 24 March 2023. The previous Survey of Bulgaria was issued in January 2021. Information on other Surveys and how they are prepared is available at www.oecd.org/surveys

Publication of this document, and the analysis and recommendations contained therein, do not prejudice in any way the results of the review of Bulgaria by the Economic Development Review Committee as part of its [process of accession to the OECD](#).

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Basic statistics of Bulgaria, 2021¹

Numbers in parentheses refer to the OECD average²

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million)	6.5 ³		Population density per km ²	63.4	(38.7)
Under 15 (%)	14.0	(17.4)	Life expectancy at birth (years, 2020)	73.6	(79.0)
Over 65 (%)	22.4	(17.7)	Men (2020)	69.9	(76.2)
International migrant stock (% of population, 2019)	2.4	(13.2)	Women (2020)	77.5	(82.0)
Latest 5-year average growth (%)	-0.7	(0.5)	Latest general election		10. 2022
ECONOMY					
Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	83.9		Agriculture, forestry and fishing	5.0	(2.6)
In current prices (billion BGN)	138.6		Industry including construction	23.8	(26.6)
Latest 5-year average real growth (%)	2.5	(1.6)	Services	71.2	(70.8)
Per capita (thousand USD PPP)	28.0	(50.8)			
GENERAL GOVERNMENT (Per cent of GDP)					
Expenditure	40.7	(46.4)	Gross financial debt	35.1	(110.4)
Revenue	36.8	(38.8)	Net financial debt	4.9	(70.6)
EXTERNAL ACCOUNTS					
Exchange rate (BGN per USD)	1.65		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	0.72		Manufactured goods	23.3	
In per cent of GDP			Machinery and transport equipment	22.5	
Exports of goods and services	62.2	(29.8)	Miscellaneous manufactured articles	13.9	
Imports of goods and services	59.8	(29.9)	Main imports (% of total merchandise imports)		
Current account balance	-0.5	(0.2)	Machinery and transport equipment	26.2	
Net international investment position	-14.4		Manufactured goods	16.9	
			Chemicals and related products, n.e.s.	15.0	
LABOUR MARKET, SKILLS AND INNOVATION					
Employment rate (aged 15 and over, %)	52.3	(56.2)	Unemployment rate, Labour Force Survey (aged 15 and over, %)	5.3	(6.1)
Men	58.6	(64.1)	Youth (aged 15-24, %)	15.8	(12.8)
Women	46.6	(48.7)	Long-term unemployed (1 year and over, %)	2.6	(1.7)
Participation rate (aged 15 and over, %)	55.3	(60.3)	Tertiary educational attainment (aged 25-64, %, 2017, OECD: 2021)?	24.7	(39.9)
Average hours worked per year	1,619	(1,716)	Gross domestic expenditure on R&D (% of GDP, 2020)	0.9	(3.0)
ENVIRONMENT					
Total primary energy supply per capita (toe, 2020, OECD: 2021)	2.5	(3.8)	CO ₂ emissions from fuel combustion per capita (tonnes, 2020, OECD: 2021)	4.8	(7.9)
Renewables (% , 2020, OECD: 2021)	14.0	(11.6)	Renewable internal freshwater resources per capita (1 000 m ³ , 2019)	3.0	
Exposure to air pollution (more than 10 µg/m ³ of PM 2.5, % of population, 2019)	99.8	(61.7)	Municipal waste per capita (tonnes, 2020, OECD: 2020)	0.4	(0.5)
SOCIETY					
Income inequality (Gini coefficient, 2019, OECD: latest available)	0.402	(0.315)	Education outcomes (PISA score, 2018)		
Relative poverty rate (% , 2019, OECD: 2018)	17.6	(11.7)	Reading	420	(485)
Median disposable household income (thousand USD PPP, 2019, OECD: 2018)	13.1	(25.5)	Mathematics	436	(487)
Public and private spending (% of GDP)			Science	424	(487)
Health care (2020)	8.5	(9.7)	Share of women in parliament (%)	23.8	(32.4)
Pensions (OECD: 2019)	16.7	(9.5)	Net official development assistance (% of GNI, 2017)	0.1	(0.4)
Education (% of GNI, 2020)	4.0	(4.4)			

1. The year is indicated in parenthesis if it deviates from the year in the main title of this table.

2. 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.

3. National Statistical Institute 2021 Population Census.

Source: Calculations based on data extracted from databases of the following organisations: OECD, International Energy Agency, International Labour Organisation, International Monetary Fund, United Nations, World Bank and National Statistical Institute 2021 Population Census.

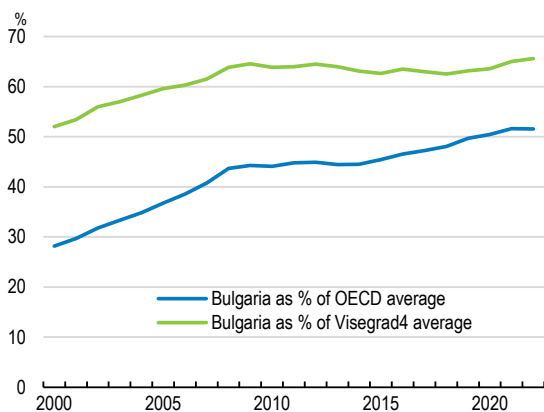
Executive summary

Bulgaria's robust recovery has been interrupted by the global energy crisis

Bulgaria's economic convergence towards more advanced economies continued over the past decade with average GDP growth of 2.3%. Bulgaria reached half of the OECD's average disposable income per capita in 2019, but convergence was slower than prior to the Global Financial Crisis and the country did not gain ground on regional peers with higher incomes (Figure 1).

Figure 1. Convergence has slowed

Disposable income per capita



Source: OECD Economic Outlook 112 database.

StatLink <https://stat.link/3to7qr>

Higher energy prices, aggravated by Russia's war of aggression against Ukraine, and weaker global demand will lower growth in 2023 (Table 1). The Bulgarian economy was rebounding from the pandemic when it started in February 2022 to face new headwinds from the war in Ukraine. As most of the energy supply comes from domestic coal and nuclear energy, reliance on Russian gas was more limited than in many other countries. With the exception of nuclear fuel and oil, Bulgaria had modest trade links with Russia. Interconnection with some neighbouring countries drove up electricity prices in the domestic market and fuelled energy exports, making Bulgaria the third largest exporter of electricity in Europe. After a strong rebound in 2021, growth moderated to 3.4% in 2022 and is anticipated to slow further in 2023 before rebounding.

The global surge in energy and food prices has pushed inflation to levels not seen in decades (Figure 2), but headline inflation is starting to decline very gradually as energy prices moderate.

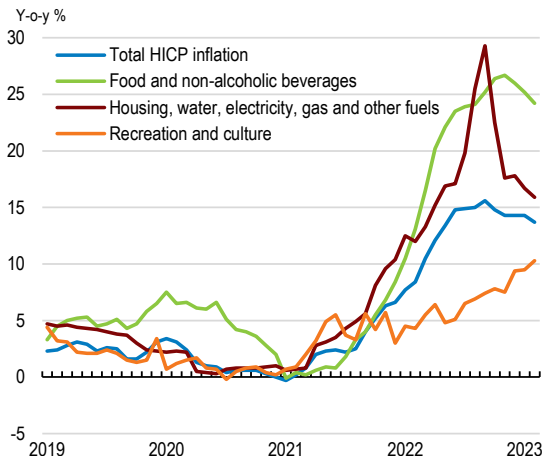
Inflation has become increasingly broad-based with core inflation picking up pace in 2022, on account of second-round effects from higher food and energy prices, strong private consumption and robust wage growth.

Table 1. Growth has slowed but is set to regain momentum

	2021	2022	2023	2024
Real GDP at market prices (annual percentage change)	7.6	3.4	1.9	3.2
Consumer price index (% change)	3.3	15.3	8.2	4.4
Unemployment rate (% of labour force)	5.3	4.3	4.5	4.2
General government gross debt (% of GDP)	35.1	37.2	39.6	41.8

Source: OECD Economic Outlook 112 database.

Figure 2. Surging energy prices lifted inflation



Source: National Statistical Institute.

StatLink <https://stat.link/hv4kt1>

There is strong momentum in wages. In recent years, real wages have grown strongly, supported by productivity gains and labour shortages. In 2022, the inflation-induced loss in purchasing power was partly offset by strong and broad-based nominal wage growth, as well as upward adjustments of social transfers. The government increased the minimum wage by around 10% in 2022 and again by 10% in January 2023. These developments create a risk of second-round inflation in the current environment.

Monetary conditions in Bulgaria follow those in the euro area through a currency board arrangement. The Bulgarian lev has participated in the exchange rate mechanism II since July 2020 and the authorities currently aim to adopt the euro in January 2025. While the currency board has

contributed to a sound macroeconomic position and a stable exchange rate, this arrangement leaves a central role to fiscal policy in managing inflation.

Short-term supports need to be carefully designed and a sound path for the public finances ensured

Fiscal discipline has resulted in low public debt. The deficit is narrowing following the COVID crisis and with energy supports financed by windfall revenues. However, spending pressures related to ageing, upgrading of infrastructure and raising skills will need to be financed by greater tax collection efficiency and higher environmental taxes.

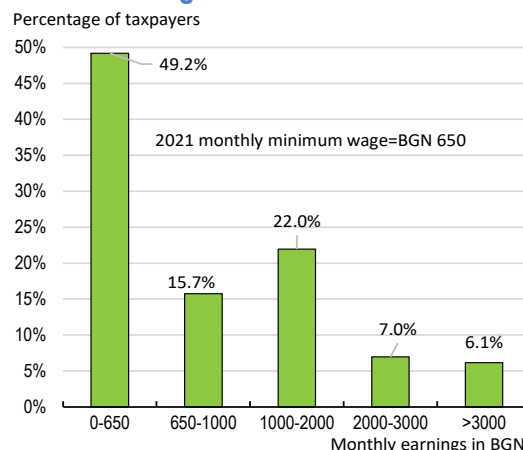
A temporary freezing of energy and water prices for households, an energy subsidy scheme for industrial end-users of electricity and other measures for high energy consumers have been introduced to cushion the impact of the energy crisis. While some measures are targeted, most are not and reduce price signals to consumers. The general government deficit is estimated to have been reduced to 2.9% of GDP in 2022 from 3.9% in 2021. Making the supports more targeted towards the most vulnerable and designing them in a way that keeps up energy saving incentives would help limit inflationary effects of fiscal policy.

Public debt is low, but ageing-related spending pressures are mounting and there are several areas where increases in social spending could strengthen growth and social outcomes. More needs to be spent on education to improve quality and on addressing large infrastructure needs. Substantial amounts of EU funds are expected in the ongoing programming period, but there is no overall public investment strategy. The fiscal council could play a stronger role in ensuring a long-term approach to fiscal policy.

Additional current spending needs could be financed by improved revenue collection efficiency and environmental, property and inheritance taxes. Informality is widespread, particularly in the form of additional undeclared “envelope” wages. Half of all taxpayers are registered at the minimum wage (Figure 3). Reducing the underreporting of revenues for income tax and social security contributions, making it more difficult for multinational companies

to shift profit overseas, enhancing VAT compliance and examining shifting the administrative responsibility for collection of property taxes to the central government could all help bring in additional revenue.

Figure 3. Half of taxpayers declare earnings at the minimum wage



Source: National Revenue Agency.

StatLink  <https://stat.link/fd0gl7>

Structural reforms would boost growth

Growth is constrained by the low level of investment and unfavourable demographic trends. Productivity has been the major driver of growth in recent years and an ambitious agenda of structural reforms could boost it further.

The investment rate at 20% of GDP is relatively low, while public investment at 3.4% is in line with the OECD average. To attract private capital, procedures around the entry and exit of firms could be streamlined. Educational attainment has improved with 40% of younger cohorts holding a tertiary degree. Raising educational attainment further and improving quality would help realise significant productivity gains in the long term.

Corruption imposes high transaction costs on businesses. Whistle-blower protection is now anchored into law. However, the system detecting and investigating corruption is fragmented, leaving some grey areas. The creation of a new body with investigative powers is welcome, but greater transparency and more stringent regulations would help the detection and reporting of corruption cases. Investigations should not be obstructed and effective mechanisms to investigate the Chief Prosecutor should be established.

The workforce is shrinking and ageing

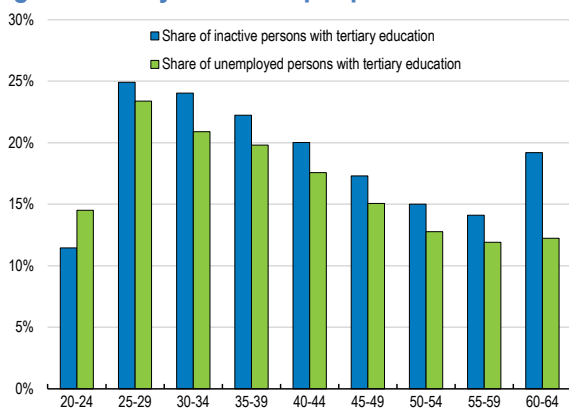
Since 2010 the working-age population has shrunk by around 19%, while the number of people aged above-65 has increased by 12.6%. These unfavourable demographic trends reduce the economy's growth potential.

Average fertility at 1.58 is close to the OECD average, but masks low birth rates among educated women, who have fewer children than they desire. The solid employment rate and the high share of women in management positions, as well as a low measured gender wage gap, imply high opportunity costs of having children for high-skilled women. Childcare is not available countrywide, and its quality is often not considered adequate. Many children are born into disadvantaged families.

Net emigration has contributed to population decline for decades. A more targeted and ambitious effort should be envisaged to make Bulgaria a more attractive place to live and to encourage workers to come, including better engaging with the diaspora to attract people back and revisiting immigration policies.

Even though the population is shrinking, many people do not work. Due to a lack of childcare facilities and homecare for the elderly, many people, mostly women, engage in caregiving and are out of the labour force. A sixth of the workforce is on disability benefits, which are more generous than social assistance and do not require registering with the Employment Agency.

Figure 4. Many educated people are not working



Source: National Statistical Institute 2021 Population Census.

StatLink <https://stat.link/u752od>

Practical training is lacking in tertiary and vocational education. A significant share of inactive and unemployed people are tertiary graduates, in particular in younger cohorts (Figure 4). Tertiary education has expanded rapidly, but quality has not kept pace, and it is not practice oriented. Vocational training often fails to equip students with practical skills as it is not always workplace based.

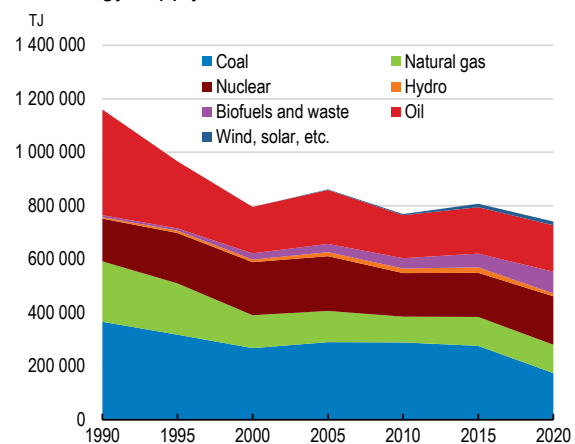
A strategy to reach net-zero is needed

The energy intensity of the economy fell in the 2000s and has since remained stable. Emissions, driven by the energy and transport sectors, have stayed at the same high levels for two decades. A comprehensive strategy to reach net zero emissions by 2050 is still to be set out.

Coal remains a major source of energy, despite a sizeable decline over past decades (Figure 5) and there is no roadmap to phase it out. Nuclear power plays a key role in Bulgaria's energy transition, serving as a baseload source of electricity. Investment in renewables, which account for a fifth of the energy supply, needs to pick up. Investment in upgrading the grid and expanding storage facilities is needed to allow for a more widespread use of renewables.

Figure 5. Coal is still a key source of energy

Total energy supply



Source: IEA World Energy Balances <https://www.iea.org/data-and-statistics/data-product/world-energy-statistics-and-balances>.

StatLink <https://stat.link/5jg0t7>

Main findings and key recommendations

Main findings	Key recommendations
Managing high inflation and the public finances and meeting long-term spending needs	
Inflation is high with strong growth of nominal wages in the context of the currency board. While the debt ratio is low, the underlying fiscal balance may have weakened in recent years.	Stand ready to tighten fiscal policy if inflation remains high.
Support measures during the cost-of-living crisis are mostly untargeted and distort price signals.	Make support measures to households and firms more targeted to the most vulnerable and ensure that they incentivise energy savings.
Informality is common and incentives to underreport wages are high.	Raise awareness of the consequences of underreporting wages, enhance compliance measures, digitalise transactions, and increase incentives to declare actual wages.
Several foreign companies shift profits, value added taxes are evaded and assigning the property tax to the subnational level has reduced collection efficiency.	Increase enforcement and collection efficiency of corporate income taxes, value added taxes and property taxes.
Spending pressures related to ageing, health and education, as well as infrastructure and the green transition, are mounting.	Establish a more integrated medium- and long-term fiscal strategy linking spending and resources.
The cost of capital is relatively low in international comparison, but uncertainty and the lack of long-term government strategy for infrastructure investment hinder investment.	Assess the medium- to long-term needs for infrastructure and other capital spending and prepare a public investment strategy based on cost-benefit analysis.
Improving the business climate	
Several bodies need to be contacted to set up a limited liability company, there are minimum capital requirements, and it is costly.	Establish a one-stop shop for setting up businesses and reduce the costs.
Liquidation of SMEs is cumbersome and makes exit difficult.	Introduce a simplified procedure for the liquidation of SMEs.
Boosting the number of workers through better jobs and higher incomes	
Childcare has become free in public facilities, but supply falls short of demand.	Ensure access to subsidised quality childcare countrywide.
The Migration Strategy 2021-25 aims at attracting Bulgarians living abroad and foreign workers to come to Bulgaria, but only a small number are relocating to Bulgaria.	Develop a comprehensive suite of measures, including the provision of information about jobs and support related to administrative requirements for the (re)settlement in Bulgaria.
Social assistance benefits are low and coverage is weak, while a large number of working-age people are on disability pensions and do not work.	Overhaul the social welfare system to provide better social support, stepping up existing efforts to gradually increase benefits to approach the poverty line, while improving activation.
Incentives to register with the Employment Agency are limited. Part of the population has no health insurance.	Increase incentives to register with the Employment Agency, including improved training and consider providing minimum (social) health coverage for people who register, with a six-month limit.
A sixth of the working-age population are on disability benefits, detached from the workforce.	Activate people with work capacity by regular assessment of the extent of incapacity by independent experts.
Vocational training is not always workplace based. Students have limited practical skills when they graduate, so the government spends extra money to train them or offers them subsidised employment.	Intensify cooperation between local authorities and the private sector to extend workplace-based vocational training across the country. Involve businesses in the design of curricula.
Accelerating the green transition	
While there are a number of policies and targets in place, there is no comprehensive strategy for the green transition.	Complete an overarching strategy for the climate transition, building on the Strategic Vision for the Sustainable Development of the Electricity Sector, and ensure it is consistent with the public investment strategy, with a roadmap and policies to achieve zero net emissions.
The existing grid capacity is not sufficient to manage future demands and a greater role for renewables.	Expand grid capacity to avoid constraints with the expansion of renewables generation.
Energy intensity and emissions are high.	Gradually increase environmental taxes for sectors outside of the EU Emissions Trading System (ETS), including excise taxes on fuels, and align these carbon prices with the ETS-price, while protecting poorer households and preserving security of energy supplies.
Fighting corruption	
Corruption continues to impose high transaction costs.	Continue designing and adopting effective measures to rein in corruption.
The system detecting and investigating corruption is fragmented, leaving some grey areas.	Extend the authority of bodies to detect and investigate corruption to cover the entire economy.
Detection of corruption is difficult.	Enhance transparency and checks and balances and implement the recently-adopted whistle-blower legislation to facilitate the detection and reporting of corruption cases.
There are few checks and balances in public-private transactions, leaving room for corruption.	Make all proposed transactions involving significant amounts of public money or public assets subject to conflict of interest checks.

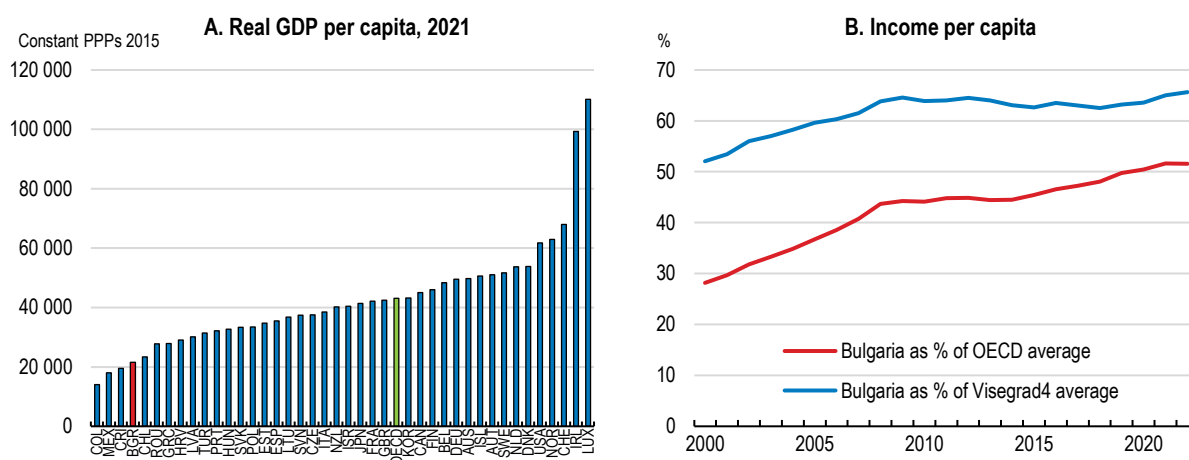
1 Key Policy Insights

Introduction

Bulgaria was on its way to returning to its pre-pandemic convergence trajectory when it was hit by the impact of the Russian war of aggression in Ukraine. Inflation emerged as a new challenge on the back of surging energy and food prices, amid heightening concerns about energy security. With budget surpluses prior to the pandemic, Bulgaria has been well positioned to temporarily support households and businesses. Cost-of-living supports, however, have not been well targeted.

The Bulgarian economy has been converging towards OECD countries for two decades and GDP per capita has reached around half of the OECD average (Figure 1.1), but its convergence to peers in the Visegrad4 group (Czech Republic, Hungary, Poland, and Slovak Republic) has stalled in the past decade. Productivity gains have been driving the catch-up and supporting real wage growth in recent years. This needs to continue. However, informality - a long-standing issue in Bulgaria – is holding back further productivity gains and contributes to a high share of low quality-jobs and high inequality. The labour force is rapidly shrinking and Bulgaria is projected to be one of the countries with the largest population decline by 2050. The unfavourable demographic trends due to high mortality, modest fertility, net emigration and ageing need to be contained and in the long term reversed. Despite these demographic pressures, a large part of the working-age population is not in work. Many lack the skills needed in the labour market, while others fall through the social safety net.

Figure 1.1. Real GDP per person is relatively low and converging slowly to more advanced countries



Source: OECD Economic Outlook 112 database.

StatLink  <https://stat.link/ufepls>

Looking ahead, the digital and green transformations will require an effective mobilisation of public and private resources. The use of EU funds and the quality of public investment will need to improve, while Bulgaria should strive to become more attractive to foreign investment and workers. The ability to raise taxes will have to improve to finance investment needs, improve skills and sustain good-quality public services.

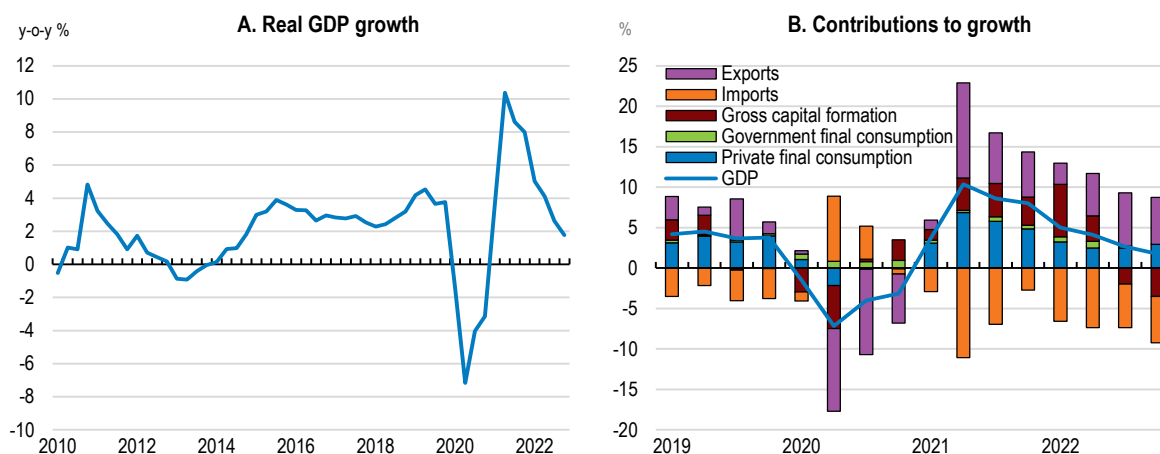
Against this background, the Survey's key messages for Bulgaria are:

- Policy support to manage the energy crisis should continue but be better targeted to reduce risks of second-round inflation and distortions to price signals. While a low deficit and a strict fiscal framework should help to ensure fiscal sustainability, improving the efficiency of tax collection, reducing informality and raising some taxes would help lift revenues to address social challenges and support growth.
- Bulgaria's convergence process to more advanced economies needs to be stepped up through an ambitious agenda of structural reforms. To this end, the business environment should become more friendly to make the country a more attractive place to invest. This includes facilitating the entry and exit of firms, as well as stepping up the fight against corruption.
- Rapid population decline has been a long-standing challenge and should be contained by family-friendly policies, improvements in job quality and better support for immigration. Inactive people should be encouraged to join the labour market by overhauling the social system, equipping people with skills and providing subsidised quality childcare country-wide.

The energy crisis has brought new challenges after the pandemic

The Bulgarian economy was rebounding from the pandemic when it started to face new headwinds from the Russian war of aggression against Ukraine. After a contraction of GDP in 2020 of 4.0%, the economy grew by 7.6% in 2021 on the back of strong export and consumption growth (Figure 1.2). Growth proved to be stronger than expected in 2022, despite deteriorating global conditions and higher energy and food prices, supported by consumption and exports. Public support programmes cushioned the impact of rocketing prices on households and businesses and helped to tame excessive inflation, with subsidies for non-residential end-users of electricity and a temporary freezing of energy and water supply prices for households (Box 1.1). The support measures were timely, but for the most part not targeted, imposing a heavy burden on the budget and discouraging energy savings.

Figure 1.2. Strong export and private consumption growth have limited the slowdown in GDP growth



Source: OECD Economic Outlook 112 database.

StatLink  <https://stat.link/6vipnr>

Box 1.1. Fiscal measures to cushion the negative effects of rising energy prices

To mitigate the negative effects of rising energy prices, several sets of policies have been implemented: (i) direct support to electricity distribution companies and other businesses, as well as to vulnerable households through various measures (some of which were phased out at the end of 2022); (ii) measures to cushion the secondary effects of energy and commodity price rises; and (iii) loan schemes for SMEs through the state-owned Bulgarian Development Bank.

In addition, a new mechanism for submitting the windfall revenues of electricity producers and electricity traders to the government has been approved and entered into force in January 2023. In accordance with an EU Regulation, it is envisaged that revenues of the energy companies above a certain threshold will be transferred to the State Electricity System Security Fund.

Energy-related direct measures:

- A temporary moratorium by the electricity and water regulatory commission on electricity price increases to households was introduced from July 2021 to June 2022. For the regulatory period of July 2022 to June 2023, the commission increased prices by 3.4%.
- About BGN 5.8 billion, or roughly EUR 3 billion in 2021 and 2022 has been allocated through the Ministry of Energy and the State Electricity System Security Fund for compensation of high energy prices to the following groups:
 - Companies that are electricity end-users have been compensated with BGN 0.5 billion in 2021 and BGN 4.1 billion in 2022 (2.5% of GDP). About 633 000 end-users benefitted from this support.
 - Compensation to electricity distribution companies for technological costs of purchases of electricity costing BGN 0.2 billion in 2021 and estimated at around BGN 0.5 billion in 2022.
 - Support with a fixed amount per MWh for residential natural gas customers and district heating companies using natural gas as the main fuel starting in December 2021 and costing BGN 0.04 billion in 2021 and BGN 0.3 billion in 2022.
 - Support for sewage and water supply companies for electricity expenses costing BGN 0.06 billion in 2021 and around BGN 0.04 billion in 2022.
 - Support for undergraduate and graduate students up to the doctoral level accommodated in state dormitories for their electricity expenses, costing around BGN 2.0 million in 2022.
- Budget funds for heating support for vulnerable groups have been increased twice during the autumn of 2022 to cover more families reaching around BGN 325 million.

The total bill for direct energy support amounts to around 3% of GDP in 2022 (0.6% of GDP in 2021) with the majority provided to companies.

Other measures to cushion direct and indirect/secondary effects:

- Increase of pensions by nearly 20% (costing around BGN 1.4 billion or 0.86% of 2022 GDP) in the first nine months of 2022 and a new mechanism effective from October 2022 applying higher coefficients (1.35% instead of the previous 1.2%) in the pension formula for each year of contribution effective from 25 December 2021, as well as an increase in the minimum pension from 1 July 2022. The maximum pension also increased in July 2022 to BGN 2 000 and in October 2022 to BGN 3 400.
- Increased tax allowances for families with children from BGN 4 500 to BGN 6 000 per year per child and tax relief for children with disabilities (from BGN 9 000 to BGN 12 000 per year per child) costing BGN 352.3 million in 2022.

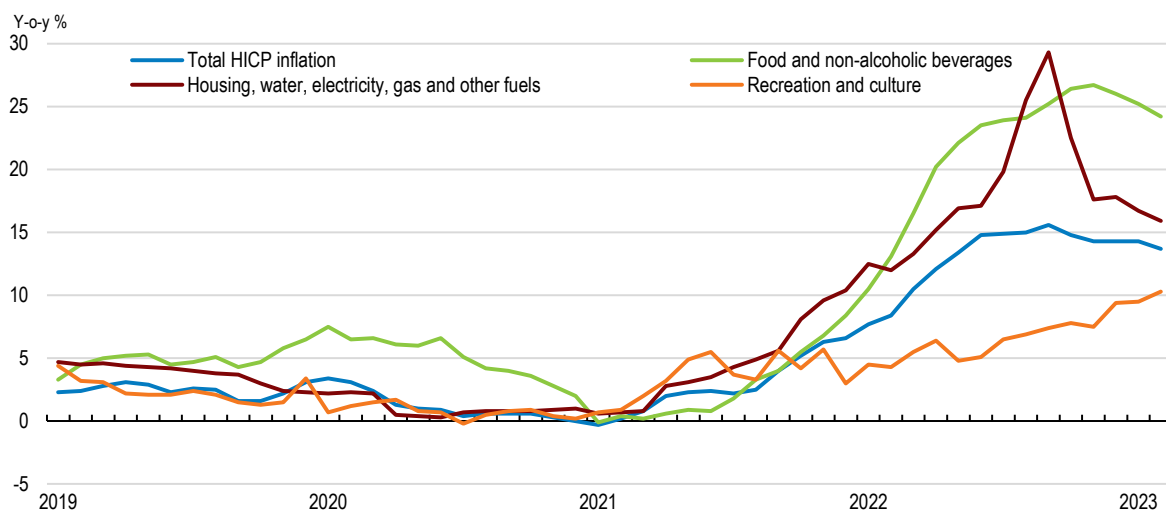
- Compensation for the most common categories of fuels used for non-business personal needs such as petrol and gas oil (diesel), LPG or propane-butane and methane for BGN 0.25/litre, effective from July until end-December 2022.
- Application of a zero VAT rate for bread and flour valid until the end of 2023 costing BGN 68.9 million in 2022 and BGN 137.7 million in 2023.
- Decreased VAT rate for natural gas and central heating from 20% to 9% until 1 July 2023, costing BGN 61 million in 2022.
- Zero rates for excise duties on certain types of LPG, natural gas, and electricity from renewables valid until 30 June 2025. In 2022 this will cost BGN 92.6 million, of which BGN 77.2 million are the foregone excise duties and BGN 15.5 million foregone VAT.

Source: Ministry of Finance of Bulgaria.

As a consequence of the global surge in energy and food prices and against the background of strong private consumption, inflation in Bulgaria reached levels unseen for more than 15 years. Harmonised consumer price inflation peaked at 15.6% in September 2022 before starting to decline very gradually as energy prices started to moderate (Figure 1.3). Inflation was even stronger, peaking at around 18.7% in September, when measured according to the national basket of consumer weights that takes the higher share of food and energy in Bulgaria into account. Food price inflation kept rising until November 2022 and fell to 24.2% in February 2023. Structural factors, such as the high energy-intensity of the economy and a large share of foreign value-added in private consumption and output (Bulgarian National Bank, 2022^[1]), contributed to a quick and substantial pass-through from elevated international energy prices. Limited competition in the retail sector might have also contributed to a quick increase in domestic prices. Inflation has become increasingly broad-based, with seven out of twelve broad spending categories exhibiting double-digit growth in February. The contribution of the services sector, along with non-energy industrial goods, to harmonised headline inflation is still on the rise, against shrinking contributions from energy and food. Slowing energy price growth is expected to translate only gradually into an easing of overall price pressures due to strong domestic demand fuelled by continued wage increases in 2023.

Thanks to strong nominal wage growth, real compensation per employee continued to grow during 2022, despite the high rate of inflation (Figure 1.4). This contrasts with many OECD countries, including those in Central and Eastern Europe (CEE). In Bulgaria, a declining work force and labour shortages, coupled with strong economic activity, supported nominal wage growth, particularly in the private sector. Moreover, the monthly minimum wage was raised in April 2022 to BGN 710 (from BGN 650) and then to BGN 780 in January 2023, resulting in a 20% annual increase. Pensions were increased by more than 20% in 2022, following a previous increase of around 20% in 2021. Although Bulgaria experienced real wage growth above 5% on average over the five years prior to 2021 supported by productivity gains, the current inflationary context requires caution in raising nominal wages to avoid a further intensification of second-round inflation and risks of more persistent core inflation.

Figure 1.3. Headline inflation surged but appears to have peaked

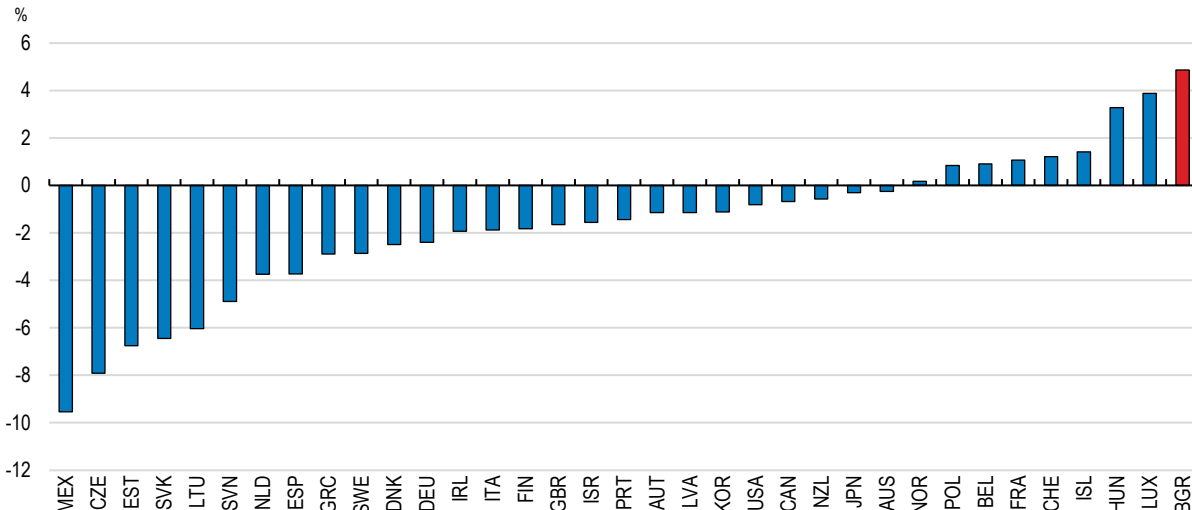


Source: National Statistical Institute.

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Figure 1.4. Real compensation has continued to grow

Real compensation per worker, 2022, y-o-y change



Note: Compensation per employee, total economy, deflated using the personal consumption expenditures deflator.

Source: OECD calculations based on the OECD Economic Outlook 112 database.

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Domestic demand pressures could pose particular challenges for Bulgaria due to its limited monetary policy instruments. The currency board arrangement fixes the Bulgarian lev to the euro. The start of monetary tightening in the euro area in 2022 has helped to counter accelerating inflation developments in Bulgaria and rising interest rates have translated into tighter financing conditions, in particular in the money market, but not necessarily to the degree required given relatively high inflation. This increases the onus

on fiscal policy to manage short-term pressures. High inflation has put Bulgaria in a difficult situation with respect to the timing of euro adoption (Box 1.2). The criteria to join the euro area foresee, among others, an inflation rate close to the three best performing EU member countries over a period of 12 months. Given the ongoing high-inflation environment, the Bulgarian authorities decided to postpone the envisaged euro adoption to January 2025. As conditions stabilise, the authorities need to ensure a transparent process and give a clear outlook on the next steps of the envisaged euro accession, while continuing to make progress on technical preparations.

Box 1.2. The road toward euro adoption

Bulgaria committed to switching from the lev to the euro upon joining the European Union in 2007. Since 2020, the Bulgarian lev has been included in the Exchange Rate Mechanism II (ERM II) in preparation of full membership of EU Economic and Monetary Union, keeping the existing currency board in place as a unilateral commitment of the Bulgarian authorities without placing additional obligations on the European Central Bank. The euro was initially to be adopted in 2024, before the envisaged adoption was postponed to 2025.

Bulgaria as an EU member country with a national currency is subject to a regular assessment by the European Commission related to the obligation to achieve convergence with the Economic and Monetary Union. Convergence is assessed according to four key requirements related to price stability, exchange rate stability, long-term interest rate stability and sound public finances, along with additional requirements including implementing appropriate legislation. An assessment in summer 2022 concluded that Bulgaria had not yet met all requirements (European Commission, 2022^[2]). Bulgaria performed well on three out of four criteria (stability of the exchange rate, long-term interest rates and public finances) due to the currency board arrangement in place since 1997 and a history of budget surpluses prior to the COVID-19 crisis. Additional reforms as part of Bulgaria's post-entry commitments upon joining the ERM II are ongoing in close cooperation with the European Commission and are to be completed by the end of 2023. They aim at strengthening convergence with the euro zone with respect to the non-banking financial sector, the insolvency framework, the anti-money laundering framework and the governance of state-owned enterprises (European Commission, 2022^[2]).

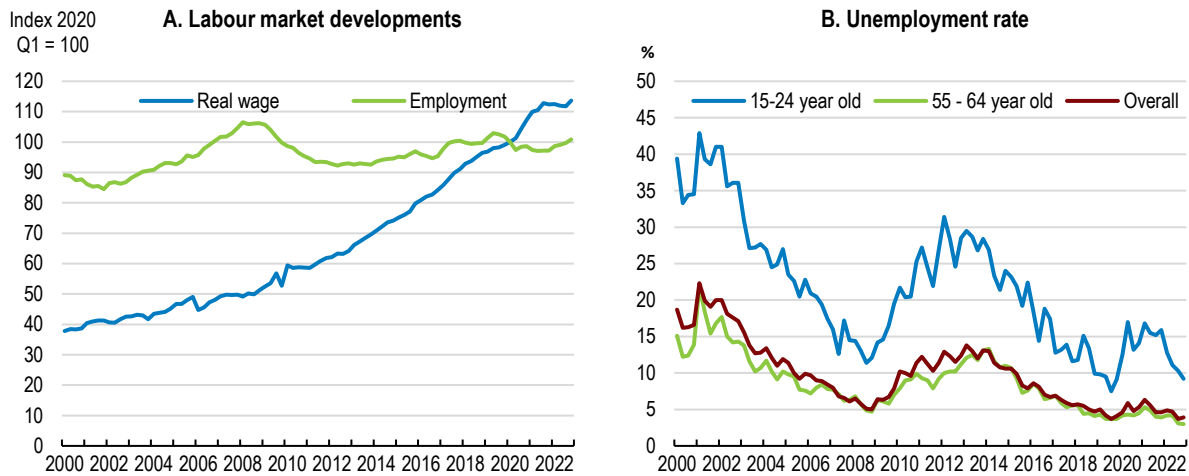
However, two criteria were not met, related to insufficient legislative compliance and high inflation. Legislative reforms have been delayed because of the absence of an elected government, with consequences for the necessary technical and operational preparations for a swift and smooth transition from one currency to another. Inflation concerns initially emerged in the wake of the recovery from the pandemic and further intensified during the energy crisis. According to the entry criteria, inflation may not exceed that of the three best performing EU member countries by more than 1.5 percentage points (usually countries with the lowest inflation rate, but countries might be excluded if there are specific factors). In 2022, inflation in Bulgaria exceeded those of the chosen three best performing countries by 1 percentage point.

The next regular assessment will follow in summer 2024, although countries are free to request an earlier assessment. Bulgaria had initially aimed to be assessed in 2023 in order to adopt the euro in 2024. Due to ongoing challenges around high inflation and delayed legislation in the context of the absence of an elected government, the Bulgarian authorities decided not to ask for a preliminary assessment. This deferral facilitates the implementation of required legislative changes and gives more time for inflation to decline further.

While the near-term growth outlook has deteriorated, the Bulgarian labour market has continued to perform well so far. Since 2020, the unemployment rate has remained stable at low levels, hovering around 5% both during the height of the COVID pandemic and more recently. In the fourth quarter of 2022 it stood at 3.9%, after it had fallen to a record low of 3.7% in the third quarter, although there has been a worrying

increase in youth unemployment. The employment rate increased to 71.5%, growing particularly strongly in services sectors, such as accommodation and food, and making up for losses since the outbreak of the pandemic (Figure 1.5). While some softening is expected in the coming year, the labour market is anticipated to remain robust overall. The labour market situation of high-skilled and low-skilled workers differs markedly: the employment rate among workers with tertiary education is 90.5%, in contrast only 41.9% for workers with lower secondary education are in work. This is a stronger divide than in many European OECD countries (OECD, 2022^[3]). While labour shortages are low overall (Figure 1.6), they are prevalent among high-skilled workers and this is often cited as a problem by Bulgarian companies (Figure 1.7). Explanatory factors include emigration, skill mismatches and a large share of inactive workers (Chapter 2).

Figure 1.5. Real wages have grown strongly but youth unemployment remains relatively high

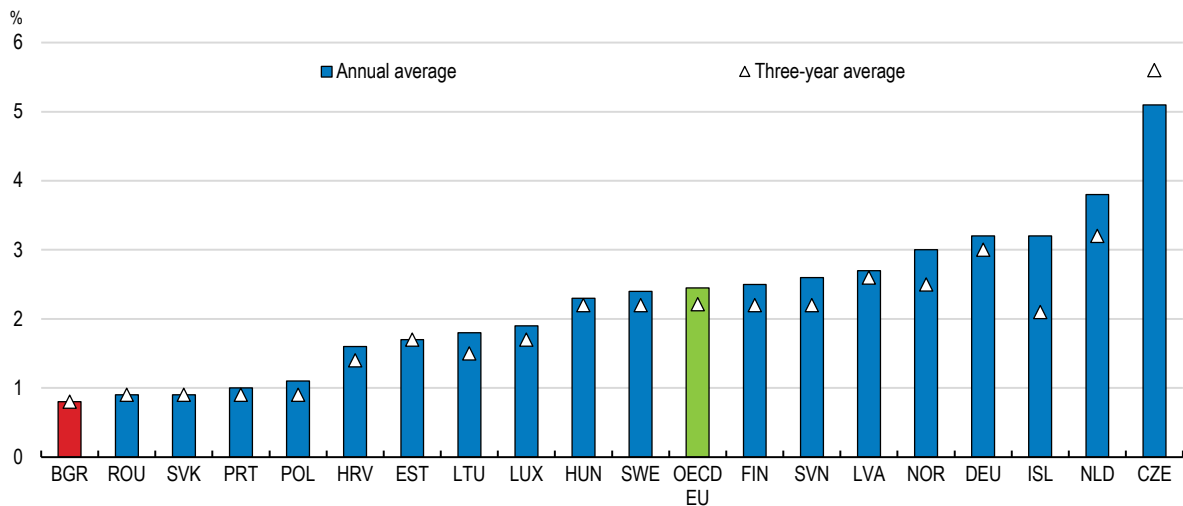


Source: OECD Economic Outlook 112 database and Eurostat.

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Figure 1.6. Labour shortages are low overall

Job vacancy rate, 2021



Note: The job vacancy rate is computed as the number of vacancies over the number of all filled and vacant jobs.

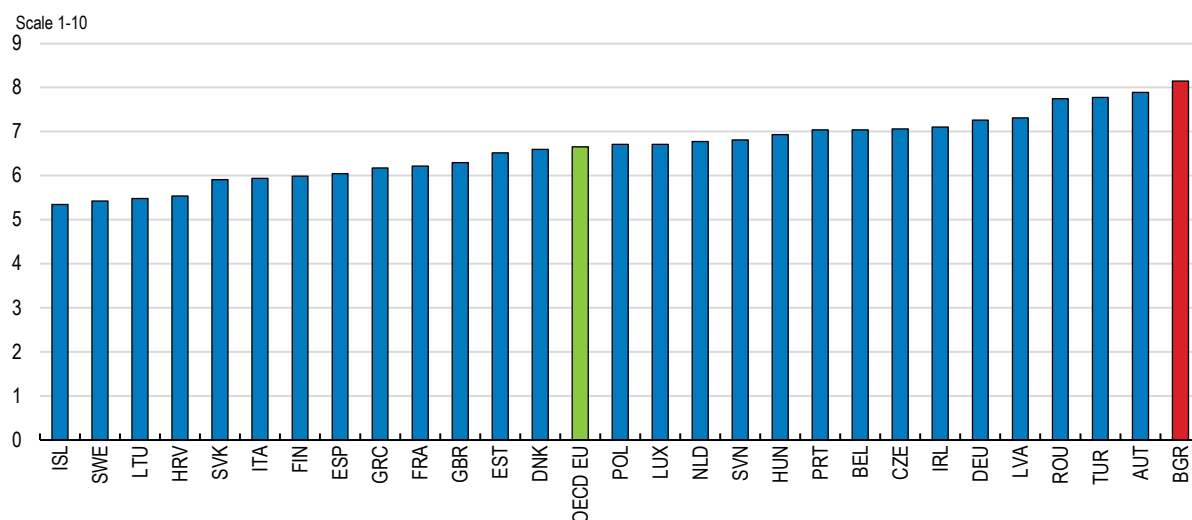
Source: Eurostat.

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A large number of Ukrainian refugees arrived after the outbreak of the war in February 2022. Around 1.1 million Ukrainians entered until the end of February 2023, but many stayed only temporarily. From approximately 150 000 who registered for official protection, only around 50 000 stayed in the country. Furthermore, only 1.7% of the 35 000 Ukrainian children had enrolled in a Bulgarian school by the summer of 2022 (de la Maisonneuve and Egert, 2023^[4]), with many likely to have online connections to the education system in Ukraine. As the war continues, an increasing number are expected to enrol in Bulgaria. Greater enrolment in childcare facilities is needed to enable mothers to work, all the more so at the current juncture where most refugees are women with children. In 2022, a total amount of BGN 239.1 million (EUR 122.4 million) was allocated for the implementation of government programmes for humanitarian aid to people seeking temporary protection, of which around half was financed by EU funds. A Programme for Humanitarian Assistance to Displaced Persons from Ukraine is active until March 2023. One-time social assistance of BGN 375 (EUR 192) is also available for displaced Ukrainian citizens. As refugees are not evenly distributed across the country, a greater effort falls on coastal districts, in particular Varna.

Figure 1.7. Recruitment of skilled workers is a major problem for firms

Severity of problem to attract skilled staff on a scale from 1-10, 2021



Source: Survey on the access to finance of enterprises, 2021, European Commission.

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Bulgaria was among the first countries subject to a ban on gas exports from Russia due to its refusal to pay according to a new scheme unilaterally imposed by the supplier, temporarily putting the country at risk of gas shortages. However, gas supplies over the winter were ensured through the operationalisation of a new pipeline interconnector to Greece that gives access to gas from Azerbaijan and LNG deliveries. Concerns remain with respect to the winter 2023/24, requiring continued efforts to ensure sufficient reserves and supplies. Bulgaria is not overly dependent on gas, which plays only a small role for industrial processes and is mostly used for heating in the capital region of Sofia. The most important source of energy is electricity, which is produced domestically at comparatively low costs, around one-third from nuclear and another third from coal-based plants. A considerable part of Bulgaria's oil imports comes from Russia and the only major oil refinery is technically adjusted to treat Russian oil, although in the medium term non-Russian types could be processed as well (Nitzov, 2022^[5]). Bulgaria is exempt from the ban of Russian seaborne oil for a period of two years and continues to receive significant amounts through the port in

Burgas, while the European price cap on Russian oil introduced in December 2022 has not led to disruptions in supply to date.

Rising headwinds are expected to lower growth to around 1.9% in 2023 before recovering to 3.2% in 2024, close to the pace recorded prior to the pandemic (Table 1.1). Growing uncertainty and persistently high inflation will continue to dampen demand from key partners, weighing on exports. At the same time, Bulgaria continues to be shielded from the negative terms-of-trade shock experienced across Europe due to its favourable external trade composition, including a strong position as an exporter of electricity that allows it to benefit from high international prices. High savings accumulated during the pandemic will partly cushion the impact of high inflation and rising interest rates on consumption. Despite the foreseen strong nominal wage growth, high inflation will continue to induce stagnating or only marginally growing real wages in the coming years. After an initial delay in the roll-out of Next Generation EU funding, implementation is expected to accelerate during the coming years to around 6% of GDP. This will contribute to stable growth in investment in key areas, such as digitalisation and decarbonisation, and supporting a sustainable modernisation of the Bulgarian economy.

Table 1.1. Macroeconomic indicators and projections

Bulgaria	2019	2020	2021	2022	2023	2024
	Current prices BGN billion	Annual percentage change, volume (2015 prices)				
GDP at market prices	120.4	-4.0	7.6	3.4	1.9	3.2
Private consumption	71.1	0.0	8.8	4.8	2.4	2.9
Government consumption	20.1	7.9	0.6	4.9	0.9	1.3
Gross fixed capital formation	22.2	0.6	-6.6	-4.3	12.7	5.9
Final domestic demand	113.4	1.6	4.4	3.0	4.1	3.3
Stockbuilding ¹	2.6	-1.3	4.8	1.5	0.0	0.0
Total domestic demand	116.0	0.1	8.7	4.1	3.4	2.8
Exports of goods and services	77.5	-10.3	11.0	8.3	3.0	6.1
Imports of goods and services	73.1	-4.3	10.9	10.5	5.4	5.6
Net exports ¹	4.4	-4.0	0.2	-1.2	-1.6	0.3
<i>Memorandum items</i>						
GDP deflator	–	4.3	7.1	15.1	7.9	4.8
Consumer price index	–	1.7	3.3	15.3	8.2	4.4
Unemployment rate (% of labour force)	–	5.1	5.3	4.3	4.5	4.2
Household saving ratio, net (% of disposable income)	–	8.1	6.4	6.9	7.1	6.8
General government financial balance (% of GDP)	–	-3.8	-3.9	-2.9	-3.0	-3.0
General government gross debt (% of GDP)	–	34.8	35.1	37.2	39.6	41.8
General government debt, Maastricht definition 2 (% of GDP)	–	24.6	23.9	23.6	28.4	30.7
Current account balance (% of GDP)	–	0.0	-0.5	-0.3	-1.3	-1.6

1. Contributions to changes in real GDP, actual amount in the first column.

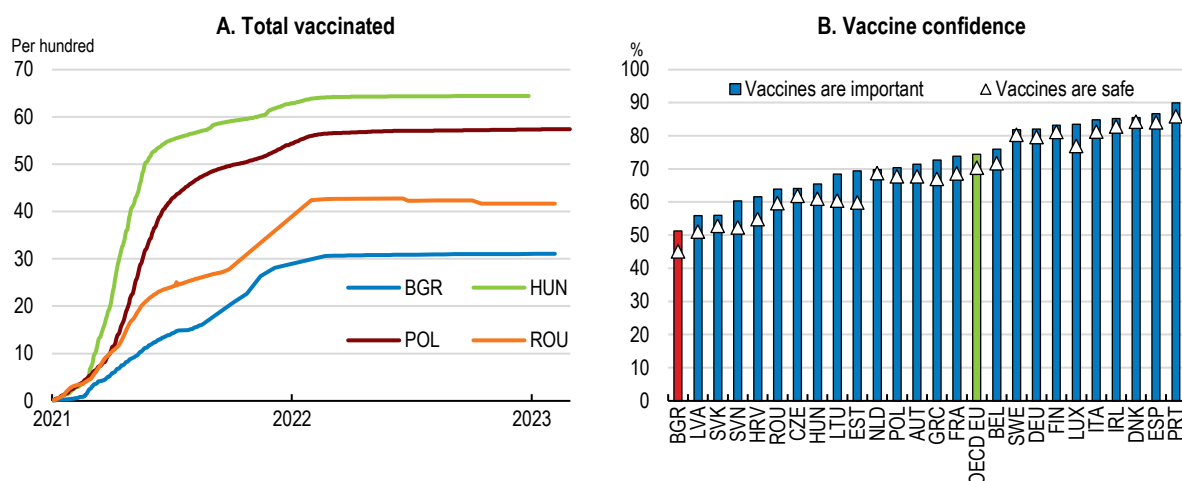
2. The Maastricht definition of general government debt includes only loans, debt securities, and currency deposits, with debt at face value rather than market value.

Source: OECD Economic Outlook 112 database.

These economic projections are subject to substantial uncertainty, in particular as regards the war in Ukraine and the consequences for global energy prices and growth (Table 1.2). In addition, Bulgaria is still particularly exposed to potential new outbreaks of COVID-19 and new variants given the very low level of completed vaccination courses compared to neighbouring countries and the already high death toll relative to the size of the population (Figure 1.8). Compared to their European peers, Bulgarians show the lowest levels of trust in COVID-19 vaccines, due to widespread rumours and disinformation during the roll-out of

the vaccination campaign. Only half of the population believes in their importance and even fewer express trust in their safety.

Figure 1.8. The COVID-19 vaccination rate and trust in COVID-19 vaccines are very low



Note: Panel B: Share of agreement within population with respective statement, 2022.

Source: ourworldindata.org; State of Vaccine Confidence in the EU survey, European Commission 2022.

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Table 1.2. Events that could lead to major changes to the outlook

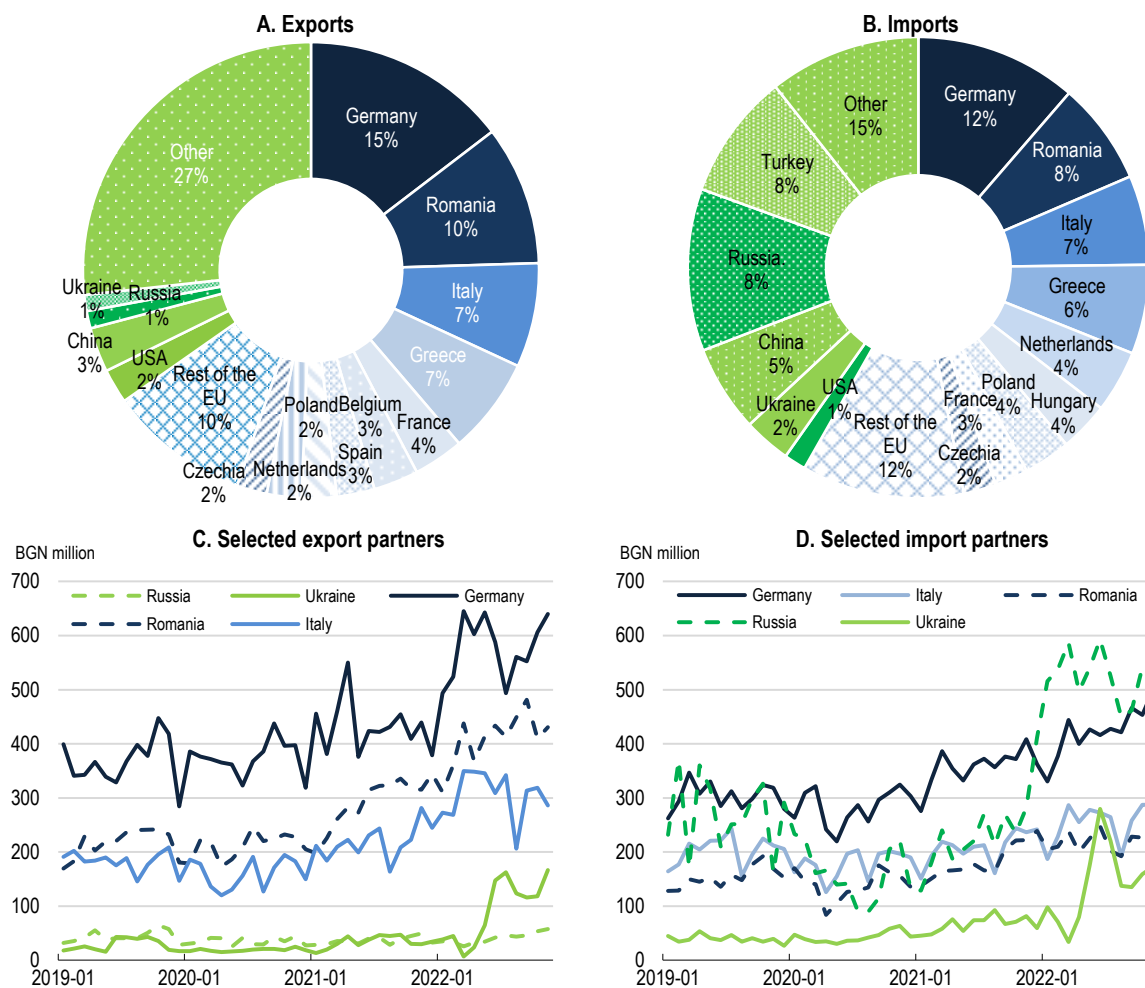
Vulnerability	Possible impact	Policy option
Disruptions to nuclear fuel supply from Russia combined with low stocks and compatibility issues with alternative sources.	Constraints on electricity supply and delays in the energy transition process in the medium term.	Procuring fuel from alternative suppliers through tenders requiring compatibility.
Deterioration of the conflict in Ukraine, pushing up energy prices further. Disruption in gas supply for next winter Europe-wide.	Lower global growth, heightened inflationary pressures. While the country is not heavily dependent on gas, disruptions may cause higher prices for a longer period as prices of alternatives are driven up.	Extension of support programmes for vulnerable groups. Bypassing gas in the energy transition process.
Heightened geopolitical tensions in the region.	Influx of large numbers of refugees and interruption of supply routes resulting in heightened inflationary pressure.	Contingency planning and better integration of refugees in labour markets.
Political instability due to difficulties in forming a government.	Delay in the adoption of major reform programmes, potentially leading to slower convergence.	Accelerate the adoption of proposals during periods with a functioning Parliament.

As a small open economy, Bulgaria is sensitive to European and global developments. It is well integrated into global value chains with a foreign value-added share of 36.8% of total exports in 2018 (OECD, 2021^[6]). Bulgarian exports cover a broad range of products from machinery to metals and food. Foreign contributions to Bulgarian exports are significant in some manufacturing industries, such as raw materials (mostly metals) and chemicals with a share of more than 50%, implying a high degree of exposure to supply chain disruptions or changes in demand. Main trading partners include countries such as Germany and Italy, which were particularly hit by the energy crisis (Figure 1.9). Nevertheless, export performance towards these countries was strong in 2022, in particular at the beginning of the year where export volumes of goods peaked at historically high levels. The development during the following months of 2022 was more muted, but still considerably stronger compared to the previous year. Direct trade exposure to Ukraine and Russia is limited, except for energy imports. In 2021, exports to Ukraine and Russia each

represented around 1% of total Bulgarian exports. Import dependence is more pronounced, in particular on Russia as the main source of gas and oil until the outbreak of the war. After an initial slump at the beginning of the war, trade with Ukraine skyrocketed, supported by large-scale diesel deliveries to Ukraine.

Figure 1.9. Large EU members and neighbours are key trading partners

Exports and imports as of 2022



Source: National Statistical Institute and Bulgarian National Bank.

StatLink  <https://stat.link/a72whg>

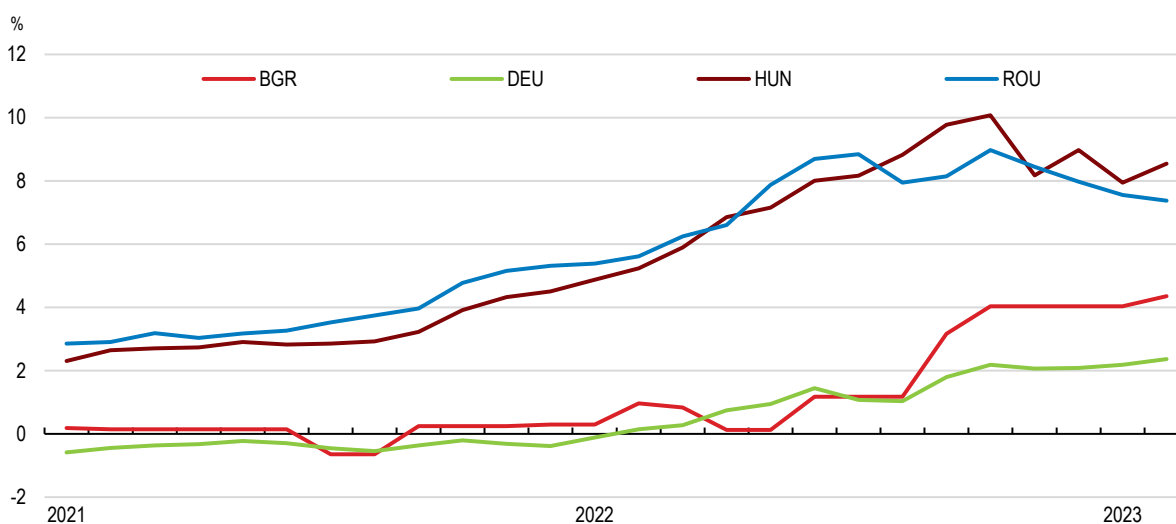
The banking system is well-capitalised, but faces headwinds from higher interest rates and debt

As a consequence of the European Central Bank's monetary policy tightening in 2022, interest rates in Bulgaria started to increase from historically very low levels, with financing conditions tightening fastest and most significantly on the money market, where average money market rates turned positive in September 2022 for the first time since 2015. The average ten-year government bond benchmark rate exhibited several stepwise increases that were in close relation with ECB announcements to raise interest rates, but also with heightened domestic instability associated with the end of the ruling coalition in June 2022 due to a vote of no-confidence and the subsequent unclear political outlook after new elections at

the beginning of October. The spread against German government bonds widened significantly towards the end of 2022, highlighting a potential re-pricing of risk premia in the current economic and political environment, although it is still considerably lower compared to neighbouring countries. Nevertheless, the harmonised long-term interest rate that is used to assess the compliance with euro area entry requirements has risen more moderately to 2.8% as of February 2023.

Figure 1.10. Interest rates and spreads have risen

10-year government bond yields, selected countries



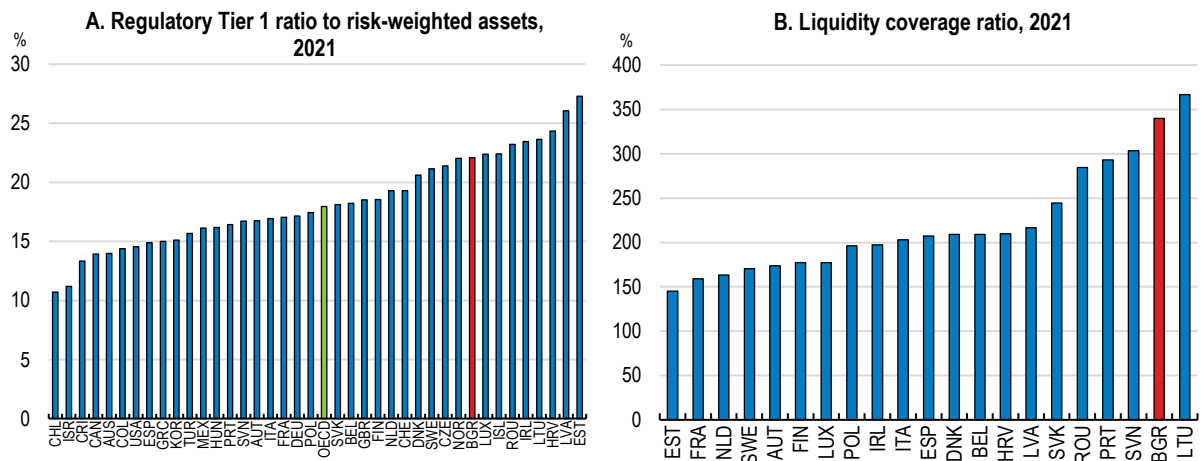
Note: The following bond yields are shown: BGR: average ten-year government bond yield on the secondary market; HUN: benchmark ten-year government bond yield, ROU: ten-year government bond yield, DEU: 10-year government bond yield.

Source: OECD Main Economic Indicators Database, Bulgarian National Bank, National Bank of Romania and Hungarian Government Debt Management Agency.

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Bulgaria's financial system is dominated by the banking sector, which proved to be resilient during adverse conditions following the COVID-19 shock. The banking system's size is comparable to neighbouring OECD countries with total bank assets of around 100% of GDP, but far smaller than in many European OECD countries. Foreign banks control 70% of bank assets, primarily in the form of subsidiaries. Five banks, which represent approximately two-thirds of total bank assets are classified as significant institutions (Bulgarian National Bank, 2022^[7]) and have been subject to direct supervision by the European Central Bank since Bulgaria joined the European Banking Union in 2020. While the presence of larger foreign banks is a valuable source of capital and know-how, their dominance can pose structural challenges and exposes Bulgaria to external decisions. Supported by a stable macroeconomic framework and prudent macroprudential policies, the banking system is well-capitalised and liquid (Figure 1.11). The liquidity coverage ratio is more than two-and-a-half times higher than the regulatory requirements. The adverse market conditions since 2020 had temporarily reduced profitability before it started to recover in early 2022. Nevertheless, the ratio of non-performing loans (NPLs) remains relatively high, reflecting historic credit problems during the Global Financial Crisis. However, the NPL share has been gradually decreasing through write-offs and sales, reaching 5.1% as of September 2022 (Figure 1.12). The exposure of Bulgarian banks to Russia or Ukraine is limited, although parent companies of Bulgarian subsidiaries might be more directly affected. Direct consequences from the war on the banking sector are, hence, expected to be weak while indirect channels through macroeconomic developments are more likely (European Parliament, 2022^[8]).

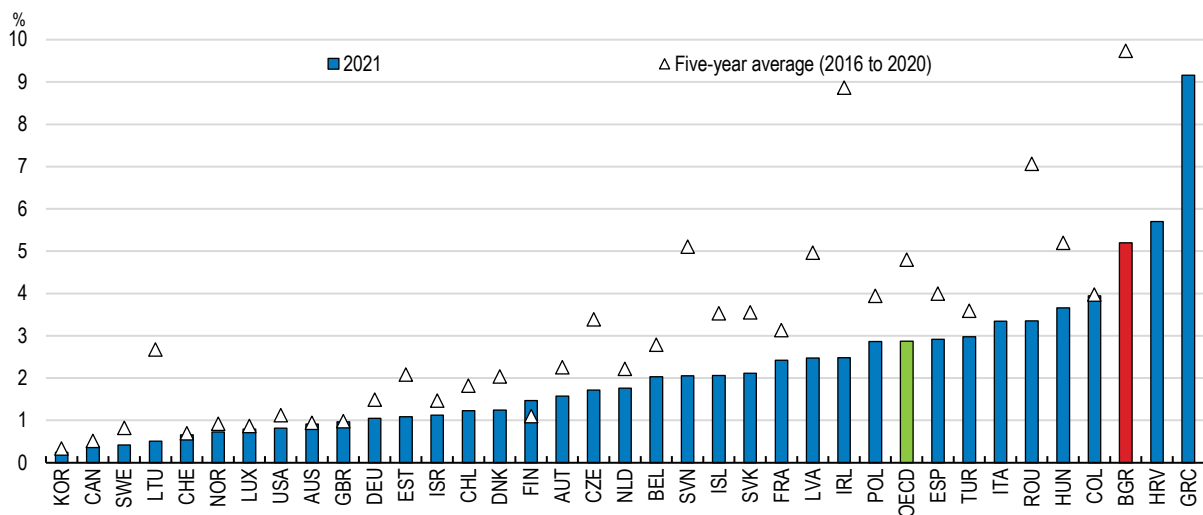
Figure 1.11. The banking system is well capitalised and liquid



Source: IMF Financial Soundness Indicator and ECB.

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Figure 1.12. The share of non-performing loans in total loans is high but decreasing



Note: PRT is excluded to keep a comparable scale for the remaining countries.

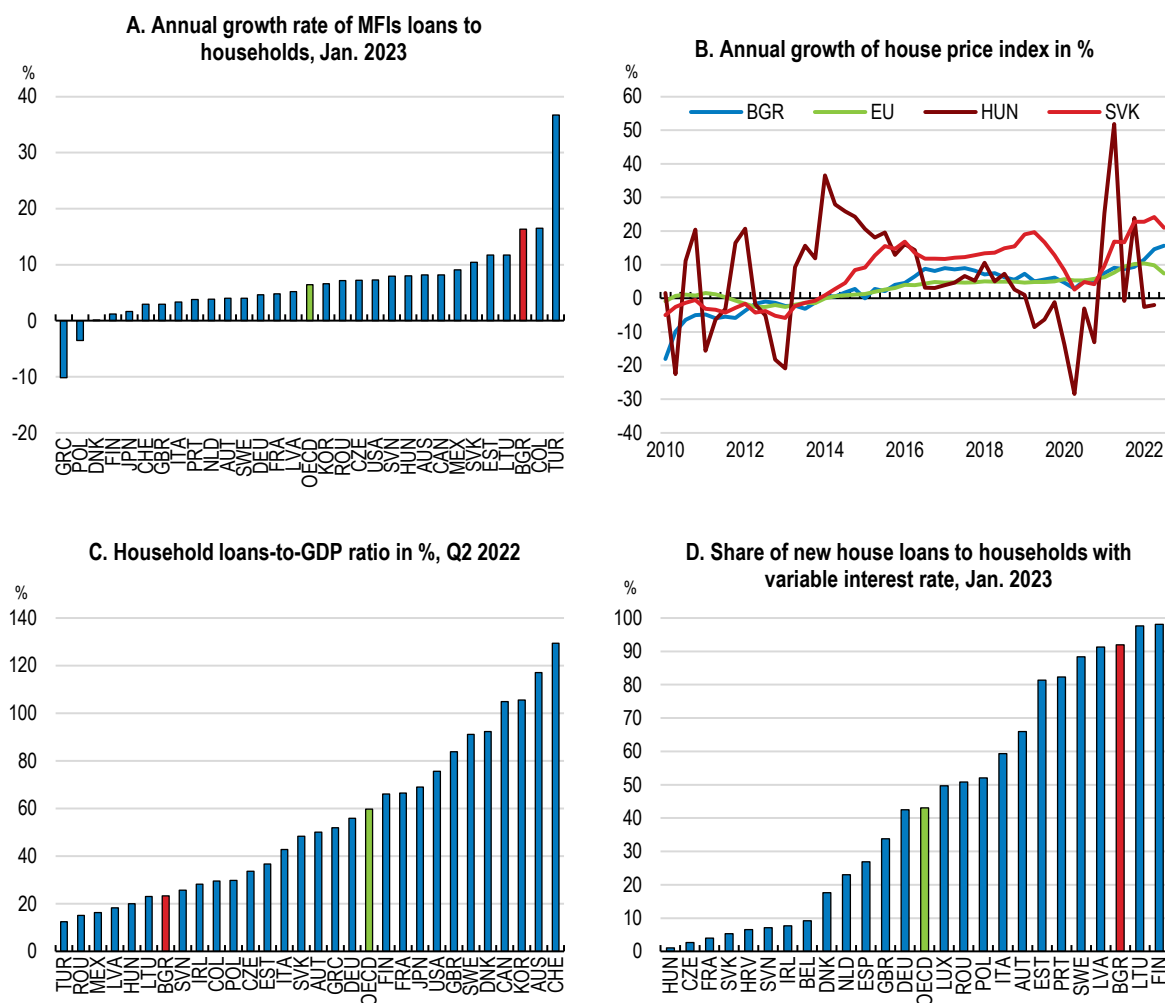
Source: IMF Financial Soundness Indicator and Bulgarian National Bank.

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Bank loans to households have been growing much faster than in Central and Eastern European OECD countries and were up by 16% in the year to January 2023. (Figure 1.13). While fast loan growth can signal risks with credit quality, Bulgaria, like other CEE countries, still has a very low household loan-to-GDP ratio of 23% when compared to other OECD countries. Credit to firms is growing more moderately in line with average growth rates in EU countries, against the background of overall modest corporate debt levels. House prices accelerated significantly, starting in 2021 with around 9% annual growth followed by 14% on average during the first three quarters of 2022, outperforming average European house price growth. Bulgarian households are sensitive to rising interest rates given that the vast majority of loans carry variable interest rates. The Bulgarian National Bank has repeatedly increased countercyclical capital buffer requirements to further strengthen the resilience of banks and prevent an excessive build-up of risks, with the latest increase coming in effect in October 2023. The muted macroeconomic outlook, together with

rising interest rates, will continue requiring heightened attention to risks from house price developments and households' credit burdens.

Figure 1.13. Loans to households and house prices have increased rapidly



Source: ECB, BIS, OECD and National Statistical Institute.

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Non-bank lenders are becoming increasingly active with a loan portfolio in December 2022 amounting to BGN 4.4 billion – or 2.7% of GDP - most of it dedicated to consumer credit with around BGN 3.0 billion, raising concerns regarding consumer protection and their interconnection with the banking sector (European Banking Authority, 2022^[9]). Although they charge higher interest rates compared to traditional banks, they are often the only source of credit for many, in particular vulnerable and financially illiterate customers. Indeed, half of the Bulgarians officially only earn the minimum wage, which is often insufficient to qualify for a bank loan. On average over all consumer loans provided by banks in national currency in January 2023, the annual effective interest rate was 8.9%; it was 22.0% for loans with a maturity of up to one year and 15.7% for loans with a maturity between one and five years. Interest rates for subprime customers of non-bank lenders are significantly higher. Currently, regulations regarding usury interest set a cap of 50% per year, but certain additional fees allow non-banks to further increase total charges (Vasileva, 2019^[10]). Instead, the cap should be defined in terms of multiples of benchmark lending rates, including any additional fees to avoid excessive costs for borrowers. While some lending corporations are

direct subsidiaries of banks, other non-bank lenders are in part financed by banks, whose loans comprised more than half of all liabilities of non-bank lending corporations in December 2022. Nevertheless, these remain a modest part of banks' balance sheets and are subject to capital requirements. From a macroprudential perspective, the interconnectedness of the non-bank sector with traditional banks through ownership and lending requires attention, although risks are assessed to be non-material according to the Bulgarian National Bank. The supervisory and prudential mandate of the Bulgarian National Bank does not include activities of lending corporations as they are not deposit taking institutions, but they are monitored by the Commission of Consumer Protection. However, the capacity of this supervisory body is limited and insufficient data impedes closer oversight. Protection of often vulnerable consumers needs to be strengthened, including by extending data disclosure requirements to a detailed breakdown of interest rates and fees charged, as well as of funding sources to facilitate monitoring, increase transparency and foster stability. Excessive interest rates and fees also raise competition concerns.

Fiscal supports need to be carefully designed, while ensuring sound public finances

Support has been timely but not well targeted

Bulgaria has swiftly adopted measures to address the COVID-19 pandemic and the energy crisis triggered by Russia's invasion of Ukraine. These helped to protect the economy from disruption and hardship, and to support demand. Current energy-related supports are expected to have had an overall fiscal cost of over 3.5% of GDP in 2022, financed in a fiscally neutral manner by windfall revenues of state-owned energy companies gained as prices soared and Bulgaria became the third largest electricity exporter in Europe.

The government needs to strike a delicate balance between providing temporary supports to those most impacted by higher energy and food prices and not contributing unduly to higher second-round inflation or distorting necessary price signals. Key measures (Box 1.1) to date to limit price increases could potentially have helped to lower inflation, but are mostly not targeted and benefit those with higher incomes most, while at the same time dampening incentives to reduce energy consumption. These measures include electricity subsidies for industrial consumers and moratoria on electricity, heating, and water supply prices, zero VAT rates for selected goods, among other types, for households. The Energy System Security Fund's excess revenues that finance the subsidies are derived from state-owned energy producers (from 1 January 2023 also private producers need to contribute their revenues above a sector-specific ceiling). As energy prices fall, existing temporary supports should be replaced by more targeted measures, including transfers to lower income households, or phased out if no longer required.

Fiscal stability has been anchored by a set of national or domestic fiscal rules (in addition to EU rules), some of which were amended in 2020 to cope with the health and economic crisis triggered by the COVID-19 outbreak and to allow for higher absorption of EU funds (Box 1.3). This necessitated an amendment of the Public Finance Act in 2020, which allowed exceeding the reference values of several rules in case of "exceptional circumstances", defined as unusual events being beyond the control of the Council of Ministers, which have a major impact on the financial position of the general government sector or an economic downturn of more than 3% in real terms. This was done to synchronise with EU legislation (this exemption corresponds to the definition under EU Regulation No 1176/2011) and to enable implementation of the general escape clause, activated by the European Commission in 2020. The exclusion of EU funds and other international programmes and treaties and the related co-financing from the national expenditure rule allows for greater absorption of EU funds. This exclusion is unlikely to threaten sustainability as long as deficit rules are observed. There are discussions on streamlining national fiscal rules, which, if pursued, should keep those rules simple in general. (Park, 2021^[11]). Further changes may need to be made to the fiscal rules in the context of the on-going EU review of economic governance, but a strong domestic framework is likely to continue to play an important role.

The general government deficit is expected to fall sharply in 2022. The deficit originally was planned to exceed BGN 6.5 billion or 4.5% of GDP, but according to preliminary estimates, it amounted to BGN 4.6 billion or 2.9% of GDP (compared with 3.8% and 3.9% of GDP in 2020 and 2021, respectively). This sharp reduction took place in the context of increasing pensions (above the rate of inflation for 2022), civil servant wages and the minimum wage, while much needed investment projects were delayed. Continuing large carryovers between years reduce budget transparency. Higher-than-anticipated social security and direct taxes receipts also contributed to the lower deficit. The surge in spending in early 2022 took place without a new Budget Law, which was delayed until March 2022 due to political instability, as until its adoption, an extension law of the budget laws on the basis of Budget Law 2021 was in force. While there are many factors at work and significant uncertainty around the underlying budgetary position, the government will need to address any structural budget weaknesses that have arisen due to the fast increase in public sector pay and pensions. Given limited domestic monetary policy instruments, the onus to manage short-term term pressures is placed on fiscal authorities.

Box 1.3. Bulgaria's fiscal rules

Being a member of the European Union, the EU Stability and Growth Pact's fiscal rules apply to Bulgaria and are transposed into national legislation. This framework is currently being revised at EU level. In addition, a number of national fiscal rules have been put in place to ensure fiscal prudence.

Fiscal rules in the EU framework

- Deficit rule: the general government deficit in annual terms (calculated on an accrual basis and under the methodology of the European System of National and Regional Accounts) should not exceed 3% of GDP.
- Expenditure benchmark rule: the annual growth of general government expenditure is not allowed to exceed the reference growth of potential GDP.
- Structural deficit rule: given that Bulgaria's consolidated general government debt is below 40% of GDP and the risks for long-term sustainability of public finances are low, the structural deficit of the general government sector may exceed 0.5% of GDP, but cannot be more than 1% on an annual basis. Non-fulfilment of this rule is allowed in exceptional cases and in case there is no threat to sustainability.
- Debt rule: the nominal amount of the consolidated debt of the general government sector cannot exceed 60% of GDP at the end of each year (Maastricht criterion).

National fiscal rules

- The consolidated budget deficit, calculated on a cash basis, cannot exceed 3% of GDP.
- Consolidated government spending in cash terms cannot exceed 40% of GDP.

Changes to the rules

Some changes were introduced in 2020 to allow to respond swiftly to the shocks related to the COVID-19 pandemic as well as the surge in energy and raw material prices amplified by the war in Ukraine. Changes followed the application of the EU General Escape Clause of the Stability and Growth Pact, while providing more flexibility in terms of national rules built over the EU ones:

- The general government deficit can exceed the ceiling of 3% of GDP under exceptional circumstances.
- Possibility for a temporary deviation from the expenditure benchmark rule under exceptional circumstances.

- The limit of the annual cash budget deficit was changed from 2% to the current 3% of GDP. In addition, an option is provided that the new limit can be exceeded under exceptional circumstances.
- The definition under the national expenditure rule was changed so that the expenditures from EU funds accounts and other international programmes and treaties and the related national co-financing were excluded from its scope.

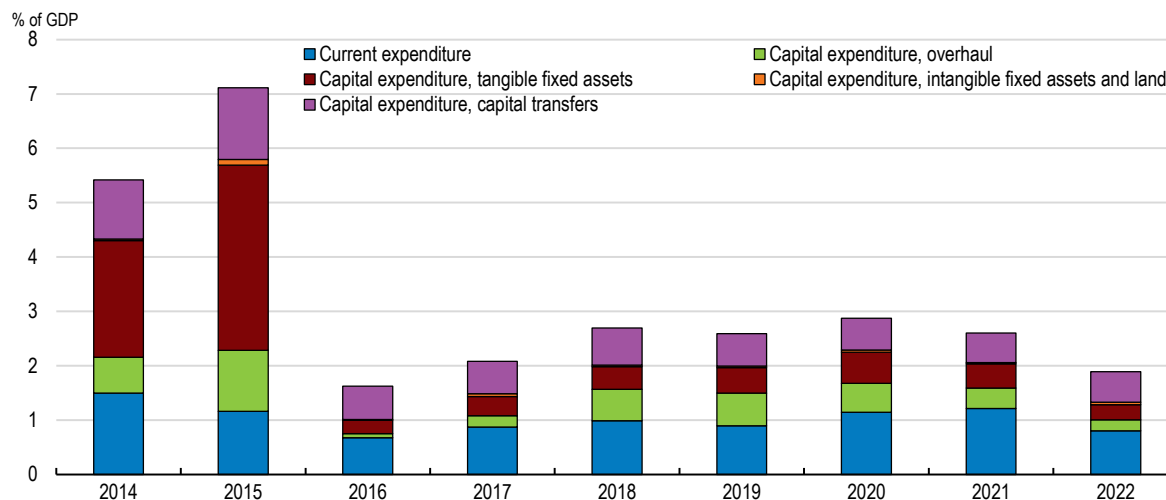
Exceeding the fiscal rules' reference values is allowed in the case of unusual events beyond the control of the Council of Ministers or an economic downturn of more than 3% in real terms, while the exclusion of EU and similar funds with the relative co-financing from the national spending rule is not conditioned on those criteria.

Source: Ministry of Finance.

EU funds (Figure 1.14) are a major source of financing public investment in Bulgaria. Simulations by the Ministry of Finance suggest that measures under the European Social and Investment Fund accounted for a 10.6% cumulative increase in the level of GDP between 2014 and mid-2022 (Ministry of Finance, 2022^[12]). Smooth implementation and successful absorption of EU projects in the next years remain crucial for the recovery from the pandemic and the energy-crisis resulting from the war in Ukraine. Effectiveness of programmes depends on project preparation, administrative capacity and the required legal changes. The late adoption of the European legislative framework created delays, but by end-2022, the absorption rate of EU programmes is expected to have approached 100%. This is an improvement compared to the previous programming period (2007-13), when due to lack of administrative capacity mostly related to coordination, the absorption rate was 95%.

Figure 1.14. EU Funds have been an important source of investment

EU Funds and national co-financing



Source: Ministry of Finance.

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The total investment budget for the programming period 2021-2027 under the main funds, including national co-financing, amounts to EUR 12.9 billion (18% of 2021 GDP). The National Recovery and Resilience Plan 2022-26 allocates EUR 5.7 billion, mainly for investments in the area of the digital and green transitions (Box 1.4). The total allocation under the EU Multiannual Financial Framework (MFF) and the Next Generation EU Initiative (including non-investment spending) is EUR 30 billion (41% of 2021 GDP), of which grants are EUR 26 billion and the remaining part is loans that Bulgaria does not intend to use. EU funds will contribute to improving the main transport infrastructure (including gas pipeline interconnectivity with Serbia) and to modernising the railway system and the regional water infrastructure. They will help in decreasing poverty, boosting innovation and strengthening education. To make best use of the EU funds, regulatory delays should be avoided and projects should be embedded in a long-term investment framework. The disbursement of large amounts of EU funds will likely add to demand in an already high-inflation environment and adds to the need to maintain a prudent fiscal stance.

Box 1.4. Bulgaria's 2022-26 National Recovery and Resilience Plan

Bulgaria is taking part in the EU Recovery and Resilience Facility aimed to mitigate the economic and social impact of the coronavirus pandemic. Through this instrument the country will finance both reforms and investments. On 4 May 2022, the National Recovery and Resilience Plan (NRRP) was approved by the European Commission. Due to the lack of a functioning parliament, the legislative amendments required to fulfil the reforms set out in the NRRP have been delayed, thereby delaying also the second payment under the Plan.

Bulgaria is expected to receive EUR 5.7 billion in the form of grants during the period 2022-26. The first payment of EUR 1.4 billion was made on 16 December 2022. Key reforms include emission reduction from the power sector (40% by 2025 compared to 2019 levels), an indicative coal phase-out date, reform of the wholesale and the retail electricity markets, a set of rule-of-law measures to address in particular anti-corruption issues and the role of the Chief Prosecutor, reforms of public procurement to reduce the use of non-negotiated in-house procedures, the minimum income scheme reform and health sector reforms.

The NRRP covers key reforms in four major pillars:

- Innovation (25.3%): technological modernisation of SMEs, cyber security and the circular economy. Support of the development of industrial zones and parks is envisaged in order to improve their connectivity to attract more investment. Under this pillar, there will be grants for education, tools for quality validation of professional skills, especially for the unemployed, development of research universities and modernisation of education infrastructure.
- Green development (41.9%): projects to achieve a low-carbon economy, including improving energy efficiency, green energy, construction of renewable energy generators with batteries and infrastructure for energy storage, research activities and a pilot project for geothermal power. The country will design a Climate Neutrality Roadmap for the economy and pilot projects for the production of green hydrogen and biogas. The green dimension also includes measures for biodiversity – restoration of key climate ecosystems in implementation of the EU Biodiversity Strategy – and the objectives of the European Green Deal ensuring the effective management of the national ecological network and sustainable agriculture.
- Connectivity (18.3%): fostering the competitiveness and sustainable development of the regions, including transport and digital connectivity. This pillar also envisages measures for reducing the carbon footprint of the transport sector by modernising the railway sector and updating the strategic framework of the transport sector. Under this pillar, there will be also projects for digital infrastructure such as increasing network coverage and digital public services and stimulating electric mobility.

- Fair society (14.6%): focused on the business environment, social inclusion, and health. Measures here are aimed to improve e-Government, cater for vulnerable groups, improve the quality and extend the scope of offered social services, as well as increase access to health care. Under this pillar, the business environment will be improved. In the field of healthcare, measures are envisaged to develop e-health and strengthen the National Health Information System, as well as to raise the attractiveness of health professions.

Source: Ministry of Finance and NRRP.

The public finances need to remain on a stable footing and meet long-term spending needs

Fiscal discipline was strong over the past two decades, but spending pressures in the coming decades are expected to increase, stemming from greater pensions and health- and long-term care needs and the financing of the large need for investment, including for the energy transition (Box 1.5). EU funds, which have been financing a third of public investments, will continue to play a prominent role, but are unlikely to be sufficient. A blend of increasing effectiveness and efficiency on both the revenue and the spending side is needed, including improving tax compliance and raising some taxes, such as environmental taxes, inheritance and property taxes.

Box 1.5. Debt levels are currently low, but ageing-related costs imply imminent pressure on spending

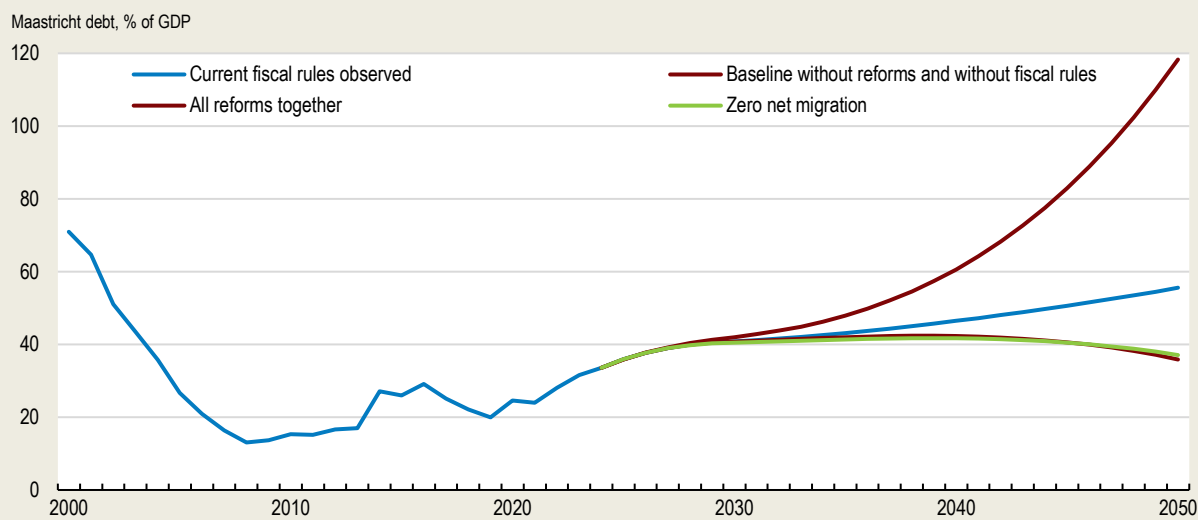
Bulgaria's public finances have been on a stable trajectory since the introduction of the currency board with prudent fiscal policies, low fiscal deficits and policies set to accumulate buffers. Support packages to businesses and vulnerable households during the Covid-19 pandemic led to increased expenses and a need for significant new debt issuance. While the deficit has narrowed, demographic pressures stemming from natural decrease of the population, as well as emigration, will put upward pressure on debt over time. Government contingent liabilities are stable and relatively low (the aggregate debt of state-owned enterprises amounted to 12% of GDP in 2021).

In the baseline scenario, rising ageing costs are met through additional borrowing to support the pension system and increasing healthcare spending due to ageing (Guillemette and Turner, 2021^[13]). In this scenario, debt starts to increase rapidly already in the medium term as the ratio of the number of pensioners and the number of insured persons increases. This scenario highlights the weight of the ageing-related spending needs and the necessity to address this by raising revenues, reducing spending elsewhere and increasing efficiency on both sides.


An alternative scenario assumes that the government adheres to the current fiscal rules, covering ageing costs by increasing revenues and reducing other spending. In this scenario, the OECD model takes into account future increases in statutory retirement ages that have already been legislated by governments (OECD, 2021^[6]). In this situation with moderate growth, public debt would gradually increase to levels that will exceed 50% of GDP in 2045 and reach around 55% of GDP in 2050 (Figure 1.15). In a further scenario, the stylised impact of the structural reforms modelled in Box 1.8 is taken into account.

The final scenario assumes that migration flows are reversed, including by re-integrating former emigrants and attracting more immigrants, so that net migration is close to zero by 2050. In this scenario, debt would fall to around 37% of GDP in 2050.

Figure 1.15. Reversing outward migration could keep debt on a sustainable path



Note: The projections incorporate actual outcomes until 2021, OECD projections until 2022 and from 2023 are based on the OECD long-term model estimates (Guillemette and Turner, 2021[12]). In the baseline scenario, where ageing costs are not compensated, it is assumed that fiscal rules are relaxed and the deficit surges, boosting public debt. In an alternative scenario, offsetting revenue increases and/or spending reduction measures are put in place to compensate for the rise in expenditures due to ageing. In this scenario, the structural budget balance gradually improves from -3.1% of GDP, as ageing costs are offset and fiscal rules are in action, to a slight surplus from the end of the decade onwards. Source: OECD calculations based on OECD Economic Outlook 112 database.

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The Fiscal Council could be well placed to increase transparency around short-term fiscal policy and to plan ahead for longer-term challenges, including around pensions and health insurance. To make it a more effective body to safeguard fiscal discipline and provide expert opinion, its capacity should increase. The Fiscal Council should provide a richer independent assessment of the macroeconomic situation, including developing its own macroeconomic tools or forecasts, the budgetary situation and long-term issues. By undertaking research on relevant issues and publishing its assessments on its own initiative, it could help to increase transparency (Box 1.6).

Box 1.6. Ensuring effective functioning of the fiscal council

Independent fiscal institutions (IFIs) represent a major innovation in public financial management and have become an important feature of the oversight of public finances in the European Union. The Bulgarian Fiscal Council was established in 2015 as part of EU governance reforms. It has a wide-ranging mandate to deliver reasoned opinions and recommendations about: the official spring and autumn macroeconomic forecasts, the draft state budget act, the draft acts of the state social security budget, the budget of the National Health Insurance Fund, the draft acts for any amendment and supplementary budgets, the drafts of the medium-term budgetary forecast, and other strategic documents of the Council of Ministers relevant for the compliance with the numerical fiscal rules.

Despite the broad mandate, there is a perception that the Fiscal Council could play a more effective role in the oversight and debate around the public finances. Its analysis of macroeconomic and budgetary developments is less developed than in some similar countries.

OECD reviews of other IFIs established in small open EU economies over the past 15 years confirm that many of them have a strong reputation for solid independent analysis, have increased fiscal

transparency and generated increased parliamentary and public debate on fiscal issues (OECD, 2020^[14]) (OECD, 2019^[15]). This includes countries such as the Czech Republic, Lithuania and the Slovak Republic.

These institutions carry out a wider range of activities than the Fiscal Council in Bulgaria, including undertaking their own macroeconomic forecasts as a background to assessing the official forecasts, in-depth analysis of the public spending and revenue forecasts, medium-term projections including debt sustainability analysis (DSA), and long-term reports analysing future trends in pensions spending and fiscal risks.

However, these institutions typically have greater resources and more effective mechanisms for information sharing with the government than in Bulgaria. It is important that the resources and capacity of the IFI match its responsibilities to ensure that it can fulfil its mandate and so that it is viewed as credible. The Bulgarian Fiscal Council has five members and five full-time staff based in the Parliament. While these employees carry out the organisational, technical and expert service of the activities of the Council, it appears difficult to recruit the needed specialised macroeconomists with analytical and statistical skills to support the work of the members. By comparison, the Czech Fiscal Council has a staff of 12 people, the Lithuanian seven, and the Slovak Fiscal Council has 15 staff. There is a Memorandum of Cooperation with the Finance Ministry on information sharing. However, regarding availability of information, it is not clear that the Fiscal Council has always received all information and data needed in a timely way.

Source: OECD and Fiscal Council and Automatic Corrective Mechanisms Act.

The ambitious agenda of structural reforms proposed in this Survey would not only boost growth in the medium-to long run as discussed in Box 1.8, but would bring about a sizeable fiscal dividend of around 3% of GDP through measures to adjust spending and raise tax revenues (Box 1.7). Some of the measures, like enhanced collection efficiency would boost revenues permanently, while others, such as increased carbon pricing, would do so only temporarily until carbon neutrality is achieved. Spending on active labour market policies is assumed to be raised incrementally to reach new levels by 2040. The cost of introducing health insurance for people who register at the employment agency is hard to address given a lack of information on public subsidies to healthcare, but it would likely be relatively sizeable given the large number of people currently without health insurance. Some of the measures have a high up-front component, such as providing health insurance, but, in the long run, there may be some offsets as health insurance coverage could improve health in general and encourage people to see a doctor before an emergency intervention is needed, which is entirely covered by the government for those without insurance.

Box 1.7. The fiscal impact of reforms

This box summarises the fiscal impact of selected reform measures in the Economic Survey (Table 1.3). These estimates are undertaken where feasible given available data and evidence and come with significant uncertainty. Behavioural effects are not taken into account. Estimation is done in the following way:

- Increase tax collection efficiency as described in
- Table 1.4
- Extra carbon pricing revenues related to measures by Bulgaria for the green transition are based on the OECD long-term model (Guillemette, 2023). Revenues related to carbon pricing include taxes on GHGs, fuel taxes, revenue from auctioned permits of emission trading systems for GHGs and energy taxes.

- Return migration-related fiscal impact is the net impact of the costs of accommodating 24 000 returning Bulgarians, 75% of working age (same as in 2020) at a BGN 2 000 cost per capita and their contribution to income taxes and social security at double the minimum wage (assuming they have higher skills).
- Increase of the general social assistance benefit to the poverty line: it is assumed that the general social assistance benefit is no longer linked to the differentiated minimum income, but the poverty line. The calculations use 2021 numbers for recipients and the poverty line, and the table shows the difference between what it would cost if the recipients got the amount equivalent to the poverty line and what they actually got.
- Spending on active labour market measures is assumed to increase gradually from the 2019 0.16% of GDP to 0.28% of GDP (which is the 2019 average of the Visegrad4 countries).
- Increasing of the child tax allowance is calculated as the difference between the current allowance of BGN 6000 per year (BGN 500 per month) and the recommended at BGN 9350 per year (BGN 780 per month) multiplied by the number of children. This is the upper bound, as the child allowance is not fully utilised.

Table 1.3. Estimated impact of selected structural reforms

	Fiscal impact in % of GDP
Measures increasing fiscal revenues/reducing spending:	
Increase tax collection efficiency	1.7%
Raise carbon pricing	1.5-2%
Return migration (net impact)	0.07%
Measures decreasing revenues/increasing spending	
Increasing the general social assistance benefit to the poverty line	-0.06%
Increase ALMP spending	-0.12%
Increase the child tax allowance to BGN 9350 per year (or BGN 780 per month)	-0.28%
Net fiscal impact	2.8%-3.3%

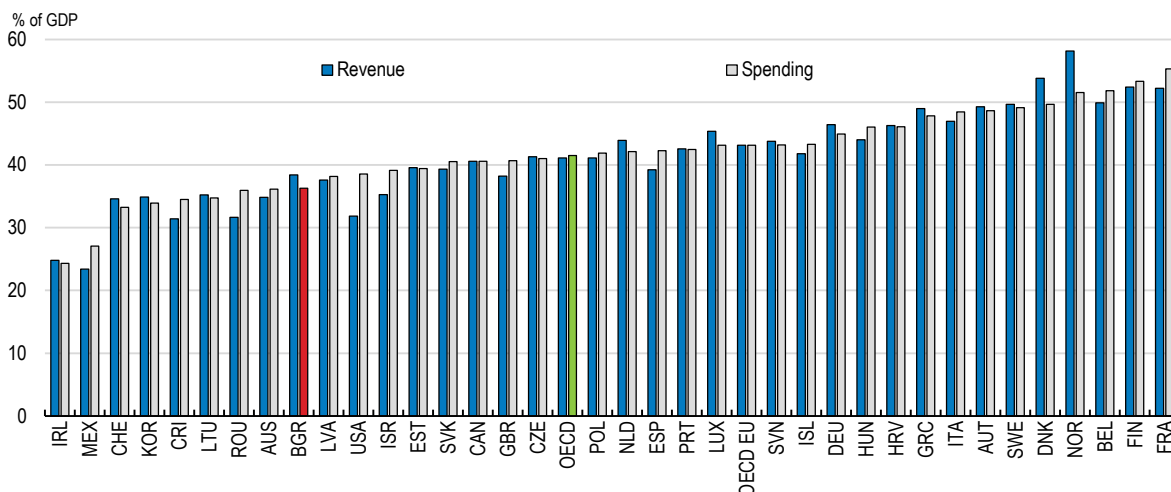
Source: OECD calculations.

Government spending is relatively low

Bulgaria's government, at less than 40% of GDP, is of modest size compared to many European OECD countries (Figure 1.16), notwithstanding similar challenges such as ageing. The share of spending on unemployment and sickness benefits is roughly half of the OECD average, while spending on health and education is lower (Figure 1.17), although needs are high with increasing skill shortages in several sectors and occupations. Similarly, part of the population is not covered by health insurance and health outcomes could improve. The Bulgarian government spends a similar share of GDP (3.4%) on investment than the average OECD country, however this is still less than many countries in the Central and Eastern European region. As Bulgaria's capital stock is low, there is scope to invest more, in particular for projects without commercial return, such as rural roads, basic utilities and institutions providing key public services. EU funds could be more effectively used for these projects. Currently, there is no overall long-term investment strategy and the former department in the Ministry of Finance in charge of capital budgeting has been abolished. The lack of an investment strategy also increases uncertainty at the local level as they have no projects in the pipeline when applying for EU funds. The importance of an investment strategy will only increase with the large inflow of EU funds in the coming programme period. Long-term capital budgeting that goes beyond the medium-term framework needs to be reinstated to meet infrastructure investment needs, including with a strong focus on cost-benefit analysis. Public investment efficiency at the local level could be raised by providing funds on a predictable basis for priority projects.

Figure 1.16. The size of the government is relatively small

2019



Note: The OECD average does not include Chile and Türkiye, for which no comparable data are available.

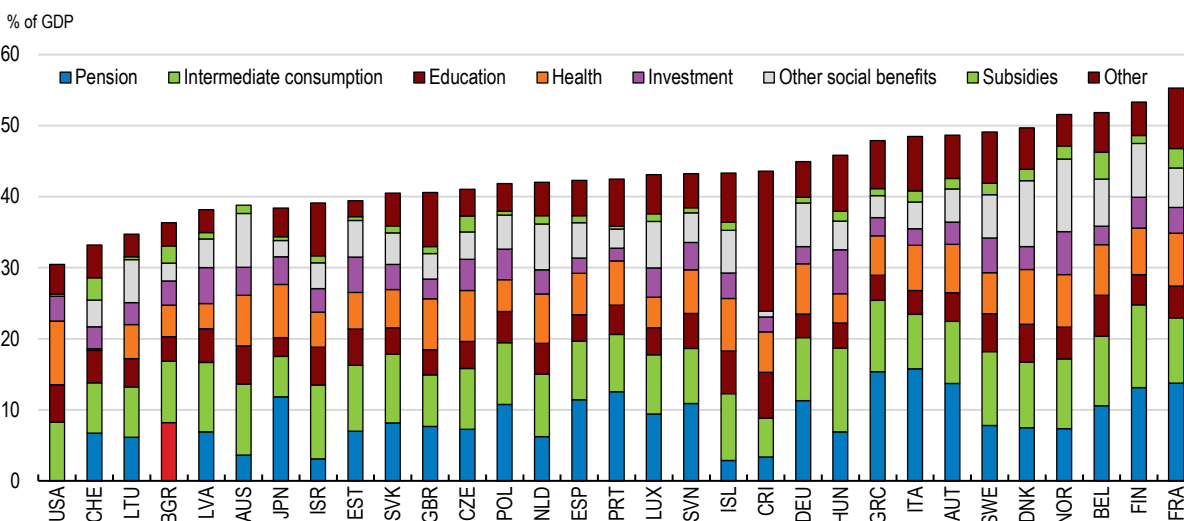
Source: OECD Economic Outlook 112 database.

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The share of subsidies, mostly to energy companies, public transport, railways and healthcare is higher than in most OECD countries (2.4% of GDP in 2019). Even though these subsidies are permitted under EU rules, scarce public funds could be more effectively used and adverse incentives should not be entrenched. Allowing the market to play a greater role in the allocation of resources and a more business-friendly business climate would lead to higher economic performance. These subsidies should be reviewed in terms of their economic impact and cost-efficiency and scaled back as required.

Figure 1.17. A large part of public spending goes to wages and government purchases, while education spending is relatively low

Public spending categories by function, 2019



Note: Other social benefits include sickness and disability, family, child and targeted or untargeted social assistance benefits.

Source: OECD Public Finance database.

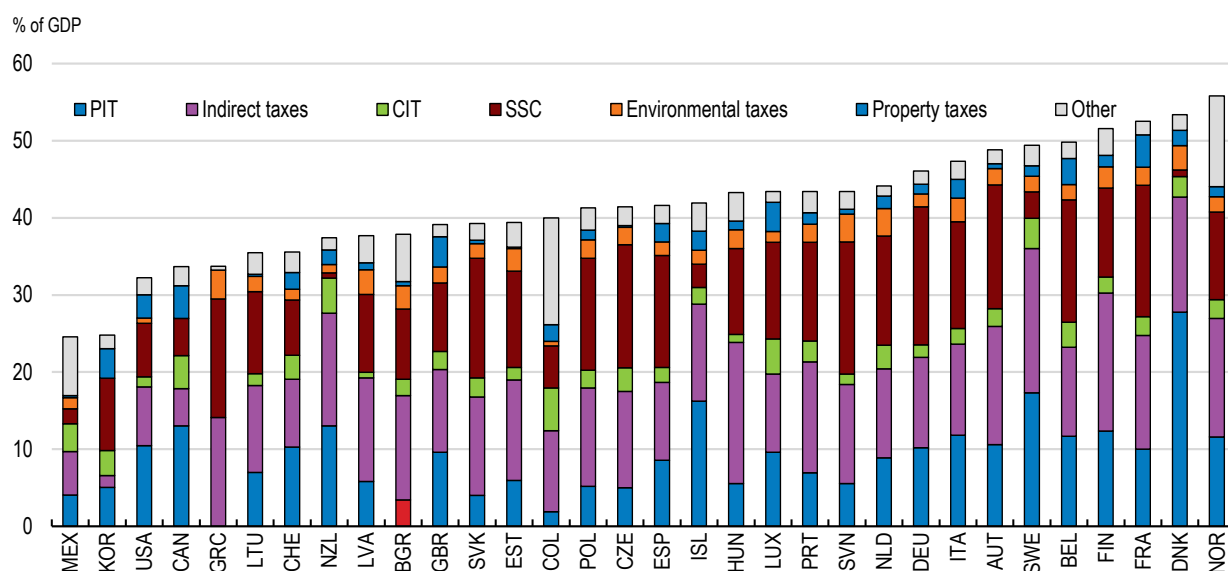
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Greater compliance, including reining in informality, would boost fiscal revenues

Mirroring the low spending-to-GDP ratio, Bulgaria's tax-to-GDP ratio is rather low in international comparison. Indirect taxes account for the bulk of tax revenues, with the value-added tax accounting for almost a third of the total and taxes on personal income and labour for less than a quarter (Figure 1.18). The taxation of personal incomes is low due to the underreporting of incomes and the flat tax rate of 10%. Social security contributions, in contrast, are high, varying between 32.7 and 33.4% depending on the profession (the difference is due to the work injury insurance) and are regressive due to the cap at five times the minimum wage (although only about 5% of the taxpayers fall into that category). Even though social security contributions are high, which encourages informality in the form of declaring lower wages and paying the rest under the table, the overall tax wedge is not particularly high compared to the OECD average. For instance, for a family with both parents earning the average wage and with two minor children, it was around 30% in 2021 (Figure 1.19). Reducing informality and activating inactive persons would broaden the base and thus allow for reducing the heavy burden of social security contributions without compromising the sustainability of the system.

Figure 1.18. Indirect taxes are the main source of public revenues

Public revenue by category, 2019



Note: PIT is personal income tax, CIT corporate income tax and SSC social security contributions. Property taxes include recurring taxes on the holding of property as well as transaction taxes. Indirect taxes include the value added tax and consumption and sales taxes. The other category includes other taxes and non-tax revenues.

Source: OECD Public Finance database.


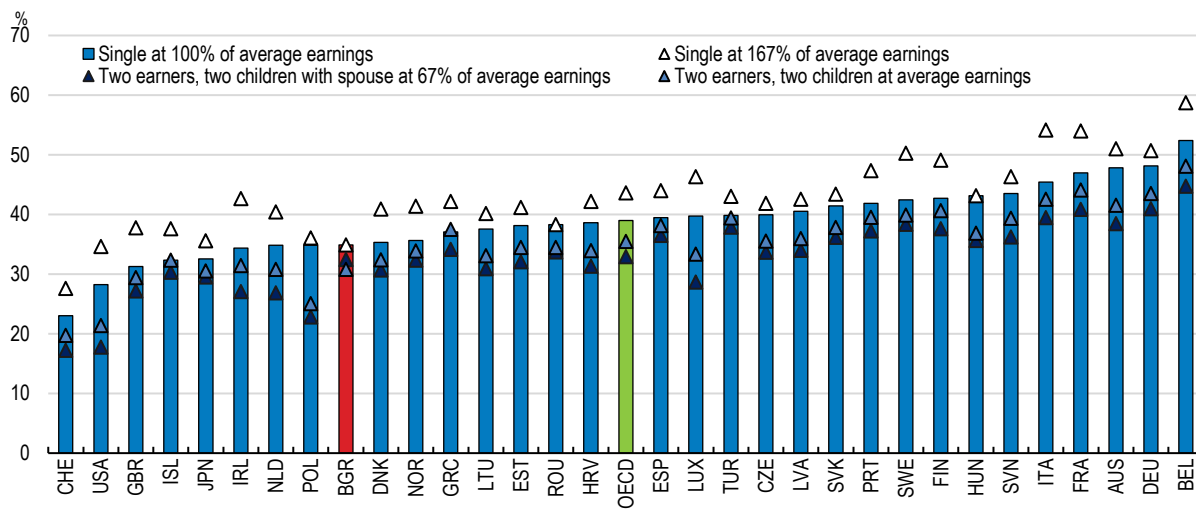
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Figure 1.19. The overall tax wedge is relatively low

2021



Note: The OECD average is the average of EU OECD countries, Australia, Iceland, Japan, Switzerland, Türkiye, the United Kingdom and the United States.

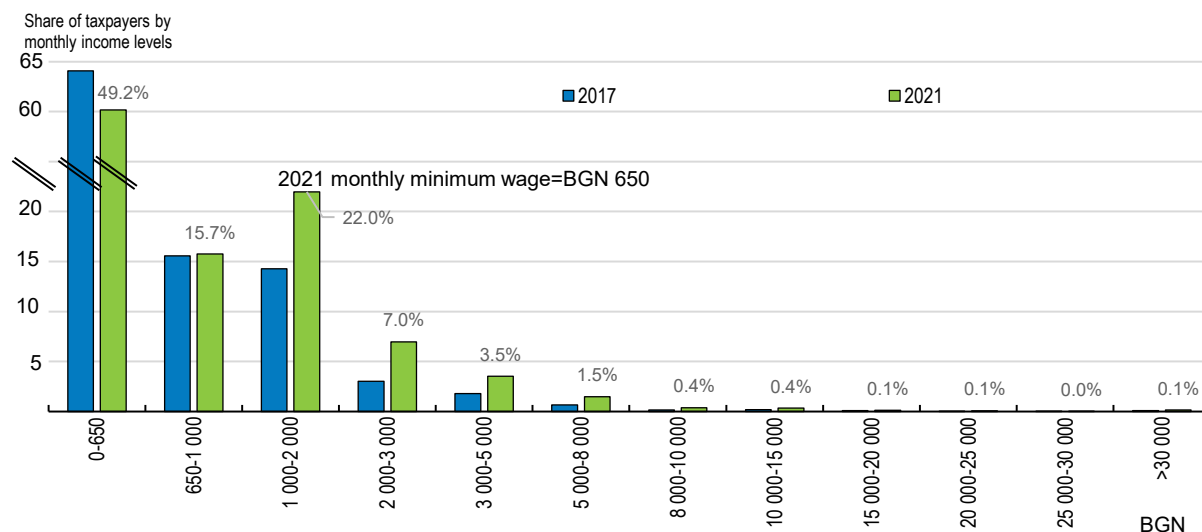
Source: European Commission Tax Benefit database.

StatLink  <https://stat.link/ajk4f6>

Underreporting incomes is a widespread practice (see Chapter 2 for more discussion of informality in labour markets) and the flat tax is designed to help address that issue. Indeed, half of all taxpayers declare revenues at the minimum wage level (Figure 1.20). The minimum income threshold is an occupation and sector-specific threshold, according to which the social security payments are made, to ensure that professionals who are unlikely to earn the minimum wage pay social security contributions at a somewhat higher level. The adoption of the thresholds helped reining in informality as it expanded the social security payment base (Bogdanov, 2020^[16]). These thresholds, however, are applied only for employees and not for the self-employed, allowing professionals to declare at the minimum wage (and pay social security contributions accordingly) as long as they are providing their services through a service provision and not an employment contract. The flat tax reduced the size of the informal economy by an estimated two-thirds over 2008-14 (Djankov, 2014^[17]). It is simple and transparent with very few allowances. The major allowance, the recently-introduced child allowance at BGN 6 000 per year (BGN 500 per month) per child up to three children, is applicable to declared income only and is currently underutilised. Raising the child allowance to BGN 9 360 per year (BGN 780 per month) would enhance incentives to declare envelope wages by lowering the cost of declaring incomes that are higher. The increase of the child allowance would lower marginal tax rates for low-income workers with children and simplify tax collection as more people would be taken out of the income tax net rather than paying very small amounts of income tax. For greater effectiveness, increased intensity of labour inspections is needed.

Figure 1.20. Half of all taxpayers are registered at the minimum wage

Share of taxpayers by monthly income levels



Note: The distribution of taxpayers is based on income declared to the tax authorities.

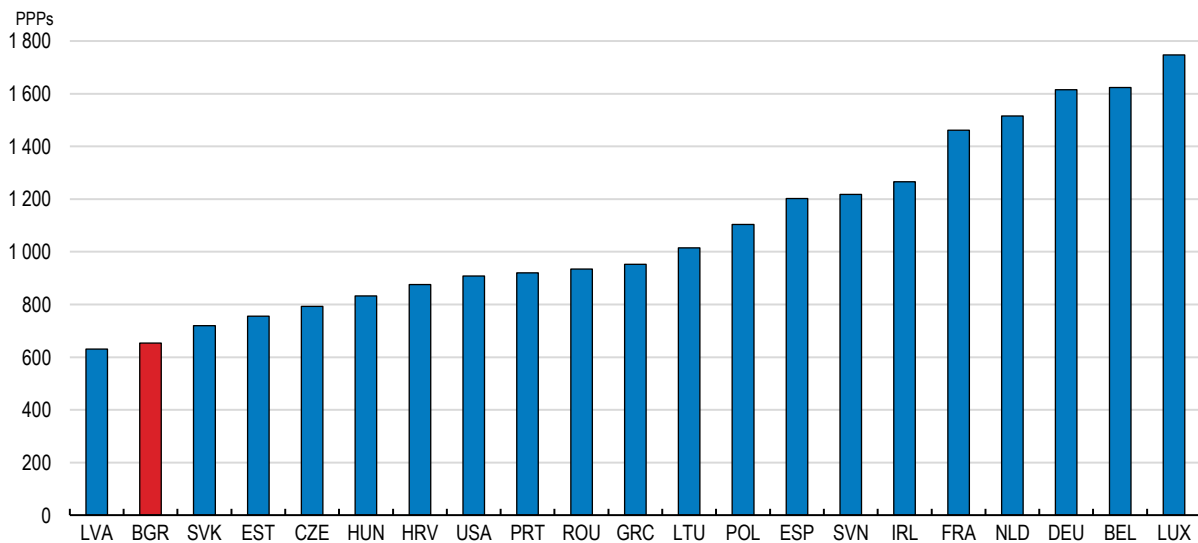
Source: National Revenue Agency.

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Increases in the minimum wage also help whitening economic activities as firms are required to declare wages at the higher minimum rate, although it imposes a real burden for firms that actually want to pay the minimum wage (rather than paying additional envelope wages). The recent increase of the minimum wage by nearly 10% is expected to have resulted in an additional estimated fiscal income of 0.3% of GDP this year due to an increase in the tax base for social security contributions and personal income taxes. Further increases over time of the minimum wage and, in particular minimum insurance thresholds for certain professions that are unlikely to be paying the minimum wage and aligning those with contributions of self-employed persons who provide the same types of services, would help reduce informality and boost fiscal revenues. The relatively low level of the minimum wage in EU comparison (Figure 1.21) may leave some room for further increases, although this needs to take into account Bulgaria's relatively low productivity. Once inflationary pressures subside and if productivity growth allows, further well-designed increases in the minimum wage could help reining in informality.

Figure 1.21. The minimum wage is relatively low

Minimum wages in EUR PPPs, 2022



Note: Nominal minimum wages for Bulgaria would be 10% higher in 2023.

Source: Eurostat.

StatLink  <https://stat.link/gj8oqw>

Better tax compliance would raise additional revenues, including revenues related to informality, profit shifting by foreign companies, tax expenditures and nonpayment of VAT. Compliance has improved in recent years, but more could be done. The National Revenue Agency estimates additional collectible revenues as equivalent to 1.7% of GDP (Table 1.4). The frequency of inspections of multinational's operations should increase, fines made a more effective deterrent, and disclosure requirements of related party and within-group transactions enhanced. Legislation needs to be changed to allow sufficient time for investigations and external industrial experts should be involved to provide expertise on relevant industrial production processes, so that revenue agency professionals are better placed to verify tax reports and identify potential tax shifting schemes. Currently, the provisions are phrased in a complicated way and multinational companies are often well-placed to reach favourable court rulings. As the language of the provisions that serve as the basis for investigations of profit hiding or shifting is complex, tax officials should be adequately trained and specialised to improve enforcement through the courts. Revenue collection efficiency could be increased by reassigning the administration and collection of the property tax to the central level, where it used to be collected in the past, as recent reforms making it a local tax brought a 30-35% drop in collection efficiency. The local tax collection system may be more prone to granting ad hoc tax exemptions or being lenient to evaders. Centrally collected revenues could still, as in other countries, be allocated or passed through to be spent at the local level.

Table 1.4. Significantly more revenues could be collected

Per year

Reasons for loss/Revenue sources	Potential collectability of taxes in BGN million	Potential collectability of foregone social security contributions in BGN million
Informality/Personal income tax	320	544
Profit shifting/Corporate income tax	300	
Tax expenditure	938	
VAT	137	
Sub-total	1695 (1.6% of GDP)	544
Restore property tax collection efficiency	0.1% of GDP	
Total	1.7% of GDP	

Note: Data refer to 2021 except for VAT, which is for 2019.

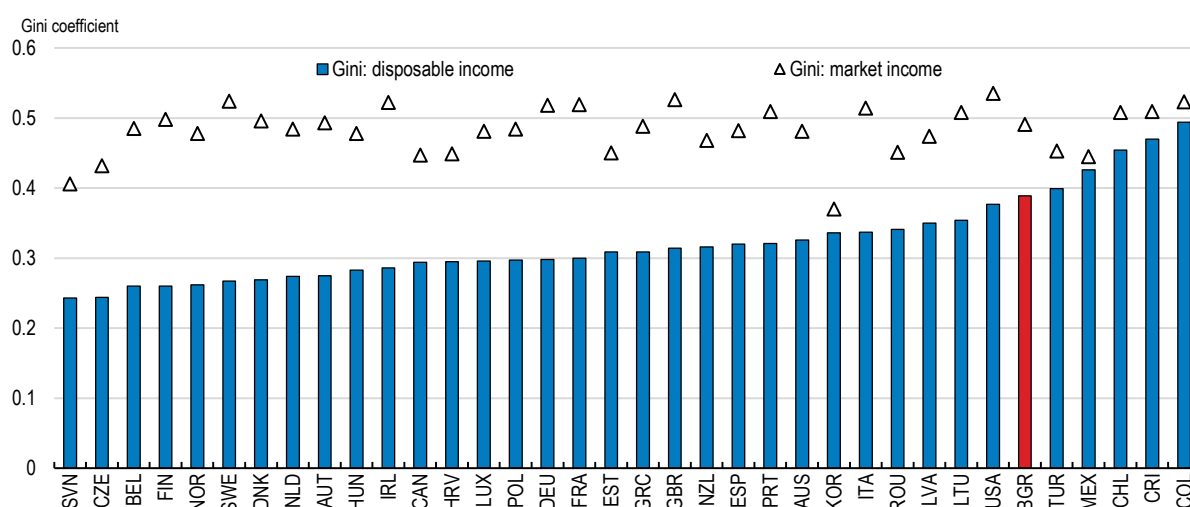
Source: National Revenue Agency.

The transfer system could play a greater role in reducing inequalities

In Bulgaria, the tax-and-transfer system does not reduce the high level of market income inequality much (Figure 1.22), which reflects both the flat tax rate designed to incentivise reporting of wages and whitening the economy rather than reducing income inequalities and the low level of transfers. With respect to fairness, it should be borne in mind that in progressive tax systems, higher-income earners can make use of various exemptions and may pay less income tax than headline marginal rates would suggest. In contrast, in Bulgaria's system, the main tax allowance since 2015 is related to children and is high enough to reduce the effective tax rates for low-income earners with children to low single-digit rates. Over the long run, consideration of moving towards a more progressive income tax system could potentially contribute to narrowing inequalities, alongside other measures, or allow more revenue to be raised to support social spending. Nevertheless, any transition in this direction should only proceed once more effective measures to support tax compliance and reduce informality are in place and as income levels rise.

Figure 1.22. The tax and transfer system does not reduce disposable income inequalities much

2020



Source: Standardized World Income Inequality Database v9.4.

StatLink  <https://stat.link/1j8q69>

Due to the flat tax with limited progressivity related to the tax allowance for children and the regressive nature of social security contributions, other taxes and transfers need to play a greater role in reducing large market income inequalities. Taxing wealth, including through inheritance and property taxes, would help reducing wealth inequalities. There are property taxes in Bulgaria, but revenue from these taxes is very low at 0.5% of GDP compared to 1.8% in OECD countries. Clarifying land ownership rights and updating valuations and registries would be prerequisites to prospective revenues from recurring taxes on the ownership of immovable property. Collection should be administered at the central rather than local level due to efficiency concerns. Taxing more movable property, such as luxury cars and yachts, could also be considered after careful evaluation. Higher inheritance taxes would help reducing wealth inequalities and would be conducive to more equal opportunities.

In addition to these taxes, which are likely to reduce income inequalities, the transfer system also needs to play a greater role. As discussed in Chapter 2 of this Survey, an overhaul of the social transfer system to increase generosity and coverage, while taking measures to strengthen labour market activation and participation, would help to reduce poverty by increasing transfers and bringing more people into work.

Stepping up reforms for faster and more sustainable growth

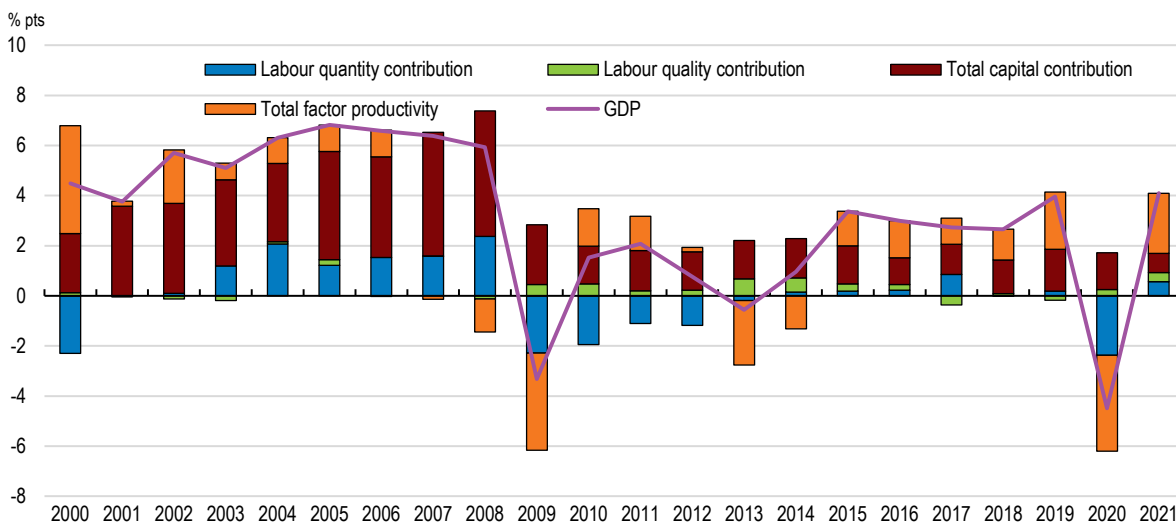
In the years prior to the pandemic, growth in Bulgaria reached a strong enough pace to allow some convergence in living standards with high-income OECD countries, albeit at a slower pace than for some other countries in the region. Growth needs to increase to foster stronger convergence in living standards and to avoid the middle-income trap, whereby Bulgaria would fail to make further progress as its wages are too high to compete with lower income countries, but its innovation performance lags behind high-income countries (Györfy, 2022^[18]). This calls for a consistent long-term strategy and ambitious reform agenda tackling a number of significant barriers to better performance. This strategy should include a comprehensive plan for the green transition towards net zero emissions by 2050 to ensure that growth is sustainable. While making efforts to constrain the demographic decline by boosting the natural population growth rate and stemming net outward migration (see the in-depth chapter of this Economic Survey), more needs to be done to make the best use of available labour, build up the capital stock and boost productivity.

Productivity-enhancing reforms would sustain convergence

Productivity is the major driver of growth with an increasing role over the past decade (Figure 1.23). Productivity gains have allowed for robust growth of real wages in recent years and are needed to continue to boost living standards. In terms of catch-up in labour productivity, expressed as value added per worker hour, Bulgaria lags behind not only the Baltic countries, but also other peers such as Croatia and Romania (Figure 1.24) reaching 80% of the Visegrad4 average. Among Bulgarian regions, the South and Southwest, nearby Sofia, are the most productive and use labour most effectively (Figure 1.25). Notwithstanding the recent productivity performance, there remains ample room to continue catching up. The National Development Programme Bulgaria 2030 sets out a vision for Bulgaria based on boosting competitiveness, creating an effective innovation system, accelerating the smart transition and upgrading human capital among its key priorities. A brand-new innovation law is in the pipeline and an Innovation Board will be set up to ensure smooth coordination among the various actors. Competition can effectively boost innovation and should therefore be enhanced by removing restrictive regulations, for instance in the area of the sharing economy, including ride-hailing services.

Figure 1.23. Total factor productivity has become the major contributor to growth

Contribution to growth by factors of production

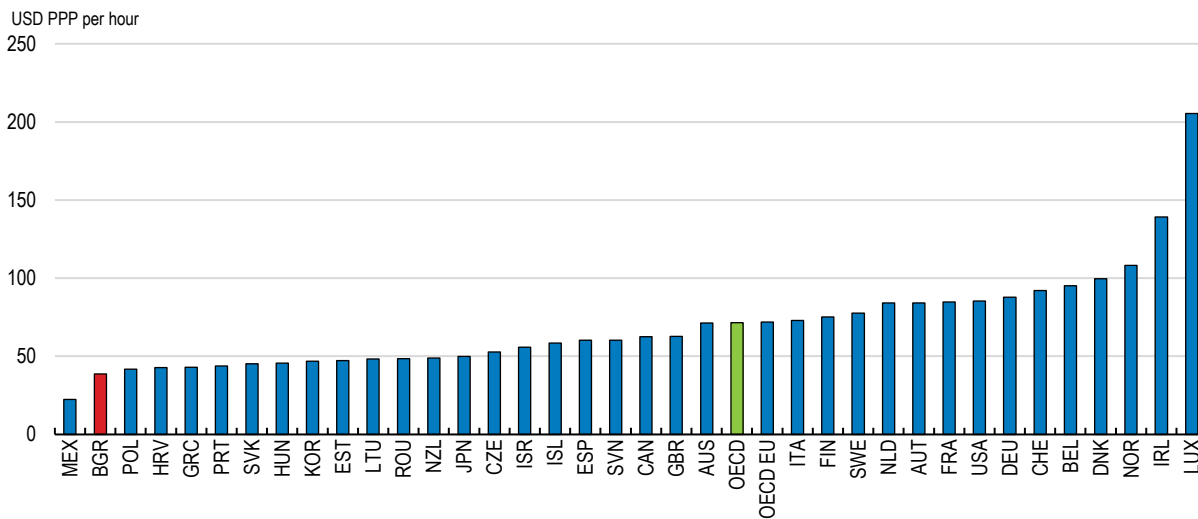


Source: The Conference Board Total Economy Database, April 2022 version.

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Figure 1.24. Labour productivity levels lag behind Visegrad4 and other countries

Value added per hour worked

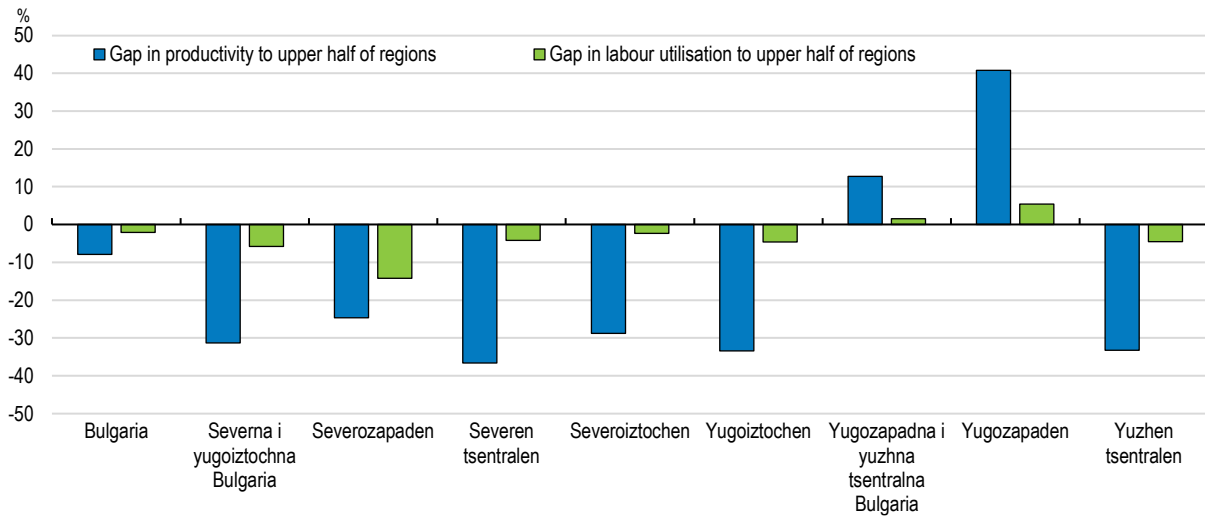


Source: OECD Economic Outlook 112 database.


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Figure 1.25. Southern regions are more productive and use labour more effectively

Gap to the upper half of regions in terms of GDP per hour and employment rate, 2020



Source: Eurostat.

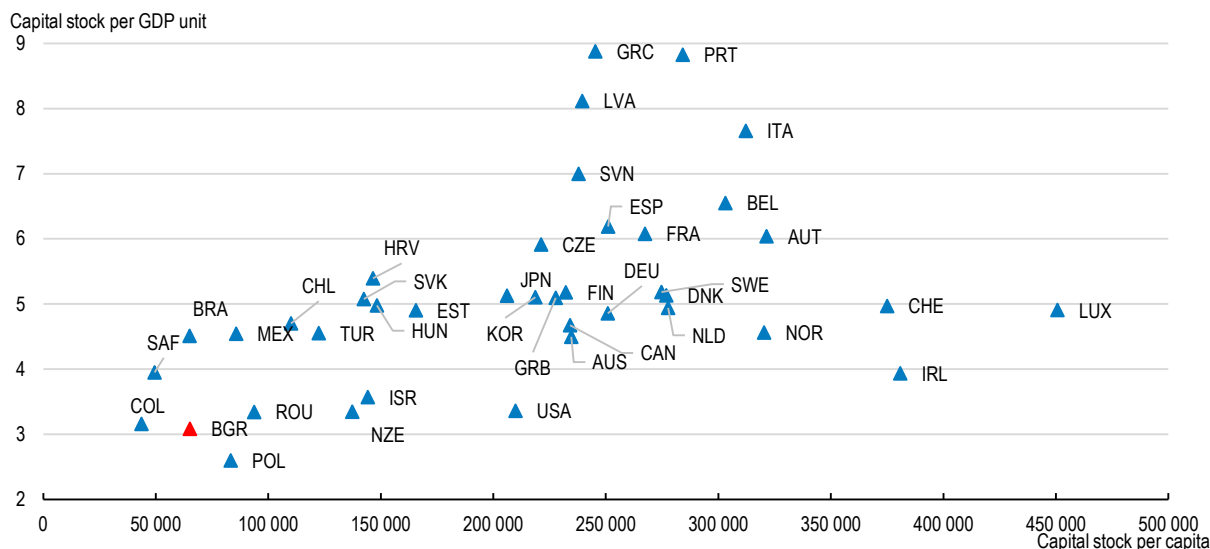
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Investment has been a major driver of growth and needs to accelerate as the capital stock is very low compared to OECD countries both relative to GDP and the population (Figure 1.26). Higher and better-quality investment is needed to raise productivity, upgrade housing infrastructure and public facilities, such as schools and hospitals, and for the energy transition. Higher investment rates are required to underpin catch-up: at around 20% of GDP, the investment rate lags behind the OECD average, as well as Central and Eastern European countries. The public investment at 3.4% of GDP in 2019 was roughly the same as the OECD average (3.6%). Roughly a third of public investment is realised through EU funds. Investment needs are particularly high in areas that will be driving future growth and sustainability. The energy transition towards net zero emissions entails a number of major investments, such as retiring hydrocarbon-based generation and restoring land and repurposing facilities; creating clean energy plants, storage and transmission networks; and improving connectivity with neighbouring countries. Furthermore, moving government and business interactions online needs a strong and secure internet. Investment in those areas is particularly needed not to miss out on the opportunities related to digitalisation and the switch to renewables. Investment decisions should be based on cost-benefit analysis. A greater participation of the private sector is needed in commercial infrastructure projects, such as toll roads, sewerage systems or telecommunications.


Recently adopted strategies and laws aim at boosting investment. The Law on Industrial Parks enacted in 2021 aims to play a crucial role in attracting investment with high value added and emerging industries. Preferential policies, including support for land purchase, infrastructure use, training of staff, R&D centres and business incubators, aim to attract investors. As in many OECD countries, clusters of industries could be built on existing successful initiatives, by identifying opportunities to join global and regional value chains and finding niches to excel based on comparative advantages. The Digital Transformation Strategy 2020-30 emphasises the importance of secure infrastructure, the acquisition of the necessary digital skills and unlocking data potential, among other goals. Estonia's X road could serve as a model for building a secure digital infrastructure with efficient data handling. Estonia's success in e-government depends crucially on two features: one (or more) secure digital ID(s), commonly accepted by service providers, and a secure, commonly accepted communication protocol, such as Estonia's X-Road (OECD, 2019_[19]).

Figure 1.26. The capital stock is low

Capital stock relative to GDP and population, 2019



Note: Capital stock at constant 2017 national prices (in million 2017 USD). Real GDP at constant 2017 national prices (in million 2017USD).
Source: Penn World Table, version 10.0.

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The relative scarcity of capital is not a result of its cost: the macroeconomic setting with a currency board and prudent fiscal policies implies low risk premia and is conducive to low interest rates. Indeed, corporate borrowing rates have been low in comparison with Central and Eastern European OECD countries. Prospective returns on capital could be enhanced by reducing corruption, accelerating productivity-enhancing reforms and making sure that there will be sufficiently large numbers of users in the coming decades for the infrastructure or business capital to be built. By the same token, potential investors need to be assured that there will be enough people to work in the factories they build or the companies they establish. A more business-friendly investment climate with easier entry and exit and lower cost of doing business would attract more capital, domestic or foreign. Indeed, simplifying registration and licensing procedures would likely result in higher inflows, as in some successful Visegrad4 countries.

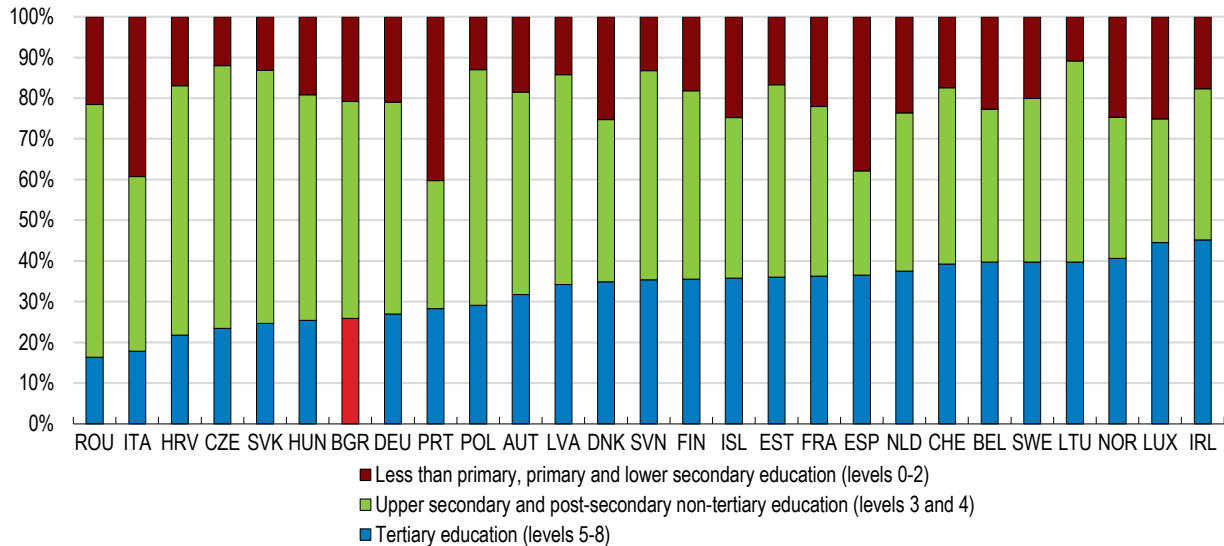
The declining workforce will contribute negatively to growth if no progress is made improving the birth rate, stemming emigration and activating people who are outside the labour force (discussed in detail in the Special Chapter of this Survey). Family policies to make it easier for women with children to work could encourage them to have more children and raise female participation for those with children. To stem the flow of emigration, more certain and promising perspectives are needed for young people, in particular equipping them with marketable skills, providing more better-quality formal jobs in the labour market and reducing perceived corruption. Those who have already emigrated need to be attracted back and pathways for immigrants developed further. There is room to utilise the available labour more intensively by bringing more people into the labour force from groups with low labour market attachment.

Improving labour quality could also boost growth as the overall level of skills is relatively low with most people only having secondary school education (Figure 1.27), and many lacking marketable skills (OECD, 2023^[20]). The share of tertiary graduates has increased steadily, reaching above 41% in younger cohorts, though nearly half are unemployed or inactive. Workplace-based training should be an integral part of vocational education (called “dual education” in Bulgaria). Given the high expected returns to vocational education, both firms and individuals have incentives to invest in it alongside the government. Future skills demand should be assessed and young people guided to find the professions of their best fit

through more tailored career counselling. To successfully acquire vocational skills, strengthening of basic skills at the primary level as well as in adult learning are prerequisites. (OECD, 2021^[6])

Figure 1.27. Most of the workforce are secondary school graduates

Highest educational attainment of 15-64 year olds, 2021



Source: Eurostat.

StatLink  <https://stat.link/64eo09>

Bulgaria still has room to lift growth by increasing factor inputs, but in the long term it is productivity growth, spurred by reforms, that should drive growth. A set of structural reforms set out below, combined with social and family policy reforms to raise the number of children and attract migrants, would jointly lift per capita GDP by 7-8% over ten years and more over longer horizons (Box 1.8). To support the process of reform, Bulgaria's independent Council for Economic Analysis has been established in 2023, following best practices in France and Germany. To be effective, the Council needs to have sufficient safeguards on its analytical independence, access to data, analytical resources and capabilities, as well as the necessary credibility and the capacity to communicate effectively its findings with policy makers and the wider public (Cavassini et al., 2022^[21]).

Box 1.8. Quantification of selected structural reforms

Selected structural reforms proposed in the Survey are quantified in Table 1.5. The estimates are based on empirical modelling of the relationship between the reform measure and total factor productivity, capital deepening and the employment rate using the OECD long-term projections model (Guillemette and Turner, 2021^[13]), as well as coefficients from cross-country econometrics analysis of policy effects (Égert, 2018^[22]). There are many uncertainties and assumptions underlying the estimates. Moreover, the reform measures that can potentially be included in the long-term projection model are limited, hence the measures below and the measures in the fiscal quantification box (Box 1.7) do not fully overlap.

The structural reforms are introduced to the model one by one, as well as altogether as a package. The cumulative effect of structural reforms is larger than the sum of the effects of individual reform measures due to synergies.

In this illustrative exercise, the following reforms are envisaged assuming a linear path with equal increments from the current place toward the 2040 target defined for each measure:

- Enhancing the rule of law to reach the level of the Visegrad4 by 2040 and staying unchanged thereafter.
- Reaching the average years of schooling of the Visegrad4's current level by 2040 and staying unchanged thereafter.
- Increasing active labour market policy (ALMP) spending to the level of the Visegrad4 countries by 2040 and keep it there.
- Product market regulatory reforms: (i) establishing a one-stop shop for starting up businesses of any type, reducing registration costs and abolishing capital requirements for limited liability companies as well as (ii) making licensing and permit one-stop-shops a standard, taking stock of existing licenses and permits and launching programmes to reduce their number
- Increasing the fertility rate to the level of the Czech Republic and keeping the same by (i) offering the retention of 75% of maternity benefits to mothers who get back to work before one year and thus lowering opportunity costs of having a child, (ii) optional paternity leave, (iii) increasing the child allowance to BGN 780 per month.
- Reaching the average net migration rate of Visegrad4 as of 2021 in 2040 and staying there by attracting returning emigrants and immigrants.

Table 1.5. Estimated impact of structural reforms on per capita GDP

Relative to the baseline

	10-year effect
Rule of law	2.6%
Raising education attainment	1.3%
Increase ALMP spending	0.4%
Product market regulatory reforms	2.7%
Higher fertility	-0.3%
Zero net migration	0.3%
Positive net immigration	0.3%
Package of structural reform measures above and higher fertility and positive net immigration	7.4%

Note: The total impact of reforms is higher than the sum of the impacts of each reform because of synergy effects between reforms.
Source: Simulations with the OECD's Long-Term Model.

Easing entry and exit procedures could bring about productivity gains

Private capital, be it domestic or foreign, needs a predictable business climate and business-friendly regulations, including of how it can enter or leave the market, both of which are relatively restrictive and make it hard for new firms to enter the market and allowing unproductive firms to remain in business. Dynamic entry and exit are part of the efficiency-enhancing process of creative destruction. Starting up a firm needs to be fast, predictable and at a little cost. The most recent OECD product market regulation (PMR) indicators show that the administrative burden on start-ups is higher in Bulgaria than in any other country covered by the indicator, including both OECD and a set of emerging economies.

The number of bodies that need to be contacted to start up a limited liability company could be reduced to a single body in a one-stop-shop setting, which is the international best practice. While this economises on the number of interactions, some of the current requirements for starting up a business could also be dropped, such as the requirement to draw up a formal deed of incorporation, offering shares for subscription, seeking approval of local authorities for registration and an overall permit for economic activities. Local authorities in general should not be granted authority to approve registration or issue a

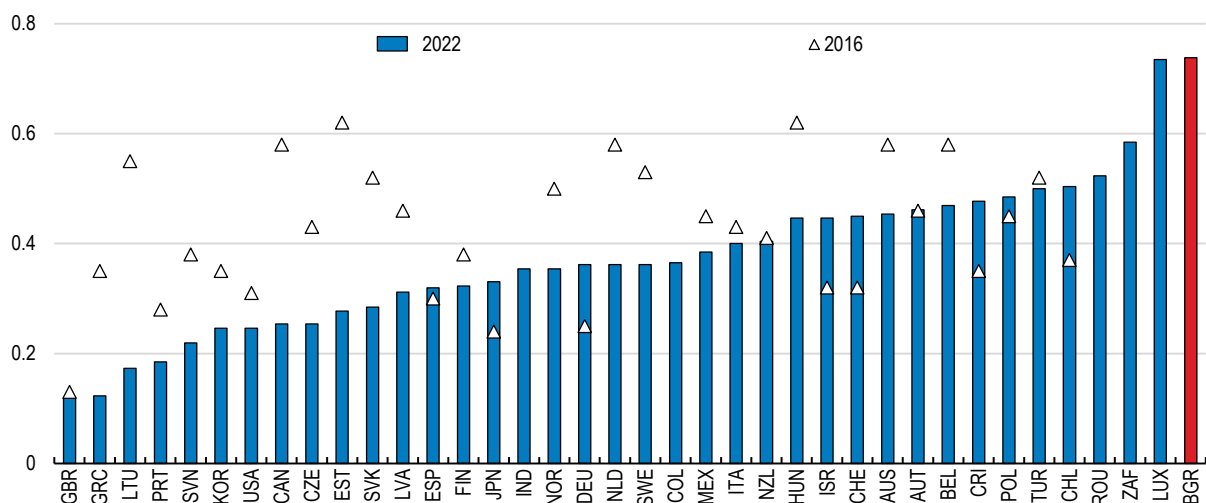
license to avoid adverse incentives and reduce the room for corruption. The whole process should go online, with automatic verification of the necessary documents (which should be as few as necessary) and as little as possible human involvement. The monetary costs of the process should be reduced.

The licensing and permits system could also be streamlined to reduce costs and realise efficiency gains. Currently, the burden of licensing and obtaining permits and authorisations in Bulgaria is greater than in any OECD country except Türkiye. A one-stop-shop system should be established for notifications, licenses and permits online with the purpose to obtain information, as well as the licenses themselves. The government should take stock of the existing licenses and permits and reduce their number at both the national and sub-national levels. Such reforms could bring about significant productivity gains: a combined package of establishing a one-stop-shop service for licenses and permits and reducing the administrative burden on start-ups is estimated to bring about an increase in per capita GDP of 2.7% after 10 years (Box 1.8).

Despite these difficulties, there is a very large number of registered companies compared to the size of the population or the economy, but this may not necessarily reflect entrepreneurial dynamism. There are incentives to register a firm to access VAT refunds on otherwise personal purchases. More importantly, insolvency procedures are more burdensome than in any OECD country (Figure 1.28) (Adalet McGowan and Andrews, 2018^[23]), (André, 2023^[24]). This makes it hard for weak companies to exit the market and imposes significant costs on the economy. These procedures should be simplified and judicial efficiency increased. Bulgaria is one of the few European countries without a pre-insolvency regime that allows debtors and creditors to negotiate outside the formal insolvency framework, but under the supervision of a court or an administrative authority. The introduction of such a regime and a simplified regime for SMEs would help. Not only the insolvency process but restructuring also appears cumbersome (Figure 1.29). The dismissal of management foregoes the benefits of continuity and familiarity with the company in the restructuring process. The envisaged introduction of cram-down (overriding the vote of non-consenting creditors) raises concerns about potential cram-down by unsecured creditors on secured creditors, but could be avoided by additional legislation.

Figure 1.28. The insolvency regime is restrictive

Composite indicator

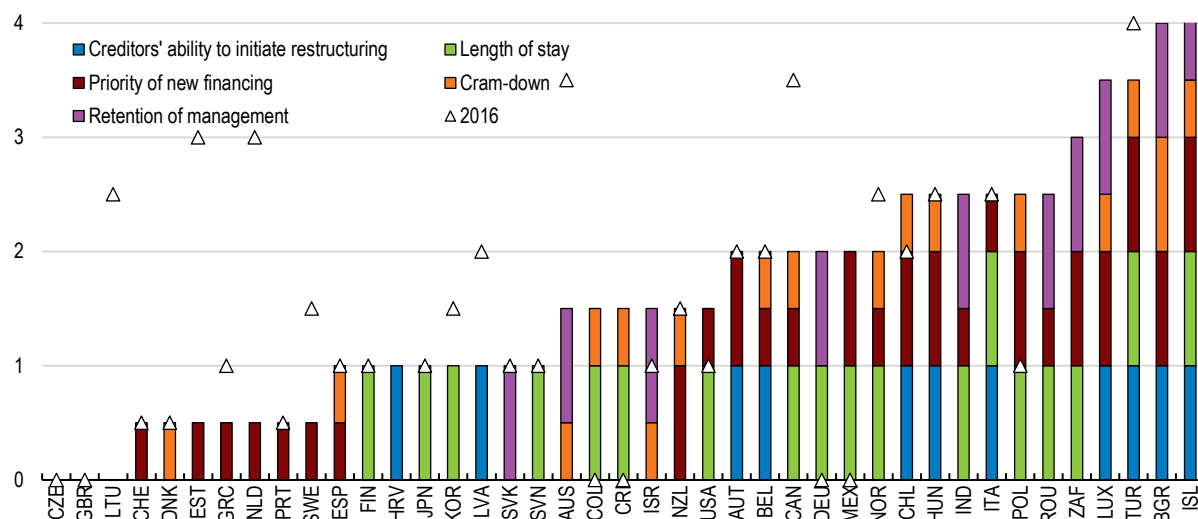


Note: Indicator composed of 13 sub-indicators; indicator values varying between 0 and 1, with higher values indicating greater restrictiveness. Source: OECD Insolvency Indicators database.

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Figure 1.29. Restructuring is cumbersome

Restructuring tools composite sub-indicator, 2022



Note: Indicator composed of 5 sub-indicators shown in the chart; indicator values varying between 0 and 5, with higher values indicating greater restrictiveness.

Source: OECD Insolvency Indicators database.

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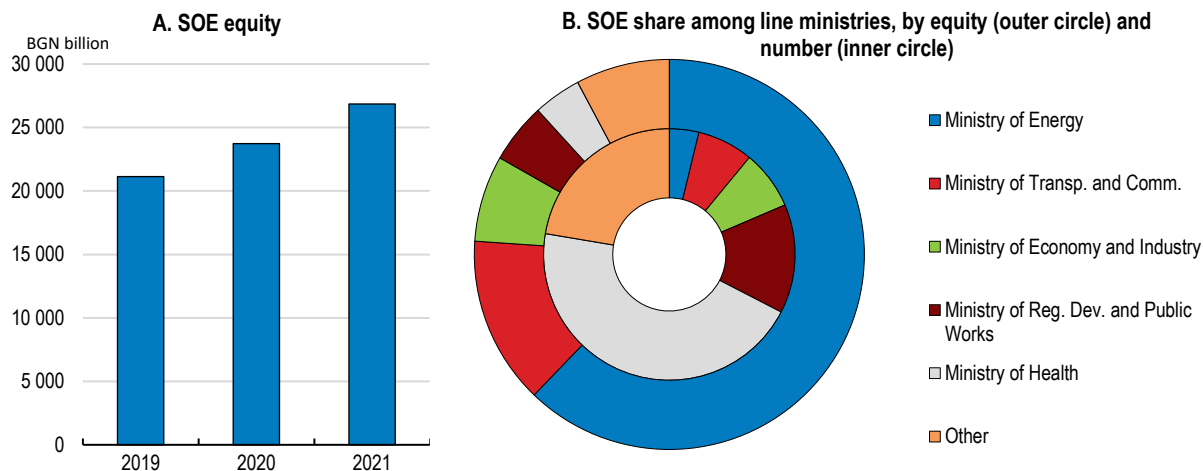
Table 1.6. Previous recommendations on entry and exit-related regulation and action taken

Recommendation	Action taken
Extend reforms put in place with the operationalisation of the one-stop shop to cover the issuing of all licences and permits, and to accept all notifications necessary to open up a business. Adopt a "silent is consent" rule to speed up the approval process.	No action taken.
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 enterprises in financial difficulties to rehabilitation (pre-insolvency) proceedings. Implement complementary policies on judicial efficiency, taxation, and regulation.	The draft legislative changes in the Commercial Act were approved by the Council of Ministers on 15 March 2023. They are still to be passed by the Parliament.

Governance of state-owned enterprises has been modernised but structural weaknesses remain

State-owned enterprises (SOEs) play a considerable role in the Bulgarian economy with 265 companies that are fully or with a majority stake controlled by the government as of August 2022. Their cumulative equity value amounted to BGN 26.9 billion in 2021, around 20% of GDP, with a workforce of around 127 500 in 2020 (4% of total employment) (Figure 1.30). Efforts to modernise their governance were intensified as part of Bulgarian commitments upon joining the Exchange Rate Mechanism II, which led to the adoption of the Law on Public Enterprises in 2019. The new law aligns the governance framework with the OECD Guidelines on Corporate Governance of SOEs, whose implementation is supported by ongoing cooperation with the OECD (OECD, 2019^[25]). Key aspects of the reform include a more effective ownership and monitoring structure, standardised and transparent appointment of management and board, better data disclosure and reporting, and a level-playing field with the private sector where possible.

Figure 1.30. The size of the state-owned enterprise sector is growing with many ministries assuming oversight



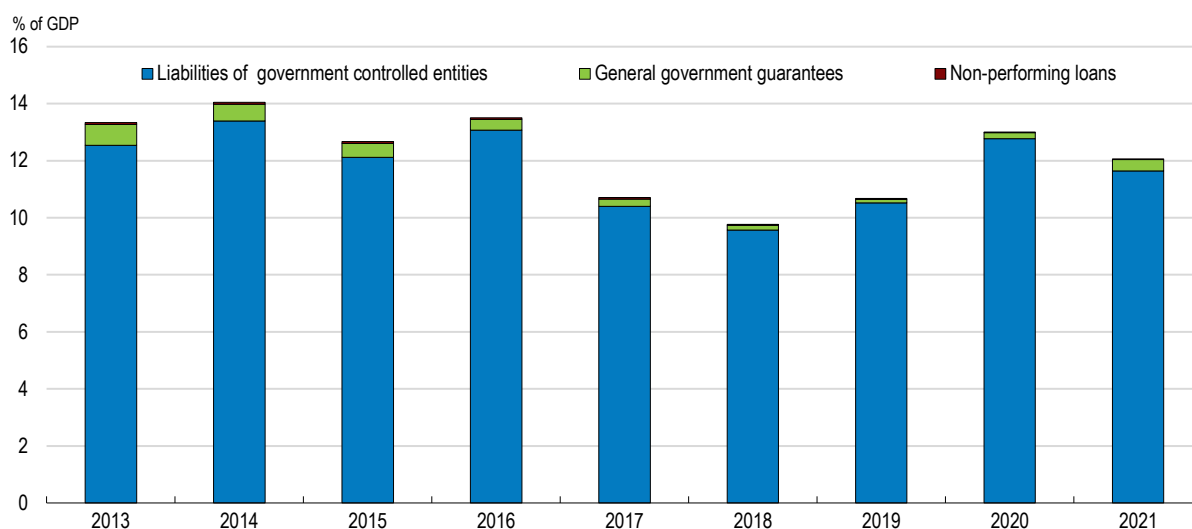
Source: Public Enterprises and Control Agency.

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A key issue is that a wide range of different entities are defined as SOEs, ranging from those with essentially commercial activities, through those with some social role, to those that are in effect delivering public services as a government agency. The new law foresees a restructuring of many activities by amending the legal form of some SOEs into commercial companies or administrative structures depending on whether they carry out commercial activities or provide public services. In a 2022 decision, the Council of Ministers has adopted a programme for the transformation of 16 statutory enterprises into budget organisations due to the fact that they carry out public functions and policies. The implementation of this transformation should be done within a specific timetable provided by the authorities. Continuous efforts are needed by policy makers to support the implementation of the law to ensure that SOEs do not distort markets in their specific sector of operation and that they are subject to an appropriate legal and organisational structure.

Several SOEs have recorded continuous losses or low profits. In 2020, only 119 out of the 265 SOEs registered profits, with nearly half of their combined profits generated by the nuclear power plant. Most of the 145 loss-makers are in healthcare as public hospitals operate as commercial entities. The railway company, Sofia airport, the port infrastructure enterprise and Bulgarian Posts Network are also making losses (Public Enterprises and Control Agency, 2020^[26]). Prior to the current energy crisis, some energy companies used to report losses regularly. SOEs, by law, are profit-oriented companies, but often have mandates to deliver goods and services below cost and other restrictions that make it hard to actually generate profits. SOEs are subject to a dividend policy determined every year by the Council of Ministers. In 2020, the dividend for the previous financial year was set to 50% for all public enterprises except hospitals, water supply and sewerage companies and several others. The uncertainty related to the annual decision on the rate of dividend submission makes it difficult to invest or innovate. Contingent liabilities related to SOEs at around 12% of GDP (from which liabilities related to loss-making companies are a much smaller 2.5% of GDP) appear manageable (Figure 1.31).

Figure 1.31. SOE-related contingent liabilities, % of GDP



Source: National Statistical Institute.

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In accordance with the OECD guidelines, the Public Enterprises and Control Agency (PECA) was created as a new centralised coordination and oversight body. While its mandate includes data collection, dissemination and analysis along with administrative support, it does not assume ownership over SOEs, which remains within the respective line ministries. The Ministry of Energy, for instance, stands out as it controls 58% of all SOEs in terms of equity, with energy production and distribution mostly state-owned, but in total 19 different ministries exert control over one or more SOEs. One of PECA's core tasks is to disclose financial information on SOEs to increase transparency: since spring 2021, financial statements for all SOEs are published electronically. However, data disclosure is not user-friendly and often delayed, preventing timely assessment and policy decisions. To strengthen PECA's role as an effective co-ordination and oversight unit, its capacity for regular and timely analysis, as well as for oversight should be enhanced by more resources.

Currently, PECA conducts competitive procedures only for the nomination and selection of the independent members in the bodies of the SOEs categorised as "large" under the Accounting Act. To limit incentives for special treatment based on potential political objectives, the managers of state-owned enterprise should be professionals and appointments should be merit based through a transparent and competitive process. The new law stipulates that at least one-third of board members and the chairman need to be independent, although best practices from the OECD suggest a larger number of independent board members (OECD, 2015^[27]). The remaining members, including the CEO, are chosen by the respective line ministry according to their own criteria such as relevant professional experience as laid down in the respective legislation. PECA as a central oversight unit would be well-positioned to have a stronger role in this procedure as they are not involved in the selection process within the ministries to date. Nomination of managers by the holding government agency and the possibility for civil servants to transfer to SOE manager positions should be halted to reduce incentives for corrupt behaviour. Representation of public interests can be done through other means than directly appointing managers, such as built-in teams of civil servants as in the case of France, or inspections.

Table 1.7. Previous recommendations on reforming state-owned enterprises and actions taken

Recommendation	Action taken
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.	The implementing arrangements have been put in place. Still not enough efforts and progress to improve the resources of the centralised ownership coordination unit.

A strategy and a roadmap for the energy transition and towards reaching net zero emissions is urgently needed

Under the aegis of the European Commission's Integrated Energy and Climate Plan (IECP) 2021-30, the National Energy and Climate Plan (NECP) set a number of targets for Bulgaria by 2030: (i) reducing primary energy consumption by 27.89% relative to the baseline, (ii) reducing final energy consumption by 31.67%, (iii) achieving a 27.09% share of renewable energy in gross final energy consumption and (iv) reducing GHG emissions by 49% relative to 1990.

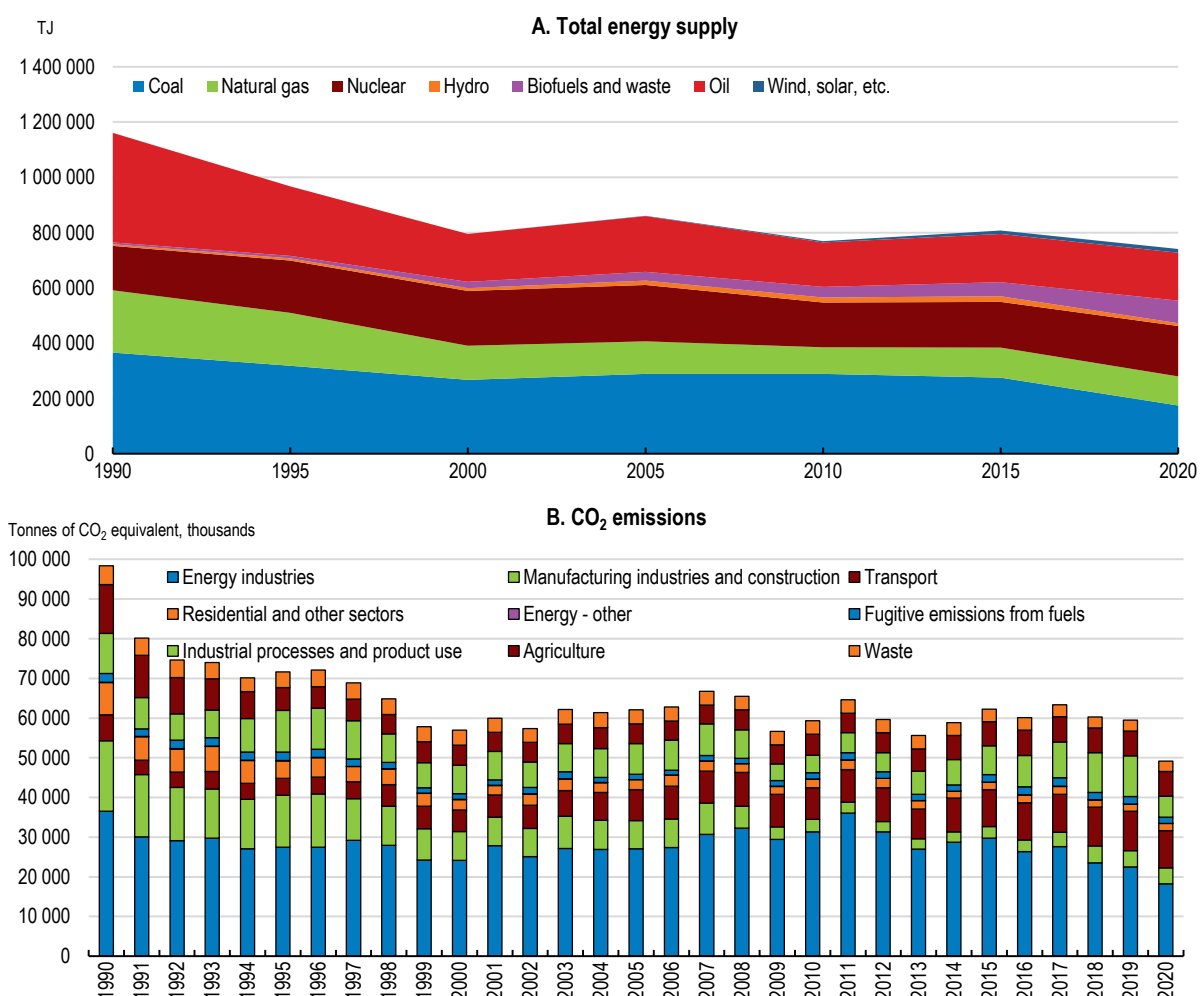
According to an initial assessment by the European Commission (NECP Fact Sheets), Bulgaria was on track to achieve its NECP targets, including the country's 2030 target for greenhouse gas (GHG) emissions not covered by the EU Emissions Trading System (non-ETS) of 10% reduction compared to 2005. However, this initial assessment was based on reform commitments and the Bulgarian parliament has since passed a resolution to renegotiate the CO₂ emission target. Any revised plan should still have to comply with all assessment criteria. The level of ambition for some of the existing targets, notably energy efficiency, is assessed as low by the European Commission.

The National Recovery and Resilience Plan (NRRP) supports programmes to achieve climate targets and aims at reducing carbon dioxide emissions by 40% by 2025 relative to their 2019 level. It introduced a cap on carbon dioxide emissions of coal-fired power plants effective from 2026. The Energy Transition Commission envisaged by the Plan has been established and will assess the different scenarios for coal/lignite phase-out by 2038. However, the National Decarbonisation Fund to provide technical assistance, grants and guarantees is still to be established. The Regional Development Programme (RDP) 2021-27 will finance energy efficiency improvements in buildings. The coming few years will be crucial in ensuring that emissions peak and putting the economy on a trajectory towards carbon neutrality by 2050.

The heightened importance of energy security should be a catalyst for the transition to carbon neutrality and the first step urgently needed is an overarching transition strategy with milestones and specific policy measures. The transition strategy should be based on the recently adopted Strategic Vision for the Sustainable Development of the Electricity Sector, which has a 2053 horizon. The newly established Energy Transition Commission was given the mandate to prepare scenarios and recommendations for a Roadmap to Climate Neutrality. Key ingredients of an effective transition strategy are: (i) transparent and participative institutions, (ii) governance frameworks and (iii) a well-designed and comprehensive policy mix combining emission pricing, standards and regulations and enabling complementary policies (including innovation support mechanisms, infrastructure investment, and others to offset adverse distributional effects and help people in transition) (D'Arcangelo et al., 2022^[28]). Funding needs should be specified as part of the transition strategy and should be consistent with the medium- to long-term infrastructure and public investment plan, as well as medium-term budgetary forecasts. Investment should be based on cost-benefit analysis. In addition to the Strategic Vision of the Electricity Sector, several ongoing programmes, including the IECP 2021-30, the NRRP, the RDP 2021-27 have been put in place, but a coherent strategy is needed to make sure all the plans work towards the shared goal of net zero emissions by 2050 and intermediate goals, including for 2030. Close collaboration across ministries participating in the programmes is also crucial for effective and efficient implementation as a number of agencies are involved.

The major source of emissions is the energy industry (Figure 1.32), reflecting heavy reliance on coal. Replacing polluting hydrocarbons with renewables and nuclear energy, as envisaged, would thus significantly curb emissions. The transport sector is also a major emitter. Electrification of railways, efforts to reduce car dependency and promoting the development of public and soft mobility options (e.g. bikes, walking) in cities (e.g. via road space reallocation, see (OECD, 2021_[29]) and (OECD, 2022_[30]) and concentrating support for purchase of electric vehicles to rural areas will be needed to achieve net zero targets. The Recovery and Resilience Plan includes targets for the digitalisation of rail networks and on-board equipment, the purchase of new zero-emission rolling stock (80 new units by 2026) and an increase of 15% in the annual number of passengers carried by railway. Overall, emissions have been reduced in recent years partly due to economic activity becoming less energy intensive and this process should continue. The extent of reduction has been smaller in transport and agriculture.

Figure 1.32. Fossil fuel-based energy supply is responsible for a large part of greenhouse gas emissions



Source: IEA World Energy Balances <https://www.iea.org/data-and-statistics/data-product/world-energy-statistics-and-balances> and OECD Green Indicators database.

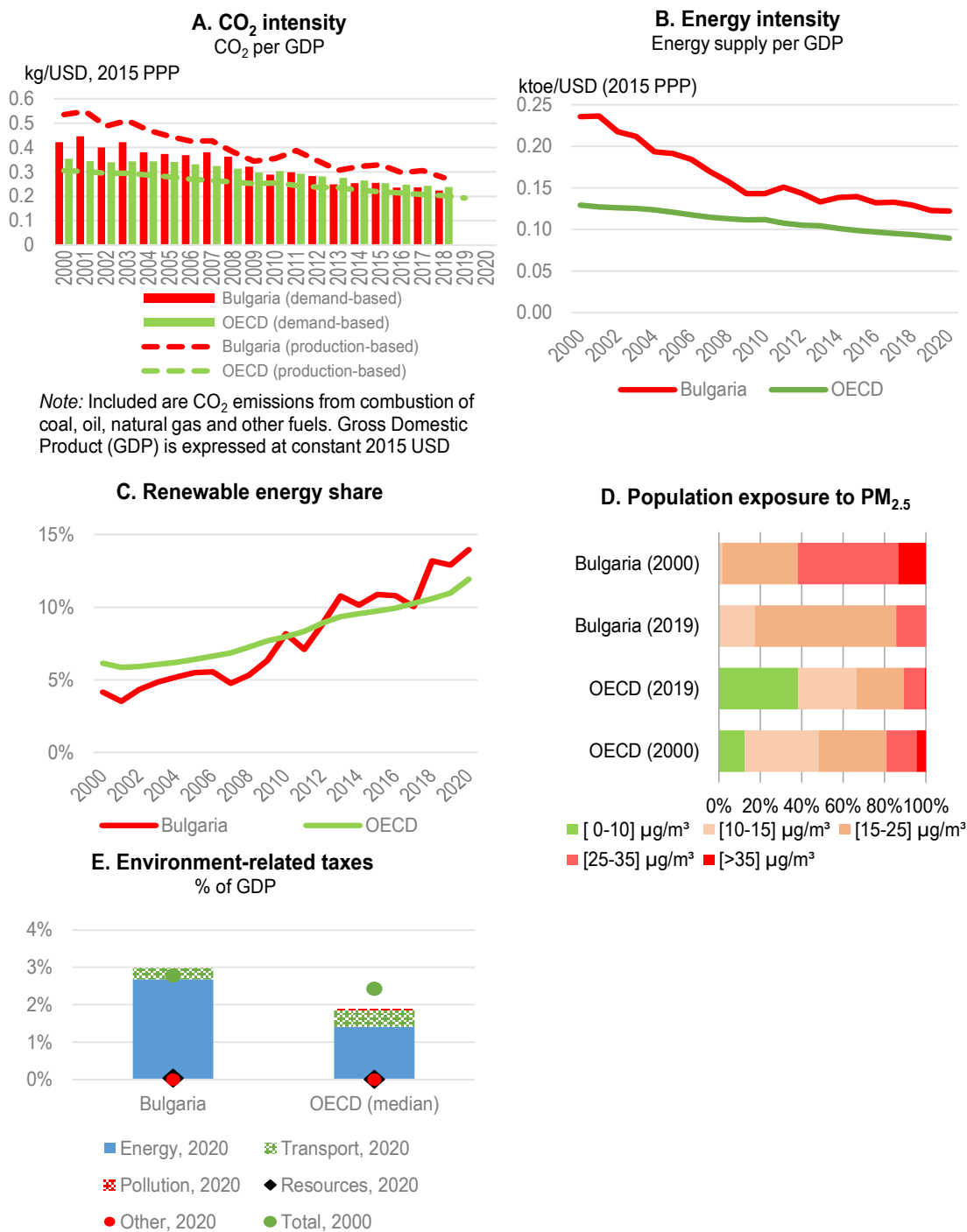
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The energy crisis should not delay the green transition, in particular the phasing out of coal. The energy crisis elevated the country to the third place in terms of electricity exports in Europe and in conjunction with the interlinkage of energy markets with neighbouring countries (realised in 2021) drove up domestic energy prices, boosted production, and generated windfall profits for state-owned coal producers. Electricity generated from coal in the whole region has increased significantly in the past year. Bulgaria will need to reduce its significant reliance on coal for electricity production through a combination of stepping up reliance on renewables, in particular solar and wind power, and ensuring sufficient baseload capacity from nuclear power and investing in the grid to manage the variations in production and increased electrification of the economy. The Recovery and Resilience Plan sets 2038 as the target year to phase out coal, but milestones to reach that target are still to be set. The Plan, together with REPowerEU, which provides an additional EUR 480 million in grants, will support the transition. Bulgaria participates in the Coal Regions in Transition programme of the European Union. Coal mining is concentrated in two regions (Stara Zagora and Kyustendil, both in the south of the country) and the transformation of the economic landscape in those regions needs to be well designed to ensure that low-skilled workers, mostly miners, are retrained, high-skilled ones (including engineers) stay in the region, land is rehabilitated (as it is mostly open-pit mining) and new industries are attracted. Bulgaria is encouraged to make good use of the funds available under the Just Transition Fund. The protracted transition process towards renewables and high profitability related to the energy crisis keeps coal-fired power plants in operation, which in turn causes heavy pollution, taking a toll on human lives. Fine particulate matter (PM 2.5) and ozone exposure alone accounted for an estimated 9% of all deaths in 2019 (over 11 000 deaths), which is higher than the EU average (4%). Air pollution contributed to deaths from circulatory diseases and some cancers.

Investment in renewables needs to be accelerated, including by creating a favourable regulatory environment and providing subsidies where justified. In European comparison, Bulgaria has relatively rich potential for solar resources as well as on- and offshore wind resources. However, very few households have so far installed solar panels or other equipment to generate renewable energy. Installation permits for household-scale solar panels or other renewables equipment should not be linked to land ownership rights of the property where it is planned to be installed as long as long-term lease is secured. A scheme for small-scale renewable investment could be introduced where producers can sell any self-generated unused electricity to the supplier through the grid at the same price as they buy it. Net metering and accounting could be introduced for simpler transactions. Expanding grid capacity should go hand in hand with an increasing dependence on renewables to avoid constraints. Envisaged measures in the Recovery and Resilience plan aim at improving the energy efficiency of residential, public and business buildings, as well as promoting renewable energy production through financial support and simplification of licensing and permission procedures for renewables.

The policy mix conducive to net zero emissions by 2050 will need to include both price-based and non-price measures. Bulgaria is part of the EU Emissions Trading System (ETS) and has committed to keep emissions not higher than their 2005 level, but the EU ETS does not cover all sources of emissions. The low level of internalisation of the cost of greenhouse gas emissions at 17% justifies raising carbon prices, even though environmental taxes relative to GDP are high (which is due to the high energy intensity of the economy (Figure 1.33)). Carbon prices in non-ETS sectors should increase to the level of ETS prices. Decarbonisation offers a potential for significant government revenues related to carbon pricing if the energy transition were entirely driven by carbon pricing (including taxes on GHGs, fuel taxes, revenue from auctioned permits of emission trading systems for GHGs, energy taxes etc.) at the early stage of the process, but any delay would sharply reduce such revenues as people move to cleaner technologies. High energy intensity and distribution concerns imply that non-price measures need to play a role in the green transition. In addition to industries, where the emissions related to industrial processes are being reduced over time, emissions by cars and buildings could also be better regulated. Currently, most of the building stock has low energy efficiency. Stricter standards for both newly built housing as well as a gradual upgrading of the existing housing stock would help reducing this source of emissions.

Figure 1.33. Energy intensity is decreasing and renewables are increasing, but there is room to do more



Source: OECD Green Indicators database.

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Table 1.8. Previous recommendations related to the energy transition and actions taken

Recommendation	Action taken
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.	No support is currently provided for fossil fuels. A roadmap is being developed to define the main elements and methods of the skills survey that will identify mismatch between the skills possessed by the workers concerned and the skills that will be needed in the future. The Roadmap is developed with wider participation of representatives of the competent public authorities, trade unions and employers in the coal regions.
Continue to support housing renovation and improve targeting to low-income groups. Provide information about the benefits of energy saving investments to households.	Recovery and Resilience Plan programmes have been adopted to continue to support housing renovation. Legislative changes have been prepared to target energy poor households. End-suppliers regularly provide explanation and information to households on the benefits of investing in energy saving and periodically run promotional campaigns.

Corruption is taking a heavy toll on the economy

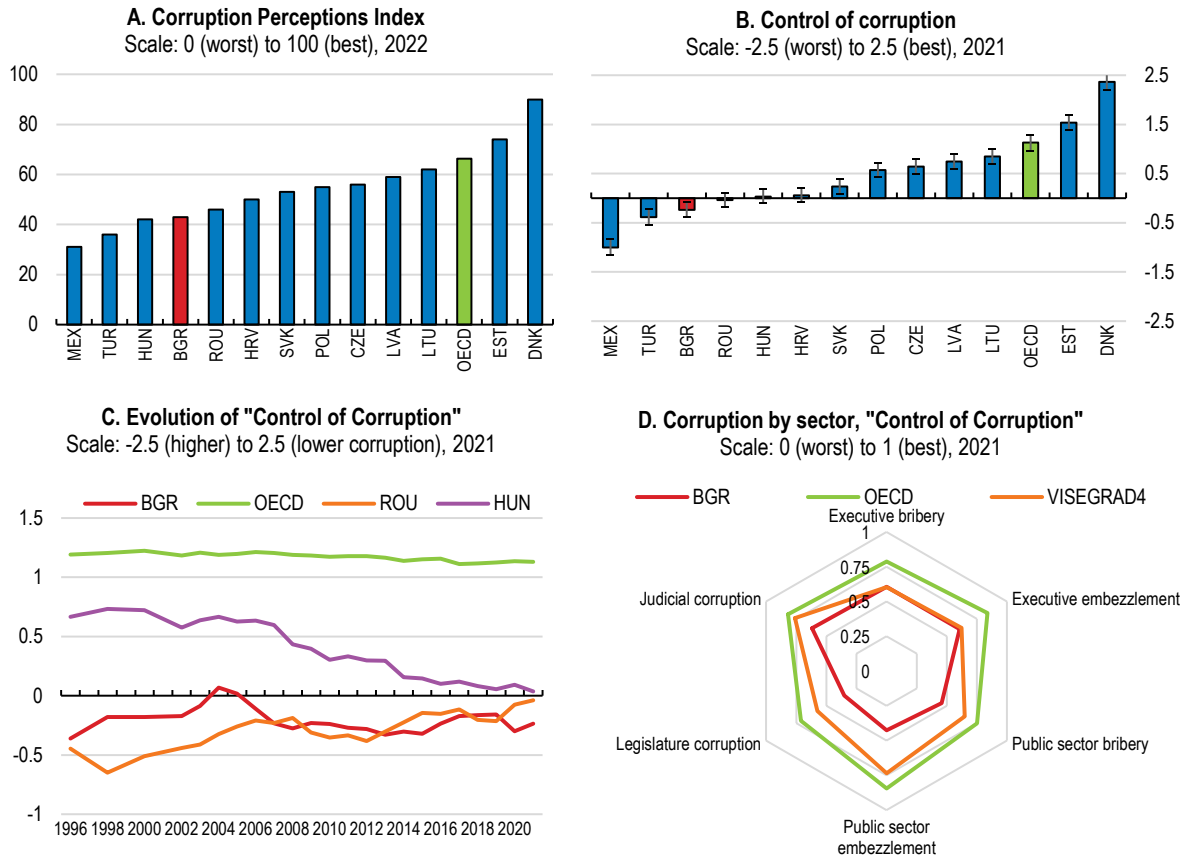
Corruption is perceived to be high in Bulgaria (Figure 1.34) by the Transparency International’s indicator, imposing hefty transaction costs, leading to efficiency losses in the allocation of resources and redistributing income to well-placed individuals. The high perception of corruption also reduces trust in institutions and discourages foreign investors through a lack of predictability and of a level playing field. The sectoral components of the Control of Corruption index suggest that legislature corruption is the most common, as is in OECD countries, followed by public sector embezzlement, which, in contrast, is the least common issue in OECD countries. Public sector bribery also appears a serious issue, while Bulgaria scores relatively better on judicial bribery, executive embezzlement and executive bribery, though still well below the OECD or the Visegrad4 average. Putting in place mechanisms to systematically and effectively prevent and repress corruption is advancing only slowly.

The spectrum of corruption ranges from petty corruption to the intertwining of business and political interests (Mineva, 2020^[31]), which is sometimes referred to as “state capture”. While petty corruption such as bribes or granting unjustified access to the delivery of government services can often be readily identified, higher levels of corruption are more difficult to trace. When it is not directly cash but favours that are being exchanged, it is much more difficult to detect. Cronyism is widespread with key public positions being filled by people nominated without a competitive selection process. Investigation is difficult given a lack of hard evidence and the use of tax havens, and investigators themselves can be prone to corruption. The removal of all limits to individual or business donations to political parties was a step back in this regard (OECD, 2022^[32]). Political parties are obliged to disclose their financing sources and are subject to auditing. While lobbying is a legitimate act of influencing the process of public decision making, the lack of regulation means that there are no transparency standards being applied nor any disclosure requirements. Bulgaria should implement the OECD Recommendation of the Council on Principles for Transparency and Integrity in Lobbying which calls on countries to provide an adequate degree of transparency to ensure that public officials, citizens and businesses can obtain sufficient information on lobbying activities, to limit undue influence and to provide a level playing field for interest groups (OECD, 2022^[33]). Introducing a legal framework for lobbying features in Bulgaria’s Recovery and Resilience Plan.

Fighting corruption should be a policy priority not least because strengthening the rule of law has the highest impact on long-term growth among all structural policy measures. Reducing corruption to the level of the Visegrad4 countries (which is still well above the OECD average) by 2040 by systematically nurturing a public integrity system and maintaining it at that level till 2060 would result in a 2.6% increase in per capita GDP ten years after the reforms and 18.3% by 2060. Corruption is so prevalent that reducing it would help realise efficiency gains through multiple channels: better allocation of resources, merit-based selection of public officials through a competitive process, lower transaction costs, higher trust in

institutions and enhanced predictability for both consumers and investors. Thus, Bulgaria needs to continue designing and adopting effective measures to rein in corruption.

Figure 1.34. Corruption is perceived as high, especially legislative corruption and public sector embezzlement and bribery

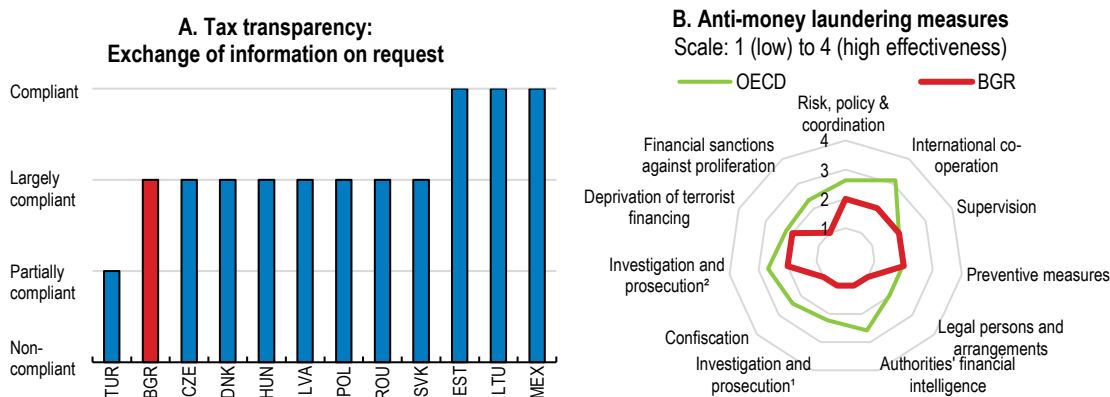


Note: Panel B shows the point estimate and the margin of error. Panel D shows sector-based subcomponents of the "Control of Corruption" indicator by the Varieties of Democracy Project.

Source: Panel A: Transparency International; Panels B & C: World Bank, Worldwide Governance Indicators; Panel D: Varieties of Democracy Project, V-Dem Dataset v12.

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Figure 1.35. Bulgaria is largely compliant on tax transparency, but anti money laundering efforts need strengthening



Note: Panel A summarises the overall assessment on the exchange of information in practice from peer reviews by the Global Forum on Transparency and Exchange of Information for Tax Purposes. Peer reviews assess member jurisdictions' ability to ensure the transparency of their legal entities and arrangements and to co-operate with other tax administrations in accordance with the internationally agreed standard. The figure shows first round results; a second round is ongoing. Panel B shows ratings from the FATF peer reviews of each member to assess levels of implementation of the FATF Recommendations. The ratings reflect the extent to which a country's measures are effective against 11 immediate outcomes. "Investigation and prosecution¹" refers to money laundering. "Investigation and prosecution²" refers to terrorist financing. Source: OECD Secretariat's own calculation based on the materials from the Global Forum on Transparency and Exchange of Information for Tax Purposes; and OECD, Financial Action Task Force (FATF).

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Nurturing a culture of public integrity, where public interests are prioritised over private interests in the public sector, as stated in the *OECD Recommendation of the Council on Public Integrity* (OECD, 2017^[34]), is key. Transparency, stakeholder engagement, a whole-of-society approach, a merit-based, professional public sector, high-level commitment, measurable objectives, accountability and enforcement are all part of a coherent and comprehensive public integrity system. To nurture a robust integrity system in Bulgaria, a number of principles should be followed. To mitigate the integrity risks at the level of senior officials and respond to the increased expectations of citizens towards government and demanding standards of conduct, Bulgaria could develop a code of ethics particularly for senior officials to specify duties, prohibitions and guidance tailored to the risks of such positions in matters such as transparency, gifts, conflict of interest and integrity in decision making. To create a culture of integrity across government agencies and consistent understanding and application of the integrity standards, Bulgaria should appoint responsible integrity advisors in all relevant agencies. Currently all public officials are obliged to submit asset declarations which creates a significant burden on both the officials and the administration; further efforts are required to streamline this process and create a more effective risk-based approach focusing on senior public officials and those working in at risk sectors or positions such as public procurement and the management of public funds (OECD, 2022^[33]). In public-private transactions, public interests should be upheld and prioritised. In addition to making them transparent, all proposed transactions involving significant amounts of public money or public assets should be subject to conflict of interest checks (OECD, 2003^[35]). In particular, special rights, preferential treatment, and monopoly rights granted to businesses need to be subject to careful scrutiny. Excessively advantageous offers by private contractors need to be treated as carefully as overpriced bids. Regular, as well as random, checks are even more important in a context where a culture of whistle-blowing has yet to take root. Special economic zones, including industrial parks and other types of areas with special incentives to attract foreign (and domestic) capital, can be prone to corruption as the granting of concessions, simplified or expedited procedures and

other privileges all cost public money and without full transparency and cost-benefit analysis, there is room for exchanging those for private benefits.

Public procurement can be vulnerable to corruption, requiring a transparent and competitive bidding process and efficient and effective ex ante and ex post control. In Bulgaria, the share of public procurement contracts not going through competitive bidding is high (OECD, 2021^[6]) due to fragmented purchases and contracts falling below the threshold and to the avoidance of open bidding. Thresholds differ by the type of goods or services: it is BGN 50 000 for construction works, BGN 70 000 for part of services such as transport, telecom, finance, computer, professional services and research included in Annex 2 of the Public Procurement Act and BGN 30 000 for the rest of supplies and services (European Commission; OECD, 2016^[36]). The high frequency of appeals following the procurement process could jeopardise the financing already secured, therefore potential incentives to avoid the bidding process are high. EU-financed projects have particularly short deadlines and, even without an appeal, going through the bidding process itself carries the risk of missing implementation deadlines and hence the availability of funds. Deadlines for repair works are particularly short: instead of opening a new bid, repair works are often lumped under an existing maintenance framework contract to economise on the time and ensure implementation. It has been documented that the public procurement process is not free from political interference, be it at the tendering phase, where often the call for tenders specifies the technology, not only the outcome, or at the selection phase, where cronies appear to win contracts either as single bidders or among competitors (Center for the Study of Democracy, 2017^[37]). The introduction of the mandatory centralised e-procurement platform in 2020 increased transparency and efficiency, implying that the situation should have improved, although there are no recent surveys on that.

The high priority of fighting corruption in the government's agenda is manifest in appointing a Deputy Prime Minister as national coordinator and establishing a National Council on Anti-Corruption Policies (NCAP) in 2015, an inter-agency body with consultative, coordinating and control functions, and a Civil Council, to monitor the implementation of the anti-corruption policies. Nevertheless, the system of institutions combatting corruption is fragmented with multiple actors and many areas left without systemic oversight (Box 1.9). A number of actions can be taken to strengthen coordination mechanisms including ensuring the continuity of the NCAP, institutionalising and resourcing its support mechanisms and ensuring that all relevant integrity actors are included. The National Audit Office (NAO) should also be made a permanent member or, at least, invited to join relevant meetings involving oversight and accountability issues. The NAO exercises control over the implementation of the budget and other public funds, which – similarly to other supreme audit institutions – gives it a unique perspective on integrity risk areas and weaknesses of the control system. Its main task is to control the reliability and truthfulness of the financial statements of budget-funded organisations, the legality, efficiency and effectiveness of public funds management. Political parties and/or candidates must also submit their financial reports to the NAO (OECD, 2022^[33]).

Box 1.9. The mandates of agencies related to public procurement or combatting corruption

Public Procurement Agency

The Public Procurement Agency conducts ex ante control before the bidding procedure, makes recommendations on how to better conform to regulations and follows up on their implementation. Only contracts for works with an estimated value equal or above BGN 1 million and for supplies and services equal or above BGN 200 000 fall under the scope of random selection control. The Agency also conducts control of negotiated procedures and of amendments to public procurement contracts when the amendment value is equal to or higher than 20 % of the contract value. Contracts are now published on the public procurement portal except direct awarding.

Commission for Anti-Corruption and Illegal Assets Forfeiture

The Anti-Corruption Commission (its full name is Commission for Anti-Corruption and Illegal Assets Forfeiture, abbreviated as CACIAF) was established in 2018, following the recommendation of the European Commission under the cooperation and verification mechanism of 2017. CACIAF includes: the Centre for the Prevention and Counteraction of Corruption and Organized Crime under the Council of Ministers, the Commission for the Prevention and Determination of Conflict of Interest, the Unit of the Audit Chamber, related to the activity under the repealed Law on Publicity of the Assets of Persons Holding Senior Public Positions and other positions and the Specialized Directorate of the State Agency National Security (SANS), related to countering corruption among persons holding senior public positions. The Commission's work covers preventive activities, collection, analysis and verification of information about acts of corruption, verification and analysis of property declarations, establishing a conflict of interest for high-level officials, verification of signals, inspection of status of property and initiation of proceeding for confiscation of illegally acquired property.

People in senior public positions are obliged to submit a declaration of assets and interests every year by May 15. In addition to themselves, the persons holding senior public positions are obliged to declare the property and income of their spouses/partners and their minor children. The scope of the persons obliged to submit such declarations to the Commission is approximately 9 000 people and another 9 000 related persons. A documentary check is carried out on all submitted declarations.

The Commission comprises a central administration and five territorial directorates. Its committee is composed of five members and decisions are majority-based. According to the 30 September 2022 draft Law on Combating Corruption among Persons Holding High Public Positions, the composition of the Agency would change, with two of its members elected by the Parliament, one appointed by the President and one elected at the general meeting of the judges of the Supreme Court of Cassation and one by the general meeting of the judges of the Supreme Administrative Court. The draft proposes that the Agency is managed on a rotating basis decided by a lot every year. These changes aim to guarantee greater independence. According to the CACIAF's Rules of Procedure, the total number of staff is 482 full-time employees.

In 2020, the employees of the Public Register Directorate at CACIAF have checked 21 587 declarations of property and interests.

The Road Construction Agency

The Road Construction Agency, which is the contractor for road projects is a second-line budget spender under the Ministry of Regional Development and Public Works, receives alerts from purchasing authorities about irregularities in road construction tenders and conducts investigations. The two most common irregularities are restrictive criteria in the selection process, which can be related to the technology or the qualifications and the contractor not meeting all the criteria for the tender.

The Financial Inspection Agency

The Financial Inspection Agency is a second-line body under the Ministry of Finance. Its mandate is confined to checking financial discipline in the management of public funds. To do so, it conducts regular checks as well as checks responding to signals. It is obliged to notify the prosecutor of irregularities within seven days of the inspection order, which may come from the Ministry of Finance or other agencies.

National Audit Office

The agency's role is limited to auditing and it lacks investigative powers.

National Revenue Agency

The Agency is well placed to identify irregularities in reporting and has powers to conduct investigations.

Anti-corruption units in individual public institutions

Lower levels of corruption and other forms fall under anti-corruption units of individual public institutions.

Institute of Public Administration

The IPA was established in 2000 as part of administrative reform in the context of forthcoming EU accession as an institution of the Council of Ministers. The Institute focuses on three work streams, namely: training, research, and consultancy to successfully modernise the Bulgarian public administration. The IPA is financially supported by the Bulgarian government, state budget and various international projects. The Institute conducts courses for newly appointed officials, for managerial positions and for professional development. In this context, it offers a course on the Code of Conduct for Public Administration Employees aimed to develop ethical standards for public administration officials and prevent corruption behaviour (OECD, 2022^[33]).

Public prosecutors

Public prosecutors are pressing charges and maintaining the indictment for criminal offences. In performing these functions, the public prosecutor directs the investigation and exercises constant supervision for its lawful and timely conduct. Only in exceptional cases the prosecutor may perform investigation or separate investigative or other procedural action.

Investigative bodies

Investigative bodies include investigating magistrates, investigating police officers and investigating customs inspectors. The division of labour between the investigating magistrates and the police is such that investigating magistrates get involved when the crimes are perpetrated by senior public officials, judges, prosecutors, investigator magistrates and law enforcement officers; in cases of some serious criminal offences (including corruption offences); when the crimes are perpetrated abroad and in case of factual and legal complexity.

Source: OECD consultation with the respective agency.

The Anti-Corruption Commission is the main institution responsible for implementing anti-corruption policies. With its current mandate, it should be well-positioned to detect and handle public sector embezzlement and bribery, both of which appear to be relatively common in Bulgaria (Figure 1.35), at least when those are committed by people in high positions or when illegally acquired property changes hands. The Commission can start an investigation on an alert or on media publications. In 2021, as a result of inspections carried out by the Commission and 22 decisions adopted to establish a conflict of interest, 6 persons occupying senior public positions were dismissed from office, for which the Commission's decisions were confirmed by the court and entered into force. Lengthy court procedures (upon the conclusion of the investigation with the filing of an indictment by the Prosecutor's Office in court, the trial can proceed before three instances of courts) lead to limited track-record of convictions in high-profile cases (European Commission, 2022^[38]). The institutional system combatting corruption is being streamlined by a proposed new legislation to establish a new body with investigative powers of high-level corruption. The proposal has been adopted at first lecture.

Greater transparency, including through digitalisation of transactions and strengthening checks and balances, would reduce the room for bribery and misappropriation of public funds and properties. Increasing detection, holding to account and leaving less discretion for decisions by individual civil servants are important. The newly adopted whistle-blower protection legislation (27 January 2023) should contribute

to better detection and now needs to be effectively implemented. In addition to detection, it is also crucial that investigations are actually conducted. To that effect, a very important element of the reform is the introduction of judicial review of the refusal of the prosecutor to start investigation. This amendment was prompted by reported passivity of public prosecutors in the past.

The Chief Prosecutor has not been accountable to any person and no one could effectively investigate him/her. The Venice Commission of the Council of Europe raised the issue of the excessively broad powers of the prosecution service that go beyond the criminal law field (European Commission for Democracy through Law, 2022[30]). The current proposal would allow for a judge appointed by the Prosecutorial Chamber of the Supreme Judicial Council to investigate even the Chief Prosecutor. This new amendment to the legislation aims at obliging the prosecutor to evaluate whether the complaint contains information about committed crime by the Chief Prosecutor. If there is information about criminal activity, the mechanism for the random selection of an ad hoc prosecutor among Supreme Cassation Court judges and judges from district and appellate courts with the rank of judges of the Supreme Court of Cassation starts. In this way, the draft law creates guarantees that every report or complaint against the Chief Prosecutor will be investigated objectively and according to the facts found.

Table 1.9. Previous recommendations on fighting corruption and actions taken

Recommendation	Action taken
Provide the integrity and anti-corruption institutions with the necessary responsibilities, coordination mechanisms and resources to fulfill their role.	A draft Law on Countering Corruption among Senior Public Office Holders (SPOH) was approved by the Council of Ministers on 1 November 2022 and was adopted by the National Assembly at first reading in plenary on 7 December 2022.
Implement an effective and transparent accountability mechanism for the Chief Prosecutor 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.	The National Recovery and Resilience Plan as well as the Bulgaria 2030 National Development Program propose measures to investigate the Chief Prosecutor in case of suspicion of irregularities in his/her conduct. The draft law amending and supplementing the Criminal Procedure Code, which provides for a framework for the establishment of a mechanism for engaging the criminal liability of the Chief Prosecutor, was adopted by the National Assembly at first reading in plenary on 27 January 2023. The draft law contains also proposals with regard to the composition of the Supreme Judicial Council.
Introduce lobbying regulation, including a code of conduct for the engagement of lobbyists with members of Parliament. Protect the independence of the media and ensure the integrity of public decision-making process.	Commitments to introduce regulation of lobbying activities are in the National Recovery and Resilience Plan and in fulfilment of Order No. LS-13-102/16.09.22 of the Minister of Justice, a working group was set up to prepare legislative proposals. A schedule with deadlines has also been put forward for the working group.
Implement the EU whistle-blower Directive and launch a campaign to enhance officials and the public's acceptance of whistle blowing.	On 27 January 2023 a Law on the Protection of Whistleblowers or Publicly Disclosing Information on Violations was adopted by the Parliament.

Table 1.10. Policy recommendations of the Key Policy Insights Chapter

MAIN FINDINGS	RECOMMENDATIONS (key in bold)
Securing a robust recovery and accelerating convergence	
Inflation is high with strong growth of nominal wages in the context of the currency board. While the debt ratio is low, the underlying fiscal balance may have weakened in recent year.	Stand ready to tighten fiscal policy if inflation remains high.
Support measures during the cost-of-living crisis are mostly untargeted and distort price signals.	Make support measures to households and firms more targeted to the most vulnerable and ensure that they incentivise energy savings.
The fiscal council has a limited impact on fiscal transparency.	Ensure effective functioning of the fiscal council based on best practices.
Significant progress has been made towards euro adoption, but there is uncertainty about the timing of when all conditions will be fulfilled.	Continue to prepare for euro adoption.
The cost of capital is relatively low, but uncertainty and the lack of long-term strategy hinder investment.	Assess the medium- to long-term needs for infrastructure and other capital spending and prepare a public investment strategy based on cost-benefit analysis.
Making the financial system more inclusive	
Non-bank lenders are an important source of funding for vulnerable consumers who in turn face hefty interest payments and fees, while the interconnection of non-banks with the banking system is untransparent.	Reduce the interest rate cap on consumer loans by non-bank finance companies and express it as a multiple of benchmark lending rates. Tighten oversight of non-banks providing lending, increase their data disclosure and enhance the capacity of the Consumer Protection Commission to better represent consumers' interests.
Meeting long-term spending needs	
Several foreign companies shift profits, value added taxes are evaded and assigning the property tax to the subnational level has reduced collection efficiency.	Increase enforcement and collection efficiency of corporate income taxes, value added taxes and property taxes.
Spending pressures related to ageing, health and education, as well as infrastructure and the green transition, are mounting.	Establish a more integrated medium- and long-term fiscal strategy linking spending and resources.
The cost of capital is relatively low in international comparison, but uncertainty and the lack of long-term government strategy for infrastructure investment hinder investment.	Assess the medium- to long-term needs for infrastructure and other capital spending and prepare a public investment strategy based on cost-benefit analysis.
Assigning the property tax to municipalities led to a 30-35% loss in collection efficiency.	Assess the option to re-assign the property tax to the central level if collection efficiency remains low.
Given social needs, the cost of an ageing population and investment shortfalls, spending may need to rise over time.	Alongside improved enforcement, assess options to increase property, inheritance and environmental taxes.
Easing business entry and exit	
There is no comprehensive list of licenses and permits required and no programme in place to simplify/reduce their number.	Take stock of the existing licenses and permits and reduce their number at both the national and sub-national levels.
Several bodies need to be contacted to set up a limited liability company, there are minimum capital requirements, and it is costly.	Establish a one-stop shop for setting up businesses and reduce the costs.
Liquidation of SMEs is cumbersome and makes exit difficult.	Introduce a simplified procedure for the liquidation of SMEs.
The envisaged introduction of cramdown threatens secured creditors being crammed down by unsecured ones.	Make sure that secured creditors' claims are not crammed down by those of the unsecured.
Better managing public enterprises	
SOE management selection procedures have been significantly strengthened, but political influence remains.	Increase transparency of the selection of all board members and managers of SOEs by strengthening the merit-based and competitive process.
Information disclosure and analysis on SOEs is often delayed and insufficient. Lack of regular publicly available aggregate data on SOEs. This prevents transparency and timely adequate measures.	Enhance capacity of Public Enterprises and Control Agency to strengthen its role as co-ordination unit and capacity for effective analysis. Ensure that aggregate reports are published on a timely basis and that the coverage is extended.
Accelerating the green transition	
While there are a number of policies and targets in place, there is no comprehensive strategy for the green transition.	Complete an overarching strategy for the climate transition, building on the Strategic Vision for the Sustainable

	Development of the Electricity Sector, and ensure it is consistent with the public investment strategy, with a roadmap and policies to achieve zero net emissions.
Few households have installed solar panels or other equipment to generate renewable energy.	Delink land ownership rights of the property where small-scale renewable energy generators are planned as long as long-term lease is secured. Introduce a scheme where producers can sell any self-generated unused electricity to the supplier through the grid.
The existing grid capacity is not sufficient to manage future demands and a greater role for renewables.	Expand grid capacity to avoid constraints with the expansion of renewables generation.
Energy intensity and emissions are high.	Gradually increase environmental taxes for sectors outside of the EU Emissions Trading System (ETS), including excise taxes on fuels, and align these carbon prices with the ETS-price, while protecting poorer households and preserving security of energy supplies..
With the phasing out of coal, mining regions need a comprehensive strategy for their transformation.	Prepare a plan for the transformation of coal mining regions ensuring that low-skilled workers are retrained, high-skilled ones stay, land is rehabilitated, and new industries are attracted.
Fighting corruption	
Corruption continues to impose high transaction costs.	Continue designing and adopting effective measures to rein in corruption.
The system detecting and investigating corruption is fragmented, leaving some grey areas.	Extend the authority of bodies to detect and investigate corruption to cover the entire economy.
Lobbying is not regulated.	Regulate lobbying.
In the current setting, no one can investigate the Chief Prosecutor and he/she can decide whether to start investigation once received a signal.	Implement the proposals related to investigation of the Chief Prosecutor and the judicial review of refusal to start investigation.
There are few checks and balances in public-private transactions, leaving room for corruption.	Make all proposed transactions involving significant amounts of public money or public assets subject to conflict of interest checks.
Detection of corruption is difficult.	Enhance transparency and checks and balances and implement the recently-adopted whistle-blower legislation to facilitate the detection and reporting of corruption cases.
Institutional measures to create a culture of integrity across government are inadequate.	Develop a code of ethics particularly for senior officials; institutionalise integrity at the agency level and increase the effectiveness of the asset declaration system.

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2 Better jobs and incomes

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The shrinking number of workers due to smaller young cohorts entering the labour market and large-scale outward migration are undermining Bulgaria's growth prospects, the sustainability of its social institutions and society more widely. Bulgaria needs to provide more support for families and make staying in the country more attractive by raising productivity, fostering the creation of more good-quality formal jobs and reinforcing the social safety net. Bulgarian women have high activity rates, a high share in management jobs and a low wage gap with men, but all this translates into high opportunity costs for educated women of having children. Policies, including access to affordable quality childcare countrywide, more egalitarian burden sharing with men and greater incentives to get back to work, would help reduce those costs. Women from disadvantaged backgrounds should be offered a career path through upgrading skills and lifelong learning. Inactivity rates among the working age population should be addressed by reforms to the social welfare system that would improve activation and through targeted measures. Vulnerable groups, including ethnic minorities, are disadvantaged in multiple ways and need tailored measures to escape poverty, acquire skills and integrate into the labour market.

Introduction

Bulgaria's incomes are steadily converging to the OECD average, but unfavourable demographic trends with a falling number of children and large-scale outward migration are undermining its growth prospects. Indeed, population projections for Bulgaria are among the gloomiest in the world: with the current trends, the population could halve in roughly 65 years. This risks shrinking the size of the economy and creating labour shortages. Net outward migration represents a loss for Bulgaria of the investment made in the education of the population that leaves. To avoid such outcomes, in addition to in the range of measures to raise living standards set out in the Key Policy Insights chapter, specific policies could help to improve the demographic outlook and make better use of people of working age. More equitable opportunities should be provided to maintain good health, upgrade skills, create more high quality jobs, and avoid people falling into poverty in between jobs.

These unfavourable demographic trends reflect a number of factors. First, the overall fertility rate is close to the OECD average, but masks lower-than-desired rates for highly educated women for whom having children imposes a heavy cost. Teenage childbearing is high, with many children born to unemployed parents and in deprived circumstances (Clarke et al., 2022^[1]), increasing infant mortality. Second, many highly educated and skilled workers leave the country and vacancies have not been filled by immigration. Net outward migration of people of child-bearing age further depresses the number of children growing up in Bulgaria.

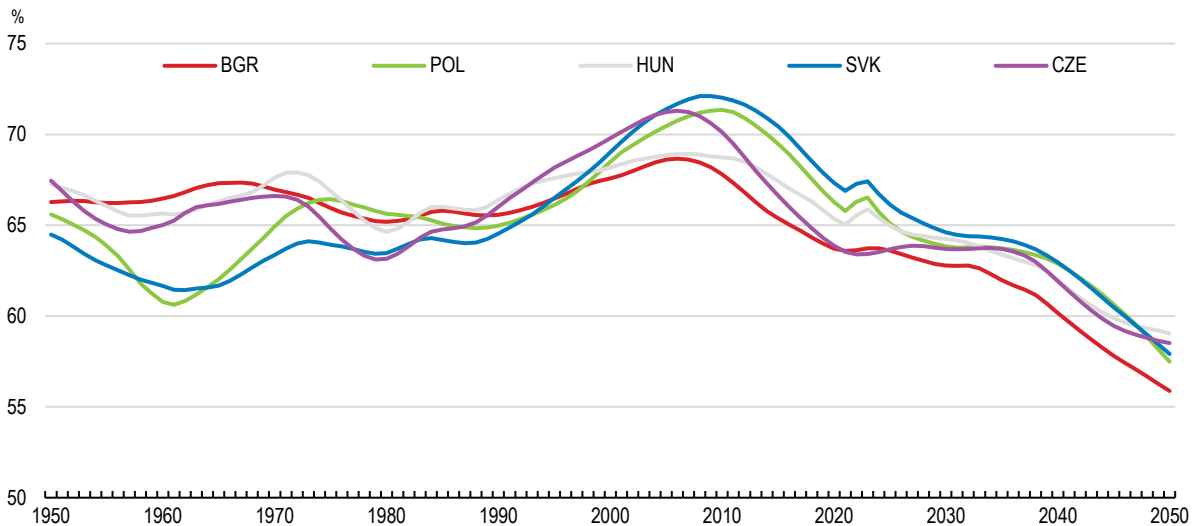
This chapter considers a package of policies that would facilitate a better balance between work and childbearing, make staying in the country more attractive by raising productivity, and foster the creation of more good-quality formal jobs. Reinforcing the social safety net would make Bulgaria a more attractive place to work. Vulnerable groups, including ethnic minorities, are disadvantaged in multiple ways and need tailored measures to escape poverty, acquire skills and integrate into the labour market.

The population is shrinking and getting older

Bulgaria's working-age population is on a trend decline (Figure 2.1), amid rapid ageing (Figure 2.2). The 18th Census of the Population and Housing, reflecting the situation as of 7 September 2021, showed a 19% decline in the working-age population since the 2011 Census, while the number of people aged above 65 increased by 12.6%. There were 6.5 million people living in Bulgaria in 2021: nearly 2.5 million fewer than in 1981, when the population decline started (UN World Population Prospects). These demographic trends will affect the economy's growth potential and its convergence prospects. The 2022 revision of the UN World Population Prospects projects that by 2050 Bulgaria will have one of the largest relative reductions in population alongside Latvia, Lithuania, Serbia and Ukraine (United Nations, 2022^[2]).

Figure 2.1. The working-age population is shrinking

The share of the working-age population in the total

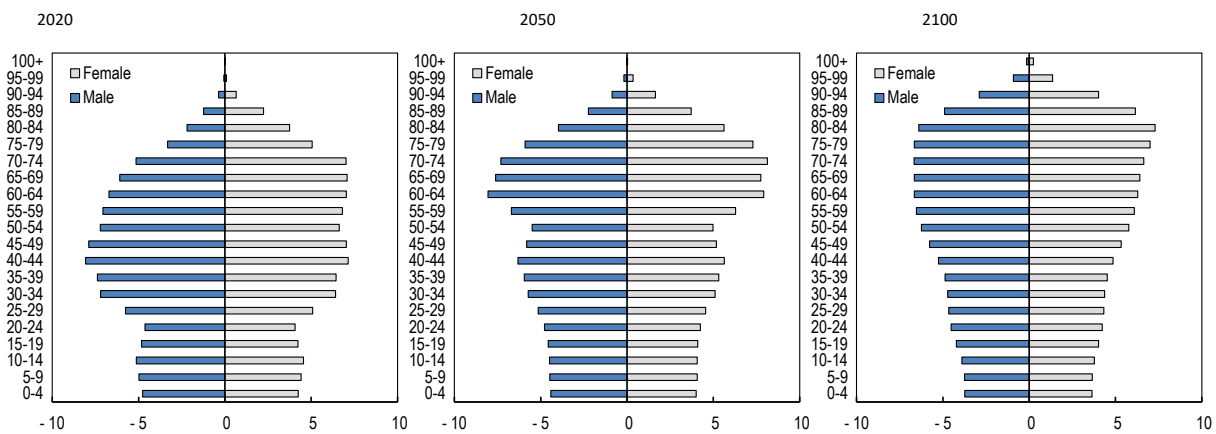


Note: Medium fertility variant.
Source: United Nations World Population Prospects 2022.

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Figure 2.2. The population is set to age sharply

Projected age and gender structure of the population



Note: Medium fertility variant.
Source: United Nations World Population Prospects 2022.

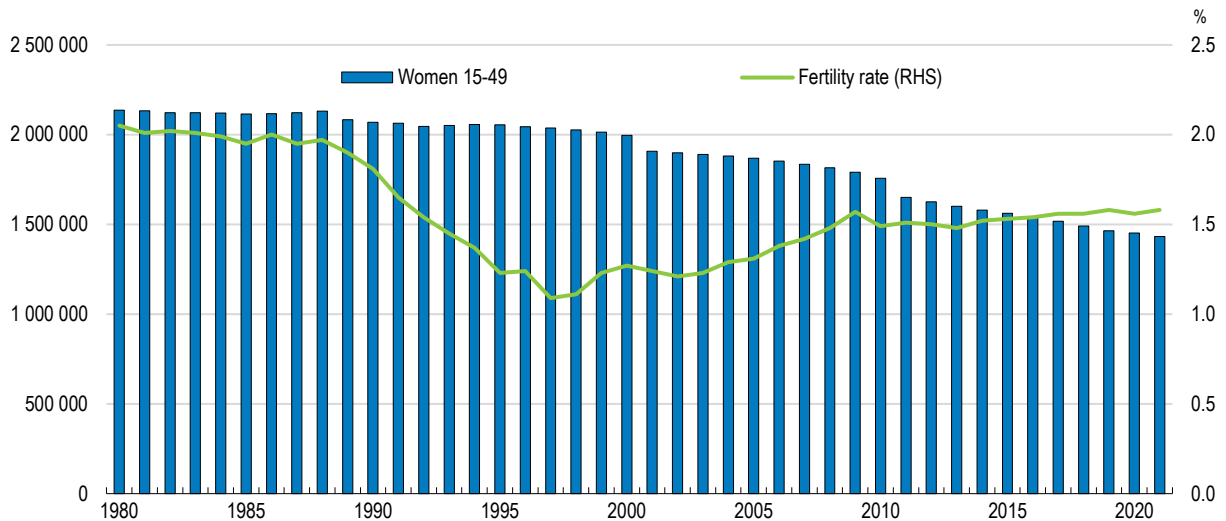
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The cohorts of those aged under 25 are about half the size of the largest cohorts (those in their late 40s). The average fertility rate – the average number of live born children per woman – at 1.58 is not particularly low in international comparison (OECD Family database), but it is significantly less than the 2.1 children per woman necessary to maintain a steady population. In addition, the number of women of childbearing age (15-49) is falling (Figure 2.3). At the same time, Bulgaria has seen consistent emigration on a significant scale (Figure 2.4). Although the number of people leaving the country has declined, Bulgaria

still lost around 30 000 people (0.4% of the population) on average per year between 2015 and 2020 as a consequence of emigration. This development puts further pressure on the number of births as around half of those who leave are of the age when people have children. While the number of immigrants has been increasing recently, it remains small relative to the outflow.

Figure 2.3. The number of women of childbearing age is declining rapidly, while the fertility rate is stable

Number of women aged 15-49 and the total fertility rate



Source: National Statistical Institute.


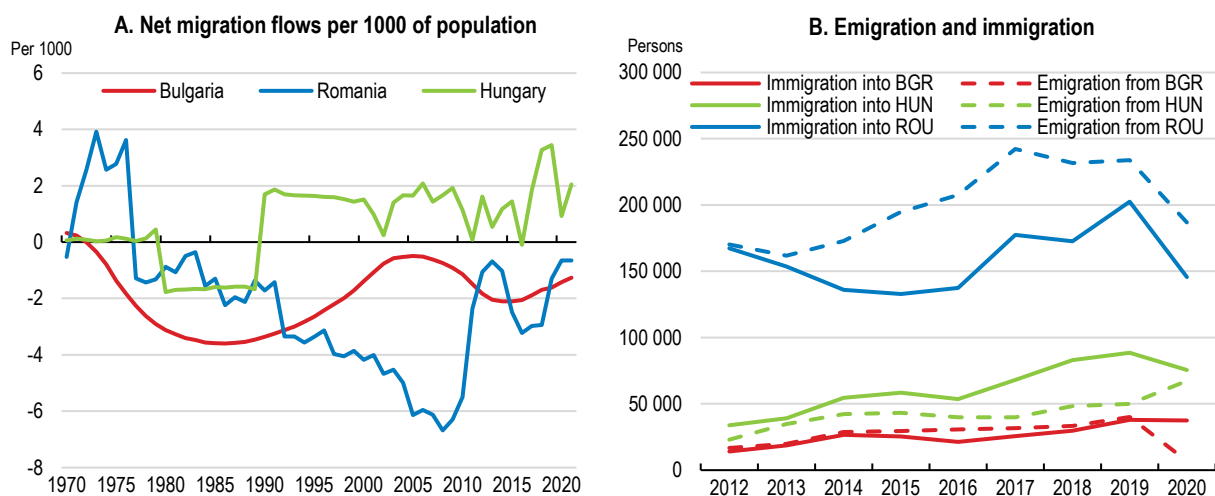
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Figure 2.4. Bulgaria has seen consistent large-scale emigration



Source: Panel A: United Nations World Population Prospects 2022, Panel B: Eurostat.

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The ageing of the population is also driven by rising life expectancy. While the expected life span (at birth) is gradually increasing as Bulgaria catches up in GDP per capita with more advanced countries, it is still lower than in any OECD country, both for men (69.9 years) and women (77.5 years) (World Bank World Development Indicators). Moreover, the gap between men and women at 7-8 years is larger than in most OECD countries with the exception of the Baltic states. The young and old-age dependency ratio increased by 10 percentage points between 2000 and 2021 to 57%. This ratio is well above the OECD average and only six OECD countries had higher dependency ratios in 2021. These changes can also impact the regional structure of the country: while Sofia still attracts younger people, the dependency ratio in the district of Vidin is over 75% and on a par with a small number of regions in the OECD with very aged populations.

The steady decline in the population has raised the issue of demographics on the policy agenda in Bulgaria. In 2021, the government introduced a demographic impact assessment for every new piece of legislation. The preliminary assessment is done by the proposer of the legislative act through a questionnaire. Following this preliminary assessment, the Council of Ministers evaluates the potential demographic impact of the proposal.

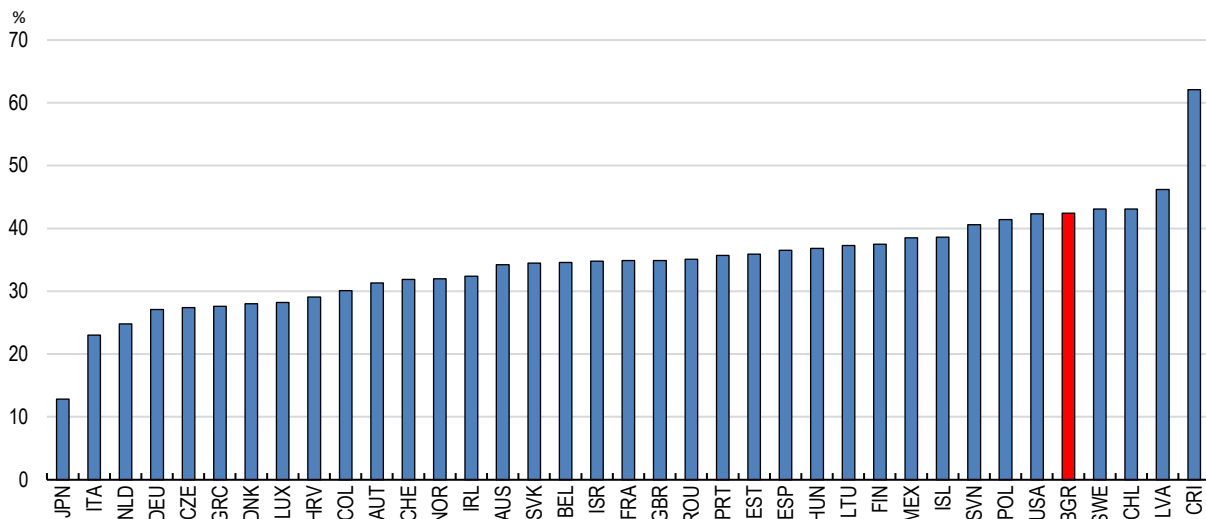
The number of children has been decreasing

While the 1.58 average fertility rate is not particularly low in international comparison, it masks a relatively low fertility rate for highly educated and urban women and a relatively high birth rate for some other social groups. The urban-rural divide is significant, with the average number of children per woman higher by 0.31 in rural areas. In contrast, fertility rates are the lowest in Sofia city, other large cities and in several districts along the Romanian border. The highest average fertility rates are in the northwest and the southeast of the country, both regions comprising areas with large shares of ethnic minorities. Historically, these groups have significantly higher fertility rates than ethnic Bulgarians (Koytcheva and Philipov, 2008^[3]). The higher fertility rate for Roma women is also observed in several Central and Eastern European countries (Szabó et al., 2020^[4]).

The employment rate for Bulgarian women is above the OECD average. The gender gap in the full-time equivalent employment-to-population rate stood at 8.6 percentage points in 2021 with only the Baltics and Finland displaying a lower gap. The female share of employment at senior and mid-manager levels in 2020 was higher than in all OECD countries except for Sweden, Latvia and Costa Rica (Figure 2.5). The share of women in top management is higher than in most OECD countries. Bulgarian women also appear to be remunerated in a more equitable manner: the gender wage gap for full-time employees, at 2.55% in 2020, was lower than in any OECD country (Figure 2.6). Bulgaria is perceived to be among the best countries in Europe for women to work, according to some surveys (such as Reboot online). Such rankings are partly related to the large number of women in leadership positions. The European Institute for Gender Equality's index ranks Bulgaria lower than the EU average on several components, but on the political, economic and social power component, the country exceeds the EU average (European Institute for Gender Equality, 2022^[5]). Due to their high social status and high activity rates, Bulgarian women are well represented in professional and scientific work. In economics, for example, according to RePEC, half of the registered Bulgarian authors are women – far above the share in most OECD countries, where it is hovering around 20-30%.

Figure 2.5. Many women make it to manager positions

Female share of employment in senior and middle management, 2020

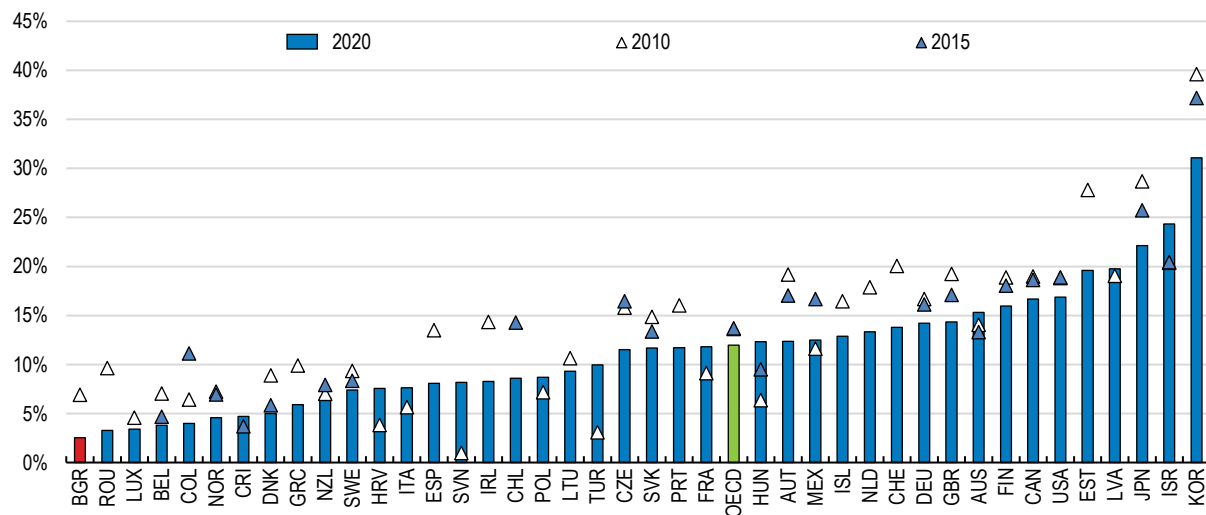


Source: World Bank World Development Indicators database.

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Figure 2.6. The gender wage gap is low

Gender wage gap at median earnings for full-time workers



Note: 2020 refers to 2019 data where 2020 data were not available.

Source: OECD Earnings database.

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Greater career opportunities can imply greater opportunity costs of having children for high-skilled women. Indeed, the population census data confirm that highly educated women are more likely to be childless than the general population. Fertility intention surveys show that educated women would, on average, like to have 2.1 children, but in fact they only have 1.2 (Fertility Survey, 2021). In many advanced economies, women are observed to postpone the birth of the first child to achieve a higher position in the labour market, but education appears to have a positive impact on the propensity to have a second child and the transition to the second child is faster (Adema, Fluchtmann and Gustafsson, 2023^[6]). By contrast, in Bulgaria, the impact of education on the likelihood of having a second child is negative (Impicciatore and Tomatis, 2020^[7]). Less egalitarian sharing of the burden of childcare tasks between men and women in Bulgaria, together with difficulties meeting expectations both at work and home, may explain the lower propensity to have a child for educated women. There is currently an optional 15-day paternity leave for men, but the take-up rate is low. There is also a 2-month paternity leave that can be taken any time before the child turns eight and can be taken at once or in parts. A lengthening of paternity leave with a high replacement rate but short duration, such as 2-3 months during the first year of the child, could encourage a more equal sharing of the burden of childcare with women and help to change perceptions of people taking leave to look after children. Alternatively, compulsory paternity leave, which has been implemented in some OECD countries, could also be considered.

Improved access to quality childcare and preschool education would help to reconcile work and family life, making it more attractive to have children. Currently, only 15% of children attend nursery school and, even at the kindergarten level, enrolment is not complete (Figure 2.7). The decision to abolish fees in public nurseries and kindergartens from 1 April 2022 is a welcome step in the direction of making childcare affordable for all. However, the number of childcare places is lacking and widespread availability needs to be guaranteed. Around 25% of inactive working-age adults have caring responsibilities, most of whom are women. Affordable and high-quality childcare should be available to all. Investment in kindergartens is being stepped up under the Recovery and Resilience Plan and four-year olds are to be included in pre-school education. In addition to building more facilities and training teachers, alternative schemes could be considered. In smaller towns and rural areas, where the number of children may be too small to operate nurseries, a scheme similar to the French “assistante maternelle” system could be adopted, where a handful of families join to hire a full-time caregiver, who often has her own child among the children to take care of. There is a system in place in Bulgaria called “Parents in employment”, implemented as part of the Ministry of Labour and Social Policy’s Human Resources Development Programme (2021-27), where the Employment Agency finances the costs of hiring unemployed people to take care of children. This is the continuation of a similar programme from 2017-23, used by some 7 700 parents. However, as those people only take care of children of the same family, costs are high and places limited. Grouping more children could help reduce the costs.

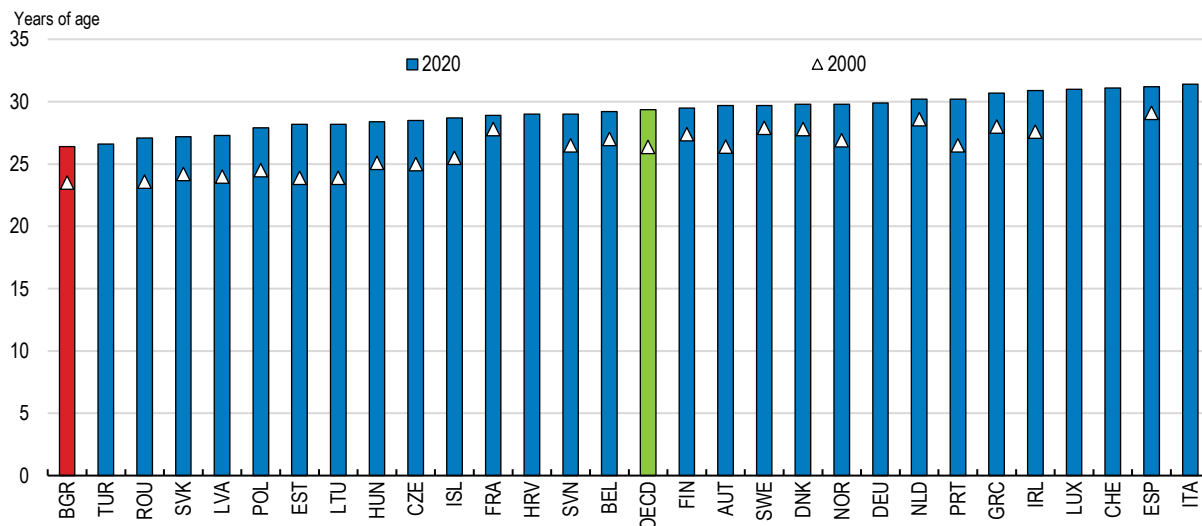
At 27 on average, Bulgarian women are among the youngest to have their first child in the European Union (Figure 2.8), driven by districts with high ethnic minority shares such as Sliven or Montana. The adolescent fertility rate (births per 1 000 women ages 15-19) is nearly four times the OECD average. Overall, 10% of children are born to mothers aged below 20 (NSI, 2021) and 13% to mothers without social security coverage, resulting in inadequate care and high infant mortality and morbidity rates (UNFPA, 2013^[11]).

The prevalence of teenage age pregnancies would be reduced by preventing early school leaving and providing better prospects for a career as an alternative to childbearing and raising children at a young age. For many women with low education levels, having a child is considered as raising their social status. While the reduction of teenage childbearing would likely reduce the number of children born, it would also likely reduce child mortality and morbidity rates. Improving prospects for a career path could include personalised training in basic skills for girls in disadvantaged groups to catch up with peers and career counselling. Extracurricular activities and sports can also help keep children engaged with school who otherwise may not be interested in academic learning. A programme was established in 2018 (CM Decree 100 of 8 June 2018) aimed at identifying the reasons for early school leaving and finding region-specific policies to address them. The programme emphasises a joint effort by parents, mediators, social workers and public educators to increase children's motivation and develop their sense of responsibility. There is also a potential penalty of suspending social assistance to families when parents do not ensure that their children attend school. The performance of the programme is evaluated twice a year, which has resulted in close collaboration with border authorities in de-registering emigrating children from the school leaver list. Efforts could be stepped up to better track returning children. In addition, the education component of the Recovery and Resilience Plan envisages introducing and adapting vocational training for school dropouts.

A large number of children are born to parents from disadvantaged groups and 11% of Bulgarian children between 0-14 live in households where no adult is working, higher than in most OECD countries (Figure 2.9). Living in households without stable income may reduce children's chance to grow up healthily and acquire the necessary social and practical skills to participate in economic activities and realise their potential (OECD, 2018^[12]). Available child well-being indicators reflect the range of issues that need to be tackled: over a quarter of children live in housing without basic sanitation facilities, 61% in overcrowded households and over one-fifth in areas with problems of crime or violence, all higher than in any OECD country for which data are available. Strengthening outreach to the inactive, encouraging them to register with the Employment Agency, providing health insurance coverage and basic social assistance (as discussed further in this chapter) would be key to prevent child poverty and improve their chances for a better future.

Figure 2.8. Bulgarian women on average have their first child at a young age

Mean age of women at the birth of their first child

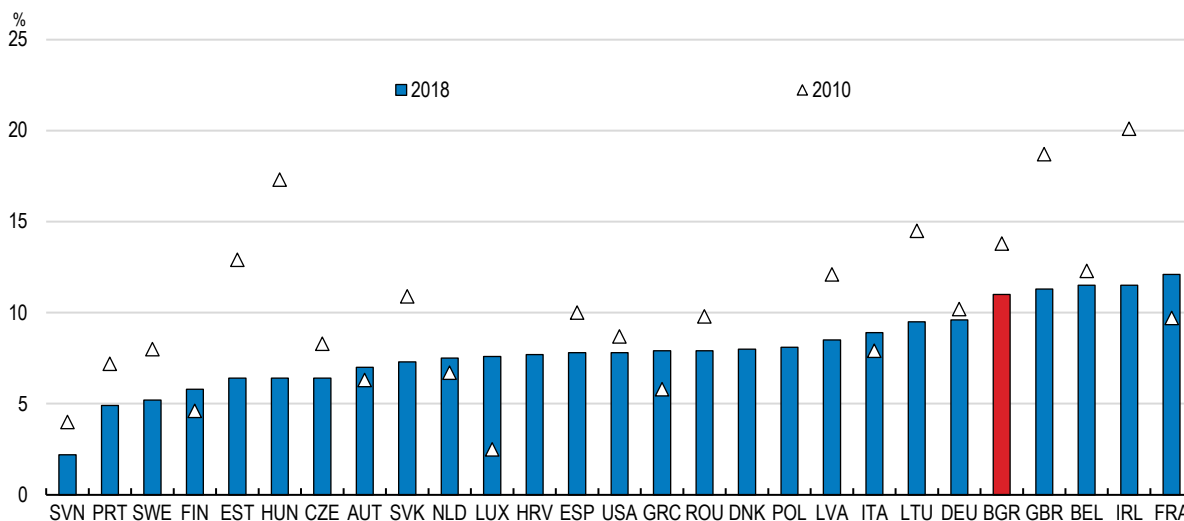


Source: ESTAT database.

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Figure 2.9. Many children are born into households without working adults

Distribution (%) of children (aged 0-14) in all households by the employment status of adults in the household



Note: Data for Türkiye refer to 2013, and for Israel to 2017. For Israel and the United States, data refer to children aged 0-17. For the United States, data cover children living with at least one parent and refer to the labour force status of the child's parent(s) only and refer to whether or not the child's parents are active in the labour force, as opposed to in employment

Source: For European countries, EU-LFS. For Israel, Central Bureau of Statistics. For Türkiye, Turkish Household Labour Force Survey. For the United States, U.S. Census Bureau.

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Net emigration is contributing to the population decline

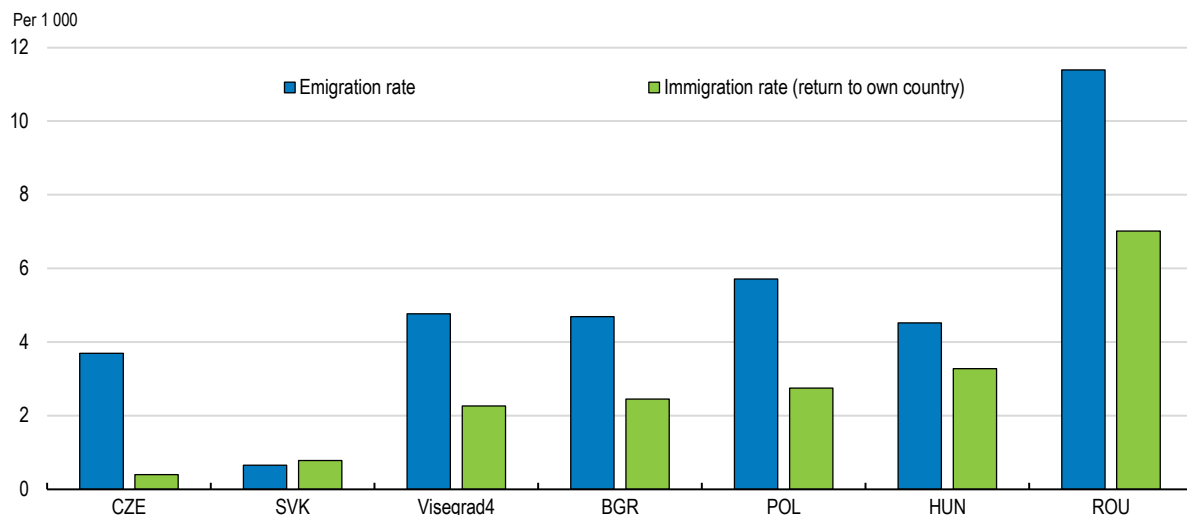
Despite robust economic development in recent years, a large number of Bulgarians still leaves the country every year to live and work elsewhere: around 27 000 did so in 2021. The total diaspora is estimated to amount to up to 2.5 million people, although some estimates record both significantly lower and higher figures. The largest share of Bulgarians abroad live in Germany, followed by Spain, the United Kingdom and Greece. 85% of emigrants are of working age and around half of them between 15 and 34 years on average in recent years, with a broadly equal share between women and men. The COVID-19 pandemic reversed this trend for the first time: the number of emigrants dropped to less than 7 000 in 2020, while the number of returning Bulgarian emigrants jumped up to around 24 000 given employment losses in contact-intensive sectors and widespread teleworking regimes abroad. However, the flow of emigrants is likely to have picked up as economies re-opened.

Higher wages and better living conditions abroad are the main reasons to migrate and Bulgaria's EU membership in 2007 has considerably facilitated the access of workers to other EU labour markets (Garotte Sanchez, Kreuder and Testaverde, 2021^[13]). A package of measures to raise productivity, wages and offer good-quality jobs and attractive living conditions as set out in the remaining sections of this Chapter will be needed to stem the tide of outward migration. Several Central and Eastern European countries, such as Slovenia, the Slovak Republic or Estonia, have seen a reversal in migration flows during the past 20 years, following Ireland's transition from a net source of migrants to a net receiving country in the 1990s. These experiences have been diverse. However, comparing wage levels at the turning point from net outflows to net inflows suggests that wages in Bulgaria might still need to rise before the trend is reversed. While Ireland stands out with an average annual wage comparable to the EU-OECD average in 1995, Central and Eastern European countries experienced a trend reversal with relatively lower wage levels with wages between 65-90% of EU-OECD wages. Bulgarian wages are still lower at around half of the EU-OECD average in 2021, suggesting that these wages are not sufficiently attractive for a significant part of potential migrants who can freely move to alternative EU countries. At the same time, labour shortages have become more pressing in many OECD countries, including in many EU countries, not least since the recovery from the pandemic (Causa et al., 2022^[14]). The concomitant wage increases in these countries may further pull workers from other countries, typically those which have already served as a source of workers, such as Bulgaria. Consequently, the tight Bulgarian labour market could come under additional pressure and might see new waves of workers leaving.

There is significant potential for Bulgaria to further increase the number of returning migrants to levels observed in other countries (Figure 2.10). Returning Bulgarian emigrants often return with new skills and qualifications acquired abroad (Nonchev and Hristova, 2018^[15]). While their number has grown in recent years, there is considerable potential to further increase return migration. The decision to return to a country of origin is a complex process that is influenced by different factors. While an economic rationale in terms of higher wages and better living conditions abroad are typical pull factors for initial emigration, non-economic factors are predominant behind the decision to return (Bakalova and Misheva, 2018^[16]). Studies show that personal and family-related reasons, such as homesickness, marriage or the need to take care of elderly relatives or children, are among the most important reasons to return to Bulgaria (Zareva, 2018^[17]). Nevertheless, there is scope for policy interventions to attract potential returnees, even if working conditions cannot compete with those in Western European countries.

Figure 2.10. Returning Bulgarians help to counterbalance emigration

Emigration rate and immigration rate of citizens to their own country of origin, average 2016-2020



Source: Eurostat.

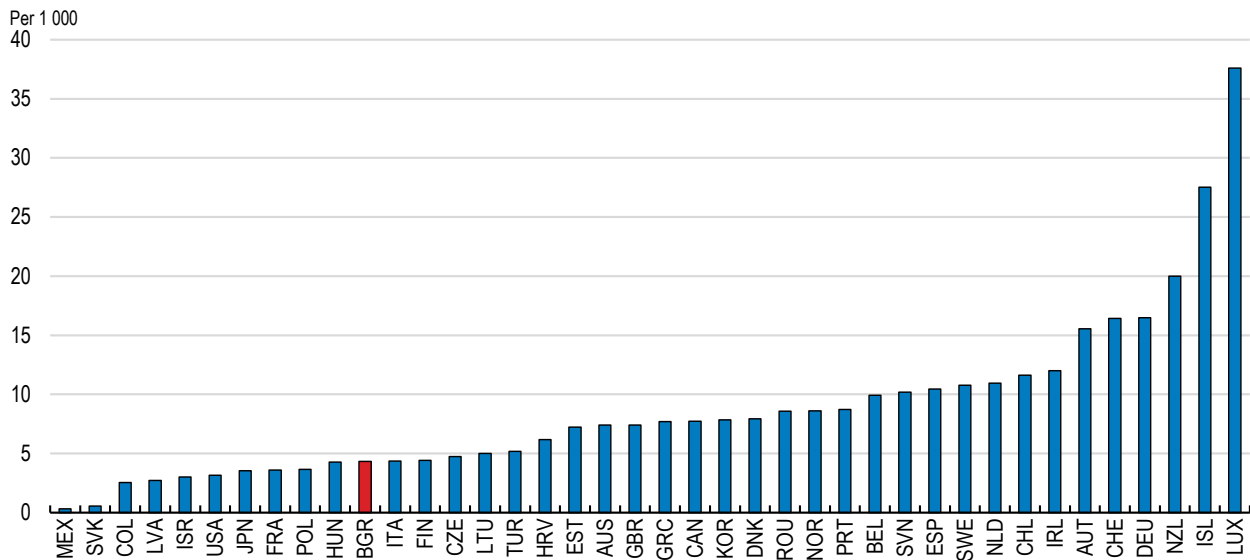
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Bulgarian governments have repeatedly articulated the intention to increase efforts to target Bulgarians working abroad, most recently in the Bulgarian Migration Strategy 2021-25, but no action plans have been formulated to date (European Commission, 2021^[18]). In line with (OECD, 2023^[19]), a comprehensive suite of measures and services should be envisaged to reach out to Bulgarians working abroad and to help them integrate back into the Bulgarian labour market. So far, the Bulgarian authorities lack detailed information on citizens working abroad. Data collection on Bulgarians living abroad needs to be broadened. Outreach could be encouraged during administrative procedures at the respective embassies, such as passport issuance or election registration. A more detailed knowledge of the diaspora would allow for a more targeted promotion of the benefits of returning to Bulgaria. Support for job search could be provided via online tools, accompanied by significant promotion through popular websites and social media. A first online career forum was organised in 2021 on behalf of the Ministry of Labour and Social Policy and the Employment Agency and attracted around 1 500 participants, including 200 Bulgarian employers, highlighting the significant interest from employers and job seekers alike. Strengthened cooperation with Bulgarian employers is needed to ensure that labour demand at home is adequately communicated to those abroad. Information related to administrative requirements, such as insurance, or the recognition of qualifications acquired abroad needs to be easily accessible. Other countries go one step further, such as Hungary, where initiatives to attract young former emigrants include a monthly stipend during the initial re-immigration phase provided for highly qualified returnees, amongst others (Zareva, 2018^[17]).

The number of foreign immigrants is very low in international comparison, contributing only marginally to offsetting outward migration (Figure 2.11). Around 90% of foreign immigrants in 2019 entered from non-EU countries. The largest share relocates from neighbouring countries such as Türkiye (Figure 2.12), which has a long-lasting relationship with Bulgaria through mutual citizenship of parts of the population, as well as from Russia and Ukraine (OECD, 2022^[20]). Family-related reasons (35%) followed by work-related reasons (21%) were the main drivers of immigration from non-EU countries in 2021 according to Eurostat. However, there is potential to attract more immigrants to enter Bulgaria, not least from countries from the broader neighbourhood where common Slavic language roots and Cyrillic script would facilitate integration.

Figure 2.11. Immigration is low in international comparison

Immigration rate, average 2016-2020

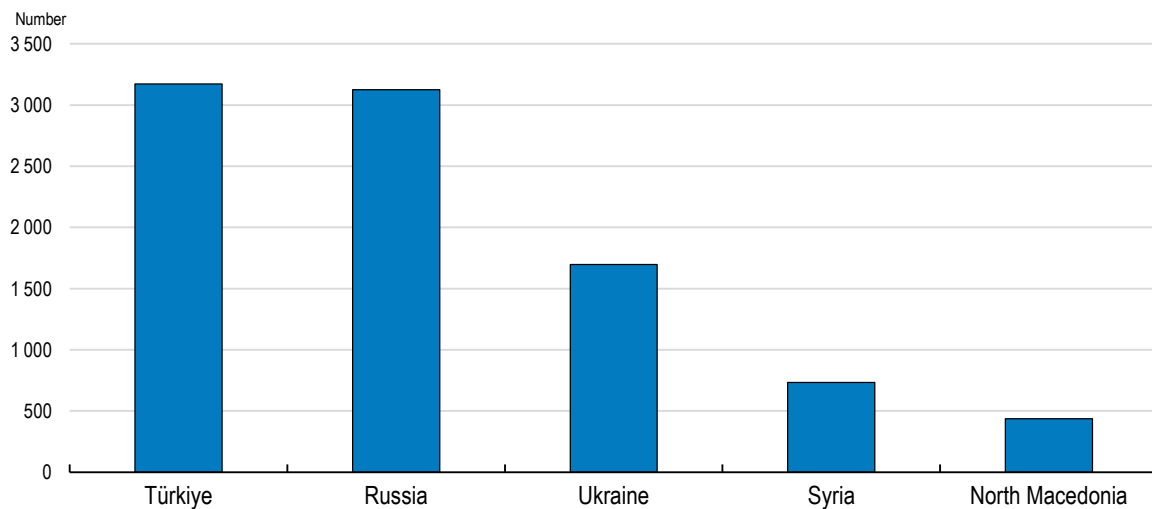


Source: OECD Migration Database and Eurostat.

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Figure 2.12. Immigrants are mainly from nearby countries

Number of immigrants to Bulgaria from top 5 source countries, 2020



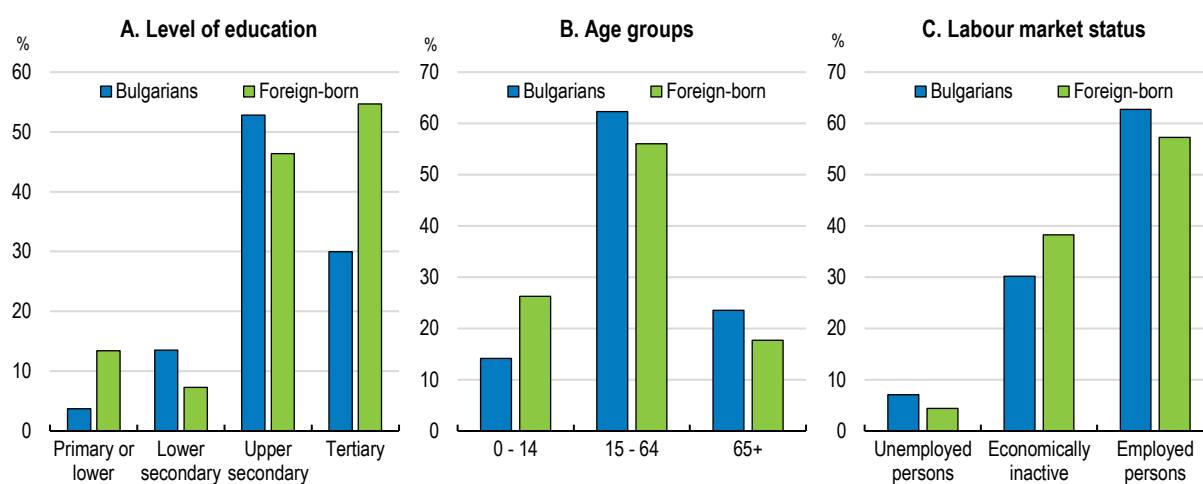
Source: Eurostat.

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Immigrants are primarily of working age and relatively well-educated, but many are not in employment. Results from the latest census from 2021 show that 45% of the foreign-born working-age population has completed tertiary education, compared to 30% among the native working-age population (Figure 2.13). However, the potential of this young and well-educated group of the population is not sufficiently used. Only 57% of the foreign-born working-age population is employed and up to 38% of them are inactive (compared to 63% and 30% respectively for native Bulgarians). Both highly-educated and low-qualified women are often inactive, possibly reflecting lack of access to childcare. Language problems might also hold back more active labour market participation. The shortfall in participation compared to the native population is especially pronounced in poorer regions.

Figure 2.13. The foreign-born population is relatively young and well educated, but has weak labour market outcomes

Share of Bulgarians and foreign-born citizens among their respective population, 2021



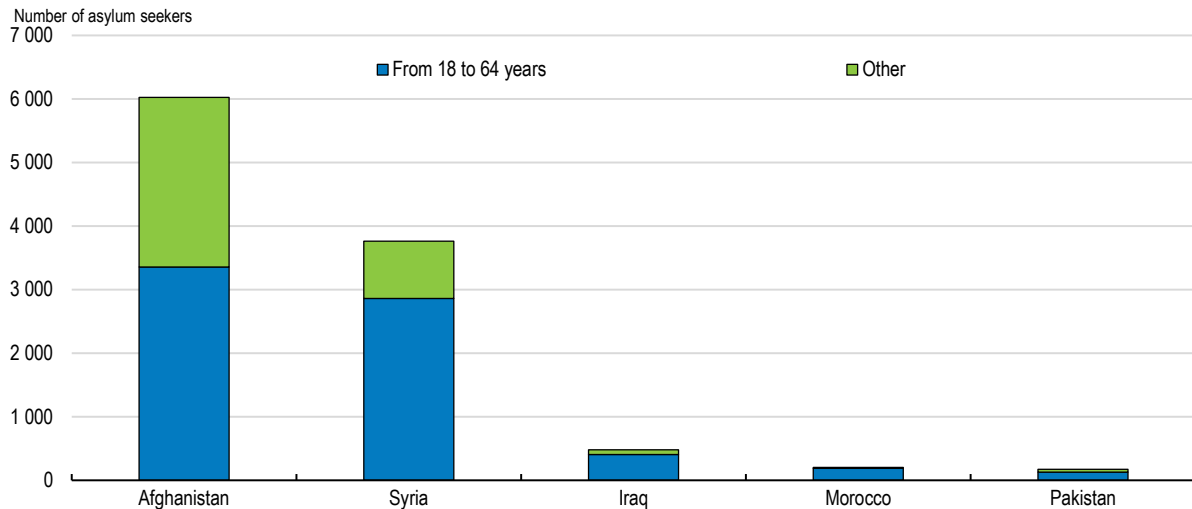
Note: Panel A and C refer to the working age population.
Source: National Statistical Institute 2021 Population Census.

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Bulgaria is currently hosting a large number of refugees from Ukraine, adding to around 11 000 asylum seekers mostly from Afghanistan, Syria, and Iraq due to Bulgaria's geographic position between Europe and the Middle East (Figure 2.14). Up to February 2023, around 1.1 million Ukrainian refugees had crossed the border into Bulgaria according to the UNHCR, where they are allowed to enter freely. However, many of them did not stay and only around 148 000 applied for and were granted temporary protection. The number of Ukrainians declined over the second half of 2022 to reach 50 000 in February 2023. Around 87% of these Ukrainians are women and children. Ukrainian refugees are likely to be better educated and could integrate into the labour market, while asylum seekers of different origin often have a limited educational background, with 77% having at most primary education according to the Bulgarian State Agency for Refugees. Laws and regulations in Bulgaria allow refugees to take up work quickly. Ukrainian refugees can directly work, while asylum seekers need to wait for three months before starting employment.

Figure 2.14. Most refugees prior to 2022 were of working age and from a few countries

Number and age structure of asylum seekers, 2021



Source: Eurostat.

StatLink  <https://stat.link/z18nqx>

Bulgaria could do more to attract foreign workers to bring in additional skills and improve its demographic diversity. The current migration channels are set out in (Box 2.1). However, Bulgaria ranks relatively poorly in the Migration Integration Policy Index (Solano and Huddelston, 2020^[21]) that measures the quality of policies to support integration, according to several sub-categories such as labour market access, family reunion, access to citizenship or discrimination. While Bulgaria's overall score is weak, labour markets are somewhat more accessible with quick access to the social security system, although targeted training opportunities and support for labour market integration were assessed to lag behind (Figure 2.17).

Box 2.1. How can foreigners legally stay and work in Bulgaria?

EU nationals can live and work in Bulgaria. Non-EU foreigners (third country citizens, or with no citizenship) are allowed to reside in the country on several grounds: protection and asylum reasons, family, work, studying, business and investment activity. They can work in the country in the following cases:

- If they are a citizen of a country with which Bulgaria has a bilateral labour market access agreement.
- Foreigners with temporary protection have rights to work and access to professional training without a work permit.
- If they have a unified residence and work permit (URWP) issued by an EU country, this allows a third-country national to reside legally in EU territory for the purpose of work.
- If they have an EU Blue Card, which entitles the holder to reside and work in an EU country on the basis of documented high professional competence. It is issued for a period of up to four years.

According to the Law on Foreigners, the status of residence can be:

- Short-term stay - up to 90 days from the date of entry.
- Prolonged (long-stay) residence - with a permitted term of up to one year.
- Long-term residence - with a permitted initial period of five years and the possibility of renewal.
- Permanent residence - with an indefinite period.

- According to the Asylum and Refugees Law, temporary or international protection can be given, as well as refugee or humanitarian status, depending on the grounds of the request.

People with the above categories of residence status can also work in Bulgaria.

The prolonged residence permit can be obtained by foreigners who carry out commercial activity in the country and maintain for the duration of the stay at least 10 full-time jobs for Bulgarian citizens, or by experts when agreed in an international agreement. This type of permit can also be granted to representatives of a registered foreign commercial company, or people setting up businesses, especially in poor regions of the country, on family and other grounds. To obtain a prolonged residence permit, foreigners should have secured housing, health insurance, sufficient means of subsistence without resorting to the social assistance system, in an amount not less than the minimum monthly wage, the minimum stipend or the minimum pension according to the legislation for the period of residence.

Long-term residence status is granted to a foreigner who has resided legally and without interruption in Bulgaria for a period of five years. Citizenship now can be granted to foreigners if born in Bulgaria, with at least one Bulgarian parent, when married to a Bulgarian, on the basis of a permanent or long-term residence permit of at least five years, etc.

A permanent residence permit can be obtained for foreigners with a Bulgarian origin, or for family reasons/relationship, or for foreigners investing in shares or bonds of Bulgarian commercial companies (no less than BGN 2 million), or in collective investment schemes in Bulgaria and rights under concession contracts (no less than BGN 1 million).

Bulgaria used to issue so-called “golden passports” to investors in government securities, and over a hundred such passports had been issued when this practice was terminated in 2022. Citizenship now can be granted to foreigners if born in Bulgaria, with at least one Bulgarian parent, when married to a Bulgarian, on the basis of a permanent or long-term residence permit of at least five years, etc.

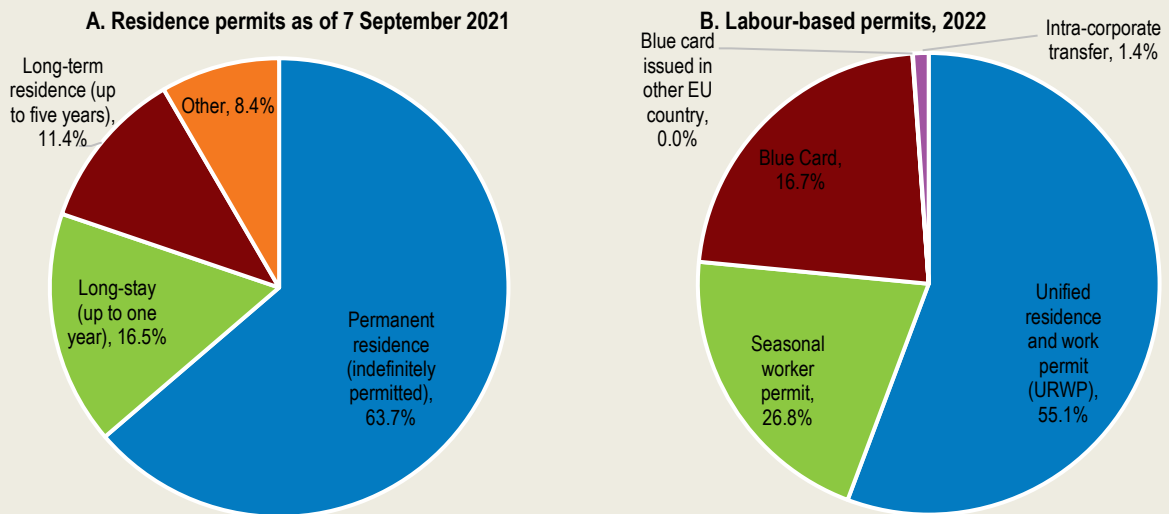
Non-residents can also stay and work in the country in the following cases:

- If they have a unified residence and work permit (URWP) issued by an EU country. It allows a third-country national to reside legally in EU territory for the purpose of work.
- If they have an EU Blue Card, which entitles the holder to reside and work in an EU country on the basis of documented high professional competence. It is issued for a period of up to four years.
- If they are a citizen of a country with which Bulgaria has a bilateral labour market access agreement.
- Foreigners with temporary protection have rights to work and access to professional training without a work permit.

There are around 50 000 foreigners in the country with residence permits, the biggest share (around 64%) has permanent residence, those permitted to stay up to one year make up 16.5%, and refugees and persons in an international protection procedure only 4.3% (Figure 2.15). 38% of the foreigners live in the Southwest (Yugozapaden), 18% in the Southeast (Yugoiztochen) and 17% in the Northeast (Severoiztochen). They mainly reside in the districts of Sofia, Burgas, Varna, Plovdiv, Blagoevgrad and Haskovo.

Around 35.4% of people who received some type of residence permit in 2021 stay for family reasons, while the share of those working is 21.3%. The number of renewed and newly issued EU-Blue cards has also been trending upwards in recent years (Figure 2.16) (Residence Permit Statistics).

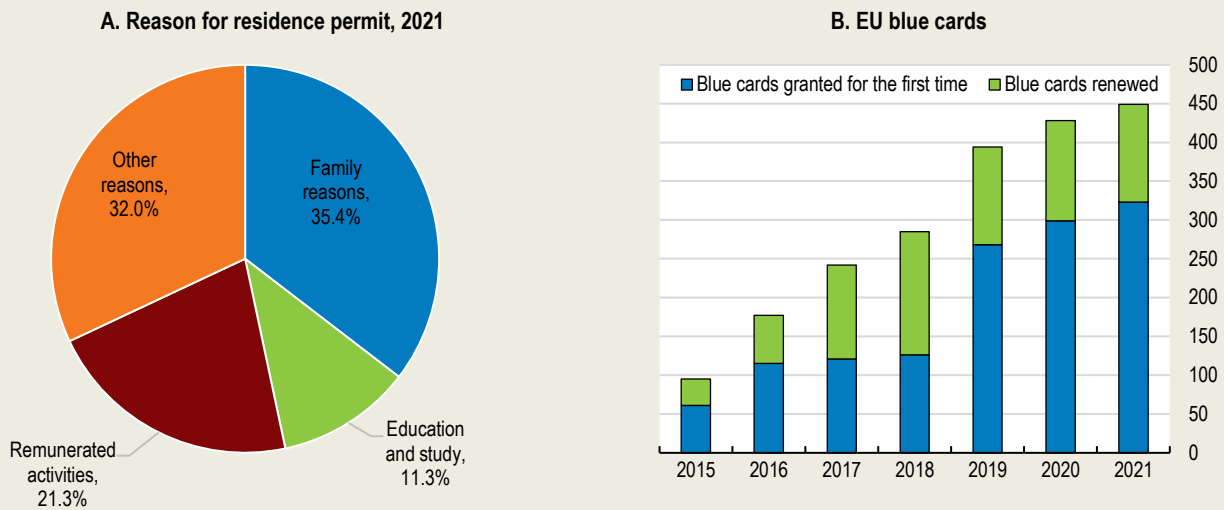
Figure 2.15. Most foreigners are permanent residents and have EU work permits



Note: Panel A: The Other category includes humanitarian, international protection procedure, refugee and other reasons.
 Source: OECD calculations based on the National Statistical Institute 2021 Population Census and Ministry of the Interior.

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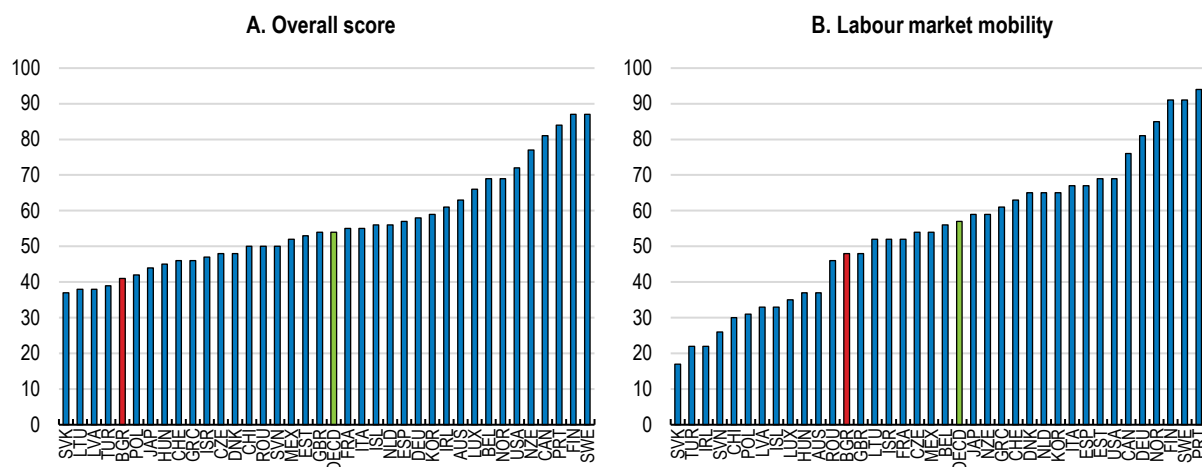
Figure 2.16. Most foreigners stay for family reasons, but EU blue card issuance has risen



Source: OECD calculations based on the National Statistical Institute 2021 Residence Permit Statistics and Ministry of the Interior.

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Figure 2.17. Integration of migrants is insufficient in international comparison



Note: Migrant integration policy index score 0-100, with the maximum of 100 is awarded when policies meet the highest standards for equal treatment. All available OECD countries.

Source: Migrant Integration Policy Index 2020 (Solano and Huddelston, 2020[21]).

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Recent amendments to the Foreigners Act, targeted at both high-skilled and low-skilled workers, are meant to facilitate market entry and working conditions of prospective foreign workers. Measures include a “Start-up visa” that accelerates the residence permit procedure for foreign investors and a long-term residence permit for entrepreneurs in the ICT sector that would mean that workers no longer lose their rights in case of a change of employer (OECD, 2022_[20]). Bulgaria is actively collaborating with countries in the region through bilateral agreements to further facilitate access of foreign workers, such as those currently in place with Moldova (2018), Armenia and Georgia (2019). There are further draft agreements and ongoing discussions with Albania, Azerbaijan, Kyrgyzstan, Turkmenistan and Uzbekistan. Prior to the war, Bulgaria had also started procedures with Belarus and Ukraine.

The Migration Strategy 2021-25 sets out objectives to attract an increasing number of immigrants, both of Bulgarian and foreign origin, by easing administrative requirements, promoting Bulgaria as a choice of place to work and by providing assistance to facilitate integration into the labour market. It envisages to ease residency requirements by accelerated visa procedures and a reduced number of required documents; to strengthen cooperation between national authorities to increase the quality of offered services for potential and actual immigrants, and to roll out and update targeted programmes to support labour market integration according to the individual background and need of immigrants. However, the formulation and implementation of specific policies to address the objectives laid out in the Migration Strategy is lagging behind, in particular regarding initiatives to foster integration into the labour market (Staykova, 2022_[22]).

Going forward, it will be important to implement additional concrete steps that facilitate labour market integration of economic immigrants and refugees (OECD, 2023_[19]). This includes help to find a job and accommodation upon arrival, facilitating recognition of education and skills from abroad, providing support for family-related issues, such as schooling and nurseries, and stepping up targeted active labour market policies. The possibility and associated advantages of registration with the Employment Agency need to be communicated more clearly. Language barriers need to be addressed from the very beginning by offering and promoting the availability of a sufficient number of courses that are easily accessible at a low cost, given that language barriers are reported to be the main single factor that impedes recruitment of refugees in Bulgaria (UNHCR, 2017_[23]). A smooth recognition of foreign degrees accompanied by

adequate professional training is even more pressing. Where foreign qualifications cannot be recognised, training and re-qualification needs to be offered to equip workers with the necessary knowledge and skills.

At the same time, employers are reported to lack information on the availability and qualification of refugees who are looking for work (CATRO-UNHCR, 2018^[24]). The educational background and qualifications acquired abroad are not automatically recorded upon registration with the State Agency for Refugees (SAR), so neither potential employers nor the Employment Agency have access to this information right away, unless the refugees register with the Employment Agency at a later stage. Such information gaps could be avoided by recording all information on education and work history directly at the SAR, such that it could be made available directly to the Employment Agency. A designated contact within the Employment Agency could then disseminate information on job searchers including their qualifications directly with employers who are looking for workers. Specific job fairs targeted at refugees and employers who would like to hire them have already been organised, but often on behalf of NGOs (UNHCR, 2017^[23]). There is a case for the Employment Agency to step in and help coordinating between refugees, employers and other involved parties such as the SAR and NGOs.

Table 2.1. Previous recommendations on immigration policies and actions taken

Recommendation	Action taken
Reduce further employment restrictions and the administrative burden for immigrants and their employers. Smooth the accreditation process for non-EU vocational and educational qualifications.	Several legislative changes in recent years facilitated access to the labour market for third-country nationals. The procedure for applying for and obtaining a Single Residence and Work Permit was simplified in 2021, which contributed to shortening the procedures. In addition, the fee for the Employment Agency's decision for access to the labour market paid by the employer was abolished.

Migration to the cities improves the situation of some, but can have negative consequences for regional development

Urban areas such as Sofia and Plovdiv are growing due to internal migrants from more rural areas and smaller urban areas, whereas deprived regions such as Montana or Vidin are losing considerable parts of their population (Figure 2.18). These poorer areas are also major sources of emigration to other countries. Internal migration can improve living and working conditions for those who are willing to move to places that offer better jobs, salaries or amenities. Higher regional GDP and lower regional unemployment are “pull” factors for internal migration (Causa, Abendschein and Cavalleri, 2021^[25]), (Cavalleri, Luu and Causa, 2021^[26]). Typically, attractive regions and cities, such as the capital Sofia, benefit from a constant inflow of workers that support growth and compensate for a generally declining population at the expense of regions where internal migrants add to considerable international emigration, resulting in depopulated regions of mostly elderly and immobile population groups.

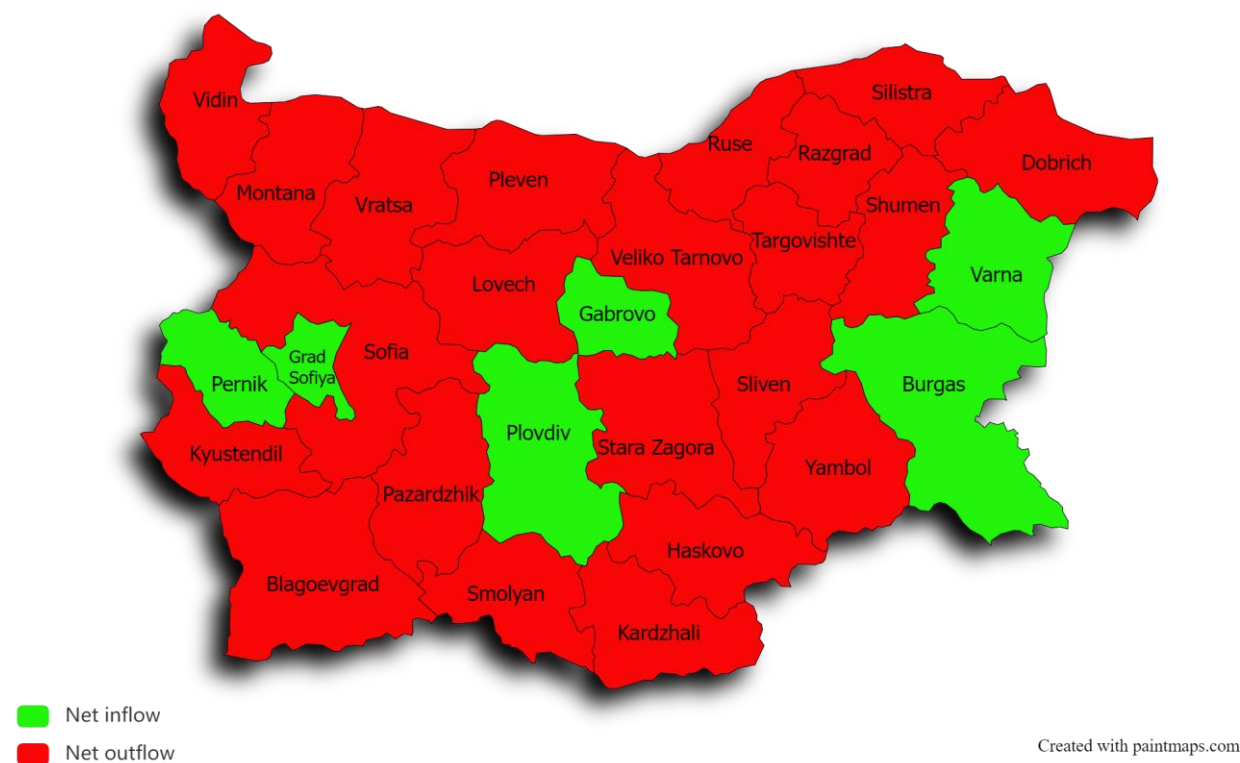
Managing this process requires a balanced approach that does not prevent people from moving to more prosperous regions, while continuing to invest in the development of all regions by means of place-based policies throughout the country. Remote and deprived regions need to be connected to the rest of the country, in particular by providing adequate infrastructure in terms of roads and public transportation, subject to a cost-benefit analysis. Some remote areas could also benefit from better connections to neighbouring countries, such as Romania and Greece, to encourage cross-border activities.

At the same time, improving living conditions in more depopulated regions will help encourage people to stay or return. This includes ensuring that good schools, kindergartens and hospitals are available. Targeted regional support can help business creation and encourage cooperation between firms, educational institutions and the employment agency to increase the number of good quality jobs and qualified workers in poorer regions. Necessary investments in the digital infrastructure will also allow more rural regions to benefit from the trend towards more remote working arrangements. Region-specific


initiatives have recently been introduced in several OECD countries to counter the effects of the pandemic on labour markets. In Australia, local job market programmes launched in 2020 fostered the local cooperation between employers and employment agency to provide training opportunities for workers in places where a special taskforce identified particular needs. Canada set up a similar spatially-targeted programme in 2020 to support regions that were particularly hard hit by the pandemic (Causa, Abendschein and Cavalleri, 2021^[25]).

Figure 2.18. People are moving to the bigger cities

Net internal migration flows across regions, 2021



Source: National Statistical Institute.

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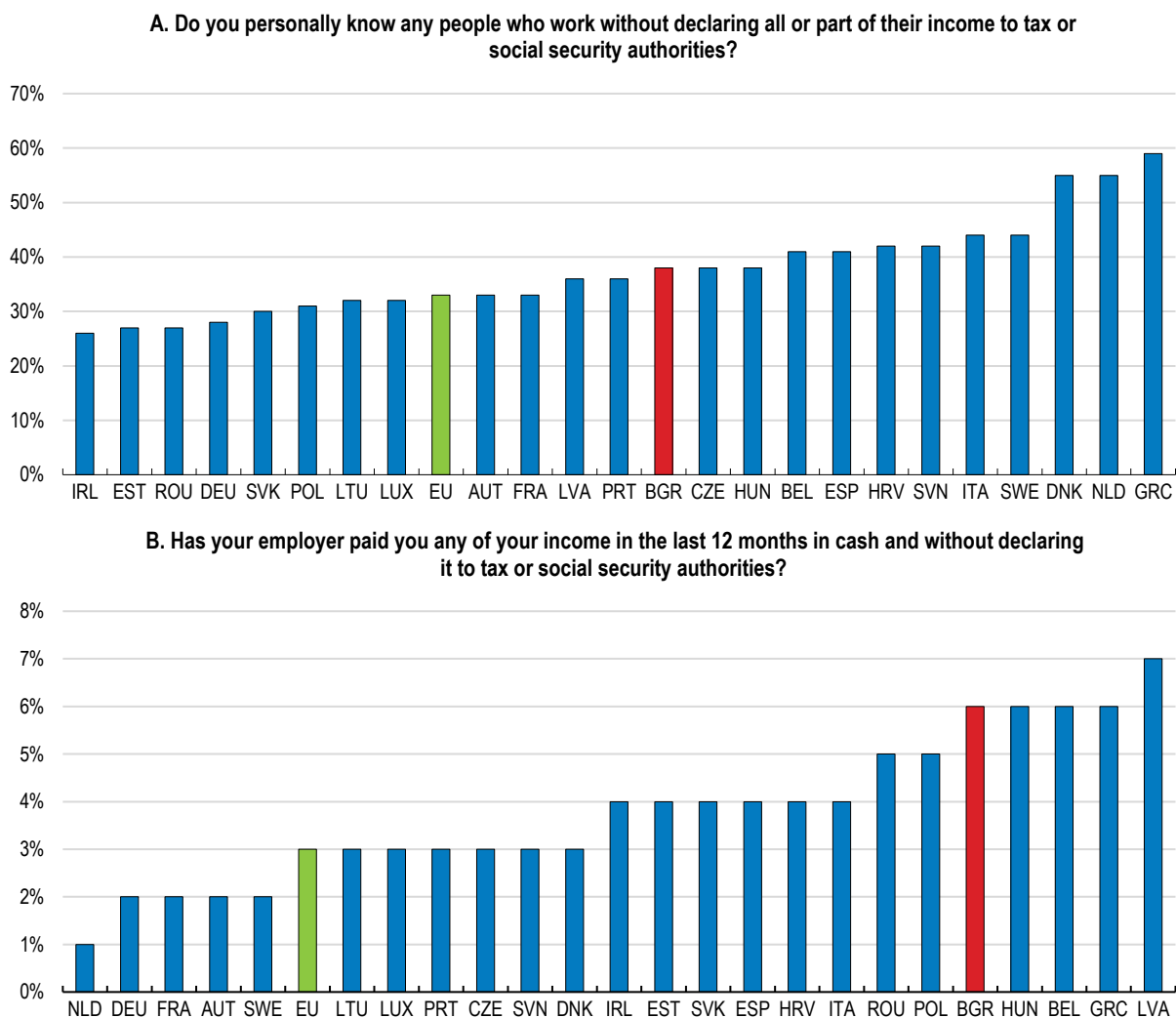
Reducing informal work would improve job quality and raise productivity

Addressing informality and raising job quality would improve workers' situations, raise productivity and make it more attractive for young people to stay in Bulgaria. Informality is a common characteristic of the Bulgarian economy, leading to poor quality jobs, inadequate pension coverage, lost tax revenues and lost opportunities to enhance productivity and retain workers. Informality is estimated to account for up to 19% of total economic activity, more than in most OECD countries (Medina and Schneider, 2018^[27]). Undeclared work is a prevalent type, mostly in form of so-called "envelope wages", where workers are registered at a lower wage than they actually receive (Stefanov, Williams and Rodgers, 2017^[28]). Typically, earnings are declared at the minimum wage or the relevant minimal social insurance threshold, but workers receive additional payments that are not declared to labour and tax authorities. Taxes and social security

contributions are then only paid with respect to the lower official salary, while the remaining part of the salary is paid “in an envelope”.

Figure 2.19. Undeclared work is common

Share of respondents answering ‘yes’ to the following question, 2019



Source: Eurobarometer 2019.

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The informal nature of undeclared work makes it difficult to get precise data, so that estimates based on surveys or administrative data can differ considerably. Data from the Eurobarometer survey suggest that Bulgarians are more familiar and more exposed to informal work than EU-OECD countries. Figure 2.19 shows that some 6% of the Bulgarian workforce received extra payments, twice as many as the European average, in 2019. A recent study from the Bulgarian Industrial Capital Association, an employer association, estimates the share of workers with envelope wages at up to 10% of the workforce. The wholesale and retail trade sectors, accommodation and food, construction and agriculture are particularly prone to informal work. Envelope wages can be paid for overtime only, as part of the salary for regular work, or for a combination of both. By contrast, fully undeclared work appears to be unusual and

makes up only around 6% of total informal work arrangements, according to estimates from the National Revenue Agency (NRA) in Bulgaria.

Undeclared work, even if only partial, poses considerable problems for workers, employers and the state. Workers face a multitude of risks when parts of their salary are not declared. They suffer from lower entitlements to social benefits that are based on reported income, such as pensions and unemployment insurance, leading to insufficient future incomes and risks of poverty. Similarly, access to credit is impeded given the lack of official proof for the entire income (Horodnic and Williams, 2021^[29]). Informal workers find themselves in a weaker position with respect to their employer (Martinelli, 2021^[30]), for example given that undeclared extra-payments cannot be enforced in court. Employers are also concerned by the prevalence of informal labour, not only on account of administrative burdens from investigations and sanctions, but also through unfair competition if their competitors are able to reduce costs because of cheaper informal labour contracts. Overall, this may encourage a labour market focussed on keeping labour costs low rather than investing in raising human capital and productivity and creating good-quality and well-paid jobs. The income loss for the state budget and social security system, such as the health and pension system, is estimated to amount to up to BGN 320 million (EUR 164 million) in 2021 according to the NRA, around 0.25% of GDP. The estimates suggest a downward trend in forgone revenue, with losses estimated at around BGN 420 million in 2014, but the potential loss in income is still significant, not least against the background of generally low tax revenues and a health and pension system struggling to provide adequate services.

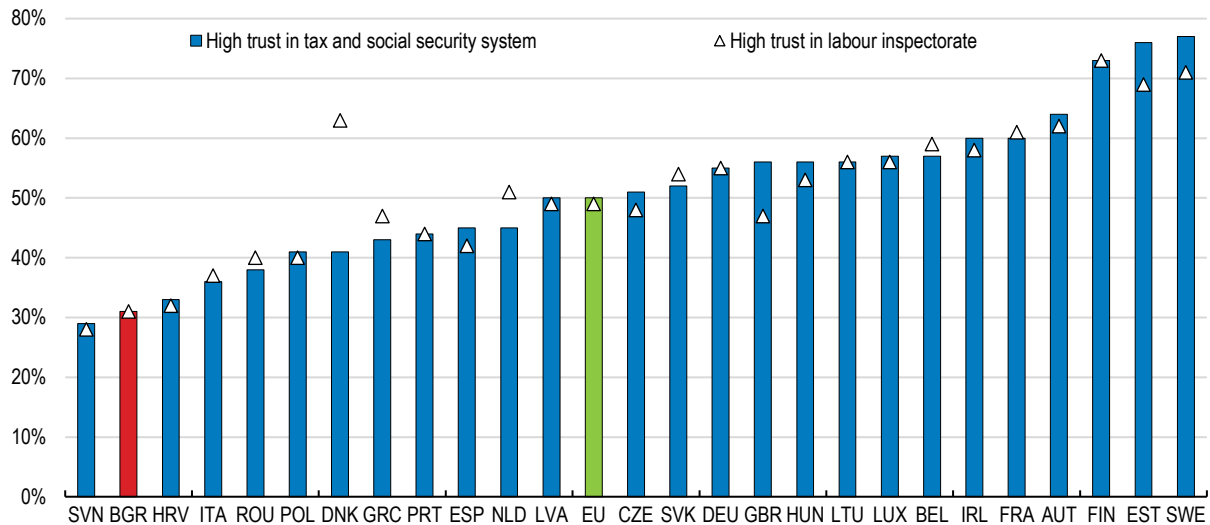
Reinforce trust in institutions to boost compliance with laws and regulations

The reasons to engage in informal labour contracts are multifaceted. The benefits for employers are straightforward as they profit from lower labour costs and more flexibility, as long as the probability and severity of potential sanctions are weak. Although employees in general do not benefit from undeclared work in the long run, they can benefit in the short run as their net salaries will be higher. With limited trust in the state and social insurance, tax morale is low and the willingness to receive the full amount of wages paid out directly is higher than financing a system whose benefits are perceived to be uncertain (OECD, 2019^[31]). Such an environment also nurtures incentives for corruption, for example to avoid potential controls or fines, leading to a vicious circle of reinforced distrust towards the system. Tackling undeclared work therefore requires a comprehensive approach that takes a multitude of reasons and motivations into account. Two main approaches stand out: first, the trust of the population in the political and social system, along with its institutions needs to be strengthened and, second, the cost-benefit relation for engaging in informal contracts needs to change so that the perceived costs outweigh benefits (Horodnic and Williams, 2021^[29]).

Bulgarians exhibit a low degree of trust in their institutions compared to other EU-OECD countries, as revealed in Figure 2.20 based on the latest Eurobarometer survey from 2019. Only 31% of respondents indicate that they tend to trust the tax and social security system. Similarly, people do not tend to trust the labour inspectorate, which is the central labour authority responsible for detecting undeclared labour. Building mutual trust within a society is a complex and long-lasting process (OECD, 2022^[32]). In order to increase tax morale and overall trust in the system, one important aspect for a successful strategy in Bulgaria is to better highlight the importance of correct tax payments and full declarations of labour contracts. This could be done by giving information on the uses of taxes, such as highlighting that hospitals, road construction projects and child or elderly care facilities are paid for by using taxes and contributions from workers. In Estonia, for example, an online tool allows to decipher the detailed breakdown of uses from taxes paid by an individual taxpayer. In the United Kingdom, such a breakdown is provided automatically in the *Annual Tax Summary* upon reception of tax fillings, ensuring that everyone is immediately informed about how taxes are used (Williams, 2021^[33]).

Figure 2.20. Trust in authorities is low in Bulgaria

Respondents with high trust in respective authorities, 2019



Source: Eurobarometer 2019.

StatLink  <https://stat.link/xjvm18>

In addition, information for workers on the negative consequences for their own financial situation from wage under-reporting can increase awareness of the downside associated with this behaviour. The NRA provides an online tool, “salary in an envelope”, where the cumulated losses from under-reporting with respect to pensions, health and other benefits from the social security system can be easily computed and displayed. While this is a useful tool to highlight accumulated losses throughout the lifetime of workers, it could be improved by providing information on forgone revenues on a monthly or annual basis, a number that will be more familiar to most users. In addition, the availability of this tool needs to be promoted more actively to increase public awareness, including through media campaigns and referencing in official correspondence from tax and labour authorities.

A more cooperative approach by enforcement authorities supported by transparent administrative procedures could also help to raise tax morale (OECD, 2018^[34]), (OECD, 2021^[35]). A stronger focus on cooperation and advice, instead of top-down inspections, could eventually lead to a different perception of enforcement bodies, such as the labour inspectorate, as being a partner that can be trusted and that can also be contacted if need be. The Bulgarian labour inspectorate is going in the right direction as it does not only conduct inspections and investigations, but it simultaneously provides information for employers and workers related to correct labour regulations and registration. This is in line with experience from the Czech Republic and Ireland, where labour enforcement bodies are explicitly commissioned to support companies to avoid incorrect registration of workers (Williams, 2021^[33]). A similar approach to strengthening mutual trust is to decrease the burden on companies from various and repeated checks and investigations by conducting joint inspections from several supervisory bodies. The Bulgarian labour inspectorate has already made steps in this direction by conducting joint inspections with the NRA. It provides a self-assessment tool that helps workers and employers assess to what extent the labour legislation applicable in Bulgaria is observed and whether labour rights are violated. Through the tool, employers can also assess whether they are applying labour legislation in a way that guarantees their employees full declaration of their employment status.

The level of taxes and social security contributions can also be intertwined with the decision to accept or avoid payments. A perceived excessive burden of charges against potentially weak benefits might incentivise the use of informal working arrangements. However, the overall tax wedge in Bulgaria is not particularly high and clearly below the OECD average (see Figure 1.19 in the KPI). A flat tax of 10% implies relatively low marginal income tax rates, although relatively high social security contributions might be a concern. Efforts to reduce this burden need to be linked with a broadening of the base to ensure the sustainability of the social security system. Enforcement needs to be improved.

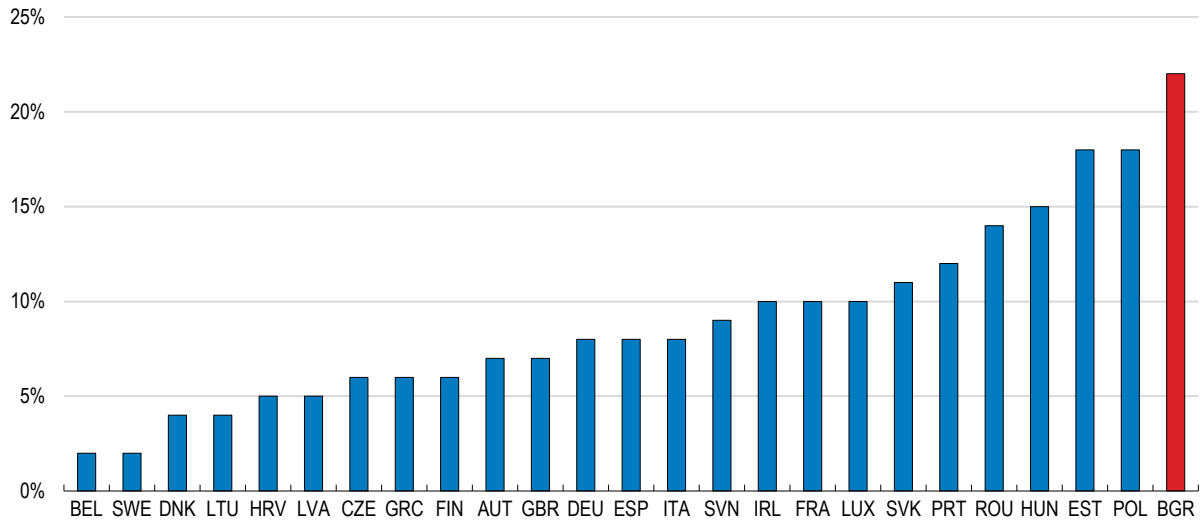
The Bulgarian authorities need to ensure that enforcement of labour contracts is credible. Information campaigns can serve as a useful tool to disseminate information on consequences and sanctions from incorrect or fraudulent labour declarations. The labour inspectorate participates in such national and international information campaigns. Such information is particularly needed in Bulgaria, as a relatively large fraction of respondents in the Eurobarometer survey did not know what consequences undeclared work could entail. Figure 2.21 shows that nearly a quarter of all respondents could not state the consequences compared to only 9% on average across EU-OECD countries. In addition, this should include advice on how to easily report illegal behaviour by ensuring strong protection for those who report it.

The probability of being caught is estimated to be low, in particular for those who are engaged in informal labour arrangements. Figure 2.22 shows that only 15% of respondents who work informally expect to be caught with a high probability, compared to twice this number for the average of EU-OECD countries. The authorities should ensure that effective checks and controls are in place and conducted in a risk-based manner in line with international best practices formulated in the OECD Regulatory Enforcement and Inspection Toolkit (OECD, 2018^[34]), (OECD, 2014^[36]). While on-site investigations are costly, time-consuming and more difficult to expand significantly, digital tools and a data driven approach need to be implemented to increase the quality of investigations (OECD, 2021^[37]). The labour inspectorate uses data from past inspections to estimate the risk of further violations. In addition, data mining instruments can be used to detect firms that are more likely to under-report their labour contracts (Williams, 2021^[33]), for example by comparing salaries paid by a firm with those from other firms in the same sector or region. More sophisticated approaches are available and have proven to be an effective instrument to increase the precision of investigations. In Belgium, the number of detections of wage under-reporting doubled following the implementation of data mining tools (De Wispelaere and Pacolet, 2017^[38]). Bulgaria already follows the international good practice to reach out to companies before an inspection to allow for pre-emptive corrections of labour registrations. The outreach to companies could be better pinpointed by specifically addressing those firms that are more prone to incorrect wage declarations. Experience from Estonia suggests that the effectiveness of pre-emptive notifications can be further increased by reaching out to employees of a suspicious firm as well (Williams, 2021^[33]).

The effectiveness of data-driven investigations largely relies on the quality and availability of data and the capacity of the authorities to analyse them. Bulgaria should ensure that all relevant data from tax records and the social security system are available to the labour inspectorate and that its staff is equipped with the necessary tools and means to make use of them. The full digitalisation of wage payments would improve data availability for enforcement bodies and make it more difficult to hide the build-up of substantial cash holdings used for informal wage payments.

Figure 2.21. The awareness of specific consequences of undeclared labour is particularly low

Share of respondents with answer “don’t know” related to question about the consequences of informal work, 2019

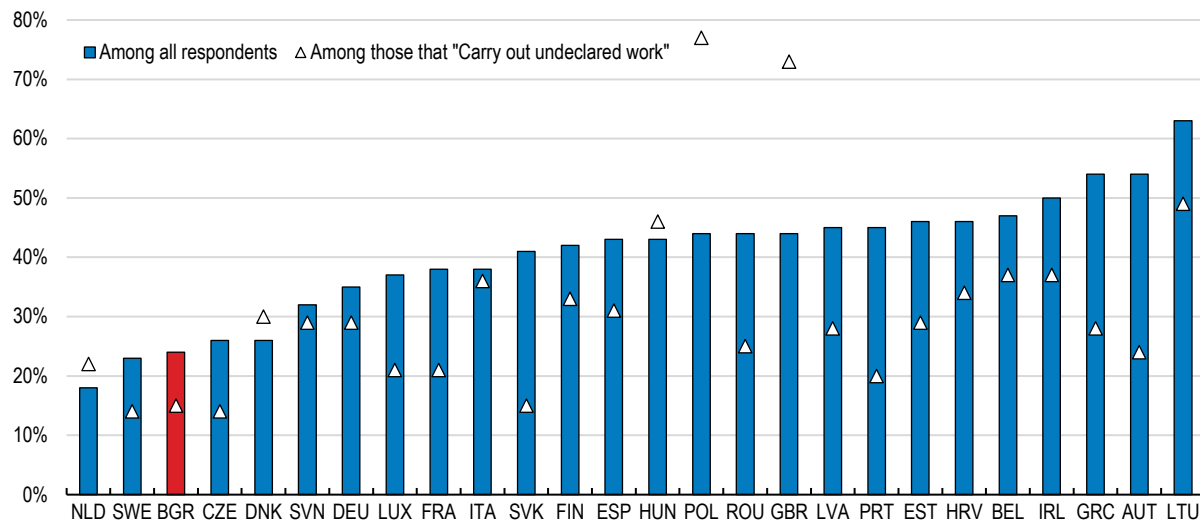


Note: Share of respondents declaring that they don't know what sanction, if any, they would imagine someone would receive if authorities find out that they receive income from work which was not declared to tax or social security authorities.
Source: Eurobarometer 2019.

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Figure 2.22. The risk of controls is seen as low

Share of respondents who estimate that the probability of controls is high, 2019



Source: Eurobarometer 2019.

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Undeclared work in the construction sector strongly declined when firms were excluded from any public contracts for a period of three years after the detection of workers without a formal contract. The effectiveness of this approach suggests extending the scheme in two directions. First, an exclusion from public contracts should follow the uncovering of any type of informal work, including envelope wages.

Second, similar regulations should be implemented in other sectors with a high share of public contracts such as in the transportation or health sector. More generally, a responsive regulation approach requires a nuanced set of sanctions of differentiated gradation to allow for an adequate response towards different forms and severity of misconduct (OECD, 2018^[34]).

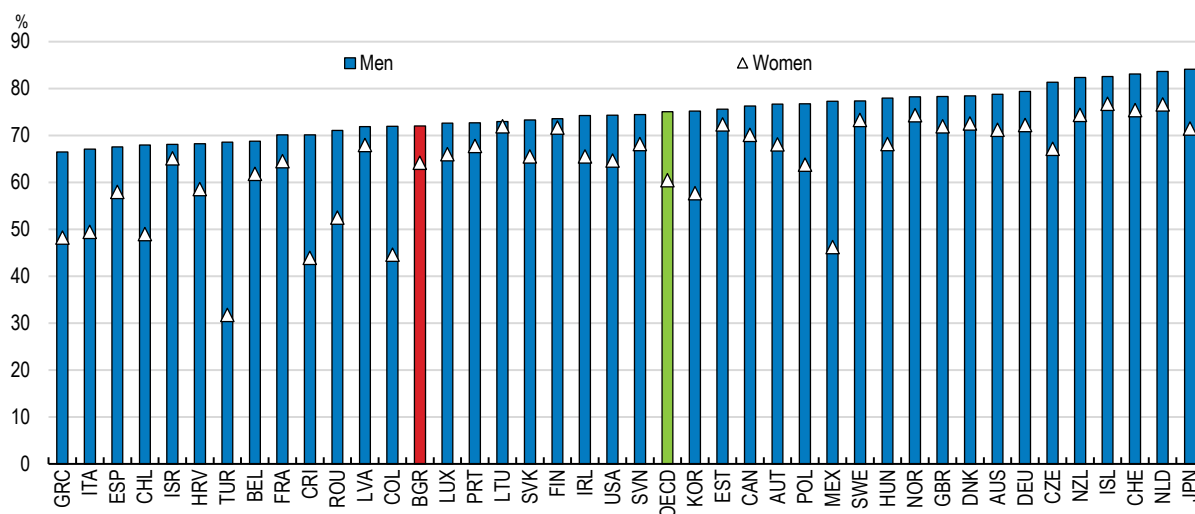
The introduction of new forms of sanctions has contributed to a strong decline in the misuse of part-time employment and self-entrepreneurship, which were a more prevalent form of informality until recently. Similar to envelop wages, declaring part-time work while working full-time instead can be used to pay lower taxes and social security contributions. Today, the labour inspectorate has the power to declare part-time contracts as regular contracts whenever they suspect that part-time work is only used as a means to avoid taxes and contributions. Self-entrepreneurship of this type means that workers set themselves up as self-employed, although they only work for one company who is effectively but not legally their employer, with the aim to circumvent taxes and contributions. Bulgaria succeeded to diminish self-entrepreneurship by prohibiting to convert to self-entrepreneurship within a company where a worker is already employed. Moreover, only a limited number of occupations are allowed to be performed as a self-entrepreneur. With the rise of the platform economy, concerns about self-entrepreneurship might return, and it will be imperative for the authorities to closely monitor ongoing developments and act swiftly to adapt current regulations to a changing environment, see also (OECD, 2022^[39]).

Making better use of people in the labour market

With a working age population that is likely to continue to decline, the Bulgarian economy needs to make the most of the potential workforce it has to achieve a strong growth rate and continued convergence, alongside measures to improve demographics. Continued productivity catch-up, digitalisation and the green transition will reshape the economic landscape and will require major changes in the labour market and the upskilling and reskilling of workers. As in other economies, labour shortages may become a growing problem. Overall employment rates are somewhat below the OECD average for men and higher for women (Figure 2.23) and a number of groups have low employment and are relatively exposed to informal work.

Figure 2.23. Overall employment rates for men are lower and women higher than the OECD average

Employment rates for men and women among 15-64 year olds, 2021



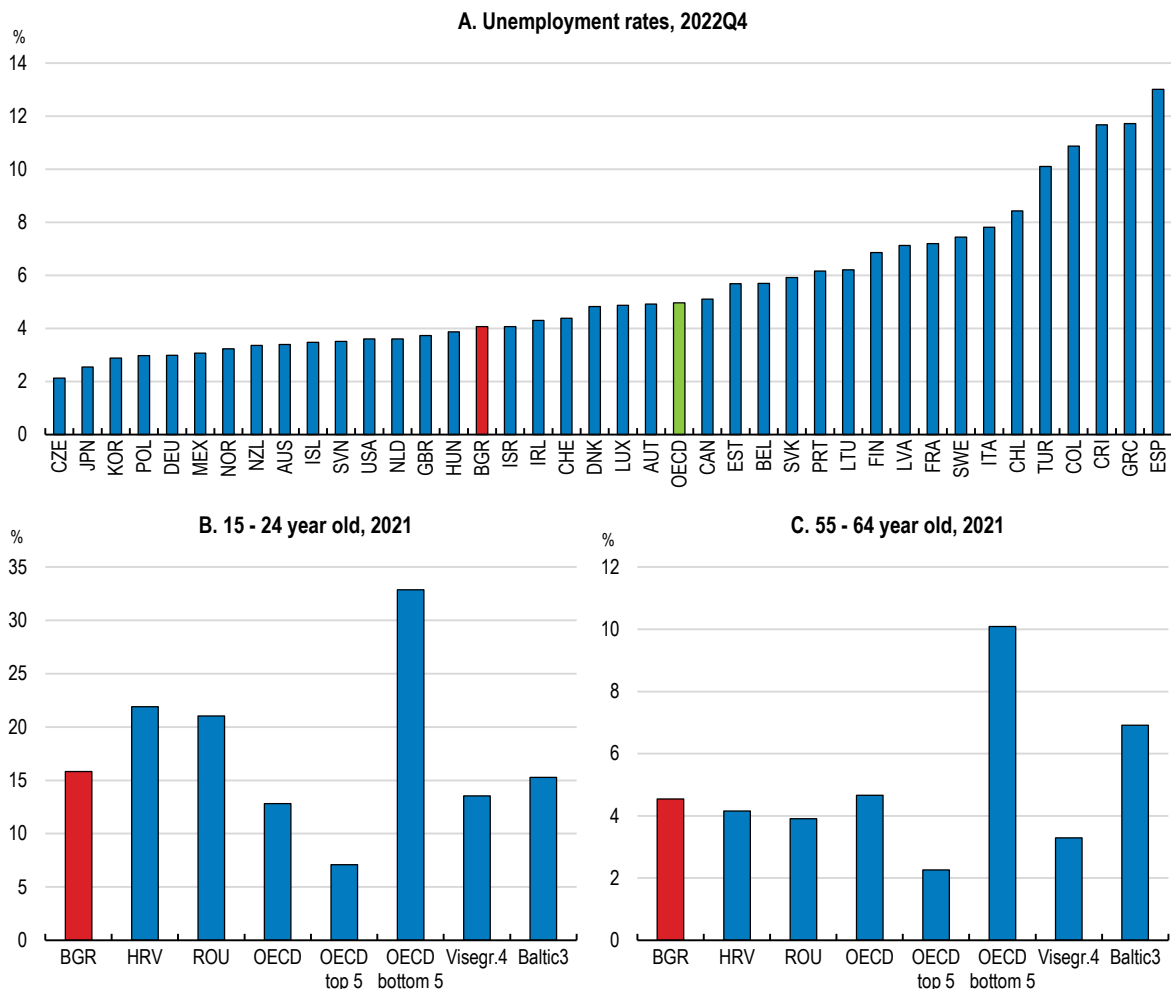
Source: OECD Labour Force Statistics database.

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Bulgaria's overall unemployment rate at 5.3% in 2021 was somewhat lower than the OECD average but is substantially above the very low rates in most Visegrad4 countries with high growth potential and ageing populations although it is more similar to Romania and Croatia. Further, the overall rate masks significantly higher rates of unemployment among the young (Figure 2.24).

Figure 2.24. Overall low unemployment masks high unemployment among younger people

Unemployment rates



Note: Panel A: data are as of 2022 Q4 for all countries except Ireland, Poland and Slovakia for which are 2022Q3.

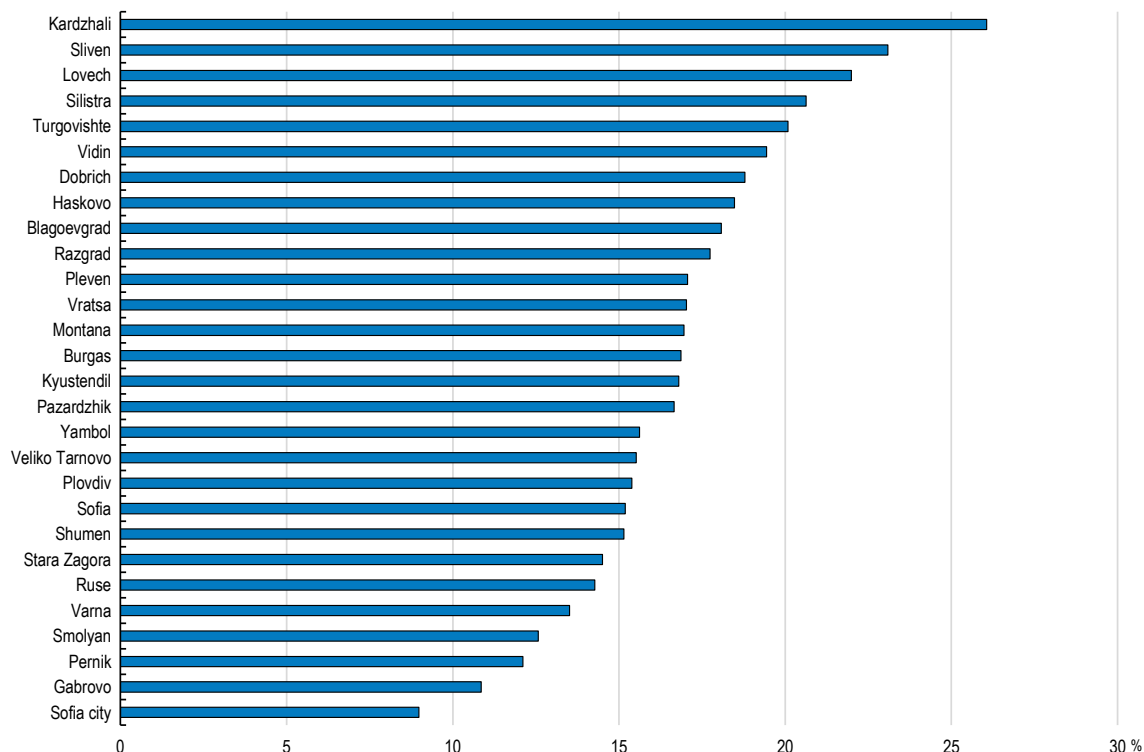
Source: OECD Labour Force Statistics database.

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Relatively low employment rates are primarily related to inactivity, the share of people who do not have a job and are not actively looking for a job, as unemployment is low. Labour force data suggests that more than one-quarter of the working-age population aged 15-64 is inactive, although the 2021 Population Census indicates a higher rate of activity. Regional disparities in the inactivity rate are large (Figure 2.25). In Kardzhali and Sliven, far away from major urban centres and with high concentrations of ethnic minority groups, inactivity is high, while it is relatively low in other areas such as Sofia.

Figure 2.25. There are large disparities in the inactivity rate across districts

The ratio of inactive people to the working-age population by district, 2021



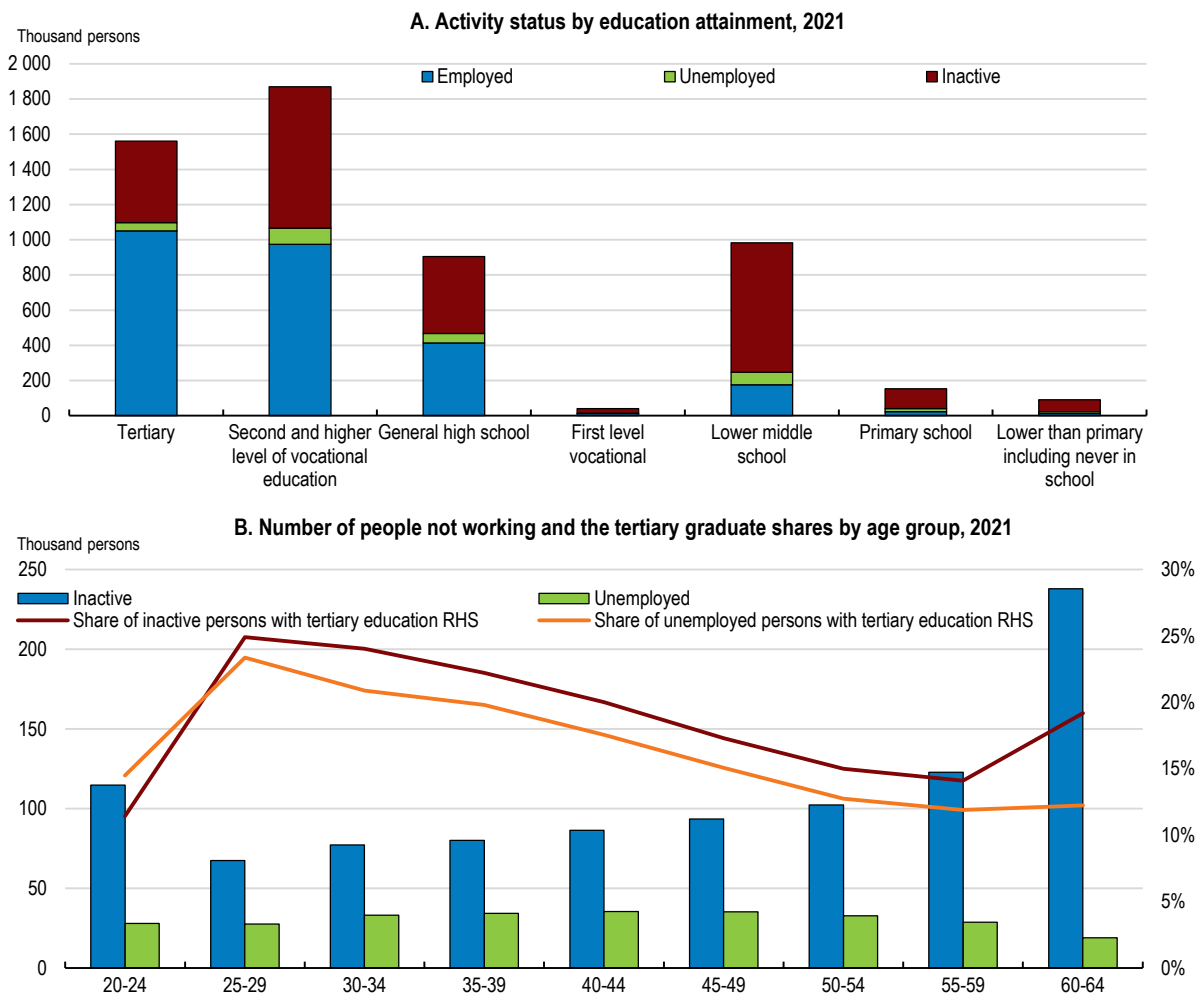
Note: The inactivity rate is calculated as a ratio of people who are not employed, are not actively seeking employment, are neither students nor pensioners and are not living from property-related income, to the working age population (15-64 year olds).

Source: OECD calculations based on the National Statistical Institute 2021 Population Census.

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Inactivity is more common among those with lower education attainment. Three-quarters of people with at most lower secondary education are out of the workforce and many of those with only high school education are inactive. While inactivity is lower among people with tertiary education attainment, still more than one-quarter of this group is inactive (Figure 2.26). Overall, those with secondary or below-secondary education account for most of the inactive. Recent legislation changes in the Employment Promotion Act (amendments came into force on 3 June 2022) aim at tackling high inactivity. The creation of an electronic register of economically inactive people and a data exchange mechanism between institutions will provide an opportunity to identify economically inactive people at the individual level. In this way, better targeted measures are expected to be developed.

Figure 2.26. Many young and educated people could be activated



Note: The inactive are people who are not employed, are not actively seeking employment, are neither students nor pensioners and are not living from property-related income as defined in the questionnaire of the Population Census.

Source: OECD calculations based on the National Statistical Institute 2021 Population Census.

StatLink  <https://stat.link/rq2fmv>

The tax and social system needs to be overhauled to bring more people into work and improve social protection

The tax and benefit system should help to ensure strong incentives for people to participate in the workforce in high-quality formal jobs, as well as providing social protection to vulnerable households. While some aspects of the social system are well-designed to support work, others reduce the incentive to work and fail to activate those in groups with weaker labour market attachment.

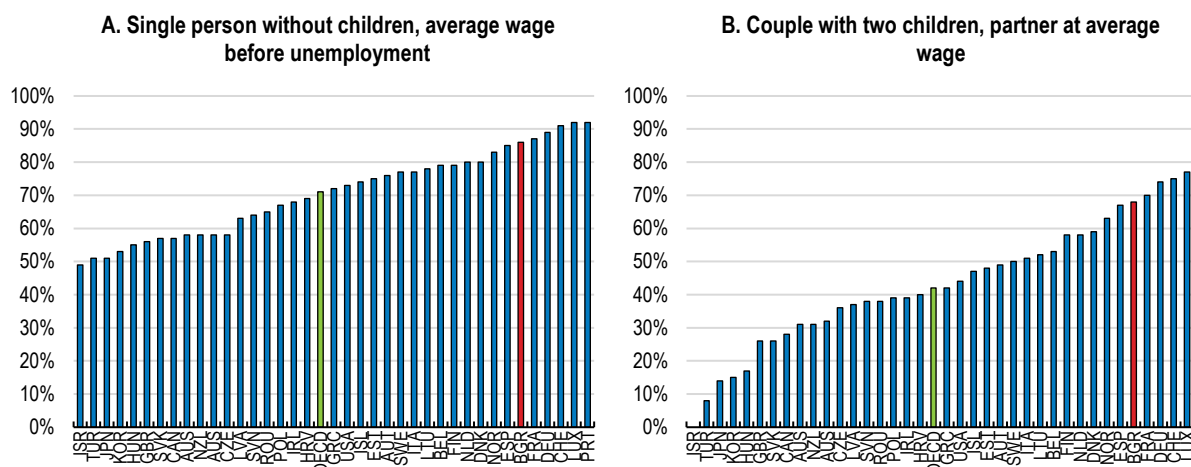
The income tax system creates favourable incentives to work, but high social security contributions may discourage formal work. Personal income tax rates are flat at 10% with a couple of tax allowances, one of which is for families with children, who since 2021 receive a tax-free allowance of BGN 6 000 per year per child (for either of the parents with the unexhausted part transferable to the other parent). This substantially reduces the effective income tax rate for a family at the minimum wage with children, introducing a certain degree of progressivity in the otherwise purely flat income tax system (Brussarski, 2021^[40]). The adoption of minimum income thresholds to ensure that skilled workers are not paying social security contributions on the minimum wage, has broadened the social security contributions base (Bogdanov, 2020^[41]).

However, social security contributions at 33% contribute to fairly high tax wedges and disincentivise people to participate in the formal labour market by using envelope wages. A more effective system that would reduce disincentives to participate in the formal labour market and raise social security coverage could be achieved through better enforcement that would allow for lowering the social security burden without compromising the sustainability of the system. Increasing the monthly tax allowance per child from the current BGN 6 000 per year to initially BGN 9 360 (the minimum wage level) and increasing it further over time would reduce the costs of declaring higher incomes and could encourage more people to report their actual wage. Raising the allowance combined with strengthened inspections could enhance incentives to report formerly unreported parts of the wage. It would also reduce the marginal tax rate for low-income people with children. An additional benefit would be simplification of the system and increased collection efficiency due to the coincidence of the child allowance and the minimum wage: in the current system, the allowance is slightly below the minimum wage, entailing relatively high administrative costs for the little tax collected.

The unemployed are supported by a well-designed unemployment benefit system, but coverage is low. The unemployment insurance net replacement rate is high, but the duration is short, and the conditions are very restrictive, so it does not reduce incentives to return to work. The 85% net replacement rate for a single person without children earning the average wage (Figure 2.27) is higher than in any OECD country except Portugal, Luxemburg, Switzerland, Germany and France. The net replacement rate for couples with two children earning the average wage is even higher in international comparison. Given the prevalence of envelope wages, the true replacement rate may be somewhat lower when measured in terms of the wage people actually receive in employment. However, limited duration and strict eligibility criteria result in low unemployment insurance coverage. The group of eligible people is limited as only those dismissed due to non-disciplinary reasons (e.g., redundancy) have access to full benefits (OECD, 2022^[42]) and people quitting voluntarily are eligible only to the minimum four-month benefits. Duration of coverage varies between four months and 12 months depending on past contributions. The minimum four months should be increased to six so that people have a somewhat longer time to search for a job and that they do not have to wait six months once they are no longer eligible for the unemployment insurance benefits until they can claim social assistance benefits (as six months waiting or six months unemployment benefits are prerequisites for receiving social assistance benefits). When people take up a job, social benefits should be withdrawn in a staggered manner.

Figure 2.27. Unemployment insurance replacement rates are high

Net replacement rates for a single person with no children and couples with two children earning the minimum wage, 2022 or latest available data



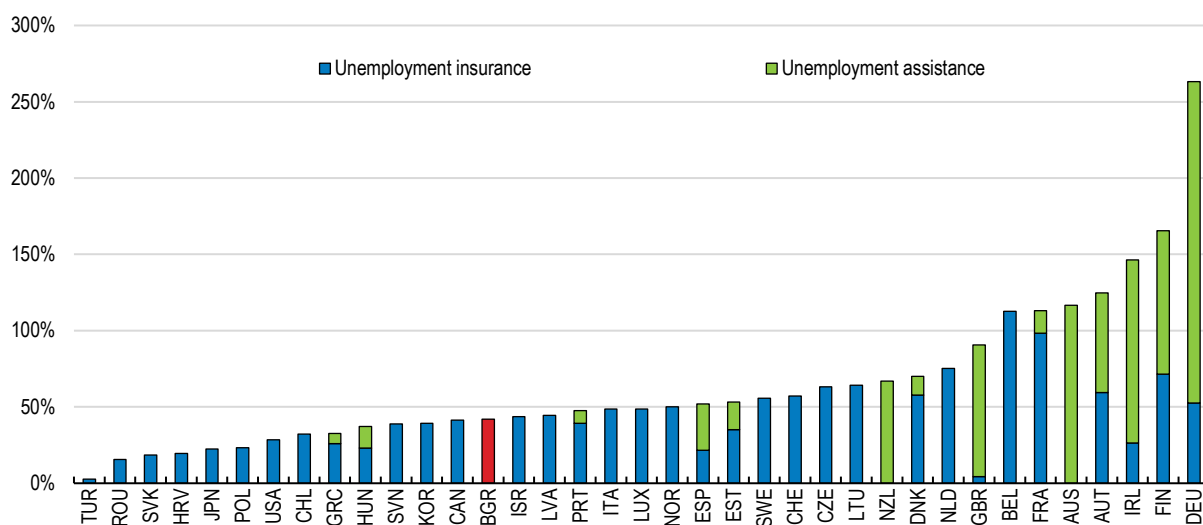
Source: OECD Benefits, Taxes and Wages database.

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While there is no straightforward indicator to measure coverage, most often the ratio of the number of people on unemployment benefits over the number of unemployed people (measured by labour force surveys) is used (OECD, 2022^[42]). This pseudo-coverage rate at around 40% is low in international comparison, though comparable to that in the Visegrad4 and Baltic countries (Figure 2.28). Bulgaria does not have an unemployment assistance scheme, unlike many OECD countries. For certain groups, who cannot possibly meet the strict criteria for unemployment insurance benefits, for example due to a lack of work experience such as young graduates, unemployment assistance benefits could be provided for up to six months to allow them to find a suitable job.


Figure 2.28. Less than half of the unemployed are covered by unemployment insurance

Pseudo-coverage of unemployment insurance and assistance, 2018



Note: Due to potential overlap between beneficiaries of various schemes, the total can exceed 100%.

Source: OECD Social Benefit Recipients Database.

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A wider problem is how to activate those who are not currently looking for work, as well as ensuring that there is an effective system to encourage unemployed people who no longer qualify for unemployment benefits to look for work. A well-designed social welfare system can support a high level of employment in good-quality jobs, as well as providing decent support to those who temporarily lose their jobs as the labour market evolves or who suffer from longer-term deprivation. Very often deprivation and poverty prevent people from joining the labour force due to ill-health or lack of opportunities.

Bulgaria's social assistance system is complex, governed by several laws, secondary legal acts and involving several agencies. Social assistance is provided as a one-off or a regular (monthly) benefit, which is targeted and can be in cash or in kind to cover basic needs. Social assistance benefits have now been linked to the poverty line in 2023 at 25% of this level with an envisaged increase to 30% in 2024 (the poverty line for 2022 is BGN 413 and for 2023, BGN 504). This is an important step, but over time this amount should increase further to approach the poverty line to meet basic needs. In general, the current system is focused on the most vulnerable social groups and provides only a very low level of support to those who receive it (around 22 000 persons in 2021). At the same time, there are many people living below the poverty line (in 2021, 22.1% of the population according to NSI) who are not covered at all. Eligibility and benefits take into account other benefits received, limiting the scope of social assistance and the amount of income support: for example, unemployed people with school-age children are not

necessarily eligible if they receive the social pension for disabled people as that would take them above the eligibility threshold even though their income would remain below the poverty line (Box 2.2).

Box 2.2. How much financial assistance can vulnerable people receive?

The maximum size of benefits a hypothetical family of four with multiple disadvantages can cumulate

This box lists the financial assistance benefits that a family of four with unemployed parents not eligible for unemployment insurance, one of them with 90% incapacity and two children, a first and an eighth grader can potentially cumulate, should they exploit all they are eligible to. As the family receives disability benefits, it is not eligible to the basic social assistance allowance, which is based on the differentiated minimum income, as the disability benefit lifts them above that. The monthly average income will be BGN 988.9, i.e., BGN 247.2 BGN per family member on average.

Table 2.2. A disadvantaged family will remain below the poverty line even after benefits

Type of support	Monthly, BGN	Annual, BGN
Target heating benefit for the winter season 2022/2023	52.0	623.6
One-time family financial help	31.3	375.0
One-off benefit for pupils enrolled in 1 st grade and monthly equivalent, Family Allowances Act	25.0	300.0
One-off benefit for students enrolled in 8 th grade and monthly equivalent, Family Allowances Act	25.0	300.0
DMI parent 1 (defined as 73% of the GMI)	54.8	
DMI parent 2 (defined as 73% of the GMI)	54.8	
Child support for both children according to the Law on Social Assistance (defined as 100% of GMI for each child)	150.0	
Family allowance for family with two children, Family Allowances Act	110.0	
Additional social support for the parent with disabilities (90%)	48.8	
Social pension for parent with disabilities (income)	325.0	
Financial support for disabilities according to the Law on Persons with Disabilities (excluded from income by Law)	235.4	
Supplement for personal assistant	185.3	
Total family DMIs	308.3	
Total family income	435.0	
Difference DMIs – Total income	-126.8	
Total income > the sum of DMIs	not eligible	
Total monthly social benefits for the family	988.9	
Average per family member	247.2	

The conditions for receiving the benefits in this box are the following. Monthly basic social assistance benefits and targeted heating benefits are the two major social assistance programmes in Bulgaria. Access to monthly basic social assistance benefits is conditional on several criteria: it is not sufficient to be without a job and fall under the minimum differentiated income threshold. In addition, a six-month registration period with the Employment Agency is mandatory. The funds for heating assistance are voted and provided by the state budget each year. The monthly amount is the BGN equivalent of 500 kWh of electricity (of which 300 kWh are daytime and 200 kWh are night-time electricity) applied for households as of October 31 of the ongoing calendar year. By acquiring the right to monthly social assistance, a family also meets the conditions for targeted assistance for heating, which for the 2022-23 heating season is BGN 623.55. For the 2021-22 heating season, 261 000 heating benefits were approved amounting to BGN 135.9 million.

Most social benefits have a small coverage and strict criteria, therefore reaching only a small share of poor families. The family income is defined as all gross receipts from labour, business activities,

agricultural production, sale and/or exchange of real estate and other property, shares, equity and other participations, rent, dividends, prizes from sports competitions, etc. Pensions, stipends, other benefits and allowances, monthly allowances for children under the Family Allowances Act are also considered as income. Targeted heating allowance and personal assistance for disabled people with reduced working capacity of more than 90% are not considered as income when determining the size of social benefits.

Unemployed persons who meet the conditions for social support are included in employment programmes. Those who refuse to participate in employment programmes are deprived of monthly benefits for a period of one year. The implementation of these programmes is carried out jointly by municipal administrations, state, municipal and private enterprises and other legal entities, the territorial divisions of the Employment Agency and the Social Assistance Agency. At the local level, municipalities provide services such as home social care and social personal assistance, family-type accommodation centres including for disabled adults, etc. A monthly targeted rent allowance for municipal housing is available to single old people over 70 years and to single parents raising a child alone when their income from the previous month is up to 250% of their differentiated minimum income. In addition, monthly targeted rent allowance is provided to orphans up to the age of 25, who have graduated from social educational and professional centres and meet income criteria. Persons with permanently reduced work capacity of 71% or more or with certain types and degrees of disabilities, children up to the age of 16 with a permanent disability and military invalids as well as their companions or social assistants are entitled to free travel twice a year – round trip, by rail in the country.

A poor family of two unemployed parents not entitled to unemployment insurance benefits with two children (below the age of 16 years) and if one of the parents is with a reduced work capacity of at least 90%, could receive the following types of social assistance under certain conditions as shown in the table above.

DMI for a family, or person cohabiting with another person, and for each of the cohabiting spouses is defined as 73% of the GMI, which in this example is BGN 54.8 for each parent. Monthly child support according to the Law on Social Assistance is defined as 100% of the GMI (BGN 75).

The family can receive one-time financial help for the year in case of emergency need for health, education, communal, and other vital needs. This benefit is defined as maximum 5 times the GMI (or BGN 375). According to the Law on Persons with Disabilities, the disabled parent from this example would be eligible to receive a monthly financial support for disabilities defined as 57% of the poverty line (or BGN 235.4). The person with a permanent disability will have the right to receive an assistance aid in the amount of 75% of the social pension for old age – BGN 185.3. This supplement could not be received when using a personal assistant dispatched under a programme.

The size of the support the family can receive is calculated based on its income from the previous month. The support is calculated as the difference between the sum of all differentiated minimum incomes and the family income from the previous month. In this example, the incomes of the family are the social invalidity pension and the monthly allowance for children. It is more than the sum of the differentiated minimum incomes, which, according to the applicable rules means that this family could not receive the basic social support according to the Law on Social Assistance.

Note: This box reflects the situation before the recent legal changes linking social assistance benefits to the poverty line.

Source: Ministry of Labour and Social Policy.

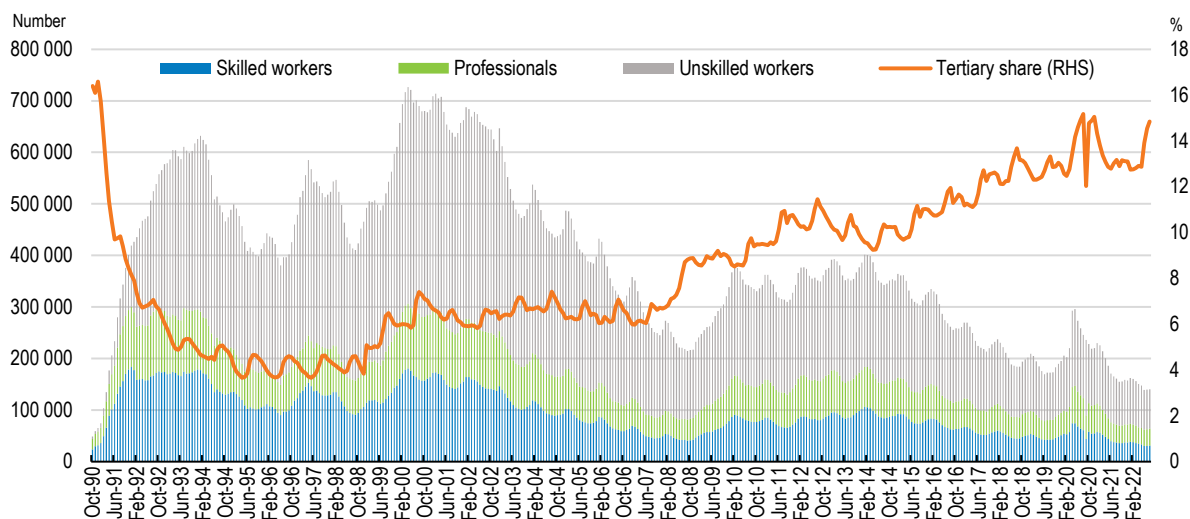
A more fundamental overhaul of the social security system would see social assistance payments increased over time to a level where they effectively avoided poverty, while at the same time providing incentives and support for people to return to work through activation policies. This would imply moving increasing social assistance benefits closer to the poverty line. Progress in this direction is an important part of the social component of the Bulgarian Recovery and Resilience Plan. The disability benefit scheme

could be included within this wider framework with activation requirements – taking into account individual’s needs – aligned to the wider system.

A key part of this approach would be to strengthen the role and resources of the Employment Agency: far from all unemployed persons, as defined by the labour force surveys, actually register with the Employment Agency. The number of registered at 140 000-150 000 has been on a declining trend in recent decades, despite the spike around the COVID pandemic (Figure 2.29). This is partly related to ageing, shrinking of the population and strong economic performance, but also reflects limited incentives to register. While registration with the agency is relatively simple, many people do not bother making this first step due to lack of effort or information, excessive privacy concerns, or occasional jobs or informal employment, although the Employment Agency tries to identify and reach out to such people and encourage them, as well as their inactive family members and others in their communities, to register. However, increasing the number of people registering would put the agency’s already scarce resources under strain. Upfront investment in digitalisation of the Agency’s services is needed and is being supported by the Recovery and Resilience Plan to improve its efficiency and expand its capacity. Jobseekers could then be profiled and matched with jobs through the online interface with only the most complex cases needing face-to-face interaction. With a substantially expanded clientele and given the upfront investment needs in digital infrastructure, more resources, both human and material, should be allocated to the Employment Agency. The increase in the share of tertiary graduates among the registered unemployed may be related to the overall increasing education attainment, lack of focus on marketable skills in higher education and greater difficulty to find a job with a college degree. Among those registered, a large share are elderly workers or persons without qualification while the share of tertiary graduates is increasing (Box 2.3).


Figure 2.29. The number of registered unemployed is trending down but the tertiary graduate share is increasing

The number of people registered at the Employment Agency by skill type



Note: Classification follows that of the Employment Agency.

Source: OECD tabulations from Employment Agency data.

StatLink  <https://stat.link/yecpku>

Box 2.3. Who are the (registered) unemployed?

The profile of registered people at the Employment Agency

People registered with the Employment Agency are a diverse group with the major shared feature of seeking a job (OECD, 2022^[42]). Given that incentives to register are limited to searching employment, receiving training and benefitting from social assistance (which is very low) and unemployment benefits (if eligible), far from all who are out of work register. In addition to discouraged workers, those employed informally or those seasonally working abroad are often missing from the registry, as are those who cannot take up a job due to caretaking obligations or health reasons. The registered person needs to be available for regular in-person meetings with the Agency.

Aggregated data from the registry shed light on the age, gender, skill and other characteristics of the pool of registered people. Women made up roughly 56% of those registered and the long-term unemployed accounted for a quarter of those registered in the first half of 2022. New inflows over the previous month comprised a sixth of the stock of registered unemployed and outflows, including due to taking up a job as well as discontinuing registration for other reasons, were of a similar magnitude.

By age group, 27-28% were aged above 55 (compared to their share of 16% among the self-declared unemployed), another 27% were aged 45-54 (slightly above their share in the population). The share of younger generations is much lower, around 11% for under 30s (compared to around 23% of the population).

Among the long-term unemployed (i.e., those registered over a year with the Employment Agency), around half are over 50 years old, more than 60% have primary or lower education attainment and more than 70% are unskilled.

Source: Employment Agency data and National Statistical Institute 2021 Population Census.

Strengthening activation and the social system would help to reduce risks of poverty. The multidimensional poverty headcount ratio (the percentage of people who are multidimensionally poor) at 32.1% of the total population was higher in 2020 than in any OECD country for which data are available, except Mexico and Türkiye. Lack of employment appears to be a major risk factor leading to poverty, which in turn may result in social exclusion. The at-risk-of-poverty rate at 50% is the highest for the unemployed among groups by activity status (National Statistical Institute). In contrast, employed people face a risk of poverty of 10%. A single person earning the minimum wage would need 35 hours of full-time work to escape poverty, more than in many OECD countries, but less than in most Visegrad⁴ or Baltic countries.

One way to encourage labour market engagement would be to provide health insurance coverage to all who register with the Employment Agency. Between a tenth and a sixth of the population is currently uninsured. In the current labour market conditions with increasing shortages of manpower, people would likely find jobs quickly. This would improve health outcomes and labour market engagement.

Table 2.3. Previous recommendations on social policies and actions taken

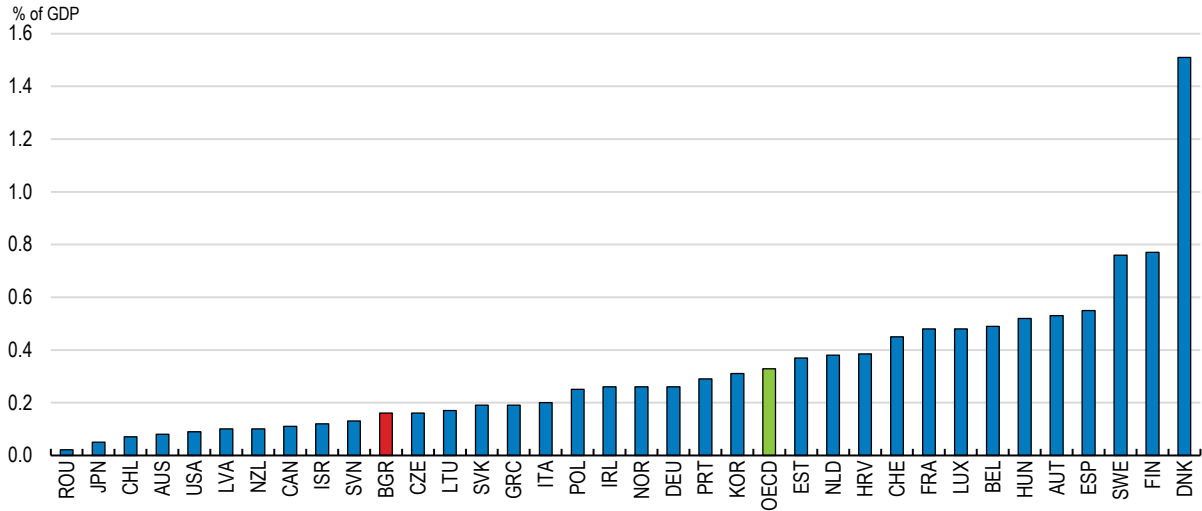
Recommendation	Action taken
Provide universal access for four-year olds to early childhood education.	Compulsory preschool education for children aged four-years was introduced through an amendment to the Preschool and School Education Act. The change should enter into force after the relevant municipality provides the needed conditions, but no later than 2023-24 for the whole country. Since April 2022 children's attendance at nursery school and kindergartens is free of charge. With the technical support of the European Commission, a National Framework for the Quality of Early Childhood Education and Care will be developed. It will include a set of indicators to monitor and evaluate the quality of services and will support early childhood education and care institutions to self-assess the quality provided.
Develop accessible and affordable long-term care.	A National Strategy for Long-Term Care with a 2034 horizon was adopted focused on creating conditions for independent and dignified life of the elderly and people with disabilities through the provision of quality, accessible and sustainable long-term care services tailored to individual needs. In July 2022, the second Action Plan for 2022-27 for the Strategy's implementation was adopted. Some of the measures are aimed at providing support in the home environment to disabled and care-dependent elderly people, increasing the efficiency of the long-term care system; and building the necessary infrastructure for the provision of services.
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.	The Social Assistance Act was amended in December 2022 to link social benefits to the poverty line. For 2023 this level is 25% of the poverty line and it is to reach 30% in 2024 and to be adjusted thereafter. Adopted legislative changes ensure the expansion of the scope of assisted persons and families as the group-specific coefficient is now applied to the newly defined anchoring element, i.e. 25% of the poverty line. The Social Assistance Act and the Rules for its Implementation shall enter into force on 1 June 2023.

Targeted policies are needed to bring more people into the labour market

With the labour force declining and unemployment low, it is important to activate groups of people who have a low rate of participation in the labour force (OECD, 2022^[42]). Currently, only modest resources are devoted to active labour market policies (0.16% of GDP in 2021, Figure 2.30). From the little money spent on activation from the state budget, the highest net effects are observed for women, young people, the long-term unemployed, people with low education attainment and people living in rural areas (Atanassov and Trifonova, 2020^[43]). There remains room to improve the evaluation of active labour market policies, including through both more frequent and more rigorous counterfactual impact evaluation and through the use of administrative data as is done in many OECD countries.

Figure 2.30. Spending on active labour market measures is low

Spending on active labour market measures for the 15-64 year olds, 2019



Note: Active labour market measures without employment maintenance incentives (i.e. measures 20-70 except 42 according to the OECD classification of labour market programmes).

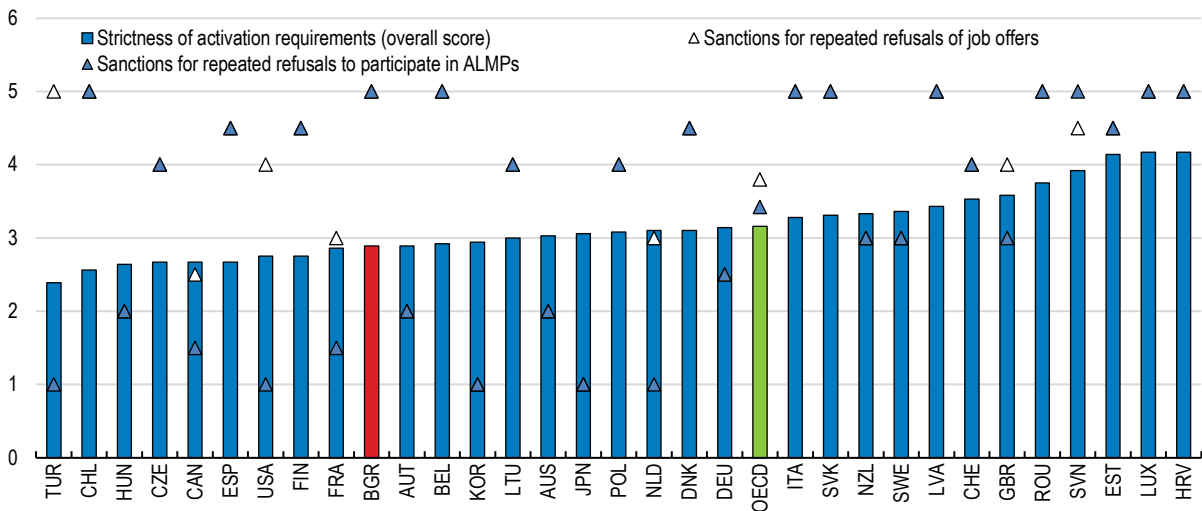
Source: OECD Labour Market Statistics database and Eurostat.

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The stringency of requirements to engage with activation measures is below the OECD average, close to the levels of France and Austria (Figure 2.31). Relatively tough sanctions are applied for repeated refusals of job offers and for failure to participate in active labour market programmes. This in practice often means cutting off access to employment services for some period.

Figure 2.31. Activation requirements are not strict except for harsh sanctions on repeated refusals of job offers or to participate in ALMPs

Ordinal scale ranging from 1 (least strict) to 5 (most strict), 2020



Note: Selected measures. The value for the indicator of sanctions for repeated refusals of job offers and to participate in ALMPs are the same for Bulgaria.

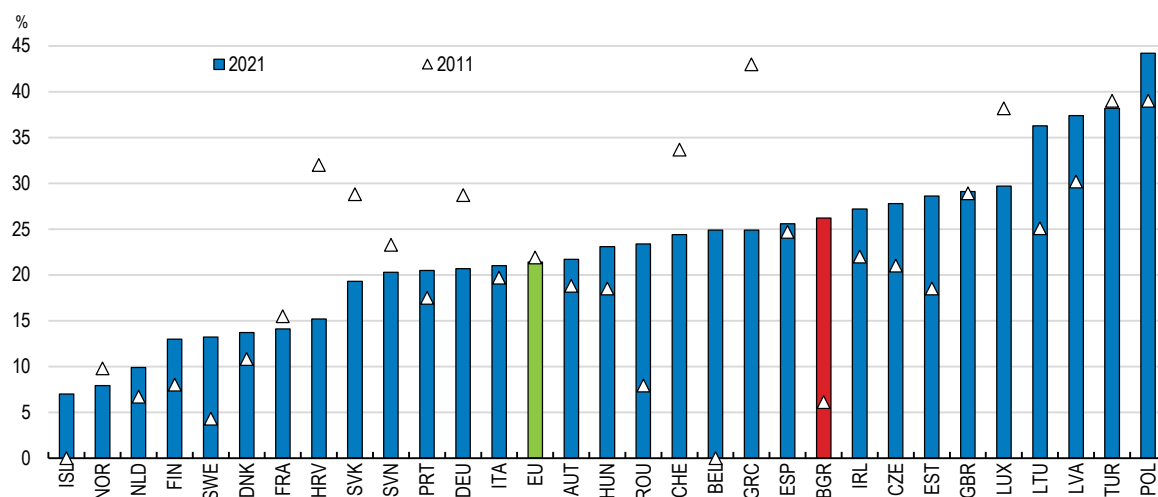
Source: OECD Labour Market Statistics database.

StatLink <https://stat.link/itdbe5>

An unusually large number of people, predominantly women, stay out of the labour market due to caregiving duties related to children and old or disabled family members (Figure 2.32). There is a further group of people who may be stuck by care obligations with low-paying jobs or jobs below their qualifications and could potentially move where jobs with higher pay or better matching their qualifications are, should they be freed from providing support for disabled or elderly relatives part-time. Recent initiatives aim at tackling this issue: kindergartens and nurseries are now free of charge. The measure called “Care at Home” by professionals as part of the Ministry of Labour and Social Policy’s Human Resources Development Programme (2021-27) will provide integrated services (including in-kind support and dispatching assistants) to 32 000 elderly and disabled people according to their individual needs starting in 2023. Municipalities were called to apply for funding of such services, alone or jointly with other municipalities, by 2023. This measure, costing BGN 175 million, could potentially free thousands of former caretakers for work or better utilise formerly underutilised labour. The measure is a continuation of the similar support scheme provided in 2018-22, during which over 44 000 persons received home-based services. This is a welcome approach and should gradually be scaled up: the rollout of home-based caretaking should accelerate, and professionals should be trained. The National Strategy for Active Ageing 2019-30 advocates independent living, which should be supplemented by occasional assistance, based on needs, at the elderly person’s home. When independence is no longer an option and 24-hour care is needed, a sufficient number of places in homes for the elderly needs to be provided, including for those living on modest pension incomes.

Figure 2.32. A relatively high share of the inactive are caregivers

Caregivers as percentage of population outside the labour force and wanting to work, 20-64 year olds



Note: 2020 value for United Kingdom and 2019 value for Türkiye.

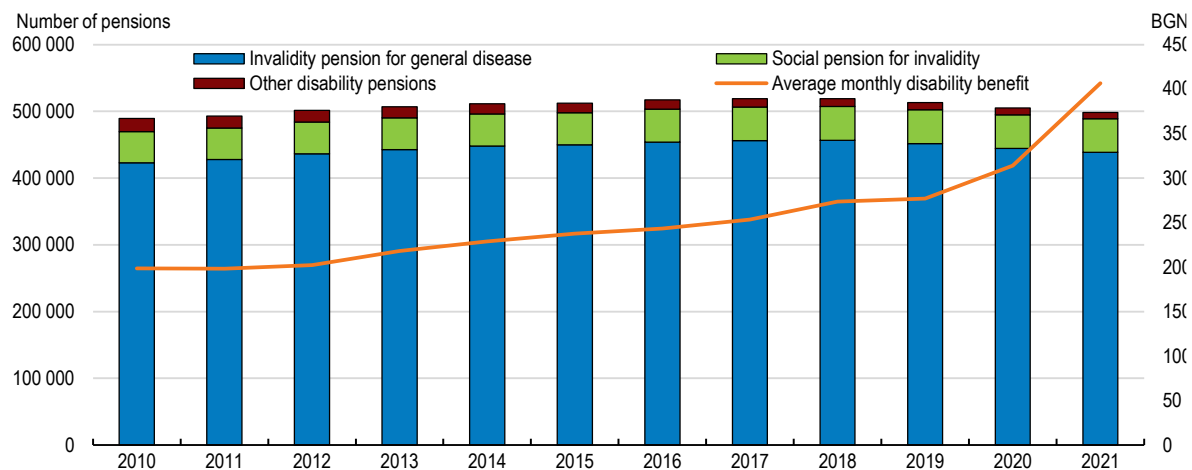
Source: Eurostat.

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Another large group of inactive persons are disability insurance recipients, whose number exceeded 438 000 in 2021 (Figure 2.33). Disability recipients account for nearly 14% of the working age population, higher than in countries with very high rates of disability receipts, such as Estonia, Hungary and Slovenia, and much higher than in other countries. People with at least 50% reduced work capacity are eligible for disability insurance benefits, which are a function of their past earnings and contributions and the extent of incapacity. In addition, there is a social disability pension, which is a non-contributory benefit, with nearly 50 000 recipients, alongside a range of smaller schemes. Recipients of disability benefits tend to be older workers with less education. It is likely that the disability payment may be acting as an alternative to social


assistance given the much higher rates of payment and a significant share of the recipients are likely to be capable to work. The incidence of disability is higher in older cohorts of the population, as in other countries. However, the share of the low-educated (people with at most lower-secondary education) disabled persons peaks in the 60-64 age group. This suggests that some people with low levels of education may use the disability schemes to retire early.

Figure 2.33. Many people live on disability benefits



Note: The “other” category comprises all disability benefit types not included in the other two categories.

Source: Ministry of Labour and Social Affairs of Bulgaria.

StatLink  <https://stat.link/xptbsu>

Disability benefit recipients are neither required to look for work nor to register with the Employment Agency. While some people may be unable to work in any way, many people are likely to have work capacity that could be used to boost their own incomes and may provide benefits in terms of engagement in society. While those with a disability are incentivised to take up a job via a tax allowance of up to BGN 7 920 per year, very few of the disability pension beneficiaries are employed. Disabled persons of working age should be required to register with the Employment Agency. In many cases, the degree of incapacity is not reassessed after starting to receive benefits. Medical reassessment should be carried out on a regular basis, for instance every year or two depending on the nature of incapacity, by specialists randomly assigned from other districts. Support should be provided to help people return to work and benefits should be phased out in a gradual manner over time as they begin working. Mobility and participation in society is also hindered by the lack of disability-friendly facilities and high out-of-pocket costs for medical services and devices. In-kind benefits related to particular types of disability (e.g. hearing aids, wheelchairs) are available for free or at highly subsidised prices. Following protests by thousands of disabled and revamping the old Socialist-era internment-focused approach, a new Persons with Disabilities Act was passed, which came into force in January 2019. This includes providing conditions for equal access to employment in a regular, specialised and sheltered work environment. In fact, the Act obliges employers with above 50 employees to hire a permanently disabled person and for those above 100 employees so that the permanently disabled make up 2% of their workforce. Companies not meeting these quotas are obliged to pay a fine. Unlike in most OECD countries, there are no specific vocational rehabilitation programmes tailored to the skills needs of people with disabilities and organised by the public employment services (OECD, 2022^[42]). Such specific programmes should be developed.

Bulgaria has the potential to bring more older workers into the workforce by raising the statutory retirement age, increase employment rates of older workers below the retirement age and encouraging people to work beyond the official retirement age. The official retirement age is currently being increased by one and two months annually to reach 65 by 2029 and 2037 for men and women, respectively. However, effective

retirement and exit from the labour force often occur earlier. The 2021 Population Census reveals that only 45% of the 60-64 age group are employed with 51% inactive and only 4% actively searching for a job. In the 65-70 age group, 16% are employed and only 1% is actively searching for a job. The National Strategy for Active Ageing 2019-30 explicitly envisages not only active participation in social life by the elderly, but also employment. In many OECD countries, with Japan as a frontrunner, people continue working well beyond the statutory retirement age. Working beyond the statutory pension age would be encouraged by maintaining the tax-free status of pension benefits and taxing only wage income. Currently people can receive both a pension (not taxed) and wage (taxed) income at the same time, and there are additional incentives to retire later. Moreover, the labour legislation does not contain provisions that oblige the employer to terminate the employment relationship upon acquiring the right to a pension. As life expectancy increases, incentives could be considered to encourage people to work longer. However, many older people have health problems or are otherwise not fit for work. In addition, given relatively low life expectancies, people may be reluctant to increase working life beyond the retirement age.

Strengthening of basic skills and workplace-based vocational training can increase the chances to find a job

With the workforce declining, upskilling the population is crucial to foster growth and further improve living standards. Providing the right skills is a key tool to break the vicious cycle of poor education, poor labour market outcomes and welfare dependence and poverty. The formal education system in Bulgaria has undergone major changes in the past decades, with increasing enrolment rates and rising educational attainment, although quality did not improve in parallel.

Basic skills, such as literacy or numeracy, are still lacking, and few adults are enrolled in training. This will need to change as the coming decades will see a revamp of the industrial landscape, implying a need for large-scale re-skilling. The lack of basic numeracy and literacy skills prevents people from participating in labour markets as few opportunities are available for such people. PISA scores reveal that basic reading and math skills lag behind other countries. The OECD Skills Needs indicators (of the Skills for Jobs database) confirm that skills deficiency is the greatest in reading comprehension and writing. The lack of basic skills is more difficult to tackle as those are the prerequisites to enrol in courses to acquire marketable skills. To shorten the period of acquiring skills for such people, who may be early school leavers or with only primary or lower secondary education, training in basic literacy and numeracy skills and vocational skills is done simultaneously. Furthermore, people without formal education can have their competences validated either in one or more specific subjects or in all general education subjects for each year of basic education.

Very often persistent unemployment is related to the lack of marketable skills. The OECD Skills for Jobs indicators reveal that the large number of manual workers with poor labour market prospects could relatively easily acquire skills that are in high demand in the labour market through targeted training. Bulgaria has a vocational education system with both secondary and post-secondary-level training, but the system does not sufficiently equip students with marketable skills as it is not necessarily workplace-based unless it is a dual programme. Better collaboration between schools and the business sector is needed to anchor workplace-based training in vocational education (OECD, 2023^[19]). Some vocational schools are in remote areas, beyond commuting distance from businesses. While future schools should consider workplace-based training opportunities when choosing a location, current remotely located schools could also be moved geographically closer to the respective businesses that offer such opportunities. Alternatively, where reasonable public transportation is not available, transportation could be organised for students to enable them to commute to workplaces. Joint design of curricula would incentivise businesses to offer workplace-based training for vocational students.

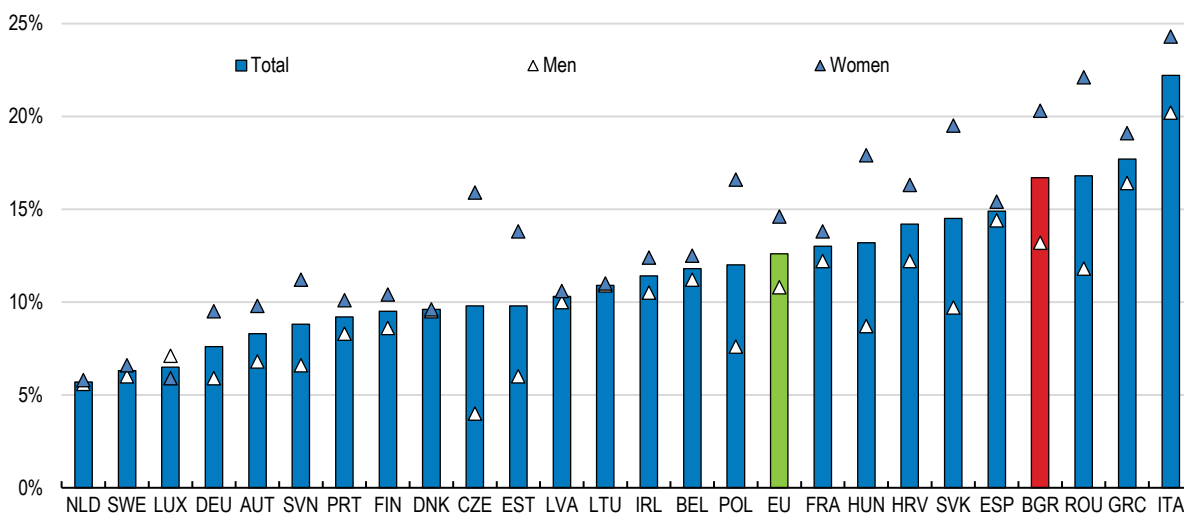
The composition of the registered unemployed reveals a growing share are tertiary graduates. Tertiary education is free and has expanded with a soaring number of graduates, but quality has not kept pace.

The lack of practice-oriented training at universities is partly behind the difficulty of taking up a job upon graduating from a university, which needs to be tackled by adjusting curricula with the participation of the business sector and incorporating training as part of the programme. Moreover, university education remains theory-oriented with little provision of practical skills, let alone internship opportunities. The Recovery and Resilience Plan supports updating curricula, prioritising science, technology, engineering and math (STEM) profiles, enabling distance and hybrid learning, creating proper incentives and the standardisation of higher education and investment in the education sector, including in STEM centres.

A particularly vulnerable group is young people, among whom a high share is not in employment, education or training (NEET) (Figure 2.34). While the NEET group is of a significant size and investing in their training can potentially bring substantial benefits, the Employment Agency can reach only a fraction of them (OECD, 2022^[42]) due to their lack of registration. Currently the Employment Agency addresses skill mismatches for educated people *inter alia* by offering subsidised employment opportunities, in particular for young people to start their career and gain practical experience. In the first eight months of 2022, over 2 500 young people (15-29) participated in training with only one-tenth being in the NEET category. Over BGN 753 million (0.5% of 2021 GDP) will be allocated to support young people and their inclusion in various forms of employment, internships and training under the Human Resources Development Programme 2021-2027. More than 100 000 other people will have the opportunity to validate informally acquired digital skills, which will increase their competitiveness in the labour market. The Employment Agency and its countrywide offices provide information, career guidance and referral services free of charge. There are career days, open days, student job fairs, employer days and other events aimed at supporting young people.


Figure 2.34. Many young people are not in employment, education or training

Youth NEET rates by gender 15-29, 2019



Note: The EU is a weighted average of the 27 member countries shown.

Source: OECD (2022) Reaching Out and Activating Inactive and Unemployed Persons in Bulgaria.

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Given the high rate of return to practical training, both the employer and the employee should have incentives to invest in it, which could economise government spending. The Employment Agency offers free training courses, many with the possibility to earn a qualification and people can participate in multiple courses without a commitment to take up a relevant job offer. Training courses offered by the Employment

Agency should focus on training specialists with good labour market prospects. Participants in free qualification-earning training courses offered by the Employment Agency should be obliged to accept a job offer that matches their qualifications unless they find a job themselves. Skill needs surveys in Bulgaria reveal that the greatest deficit in specialists is in tourism, construction and textiles and clothing in the short run, while the greatest increase in demand in the longer term will arise in health, education and social services. While such information is available online, better dissemination at the school level of not only future skills demand but also of the necessary qualifications and remuneration for each profession would help children and teenagers to plan their future career.

The Employment Agency also offers subsidised employment in addition to free training and the rate of subsidisation can reach 100% for vulnerable groups such as new graduates. The rate of subsidisation of employment should not be 100% and should not be without commitment on the part of the employer to hire at least some of the workforce they availed at low cost or for free.

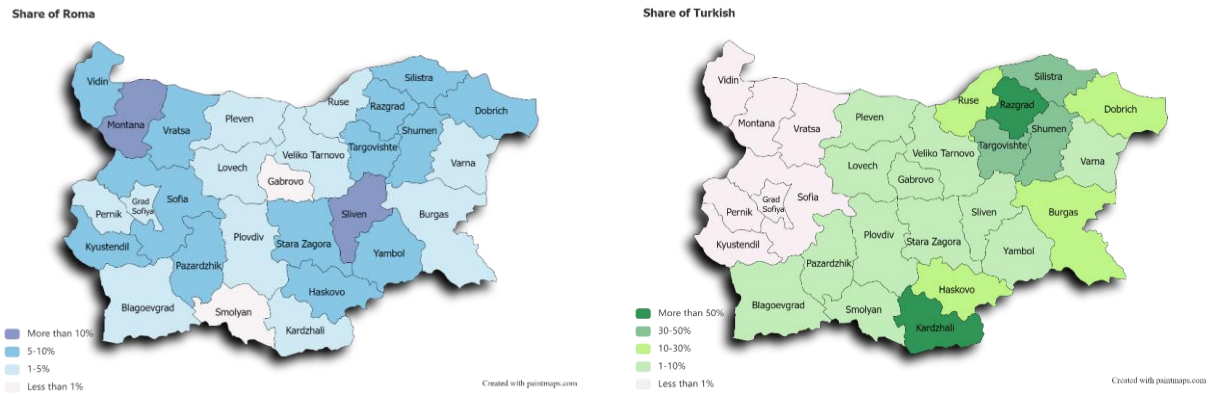
Table 2.4. Previous recommendations on vocational training and actions taken

Recommendation	Action taken
Deepen the role of workplace training in vocational education and training provision.	Participation in workplace-based VET programmes (dual training), introduced in 2017 by the School Education Law and VET Act, has been expanding. The number of participants in dual training programmes for the first school year 2017/18 was 1752, which is 1.27% of the total number of VET students. By 2022/23, it had risen to 11 705, or 7.8% of the total number of VET Students. Policy actions are targeted to promote dual training, including with financial incentives at the first stage of secondary education (8-10 grade) for all students involved in such programmes. In addition, through the European Social Fund (ESF) support, a dual training project is being rolled out in 2020-23. In this context, over 100 training programmes have been designed with the active participation of employers and a pilot model for evaluating the quality of work-based learning (dual training) has been developed and tested.

The living standards of minorities lag behind

A few ethnic minority groups live in Bulgaria. The Turkish with 8.4% of the population and the Roma with 4.4% form the largest minorities according to self-declaration in the 2021 Census. Other minorities jointly make up slightly over 1% of the population. Ethnic minorities mostly live in more remote and poorer regions, which hinders their material development and contributes to deprivation. The Turkish population constitutes the majority in two districts, Kardzhali near the Greek border with a share of 65% of the population, followed by Razgrad in the Northeast with around 50% (Figure 2.35). Significant Roma populations are located in Sliven in the Southeast with a share of 15% of the total population and in Montana in the Northwest with around 12%.

Figure 2.35. Ethnic minorities live in remote districts in the east and northwest



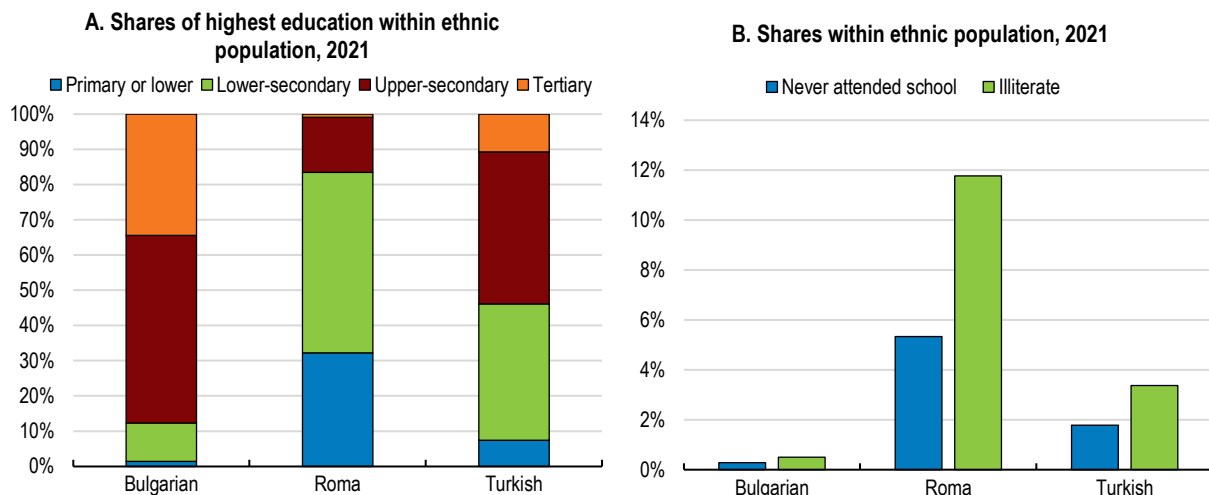
Source: National Statistical Institute 2021 Population Census.

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Socio-demographic characteristics differ considerably between the ethnic Bulgarian population and ethnic minorities and are often most pronounced between the Roma and ethnic Bulgarians, whereas the Turkish minority is somewhat in-between. The Roma are younger by far than both other population groups with a share of 27% under the age of 15, against only 12% and 14% among ethnic Bulgarians and Turks, reflecting that the number of children for each Roma woman is twice as high as that of ethnic Bulgarians with 2.6 children per woman compared to 1.4. Conversely, the share of elderly age groups is marginal within the Roma population with only 7% above the age of 64, compared to a quarter of the ethnic Bulgarian population, reflecting significantly lower life expectancy among the Roma.

The labour market potential of the younger Roma cohort is severely limited by their relatively poor educational outcomes. Only 1% of the Roma working age population has a tertiary degree (11% of Turkish) and only 16% an upper-secondary degree, including specialised vocational education (43% of Turkish), compared to 34% and 53% for the ethnic Bulgarian working age population (Figure 2.36). Roma have most often a lower-secondary education (51%) or only primary or lower education (32%). Consequently, up to 12% of Roma (3% of Turkish) older than 8 years are illiterate and 5% (2% of Turkish) have never attended school, whereas these shares are negligible among ethnic Bulgarians with 0.5% and 0.3%, respectively.

Figure 2.36. Ethnic minorities have lower educational attainment and are more likely to be illiterate



Note: Panel A refers to the working age population, Panel B to population 8 years and older.

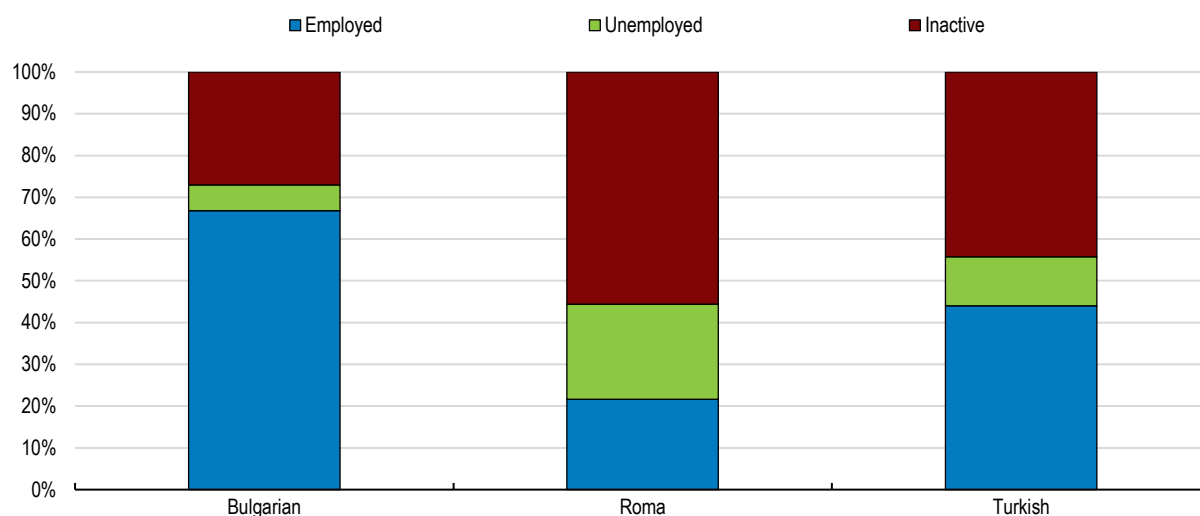
Source: National Statistical Institute 2021 Population Census.

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The lower education levels of ethnic minorities are a strong impediment for labour market participation, even in the tight Bulgarian labour market. The majority of the Roma working age population is inactive (56%), and also the Turkish (44%) are far more often inactive than ethnic Bulgarians with 27% (Figure 2.37). This is also reflected in the share of unemployed among the respective working age population, which is twice as high for the Turkish (12%) and around four times higher among the Roma (23%) compared to ethnic Bulgarians (6%). The likelihood of being inactive is higher for women in both groups, whereas men are more prone to unemployment. Workers from ethnic minorities are more often employed in sectors with a weaker demand for skills, such as construction and agriculture, and they are also strongly represented among low-skilled occupations. Over half of Roma workers have manual jobs classified as elementary occupation, with a quarter of the Turkish and only 10% of ethnic Bulgarians.

Figure 2.37. Employment lags behind for the Roma and Turkish minorities

Share within ethnic population according to economic activity, working age population, 2021



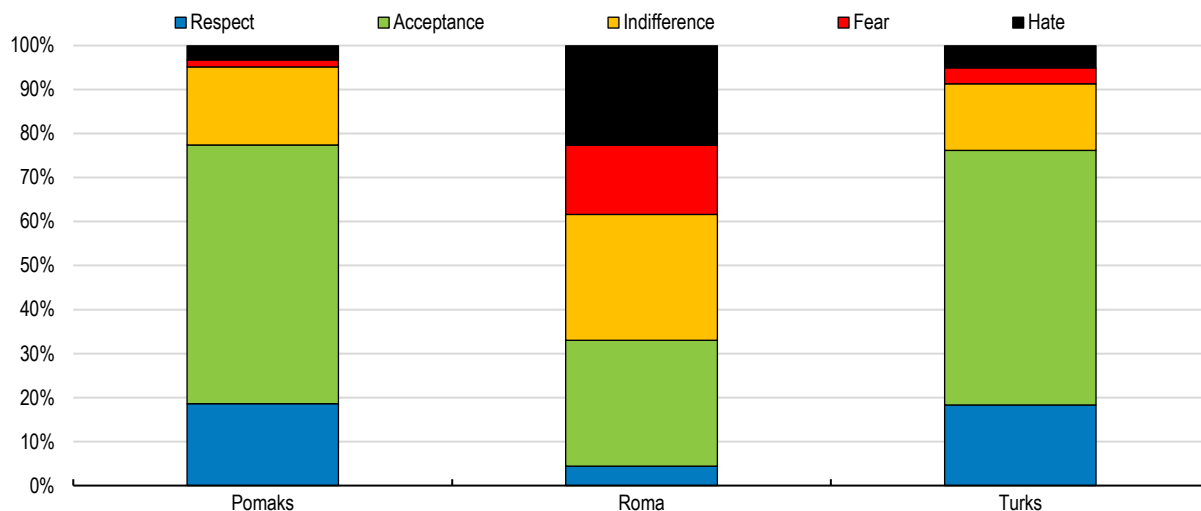
Source: National Statistical Institute 2021 Population Census.

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The often-deprived situation of minorities requires continued and reinforced policy actions to improve living conditions across all groups of the population. The vicious cycle of low education, low labour market attachment and poverty needs to be broken in a context of a rather unfavourable attitude of the population towards the minorities, leading to further exclusion and segregation. Especially the acceptance of the Roma population within the Bulgarian society is rather low (Figure 2.38).

Figure 2.38. The Roma are the least accepted by society

Share of respondents among population with stated attitude towards minority groups, 2020



Source: European Union Agency for Fundamental Rights.

StatLink  <https://stat.link/ns520w>

Labour market activation, education and housing are some of the key areas to foster the integration of Roma into the Bulgarian society, which is often supported by Roma mediators and associations (OECD, 2023_[19]), (OECD, 2019_[44]). They play an important role to increase outreach within their communities and to explain and support access to public services. In this context, they are officially mandated to support and motivate the registration of inactive Roma with the Employment Agency to enable the provision of training and healthcare along with social services. The Employment Agency does not offer specific programmes for the Roma to tackle inactivity, but provides a battery of different programmes to support and encourage labour market participation in general and for other vulnerable groups such as low-skilled or disabled workers. However, according to official data from the Employment Agency, Roma are only marginally represented among the participants in these programmes, suggesting difficulties in terms of outreach and activation. The Agency should ensure that their programmes meet the needs of their target groups, including specific needs of ethnic minorities. Roma mediators can play a role in strengthening outreach to their communities to raise awareness of the services and concomitant benefits offered by the Agency. Given the unfavourable attitudes towards Roma in the population, targeted support should also address employers to promote hirings of Roma workers.

To improve educational outcomes of Roma and prevent early school-leaving, schools in Roma areas need to provide good quality teaching and should ideally be integrated into a wider set of initiatives that offer extra-curricular activities to students, including potential participation of their families (Milenkova and Hristova, 2017_[45]). The former is dependent on the quality and availability of teachers, so incentives for teachers need to be introduced to encourage at least temporary postings, for example in form of rotation schemes where teachers commute a few days per week to schools with a high share of Roma, or in the form of monetary incentives. It also requires initial teacher education and continuous professional development to equip teachers with skills to work effectively with Roma students (OECD, 2023_[19]). Investment in youth centres would also help to target the labour market integration and skill development of young people with a focus on the youth from vulnerable groups, including Roma. Adequate transportation for Roma students should be provided to facilitate access to better-quality schools outside their narrow neighbourhood. Potential language barriers need to be addressed, given that more than 80% of Roma report a Roma language as their mother tongue. In addition, extra-curricular activities

can help to keep students busy after school and they can be used to raise interest among Roma students by offering activities that are more closely related to their way of life. Experience from Hungary shows that activities in this context related to gardening, cooking or dancing spark most interest among Roma students, while the presence of students after school can also be used for medical checks and sexual education

(Bardarov and Tsvetkov, 2019^[46]). A pilot project - in close cooperation with Roma mediators – in the Bulgarian town Straldzha in Yambol district made participation in extra-curricular activities related to sports or arts conditional on regular attendance at school, which led to an increase of attendance of Roma students by around 40% within one year (Bardarov and Tsvetkov, 2019^[46]).

Housing and associated property rights are further important impediments to the integration of Roma. Many Roma live in dwellings that are not officially registered, with consequences for sanitary conditions and the risk of evictions. Although state-funded projects were initiated to sell rural land at 20% of the market price to the Roma, large urban settlements persist where official registration is complicated by unclear land tenure, partly reflecting administrative costs or insufficient willingness from the side of Roma owners for fears that dwellings need to be demolished or heavily renovated to comply with official housing regulations. In addition, a considerable share of Roma is not registered with the population registry themselves, preventing the legalisation of land or house ownership (Stanchev, 2021^[47]). These challenges can only be tackled in a holistic approach to Roma integration that encourages official registration of people and dwellings, supported by targeted assistance with the administrative proceedings.

Table 2.5. Main policy recommendations for better jobs and incomes

Findings	Chapter recommendations (key in bold)
Ensuring adequate support for families	
Childcare has become free in public facilities, but supply falls short of demand. The maternity benefit replacement rate is adequate, but the length of the maternity leave implies difficulties with keeping up skills. Given the lack of childcare facilities, educated women face high opportunity costs of having children.	Ensure access to subsidised quality childcare country wide. Allow keeping 75% of the maternity allowance for mothers willing to return to work before the end of the 1-year maternity leave.
Many children are born to teenage mothers with many of those uninsured, leading to high infant mortality and morbidity rates.	Reduce teenage childbearing by keeping school-age children in school, and equipping the young with marketable skills.
Encouraging return migration and immigration	
The Migration Strategy 2021-25 aims at attracting Bulgarians living abroad and foreign workers to come to Bulgaria, but only a small number are relocating to Bulgaria.	Develop a comprehensive suite of measures including the provision of information about jobs and support related to administrative requirements for the (re)settlement in Bulgaria.
Although the foreign population is better educated, they exhibit lower employment rates than ethnic Bulgarians.	Encourage registration with the Employment Agency and offer training for professional development more proactively.
Rural regions are at risk from depopulation and deprivation.	Better connect remote regions to the rest of the country by providing adequate infrastructure and ensure access to social amenities everywhere.
Increasing participation in formal labour markets	
Informality is common and incentives to underreport wages are high.	Raise awareness of the consequences of underreporting wages, enhance compliance measures, digitalise transactions, and increase incentives to declare actual wages.
Incentives to underreport wages are high and the birth rate is low.	Assess the option to increase the monthly tax allowance per child up to the level of the minimum wage.
Trust in public institutions is low.	Provide information on uses of tax payments, such as a breakdown by spending category. Continue to work towards a more collaborative approach of the labour inspectorate by strengthening its role as focal point for information and advice.
Awareness of consequences from wage underreporting on future incomes and the probability and severity of sanctions is insufficient.	Ensure that regular and effective checks and controls are in place and conducted in a risk-based manner. Inform the public about consequences and sanctions of undeclared work by updating and promoting already existing online tools.
Labour investigations are insufficient and inefficient.	Use modern data analysis to detect illegal behaviour more automatically.

	<p>Ensure that the labour inspectorate has full data access from all institutions to detect illegal behaviour.</p> <p>Extend pre-emptive notification of investigations to employees.</p>
Informal work arrangements are facilitated by widespread use of cash.	Require all wage payments to be made electronically.
Streamlining social insurance and assistance	
Social assistance benefits are low and coverage is weak, while a large number of working age people are on disability pensions and do not work.	Overhaul the social welfare system to provide better social support, stepping up existing efforts to gradually increase benefits to approach the poverty line, while improving activation.
A large number of people, in particular women, stay out of the labour market due to care-giving duties.	Accelerate the rollout of home-based caretaking by professionals. Nurture the caretaking sector by expanding current institutions and training professionals to free family members (mainly women) for labour market participation and to meet demand amid rapid ageing of the population.
People with insufficient contribution history or amounts are only eligible to four months of unemployment benefits and after that period need to wait six months to be eligible for social assistance. They risk falling into poverty. Moreover, benefits are withdrawn immediately after taking up a job.	Extend the minimum unemployment insurance period to six months, provide young graduates with non-contributory social assistance and withdraw benefits in a staggered manner when taking up a job.
Gearing labour market policies towards activation	
Incentives to register with the Employment Agency are limited. Part of the population has no health insurance.	Increase incentives to register with the Employment Agency, including improved training and consider providing minimum (social) health coverage for people who register, with a six-month limit.
A sixth of the working-age population are on disability benefits, detached from the workforce.	Activate people with work capacity by regular assessment of the extent of incapacity by independent experts.
Subsidised employment is used to create jobs and the extent of subsidies can be up to 100% without a commitment by the employer.	Reduce the subsidy share of wages in subsidised employment, in particular where they are at full or close to full subsidisation to avoid adverse incentives and create sustainable employment.
Most interactions with the Employment Agency are in person or by email. Its resources are strained already.	Allocate more resources to the Employment Agency to digitalise its services and handle a larger number of registrations once health insurance coverage is offered.
People with disabilities do not have programmes tailored to their skills needs organised by employment services.	Introduce specific vocational rehabilitation programmes tailored to the skills needs of people with disabilities.
Roma participation in labour market programmes is low.	Consider the specific needs of Roma when designing labour market programmes and increase outreach to their communities to raise awareness of services and benefits of the Employment Agency.
Training for labour market needs	
Vocational training is not always workplace based. Students have limited practical skills when they graduate, so the government spends extra money to train them or offers them subsidised employment.	Intensify cooperation between local authorities and the private sector to extend workplace-based vocational training across the country. Involve businesses in the design of curricula.
Some vocational schools are remote from businesses.	Consider workplace-based training opportunities when choosing a location for new VET schools and move remote VET schools geographically closer to workplaces offering training opportunities or organise transportation.
Training programmes are offered by the Employment Agency without a requirement to take up a job following the completion of the course or even multiple courses.	Ensure that government-financed training better meets market demand and oblige participants in qualification-earning programmes of their choice to take up the job offered upon successful completion unless they find a job themselves.
Participation in vocational training among disadvantaged groups is often hindered by the lack of basic skills.	Reinforce personalised training in basic skills for disadvantaged groups.
Skills needs surveys are regularly collected and are available online but may not reach all the potentially concerned.	Disseminate better at the school level not only projections of future skills demand but also of the necessary qualifications and remuneration for each profession to help students plan their future career.

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BULGARIA

Bulgaria's convergence towards more advanced economies has continued but at a slower pace. Soaring energy and food prices have pushed up inflation to its highest levels in decades. However, support packages and strong momentum in wages and pensions have stabilised purchasing power. With the currency board arrangement, the onus to decrease short-term inflationary pressures is on fiscal policy. Fiscal discipline has resulted in low public debt, but growing spending pressures related to ageing, infrastructure and skills will need to be financed by greater tax collection efficiency and higher environmental taxes. The fight against corruption, which imposes high transaction costs, needs to continue by implementing more effective measures. Bulgaria's climate transition strategy is under development. Environmental taxes, including excise taxes on fuels and carbon taxes on sectors outside of the emissions trading system need to increase to curb energy intensity and reduce emissions. The shrinking number of workers due to smaller young cohorts entering the labour market and outward migration are undermining Bulgaria's growth prospects and the sustainability of its social institutions. Bulgaria needs to provide more support for families, including quality childcare country-wide, and make staying in the country more attractive by raising productivity, fostering the creation of good-quality formal jobs and reinforcing the social safety net.

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