1 Assessment and recommendations

This chapter documents the overall development context in Bulgaria since the late 1990s, describing the current economic situation and the main investment policy reform efforts and identifies specific challenges that hinder investment, economic growth and well-being. It summarises the key findings in each policy areas covered by the Review and provides tailored recommendations.

Introduction

Bulgaria's reform trajectory has been nothing short of remarkable. In under three decades, successive structural, regulatory and economic reforms have propelled it from one of the poorest Eastern European countries to an upper-middle income economy. In the years leading to its European Union (EU) membership, the country made impressive progress based on continued reforms to attract investors and support private sector development. Since then, deepening integration with the EU has further allowed progress despite disruptions caused by, first, the financial global crisis in the late 2000s and then the COVID-19 crisis. Although the COVID-19 pandemic interrupted Bulgaria's impressive progress in terms of GDP growth, economic growth rebounded by 4.2 % in 2021 after real GDP contracted by 4.1% in 2020.

Foreign direct investment (FDI) has been pivotal in this success. In the late 1990s and during the 2000s, Bulgaria experienced rapid growth in FDI with a peak in 2007, the year that Bulgaria became an EU member, with FDI inflows amounting to EUR 10.1 billion. Bulgaria started with a small inward FDI stock in the 1990s (accounting for 3.5% of GDP in 1995), which increased at a spectacularly high rate over the following decade. For the 1995-2007 period, the share of inward FDI stock to GDP increased from 3.5% of Bulgaria's GDP in 1995 to 85% in 2007. FDI inflows in Bulgaria in the recent years were higher compared to all its EU regional peers. Until the outbreak of the COVID 19 crisis, FDI inflows averaged about 2.6% of GDP in the period 2014-19, albeit lower compared to the pre-financial crisis annual average of more than 10% of GDP.

Due to the global financial crisis, foreign direct investment in Bulgaria declined, dropping from 28% in 2008 to about 2% of GDP in 2018. The COVID-19 pandemic further affected FDI trends. In the first half of 2020, Bulgaria experienced a significant drop in FDI inflows, representing a 32.8% year-on-year decline. In 2021, foreign direct investment in Bulgaria stood at EUR 1.04 billion, the equivalent of 1.5% of GDP according to Bulgaria's National Bank data. According to statistics from the Bulgarian National Bank issued in June 2022, FDI in Bulgaria in the first four months of 2022 stood at EUR 653.2 million, the equivalent of 0.9 % of the GDP; in the same period of 2021, FDI was EUR 196.8 million.

Bulgaria continues to face challenges to meet its objectives of ensuring long-term sustainable growth and development that can deliver benefits for all and protect the planet as well as supporting local productive capacity, innovation and competitiveness to help the country prepare for the future. This *Investment Policy Review of Bulgaria* (hereafter: the *Review*) considers the extent to which FDI can contribute to achieving these objectives and how different aspects of investment policies in Bulgaria can help support their realisation. It assesses Bulgaria's policy convergence in the framework of the country's June 2022 adherence to the OECD *Declaration on International Investment and Multinational Enterprises* (hereafter: the OECD *Declaration*), including the country's ability to comply with the principles of openness, transparency and non-discrimination and responsible business conduct (RBC) practices (Box 1.1). Capitalising on the OECD *Policy Framework for Investment* (Box 1.2), the *Review* studies other policy areas that are of key relevance to investment and sustainable and inclusive development in Bulgaria such as investment protection, promotion and facilitation; innovation; the state of infrastructure; and public governance.

Box 1.1. The Declaration on International Investment and Multinational Enterprises

The Declaration is a policy commitment by Adherents to provide an open and transparent environment for international investment and to encourage the positive contribution multinational enterprises can make to economic and social progress.

The Declaration consists of four elements (each underpinned by a decision of the OECD Council on follow-up procedures):

The Guidelines for Multinational Enterprises: Recommendations on responsible business conduct (RBC) addressed by governments to multinational enterprises operating in or from Adherents. Adherents commit to promote the Guidelines and establish their built-in implementation mechanism – the National Contact Points (NCPs) to further their effectiveness.

National Treatment: A voluntary undertaking by Adherents to accord to foreign-controlled enterprises established on their territories treatment no less favourable than that accorded to domestic enterprises in the same situations.

International investment incentives and disincentives: Adherents recognise the need to give due weight to the interest of other Adherents affected by laws and practices in this field; they need to strengthen international co-operation in this area and endeavour to make measures as transparent as possible.

Conflicting requirements: Adherents agree to co-operate so as to avoid or minimise the imposition of conflicting requirements on multinational enterprises.

As of June 2022, all 38 OECD member countries had adhered to the Declaration, as had 13 non-member countries: Argentina (22 April 1997), Brazil (14 November 1997), Egypt (11 July 2007), Jordan (28 November 2013), Kazakhstan (22 June 2017), Morocco (23 November 2009), Peru (25 July 2008), Romania (20 April 2005), Tunisia (25 May 2012), Ukraine (10 March 2017), Croatia (17 October 2019) Uruguay (25 February 2021) and Bulgaria (9 June 2022).

Box 1.2. The Policy Framework for Investment

The Policy Framework for Investment (PFI) helps governments to mobilise private investment in support of sustainable development, thus contributing to the prosperity of countries and their citizens and to the fight against poverty. It offers a list of key questions to be examined by any government seeking to create a favourable investment climate. The PFI was first developed in 2006 by representatives of 60 OECD and non-OECD governments in association with business, labour, civil society and other international organisations and endorsed by OECD ministers. Designed by governments to support international investment policy dialogue, co-operation, and reform, it has been extensively used by over 35 countries as well as regional bodies to assess and reform the investment climate. The PFI was updated in 2015 to take this experience and changes in the global economic landscape into account.

The PFI is a flexible instrument that allows countries to evaluate their progress and to identify priorities for action in 12 policy areas: investment policy; investment promotion and facilitation; trade; competition; tax; corporate governance; promoting responsible business conduct; human resource development; infrastructure; financing investment; public governance; and investment in support of green growth. Three principles apply throughout the PFI: policy coherence, transparency in policy formulation and implementation, and regular evaluation of the impact of existing and proposed policies.

The value added of the PFI is in bringing together the different policy strands and stressing the overarching issue of governance. The aim is not necessarily to break new ground in individual policy areas but to tie them together to ensure policy coherence. It does not provide ready-made reform agendas but rather helps to improve the effectiveness of any reforms that are ultimately undertaken. By encouraging a structured process for formulating and implementing policies at all levels of government, the PFI can be used in various ways and for various purposes by different constituencies, including for self-evaluation and reform design by governments and for peer reviews in regional or multilateral discussions.

The PFI looks at the investment climate from a broad perspective. It is not just about increasing investment but about maximising the economic and social returns, which can differ substantially from region to region, even within a country. Quality matters as much as the quantity as far as investment is concerned. It also recognises that a good investment climate should be good for all firms – foreign and domestic, large and small. The objective of a good investment climate is also to improve the flexibility of the economy to respond to new opportunities as they arise – allowing productive firms to expand and uncompetitive ones (including state-owned enterprises) to close. The government needs to be nimble: responsive to the needs of firms and other stakeholders through systematic public consultation and able to change course quickly when a given policy fails to meet its objectives. It should also create a champion for reform within the government itself. Most importantly, it needs to ensure that the investment climate supports sustainable and inclusive development.

The PFI was created in response to this complexity, fostering a flexible, whole-of-government approach which recognises that investment climate improvements require not just policy reform but also changes in the way governments go about their business.

Bulgaria's FDI trends and macroeconomic performance

Bulgaria has been a member of the European Union (EU) since 2007. It is a relatively small, upper-middle-income economy, with a population of about 7 million (the 13th smallest in the EU in 2020). Around

1.3 million people lived in the capital city of Sofia in 2021.The transition from a centralised, planned economy to an open, market-based one begun in February 1991 and was initially hampered by slow institutional restructuring, opaque privatisation, high indebtedness, a deep economic and banking crisis, and a loss of savings. Gross domestic product (GDP) was correspondingly low and the promises of convergence failed to materialise. The situation started to improve in the late 1990s, thanks to the introduction of the currency board in 1997 as the key component of a broad macroeconomic stabilisation programme.

Since then, Bulgaria has established itself as a country with a strong macroeconomic performance and sound monetary and fiscal stability. In the late 1990s, a broad range of structural reforms ensured Bulgaria's transition from a command economy to an open market economy. The 2000s were a decade of economic growth and improved living standards. Although some of those gains were undone by the global economic crisis (GDP contracted in 2009), even in the most difficult moments inflation was kept low, in line with trade partners. The fiscal deficit was trimmed to less than 1% of GDP in 2012-13 from 4.2% in 2009. In 2011, Bulgaria exited the excessive fiscal deficit procedure. Government debt increased slightly to about 25% of the country's GDP in 2020, the third lowest in the EU. Throughout the years ahead of Bulgaria's accession to the EU, FDI trends followed an upward trajectory. Since then, deepening integration with the EU has further allowed progress despite the disruptions caused by the financial global crisis in the late 2000s and the COVID-19 crisis. Although Bulgaria's economy declined in 2020 as result of the COVID-19 pandemic, growth for 2021 as a whole totalled 4.2%, contrasting the 4.3% contraction recorded in 2020. GDP growth surpassed pre-crisis level by mid-2021, thanks to strong consumption supported by significant fiscal support and buoyant wage growth.

Many investors have continuously seen Bulgaria as an attractive investment destination. Prior to the COVID-19 crisis, the share of inward FDI stock stood at 78.5% of GDP, above the OECD and EU averages (of 46% and 59%, respectively), an illustration of Bulgaria's attractiveness to foreign investors. In 2020, Bulgaria's FDI flows were EUR 2.2 billion corresponding to about 3.5% of 2020 GDP, compared to 1.9% of GDP in 2019. Figures for January 2022 showed that FDI had more than doubled compared to January 2021. Among the world's leading manufacturers, the country ranks among the top locations for outsourcing production activities. With economic development, Bulgaria has also become an important investor abroad. According to preliminary figures issued by Bulgaria' Central Bank in June 2022, Bulgarian investment abroad increased by EUR 107.2 million in the first four months of 2022, compared to EUR 62.6 million in the same period of 2021.

Bulgaria's competitive stance

Tackling the challenge of sustaining efforts to promote innovation, digitalisation and better infrastructure

The COVID-19 crisis has brought up the importance of digitalisation and innovation, where Bulgaria is lagging. Further investment in Bulgaria's communication infrastructure networks and innovation across all regions is essential to support Bulgaria's economic recovery and attracting FDI. Yet low levels of public and private investment in R&I, fragmented public science base, lack of ICT skills as well as insufficient science-business linkages are still challenging Bulgaria's digital and innovation ecosystem. Progress in this direction would ensure greater social inclusion in the post-COVID-19 times.

With respect to infrastructure, Bulgaria started in the late 1990s to invest in the development of key physical infrastructure as a fundamental element of national integration. This effort was particularly important in road and rail transport. Nonetheless, despite significant progress achieved in improving both road and rail infrastructures, Bulgaria still suffers from a rather poor state and big disparities of infrastructure and big regional disparities as highlighted in international organisations' reports such as the World Bank *Doing*

Business 2020 report. Significant infrastructure disparities remain across regions, which is still a challenge for unlocking their potential for investment and growth. For Bulgaria to attract more private investment, several obstacles for investment would need to be addressed such as poor road quality, insufficient railroad connectivity as well as a slow-pace implementation of ongoing projects and reforms.

Labour market and skills

A set of factors such as Bulgaria's relatively high level of enrolment in education, low employment costs compared to other EU member states as well as Bulgaria's EU membership have made Bulgaria's labour market attractive for investors. The adult literacy rate in Bulgaria is 98.4% (15 years and older) according to the most recent data from the UN's Human Development Report, although illiteracy is higher among some minorities such as the Roma population. Against the background of a rapidly ageing population and negative net migration flows, Bulgaria will need to pursue its efforts to improve the labour and social context and to decrease the brain drain of Bulgaria's population.

SOEs reforms have advanced

Poor governance and economic performance of Bulgaria's State-Owned Enterprises (SOEs) has been seen for many years as an obstacle to private investment. Bulgarian SOEs still dominate large parts of the economy in key sectors such as energy, health, and transport. In order to diffuse these concerns, significant changes have been introduced by Bulgaria to improve the legal framework for SOEs through the adoption of a new Law and bylaws in line with the OECD *Guidelines on Corporate Governance of State-Owned Enterprises ("SOE Guidelines")*. Strengthening the governance of SOEs, including local SOEs, has become one of the main priorities of Bulgaria's government.

For the past six years, reforms to improve governance and promote the integrity of SOEs have progressed. In December 2019, Bulgaria became adherent to the SOE *Guidelines* and as such has committed itself to further promote the implementation of the *Guidelines* and defining a framework for the corporate governance of SOEs. In October 2019, with the technical and legal support of the OECD Secretariat, Bulgaria adopted the Law on Public Enterprises (LPE). One of the main novelties introduced by the LPE is the establishment of an ownership co-ordination entity, the Public Enterprises and Control Agency (PECA) (a transformation of the former Agency for Privatisation and Post-privatisation Control). PECA's new role responds to the need to improve the decentralised SOEs model of the country. In April 2020, Bulgaria adopted the "PECA's rules of procedures" as well as the "Rule of Implementation of the Law on Public Enterprises". Despite these encouraging developments, these reforms are still recent and need to be practically implemented by relevant authorities in order to be effective.

Competition policy

For the past two decades, Bulgaria has taken steps to promote entrepreneurship and to guarantee a level playing field for both domestic and foreign investors. As part of EU membership requirements, Bulgaria has aligned its legal and institutional framework with EU standards. Bulgaria has a competition authority to promote competition and entrepreneurship and enable FDI. Still, Bulgaria's market functioning has been of concern for some investors. Bulgaria has an opportunity to leverage its standards and practice in the context of its work with the OECD Competition Committee.

Bulgaria's investment regime and policy framework for investment

Bulgaria is open to foreign investment

Since the early 2000s, attracting investment has been a top priority of the government, as evidenced by Bulgaria's national development strategy plans and other governmental strategic documents. With a view to enhancing FDI inflows, continuous efforts have been made to reform the regulatory framework under favourable terms in line with the European legislation and other international standards. Bulgaria is open to foreign investment, with few formal ownership restrictions, and the key standards of investor treatment and protection are guaranteed under the Constitution and other laws.

There are no generalised screening or approval mechanisms for new investments or established companies in Bulgaria. In addition, Bulgaria does not impose limits on access to local finance and incentives (e.g. tax concessions) or government purchasing markets for foreign-controlled enterprises incorporated in the country. National treatment of foreign investors in the post-establishment phase is guaranteed, which means that foreign investors, when incorporated and headquartered in Bulgaria, are considered domestic legal entities, with all the rights and obligations that are applied to domestic investors. The few existing exceptions to national treatment are limited to foreign ownership restrictions in a handful of sectors, namely in the acquisition of land (agricultural, for commercial purposes and real estate), forestry, air and maritime transport, as well as restrictions for the provision of rail transport, legal services and mining.

Other existing barriers to FDI mainly concern conditions imposed at establishment (e.g. establishment requirements for investment in energy, private security, legal services and selected financial services). These barriers are few, mostly sector-specific, and typically limited in their scope, applying almost exclusively to investors from outside the EU, the European Economic Area (EEA) or Switzerland, or to investors from countries that are not WTO members. As a result, using the methodology of the OECD FDI Regulatory Restrictiveness Index, which is based on statutory measures that are discriminatory in nature, Bulgaria's degree of restrictiveness is low in comparison to both the OECD average and the average of non-OECD economies that have adhered to the *Declaration*.

The key standards of investor treatment and protection, including with respect to intellectual property rights, are guaranteed under the Constitution and ordinary laws. The protection of investment, combined with effective enforcement mechanisms, is an important pillar of a sound investment climate. Protecting investors from improper treatment can lower their perception of risk for new investments, and investors who perceive lower risks will generally make capital and resources available at a lower cost and with longer amortisation process.

Protection of investment is strong

Bulgaria's domestic framework provides investor protection aligned with international standards. Bulgaria's Constitution includes protections for local and foreign investors against forcible expropriation of property, and property rights and regulations on acquisition, benefits and use of property are well defined.

Bulgaria also benefits from a modern intellectual property (IP) legislation that is aligned with the EU norms and standards, which is an important precondition for attracting and retaining investment. Bulgaria grants constitutional-level protection to IP rights, in particular to scientific and technological creativity, as well as inventors' rights, copyrights and related rights. Bulgaria is also a party to all international treaties and conventions on intellectual property administrated by the World Intellectual Property Organization (WIPO), with the exception of the Geneva Act of the Lisbon Agreement on Appellations of Origin and Geographical Indications. National laws are aligned with EU directives, even going beyond the minimum requirements of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).

Bulgaria is also arbitration and mediation-friendly. It has also made tangible progress in reducing delays related to contract enforcement as illustrated in the 2020 World Bank Doing Business report, in which Bulgaria ranked 42nd in the ease of enforcing contracts among 190 economies, moving up 33 spots since its 2015 ranking. Progress in reforming the judicial system has been steady since Bulgaria's accession to EU membership, in particular towards strengthening the independence and professionalism of the judiciary. Challenges nevertheless remain to tackle judicial and administrative delays and costs to enforce contracts.

A significant network of investment treaties adds protection for foreign investors

Like many other countries, Bulgaria grants additional and preferential protections to some foreign investors through its network of investment treaties with broad range of countries. Most of these treaties, which nominally cover over 50 jurisdictions and a large share of Bulgaria's inward and outward FDI stock, were concluded in the 1990s and early 2000s. They bear the hallmarks of agreements concluded at a time when few treaty-based claims had been brought by investors, awareness of treaty implications was lower among governments and belief in the potential benefits of such treaties was greater than it is today.

Bulgaria has changed its approach to investment treaties in recent years. Some of this change corresponds to commitments that Bulgaria made as part of EU accession and a new role for the European Commission on investment policy in the EU since 2009. It also likely reflects Bulgaria's experiences facing claims by investors in arbitration cases under its older treaties – at least ten such cases at the time of writing of this report – and intensification of policy debates regarding effects, designs and outcomes of investment treaties.

Central in these debates is the desire to strike an appropriate balance in these treaties between investment protection and sovereign rights to regulate in the public interest. A new Bulgarian model BIT, which was approved by the Council of Ministers in November 2018, seeks to achieve a more balanced approach and serve as a basis for future treaty negotiations with non-EU countries. This represents an important achievement but seeking to update existing treaties remains a separate challenge. Bulgaria is keenly aware of these issues through its participation in several ongoing inter-governmental treaty reform processes.

Bulgaria has modern investment promotion mechanisms for FDI attraction

Bulgaria's policy framework for investment also contains modern and well-co-ordinated investment promotion mechanisms. Over the years, Bulgaria's governments have developed several framework documents that provide the overall vision for the country's medium and long-term socio-economic development and the role of investment promotion and facilitation within it. In particular, the Act on Investment Promotion (AIP) sets out the specific objectives of the national investment promotion policy, delineates responsibilities of different bodies, and outlines the criteria for state support.

The Ministry of Economy until recently has been in charge of the development of the national investment promotion policy, aided in its implementation by InvestBulgaria Agency (IBA), at the national level, and by regional governors and mayors at the sub-national level. In addition, several bodies have aimed to facilitate cross-institutional co-ordination, for example the high-level permanent taskforce of the Ministry of Economy, the National Economic Council and the National Council for Tripartite Co-operation. Given the commitment of the new government established in late 2021 to update the rules for doing business in Bulgaria, developing an action plan with specific planned government initiatives listed, responsible institutions and applicable timelines could help ensure that crosscutting reforms are implemented as envisioned.

Bulgaria relies on the provision of investment incentives to attract entrepreneurs

Bulgaria has a relatively low rate of corporate taxation and a well-developed framework for provision of investment incentives. Fiscal incentives are regulated by the underlying tax legislation and financial incentives by the AIP. As an EU Member State, Bulgaria is also subject to the EU State Aid rules. Overall, there are four types of certified investment projects in Bulgaria – Class A, Class B, Class C (which are provided by municipalities) and priority investment projects – that can benefit from government support. The certificates differ in the application process and the eligibility criteria, which relate to the character of the economic activity, size of investment and job creation effect, among others. About 300 investment projects were certified in Bulgaria in 2004-20 (most of which were Class A projects), which were associated with a creation of over 70 000 direct jobs.

Bulgaria also offers investors advantages associated with locating in one of the industrial zones. Importantly, industrial zone users in Bulgaria do not benefit from a reduced profit tax rate. Instead, such zones exist for custom purposes only, and they aim to provide investors with high-quality infrastructure. Technological parks are also available, which need to satisfy the conditions of an industrial zone and host predominantly scientific research and development activity, education, information technologies or advanced manufacturing. According to AIP, investment projects aiming to create an industrial zone or a technological park are eligible to become certified investment projects and the planned legislation on technological parks aims to regulate the parks' creation and management. In the future, improving monitoring and evaluation of such instruments can help ensure their optimal use.

The national investment promotion agency, IBA, plays an important role in facilitating the process of investors' applications to become a certified investment project and more generally help attract investment. IBA is an executive public agency. Beyond processing investment project applications, its task is to provide free-of-charge information, contacts and project management support to potential investors. Relative to OECD agencies, IBA is small and has relatively low levels of institutional independence. In order to maximise its positive impact, the agency could consider boosting its proactive prioritisation efforts, monitoring and evaluation and co-operation with regional bodies to fully embed its policies with regional development policies. It could also reflect on the feasibility of extending its aftercare services and offering information on local suppliers/buyers to embed them better to the region, personnel recruitment or training support to help bridge the skills gaps in the country.

EU funds also play an important role in mobilising investment

Another aspect influencing Bulgaria's investment attraction policy is the availability of EU funds. Bulgaria is one of the countries that has benefitted most from the EU support during the budget cycle between 2014 and 2020. These funds provide additional source of financing for firms and can mobilise additional private capital, improving the overall liquidity. In the medium and long run, they can also support building of necessary infrastructure and educating the labour force, helping to improve Bulgaria's attractiveness as an investment destination. For example, a large share of EU funding goes towards greening of the economy, educational and vocational training initiatives, research and innovation and high-quality employment programmes. Several EU programmes are also specifically geared towards supporting SMEs in Bulgaria, including in the aftermath of the COVID-19 pandemic. Yet, Bulgaria's system for managing EU funds in the 2014-20 programming period was centralised in the hands of national managing authorities, and lacked a place-based and integrated approach. In addition, the use of EU funds have been highly concentrated in large cities, where substantive infrastructure is located. This unbalanced use of EU support has further entrenched diverging development trends among regions and localities in Bulgaria.

Bulgaria has undertaken a number of actions to reduce administrative burden but additional efforts are required

Bulgaria has undertaken a number of initiatives to reduce administrative burdens. For example, several consecutive programmes involved reaching of quantitative targets. Legal changes in 2016 have also improved the legal requirements of creating new regulations; and an SME Test has been introduced to assess possible regulatory effects on smaller firms. Bulgaria has also made strides in digitising administrative procedures and offering e-services, including to business. Yet, international rankings and feedback from the private sector suggest that the ease of obtaining licenses and permits remains a challenge to doing business in Bulgaria. For example, there were 18 procedures for dealing with construction permits in Bulgaria at the time of writing of this *Review*. Overall, it took 97 days to deal with the 18 procedures according to the 2021 OECD *Review on Decentralisation and Regionalisation in Bulgaria*. In this context, the government could consider if establishing a single window for investment could be a useful and feasible step and continue the process of improving the overall quality of regulations in the country.

Strengthening public governance

The quality of public governance at the national, regional and local level has a significant influence on the climate for business and investment. Poorly designed or loosely applied regulations can slow business responsiveness, divert resources away from productive investments, hamper or delay entry into markets, reduce job creation and generally discourage entrepreneurship. Nothing contributes more to investor confidence about regulation than predictability and that rules achieve their state objectives. The quality of public services also significantly influences the investment climate, and this includes the quality of the justice system. Integrity is also a crucial determinant of a favourable investment climate.

Bulgaria has made progress in strengthening its anti-corruption and public integrity framework but challenges persist

Bulgaria has made progress in reducing opportunities for corruption and limiting discretion in public decision-making. The Criminal Code prohibits various corruption offences, including extortion, trading in influence, facilitation payments and, in line with the OECD *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*, bribery of foreign public officials. In late 2017, Bulgaria adopted a comprehensive anti-corruption law, setting up a single anti-corruption agency based on a merger of existing institutions, to tackle corruption among high-level officials and to deal with issues such as conflicts of interest and declaration of personal assets. The new legislation also introduced new principles such as legality, transparency and impartiality. New anti-money laundering legislation was adopted in 2018, following the Fourth European Union Anti-Money Laundering Directive (AMLD4) of 2015.

Nevertheless, the complex legal framework and weak enforcement have hampered Bulgaria’s ability to effectively tackle all challenges related to corruption, as illustrated by the April, July and November 2021 legislative elections during which anger over corruption weighed on the campaign period. Despite the many encouraging steps taken, corruption continues to be perceived to be widespread. According to the 2019 EU *Flash Eurobarometer* on attitudes towards corruption, 85% of businesses operating in the country described corruption as widespread. In the *Transparency International Corruption Perception Index* for 2021 released in January 2022, Bulgaria remained below other EU member states, ranking 78th overall in the report, the worst ranking of an EU country among 180 countries surveyed. Bulgaria still lacks a solid criminal record of accomplishment of concrete results on high-level corruption cases as well on tackling corruption at the local level that would help to build public trust. In 2017, the *Local Integrity System Index* developed by Transparency International Bulgaria showed that the 27 municipalities-district centres had an average score of 3.29 (on a scale from one to five). The EU Co-operation and Verification Mechanism

(CVM) specifically included a recommendation concerning the need to fight against corruption at the local level.

Judicial reform has advanced although challenges remain

Bulgaria has undertaken noticeable reforms to tackle major issues of concern to businesses such as the perceived judiciary's lack of professionalism and impartiality. Policy steps have been taken to enhance the independence of magistrates. The Bulgarian authorities have also seen building the capacity of the judiciary as critical. Because of these efforts, the latest and last (2019) EU Co-operation and Verification Mechanism report assessed positively the progress of Bulgaria in the area of judicial reforms. Because of these policy developments, the Commission proposed that Bulgaria exit the mechanism, which was initially set up at the time of its EU accession in 2007.

Despite these encouraging developments, public perception of Bulgaria's judiciary has improved only marginally. According to the 2021 Index of Economic Freedom of the Heritage Foundation, court backlogs and delays have continued to be perceived as a significant issue and the judicial system has remained the least trusted Bulgaria's institution. Similarly, according to the 2020 EU Justice Scorecard, the perceived independence of Bulgaria's judiciary was among the lowest in the EU. This suggests that further progress towards improving judicial independence is required.

Reforms of Bulgaria's public procurement system is on-going under guidance of the European Commission

Unfair or opaque procurement processes may send negative signals to businesses and mislead them into considering that corruption is part of the normal course of doing business in a country. An average of around BGN 5 billion is spent annually through public procurement in Bulgaria. For years, public procurement in Bulgaria has been considered as vulnerable to corruption. For example, the amount of allegedly corrupt procurement represented 36% of the total public funds spent by municipalities in 2015 according to a 2021 OECD report on decentralisation and regionalisation in Bulgaria.

Administrative capacity has been another challenge for the procurement system, causing formal errors and delays. Persistent concerns have also related to the lack of consistency and 'formalistic' ex ante and ex post controls of procurement procedures. According to the EU Single Market Scorecard, Bulgaria's public procurement performance in 2019 was average, a performance comparable to the performance of other EU countries such as Belgium, France, Germany, Hungary, Italy, Ireland, and the Slovak Republic.

In response to these concerns, Bulgaria has continuously reformed its public procurement system in an effort to make it both compliant with the EU acquis and improve performance in terms of competition, openness and transparency – reforms that have affected all spheres of the procurement cycle, including oversight and law enforcement. For example, the Bulgarian National Strategy for the Development of Public Procurement Sector 2014-20, and its accompanying Action Plan, were elaborated to meet the requirements that stem from the new EU public procurement directives, the country specific recommendations proposed by the European Commission and adopted by the Council of the EU, the National Reform Programme 2014-20 and the EC Co-operation and Verification Mechanism. The strategy aimed at reducing the risk of irregularities in public procurement through measures in five areas: legislation, law enforcement, publicity and transparency, strengthening of administrative capacity and professionalism and control systems. It also contained actions, related to the adoption of e-procurement, which resulted in the operationalisation of e-procurement platform, together with amendments in the Law on Public Procurement.

Bulgaria has made strides in improving the quality of its overall regulatory system

In response to concerns by the business community about the regulatory environment in Bulgaria that has been characterised by complexity and lack of transparency, Bulgaria has made strides in improving the overall quality of its regulatory system. This is reflected in the country's scores on the World Bank's *World Governance Indicators* and the OECD *Indicators of Regulatory Policy and Governance* (iREG). For example, recent legislative changes improved the legal framework for publishing draft laws, conducting public consultations, preparing regulatory impact assessment and ensuring better regulatory oversight.

Still, in the area of conducting *ex post* evaluations of regulations, Bulgaria could achieve further progress to reach the levels found in other OECD countries. In particular, reducing administrative burdens and mixed feedback in reaching quantitative reduction targets point that this area is an ongoing challenge and will require further efforts to review and, wherever possible, streamline most burdensome regulations. Ensuring that the requirements of prior publication, public consultations and *ex ante* regulatory impact assessment are respected in practice when preparing draft regulations will also be important. Addressing recommendations stemming from the OECD *Regulatory Policy Scan of Bulgaria* released in 2022 could be helpful in this regard.

Promoting and enabling responsible business conduct

Promoting and enabling responsible business conduct (RBC) is vital to attract and retain quality investment and ensure that business activity contributes to broader value creation and sustainable development. Internationally recognised RBC principles and standards such as the OECD *Guidelines on Multinational Enterprises* set out an expectation that all business avoid and address negative impacts of their operations, while contributing to sustainable development where they operate.

Bulgaria has taken steps to promote RBC, including through the adoption of a National CSR Strategy and the mainstreaming of RBC principles and several policies and sectoral strategies. Various actors, notably business associations have been active in RBC promotion. These efforts have resulted in a growing awareness of RBC in the country. Understanding and implementation of RBC however vary significantly across businesses. Moreover, the concept of due diligence – a key process for the implementation of RBC principles – is not yet at the forefront of the public discourse and national efforts on RBC. Promoting a common understanding of RBC based on internationally recognised RBC standards, can help promote sound business practices, while supporting the government national priorities for Bulgaria's sustainable development.

Furthermore, deepening efforts to promote RBC due diligence could go a long way in addressing some of the main environmental and social risks that are associated with certain industries, for example the garment, mining and energy production sectors. The government could consider leveraging and actively disseminating international standards and tools to help businesses better manage such risks, improve industrial relations and maximise the contribution of the sectors to economic, but also environmental and social outcomes.

Beyond promoting standards, the government can play a role by facilitating the due diligence process, and creating an enabling environment for RBC. Ensuring that stakeholders, workers and journalists can play their role in consultative and accountability processes is key to ensure that businesses can meet international RBC standards. More broadly, a sound judicial system, as well as predictable and transparent processes are important elements to underpin RBC. As noted above, the government has made efforts in that regard. Bulgaria is encouraged to deepen reforms to support further uptake and implementation of RBC.

Countries that are Adherents to the OECD *Declaration* are required to set up a National Contact Point (NCP) for the *Guidelines*. NCPs are created to further the effectiveness of the *Guidelines*, and Adherents are required to make human and financial resources available to their NCPs so they can effectively fulfil their responsibilities, taking into account internal budget priorities and practices. In addition to promoting the *Guidelines*, NCPs contribute to the resolution of issues that arise relating to their implementation in specific instances. Throughout the year 2021, Bulgaria took important steps to establish its NCP as evidenced by the Council of Ministers Decision No. 682 adopted on 17 September 2021 establishing and organising the activities of Bulgaria's NCP for the implementation of the *Guidelines*. During the first half of 2022, in the context of its formal adherence to the *Investment Declaration*, Bulgaria made additional efforts to operationalise its NCP.

Challenges ahead

Political instability has been of concerns to investors. Although the political situation in Bulgaria stabilised in 2017 up to the end of 2020, for most part of 2021 Bulgaria did not have a functioning parliament. After this prolonged political crisis, a new coalition government was formed in December 2021. In summer 2022, Bulgaria was nevertheless facing new risk of political instability after a no confidence vote in parliament that led to the resignation of the government formed in December 2021.

The war in Ukraine has also clouded the economic outlook. While the economic recovery from the COVID-19 crisis was gaining momentum in 2021, the war has been dampening growth.

The many years of expansion until the COVID-19 crisis saw deep transformation in the economic structure, in particular of exports, which have proven to be particularly important given the small size of the Bulgarian economy and therefore the relevance of trade for overall economic performance. Exports of goods and services was equal to 65% of 2015-19 GDP (as against 29% in OECD, 41.5% in Romania and 33.6% in Greece during the same period). Until the COVID-19 crisis, private consumption expanded at a robust rate based on low inflation and favourable labour market conditions. Between 2015 and 2020, GDP growth was well in excess of 3%. Exports, supported by increasingly strong linkages with global value chains (GVCs), especially with EU countries, have been the key driver for growth. In late 2019, before the COVID-19 crisis, more than 50% of all Bulgarian exports were sourced and sold in GVC linkages. Bulgaria's GVC participation was above the EU-28 level, although lower than in countries such as the Slovak Republic and Hungary. Bulgaria is highly integrated in the regional value chain with the EU: in 2019, 48% of foreign value added content (FVA) in Bulgarian exports were sourced from EU (mainly Germany and Spain).

The global economic fallout resulting from the COVID-19 outbreak affected Bulgaria. Economic activity contracted sharply when confinement measures were first introduced to contain the pandemic. According to data issued by the National Statistical Institute (NSI) in March 2021, Bulgaria's economy dropped by 4.7% in the fourth quarter of 2020. In annual terms, the economic drop in the third quarter of 2020 was 4.2% compared to the same period of 2019.[1] Overall GDP fell by 4.1% in 2020. Employment fell, eroding recent gains. The reduced actual and expected business activity because of the COVID-19 crisis prompted domestic and foreign companies to postpone investment plans. Thanks to anti-crisis measures, including fiscal ones, adopted by the government in the aftermath of the COVID-19, economic growth rebounded by 4.2% in 2021, primarily driven by domestic demand and exports. According to the OECD June 2022 *Economic Forecast Summary*, growth was nevertheless expected to weaken to 2.5 % in 2022 and 2.25 % in 2023 because of the war in Ukraine.

In the context of this challenging time, business environment improvements could further support investment and growth. As recognised by Bulgaria's authorities, further efforts are required to attract high-value added investment to support the modernisation of the economy to achieve the country's goal of ensuring long-term sustainable growth and development that can deliver benefits for all as well as supporting local productive capacity and innovation and competitiveness to help the country prepare for the future. Further investments in infrastructure, more and better-targeted public policies in digitalisation and in R&D, completion of the major reform of the corporate governance framework of state-owned enterprises (SOEs), additional measures to strengthen the judiciary, and effective enforcement of the anti-corruption legislation, could help attracting more domestic and foreign direct investment and strengthen business competitiveness. Targeted investment promotion could also help to tackle regional disparities and unlock growth potentials in all regions, particularly in the North-West region (OECD, 2021).

It is important that policies and institutions take into account regional heterogeneity – as firms certainly do when making decisions on where and what to invest. An existing concept that already begins to do this is the EU Smart Specialisation Strategy. This strategy works on identifying local assets and then increasing the competitiveness of these assets, including through diversifying within this realm to higher value added operations. It also identifies a region's weaknesses and works to mitigate them for example through increasing service and infrastructure linkages to higher achieving regions. Thus, one of the best ways to ensure investment will lead to spill overs is to attract the foreign or domestic firms that match regional assets and ambitions.

Policy recommendations

National treatment of investment

- Evaluate the costs and benefits of continuing to open up the economy to international investment by further reducing the exceptions to the OECD National Treatment instrument. Discriminatory measures only serve the broader public interest to the extent that their potential costs in terms of forgone investment and efficiency gains are compensated by broader social and economic benefits. For this reason, they need to be constantly re-evaluated to determine whether such restrictions still fulfil their original roles in an efficient manner and no other non-discriminatory alternative measure is available for such purposes. This should include an assessment of the proportionality of the measure to ensure they are not greater than needed to address specific concerns and objectives.

Investment protection

- Consider recognising foreign-based conciliation commissions and foreign-based mediation procedures as an alternative method of resolution of legal and non-legal disputes, as done with mediation that takes place in Bulgaria. This would avoid the current burdensome requirement for out-of-court settlements to undergo the general procedures for enforcement of contracts.
- Take additional steps to reduce the length of judicial procedures. These measures should include specific rules of procedure to prevent or limit dilatory measures and fixed time limits for the performance of each judiciary step, eliminating the need of interested parties to resort to the superior court to avoid time-delaying tactics.
- Continue to reassess and update the government's priorities with respect to investment treaty policy. An important issue in this regard is an evaluation of the appropriate balance between investor protections and the government's right to regulate, and how to achieve that balance in practice. Clearer specification of key provisions in older BITs would likely help to reflect government intent and ensure policy space for government regulation. It has proven difficult for governments to update older treaties but some multilateral reform initiatives are underway. Depending on whether the parties wish to clarify original intent or revise a provision, it may be possible to clarify language through joint interpretations agreed with treaty partners or treaty amendments. Replacement of older investment treaties by consent may also be an appropriate option in some cases.
- Continue to participate actively in and follow closely government and other action on investment treaty reforms at the OECD, UNCITRAL and for the ECT. Consideration of reforms and policy discussions on frequently invoked provisions in ISDS cases and whether investment treaties are achieving their intended purposes are of particular importance in current investment treaty policy. Emerging issues such as the possible role for trade and investment treaties in fostering responsible business conduct as well as ongoing discussions about treaties and sustainable development also merit close attention and participation.
- Continue to develop ISDS dispute prevention and case management tools. The government advised during the course of this Review that there is currently no dedicated unit responsible for handling investor grievances before they become ISDS cases under investment treaties. The government may wish to consider drawing on examples of institutional frameworks in other countries for the prevention of investment disputes and policy-setting activities. It may also wish to consider ways to promote awareness-raising and inter-ministerial co-operation

regarding the government's investment treaty policy and the significance of investment treaty obligations for the day-to-day functions of line agencies.

Investment promotion and facilitation

- Establish a list of priority investment climate reforms and specific projects with clearly identified timelines and responsible institutions. The plan should build on the existing strategic planning documents and diagnostics. It could be made publically available and periodically updated. The National Economic Council (NEC) and the ministry in charge of investment policy could play a lead role in this regard, supported by high-level of government.
- Strengthen regional component in investment promotion and develop terms of reference for co-operation across agencies at the central and sub-national level. Differentiate investment promotion according to regional comparative advantages. Use the EU Smart Specialisation framework to aid in this exercise. Rules for engagement with sub-national investment promotion bodies appear limited to processing of certified investment projects. For example, InvestBulgaria Agency (IBA) does not have a regional development mandate and lacks terms of reference for engaging with sub-national bodies. The development and implementation of such rules could help ensure complementarity of efforts and attraction of FDI into different regions.
- Consider strengthening the aftercare services and technical capacity of InvestBulgaria Agency (IBA) and of local initiatives such as InvestinSofia agency. While IBA performs all standard investment facilitation functions in the pre-establishment stage, it does not offer many aftercare services to firms (outside of certified investors). In particular, considering skilled labour shortages in Bulgaria and potential spillovers from SME-MNE links, the agency could consider developing such programmes. Specific projects, supported by international donors, could also help strengthen IBA's monitoring and evaluation and prioritisation capacity.
- Continue reducing administrative burdens. Administrative burden may be necessary for fair taxation, health, safety, environmental stewardship and other governmental commitments in line with the OECD *Guidelines on Multinational Enterprises* to improve social progress and the overall quality of citizens' life. Still, from the perspective of business, administrative burdens can be a cost, delay and source of uncertainty with respect to operations and projects. Given the number of procedures that companies have to comply in order to establish a business in Bulgaria, including registration with the Commercial (Business) Register at the Registry Agency (which takes two days) and registration for VAT at the National Revenue Agency (which takes 12 days), and the overall time needed for establishing a business in Bulgaria (23 days in total according to the World Bank's 2020 *Doing Business* report), these could be natural areas of focus in the short run. In the medium term, the government could consider whether establishing a one-stop solution for investment would help businesses deal with government regulations. In the long run, progress in improving the quality of regulations would also help reduce the stock of burdensome requirements.

Public governance

- Build on the progress made in improving the overall quality of regulations across all levels of government by systematising and improving the oversight and transparency of regulatory processes. In particular, ensure that the requirements of prior publication, public consultations and ex ante regulatory impact assessment of draft regulations are respected in practice. Also, advance on conducting ex post evaluations to reduce administrative burdens and implement any specific recommendations identified as part of the 2022 OECD Regulatory Policy Scan of Bulgaria.

- Continue ongoing promising reforms to combat corruption, notably by perfecting Bulgaria's public integrity framework at national and local levels.
- Continue judicial reforms to strengthen judicial independence and increase public confidence; implement an effective and transparent accountability mechanism for the Prosecutor General in line with international standards.
- Develop an adequate framework for the protection of whistle-blowers in compliance with the 2019 EU Whistleblowing Directive, which requires the EU Member States to adopt national whistleblowing legislation no later than December 2021 and launch a campaign to enhance officials and public acceptance of whistleblowing.

Responsible Business Conduct

- Establish an effectively functioning NCP to further the effectiveness of the OECD Guidelines. All Adherents to the OECD Declaration have an obligation to establish an NCP, in accordance with the Decision of the Council on the OECD Guidelines for Multinational Enterprises. Bulgaria should ensure that structure of the NCP retains the trust of stakeholders and guarantees its impartiality. In this context, further clarify the relations between the NCP's Chair, Secretariat and Working Group as well as its relation with the National Economic Council with respect to NCP's impartiality as highlighted in the OECD Procedural Guidelines.
- Promote policy coherence and ensure co-ordination on RBC-related policies within the government. In particular, the government should ensure that the mandates of different bodies, including those created through the process of establishing the NCP, are clearly delineated and co-ordinate adequately. As Bulgaria plans to develop a NAP on RBC, ensuring consistency and complementary with the existing CSR Strategy will be of particular importance. The government should also make sure that the development of the NAP follows international best practice notably with regards to the consultation processes and involvement of stakeholders.
- Set clear expectations as to what RBC entails, including in relation to due diligence. The governments could leverage the presence of large business associations active in RBC promotion to translate and disseminate the OECD Guidelines as well as all OECD due diligence guidance, to establish a common understanding across businesses of what RBC means and what government expectations are in that respect.
- Actively promote the Guidelines and the NCP among businesses operating in Bulgaria and Bulgarian companies operating abroad, as well as workers and stakeholders. This entails organising awareness raising events, capacity building activities and consultations on RBC with all stakeholders to identify priorities and needs. Ensuring that RBC principles and standards, as well as the NCP mechanism, are known among all relevant stakeholders is an important aspect of ensuring that the NCP can effectively fulfil its mandate.
- Promote the use of the OECD sectoral due diligence guidance, in particular the OECD Due Diligence Guidance in the Garment and Footwear Sector, OECD Minerals Guidance and OECD Guidance in Extractive Industries, through active support to these enterprises in implementing the recommendations of the due diligence instruments. Countries that adhere to the OECD Declaration commit to also adhere to all of the related OECD legal instruments aimed at supporting the implementation of the OECD Guidelines, including the OECD due diligence guidance. Promoting and supporting implementation of these instruments will contribute to facilitate businesses in meeting RBC expectations in Bulgaria.
- Facilitate meaningful stakeholder engagement in the design and implementation of RBC policies and processes. This includes ensuring that all stakeholders are empowered to express their views and take part in the public debate and encouraging companies to consider

the views of stakeholders and affected communities. The OECD Due Diligence Guidance for Meaningful Stakeholder Engagement in the Extractive Sector can provide a useful framework that can be particularly relevant for the coal industry.

- Ensure full compliance with EU legislations related to RBC, including the EU Non-Financial Reporting Directive, and support businesses in observing RBC-related laws and expectations. The government could consider leveraging the NCP to identify challenges faced by businesses and provide relevant tools and guidance to facilitate businesses in meeting RBC expectations.
- Seize the momentum created by SOE reforms to promote and implement RBC standards within SOEs, including local SOEs. As an economic actor in its own right and owner of enterprises, the government could take steps to establish clear expectations and requirements for SOEs about RBC performance and due diligence, and reporting on RBC-related risks. The government could rely on OECD due diligence guidance to practically operationalise RBC in Bulgarian SOEs.

References

OECD (2021), *Decentralisation and Regionalisation in Bulgaria: Towards Balanced Regional Development*, OECD Multi-level Governance Studies, OECD Publishing, Paris, https://doi.org/10.1787/b5ab8109-en.

Notes

[1] See Gross Domestic Product for the Fourth Quarter of 2020 (Flash Estimates), published on 16 February 2021, www.nsi.bg/sites/default/files/files/pressreleases/FlashEstGDP2020q4_en_ZPA374U.pdf.

From:

OECD Investment Policy Review: Bulgaria

Access the complete publication at:

https://doi.org/10.1787/6a0325b7-en

Please cite this chapter as:

OECD (2022), “Assessment and recommendations”, in *OECD Investment Policy Review: Bulgaria*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/5020bf6a-en