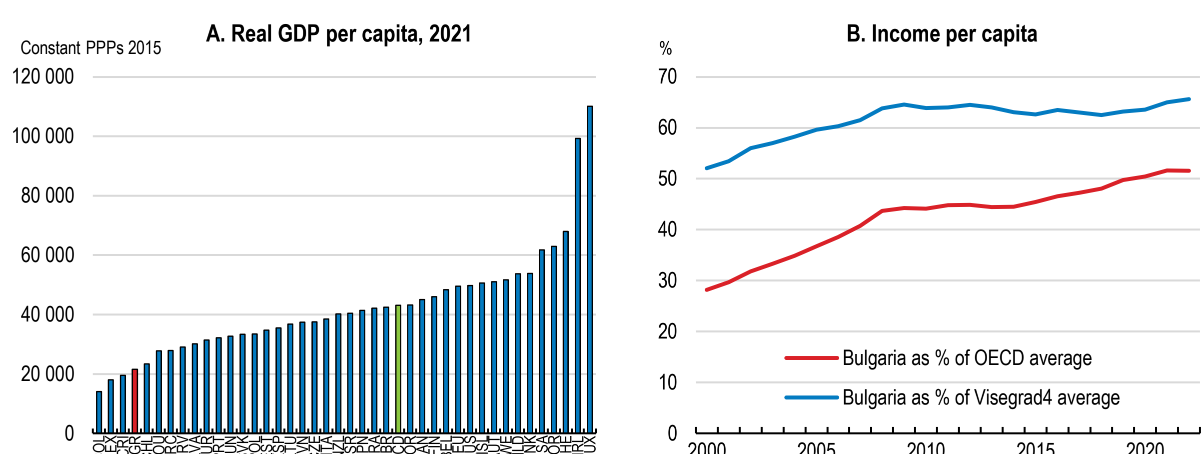
1 Key Policy Insights

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.

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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.

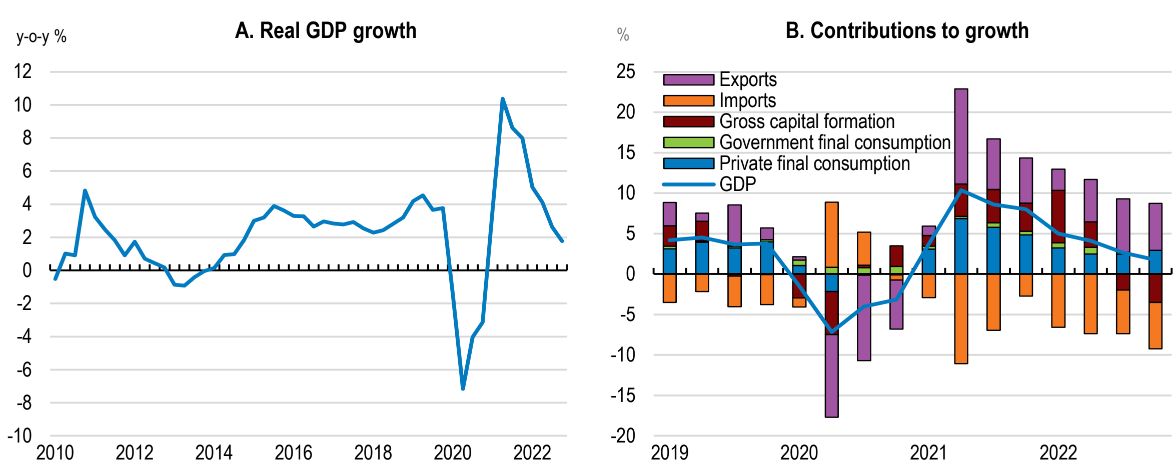
Against this background, the Survey's key messages for Bulgaria are:

- 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.

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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.

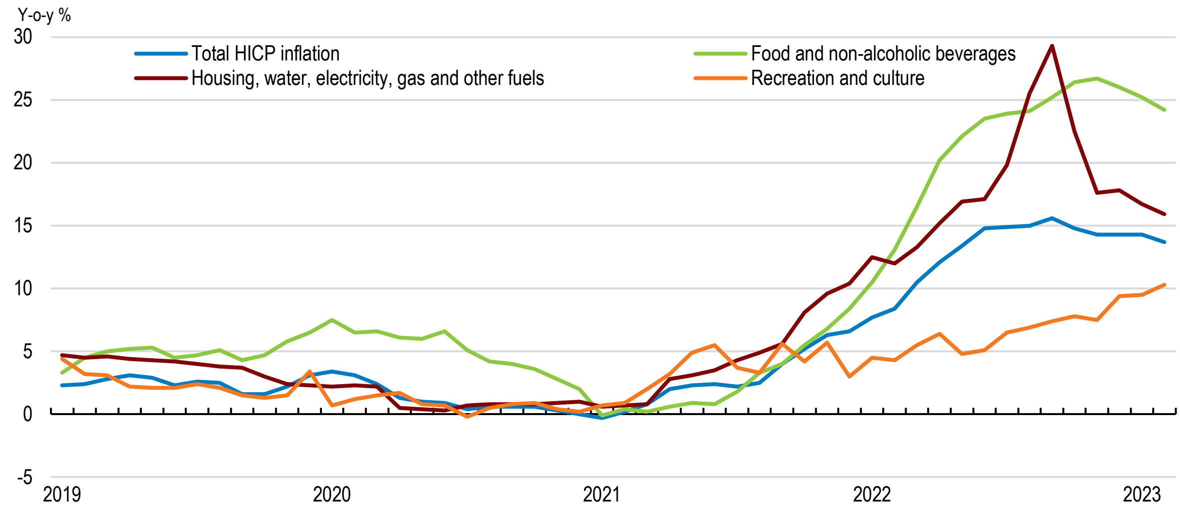
- Compensation for the most common categories of fuels used for non-business personal needs such as petrol and gas oil (diesel), LPG or propane-butane and methane for BGN 0.25/litre, effective from July until end-December 2022.
- Application of a zero VAT rate for bread and flour valid until the end 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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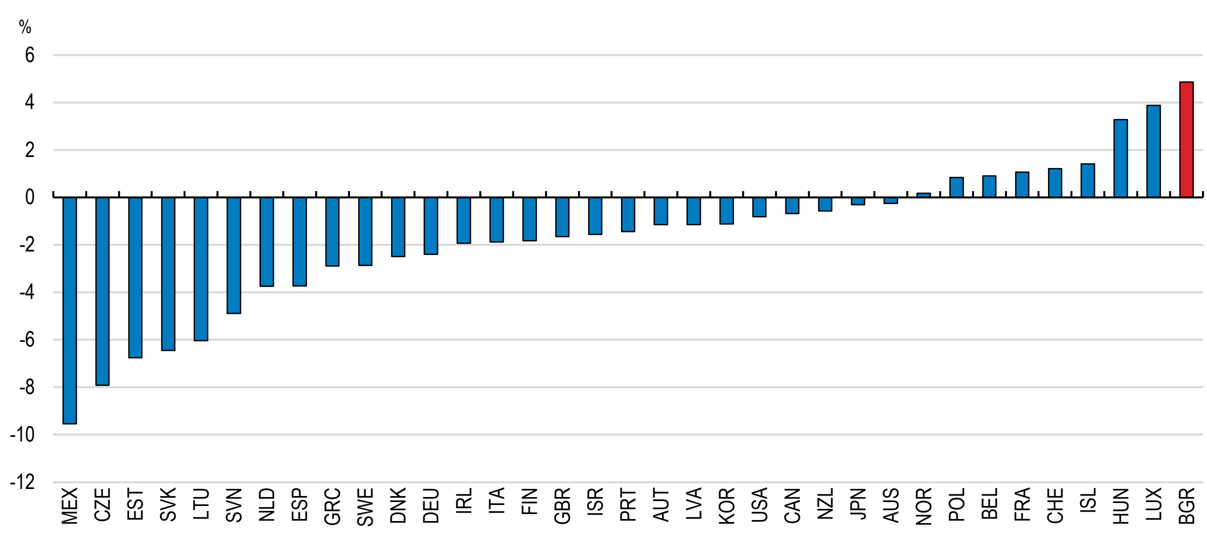
Figure 1.4. Real compensation has continued to grow

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.

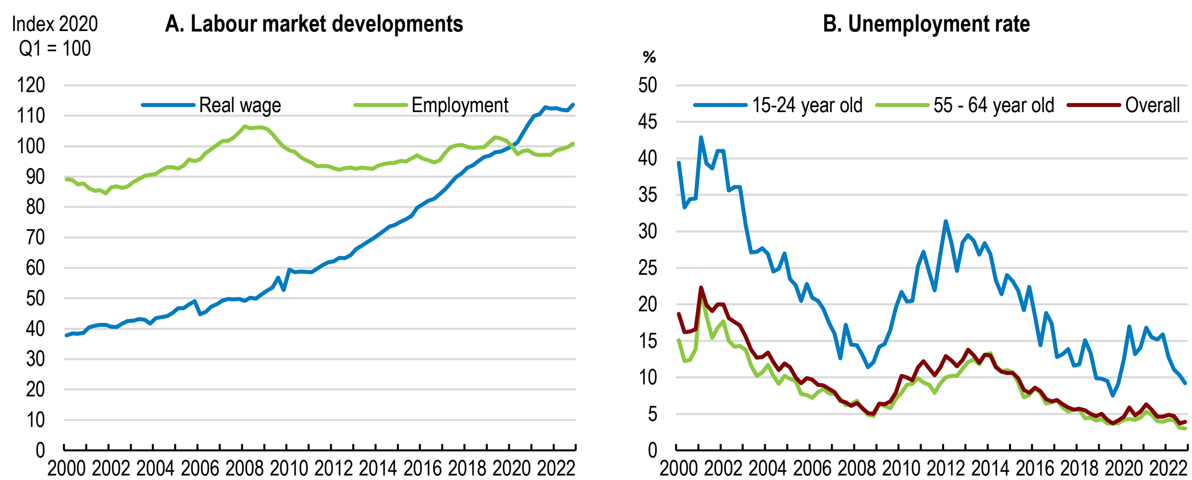
Bulgaria as an EU member country with a national currency is subject to a regular assessment by the European Commission related to the obligation to achieve convergence with the Economic and Monetary Union. Convergence is assessed according to four key requirements related to price stability, exchange 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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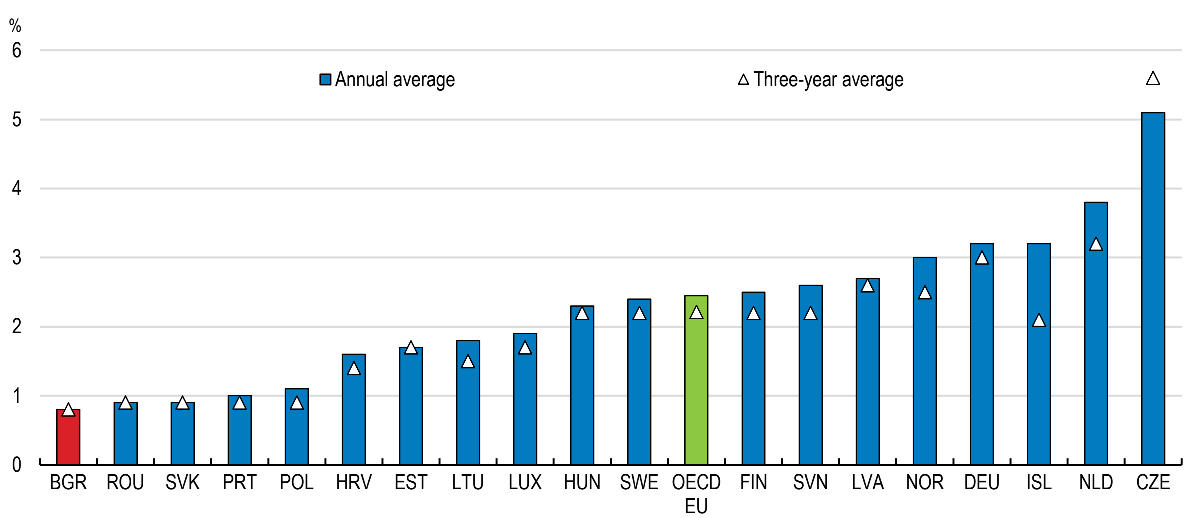
Figure 1.6. Labour shortages are low overall

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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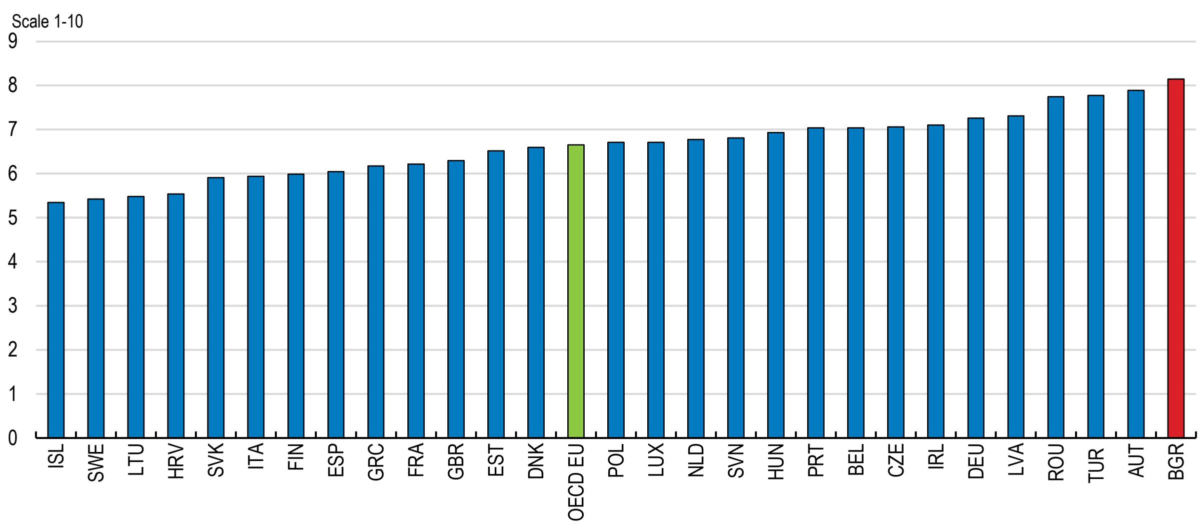
A large number of Ukrainian refugees arrived after the outbreak of the war in February 2022. Around 1.1 million Ukrainians entered until the end of February 2023, but many stayed only temporarily. From approximately 150 000 who registered for official protection, only around 50 000 stayed in the country. 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.

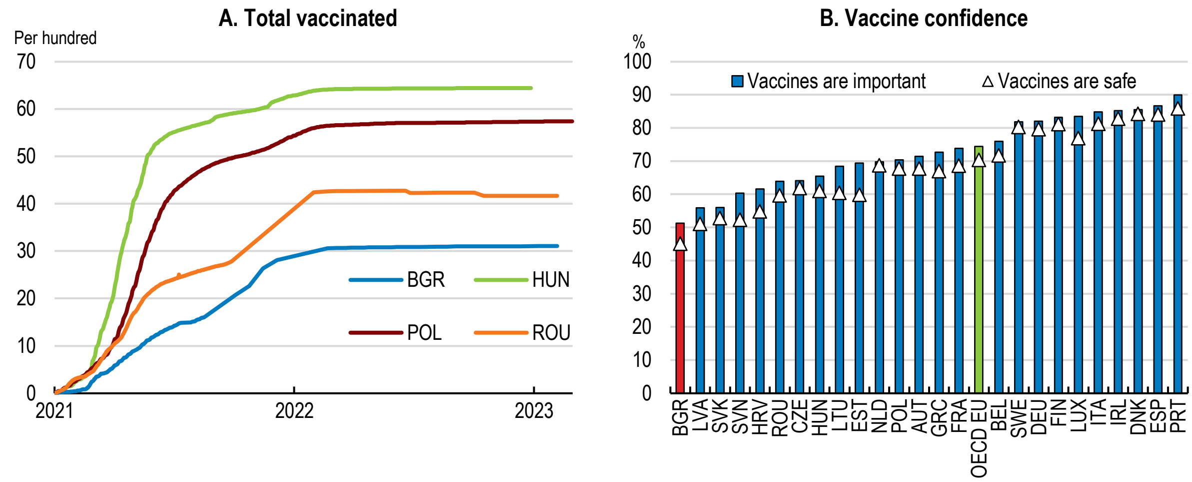
Table 1.1. Macroeconomic indicators and projections

	2019	2020	2021	2022	2023	2024
Bulgaria	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
Memorandum items						
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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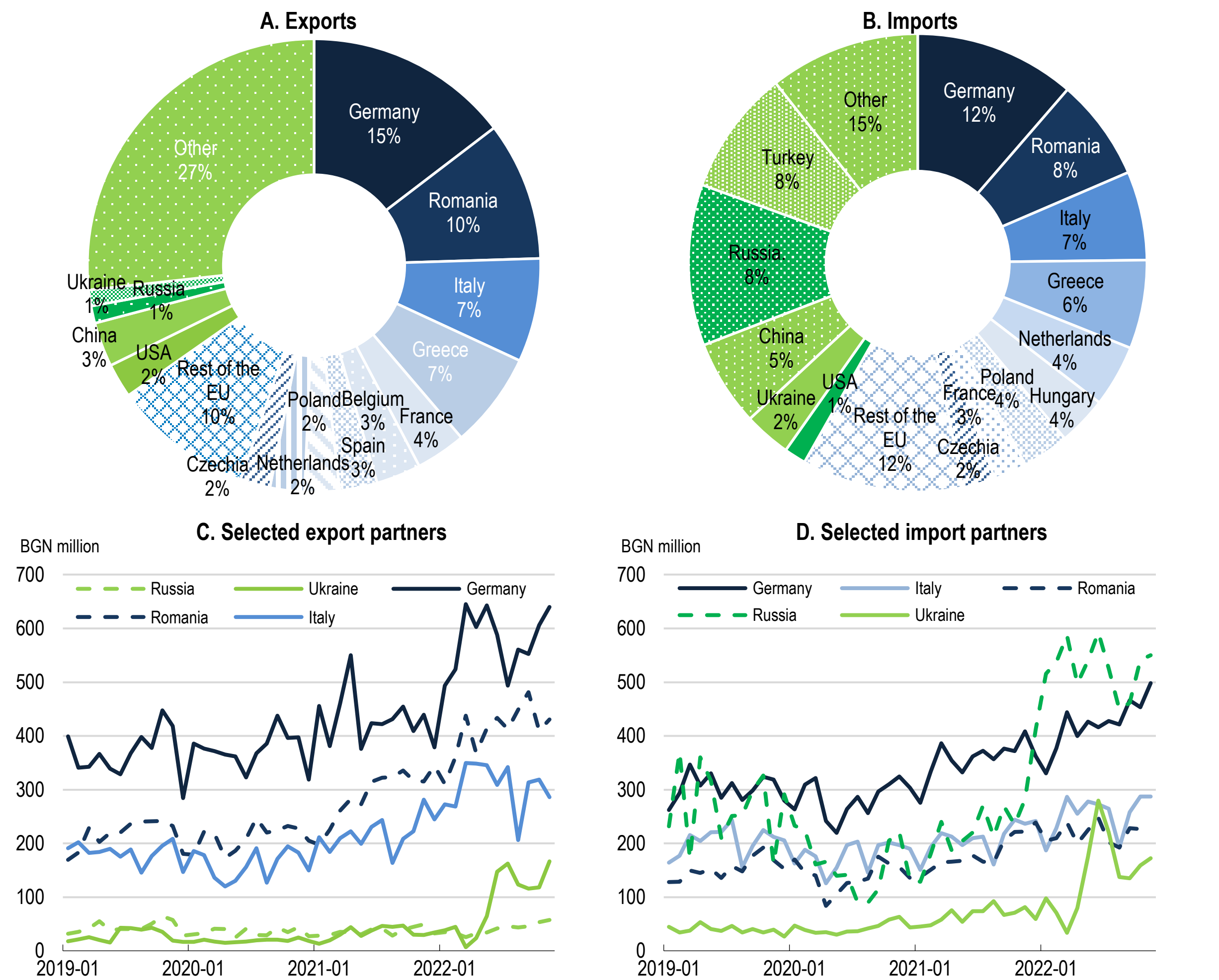
Table 1.2. Events that could lead to major changes to the outlook

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.

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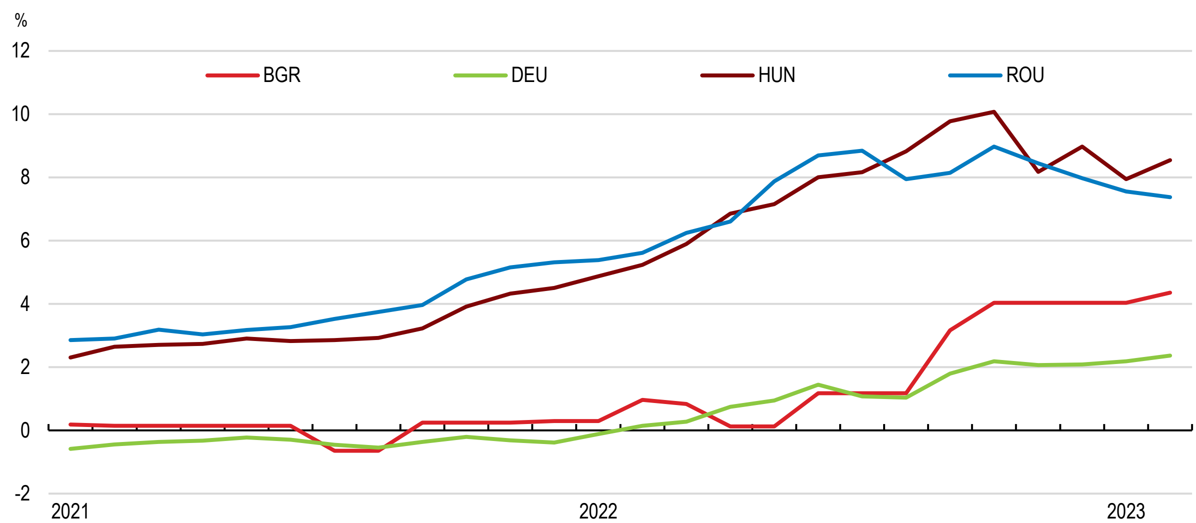
The banking system is well-capitalised, but faces headwinds from higher interest rates and debt

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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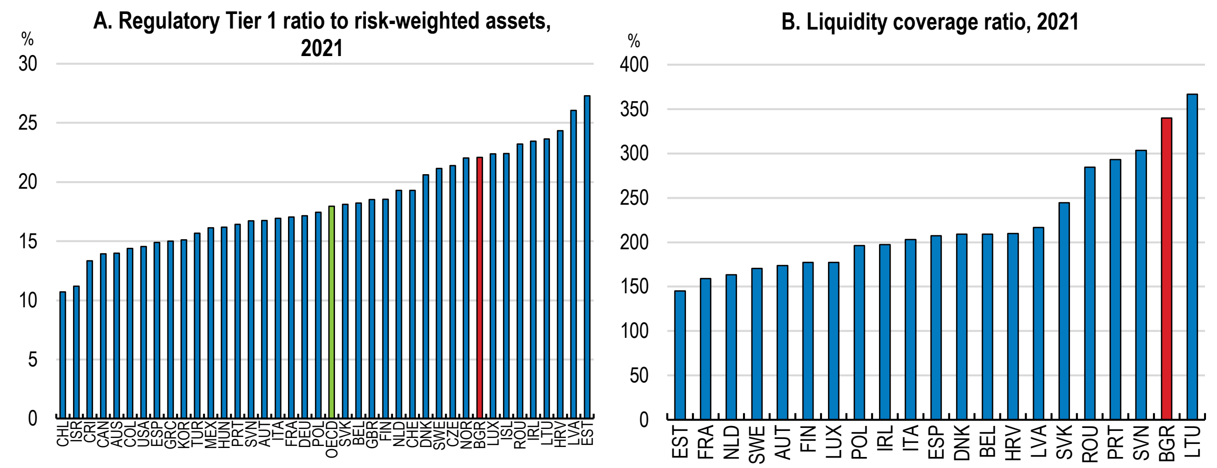
Bulgaria's financial system is dominated by the banking sector, which proved to be resilient during adverse conditions following the COVID-19 shock. The banking system's size is comparable to neighbouring OECD countries with total bank assets of around 100% of GDP, but far smaller than in many European 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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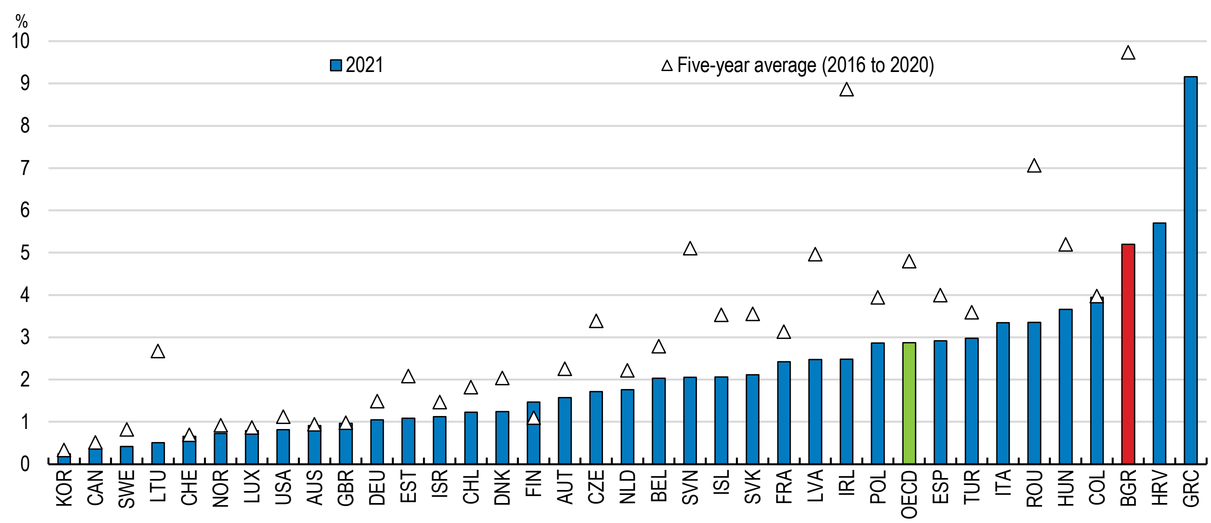
Figure 1.12. The share of non-performing loans in total loans is high but decreasing



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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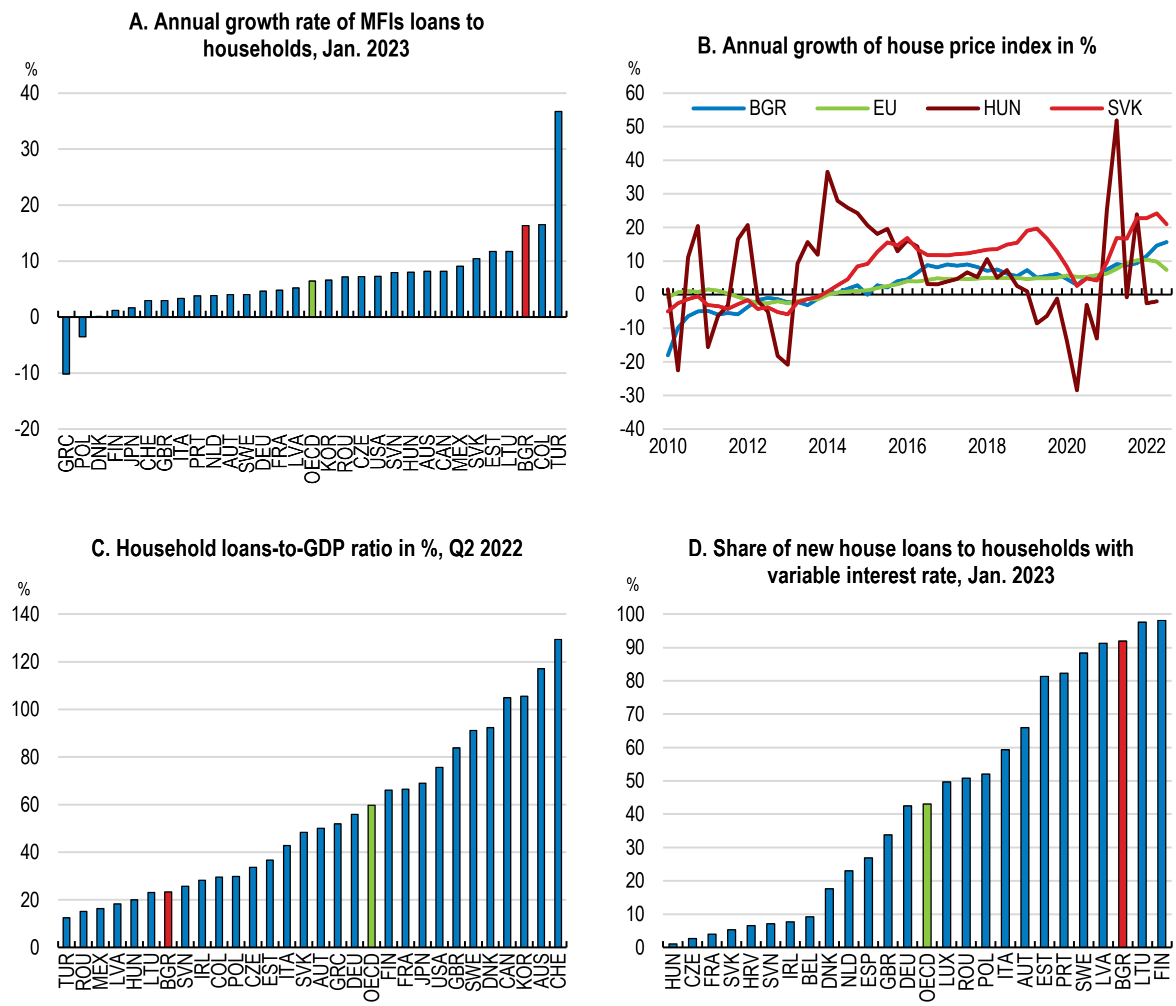
Bank loans to households have been growing much faster than in Central and Eastern European OECD countries and were up by 16% in the year to January 2023. (Figure 1.13). While fast loan growth can signal risks with credit quality, Bulgaria, like other CEE countries, still has a very low household loan-to-GDP 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 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.

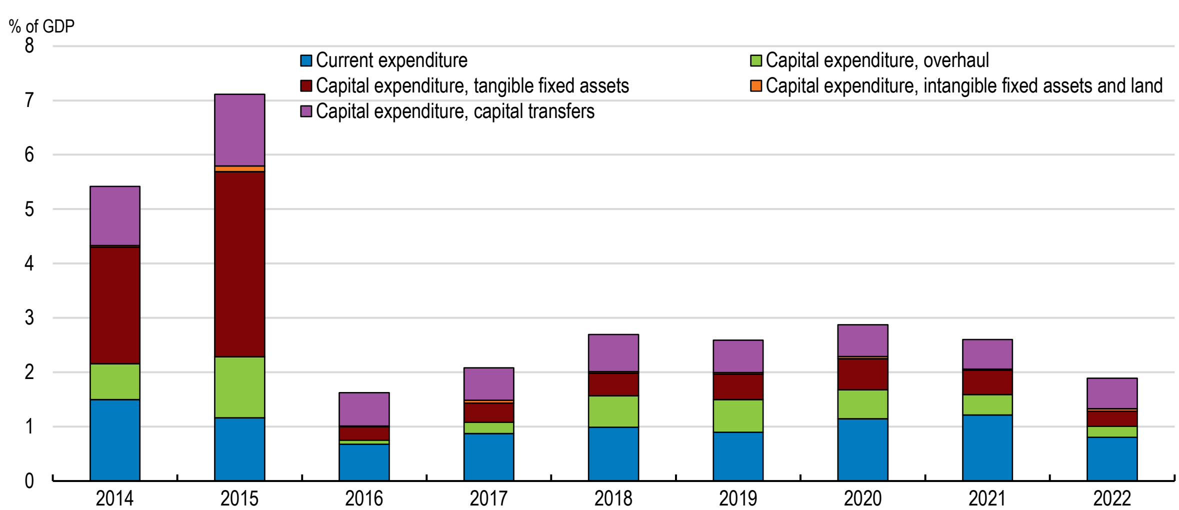
Exceeding the fiscal rules' reference values is allowed in the case of unusual events beyond the control of the Council of Ministers or an economic downturn of more than 3% in real terms, while the exclusion of EU and similar funds with the relative co-financing from the national spending rule is not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

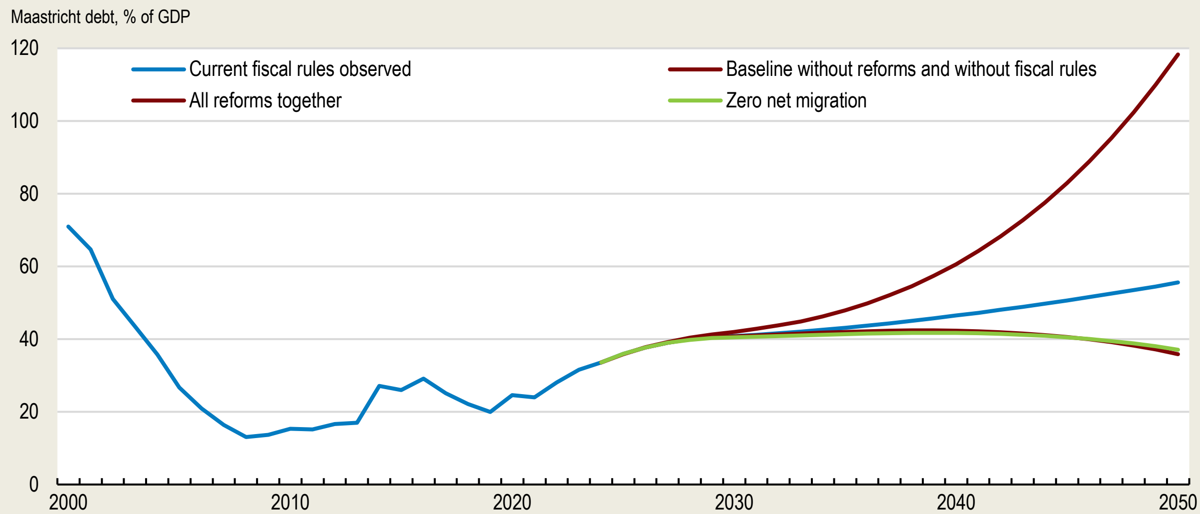
Bulgaria's public finances have been on a stable trajectory since the introduction of the currency board with prudent fiscal policies, low fiscal deficits and policies set to accumulate buffers. Support packages to businesses and vulnerable households during the Covid-19 pandemic led to increased expenses 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%

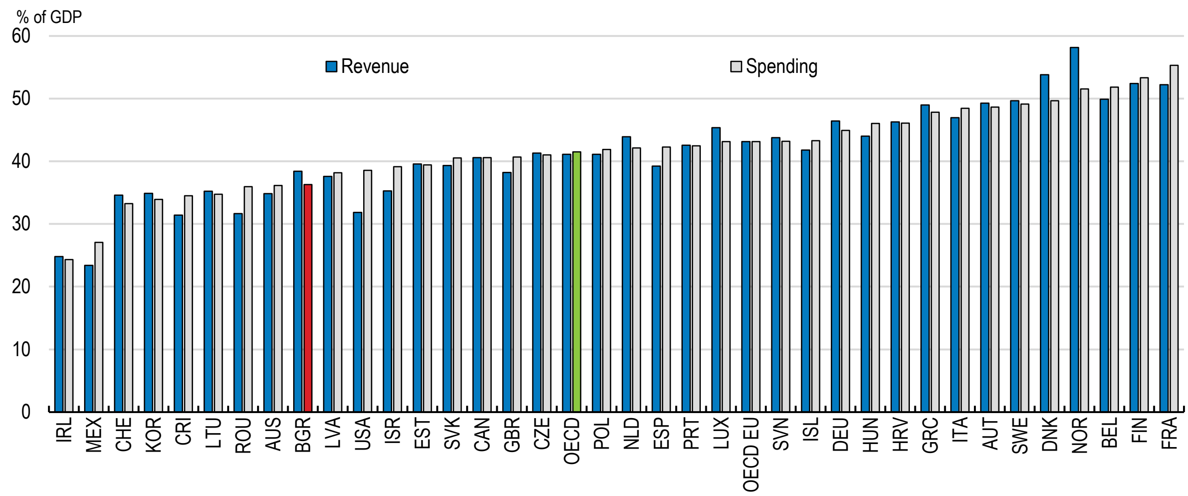
Source: OECD calculations.

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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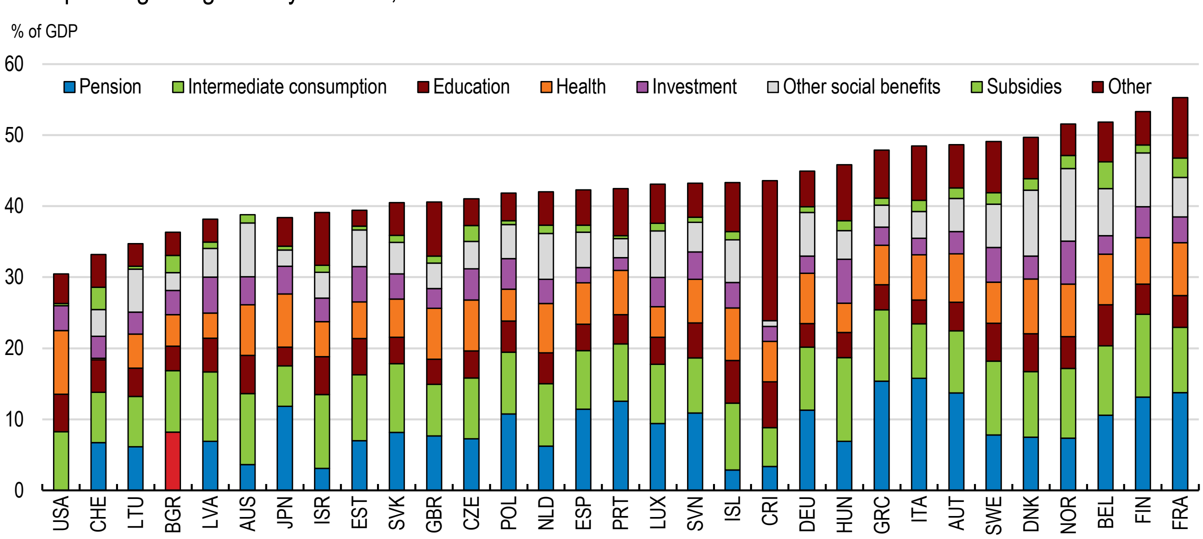
The share of subsidies, mostly to energy companies, public transport, railways and healthcare is higher than in most OECD countries (2.4% of GDP in 2019). Even though these subsidies are permitted under EU rules, scarce public funds could be more effectively used and adverse incentives should not be 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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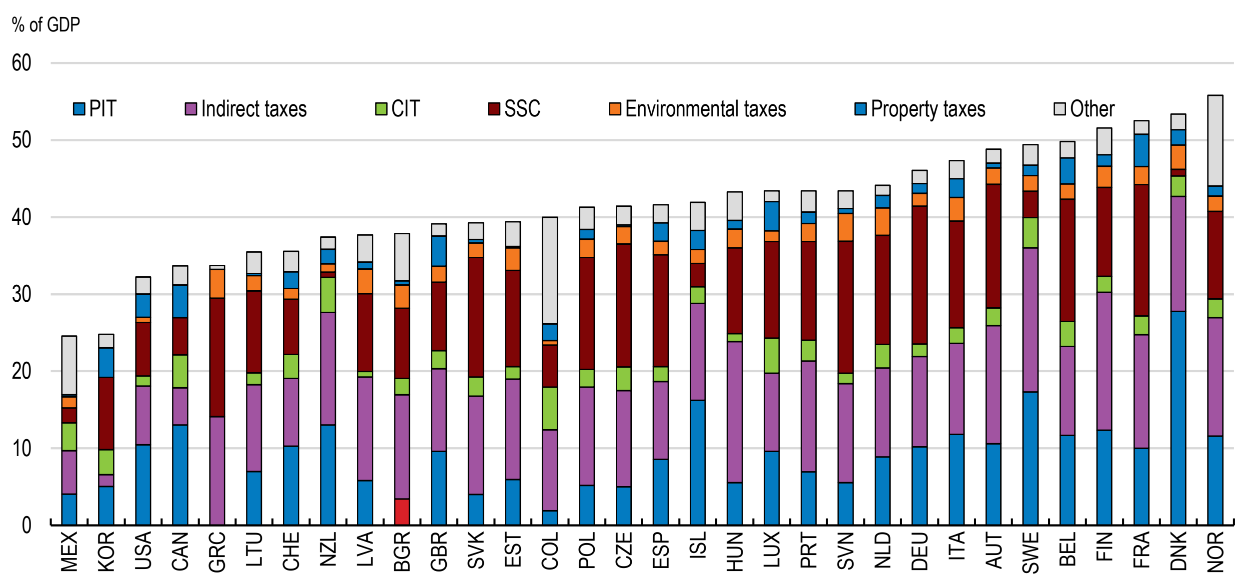
Greater compliance, including reining in informality, would boost fiscal revenues

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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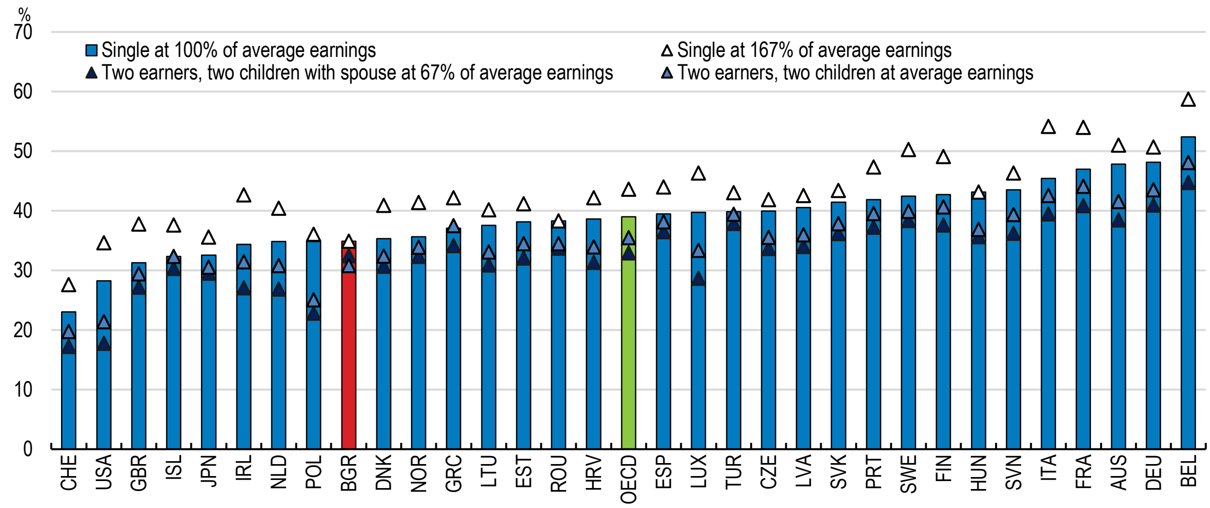
Figure 1.19. The overall tax wedge is relatively low

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.

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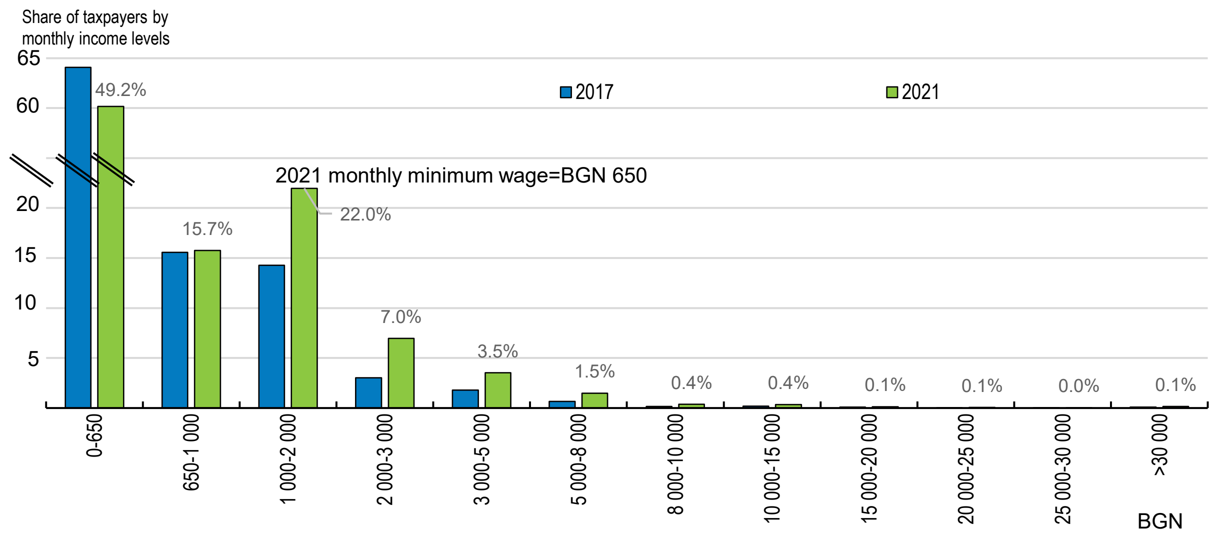
Underreporting incomes is a widespread practice (see Chapter 2 for more discussion of informality in labour markets) and the flat tax is designed to help address that issue. Indeed, half of all taxpayers declare revenues at the minimum wage level (Figure 1.20). The minimum income threshold is an occupation 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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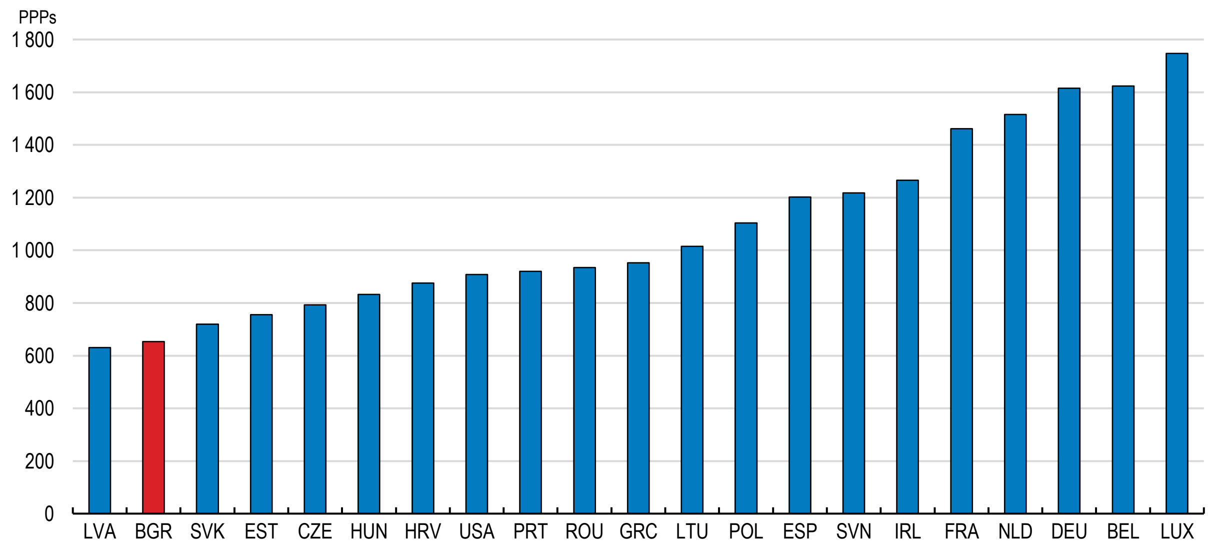
Increases in the minimum wage also help whitening economic activities as firms are required to declare wages at the higher minimum rate, although it imposes a real burden for firms that actually want to pay the minimum wage (rather than paying additional envelope wages). The recent increase of the minimum 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.

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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	

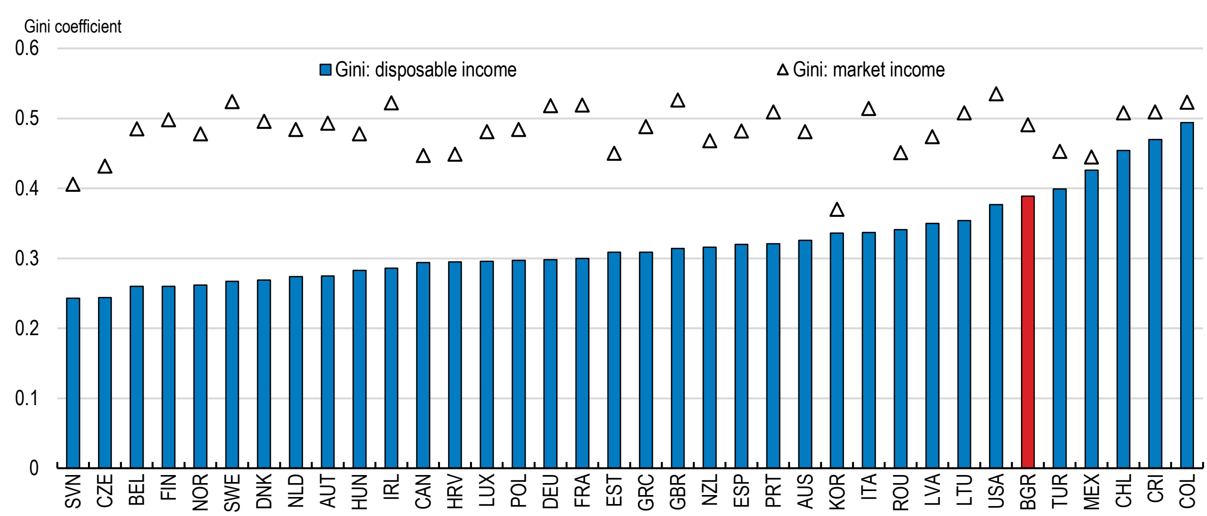
Note: Data refer to 2021 except for VAT, which is for 2019.
Source: National Revenue Agency.

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.

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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

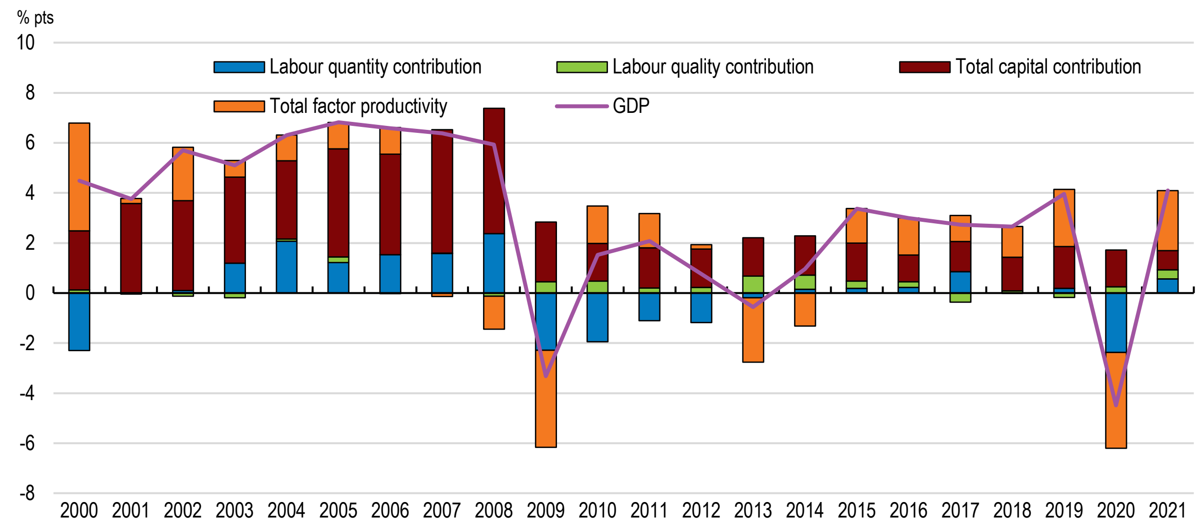
In the years prior to the pandemic, growth in Bulgaria reached a strong enough pace to allow some convergence in living standards with high-income OECD countries, albeit at a slower pace than for some other countries in the region. Growth needs to increase to foster stronger convergence in living standards 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 (Győrffy, 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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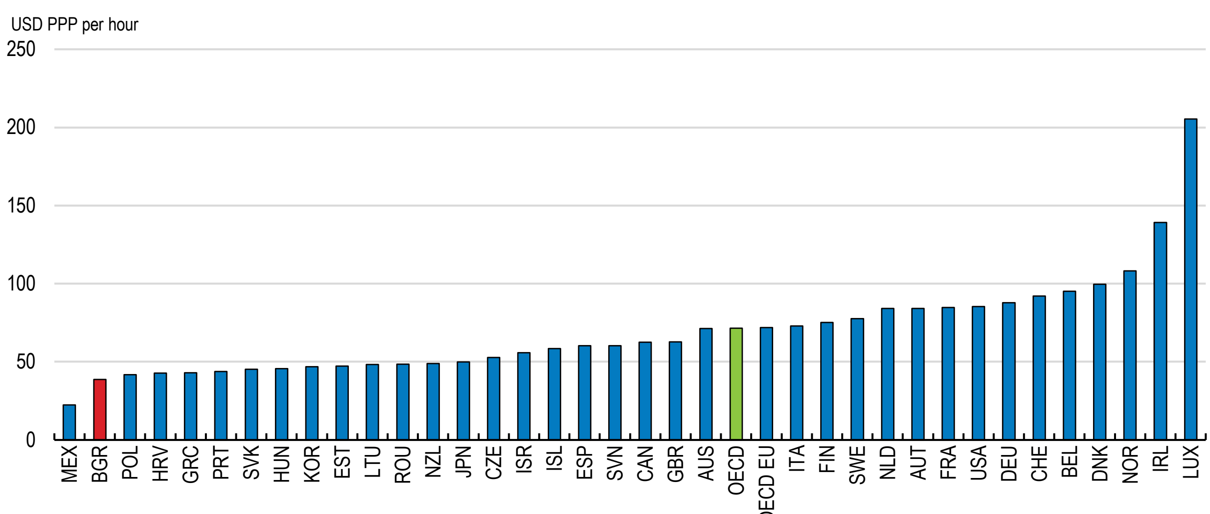
Figure 1.24. Labour productivity levels lag behind Visegrad4 and other countries

Value added per hour worked



Source: OECD Economic Outlook 112 database.

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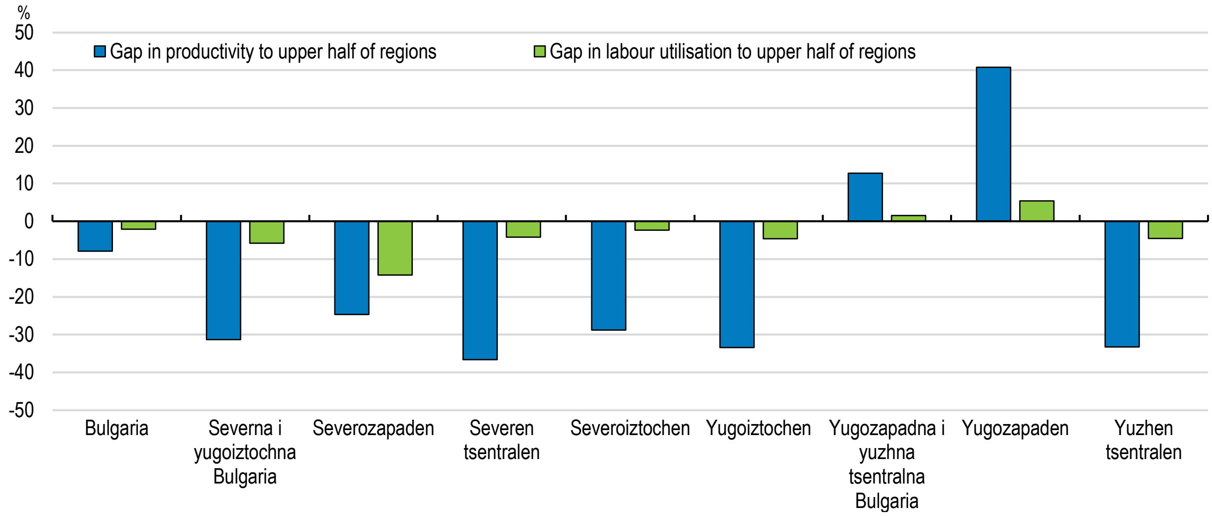
Figure 1.25. Southern regions are more productive and use labour more effectively

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



Source: Eurostat.

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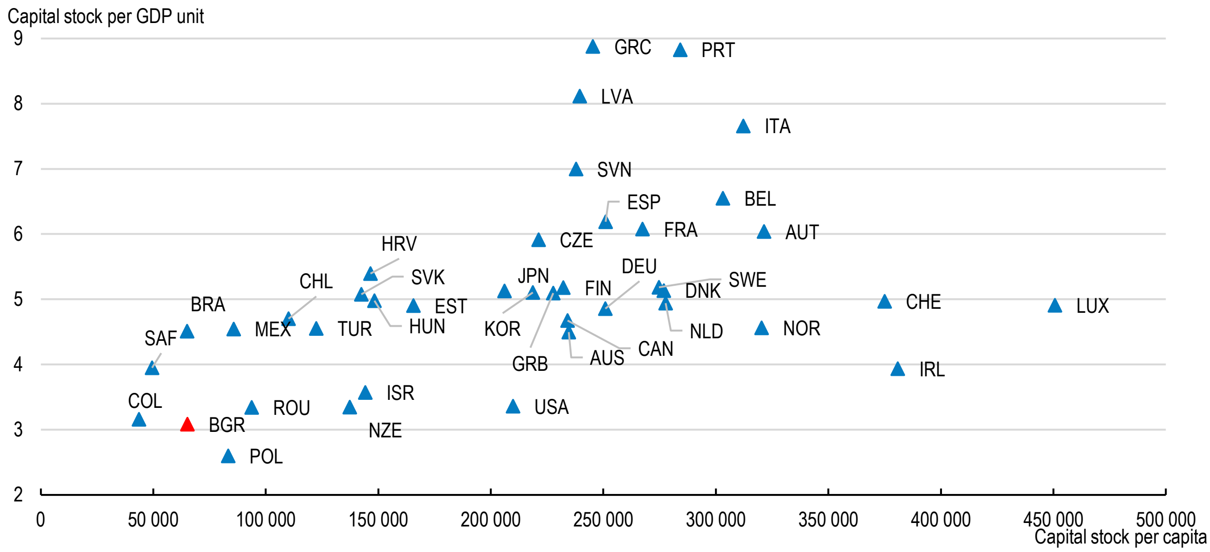
Investment has been a major driver of growth and needs to accelerate as the capital stock is very low compared to OECD countries both relative to GDP and the population (Figure 1.26). Higher and better-quality investment is needed to raise productivity, upgrade housing infrastructure and public facilities, 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 hydro-carbon-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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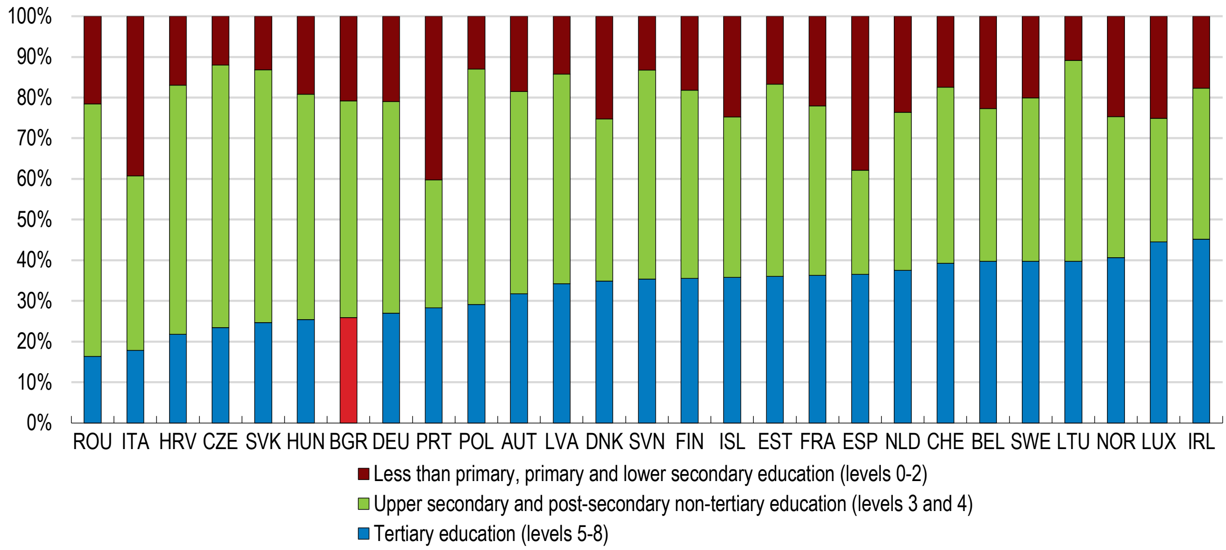
The relative scarcity of capital is not a result of its cost: the macroeconomic setting with a currency board and prudent fiscal policies implies low risk premia and is conducive to low interest rates. Indeed, corporate borrowing rates have been low in comparison with Central and Eastern European OECD 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.

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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.

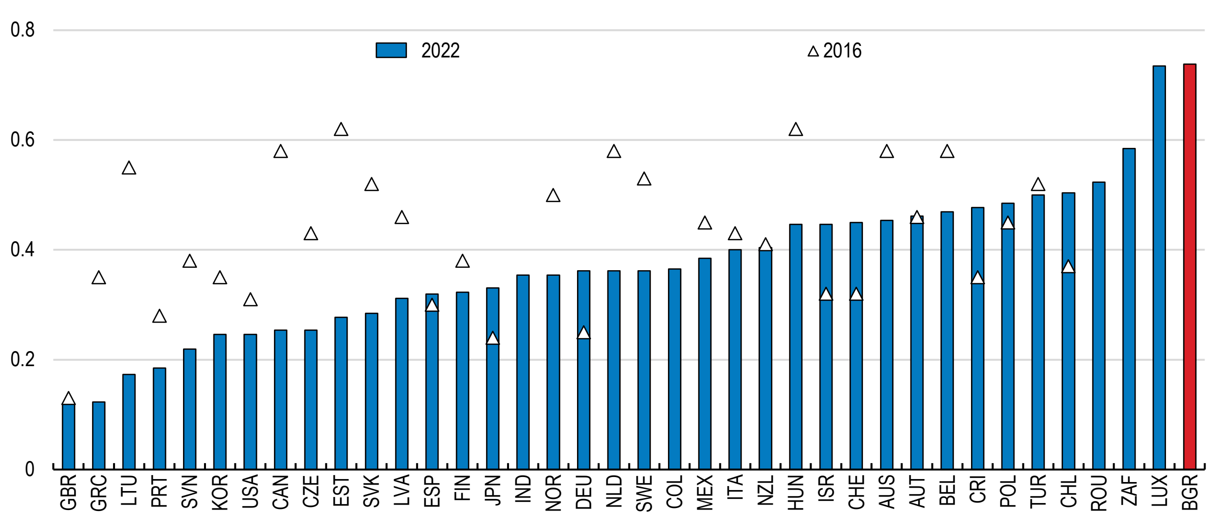
The number of bodies that need to be contacted to start up a limited liability company could be reduced to a single body in a one-stop-shop setting, which is the international best practice. While this economises on the number of interactions, some of the current requirements for starting up a business 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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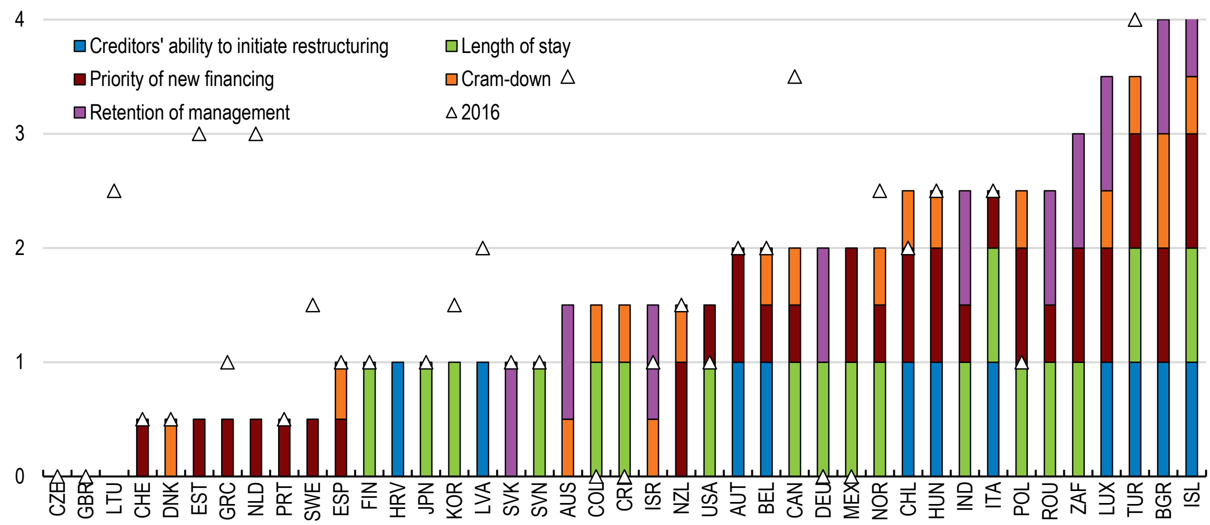
Figure 1.29. Restructuring is cumbersome

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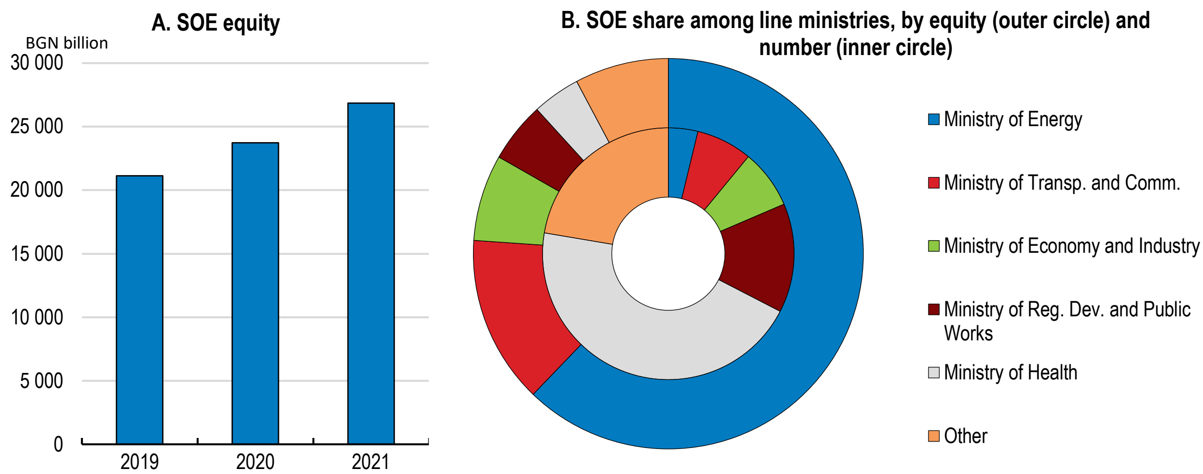
Table 1.6. Previous recommendations on entry and exit-related regulation and action taken

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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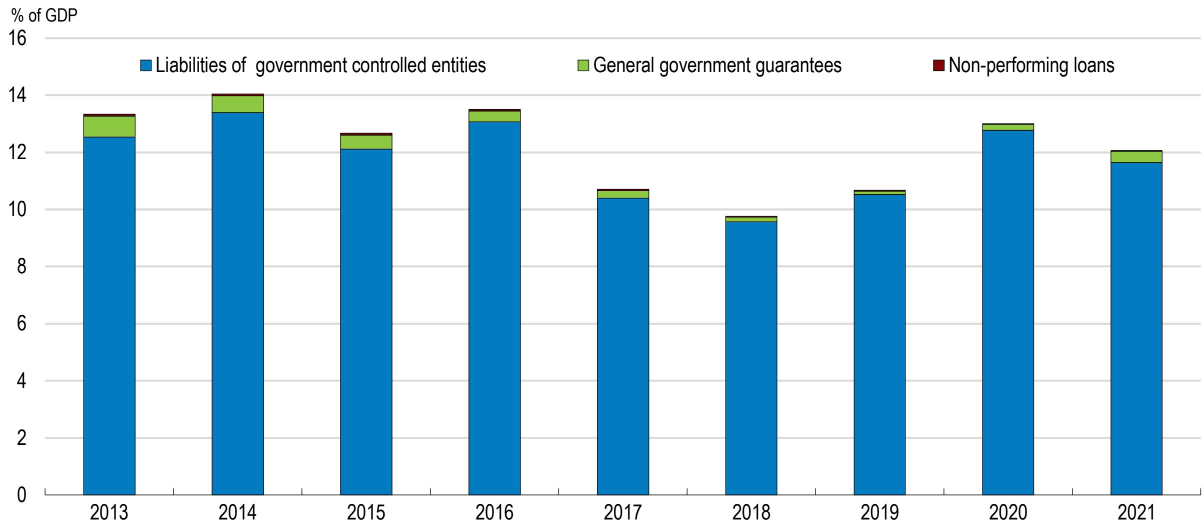
A key issue is that a wide range of different entities are defined as SOEs, ranging from those with essentially commercial activities, through those with some social role, to those that are in effect delivering public services as a government agency. The new law foresees a restructuring of many activities 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.

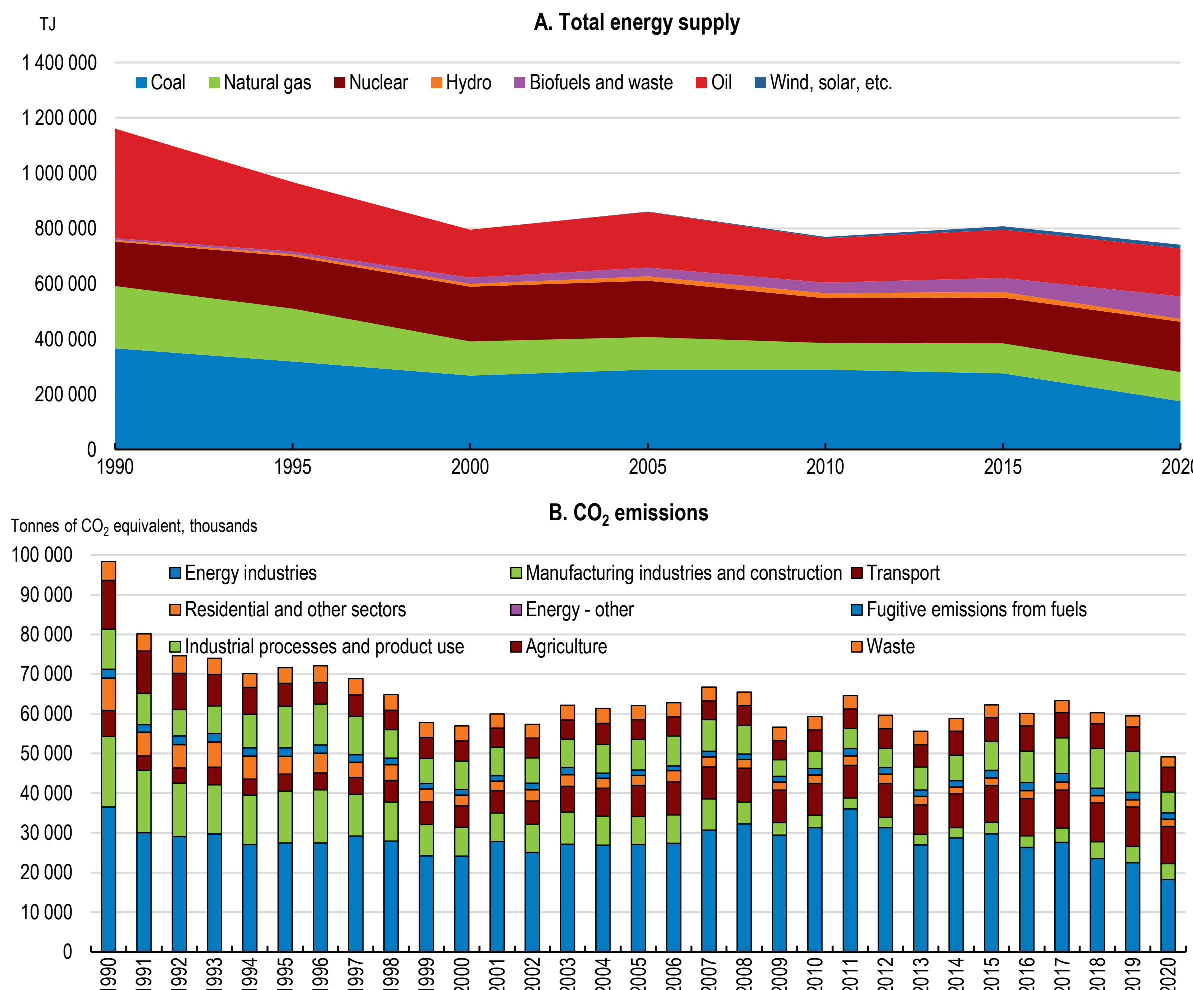
According to an initial assessment by the European Commission (NECP Fact Sheets), Bulgaria was on track to achieve its NECP targets, including the country's 2030 target for greenhouse gas (GHG) emissions not covered by the EU Emissions Trading System (non-ETS) of 10% reduction compared to 2005. However, 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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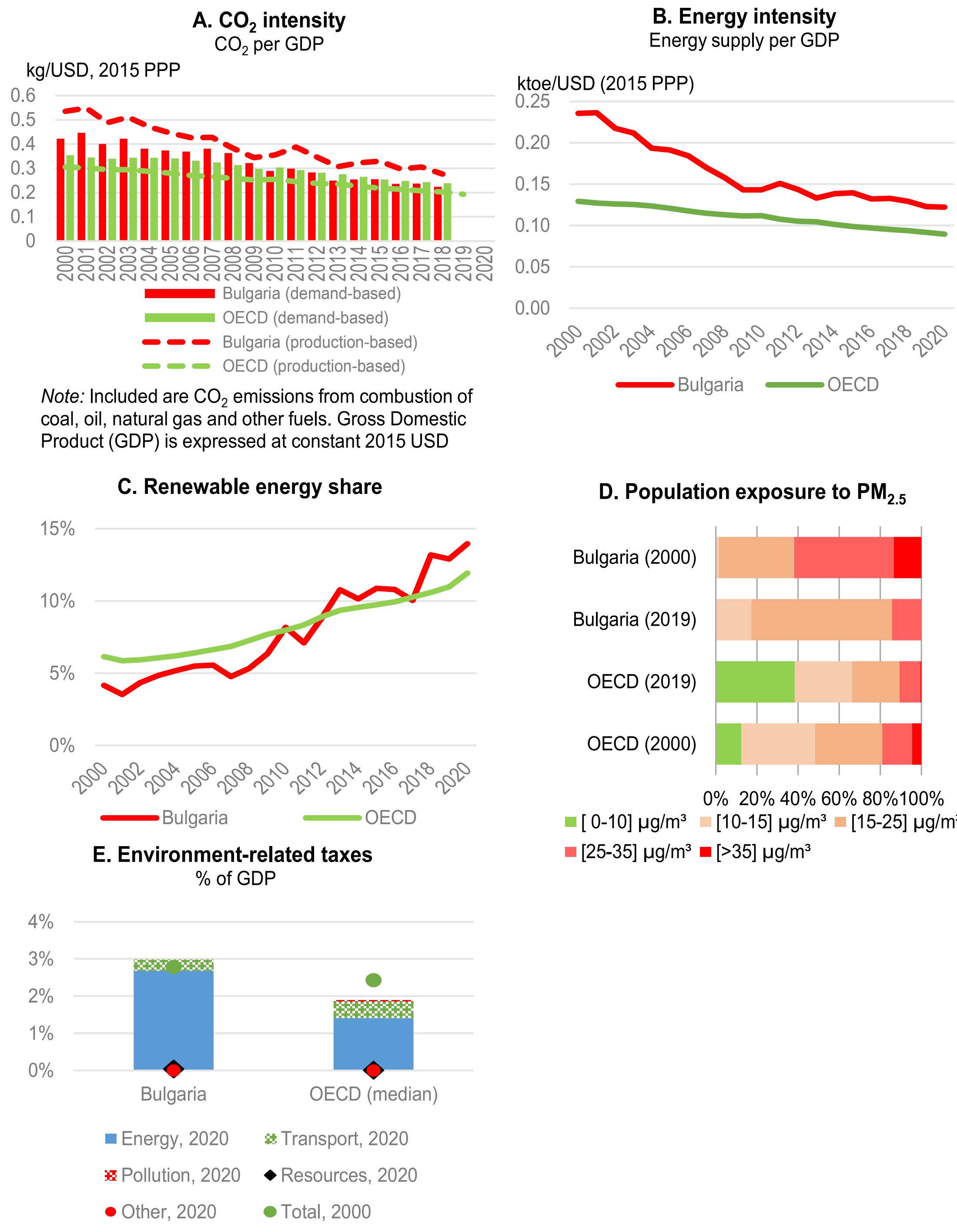
The energy crisis should not delay the green transition, in particular the phasing out of coal. The energy crisis elevated the country to the third place in terms of electricity exports in Europe and in conjunction with the interlinkage of energy markets with neighbouring countries (realised in in 2021) 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 and 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



Note: Included are CO_2 emissions from combustion of coal, oil, natural gas and other fuels. Gross Domestic Product (GDP) is expressed at constant 2015 USD

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.

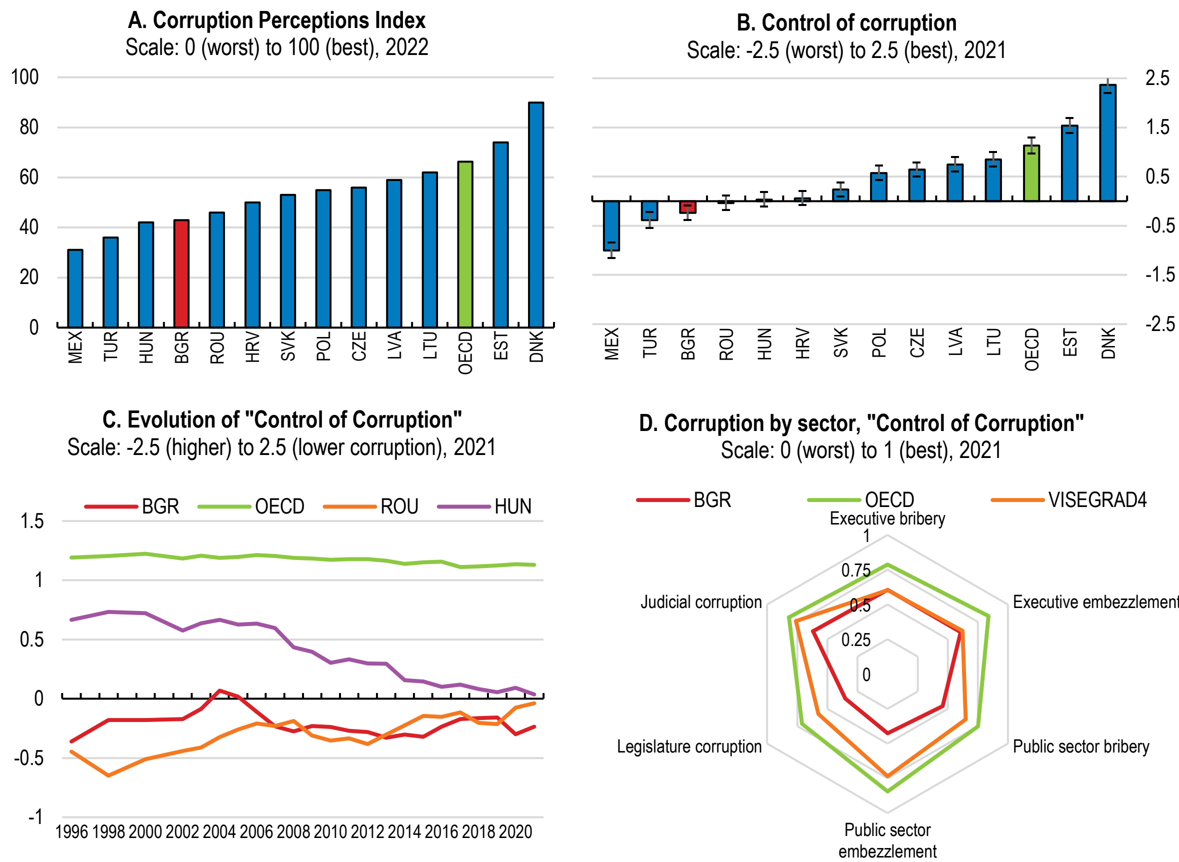
Corruption is taking a heavy toll on the economy

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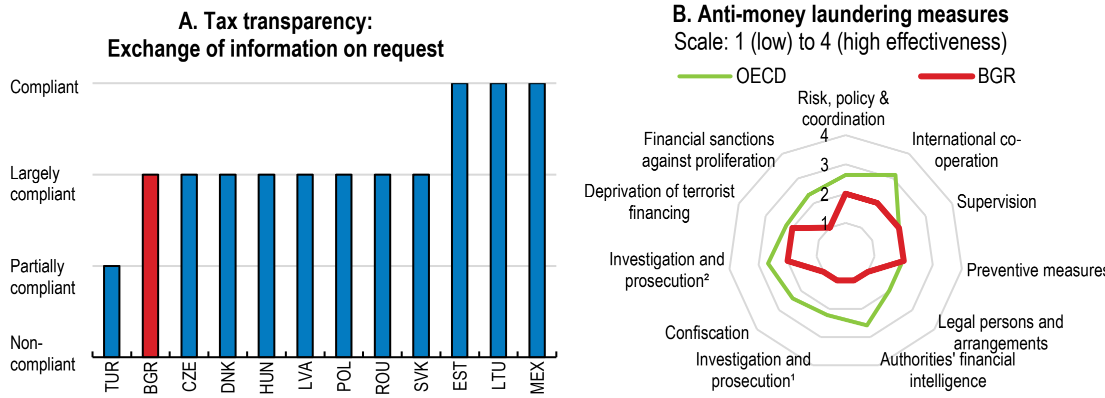
Figure 1.35. Bulgaria is largely compliant on tax transparency, but anti money laundering efforts need strengthening



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 prosecution[1]" refers to money laundering. "Investigation and prosecution" 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 or 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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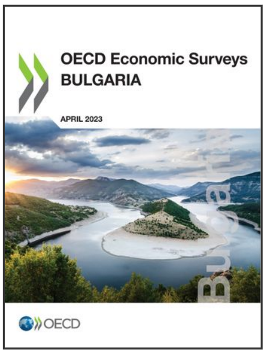

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