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Recommendation for a

COUNCIL RECOMMENDATION

on the 2018 National Reform Programme of Bulgaria

and delivering a Council opinion on the 2018 Convergence Programme of Bulgaria

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies¹, and in particular Article 9(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances², and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission³,

Having regard to the resolutions of the European Parliament⁴,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 22 November 2017, the Commission adopted the Annual Growth Survey, marking the start of the 2018 European Semester of economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 22 March 2018. On 22 November 2017, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Bulgaria as one of the Member States for which an in-depth review would be carried out.
- (2) The 2018 country report for Bulgaria⁵ was published on 7 March 2018. It assessed Bulgaria's progress in addressing the country-specific recommendations adopted by

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 306, 23.11.2011, p. 25.

³ COM(2018) 402 final.

⁴ P8_TA(2018)0077 and P8_TA(2018)0078.

the Council on 11 July 2017, the follow-up given to the recommendations adopted in previous years and Bulgaria's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 7 March 2018⁶. The Commission's analysis leads it to conclude that Bulgaria is experiencing macroeconomic imbalances. Vulnerabilities in the financial sector are coupled with high indebtedness and non-performing loans in the corporate sector, in a context of incomplete labour market adjustment.

- (3) On 19 April 2018, Bulgaria submitted its 2018 National Reform Programme and its 2018 Convergence Programme. To take account of their interlinkages, the two programmes have been assessed at the same time. Bulgaria's National Reform Programme includes commitments both for the short and medium term and covers the challenges identified in the 2018 country report. In particular, it announces measures to strengthen banking and non-banking supervision, to improve the insolvency framework and to reduce remaining weaknesses identified in the 2016 stress tests exercises. There are also measures to reinforce tax collection and tackle the shadow economy, to improve the targeting of active labour market policies, to increase social protection and to address various challenges in the healthcare and education sectors. Overall, the effective implementation of the National Reform Programme would underpin the correction of imbalances.
- (4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council⁷, where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the European Structural and Investment Funds to sound economic governance⁸.
- (5) Bulgaria is currently in the preventive arm of the Stability and Growth Pact. In its 2018 Convergence Programme, the government, starting from a headline surplus of 0.9 % of GDP in 2017, aims at a balanced budget in 2018 and a surplus of 0.3 % of GDP in 2019, 0.5 % in 2020 and 0.2 % in 2021. The medium-term budgetary objective — a structural deficit of 1 % of GDP — is planned to continue to be met with a margin throughout the programme period. According to the 2018 Convergence Programme, the general government debt-to-GDP ratio is expected to decline gradually from 25.4 % of GDP in 2017 to 19.4 % in 2021. The macroeconomic scenario underpinning those budgetary projections is plausible. Based on the Commission 2018 spring forecast, the structural balance is forecast to remain in surplus but to decrease from 0.9 % of GDP in 2017 to 0.6 % of GDP in 2018 and remain at the same level in 2019. The structural balance is thus forecast to remain

⁵ SWD(2018) 201 final.

⁶ COM(2018) 120 final.

⁷ Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

⁸ COM(2014) 494 final.

above the medium-term budgetary objective in both years. Overall, the Council is of the opinion that Bulgaria is projected to comply with the provisions of the Stability and Growth Pact in 2018 and 2019.

- (6) Increasing the efficiency of fiscal policy is of utmost importance. Tax revenues and tax compliance are improving but more as a result of a better economic outlook than of improved tax administration and collection. Efficiency of public spending in Bulgaria is very low. Reforms in the field of public finances management are important in this regard and the current economic and fiscal conditions are particularly favourable for such reforms. The economic performance of state owned enterprises is weak compared with other countries in the region and with the private sector and it is also a source of uncertainty and risk for public finances as the arrears of such companies represent contingent liabilities. Overall, corporate governance of state owned enterprises remains a challenge and does not fulfil international standards. Additionally, reforms in this area are very important for the business environment.
- (7) The soundness of the financial sector continued to improve despite remaining vulnerabilities. Corporate non-performing loans are still high, although they have been reduced. Capital buffers are comfortable on average, thus providing space for a balance-sheet clean-up. There has been notable progress in improving financial sector supervision, but some important measures are still to be fully implemented. Mitigating remaining risks associated with related-party exposures and improving asset valuation are key to further strengthening balance sheets and boosting the resilience of banks and insurance companies.
- (8) The ineffectiveness of the insolvency framework is slowing the reduction in private sector indebtedness and the work-out of non performing loans. Procedures are lengthy and the recovery rate is low. Some elements of a functioning framework are still lacking, in particular rules for debt discharge and for granting a second chance to entrepreneurs within a reasonable timeframe following bankruptcy. The lack of data gathering and adequate monitoring tools prevents an assessment of the effectiveness of either older or new procedures, including for business restructuring.
- (9) Levels of undeclared work remain high, which has considerable implications for fiscal revenue, labour conditions and the adequacy of income after retirement. Bulgaria has taken a number of recent measures seek to improve the situation These include one-day contracts in agriculture, improved cooperation between fiscal and labour authorities and increased efforts to raise awareness about the negative consequences for employees. Their efficiency will depend on effective implementation. Accelerating the transition to the formal economy is essential for achieving inclusive growth and ensuring fair working conditions for all.
- (10) The labour market has improved but challenges persist. Employment reached pre-crisis levels and unemployment is below the EU average. However, the positive labour market developments are not equally benefiting the whole working-age population. The long-term unemployed, inactive young people, Roma and people living in poorer regions and rural areas continue to face significant difficulties in entering or re-entering employment The ageing and shrinking population, combined with an activity rate below the EU average, leads to labour and skills shortages, thus weakening long-term prospects of the economy. A reinforced focus on upskilling and training would therefore be warranted. Labour market participation and employability could be fostered through a mix of effective outreach measures, active labour market policies and social services.

- (11) Inequality of income and access to services (education, healthcare and housing), as well as the risk of poverty or social exclusion remain among the highest in the EU. In 2016, two-fifths of the population was at risk of poverty or social exclusion while the income of the richest 20 % of households was almost eight times that of the poorest 20 %. Spending on social protection is low, including on the general minimum income scheme, whose coverage and adequacy are limited, as well as its impact on reducing poverty and inequality. An objective mechanism to revise the level of benefits is lacking. In spite of recent improvements in the adequacy of social assistance benefits and minimum pensions, the social protection system does not provide sufficient levels of support to the most vulnerable or disadvantaged groups, such as Roma, children, the elderly, persons with disabilities and people living in rural areas. The provision of social services remains weak and their integration with labour market and other services is incomplete.
- (12) The minimum wage is set without a clear and transparent mechanism and the percentage of workers at the minimum wage has increased more than two fold over the last six years. The lack of such a mechanism may put at risk the achievement of a proper balance between the objectives of supporting employment and competitiveness, while safeguarding labour income. In addition, it creates uncertainty that can adversely impact the predictability of business conditions. The government has tabled proposals for a minimum wage setting mechanism addressing this shortcoming. However, there is no agreement between the social partners on this issue. Also, in its budget forecast, the government included increases of minimum wage until 2020. In 2018, Bulgaria ratified the International Labour Organisation's Minimum Wage Fixing Convention. This could be a good basis for setting an objective mechanism.
- (13) Limited access to healthcare caused by low public spending, uneven distribution of limited resources and low health insurance coverage remains a significant challenge. The low level of public expenditure needs to be compensated by high private spending, mainly in the form of out-of-pocket payments. The proportion of Bulgarians without health insurance is high in relation to the majority of EU Member States. District-level differences in the distribution of doctors and the low number of nurses remain problematic. On a positive note, the number of doctors leaving Bulgaria has recently dropped. Measures like the National Health Strategy should be used to tackle these weaknesses.
- (14) Despite recent measures to modernise the education system, educational outcomes are low and strongly influenced by socio-economic status. Children from disadvantaged families, particularly Roma, do not enjoy equal opportunities. High levels of early school leaving have negative consequences for future employability and labour market performance. Providing ethnically mixed kindergartens, schools and classes remains a challenge for the provision of quality inclusive mainstream education. Curricular reform seeks to improve educational outcomes and digital skills. However, the level of digital skills is still among the lowest in the EU and varies between different socioeconomic groups. Despite recent measures, the labour market relevance of vocational education and training remains insufficient. Higher education reform is underway, but addressing skills shortages is a challenge given the unbalanced profiles of graduates by sectors. Participation in adult learning is very low in spite of the need for upskilling. In a context of pronounced ageing among teachers, measures to address future shortages have started. Notwithstanding recent improvements, teacher education programmes require further strengthening.

- (15) Many of the measures included in the National Public Procurement Strategy have been put in place. However, the national authorities should put more efforts to ensure their effective implementation. According to business and non-governmental organisations, the overall public procurement landscape has already begun to improve. However, transparency and corruption are still a matter of concern. The increased use of direct awards and the high number of single bids could significantly hamper the system's transparency and effectiveness. The first independent evaluation of the new control functions of the Public Procurement Agency is ongoing. Regular updates would be necessary to ensure further optimisation of the Agency's control functions. The remaining problems with the administrative capacity, including at the municipal level, call for further efforts on professionalization, standardisation and serious consideration of the possibilities offered by central purchasing bodies. Aggregation of demand could also improve effectiveness and economy in the health procurement system. Finding a solution for the prevention of delays related to important public projects still necessitates further reflection.
- (16) Structural shortcomings and high fragmentation in the research, development and innovation system limit its contribution to productivity and growth. Lower technology segments still dominate manufacturing and innovation is very low. The level of public as well as business spending on Research & Development is particularly low. The sluggish reforms hinder the move towards an innovation-oriented system. While there are many universities and research institutes, only a few of them are producing high-quality scientific output. Commercialization of research remains a major weakness. The research funding system lacks competitive calls, international evaluation, and performance-based funding of research institutions. Public-private cooperation in research and development is weak. The flagship 'Sofia Tech Park' still faces a number of challenges, including: inefficient governance, unstable management, underutilised scientific infrastructure and a lack of long-term financial commitment from the government. Structural transformation, combined with effective governance and a stable level of public research and innovation resources can maximise the impact on productivity and growth and support the transition of the economy to higher value added activities in line with the smart specialisation strategy.
- (17) The business environment needs further improvement. While a number of reforms have been adopted, their practical implementation is lagging behind. Businesses are still concerned about corruption, institutional shortcomings and insufficient labour supply. Progress in public administration reform and e-government is slow. Governance in the public sector could benefit from more transparency, clearer rules and a long-term perspective. In addition, the role of social dialogue can further evolve, facilitated, when necessary, by public authorities. Shortcomings in infrastructure are reflected in the low effectiveness and performance of the transport sector. The rail passenger market has been suffering from a lack of effective competition. Well-targeted and effective measures to reduce air pollution have not been put in place.
- (18) In 2017, Bulgaria continued its efforts to reform its judiciary and address shortcomings in the fight against corruption and organised crime. New elections to the Supreme Judicial Council confirmed the positive impact of constitutional and legislative reforms carried out in 2015 and 2016. Reforms of the criminal code have been adopted to improve the system of prosecution in high-level corruption cases and further reforms are under consideration. A law was adopted in early 2018 establishing a new unified anti-corruption authority to strengthen prevention and deterrence of high-level corruption. Under the Cooperation and Verification Mechanism, the

Commission continues to monitor the judicial reform and the fight against corruption and organised crime in Bulgaria. These areas are therefore not covered in the country-specific recommendations for Bulgaria, but are relevant for the development of a positive business environment in Bulgaria.

- (19) In the context of the 2018 European Semester, the Commission has carried out a comprehensive analysis of Bulgaria's economic policy and published it in the 2018 country report. It has also assessed the 2018 Convergence Programme and the 2018 National Reform Programme and the follow-up given to the recommendations addressed to Bulgaria in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Bulgaria but also their compliance with Union rules and guidance, given the need to strengthen the Union's overall economic governance by providing Union-level input into future national decisions.
- (20) In the light of this assessment, the Council has examined the 2018 Convergence Programme and is of the opinion that Bulgaria is expected to comply with the Stability and Growth Pact.
- (21) In the light of the Commission's in-depth review and this assessment, the Council has examined the National Reform Programme and the Convergence Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations 2 and 3 below.

HEREBY RECOMMENDS that Bulgaria take action in 2018 and 2019 to:

- 1. Improve tax collection and the efficiency of public spending, including by stepping up enforcement of measures to reduce the extent of the informal economy. Upgrade the State owned enterprise corporate governance framework in line with international good practices.
- 2. Take follow-up measures resulting from the financial sector reviews and implement the supervisory action plans in order to strengthen the oversight and stability of the sector. Ensure adequate valuation of assets, including bank collateral, by enhancing the appraisal and audit processes. Complete the reform of the insolvency framework and promote a functioning secondary market for non-performing loans.
- 3. Increase the employability of disadvantaged groups by upskilling and strengthening activation measures. Improve the provision of quality inclusive mainstream education, particularly for Roma and other disadvantaged groups. In line with the National Health Strategy and its action plan, improve access to health services, including by reducing out-of-pocket payments and addressing shortages of health professionals. Introduce a regular and transparent revision scheme for the minimum income and improve its coverage and adequacy.

Done at Brussels,

*For the Council
The President*