

World Bank Issues Report on Bulgaria's Economy

15:32 - 27 February 2006 - The World Bank has just released a new Country Economic Memorandum (CEM) on Bulgaria's integration with the EU and the world markets. The report, "The Road to Successful EU Integration—The Policy Agenda," highlights Bulgaria's impressive economic progress to date.

As a result of sound macroeconomic policies and deep structural reforms, average growth has reached the levels of eight European Union (EU) New Member States.

Increased growth and low inflation have contributed to increased per capita income and standard of living: per capita income at purchasing power parity (PPP) reached US\$8,260 in 2004.

The unemployment rate started declining in 2003 and for the first time there was net employment creation by the private sector in 2004, which contributed to a further reduction in unemployment to 12.7 percent.

FDI flows have increased to an average of 7 percent of GDP per year since 1998.

Investors' confidence has improved over time, both domestically and externally, with spreads of Brady and Euro bonds declining since 2002.

During the summer of 2004, S&P and Fitch upgraded Bulgaria's long-term foreign currency debt to investment grade rating.

Stability, growth, and to some extent the extensive social protection system have also contributed to a substantial reduction in poverty, which continues to decline.

Disciplined fiscal management underpinning macroeconomic stability and progress in structural reforms, while preserving social cohesion, are the cornerstones of Bulgaria's medium-term program.

At the same time, important challenges remain.

The study notes that Bulgaria faces a large income gap with EU25—its per capita income is about one-third of the EU25 average.

Improving efficiency of the economy is necessary to ensure, that as Bulgaria approaches EU accession, it will rapidly narrow its income gap and generate sustained improvements in living standards.

To narrow the income gap and facilitate the convergence with the EU, Bulgaria needs to increase employment and productivity consistent with the Lisbon agenda.

These reforms are particularly pressing for Bulgaria, because the country has a negative natural rate of population growth (about -0.7 percent per year) and out-migration (about -0.1 percent per year).

These have resulted in a rapidly declining working age and a growing share of old people in the total population. To catch up with the EU, employment and labor market participation need to be raised.

As Bulgaria approaches EU accession, it has the opportunity to act on these challenges and set the economy on a higher growth path and accelerated improvements in the standards of living. The report proposes a reform agenda focused on five areas to accelerate convergence with the EU:

Improve the quantity and quality of human capital

To promote labor productivity and expand export capacity beyond unskilled labor-intensive products, there is a need to upgrade the skills of the labor force.

This would call for a reform of the education system, including universities and vocational schools, to:

(a) strengthen the links between the skills acquired in the education system and those needed in the job market through establishment of links and feedback mechanisms between the education system and labor markets

(b) improve the efficiency and effectiveness of public outlays in education by reallocating resources from underused facilities and excess staffing to modernization of curriculum, textbooks, and teaching materials; implementing a composite per student resource allocation; and linking financing to educational results in addition to enrollment levels.

Improve the quantity and quality of physical capital

Bulgaria's transport network needs upgrading since maritime ports and close to two-thirds of roads are in poor condition.

Priority in resource allocation would thus need to be given to maintenance rather than new investment.

The sequencing of reforms in this area would need to be based on cost-benefit analysis, and take into account liberalization of international trucking in the context of EU integration. Priority reform areas would be as follows:

(a) upgrading and addressing bottlenecks along road segments that carry long distance international traffic

(b) reform of maritime ports, including introduction of landlocked port, with the separation of operational and commercial functions, privatization of port services, and concessioning of large container and bulk terminals to private operators.

Promote efficient and transparent public sector management, including further public expenditure restructuring.

Bulgaria has implemented a series of reforms aimed at improving the functioning of the public sector.

A large number of new laws and regulations have been introduced to achieve this.

The next stage of reform would need to focus on:

(a) increasing efficiency of health and social assistance spending;

(b) extending program budgeting to all ministries and linking budget allocation with performance indicators

(c) implementing the financial management information system

(d) applying merit criteria for hiring, promotion, and salary increases

(e) implementing anti-corruption strategies and enforcing conflict of interest and asset declaration regulations

(f) ensuring transparent and competitive procurement for civil works. Improve labor market performance.

The current labor framework provides large benefits to those with labor contracts and seniority, leaving behind a large share of the long-term unemployed with few job opportunities and workers in the informal sector.

Key reforms in this areas would include:

(a) reducing payroll taxes to decrease disincentives to employment creation

(b) adopting policies for flexible use of fixed-term contracts and working schedules

(c) allowing more flexible terms for hiring and firing owing to fluctuations in production levels, performance, and absenteeism

(d) strengthening the link between wages and performance by folding the seniority premium into the basic wage and thereby eliminating it

(e) adjusting unemployment benefits to the average level and duration of OECD countries to eliminate disincentives to work

(f) increasing labor force participation by allowing flexible use of temporary and part-time contracts.

Improve functioning of the judiciary and reduce regulatory complexity.

While the investment climate has improved in the past years, Bulgaria's legislative and regulatory framework remains excessively complex and contract enforcement weak.

To promote competition in the domestic market and private sector activity overall, it would be important to streamline the regulatory regimes and implement judicial reform to strengthen enforcement of contracts.

This would include:

(a) simplifying contract enforcement procedures

(b) streamlining the licensing regimes

(c) transferring registration out of courts

(d) eliminating or reducing the level of minimum capital for private limited companies

(e) simplifying documentation required for new business registration

(f) introducing statutory response time ("silence is consent" rules) for business registration and licensing.

The study is intended to inform policy makers, civil society, development partners, and investors on achievements to date and challenges going forward.

The CEM is based on analyses that cover the period from the early 1990s to 2004.

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