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Recommendation for a

COUNCIL RECOMMENDATION

on the National Reform Programme 2011 of Bulgaria

and delivering a Council opinion

on the updated Convergence Programme of Bulgaria, 2011-2014

{SEC(2011) 711 final}

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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 Article 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 policies[1] , and in particular Article 9(3) thereof,

Having regard to the recommendation of the European Commission[2],

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

After consulting the Economic and Financial Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the European Commission's proposal to launch a new strategy for jobs and growth, Europe 2020, based on enhanced coordination of economic policies, which will focus on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council adopted a recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and on 21 October 2010, adopted a decision on Guidelines for the employment policies of the Member States[3], which together form the "integrated guidelines". Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

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1 OJ L 209, 2.8.1997, p. 1.

2 OJ C , p. .

3 Maintained for 2011 by Council Decision 2011/308/EU of 19 May 2011.

(3) On 12 January 2011, the Commission adopted the first Annual Growth Survey, marking the start of a new cycle of economic governance in the EU and the first European semester of ex-ante and integrated policy coordination, which is anchored in the Europe 2020 strategy.

(4) On 25 March 2011, the European Council endorsed the priorities for fiscal consolidation and structural reform (in line with the Council's conclusions of 15 February and 7 March 2011 and further to the Commission's Annual Growth Survey). It underscored the need to give priority to restoring sound budgets and fiscal sustainability, reducing unemployment through labour market reforms and making new efforts to enhance growth. It requested Member States to translate these priorities into concrete measures to be included in their Stability or Convergence Programmes and National Reform Programmes.

(5) On 25 March 2011, the European Council also invited the Member States participating in the Euro Plus Pact to present their commitments in time to be included in their Stability or Convergence Programmes and their National Reform Programmes.

(6) On 15 April 2011, Bulgaria submitted its 2011 Convergence Programme update covering the period 2011-2014 and its 2011 National Reform Programme. In order to take account of the interlinkages, the two programmes have been assessed at the same time.

(7) The economic crisis interrupted a period of strong growth fuelled by substantial foreign direct investment inflows and credit expansion. GDP growth returned in the second quarter of 2010, after falling cumulatively by 7.1% from peak to trough, resulting in a broadly flat real GDP for 2010 as a whole. A strong upturn in exports, restocking of inventories have been the most important growth drivers. The general government balance moved form a surplus prior to the crisis into a deficit of 4.7% of GDP in 2009 and 3.3% of GDP in 2010. While output and employment in export-led industries increased, subdued activity in construction, real estate and retail has constrained the recovery over the past year. Employment bore the brunt of the output correction with a loss of about 358.000 jobs since the peak in 2008. As a result, unemployment increased by several percentage points to 10.2% in 2010, and employment is not expected to return to its pre-crisis level in the medium-term.

(8) Based on the assessment of the updated Convergence Programme pursuant to Council Regulation (EC) No 1466/97, the Council is of the opinion that the macroeconomic scenario underpinning the fiscal projections is based on more favourable growth projections than those of the Commission services' forecast. After a considerable and frontloaded budgetary adjustment of more than 2 percentage points in structural terms in 2010, the fiscal effort in 2011 is well below the recommended adjustment of at least 0.75% of GDP. Nevertheless, the updated Convergence Programme foresees a correction of the excessive general government deficit in 2011 in compliance with the Council Recommendation and further reductions afterwards.. However, the update does not provide sufficient details of the planned budgetary measures to achieve the fiscal targets in 2012-14. The downward revised medium-term objective (MTO) of a structural deficit of 0.6% of GDP, scheduled for 2014, is still more ambitious than the minimum required level. It reflects the objectives of the Stability and Growth Pact and it is foreseen to be achieved by the end of the programme period (2014). However, the envisaged annual average structural fiscal effort in 2012-14, after the planned

correction of the excessive deficit in 2011, is well below the minimum annual structural improvement of 0.5% of GDP recommended. In view of the gradually improving economic outlook, the programme should aim for a faster progress towards the achievement of the MTO. When assessed against a prudent estimate of medium-term potential output growth, the projected budgetary expenditure growth in 2012-13 seems to be on the optimistic side, posing a risk to the structural fiscal position in the medium term.

(9) Correcting the excessive deficit as envisaged by the end of 2011 will help regain confidence and strengthen the credibility of government policies. Over the medium term, achieving the objective of a small structural deficit of 0.6% of GDP is important to ensure that fiscal policy is supportive to the monetary regime in place. However, fiscal consolidation is hindered by inefficiencies in the public sector which may lead to considerable expenditure pressures while budget revenues are likely to be structurally lower than in the pre-crisis boom years. Ambitious public finance reforms are thus needed in order to carry out the necessary fiscal adjustment and help secure funding for the implementation of necessary structural reforms, including the co-financing needed for EU-supported projects.

(10) The Bulgarian fiscal performance was relatively positive in the favourable economic environment prior to the crisis. Fiscal targets were consistently met and sizeable fiscal buffers were accumulated. In 2009, under the impact of the economic crisis; for the first time in many years the budget went into deficit, and the rule to keep the budget balanced or in surplus and public expenditure below 40% of GDP was breached. This was partly related to weaknesses in expenditure planning and control. It further reflected the fact that the revenue windfalls resulting from the buoyant economic activity prior to the crisis had been used to finance relatively large increases in ad-hoc expenditure and cuts in the social security rate. To address these problems, the authorities undertook several initiatives to improve expenditure control and monitoring and reporting systems, including the adoption of a comprehensive legislative package, strengthening the fiscal rules and the medium-term budgetary framework. It is expected to enhance fiscal discipline and the predictability of policies, to reduce macroeconomic volatility and to ensure less a pro-cyclical fiscal policy.

(11) The pre-crisis boom years saw a considerable tightening of the labour market and high wage growth, outpacing the increases in productivity. Wage growth peaked at an annual rate close to 20% in the fourth quarter of 2007. Following the downturn, wages have started to decelerate, although wage growth remained relatively high at close to 10% in 2010 for employees under labour contracts (representing around 65% of the labour force). Bringing wage growth in line with productivity growth will facilitate the internal restructuring of the economy towards productive and export-led sectors.

(12) Labour market participation barriers reflect in part the insufficient provision of properly targeted and tailored active labour market policies (ALMP), together with ineffective and underfunded Public Employment Services. The quality of public services in the areas of activation, job search assistance and retraining is low as is public spending. ALMP coverage is also limited with only 12% of jobseekers participating in activation measures. Launching more region-based employment programmes, and European Structural Funds large-scale training programmes, will have a positive effect in the short term. However, weak capacity to monitor and evaluate programme results hampers policy design. As pointed out by a recent report

commissioned by the Public Employment Service ("Evaluation of the net effect of ALMPs in Bulgaria"), more individualised and better-quality services, as well as better infrastructure of labour offices, would support more effectively the unemployed in finding a job.

(13) The economic crisis continues to impact the labour market. The unemployment rate increased from 5.4% in 2008 to 10.2% in 2010, while for young persons (aged 15-24) it reached 23.2% in 2010. The crisis particularly hit the low skilled (including a large part of the Roma minority) who represent almost 70% of the unemployed. The share of long-term unemployment (46% in 2010) is higher than the EU average (2010: 40%), and there may be a risk of it becoming structural. The youth activity rate has consistently stayed at less than two thirds of the EU average (2009: 29.5%; EU: 43.8%). The youth employment rate was 24.8% in 2009 (EU: 35.2%). Bulgaria also has the highest share of young people who are neither in education or employment (19.5% of persons aged 15-24). One of the main barriers to youth participation in the labour market is the shortage of opportunities to combine education and work, in particular through internships and apprenticeships in their field of study, which facilitate transition to the labour market.

(14) Despite an above average educational attainment, Bulgaria has over 40% of low achievers in literacy and numeracy. This shows there is scope for improvements in the education system to better align it to labour market needs. Building on the positive results of the recent school decentralisation reform, the upcoming Law on Pre-School and School Education is expected to provide some solutions which can be further strengthened, i.e. with respect to financial autonomy, pre-school participation rates and external evaluation, as well as ensuring accountability. The early school leaving rate (14.7% in 2009) is close to the EU average, but is particularly high among the Roma (where it was estimated at 43% in 2008). Tertiary attainment rates (27.9% in 2009) remain below the EU average (32.2%). Bulgaria has significantly delayed its higher education reform. The new Higher Education Law, already tabled in 2010 but subsequently withdrawn, should provide a useful step to address reform needs.

(15) The pension reform decided in 2010 is not linked to life expectancy or to the situation of the health and long-term care system. The implementation period is from 2011 to 2026, with most of the measures taking effect in the second half of the period which could put both the implementation and the sustainability of the first pillar of the pension system at risk.

(16) Bulgarian citizens experience a greater degree of poverty in comparison to the EU average (41.9% of the population experiences severe material deprivation as compared to 8.1% for EU). Around 66% of the elderly are at risk of poverty, which is considerably higher than the EU average. There are signs of deteriorating living conditions in the last couple of years. Given the demographic situation, achieving the NRP targets for poverty reduction depends to a large extent on the proper design of policies for older workers and disadvantaged people, as well as on the adequacy of social transfers. The NRP announces the development of an operational strategy for Roma integration (estimated at 10% of the population), to address the multiple barriers faced in the domains of employment, education, health and housing in a single comprehensive plan.

(17) The low efficiency of public services remains an obstacle to growth. Despite recent streamlining, the public administration reform has not dealt with upgrading the quality of staff or key functions. Bulgaria has a very low fixed broadband penetration – at 14.9% it has the second-lowest figure of the EU, which also limits uptake of all electronically delivered services.

(18) The public procurement irregularity rate reaches 60% of all procedures verified and is even higher for large public infrastructure projects, where the authorities have an obligation of ex-ante control. The capacity of the Public Financial Inspection Agency has been reduced substantially and as a result, the agency performed ex-post controls in only 12% of all public procurement procedures in 2009.

(19) The energy intensity of the Bulgarian economy is one of the highest in the EU. A salient example is household heating, with poorly maintained multi-apartment buildings accounting for the bulk of the problem. Recent changes in the eligibility rules create the possibility of using EU Structural Funds to support energy efficiency investments. Few investments have been made, whilst revenues from energy and transport taxes have fallen relative to GDP and also relative to taxes on labour, which are well above the EU average. Access to the energy market is hampered by reduced competition and opaque price setting mechanisms.

(20) Bulgaria has made a number of commitments under the Euro Plus Pact[4]. On the fiscal side, the commitments indicate that the sustainability of public finances will be underpinned by pension reform measures, action to ensure performance-based pay in the public sector by freezing pensions and wages until 2013 and strengthening of the domestic fiscal framework through the adoption of a Financial Stability Pact, which includes binding numerical fiscal rules. To foster employment, measures will be taken to reduce the share of undeclared employment and increase labour participation. Competitiveness measures focus on reducing administrative burdens and increasing e-governance; improving access to education and enhancing the performance of the education system.. The above commitments refer to three out of the four areas of the Pact, leaving out the financial sector. They represent a continuity of the broader reform agenda outlined in the Convergence and National Reform Programmes, and step up ongoing reform projects in the areas of fiscal governance, public administration, and education. The Euro Plus Pact commitments have been assessed and taken into account in the recommendations.

(21) The Commission has assessed the Convergence Programme and National Reform Programme, and the Euro Plus Pact commitments[5]. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Bulgaria but also their respect of EU rules and guidance, given the need to reinforce the overall economic governance of the European Union by providing EU level input into future national decisions. It considers that after a considerable and frontloaded budgetary adjustment in 2010, fiscal consolidation plans for 2011 should be implemented as envisaged and the deficit should be brought below the 3% reference value in line with the Council Recommendation. The update does not provide sufficient details for planned budgetary measures to achieve the fiscal targets in 2012-14 and a faster progress towards the selected medium term objective could have been ensured.

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4 More details on the commitments made under the Euro Plus Pact can be found in SEC(2011) 711.

5 SEC(2011) 711.

Strengthening of the domestic fiscal framework will anchor fiscal discipline and provide for predictability and credibility of government policy in the medium-term. Further steps should also be taken to strengthen competitiveness, to help people into jobs, to protect the most vulnerable groups facing multiple barriers, to enhance the capacity of public administration and regulators, to increase resource efficiency as well as to open up more opportunities for investment and growth.

(22) In light of this assessment, also taking into account the Council Recommendation under Article 126(7) Treaty on the Functioning of the European Union of 2 June 2010, the Council has examined the 2011 update of the Convergence Programme of Bulgaria and its opinion[6] is reflected in particular in its recommendations under (1) and (2) set out below. Taking into account the European Council conclusions of 25 March 2011, the Council has examined the National Reform Programme of Bulgaria,

HEREBY RECOMMENDS that Bulgaria should take action within the period 2011-2012 to:

(1) Proceed with effective budget implementation so as to correct the excessive deficit in 2011. Specify the measures underpinning the budgetary strategy for 2012-2014 and take advantage of the ongoing economic recovery to speed up fiscal adjustment towards the medium-term budgetary objective, primarily by keeping expenditure growth in line with medium-term potential growth, while increasing the share of growth-enhancing public expenditure.

(2) Take steps to improve the predictability of budgetary planning and its implementation in particular by strengthening fiscal governance. To this end, design and put in place binding fiscal rules and a well-defined medium-term budgetary framework that ensures transparency at all government levels. Introduce measures to put budget reporting on an accrual basis.

(3) Take steps to speed up the current reform of the pension system and strengthen measures to help older workers to stay longer in employment.

(4) Promote, in consultation with the social partners and in accordance with national practices, policies to ensure that wage growth better reflects developments in productivity and sustain competitiveness.

(5) Take steps to address the challenge of combating poverty and promoting social inclusion, especially for vulnerable groups facing multiple barriers, by : expanding the market for private job service providers; modernising public employment services to enhance their capacity to match skills profiles with labour market demand; and focusing support on young people with low skills. Advance the educational reform by adopting a Law on Pre-School and School Education and a new Higher Education Act by mid 2012.

(6) Step up efforts to enhance administrative capacity in key government functions and regulatory authorities, in order to make public services more effective in responding to the needs of citizens and businesses; introduce measures to check public procurement on the basis of risk assessments, strengthen the capacity of the

[6] Foreseen in Article 9(3) of Council Regulation (EC) No 1466/97.

authorities to prevent and sanction irregularities, in order to improve quality and value-for-money in the use of public funds.

(7) Abolish barriers to entry, guaranteed profits arrangements and price controls and ensure full independence of the Bulgarian Energy Regulator, in order to open up the electricity and gas markets to greater competition. Introduce incentives to upgrade the energy efficiency of buildings.

Done at Brussels,

For the Council
The President