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Recommendation for a

COUNCIL RECOMMENDATION

on Bulgaria's 2014 national reform programme

and delivering a Council opinion on Bulgaria's 2014 convergence programme

{SWD(2014) 403 final}

Recommendation for a

COUNCIL RECOMMENDATION

on Bulgaria's 2014 national reform programme

and delivering a Council opinion on Bulgaria's 2014 convergence programme

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 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 306, 23.11.2011, p. 25.

³ COM(2014) 403 final.

⁴ P7_TA(2014)0128 and P7_TA(2014)0129.

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, on the basis of the Commission's proposals, 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, which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.
- (3) On 29 June 2012, the Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.
- (4) On 9 July 2013, the Council adopted a recommendation on Bulgaria's national reform programme for 2013 and delivered its opinion on Bulgaria's updated convergence programme for 2012-2016.
- (5) On 13 November 2013, the Commission adopted the Annual Growth Survey⁵, marking the start of the 2014 European Semester of economic policy coordination. On the same day on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report⁶, in which it identified Bulgaria as one of the Member States for which an in-depth review would be carried out.
- (6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.
- (7) On 5 March 2014, the Commission published the results of its in-depth review for Bulgaria⁷, under Article 5 of Regulation (EU) No 1176/2011. The Commission's analysis leads it to conclude that Bulgaria continues to experience macroeconomic imbalances, which require monitoring and policy action. In particular, the protracted adjustment of the labour market warrants policy actions, while the correction of the external position and corporate deleveraging are progressing well.
- (8) On 17 April 2014, Bulgaria submitted its 2014 national reform programme and its 2014 convergence programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.
- (9) The objective of the budgetary strategy outlined in the 2014 Convergence Programme is to reach the medium-term objective of a structural deficit of -1% of GDP by 2016. The medium-term objective is more stringent than what the Stability

⁵ COM(2013) 800 final.

⁶ COM(2013) 790 final.

⁷ SWD(2014) 76 final.

and Growth Pact requires. Bulgaria has benefited from the possibility of a temporary deviation from the medium-term objective by 0.6% of GDP in 2013 and by 0.1% of GDP in 2014 allowed for jointly financed projects. The programme plans a deterioration in the (recalculated) structural balance by 0.3% of GDP in 2014, to -1.3% of GDP, and for an improvement by 0.3% of GDP in 2015, to -1.0% of GDP, ensuring the return to the medium-term objective. The growth rate of government expenditure would not exceed the relevant reference medium-term expenditure benchmark in 2014-15. Therefore the budgetary plans are in line with the requirement of the Stability and Growth Pact. The debt ratio is well below 60% of GDP and, according to the Convergence Programme, it is expected to increase only slightly to 20.6% of GDP by the end of the Programme period. The macroeconomic scenario underpinning the budgetary projections in the Convergence Programme is optimistic for the 2014-15 period, with annual growth expected to reach 2.1% in 2014 and 2.6% in 2015 instead of respectively 1.7% in 2014 and of 2.0% in 2015 projected in the Commission 2014 spring forecast. According to the Commission forecast Bulgaria's deviation from its medium-term objective in 2014 is larger than what is allowed on the basis of the temporary deviation allowed for jointly financed projects, and the required return to the medium-term objective would not be achieved in 2015. Based on the assessment of the 2014 Convergence Programme and the Commission forecast, pursuant to Regulation (EC) No 1466/97, the Council is of the opinion that there is a risk of deviation from the medium-term objective in 2014-15.

- (10) Tax compliance and the quality of the tax administration remain central challenges in Bulgaria. Available estimates point to a considerable size of the shadow economy, confirmed by data for undeclared work in Bulgaria. The administrative costs of revenue collection and the compliance costs of paying taxes are relatively high. Despite several measures taken to respond to these challenges, Bulgaria still lacks a fully-fledged tax compliance strategy, which would cover the work of all tax collection authorities and include a prior analysis of the most significant risks to tax collection as well as an evaluation of the measures already in place, including simplification measures as well as improved controls.

- (11) In 2013, Bulgaria took a step back from past commitments in the area of pension reform. Additional early retirement schemes were introduced and the planned annual increase in the statutory retirement age was postponed. No progress was made with regard to harmonising the retirement age for men and women and no steps were taken to tighten eligibility criteria and controls to limit abuse in the allocation of invalidity pensions. Bulgaria has one of the most rapidly ageing populations in the EU, which has negative implications for the labour market, for growth potential in the economy and for the financing of its pension system. Bulgaria therefore needs to continue the reform of its pension system. Bulgaria also faces important challenges in the rationalisation and management of the hospital sector, including a lack of transparency in hospital financing and insufficiently developed services for out-patient care. Furthermore, the high level of formal and informal payments borne directly by the patient effectively excludes certain segments of the population from access to health-care. Health status indicators are weak in comparison with other Member States, indicating that structurally higher public expenditure on health may be required in the future.

- (12) The labour market has been underperforming in recent years, thus limiting the adjustment capacity of the economy and undermining its growth potential.

Unemployment levelled off in 2013, but the number of young and long-term unemployed has continued to rise. Bulgaria faces one of the highest proportions of young people who are neither in employment, education nor training, implying a severe underutilisation and underdevelopment of human capital. There has been only very limited progress in strengthening the capacity of the Employment Agency. There is also a need to extend the coverage and efficiency of active labour market policies. Bulgaria lacks effective measures to target the non-registered young people, including Roma, in line with the objectives of a youth guarantee. Significant proportions of the unemployed are not covered by the standard safety nets (unemployment benefits and social assistance) but rely instead on family solidarity or informal work. Bulgarians experience one of the highest risks of poverty and social exclusion in the EU. Minimum thresholds for the payment of social insurance contributions could prevent the low-skilled from participating fully in the formal economy. Some analyses have been carried out to assess the possible impact and these need to be assessed and followed up with appropriate policy action. There are no clear guidelines for transparent minimum wage setting in Bulgaria. Statutory minimum wages have been increased substantially in 2013 which may have a negative impact on employment and should, therefore, be monitored.

- (13) Bulgaria has still not adopted the School Education Act providing a framework for implementation of the necessary comprehensive reforms of the school system, including the modernisation of curricula and the improved training for teachers. There is a need to enhance the quality of vocational education and training in Bulgaria and to integrate it better into the general educational structures so as to allow for flexible pathways, reduce early school leaving and improve access to lifelong learning. Higher education, in turn, faces persisting challenges in responding better to labour market needs. The low standard of quality certification contributes to poor performance. A new strategy on higher education is being discussed, calling for the restructuring of university management through the direct involvement of interested stakeholders such as businesses and students, the consolidation of universities, and a performance-based approach to better align educational outputs with the demands of the labour market. A continuing challenge concerns the access to education for disadvantaged children, in particular Roma children. The two-year obligatory pre-school is a key measure going in the right direction and should be strictly implemented, together with measures to prevent early school leaving. There is a need to scale up existing initiatives to improve the training of teachers and reduce *de facto* segregation in schools. The rules linking the child allowance with participation in education are not yet effectively implemented.
- (14) Broader efforts to modernise the public administration have had a limited impact due to a fragmented approach and insufficient commitment to in-depth reforms. Bulgaria needs a coordinated strategy for public administrative reform to enhance the professionalism and independence of the public administration and of its regulatory agencies, including a merit-based system of appointments and career development for civil servants and effective structures to address the risk of corruption. Continued efforts are needed to improve the general business environment. Challenges include the procedures for obtaining permits and registering businesses. Resolving insolvencies takes over three years on average and the recovery rate is low. New rules on late payments were adopted in 2013 and need to be implemented. The development of e-government has stalled, and coordination to ensure interoperability of systems and creating a single point of contact is insufficient, thus limiting the

efforts to increase transparency and reduce administrative burdens. In the area of public procurement a simple and codified legal framework is lacking, resulting in a complicated legal and regulatory landscape which creates uncertainty for operators. The independence of the judiciary also remains a major concern affecting the business environment in Bulgaria. Bulgaria has taken some steps to address corruption, but overall progress has been limited and remains fragile, calling for more consistent checks and dissuasive sanctions for conflicts of interest. There is also a need to ensure better co-ordination among anti-corruption institutions and shield them from political influence.

- (15) Competition in the electricity and gas sectors remains limited. Areas of particular concern for improving the functioning of the energy markets include the lack of electricity and gas exchanges and the absence of a transparent wholesale market. The free market in electricity is dominated by a sole supplier and its limited size means that competition cannot fulfil its function of ensuring cost efficiency. The independence and effectiveness of the national regulator remains limited. Dependency on imports from a limited number of suppliers and lack of infrastructure development create a risk of supply shocks. A comprehensive package of measures to improve energy efficiency has been proposed for EU financing in the new programming period 2014-2020.
- (16) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Bulgaria's economic policy. It has assessed the convergence programme and the national reform programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Bulgaria but also their compliance with 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. Its recommendations under the European Semester are reflected in recommendations (1) to (6) below.
- (17) In the light of this assessment, the Council has examined Bulgaria's convergence programme, and its opinion⁸ is reflected in particular in recommendation (1) below.
- (18) 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 (3), (4) and (5) below.

HEREBY RECOMMENDS that Bulgaria take action within the period 2014-2015 to:

- 1. Reinforce the budgetary measures for 2014 in the light of the emerging gap relative to the Stability and Growth Pact requirements. In 2015, strengthen the budgetary strategy to ensure reaching the medium-term objective and remain at it thereafter. Ensure the capacity of the new fiscal council to fulfil its mandate. Implement a comprehensive tax strategy to strengthen tax collection, tackle the shadow economy and reduce compliance costs.
- 2. Adopt a long-term strategy for the pension system, proceeding with the planned annual increase in the statutory retirement age and setting out a mechanism to link the statutory retirement age to life expectancy in the long term, while phasing out

⁸ Under Article 9(2) of Council Regulation (EC) No 1466/97.

early retirement options and equalising the statutory retirement age for men and women. Tighten eligibility criteria and procedures for the allocation of invalidity pensions, for example by taking better account of the remaining work capacity of applicants. Ensure efficient provision of healthcare including by improving transparency in hospital financing, optimising the hospital network and developing out-patient care.

3. Improve the efficiency of the Employment Agency by developing a performance monitoring system and better targeting the most vulnerable, such as low-skilled and elderly workers, the long-term unemployed and Roma. Extend the coverage and effectiveness of active labour market policies to match the profiles of job-seekers, and reach out to non-registered young people who are neither in employment, education or training, in line with the objectives of a youth guarantee. Improve the effective coverage of unemployment benefits and social assistance and their links with activation measures. Take forward the comprehensive review of minimum thresholds for social security contributions so as to make sure that the system does not price the low-skilled out of the labour market. Establish, in consultation with social partners, transparent guidelines for the adjustment of the statutory minimum wages taking into account the impact on employment and competitiveness. In order to alleviate poverty, further improve the accessibility and effectiveness of social services and transfers for children and older people.
4. Adopt the School Education Act and pursue the reforms of vocational and higher education in order to increase the level and relevance of skills acquired at all levels, while fostering partnerships between educational institutions and business with a view to better aligning outcomes to labour market needs. Strengthen the quality of vocational education and training institutions and improve access to life-long learning. Step up efforts to improve access to quality inclusive pre-school and school education of disadvantaged children, in particular Roma, and implement strictly the rules linking the payment of child allowance to participation in education.
5. Continue to improve the business environment, in particular for SMEs, by cutting red tape, promoting e-government, streamlining insolvency procedures and implementing the legislation on late payments. Improve the public procurement system by enhancing administrative capacity, strengthening the ex-ante checks performed by the Public Procurement Agency and taking concrete steps for the implementation of e-procurement. Enhance the quality and independence of the judiciary and step up the fight against corruption.
6. Scale up the reform of the energy sector in order to increase competition, market efficiency and transparency, and energy efficiency, in particular by removing market barriers, reducing the weight of the regulated segment, stepping up efforts for the creation of a transparent wholesale market for electricity and gas, phasing out quotas, and strengthening the independence and administrative capacity of the energy regulator. Accelerate interconnector projects with neighbouring Member States and candidate countries and enhance the capacity to cope with disruptions.

Done at Brussels,

*For the Council
The President*