

## **CONCLUSIONS, RECOMMENDATIONS AND POSSIBLE APPROACHES FOR ECONOMIC POLICY DEVELOPMENT**

The Annual Report of the Economic Research Institute at BAS analyzes the economic policy in the country, studying the level and dynamics of macroeconomic indicators in main areas of social-economic development. An important aspect of the analysis is the labour market and the carried out social-economic policies, as well as the regional policy and its impact on the development of the regions in the country. Each year the Annual Report focuses on certain topic with current significance to the economic and social development – competitiveness of the Bulgarian economy (2012), policies in health care and progress of the reform in this area (2013), policies for reducing poverty and social inequality (2014).

The economic development and policy have always been a discussion topic in the theory and practice. Theoretical discussions include on one side the self-regulation of the market, on the other – the necessity of active state regulations and participation of the state in the economic development. In a time of dynamic integration processes, the issues of national and over-national policies and their coordination become more and more current in international, as well as in the national political and scientific spaces.

In the newest history of Bulgarian economic development there is hardly any consecutively applied theoretical concept for the development of the economy. And if introducing the market principles is not discussed, their real use in the practice is an inconsecutive and winding process, the steps in this direction are at slow speed, often the processes of change stop and there is even set back. This makes the price of changes more and more expensive for the Bulgarian people and tax payers, and their discontent is shown in the increasing mistrust in the state institutions. The support for the institutions and power drops more and more, and it is more often at the limit of intolerance. The strikes, demonstrations and increasing emigration are the real manifestations of the public discontent from the lack of clear vision and perspectives in the social-economic development, supported by complex acting programmes.

In this context the main advantages of the Annual Reports of ERI-BAS are the attempts to hint the pragmatic solutions, and to work in favor of the economic development. Another aspect of its usefulness is the identifying and drawing the attention of the public and politicians towards problem areas of the economic development, their discussing and looking for public consensus on possible solutions.

The development of the Bulgarian economy to a high extent is connected with the cyclic recurrence and dynamics of the external economic environment. Often this thesis is supported by arguments on the “small” size of the economy in comparative plan and the high degree of openness of the economy to foreign markets. At the same time, there are rarely talks about the ability of the economy to “protect” from the “shocks” on the foreign markets; the middle-term and long-term planning is more a wish than a real activity, the evaluation of possible risks and reported benefits and omissions from the carried out policies is not a practice. This means that the economic

development is carried out without purposeful and consecutive management of the economic processes at macro level and favorable conditions for business development at micro level. Without being a special object of analysis, the issues of quality and effectiveness of managing the economy at all levels are extremely important and have their contribution to the achieved results from the changes in the last 25 years.

### **Main Conclusions of Annual Report 2014**

1. The year 2013 (as the previous two years) is determined as a year of economic stagnation, and survival has been a main task for most of the firms and households. In 2013 Bulgarian economy registered a modest economic growth of 0.9% in real size.
2. The impact of the external environment on the economic development in Bulgaria in the last year is ambiguous. On one hand, the signs of exhilaration in the second half of 2013 in some of the important trade partners have influenced favorably the foreign demand, and the export volumes continued the positive trend of the previous year. On the other hand, the uncertainty continues to be a characteristic of the global, as well as the Bulgarian economy. The global growth remains low, and its accompanying risks continue to be high.
3. The uncertain and often inconsistent actions of the EU government on managing the long crisis increase the feeling of confusion; they hold the investors from initiating new projects in the expectation of better times.
4. Economic and political uncertainty in the country had a negative influence on the consumption and investments in the country. The government economic policy did not manage to influence significantly on the growth. The very fragmented political space again did not allow forming and asserting clear economic priorities.
5. By economic sectors, in 2013 financial and insurance activities, state governance and social activities and agriculture have contributed most to the growth. On the other hand, industry, construction and trade, transport and hotel business, have contributed negatively on GDP by 0.1 percentage point each.
6. The competitiveness of Bulgarian export by tradition in 2013 again bet on the low labour payment. Such strategy cannot be winning in long-term plan. It is a conclusion, which the authors of the Annual Report have formulated also in the previous two annual reports.
7. The current account of the payment balance in 2013 is positive, influenced by the decrease of the deficit of the trade balance, as well as the dynamics of the services and positive net current transfers.

8. In 2013 the gross foreign debt decreased nominally by almost 450 million EUR. This dynamics came from the decrease of the debt of the banks and government, while the inter-firm loans and other sectors had an increase.
9. The fiscal policy in 2013 has been directed towards maintaining stable government finances and showing clear signs in this direction towards the investment community for achieving lower prices on the debt emissions. Although in this form the fiscal policy is far from optimal, i.e. from the one that stimulates more intensive economic growth, it protects the interests of the state, maintaining the status quo successfully, especially in the turbulent political situation of 2013.
10. The prognosis on the budget balance have confirmed – it is negative in 2013, and although its size increases by 4 times compared with the previous year, the budget deficit remained under the limit of 2% of GDP, regulated by the Law on Public Finances.
11. The budget deficit in 2013 has been covered mostly by funds from the fiscal reserve, which decreased by 1.4 billion BGN. The state and state-guaranteed debt increased insignificantly in 2013 – only by 211 million BGN, reaching 19.1% of GDP.
12. The tax area in 2013 has not been an object of special changes, despite the discussion on the family income taxing, the debate “flat against progressive tax, etc. The argued changes leading to different treatment of the turnovers in VAT taxing, as well as the casus “unified tax account”, subsequently revoked by the court, added up to the picture of small and non-systematic tax changes.
13. In 2013 the banks in the country made a partial restructuring of assets and liabilities, which is indicative of their intentions in 2014. The rate of increase of the capital instruments in the portfolio of assets for trading is considerably fast. The change of the risk profile of the banks can be traced clearly also through the rates of dynamics of securities. In 2013 there is certain change of the policy of accounting the acquired securities on bad credits.
14. The comparison of the total growth of debt instruments and the change of credits and advances in the last 2 years shows that the policy on bank assets in the country starts to change. There is a process of revival of the consumer crediting.
15. In 2013 the tendencies on the labour market were similar to the observed ones in the previous years. Although the economy again registered growth, the employment continued to decrease, and the unemployment level to increase.
16. In Bulgaria the labour costs increased faster than in most of the other European economies, due to the low basis (low relative wages from the previous year), as well as administrative measures (changes of minimal wage and minimal insurance thresholds).

17. The policy on the labour market includes the regular changes in the minimal insurance thresholds; changes in the level of minimal wage from 290 to 310 BGN since 1<sup>st</sup> January 2013; active policy on the labour market for opening work places (250 000 for the mandate of the last government); initiating a programme for increasing the youth employment.
18. In EU Bulgaria has the lowest economic level and highest regional differences and unfavorably set tendencies.
19. Inequalities in the access to financing of the non-financial enterprises are one of the visible generators of indebtedness in the whole economic system.
20. The share of credited households in 2013 was 22.8% (33.8% in 2009). The smaller number of debtors in 2013 served an almost identical volume of gross credit debts of little over 18 billion BGN. The share of "bad credits" was 18-19% (increase of 5-6% in 2009).
21. There is a clear tendency towards increase of the duration of the delays in servicing the credit debts compared with 2009. The negative tendencies are especially clear in the house mortgages, where the drop of prices and the stagnation of real estate are an additional factor.

### **Perspectives**

1. The uncertainty of the macroeconomic prognosis of Bulgaria is significant. It refers mainly to the uncertainty of the rates of restoring the consumption in Bulgaria, as well as of the economic growth in EU. The political uncertainty should also be mentioned.
2. The external environment has indications of improvement: the slowing down of the economic dynamics in the newly emerged and developing economies seems under control for now, and in 2013 the rates of growth are higher than the previous two years; the growth in the Euro zone is expected to stabilize, but at considerably low levels. In middle-term plan, expected is smooth acceleration of the rates of economic growth in Bulgaria. Unlike the period from the crisis till the moment when the foreign sector had a main contribution to the growth, in the next few years expected is ensuring a more balanced basis for growth with restoring the consumption and investments. However, as a whole in middle-term plan the growth will remain rather low and unstable.
3. Short-term expectations of the business and their evaluations of the business climate in the country show that in all sectors there is improvement in the last months.
4. The rates of export increase will remain low, which will reflect also on low rates of economic growth in the next few years.

5. In short-term plan expected is (if the smooth restoration of the internal demand continues in the next years) a decrease of the positive balance on the current account of the payment balance, and even a deficit (if the import restores its previous volumes).
6. Concerning the fiscal policy, the tendency towards a moderate increase of the indebtedness of the state is expected to continue, and in 2014 the debt will increase with higher rates due to the maturity of global bonds in the beginning of 2015.
7. In 2013 there was a clear tendency of accelerating the redistribution processes through the state budget, the expenditures exceeded the incomes lastingly, and the difference was covered by increasing debt. This tendency is expected to continue till 2015, after which it will slightly stagnate to the level of incomes and expenditures under 40% each. In conditions of revival from the crisis, this general tendency of development in the fiscal sector, a result of attempts for pro-active fiscal policy, is explicable and logical.
8. The social insurance and cares had the highest share in the total government expenditures in 2013. The increase was insignificant compared with 2010. This fact shows the strategically unfavorable situation of the Bulgarian economy. It will probably remain a hostage of the social payments and transfers to pensioners, ill people and socially weak people in the society.
9. In 2013 many processes were activated in the bank area, which would lead to redistribution on the market of financial services in Bulgaria. It can be expected that in 2014 there will be certain revival of crediting, improvement of the quality of credits, and activating processes of merger and acquiring banks.
10. The maintaining of high intent to save, despite the decrease of the interest rates on the deposits, can be explained by the lack of enough investment alternatives, i.e. people and enterprises have no other opportunities for realization of the free funds.
11. With the continuing stagnation of the economy and the high level of bad *credits*, *the low income norm will remain the main problem* for most of the banks in the country.
12. With the narrowed crediting, in the next 2-3 years the resource price in itself will play more and more insignificant role to forming the profit. The improvement of the credit norm will have far more important contribution to the profit, and that is why in 2014 the banks are expected to continue to lower aggressively the deposit interests, in order to even the rates of increase of the attracted resource and credit portfolio.
13. In 2013 the dynamics of the labour demand to a great extent was determined by the activity of the production subjects. This is a reason to expect that if the

economic growth continues and even accelerates by ranging more sectors, then the employment in 2014 at last will increase.

14. The expectations for 2014 are for stopping the drop of employment and its increase by not more than 10-20 thousand people. This will lead to a minimal decrease of the number of unemployed and the unemployment level. The employment decrease will not turn completely into a decrease of unemployment due to return of some of the people outside the labour force back on the labour market. The high unemployment and low inflation will be a main factor to limit the increase of the nominal work wage in 2014.

### **Policy Recommendations**

1. Bulgaria has not yet exhausted the opportunities of the export oriented growth. We recommend policies for optimizing these opportunities. A strategy of economic growth, based only or mostly on the development of the export potential, sooner or later will reach its limit. This imposes already to carry out policies for achieving a growth based on the domestic consumptions.
2. The public investment programme is a main focus in the government measures for stimulating the economic growth; some social payments, which impact on the consumption in the country. However, the latter have a short-term effect and cannot be considered significant regarding the future of the growth.
3. The impact on the business is sought through ensuring an additional liquidity (on the line of reducing the term of reimbursing VAT). This policy would have a positive influence on making business in Bulgaria, but it has no direct effect on the economic growth in long-term plan.
4. The purposeful and effective assimilation of the European funds could have a significant impact on the Bulgarian economy in short-term as well as long-term aspect.
5. Other main priorities of the government policy should concern reforming the systems, which now work extremely ineffectively (social, educational and health systems).
6. Investment in infrastructure should continue to be a main channel for a better and cheaper access to neighboring markets, and at the same time an instrument for indirect drawing of attention of the international investors, interested in bigger regional market.
7. The export oriented strategy, supported also by many instruments like partial geographic reorienting of the foreign trade and FDI origin, in EU (to more dynamic and competitive partners, including the new member countries) and outside EU; clear preferences to preferred sectors, without breaking EU rules of

competition and by avoiding state interference in the economic development, which would distort the market.

8. Analysis of the opportunities for replacing bigger part of the imported goods, used in export-oriented manufacturing, with goods manufactured in Bulgaria by local or foreign companies (mostly small and medium-sized).
9. Supporting the export oriented growth of small and medium-sized firms in three different ways: their including (as subsidiaries) in the net of manufacture and services of transnational companies working in Bulgaria for export; their turning into autonomous and direct exporters of different goods and services (in the beginning mostly to neighboring markets like Romania, Western Balkans, some of the new member countries, as well as Greece, Turkey and Ukraine); and finally, developing their competitive advantages and their successful competing with foreign companies in selected sectors of the Bulgarian consumer (or investment) market (with special focus on foods and other main sectors manufacturing consumer goods).
10. Creating a capacity for structural renovation in a given sector of manufacturing enterprises in Bulgaria, managed by transnational companies, through closer cooperation with the transnational companies; constant improving of the business environment in the country; counting the development of the international business influencing on the global position and business perspectives of these companies.
11. Structural modernization – higher level of technologies in manufacturing, employment of higher qualified employees and higher internal added value, which at certain stage should focus on creating strategic clusters with significant effects of synergy and expanding the positive effects to different sectors and areas of the economy.
12. Effective cooperation with export oriented transnational companies requires continuous efforts of establishing a net at a level of cooperation in manufacturing, as well as at level of government and its high representatives, responsible for the economic policies of the country.
13. Tax policy should adopt the perspective of changes in accordance with a more general principal approach, counting not only the tax incomes of the state and the interests of the economic groups, but also the economic effects and justice of the taxes. This approach is a basis for a higher collecting of taxes and then on this base measures for increased control would give real results.
14. The question whether the acting now proportional scale should be replaced with a progressive one remains current. The first steps of a factual rejection of the proportional taxing are the changes in the Law on taxes of the incomes of physical entities, which are active since the beginning of 2014. This is a positive step in the right direction, which aims to restore the justice of the personal income tax. The danger is if this reform is also carried out on the pendulum principle and

in the future will lead to a steep tax progression, acting in Bulgaria. It would be wiser to restore the non-taxed minimum and to keep the proportional tax scale. Of course, it cannot remain at 10% level and should be increased, so such reform will remain neutral to the incomes.

15. Processes in the bank system can hardly be managed, since Bulgaria cannot carry out an independent monetary policy and the Central Bank has limited opportunities to impact on the system. What can be done is to maintain a fair balance between financial mediators and their clients. The new Law takes a step in this direction, but it is still early to say whether this balance is fair and sustainable, since the Law eliminates the barriers for pro-term cancellation of the contracts.
16. Transparency in the sector should increase. The regulator has foreseen a possibility for public access to aggregated report data of the bank system at the end of each report period. It would be good if these reports range additional information, which would facilitate a more adequate and more informed choice by the clients.
17. Improvements of the labour market include policies on the labour market itself, as well as policies outside it. Among the policies on the labour market are increase of the value and analytical phase in developing, applying and implementing the measures. The evaluation of the effect of previous programmes gives an impression of certain sporadicity, juncture and arbitrariness in developing the government policy on the labour market, which harms the people's trust in its efforts to improve the situation on the labour market.
18. The second type of policies for improving the functioning of the labour market concerns an entire improvement of the business climate in the country and encouragement of the investment activity of the firms, as well as improvement of the efficiency of the legal system, functioning and restoring the "power of law" to highest degree. There is already a sign that the implementing of some of these policies has started (reviewing the full picture of the existing license and permit regimes and eliminating the ones not particularly significant and only hindering the inclusion of the firms on the market). Other policies need a substantial work and demonstration of a political will for their realization.
19. The working regional policy should meet certain requirements: conforming to the specific comparative advantages of the region, engagement of the national sector policies with the problems of the regional development. Regional policy at this stage of the country's development cannot be a priority, but there should be a clear vision of its goals and instruments for its realization.
20. Overcoming the problems from inequalities in the access to financing from bank institutions requires actions in many directions: a) a long-term policy for developing the capital market; b) wide informing of the decision makers in the enterprises about the opportunities of the international financial institutions; c) legislative changes towards introducing an unified standard of credit contracts



without hidden clauses and announcing the annual percentage of the expenditures on servicing the credit; d) introducing mandatory minimum and maximum thresholds of the ratios profit/volume of the credit and turnover/volume of the credit, which can be used by the firms in covering their credit liabilities; e) introducing the rule of a full satisfaction with the value of the security, as well as the rule for securing not more than 200% of the credit size; speeding the procedure on announcing bankruptcy; f) strict control over the bank, which has signed a contract with the National Guarantee Fund for following the contract clauses when crediting the beneficiaries on the EU cohesion programmes.

21. The restoration of the equality and protection of the consumers should include introducing of: a) *mediating organs*, which would facilitate reaching out-of-court agreements, restoring the trust between creditor and debtor and finding cooperative decisions in creating covering plans in problematic liabilities; b) measures for *improving the financial literacy* of the Bulgarians through programmes for financial literacy of the future credit users, as well as introducing similar school subjects in the system of secondary education; c) *unified standard of credit contracts*, providing clear full information on the liabilities of the debtors and the possible dynamics of the interests on the credit and the methods of their calculation; d) obligatory announcement of the annual percentage of the expenditures on servicing the credit; e) regulation of the unregulated and de jure completely liberalized market of credits from “non-financial credit institutions”; f) in middle-term and long-term perspective there is a need of considering the introducing of a legal frame for insolvency (bankruptcy) of physical entities.