Promoting Decent Work and Social Justice in Bulgaria

An ILO Contribution to the Economic and Social Policy Debate[1]

Decent Work in Bulgaria

[1] This background paper is based on contributions from a number of ILO officials including: Alena Nesporova, Sandrine Cazes, Kenichi Hirose, Natalia Popova, Carolin Vollmann and Robert Kyloh. The paper also draws on background material provided by Michael Landesmann and Vladimir Gligorov from the Vienna Institute for International Economic Studies.

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Executive Summary

In the past Bulgaria has had a relatively sound reputation for social dialogue. However national trade union centres and the majority of employers' organisations complain that the environment for social dialogue deteriorated after the onset of the global economic crisis when several tripartite agreements were not fully implemented. This is unfortunate because Bulgaria will require greater consensus and tripartite commitment to an agreed economic and social agenda if the country is to forge a strong, sustained and balanced economic recovery.

The economic challenges confronting Bulgaria are substantial. Economic recovery slowed significantly in mid to late 2011 and real GDP remains roughly 3 % below the pre-recession peak. Moreover, the deterioration in labour market conditions since the recession is among the worst in the EU-27. Despite having a very flexible labour market, Bulgaria has experienced a very large and disproportionate decline in employment compared to the change in output over the same period. In fact in the third quarter of 2011 total employment was still some 11.5% below the pre-recession peak.

In the period prior to the recession Bulgaria had relatively rapid economic and employment growth thanks largely to capital inflows into the non-traded goods sector, causing "bubbles" is some sectors such as construction. However this growth model could not be sustained after the onset of the global economic crisis and in any case it had not result in a substantial improvement in decent work.

Given the global economic conditions that currently prevail a return to the pre-crisis growth model is unrealistic and would be socially undesirable. Achieving economic growth rates that are compatible with acceptable employment levels and decent work in the circumstances that are likely to prevail in 2012 and beyond will therefore require alternative drivers of growth to those relied upon in the pre-crisis period plus institutions and policies that will share the benefits of growth more equitably. Unfortunately the outlook for exports, domestic consumption and investment are all bleak.

In these circumstances it would be appropriate to focus tripartite discussions on the scope for some limited fiscal stimulus and the most appropriate targets for any such increase in public expenditure. Possibilities include: additional physical infrastructure that would facilitate increased private investment in high value added export industries; restoring government expenditure on Active Labour Market Policies to the levels that prevailed in 2004-2005; stimulating income led growth through further adjustments to the minimum wage and social transfers which remain extremely low by the standards of other EU countries; and, providing additional support to private investors, particularly small and medium sized enterprises, who are constrained by high real interest rates and limited access to credit.

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1 Introduction

The main function of the ILO is to promote decent work which encompasses both the quantity and quality of jobs. The ILO also has a Constitutional obligation to review *"all national and international policies and measures, in particular those of an economic and financial character"* and to *"judge"* the extent to which they promote or hinder the fundamental objective of *"social justice"*.[2] Consequently in contributing to the economic and social policy debate in Bulgaria the objective of the ILO is to raise issues and suggest reforms that will advance decent work and social justice.

However we do not start from scratch in Bulgaria. In March 2011 the Bulgarian constituents of the ILO endorsed a document titled the 'Global Jobs Pact Country Scan' which set out a comprehensive analysis of past economic and labour market developments and provided recommendations for future policy.[3] The recommendations in the Scan resulted from discussions and negotiations among the tripartite constituents in Bulgaria and therefore represent a high degree of tripartite consensus. Also in March 2012 the International Trade Union Confederation and the two national trade union centres held a major conference in Bulgaria concerning jobs and incomes.[4] Both the ILO and the IMF actively participated in this conference along with senior representatives from the Bulgarian Government, the employers' associations in Bulgaria and a variety of academics (for the main conclusions see Appendix A).

Bulgaria has the necessary formal institutions to conduct effective social dialogue including representative national trade unions and employer associations with the capacity to engage in detailed discussions and negotiations over complex economic and social issues. It also has considerable experience with tripartite negotiations through the National Council for Tripartite Cooperation. However, effective social dialogue requires more than just formal institutions. The most important ingredient for securing consensus and a shared commitment to policies in difficult economic circumstances is trust between the parties. In recent years social dialogue resulted in a number of tripartite agreements concerning both general economic stimulus measures and more specific issues including reform of the pension system. Unfortunately many aspects of these agreements were not implemented. Explanations for such changes in policy direction were not provided, or were offered after the event, without adequate opportunity for discussion. Trust between the Government and the social partners was undermined by such events and tripartite dialogue broke down in the second half of 2011.

Trust must now be rebuilt. A start towards this objective was made in early 2012 when the national trade union centres and employers' associations reached new bipartite agreements on pension reform and access to affordable credit. The conference organised by the trade union movement in March 2012 was another important step in re-establishing consensus about economic and social policy.

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2 ILO, Declaration Concerning the Aims and Purposes of the International Labour Organisation, Annex to the Constitution of the International labour Organisation, 1944.

3 ILO, Global Jobs Pact Country Scan Bulgaria, 2011.

4 "International Conference: Jobs and Incomes - A Better Deal for Bulgaria", 8-9 March 2012.

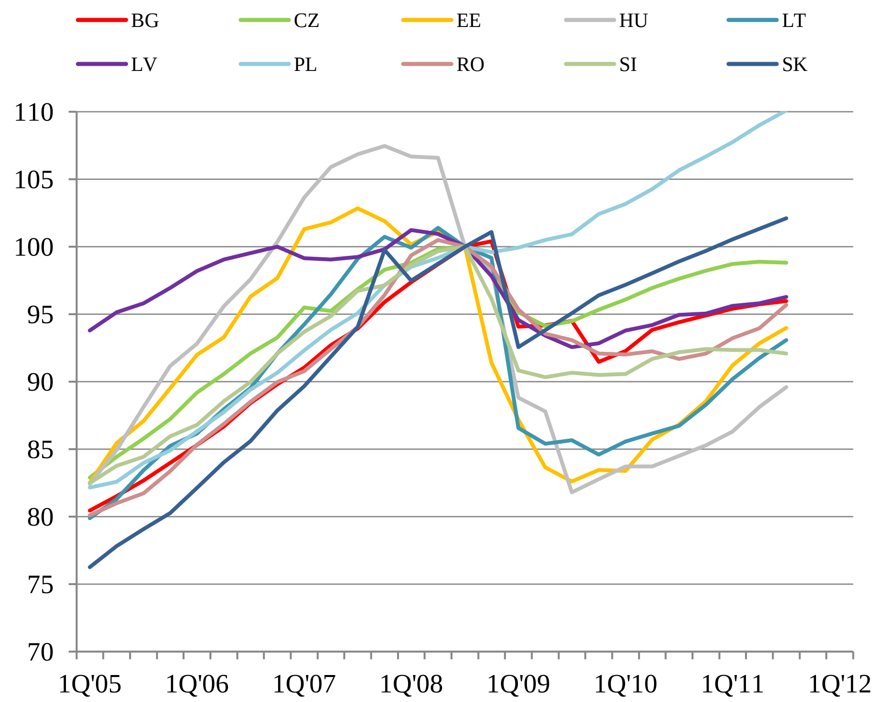
Open and frank debate is a cornerstone of democracy and good governance. This approach was strongly endorsed at the joint IMF–ILO conference held in Oslo in September 2010 which provided the launching pad for activities in Bulgaria and several other countries. One of the key conclusions to emerge in Oslo was that:

> *"There was also agreement on the central role that effective social dialogue can play in building the consensus needed to tackle the difficult adjustment challenges created by the crisis, and to ensure that the social consequences of crisis and its aftermath are taken fully into account."*[5]

2 Recent economic and labour market developments

The global recession hit economic growth in Bulgaria relatively severely, with real GDP declining by roughly 9 % from a peak in the fourth quarter of 2008 to the trough in the fourth quarter of 2009. Compared to other countries among the European Union (EU) New Member States (NMS) the initial impact of the recession on GDP in Bulgaria was significant but less dramatic than in several other of the EU-NMS (see Figure 1).

Figure 1: Development of quarterly GDP with 3Q'08 =100

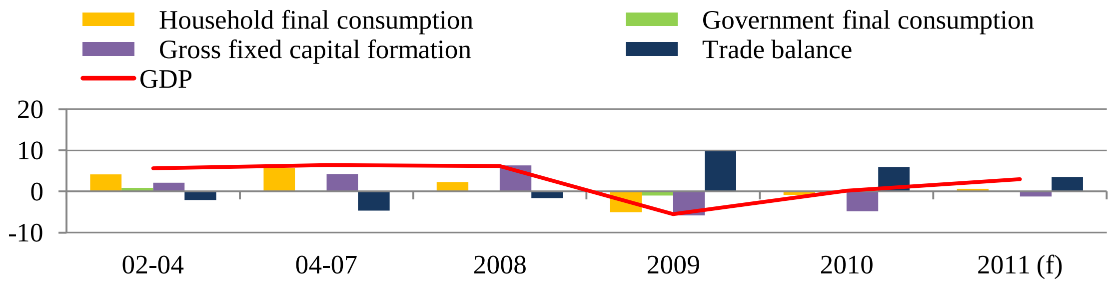


Note: Seasonally adjusted and adjusted by working days.
Source: wiiw Database incorporating Eurostat statistics.

While there were some tentative signs that economic growth was starting to recover during 2010 and the early part of 2011 this was almost entirely due to a pick-up in net exports (see Figure 2).

[5] IMF, Press Release No 10/339, Oslo Conference Calls for Commitment to Recovery focused on Jobs, September 13, 2010.

Figure 2: Contributions to the GDP growth rates in percentage points



Note: Contributions of changes in inventories are not shown; data for 2011are forecasts.
Source: wiiw estimates incorporating national sources.

However exports slowed significantly thereafter. Preliminary GDP estimates for the final quarter of 2011 confirm that growth slowed considerably and real GDP remains about 3% below the peak that was achieved in 2008. Partial indicators including data on retail sales and construction activity would suggest that domestic demand was static or declining from mid-2011 (see Table 1 for domestic demand).

Table 1: Changes in main economic indicators (year on year)

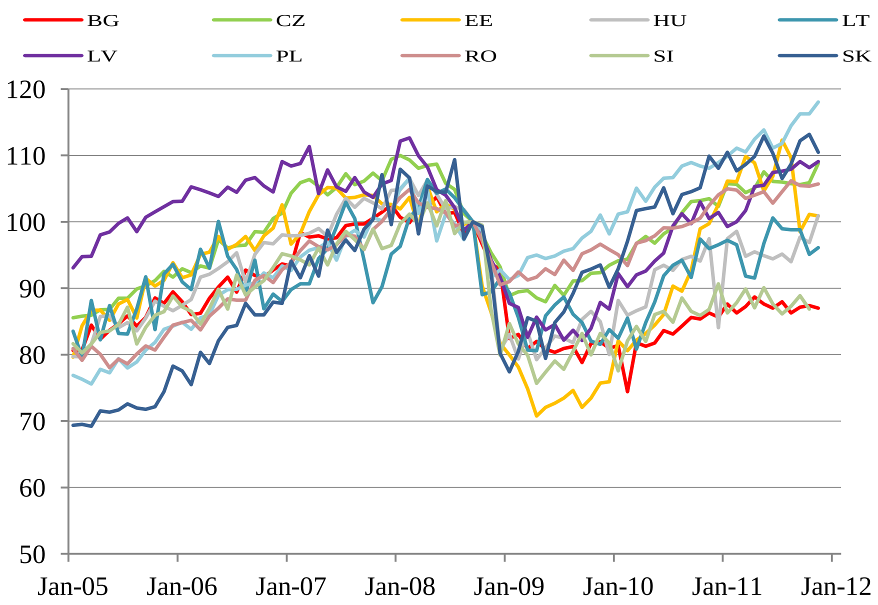
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011 Q1	2011 Q2	2011 Q3
Real GDP	5.7	4.2	4.7	5.5	6.7	6.4	6.5	6.4	6.2	-5.5	0.2	3.3	2.0	1.6
Exports	-15.9	6.0	9.8	10.6	11.9	-17.5	50.7	6.1	3.0	-11.2	16.2	21.6	12.2	2.0
Imports	-9.5	14.3	6.8	16.7	13.9	-7.6	47.7	9.6	4.2	-21.0	4.5	10.0	7.5	8.1
Private Consumption	7.3	7.9	3.6	6.8	7.7	6.7	8.6	9.0	3.4	-7.6	-1.2	1.3	1.2	1.9
Gross Capital Formation	12.4	17.6	5.5	16.9	14.8	25.9	21.4	13.0	16.3	-24.9	-14.0	1.6	8.4	-2.8
Domestic Demand	8.5	8.6	3.5	9.1	8.4	9.8	10.9	8.7	6.4	-12.7	-4.5	1.3	2.9	0.6
Government Consumption	9.4	2.8	1.2	8.8	3.5	0.4	3.5	0.3	-1.0	-6.5	-1.0	0.2	1.9	1.2

Source: Eurostat statistics.

Figure 3 shows trends in industrial production for a range of EU-NMS. This data confirms that – in contrast to many other countries – the very moderate economic recovery in Bulgaria stalled in early 2011 at levels well below the pre- recession peak. Equity prices have also been in free fall with the main Bulgarian stock market index declining by over 25 % in the second half of 2011.[6] Caution is now rampant in the domestic private sector and confidence may ebb even lower during 2012.

[6] See data on the Sofia Stock Exchange index provided by Eurostat.

Figure 3: Development of gross industrial production



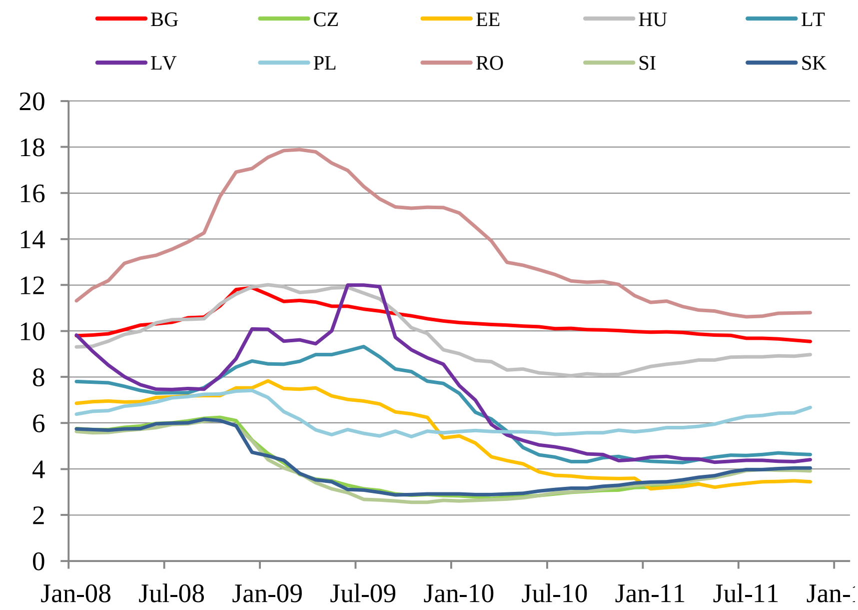
Note: September 2008 =100, seasonally adjusted.
Source: wiiw Database incorporating Eurostat statistics.

In Bulgaria, as elsewhere, the global economic crisis and the events that followed were reflected in a dramatic shock to domestic demand. Investment expenditure had been a major contributor to growth in the boom. But both private consumption and investment expenditure declined rapidly in 2009 and 2010. While domestic demand had started to recover in many of the EU-New Member States by early 2011, there was no clear signs of a substantial turn-around in these two key drivers of growth in Bulgaria (see Table 1).

Moreover at the start of 2012 the outlook for both private consumption and investment appear bleak. Households are heavily constrained by low incomes, high unemployment, the negative wealth effect of declining property prices and the fear that the jobs market will deteriorate further. While domestic investment is being held back by the legacy of high corporate debt, excess capacity and insipid demand. Severe constraints on access to credit, concerns about liquidity in banks with strong linkages to EU-15 countries and very high real interest rates are also major factors inhibiting investment.

Figure 4 shows trends in nominal interest rates for loans to non-financial corporations in a range of NMS. It is evident that nominal interest rates in Bulgaria have not fallen significantly since peaking in 2008 and remain stuck at around the 10 % level. Given that inflation has moderated considerably over this period real interest rates have in fact risen despite weak demand. Employers from small and medium sized enterprises in Bulgaria complain that it is extremely difficult to access funds even at much higher interest rates than those suggested in Figure 4 and that the terms and conditions attached to loans are often changed without justification, adding to uncertainty and undermining business confidence.

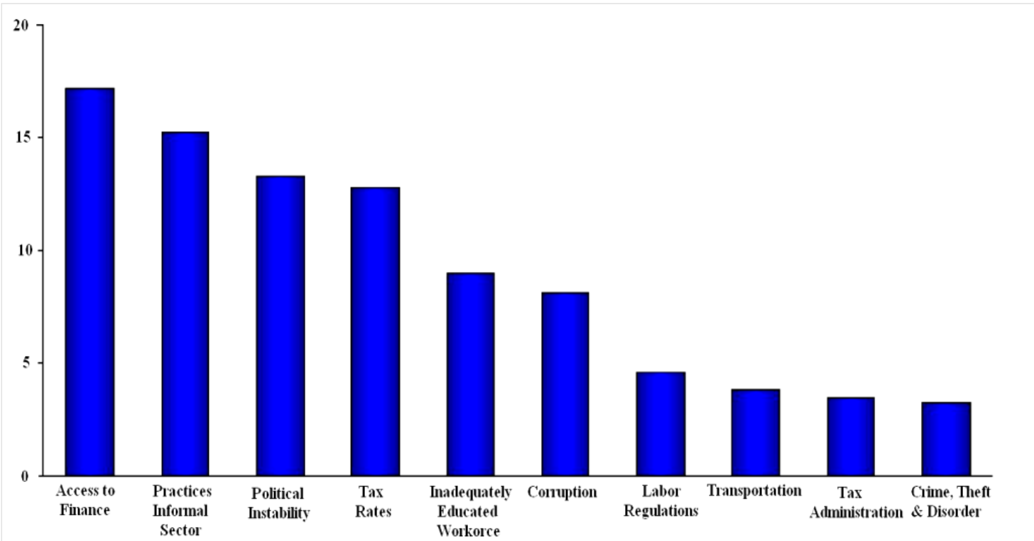
Figure 4: Interest rates for loans to non-financial corporations (maturity greater than 5 years)



Source: Eurostat statistics.

Even before the recent hike in real interest rates, and the onset of liquidity problems in the banking sector, entrepreneurs in Bulgaria had identified access to credit as the main obstacle to investment (see Figure 5).This is particularly true for small and medium sized enterprises, which play a dominant role in the Bulgarian economy. Some 98 % of all enterprises in Bulgaria employee 49 or less workers.[7] Other key barriers to investment according to the World Bank survey are political instability and practices in the informal economy.

Figure 5: Percentage of firms identifying the problem as the main obstacle in 2009



Source: World Bank, Enterprise Survey, Bulgaria Country Profile 2009, January 2010, p. 4.

[7] European Commission, Enterprise and Industry, SBA Fact Sheet BULGARIA 2010/11, p.1.

As noted above the only significant source of economic growth since the crisis has been net exports. However with around 62% of Bulgarian exports destined for the EU[8] and a high share to those countries at the centre of the crisis there is little prospect of strong export led growth in the near term. In fact the World Bank, IMF and European Commission have all forecast a decline in output for the Euro zone in 2012.[9] Moreover the World Bank and various other institutions have stated that even this assessment may be overly optimistic and there is a risk of a global crisis similar in magnitude to that caused by the Lehman crisis.

Given the outlook for both private domestic demand and the external environment the World Bank have forecast GDP growth of just 1.2 % for Bulgaria in 2012.[10] This is somewhat lower than the comparable forecasts for several other countries in South-East Europe including Romania, Serbia and Albania. The rapid deterioration in economic conditions in recent months is underlined by the fact that in October 2011 the IMF was forecasting growth of 3 % for Bulgaria in 2012.[11]

Growth of the magnitude now expected this year – slightly above 1 % – will be insufficient to prevent a further deterioration in the labour market which in turn will have adverse consequences for social cohesion and political stability. After five years in which labour market indicators improved significantly Bulgaria has lost over half-a-million jobs during the recession.[12] This is a dramatic outcome for a country where total employment is only around 3 million. As a result the employment rate declined by between 5 and 6 percentage points between 2008 and 2011 (see Table 2). Over the same period the unemployment rate (LFS definition) more than doubled and the European Commission has forecast that unemployment will remain above 12 % in 2012.[13] Long-term unemployment has also more than doubled over this period (see Table 2).

This was despite the fact that many people became discouraged and gave up searching for work in this period and outward migration accelerated. Estimates concerning the proportion of Bulgarian citizens living outside the country vary but the numbers are significant. The World Bank recently estimated that in 2010 16 % of the population had migrated.[14] Moreover, a survey in 2011 by the Bulgarian Academy of Sciences suggested that an additional 20 % of Bulgarians currently working in the country would like to migrate and that this proportion has been increasing in recent years. The main reason cited for wishing to leave Bulgaria is the prospect of better paid and more secure employment outside the country.

As a result of these factors the labour force participation rate declined by around 2 percentage points between 2008 and 2011. The ILO estimates that if open unemployment and discour-

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8 See United Nations Conference on Trade and Development Statistics for 2010.

9 World Bank, Global Economic Prospects, January 2012, p. 2. IMF, World Economic Outlook Update, 24 January 2012, p. 2. European Commission, Directorate-General for Economic and Financial Affairs, Interim Forecast, February 2012.

10 World Bank op.cit. , p. 103. See also, European Commission Directorate-General for Economic and Financial Affairs, Interim Forecast, February 2012, which has forecast GDP growth of 1.4% for 2012.

11 IMF, World Economic Outlook – Slowing Growth, Rising Risks, September 2011, p. 78.

12 The decline in total employment from peak in the third quarter of 2008 to trough in the first quarter of 2011 was 510,900 according to Eurostat data, the decline in the number of employees in the same period was 451,400.

13 European Commission, Economic and Financial Affairs, European Economic Forecast - Autumn 2011, p. 87.

14 World Bank, Migration and Remittances Fact Book, 2011.

aged workers are taken together the composite unemployment rate at the end of 2011 would be close to 19 %.

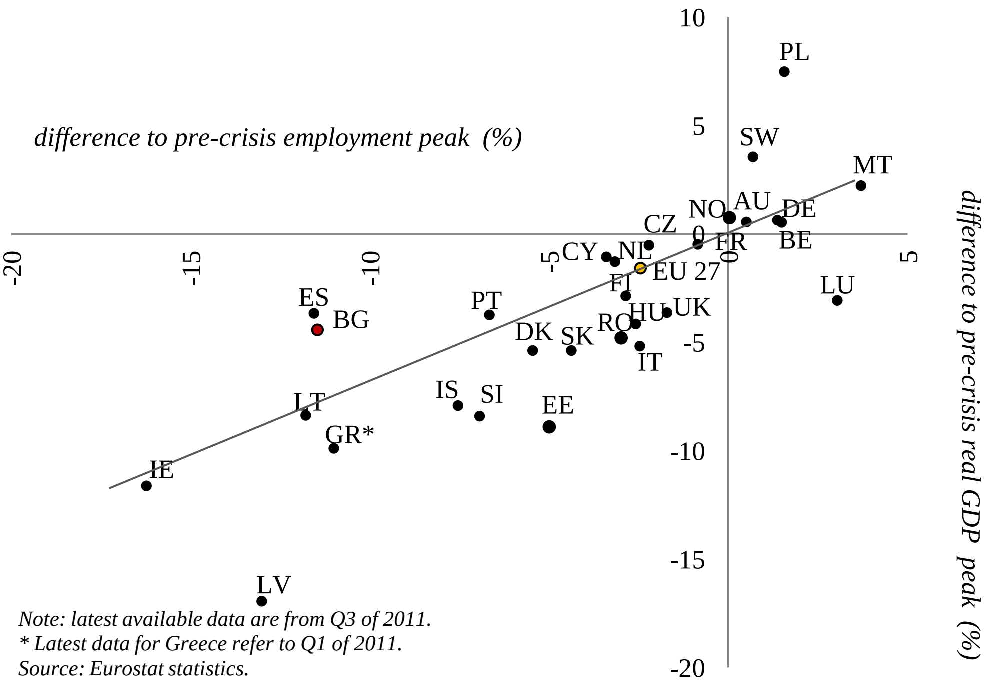
Table 2: Recent labour market indicators (rates and percentage change)

	2008				2009				2010				2011			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Employment (15-64)	62.6	63.9	65.0	64.3	62.6	63.3	63.1	61.2	58.8	60.2	60.6	59.0	57.3	58.2	59.9	58.7
Empl. Change (y/y)	2.9	2.3	2.3	1.4	0.0	-0.6	-1.9	-3.1	-3.8	-3.1	-2.5	-2.2	-1.5	-2	-0.7	-0.3
Participation (15-64)	67.0	67.9	68.5	67.8	66.9	67.6	67.7	66.5	65.5	66.9	67.1	66.6	65.2	65.6	66.8	66.3
Unemployment (15-64)	6.6	5.9	5.2	5.1	6.4	6.4	6.7	8.0	10.2	10.1	9.6	11.3	12.1	11.3	10.3	11.5
Youth unemployment (15-24)	14.4	13.1	11.4	12.1	14.2	14.6	16.5	19.5	23.8	21.2	21.4	26.5	29.1	25.3	23.3	28.9
Long-term unemployment (over 1 year)	3.3	2.9	2.7	2.7	2.8	2.9	2.8	3.4	4.3	4.3	4.5	5.9	6.3	6.3	6.2	6.4

Source: National Statistic Institute, Labour Force Survey.

Figure 6 depicts the change in employment and GDP from the pre-recession peak to the third quarter in 2011 across a wide variety of EU countries. Bulgaria is among the European countries with the largest employment loss; with total employment in the third quarter of 2011 still some 11.5 % below the peak (which was recorded in the third quarter of 2008). Only Ireland, Latvia and Lithuania have performed worse in terms of employment decline since the onset of recession. In fact the fall in employment in Bulgaria is on a par with, or significantly greater than, that recorded in several countries at the epicentre of the sovereign debt crisis including Greece, Spain, Portugal and Italy.

Figure 6: Remaining difference (Q3 of 2011) to pre-crisis peak in employment and real GDP in percentage points



Note: latest available data are from Q3 of 2011.
** Latest data for Greece refer to Q1 of 2011.*
Source: Eurostat statistics.

However, what is even more striking from Figure 6 is the comparison between the decline in output and employment across countries since the recession. Compared to other countries in the EU, Bulgaria and Spain stand out because they have experienced a much larger decline in employment relative to more moderate declines in output (from the pre-recession peak). Some international institutions have suggested that strong labour market institutions, such as industry level collective bargaining and employment protection legislation, contributed to the relatively large employment decline in Spain.[15] Yet as we will see below the Bulgarian labour market has performed similar to Spain with perhaps the most flexible labour market in the EU. What Spain and Bulgaria did share in common was an unsustainable 'bubble' in the construction sector in the pre-crisis period.

Young workers have been particularly vulnerable in the crisis and as a result youth unemployment has soared from a low of 12 % at the end of 2008 to nearly 29 % in late 2011 (see Table 2). Within the EU-27 Bulgaria has the highest level of youth that are neither in employment or education.

Job losses during the crisis have been spread widely across most industries or sectors of the economy. Only the financial sector, real estate and retail trade recorded any increase in employment during the 2008-2010 period (see Figure 22 for details).

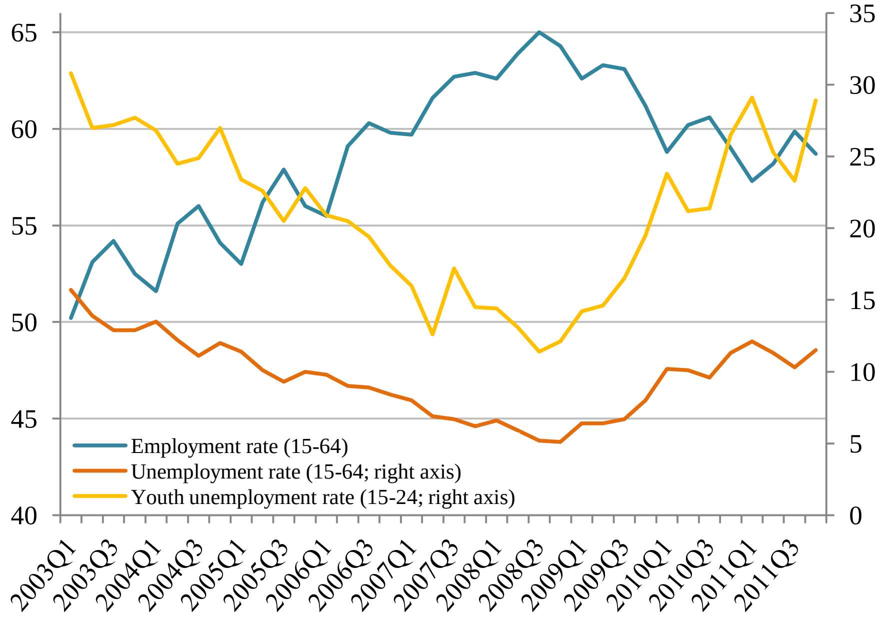
In the short term the main economic priority in Bulgaria must be the generation of decent jobs and the preservation of social cohesion, which has appeared under threat in recent months. This requires the restoration of economic growth levels that are compatible with sustained and decent job creation and a return to low single digit unemployment levels. The key issue that therefore needs to be addressed is: how can economic growth be accelerated in the short term given prevailing conditions?

3 Macroeconomic trends and policies

In the period between 2000 and 2008 Bulgaria – like many other transitional countries in Central and Eastern Europe – experienced average GDP growth rates of about 6 % p.a. This outcome relied heavily on strong capital inflows, an excessive expansion of credit to the private corporate sector and a rapid expansion of the non-traded goods sector. This led to the emergence of an unsustainable current account deficit. On the plus side the pre-crisis growth model proved compatible with increased labour force participation, a significant jump in employment levels and much lower unemployment (see Figure 7). The gains in labour force participation and employment were not sustained and have been largely reversed since the recession.

[15] IMF, Spain Country Report No. 11/215, July 2011, p. 25-27; see also IMF, The Spanish Labor Market in a Cross-Country Perspective, Working Paper 11/11, January 2011.

Figure 7: Recent trends in employment, youth and total unemployment



Note: Employment data are not seasonally adjusted
Source: National Statistic Institute, Labour Force Survey.

While the quantity of employment improved in the pre-recession period serious questions remain about the quality of the jobs created and whether they constituted decent work. For example, wage levels remained very low relative to other EU countries and employment conditions were inferior. Wage and income inequality widened in this period. Poverty also remained pervasive and productivity growth was moderate by comparison with many other EU-NMS (see Section 3 for details). Throughout this rollercoaster economic ride the magnitude of the informal economy remained excessive and recent evidence suggests it is once again expanding as workers seek survival strategies in the face of declining formal job opportunities. High level corruption and organised crime continue to be issues of concern that are cited by the European Commission.[16] It is important to consider whether the failure to adequately tackle these problems has had any impact on the structure of the economy and the nature of investments in Bulgaria.

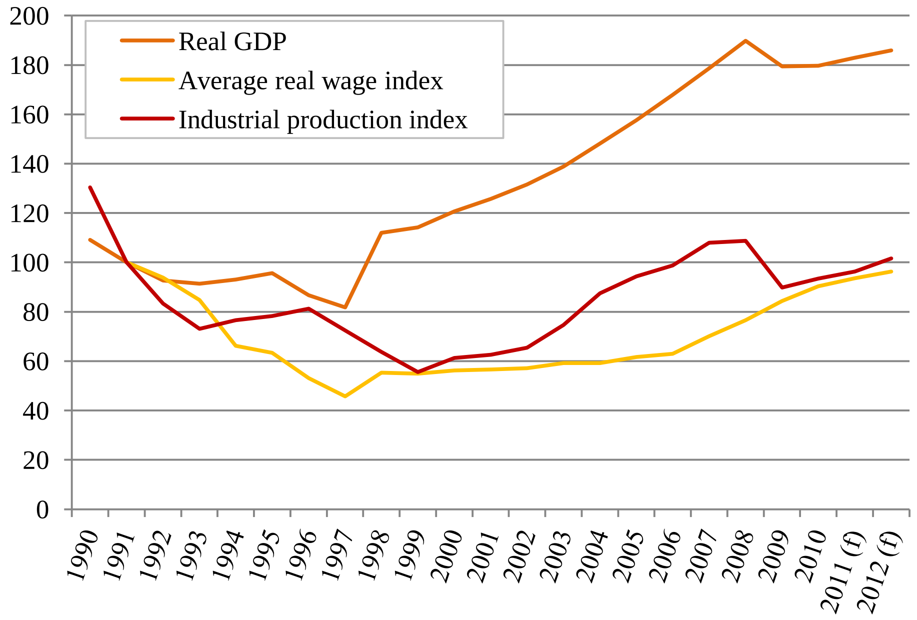
In the period ahead liquidity levels and appetites for risk are highly unlikely to return to pre-recession levels and competition between countries for foreign investment will be very intense. A return to the pre-crisis growth model would therefore appear unrealistic and in any case would be socially undesirable. Achieving economic growth rates that are compatible with acceptable employment levels and decent work in the circumstances that are likely to prevail in 2012 and beyond will therefore require alternative drivers of growth to those relied upon pre-crisis period plus institutions and policies that will share the benefits of growth more equitably.

[16] European Commission, Report from the Commission to the European Parliament and the Council on Progress in Bulgaria under the Co-operation and Verification Mechanism, 8 February 2012, p. 1f.

3.1 The legacy of the 1990s and current debates about fiscal space

Throughout the early and mid 1990s Bulgaria experienced considerable instability. Between 1989 and 1997 the Government changed seven times. Social tensions were prevalent. During this period economic output declined sharply and incomes plummeted (see Figure 8).

Figure 8: Real GDP, industrial production and real wages (1991=100)



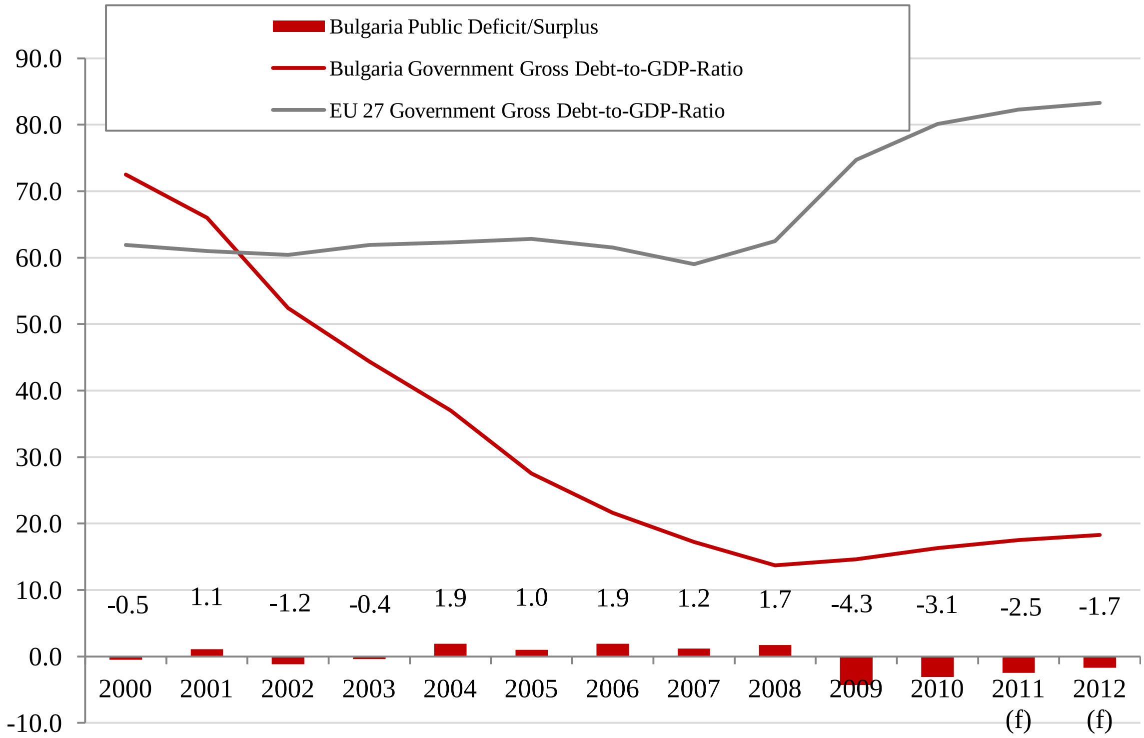
Note: 2011 and 2012 are forecasts.
Source: Economist Intelligence Unit Database.

In the latter half of the 1990s hyper-inflation compounded these economic woes. Consequently, by the late 1990s industrial production was roughly half what it had been at the outset of transition and real GDP had declined by about 25 %. Political and economic instability culminated in a the currency and banking crisis in 1997.This period of political, social and economic instability has left lasting scars that continue to influence the political landscape today and impinge on debates concerning economic policy space. This legacy is relevant in determining what policy reforms can be made while preserving market confidence and the credentials Bulgaria has acquired in recent years for sound macroeconomic management. This very protracted contraction in industrial production and output during the 1990s was common throughout the emerging economies in South East Europe but stood in stark contrast with the more swift process of economic transition and recovery in most of the EU-NMS like Poland, Czech Republic, Slovakia and several of the Baltic countries.

3.2 Macroeconomic policy after the millennium

A significant degree of macroeconomic stability was eventually restored in Bulgaria in the late 1990s. The introduction of the Currency Board Arrangement (CBA) that pegged the exchange rate to the D-Mark and later to the Euro was the first in a serious of macroeconomic and structural reforms. Since that time a series of governments – comprised of different political parties – maintained this exchange rate arrangement that severely limits flexibility with monetary policy. Macroeconomic policy has also been prefaced on the assumption that sustainability of the currency board regime requires a build-up in foreign reserves and a very prudent fiscal policy. As a result there has been a commitment to balanced public budgets or even a fiscal surplus in the period 2004 to 2008 when economic growth rates were substantial. As a result the public debt to GDP ratio declined considerably in the decade prior to the crisis, reaching a low point of just 12 % in 2008. Despite the emergence of moderate fiscal deficits in the last three years the overall public debt to GDP ratio remains well below 20 % and less than one quarter of the corresponding average ratio for the EU-27 (see Figure 9).

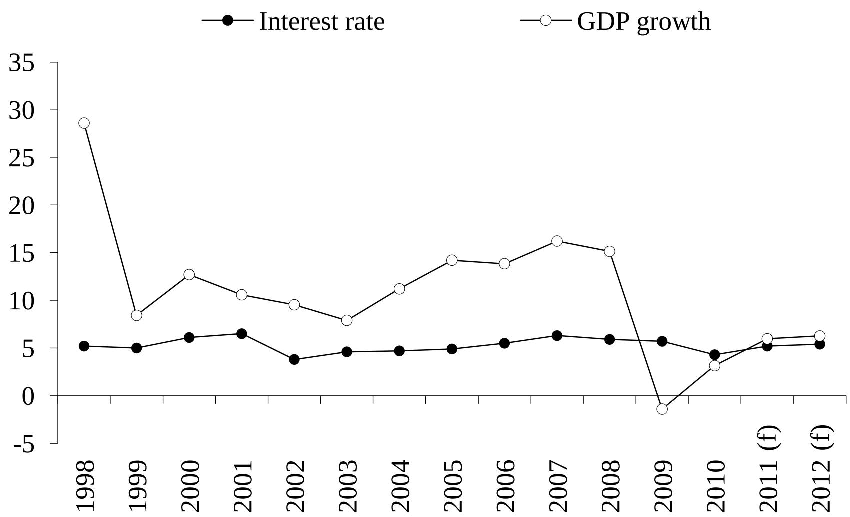
Figure 9: Government gross debt and fiscal balance after 2000



Note: 2011 and 2012 are forecasts from the European Commission.
Source: Eurostat statistics.

As can be seen from Figure 10 throughout the period from the late 1990s up until 2009 nominal GDP growth in Bulgaria exceeded the interest rate that the Government was required to pay on public debt thus allowing the public debt to GDP ratio to rapidly decline as mentioned above.

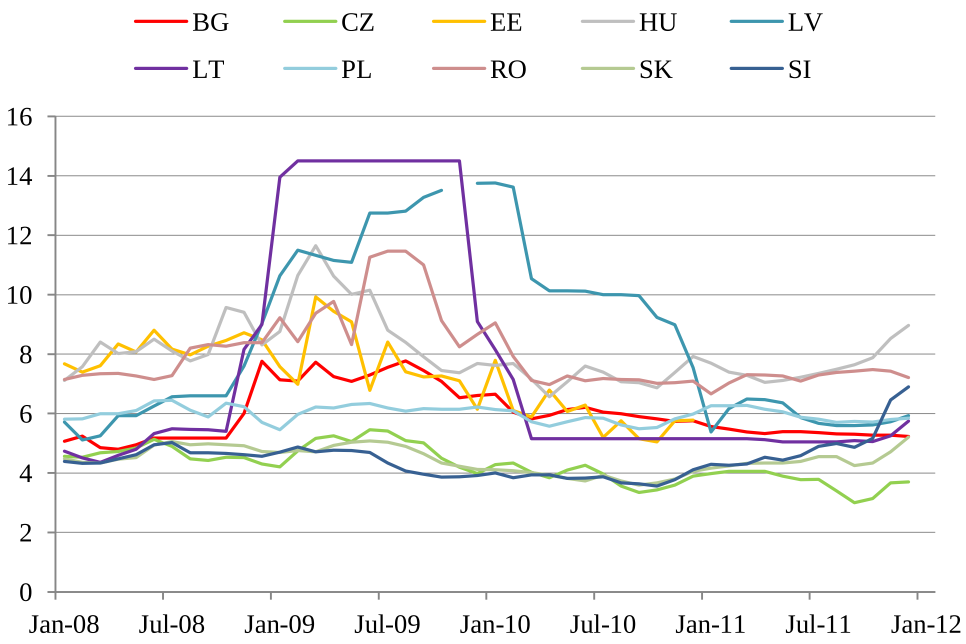
Figure 10: GDP growth and interest rate on Government debts



Note: The interest rate refers to actual interest payments on public debt; both interest rates and growth rates are in nominal terms; 2011 and 2012 are forecasts.
Source: Eurostat statistics.

Yields on Bulgarian government bonds did rise after the onset of the global economic crisis albeit not to the extreme levels experienced in several other EU-12 countries. This rise in yields in late 2008 probably reflected a severe liquidity shortage in the banking system that required banks and financial institutions to sell bonds rather than any fundamental reassessment about sovereign risk in Bulgaria. Importantly Bulgarian bond yields returned to more moderate levels in 2010 and 2011 and did not spike upwards in the latter part of last year when economic growth faltered and fears about sovereign risk in various other EU countries intensified (see Figure 11).

Figure 11: Yields on government bonds in selected NMS (maturity 10 years)



Source: International Finance Statistics (IMF), Eurostat, National Banks and National Ministries of Finance.

Bulgaria has therefore gained some relative advantage in assessments about European sovereign risk from prudent fiscal policies in recent years and needs to preserve this creditability. But participants in bond markets have also demonstrated they are less myopic than many believe and are also concerned about growth prospects. Thus, in trying to assess what fiscal space Bulgaria may have available in 2012, it is worth noting the moderate debt to GDP ratio and that the European Union have forecast a general government deficit of 1.7 % and a structural budget deficit of just 0.7 % of GDP in 2012, plus a small surplus on current account balance.[17] These forecasts may require revision if there is a significant deterioration in economic conditions but nevertheless they remain reasonably consistent with the requirements in the recently negotiated EU 'Fiscal Compact'.[18] It may also be relevant to bear in mind the latest policy advice from the IMF in respect of fiscal policy, which states:

> *"Importantly, not all countries should adjust in the same way, to the same extent, or at the same time, least their efforts become self-defeating. Countries with relatively strong fiscal and external positions, for example, should not adjust to the same extent as countries lacking those strengths or facing market pressure."*[19]

Compared to many countries in the EU, Bulgaria has a relatively strong fiscal position and a much improved external position. This may suggest there could be some small degree of freedom for the Government to finance a slightly more expansionary public Budget than what is currently envisaged for 2012 and 2013. At the very least this is a topic that warrants debate.

3.3 Tax reforms and their impact on the informal economy and income distribution

Over the last decade Bulgaria pursued economic reforms designed to attract foreign direct investment and reduce the magnitude of informal economic activities. This growth model relied on a high degree of liberalisation and openness in external and internal economic relations. On the external front trade was liberalised, there was a commitment to free international capital movements and financial markets were opened up to foreign financial institutions. As a result foreign banks obtained a dominant position in the finance sector.

Significant reforms were also made to the tax system over the last decade with a progressive reduction in payroll taxes (see Section 3 for details) plus heavy reliance on regressive consumption and excise taxes. As can be seen from Figure 12 Bulgaria is among the European countries that rely very heavily on consumption taxes with relative low taxes on both labour and capital.

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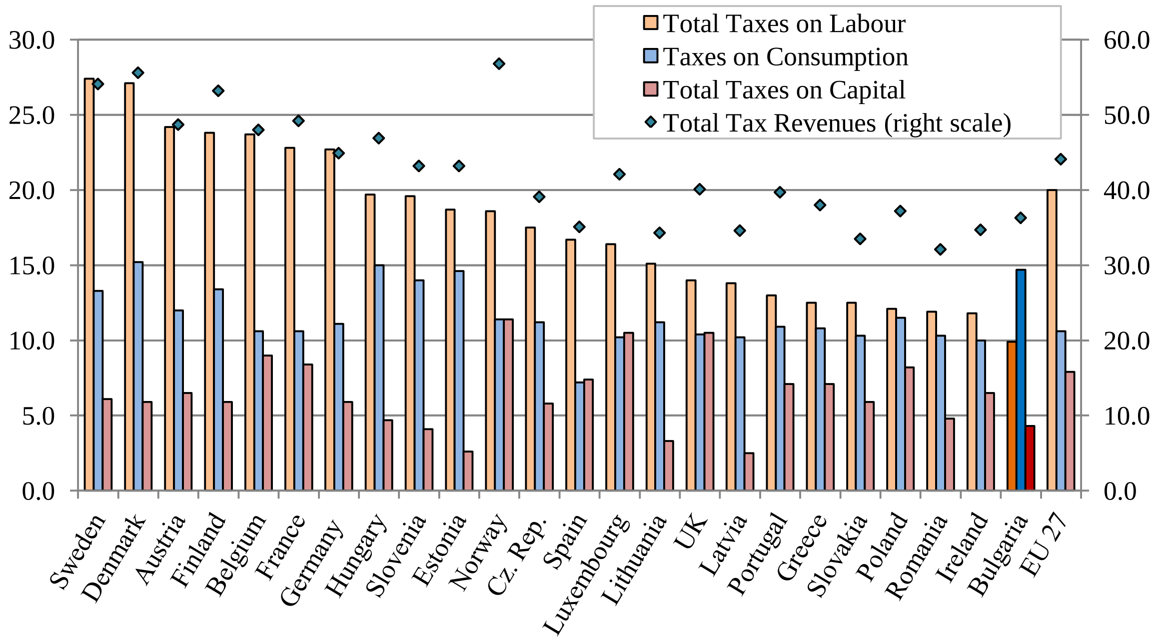
[17] European Commission, Economic and Financial Affairs, European Economic Forecast - Autumn 2011, 2011, p. 87.

[18] In March 2012 Prime Minister Boyko Borisov signed the 'Treaty on Stability, Coordination and Governance in the Economic and Monetary Union' on behalf of Bulgaria. The Treaty reasserted the importance of the Maastricht criteria, including the requirement to maintain a public deficit of less than 3 % of GDP and a public debt to GDP ratio below 60 %. The Treaty also makes reference to the Euro-Plus-Pact which Bulgaria signed in March 2011. However, the new Treaty goes beyond these previous agreements in stipulating that the contracting parties commit to limit their structural budget deficit to not more than 0.5 % of GDP (1.0 % in countries where the public debt to GDP ratio is "significantly below 60 %"). According to Bulgarian media, Prime Minister Borisov announced limitations regarding Part IV of the Treaty, which concerns economic policy coordination and convergence among EU Members.

[19] IMF, World Economic Outlook Update, 24 January 2012, p. 6.

Figure 12: Tax revenues as percentage of GDP in 2009



Note: 2009 is the latest year for which data on labour, consumption and capital tax revenues are available.
Source: Eurostat statistics.

The IMF stated in 2001:

> *"The authorities' medium-term objective is to lower tax rates and broaden the tax base. High tax rates in Bulgaria impose a deadweight loss on the economy and have contributed to the high share of the informal economy…Measures to reduce the tax burden – especially for labor – and to reduce disincentives to enter the formal sector are thus high on the agenda."*[20]

Tax reforms culminated with the introduction of a flat tax rate of 10 % on corporate profits in 2007 and on incomes in 2008 plus the elimination of the tax exempt threshold. It is not clear that these reforms achieved their stated objectives of reducing tax evasion and the size of the informal economy while increasing tax revenue. Empirical studies examining the relationship between the size of the informal sector and the tax system suggest there is no robust correlation.[21] Table 3 provides estimates on the size of the informal or 'shadow' economy in a wide variety of European countries. On the basis of these estimates it would appear that the shadow economy declined from around 36 % of official GDP in 2003 to 32 % in 2008. However, it would appear that since the onset of the recession the downward trend has halted (see Table 3) and Bulgaria continues to have the largest informal sector in the EU-27.

[20] IMF, The Role of Medium-Term Fiscal Frameworks for Transition Countries – The Case of Bulgaria, 2001, p. 12.

[21] See for example Schneider et al, New Estimates for the Shadow Economies all over the World, 2010 and Kyle et al, Measuring the Shadow Economy in Bulgaria, 2001.

Table 3: Size of the shadow economy in different EU countries in percentage of GDP

	2003	2004	2005	2006	2007	2008	2009	2010
Bulgaria	35.9	35.3	34.4	34.0	32.7	32.1	32.5	32.6
Romania	33.6	32.5	32.2	31.4	30.2	29.4	29.4	29.8
Lithuania	32.0	31.7	31.1	30.6	29.7	29.1	29.6	29.7
Estonia	30.7	30.8	30.2	29.6	29.5	29.0	29.6	29.3
Latvia	30.4	30.0	29.5	29.0	27.5	26.5	27.1	27.3
Greece	28.2	28.1	27.6	26.2	25.1	24.3	25.0	25.4
Poland	27.7	27.4	27.1	26.8	26.0	25.3	25.9	25.4
Slovenia	26.7	26.5	26.0	25.8	24.7	24.0	24.6	24.3
Hungary	25.0	24.7	24.5	24.4	23.7	23.0	23.5	23.3
Italy	26.1	25.2	24.4	23.2	22.3	21.4	22.0	21.8
EU 27 average	22.3	21.9	21.5	20.8	19.9	19.3	19.8	19.5
Spain	22.2	21.9	21.3	20.2	19.3	18.7	19.5	19.4
Portugal	22.2	21.7	21.2	20.1	19.2	18.7	19.5	19.2
Belgium	21.4	20.7	20.1	19.2	18.3	17.5	17.8	17.4
Czech Republic	19.5	19.1	18.5	18.1	17.0	16.6	16.9	16.7
Slovakia	18.4	18.2	17.6	17.3	16.8	16.0	16.8	16.4
Sweden	18.6	18.1	17.5	16.2	15.6	14.9	15.4	15.0
Denmark	17.4	17.1	16.5	15.4	14.8	13.9	14.3	14.0
Finland	17.6	17.2	16.6	15.3	14.5	13.8	14.2	14.0
Germany	17.1	16.1	15.4	15.0	14.7	14.2	14.6	13.9
Ireland	15.4	15.2	14.8	13.4	12.7	12.2	13.1	13.0
France	14.7	14.3	13.8	12.4	11.8	11.1	11.6	11.3
UK	12.2	12.3	12.0	11.1	10.6	10.1	10.9	10.7
Netherlands	12.7	12.5	12.0	10.9	10.1	9.6	10.2	10.0
Austria	10.8	11.0	10.3	9.7	9.4	8.1	8.5	8.2

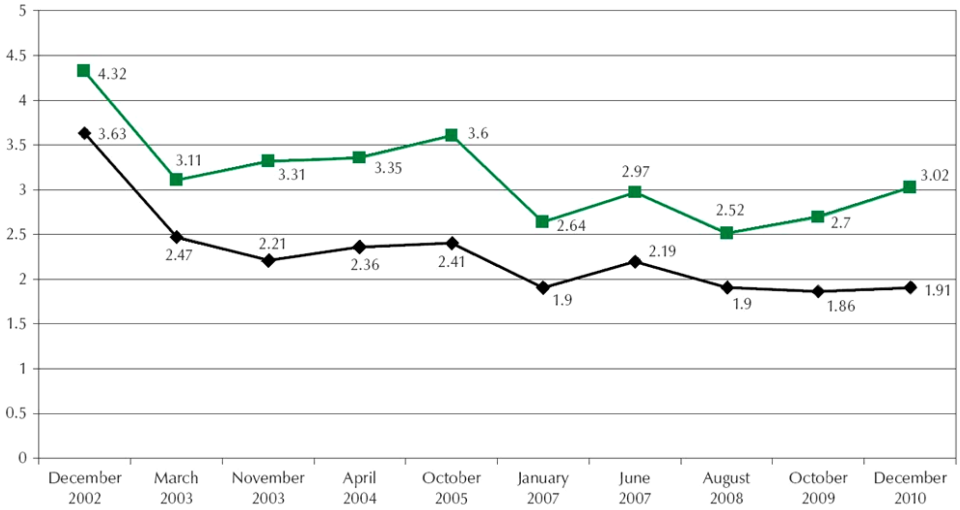
Source: Schneider, Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries (2003-2011), 2011, p. 5.

The informal economy and informal employment are terms that cover a wide variety of activities. Studies conducted by the Centre for the Study of Democracy attempt to shed more light on various sub-sets of informal employment.[22] The majority of informal employment involves workers receiving ‘under the table payments’ with an estimated 32 % of all workers falling into this category. By comparison around 10 % of employees had no contract what-so-ever in 2008.[23] Figure 13 suggests that both sub-sets of informal employment declined significantly when economic and employment growth rebounded strongly in the early 2000s. Thereafter the trends are mixed. In particular the proportion of workers receiving ‘under the table payments’ fluctuates and it is difficult to detect any clear relationship with tax reforms. However, it is evident that the proportion of workers receiving ‘under the table payments’ has risen since the onset of recession in mid-2008 as incomes have declined and job opportunities in the formal economy have become scare.

[22] See Center for the Study of Democracy, The Hidden Economy in Bulgaria and the Global Economic Crisis, 2011.

[23] Goev, Estimating the hidden economy in Bulgaria, South-East Europe Review, No. 1/2009, pp. 77–93.

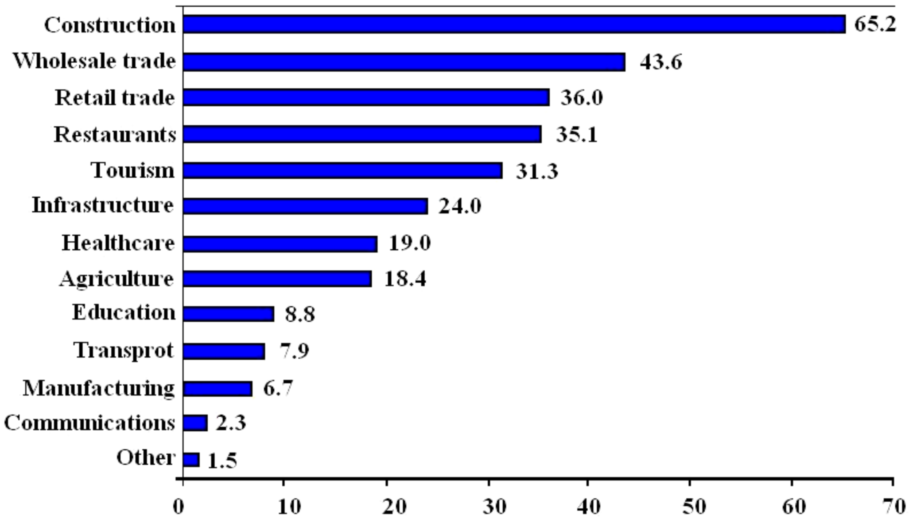
Figure 13: Dynamics of the sub-indices 'employed without contract'(black line) and 'employed under a contract with hidden clauses' (green line), 2002 – 2010



Note: minimum = 0, maximum = 10.
Source: Center for the Study of Democracy, The Hidden Economy in Bulgaria and the Global Economic Crisis, 2011, p. 46.

Figure 14 shows the magnitude of informal activities in various sectors of the economy. The estimates suggest that around 65 % of activities in the construction sector are informal. Other sectors with a high proportion of informal activities are wholesale trade (44 %), retail trade (36 %), restaurants (35 %) and tourism (31 %). While the construction sector is characterised by a high level of informal activities in many economies a very high level of informal activities in the service sector is less common in most advanced economies. These non-financial service sectors in Bulgaria benefited from substantial foreign capital inflows in the pre-crisis period and rapid employment growth. Nevertheless they are industries where wage levels and labour costs are relatively low. It may well be that foreign investment was attracted to these industries by low labour costs prior to 2008 but it would also appear that foreign investors did little to eradicate informal activities from these industries.

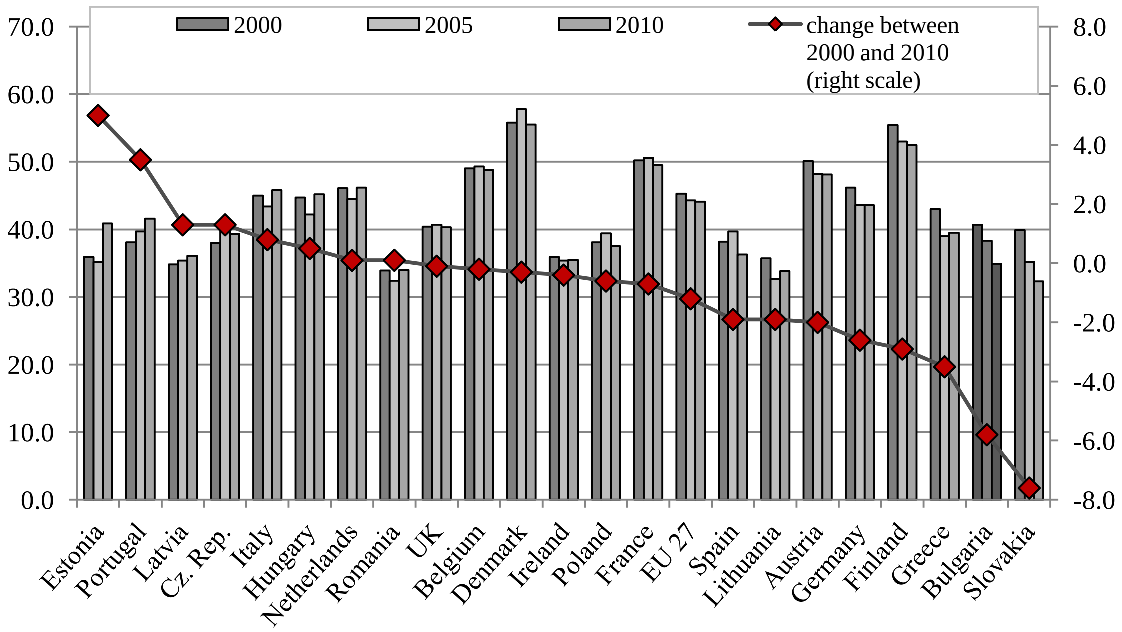
Figure 14: Size of hidden economy by sector in percentage points of GDP



Source: Goev, Estimating the hidden economy in Bulgaria, South-East Europe Review, No. 1/2009, pp. 77–93.

Tax revenue as a proportion of GDP peaked in 2007 at 40.9 % before plummeting to 34.9 % in 2010 (see Figure 15). This was largely due to the recession but there is little evidence to suggest that the introduction of the highly regressive flat tax system led to a substantial improvement in compliance or to a broadening of the tax base. Total tax revenue in Bulgaria remains well below the EU-27 average.

Figure 15: Total tax revenues as percentage of GDP 2000 to 2010



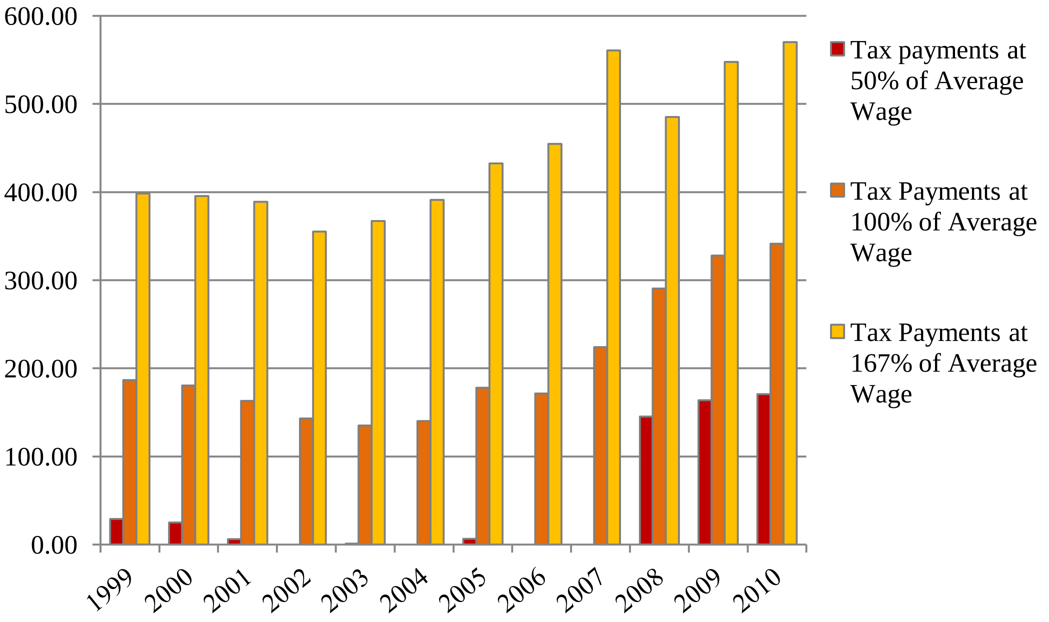
Source: Eurostat statistics.

The proportion of total tax revenue derived from income taxes remained low throughout the last decade and actually decreased from 4.1 % of GDP in 2000 to 2.9 % in 2010.[24] The burden of income tax shifted decisively, with low income groups adversely impacted. After the reforms of 2007-08 the monthly tax burden for a single person at 50 % of average wage increased from zero to 145 Euros while for a person earning 167 % of the average wage monthly tax payments declined by around 76 Euros (see Figure 16). Income tax payments on low income families with children increased more dramatically. For example in 2008 income tax for a single parent with two children who was earning 67 % of average wage rose from zero to 195 Euro. While for a family with one person earning the average wage and two children, the monthly tax payments jumped from around 130 Euro in 2007 to 290 Euros in 2008, an increase of around 123 %.[25]

[24] IMF, Bulgaria 2004 Article IV Consultation, Country Report No. 04/176, June 2004, p. 34. and IMF, Bulgaria 2011 Article IV Consultation, Country Report No. 11/179, July 2011, p. 34.

[25] Eurostat statistics.

Figure 16: Tax burden for a single person at different income levels (Euro)

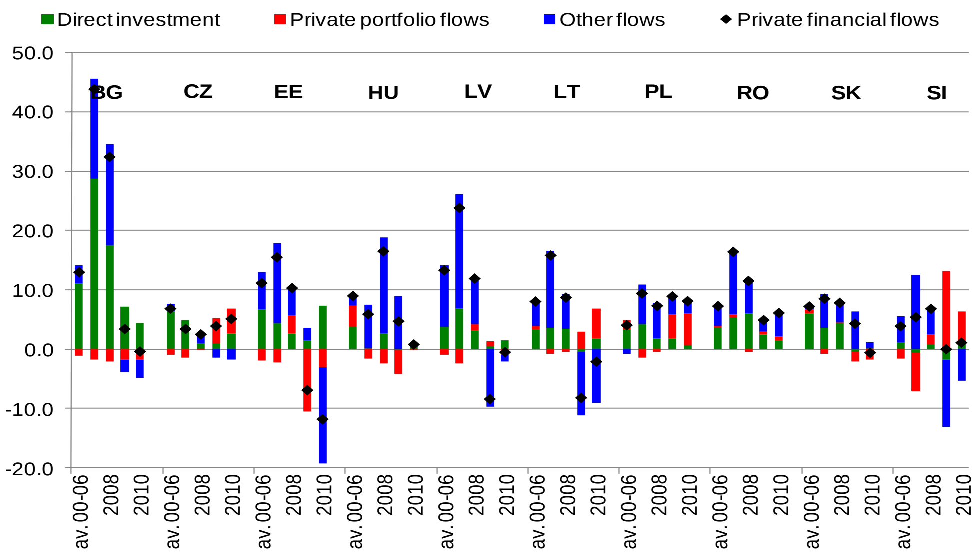


Source: Eurostat statistics.

3.4 The consequences of rapid capital inflow

For several years following the millennium the above mentioned macroeconomic stabilisation and structural reforms plus the prospect and eventual achievement of EU membership led to significant capital inflows. From Figure 17 it is evident that in the years immediately prior to the crisis these capital inflows – which were composed of both foreign direct investment (FDI) and net credit inflows largely via the banking system – significantly exceed the comparable flows into the other EU-NMS.

Figure 17: Net private financial flows in percentage of GDP



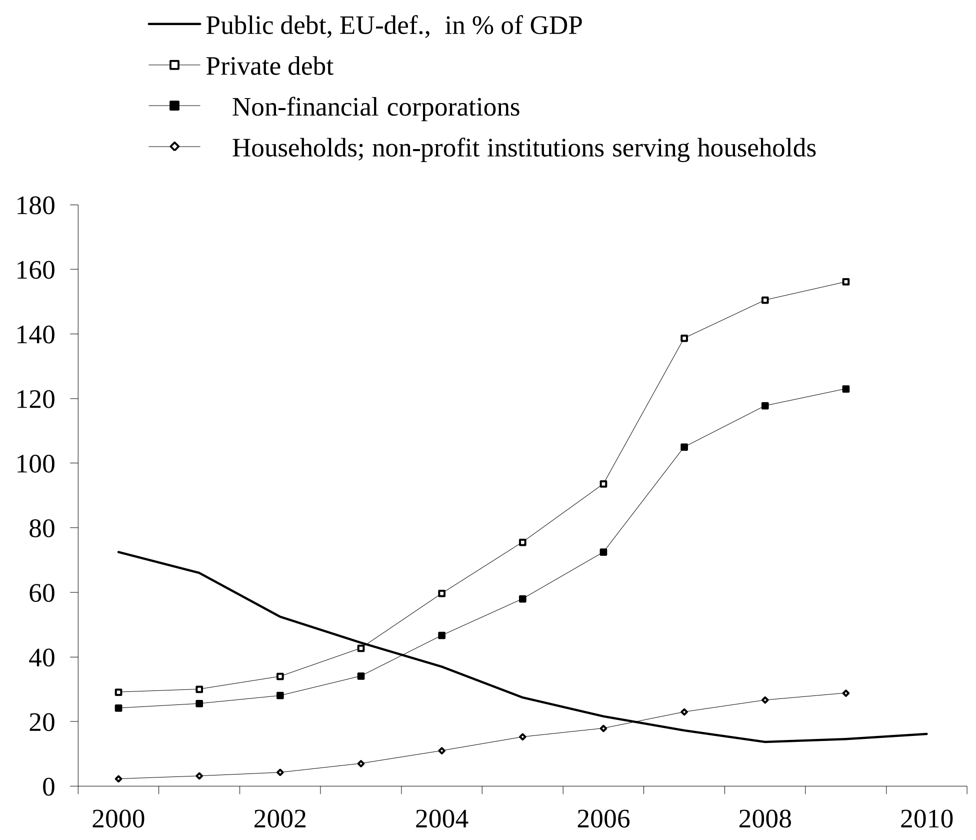
Source: wiiw Database and Eurostat statistics.

In fact capital flows into Bulgaria peaked in 2007 at well over 40 % of GDP, roughly double the level recorded in Latvia which was the EU-NMS with the next highest level of capital inflow. It is also evident from Figure 17 that in 2009 net credit inflows suddenly collapsed after the global financial crisis hit and liquidity and confidence evaporated. Capital inflows have subsequently failed to recover.

Capital inflows of such magnitude were reflected in a rapid expansion in corporate debt, much of it from foreign sources. As can be seen from Figure 18 the period between 2002 and 2008 was characterised by a rapid decline in public debt, a mild expansion in household debt (significantly lower than in most other EU-12 countries) and a dramatic expansion in the debts of private non-financial corporations.

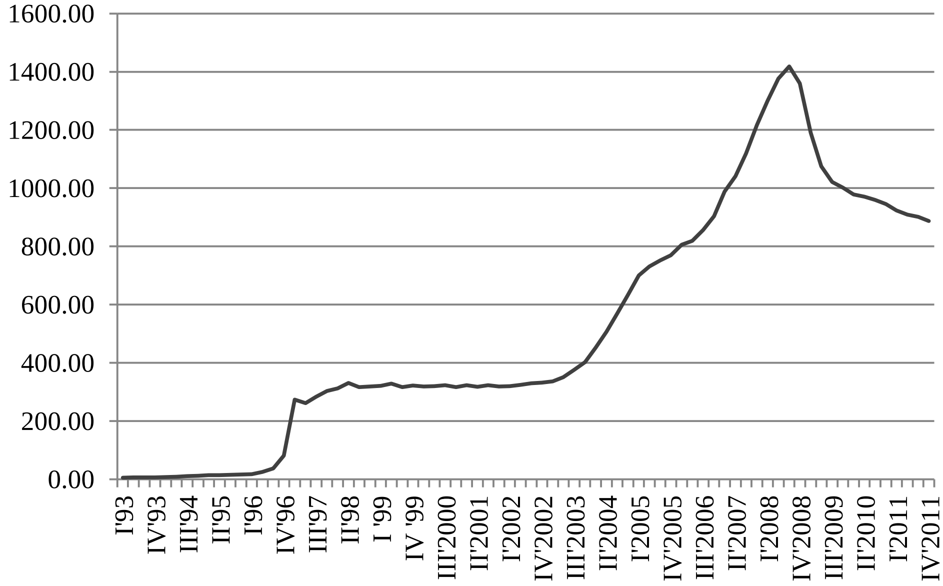
In Bulgaria a significant proportion of these capital inflows were invested in the non-traded goods sector of the economy. This helped create boom conditions in the construction, real estate and financial services sectors. The expansion of commercial real estate, including large new shopping malls, and the building of hotels and other tourist facilities became notable features on the landscape and has led to concerns about sustainable investment and their impact on the environment. During the construction boom, from late 2003 to 2008, average housing prices increased by well over 300 % (see Figure 19).

Figure 18: Public and private debt in percentage of GDP



Source: Eurostat statistics.

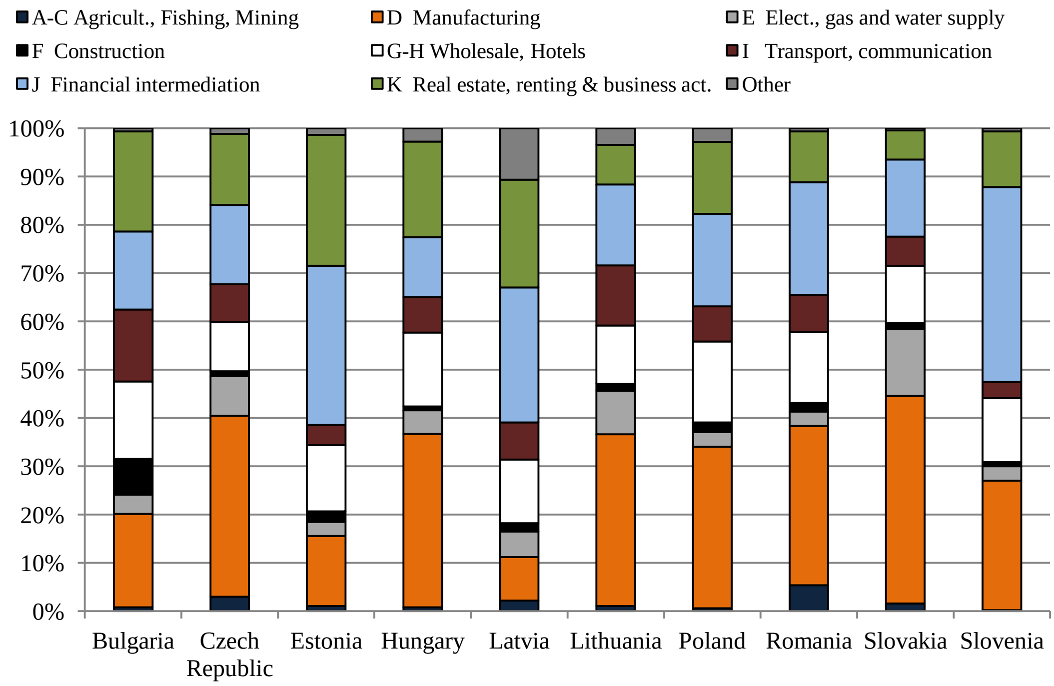
Figure 19: Quarterly average market prices of dwellings in BGN per square meter



Source: National Statistic Institute.

Meanwhile Bulgarian investment in the export sector lagged well behind trends in most other EU-12 countries. Figure 20 shows the breakdown of the FDI stock by sector for a variety of EU-NMS and other Eastern European countries. It is evident that in Bulgaria only about 20 % of the FDI stock was directed to the manufacturing sector. In many of the other NMS this ratio was roughly double that in Bulgaria. On the other hand Bulgaria experienced FDI flows into the construction sector that significantly surpassed other countries in the region.

Figure 20: FDI stock by activities as of December 2007, shares in percentage point

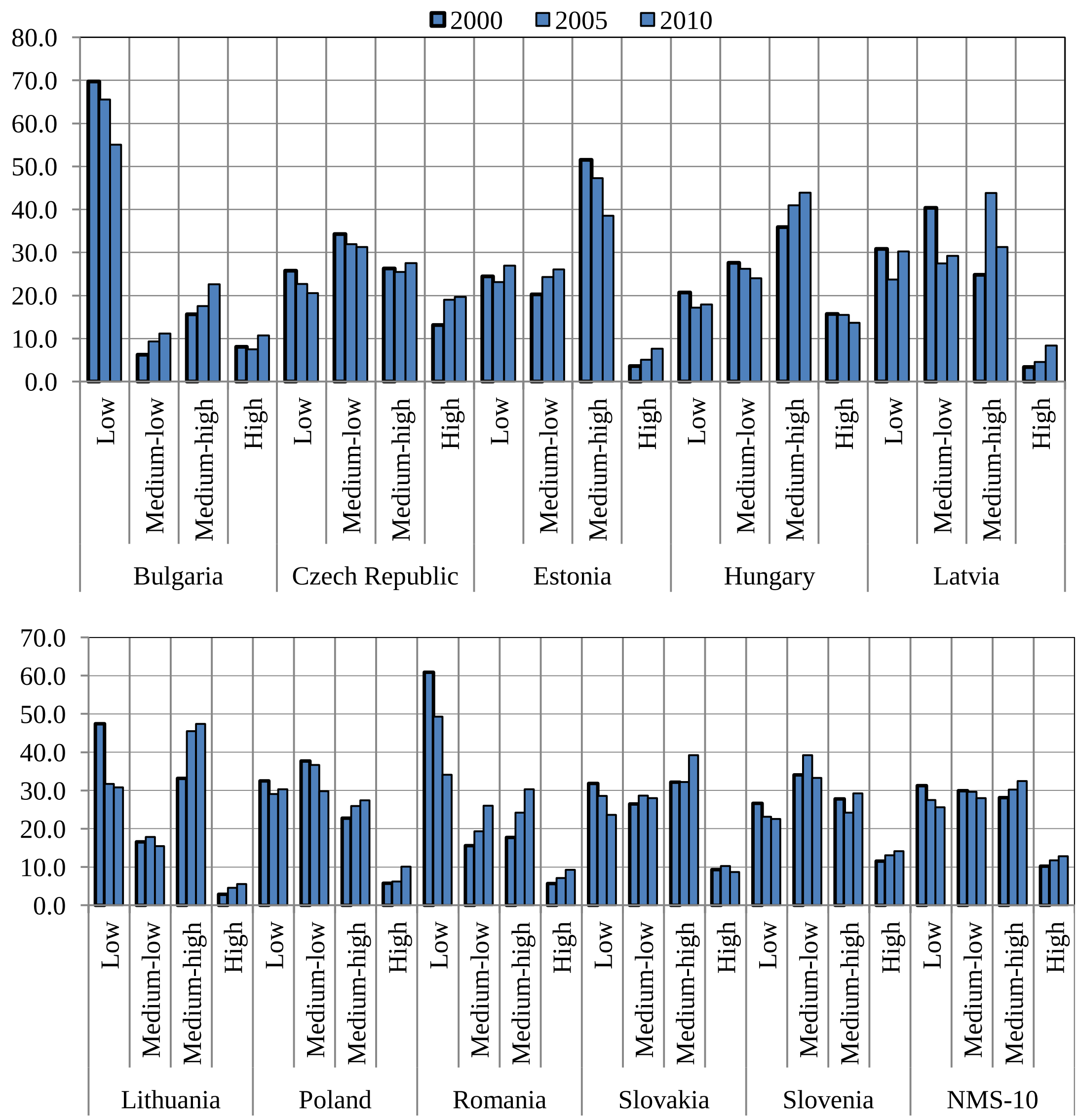


Note: Data for Slovakia refer to 2006.
Source: wiiw FDI Database.

While significantly lower than in many others of the EU-NMS, Bulgaria still received sizable FDI inflows into the manufacturing sector in the boom years prior to the global recession. Yet, a large proportion of this foreign investment was directed into low value added products in the clothing and footwear industries and lower quality machinery and equipment. Investment was scant in medium and high skill content manufacturing.

This is reflected in the composition of exports and the trend in export growth over the last decade. Figure 21 compares the export structure of Bulgarian exports to the EU27 with that of the other NMS using a common classification of exports by skill content.

Figure 21: Share of manufacturing exports by skill content

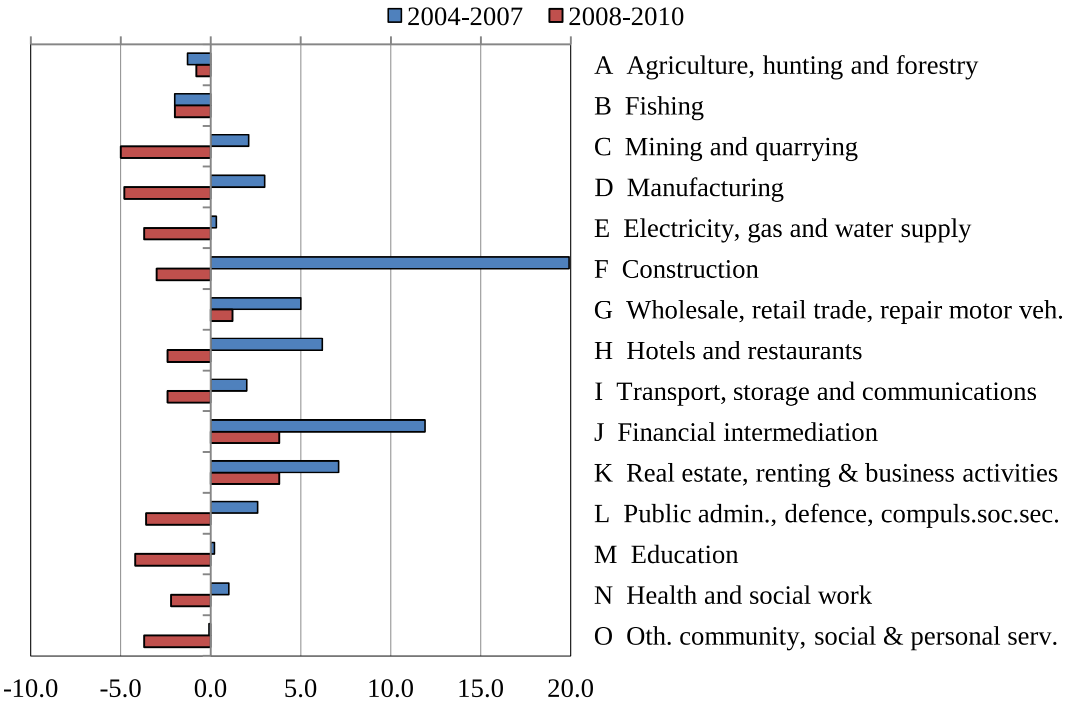


Source: Comext; own calculations.

It is evident that Bulgaria's export structure remained very heavily specialized towards exports with the lowest skill content. In 2000 about 70 % of Bulgarian manufacturing exports were of products with very low skill content. Over the last decade this ratio has declined but remained at about 55 % in 2010. Over the same period Romania reduced its proportion of low-skilled exports from over 60 % to around 30 %. Compared to other EU-NMS the Bulgarian export sector appears to be less focused on products that require a medium level of skill input. This could potentially result from skill deficiencies and other supply side problems with the Bulgarian labour force. Alternatively, it may be related to low wage levels in Bulgaria relative to other EU countries, which has helped maintain the attractiveness of low-skilled labour intensive activities and reduced the incentive for capital/labour substitution. This could be an important factor that has discouraged up-grading to higher value added products in the industrial and export structure in Bulgaria and limited productivity improvements (this issue is taken up further in the next session).

An examination of employment growth by sector and the contribution of various sectors to GDP growth confirms that the pattern of growth in the pre-recession period was highly distorted away from the traded goods sector. Figure 22 shows trends in employment across different sectors of the economy in the pre and post 2008 periods. It is clear that the boom before the crisis resulted in a disproportionate expansion of employment in the non-tradable sectors of the economy, with jobs in the construction sector expanding by 20 % between 2004 and 2007. Significant increases were also recorded in financial intermediation, real estate, wholesale and retail sales as well as hotels and restaurants. As noted previously several of these sectors also have a very high proportion of informal activities.

Figure 22: Sectoral employment growth before and after the outbreak of the crisis



Source: wiiw Database incorporating Eurostat statistics.

Table 4 compares the contribution that different sectors made to economic growth (in both constant and current prices) in different time periods. A notable acceleration can be detected in the growth contributions derived from non-tradable sectors such as construction, wholesale and retail trade, financial intermediation and real estate over the period 2004-2008 compared with the earlier period 2000-2004. However there was no such development in the manufacturing sector. This pattern of growth led to unsustainable ‘bubbles’ in construction and real estate prices as mentioned before. This is evident when one compares the acceleration in the growth contribution from these two sectors in constant prices (where they doubled) and current prices (where they tripled).

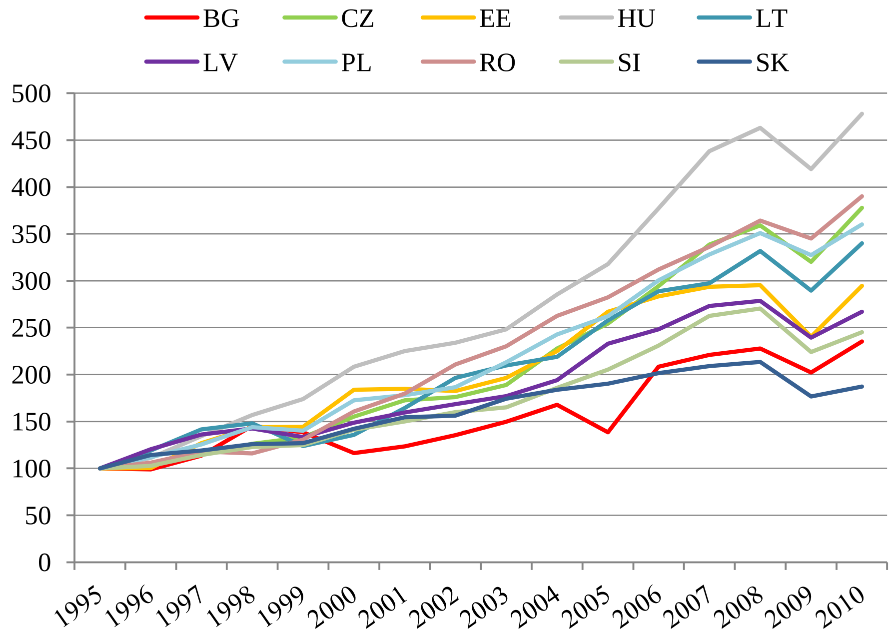
Table 4: Contributions to GDP growth by various sectors

	at constant prices		**at current prices**	
	2000-2004*	**2004-2008**	**2000-2004***	**2004-2008**
A Agriculture, hunting and forestry	-0.4	-0.3	0.2	0.1
B Fishing	0.0	0.0	0.0	0.0
C Mining and quarrying	0.0	0.0	0.2	0.5
D Manufacturing	1.1	1.1	1.3	1.6
E Electricity, gas and water supply	0.3	0.0	0.7	0.3
F Construction	0.2	0.5	0.4	1.5
G Wholesale, retail trade, repair motor veh.	0.5	0.9	1.7	2.2
H Hotels and restaurants	0.1	0.1	0.2	0.4
I Transport, storage and communications	0.7	0.3	1.7	0.7
J Financial intermediation	0.6	1.0	0.6	1.2
K Real estate, renting & business activities	0.3	0.7	0.8	2.0
L Public admin., defence, compuls.soc.sec.	0.2	0.1	0.6	0.7
M Education	0.1	0.1	0.6	0.4
N Health and social work	0.0	0.1	0.2	0.2
O Oth. community, social & personal serv.	0.2	0.2	0.2	0.4
Gross value added at basic prices	3.9	5.1	8.1	11.1
FISIM	.	.	.	.
Net taxes on products	1.4	1.4	2.5	3.0
Gross domestic product (sum)	**5.2**	**6.2**	**11.7**	**15.1**

Notes: Unrevised data in 1998-2008. From 2002 FISIM reallocated to industries.
** Average 2000-2004 does not incude the year 2002, due to a break in data because of changes in FISIM allocation.*
Source: wiiw Annual Database incorporating national statistics, Eurostat statistics. wiiw calculation.

This growth pattern and in particular the boom in construction contributed to a massive increase in imports. Unfortunately, because manufacturing growth was more subdued, exports grew more modestly. In fact Bulgaria had the second slowest export growth rates among the EU-NMS over the period 1995 to 2010 (see Figure 23).

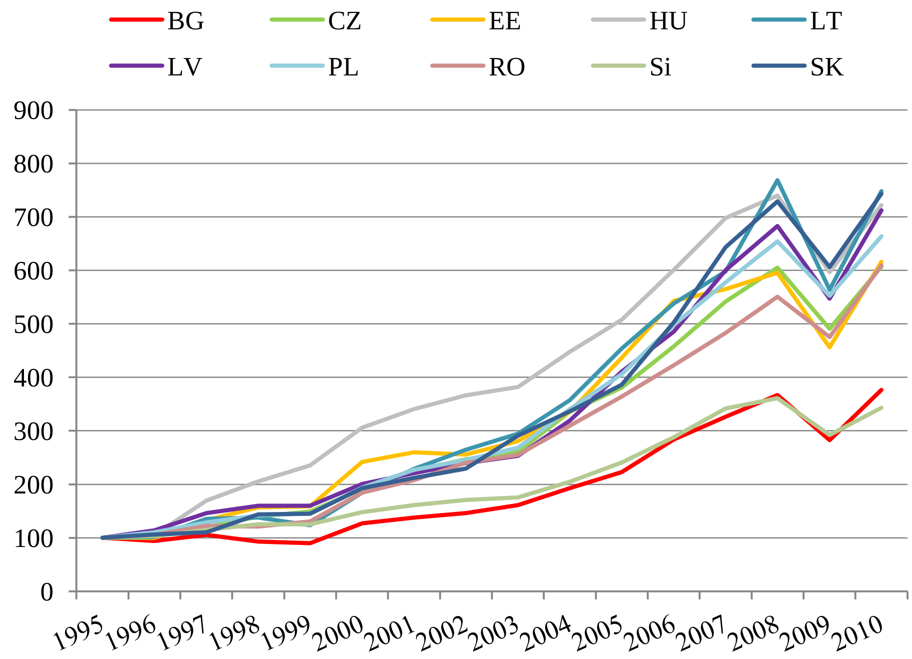
Figure 23: Development of exports of goods and non-financial services (1995=100)



Source: wiiw Database incorporating Eurostat statistics.

This relatively moderate export performance is even starker if we just examine trends in the export of goods (see Figure 24).

Figure 24: Development of exports of goods (1995=100)

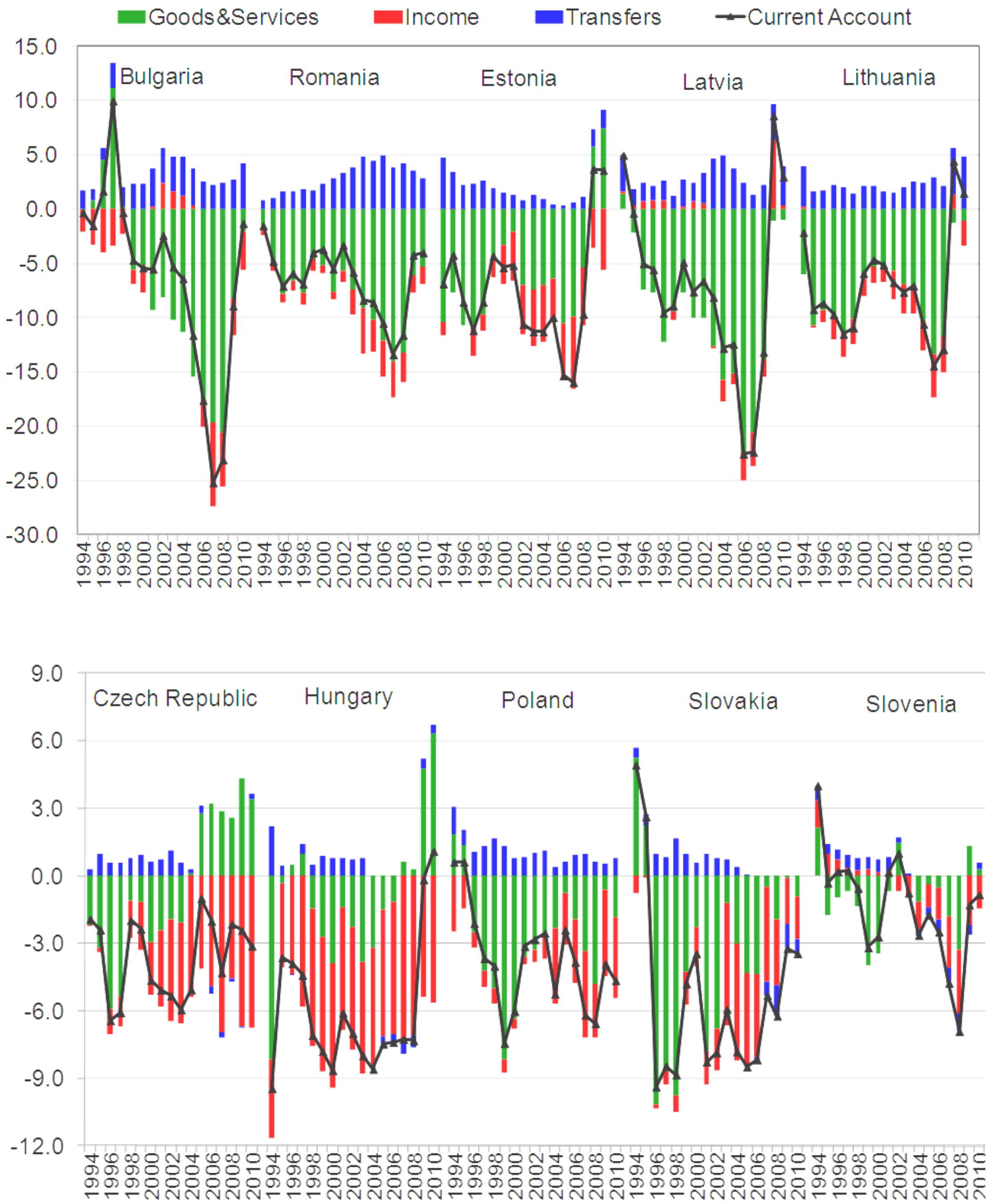


Source: wiiw Database incorporating Eurostat statistics.

The overall impact of these developments in Bulgaria was a sharply deterioration in the current account position, with the deficit reaching 25 % of GDP in 2007 before the crisis. Similar trends were evident in the Baltic countries and Romania. But Bulgaria stands out as the country with the most dramatic deterioration in the current account balance pre-crisis.

This stands in stark contrast to developments in the several Central European NMS (Czech Republic, Hungary, Poland, Slovakia and Slovenia) where the current account either moved into positive territory or close to balance in the pre-crisis period (see Figure 25).

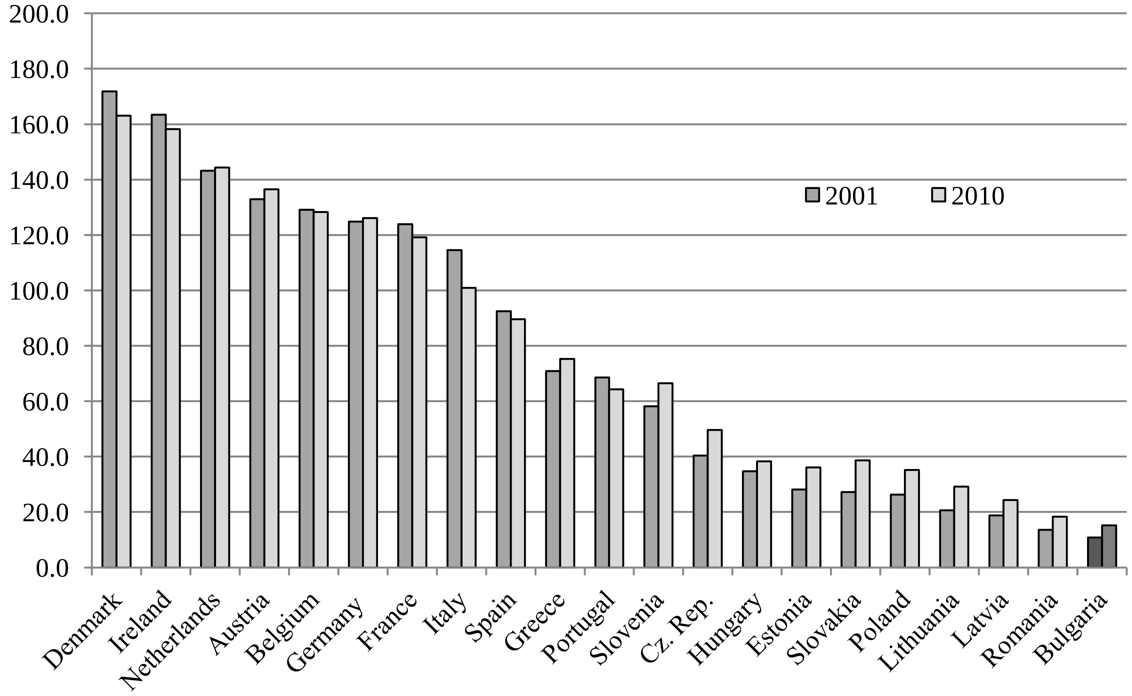
Figure 25: Composition of the current account of the balance of payments 1994-2010 in percentage of GDP



Source: wiiw Database incorporating Eurostat statistics.

Despite this mixed economic performance in this period between the late 1990s and the onset of the global economic crisis in 2008 Bulgaria (along with all other emerging economies in Central and Eastern Europe) established a persistent growth differential of 2 to 3 percentage points of GDP over the average annual growth rates in 'Old Europe' (the EU-15). Consequently the process of economic 'catch-up' with higher income countries in the EU commenced and expectations about economic convergence between 'Old Europe' and Bulgaria as part of the 'New Europe' were promoted. Despite this desirable development, on the eve of the global economic crisis in 2008 GDP per capita in Bulgaria remained the lowest in the EU and by 2010 it was still only 15.2 % of the EU 27 average, which was roughly 4 percentage points above the level in 2001 (see Figure 26).

Figure 26: Real GDP per capita as percentage of the EU 27 average (=100)



Source: wiiw Database incorporating Eurostat statistics.

4 Trends in labour and social policies

4.1 Labour legislation reform and increased labour market flexibility

As noted previously the focus of economic policy in the decade prior to the 2008 economic crisis was on deregulation and liberalisation. This approach was applied rigorously in the labour market. The IMF noted a decade ago that:

> *"...Bulgaria liberalized labour markets early on in the transition, quickly moving away from many of the Soviet-style policies of the past. There is relatively little in the way of constraints on the ability of enterprises to hire and dismiss employees, unions have relatively minor roles, minimum wages are fairly low, and unemployment insurance is not overly generous."*[26]

Despite this assessment in the decade that followed, Bulgaria was regularly encouraged to implement further labour market reforms and maintain a very restrictive incomes policy. For example in 2004 the IMF noted with approval that:

> *"The authorities believed that continued implementation of a strict incomes policy and increasing labour market flexibility were needed to strengthen competitiveness......The authorities intended, in collaboration with the World Bank, to amend the labour law with a view to making entry to and exit from work more flexible..."*[27]

In 2006 the IMF stated:

> *"Staff stressed that a prudent incomes policy and efforts to increase labour market flexibility would be critical to maintain competitiveness and agility of the economy.... The authorities concurred with staff's observations on labour market flexibility, and intend to increase working time flexibility and eliminate the portability of the seniority bonus when changing jobs."*[28]

Despite this continuous process of labour market deregulation just one year later the IMF called for further flexibility, arguing that:

> *"Improving the business climate and enhancing wage and labour market flexibility were seen as priorities..... In the labour market, limited intersectoral mobility in particular called for amending the overly prescriptive Labour Code to provide the social partners with more flexibility to set wages, benefits, seniority bonuses and overtime and part-time work"*[29]

The advice provided by the IMF in respect of the labour market over the last decade was closely followed. As a result in the 2008 Article IV Report the IMF was able to conclude that:

> *"Recognising the importance of further increases in employment and labour productivity, Bulgaria has recently introduced significant education and labour reforms. Bulgaria has also made considerable progress in reducing the burden of regulation in*

[26] IMF, Labor Markets in Hard-Peg Accession Countries: The Baltics and Bulgaria, Country Report No. 01/100, July 2001, p. 7.
[27] IMF, Bulgaria 2004 Article IV Consultation, Country Report No. 04/176, June 2004, p. 20.
[28] IMF, Bulgaria 2006 Article IV Consultation, Country Report No. 06/298, August 2006, p. 16.
[29] IMF, Bulgaria 2007 Article IV Consultation, Country Report No. 07/389, 2007, p. 28.

recent years, ranking among the top 10 reformers in the World Bank's Doing Business *Report in 2006/07.'*[30]

Thus although the IMF clearly stated that Bulgaria had a very flexible labour market in 2001 the country was urged to implement further far reaching labour reforms over the last decade. These recommendations were implemented. As a consequence in the decade after the millennium employment protection legislation (EPL) was weakened, working time regulations were relaxed and the scope for precarious forms of work was enhanced. For example Table 5 provides data on an index of EPL for various EU-15 countries in the late 1990s and 2003. The index essentially measures how difficult it is to dismiss workers and the degree of compensation (severance payments) that the dismissed worker receives (lower numbers would be an indication of greater 'flexibility'). It is evident that in the relatively short period for which data is available EPL was weakened considerable in most countries and Bulgaria and Slovenia were among those with the most far reaching reforms. By 2003 EPL was significantly weaker in Bulgaria then on average in both 'Old' and 'New Europe'.

Table 5: EPL strictness indices in the new EU member states in 2003 compared to the late 1990s

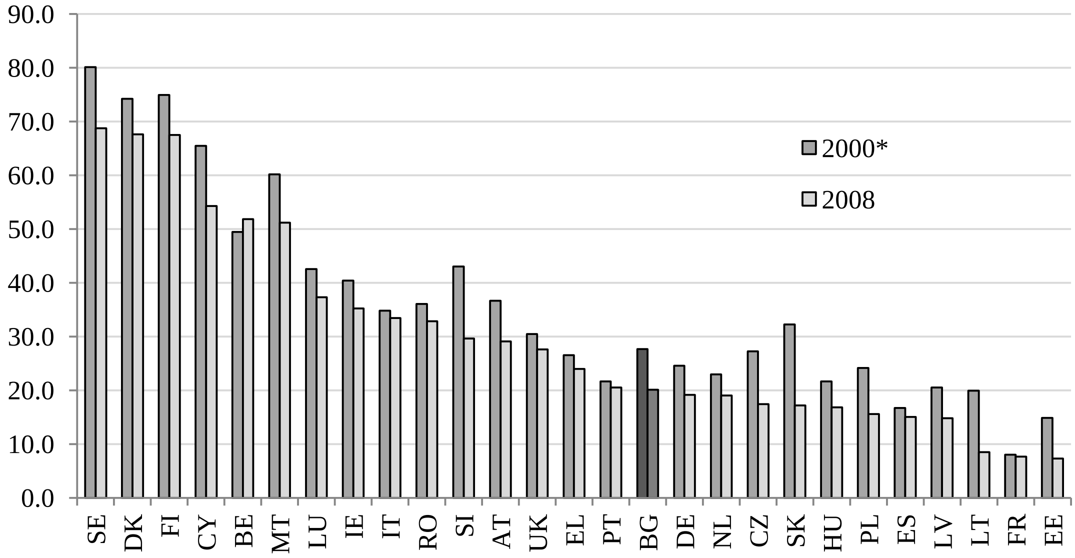
Country	permanent contracts 2003	temporary contracts 2003	temporary and regular contracts 2003	EPL summary index 2003	EPL summary index late 1990s	Difference in summary index 1990s to 2003
Slovenia	2.7	1.8	2.25	2.4	3.3	-0.9
Bulgaria	2.1	0.9	1.50	2.0	2.8	-0.8
Slovakia	2.9	0.3	1.60	1.8	2.3	-0.5
Cz. Rep.	3.0	0.3	2.20	1.8	2.2	-0.4
Hungary	2.1	0.4	1.25	1.6	1.8	-0.2
Estonia	2.7	1.3	2.10	2.3	2.4	-0.1
Lithuania	2.9	2.4	2.65	2.8	n.a.	n.a.
Poland	2.0	1.8	1.90	2.1	2.0	+0.1
New EU-8	2.6	1.2	1.9	2.15	2.4	-0.25
EU-14*	2.3	2.0	2.15	2.36	2.4	-0.04

Note: EPL strictness index moves from 0 for fully liberal EPL to 6 for completely restrictive EPL.
** Old EU countries without Luxembourg.*
Source: ILO Calculations on the basis of an OECD methodology.

Bulgaria, like many other countries in Eastern Europe, has also witnessed a massive decline in trade union density. Between 1990 and 2000 trade union density fell from over 80 % to under 30 %. In the last decade the rate of decline in trade union membership moderated but by 2008 only around 20 % of workers were members of a trade union (see Figure 27).

[30] IMF, Bulgaria 2008 Article IV Consultation, Country Report No. 09/96, March 2009, p. 36.

Figure 27: Union density by country in 2000 and 2008

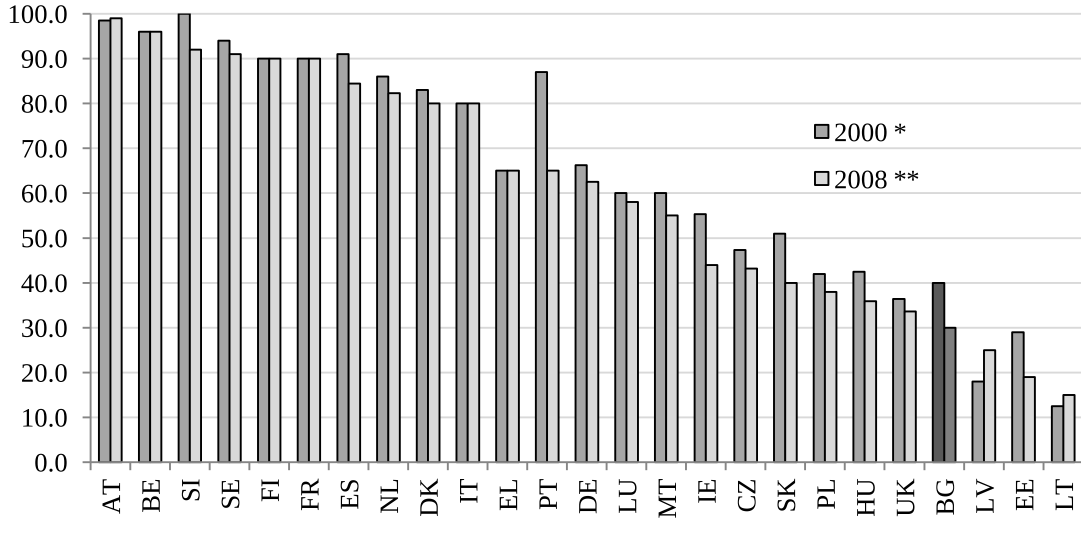


** SI: 1998, LT: 2001, RO: 2002, LV: 2003*

Source: Visser, J. (2010) ICTWSS Database.

The proportion of workers covered by collective agreements also declined dramatically over the last two decades. By 2008 only 30 % of workers were covered by collective agreements. As can be seen from Figure 28 within the EU only the Baltic countries (Latvia, Estonia and Lithuania) had lower collective bargaining coverage in 2008.

Figure 28: Bargaining coverage rates in 2000 and 2008



**PT :1999, MT : 2002, PL : 2001, HU : 2001, BG : 2003, LV : 2002, EE : 2001, LT : 2002*
***FI : 2007, DK : 2007, EE : 2009*

Source: Visser. J. (2010) ICTWSS Database.

The vast majority of collective agreements have traditionally been negotiated at the enterprise level but in recent years the importance of branch or sector level agreements has increased slightly.[31] The Labour Code provides for the extension of collective agreements by decree by

[31] Eurofound, European Industrial Relation Observatory (EIRO), Bulgaria: industrial relations profile, October 2009, p. 7.

the Minister for Labour and Social Affairs. This procedure has been used on a few occasions in the recent past and might be used more extensively in the future. The Ministry of Labour and Social Policy has expressed concerns about the impact of low incomes and the need for increased coordination of bargaining. In a recent paper the Ministry noted that:

> *"Bulgaria needs a considerable change in the income policy concerning the population, mostly with regard to the employment income. The low income represents something like a barrier to economic development because it does not provide incentives for quality reproduction of the work force. A debate is needed in this area, a clear vision and coordinated action on the part of all partners."*[32]

Proposals for a change in income policy warrant discussion and a move towards increased collective bargaining coverage and greater coordination of bargaining would be desirable. The Minister for Labour and Social Policy could make more extensive use of the powers provided in the Labour Code to extend branch level collective agreements in order to help overcome the problem of low pay in Bulgaria.

4.2 The consequences for employment conditions

The emphasis in public policy on labour market deregulation and increased flexibility over the last decade has been one factor ensuring that the quality of jobs in Bulgaria has remained low by EU standards. As noted above several of the reforms focused on making working time more flexible. Thus average annual working time for Bulgaria in 2010 was 1,848 hours, which was among the third highest in the EU and some 130 hours above the EU-27 average. While the length of annual paid leave in Bulgaria is the lowest in the EU (see Table 6).[33] The 2010 European Working Conditions Survey asked workers across the EU the following question: "how is your working time arrangements set?" In Bulgaria nearly 80 % of workers replied that their hours of work were established unilaterally by the employer, meaning that workers in Bulgaria have the least influence over their working hours in all of Europe.[34]

It may therefore be desirable to expand the workplace issues that are regulated through collective bargaining with a particular focus on working time arrangements. Workers and their trade unions should have a greater role to play in determining working conditions and collective bargaining should be more extensively used to establish conditions that improve upon standards established in legislation.

[32] Ministry of Labour and Social Policy, Brief analysis and estimates concerning the fixing of the minimum wage, unpublished monograph, November 2011.
[33] Eurofound, European Industrial Relation Observatory (EIRO), Working time developments – 2009, 2010, p. 23-25.
[34] Eurofound, European Working Conditions Survey 2010, http://www.eurofound.europa.eu/surveys/smt/ewcs/ewcs2010_12_02.htm.

Table 6: Average collectively agreed normal annual working time 2010

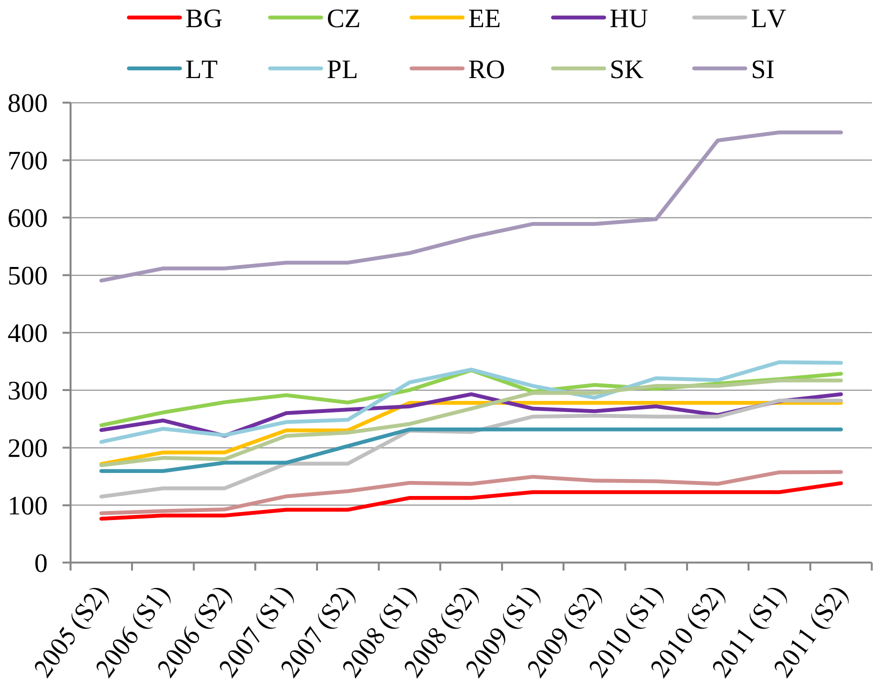
Country	A Weekly hours	B Gross annual hours (Ax52)	C Annual leave (days)	D Public holidays (days)	E All leave (C+D) (hours)	F Annual hours (B–E)
Romania	40	2,080	21	6	216	1,864.00
Poland	40	2,080	20*	8	224	1,856.00
Bulgaria	40	2,080	20*	9	232	1,848.00
Estonia	40	2,080	20	9	232	1,848.00
Hungary	40	2,080	20	9	232	1,848.00
Slovenia	40	2,080	20*	9	232	1,848.00
Latvia	40	2,080	20*	11	248	1,832.00
Lithuania	40	2,080	20*	11	248	1,832.00
Greece	40	2,080	23	10	264	1,816.00
Luxembourg	40	2,080	25*	10	280	1,800.00
Malta	40	2,080	24*	13	296	1,784.00
Ireland	39	2,028	24	8	249.6	1,778.40
Slovakia	38.9	2,022.80	21.2	13	266.1	1,756.70
Austria	38.8	2,015	25*	11	279	1,736.00
Portugal	38.2	1,986.40	22*	11	252.1	1,734.30
Belgium	37.6	1,955.20	20*	10	225.6	1,729.60
Spain	38.6	2,007.20	22*	14	277.9	1,729.30
Cyprus	38	1,976	20	13	250.8	1,725.20
Netherlands	37.5	1,950	25	5	225	1,725.00
UK	37.5	1,950	24.6	8	244.5	1,705.50
Czech Rep	38	1,976	25	11	273.6	1,702.40
Finland	37.5	1,950	25*	9	255	1,695.00
Italy	38	1,976	28	9	281.2	1,694.80
Norway	37.5	1,950	25	10	262.5	1,687.50
Sweden	37.2	1,934.40	25*	9	253	1,681.40
Germany	37.7	1,960.40	30	10	301.6	1,658.80
Denmark	37	1,924	30	10	296	1,628.00
France	35.6	1,850.68	25	10	249.1	1,601.60
EU27	38	1,976	24.8	9.6	261.1	1,714.90
EU15	37.6	1,955.20	25.9	9.9	268.8	1,686.40
NMS12	39.7	2,064.40	20.9	8.7	234.8	1,829.60

** Statutory annual leave has been used, since figures on average collective agreed annual leave are not available.*
Source: Eurofound, European Industrial Relation Observatory (EIRO), Working time developments – 2009, 2010, p. 24f.

4.3 Minimum wages

Bulgaria has not ratified the ILO Minimum Wage Fixing Convention (for a list of all ratified conventions see Appendix B) but it does have a long history with minimum wage fixing. The minimum wage is supposed to be discussed annually in the National Council for Tripartite Cooperation although final decisions on adjustments are made by the Council of Ministers. The monthly national minimum wage was frozen for two and half years at 240 BGN (122 Euro) before being increased in September 2011 to 270 BGN or 138 Euro.[35] After adjusting for income tax and social security charges the net take home pay for a person receiving the minimum wage is currently 188 BGN or 96 Euro.[36] This would mean that a worker (and their dependents) receiving the minimum wage would have to survive on around 3.60 Euro per day. Figure 29 shows trends in level of the gross minimum wage for the EU-NMS from Eastern and Central Europe. Despite the recent increase, the Bulgarian minimum wage is still around or significantly less than half the minimum wage applying in Poland, Czech Republic, Slovakia, Hungary, Latvia and Estonia and around one-seventh of that in Slovenia.

Figure 29: Gross monthly minimum wages across Eastern Europe in Euro



Source: Eurostat statistics.

One important consequence of restricting adjustments in the level of the minimum wage is that the number of workers directly impacted by the minimum has declined significantly. The Ministry of Labour and Social Policy estimated that the number of workers receiving the minimum wage declined from 337,315 in 2005 to just 116,535 in the second quarter of

[35] The Government has announced that it will increase the minimum wage by 20 BGN or about 10 Euro from May 2012.

[36] Ministry of Labour and Social Policy, Brief analysis and estimates concerning the fixing of the minimum wage, unpublished monograph, November 2011, p. 1.

2011.[37] That means that just roughly 5 % of all persons in employment are now receiving the minimum wage. Thus the 'bite' or impact of the minimum wage on poverty reduction and the income structure in Bulgaria has been eroded in recent years. This also means that the fiscal implications of increasing the minimum wage have become very minor.

The social partners in Bulgaria have been debating for some considerable time the appropriate methodology to use when adjusting the minimum wage. The Ministry for Labour and Social policy recently noted that:

> *"With regard to the minimum wage, there is consensus among all social partners that a machinery has to be developed for determining its amount, but no agreement has yet been reached on which indicator should be linked to the minimum wage."*[38]

The National Reform Programme of 2011 noted that reforms to the wage fixing mechanism were a priority for the Government.[39] The Government should finalise ongoing tripartite negotiations concerning the establishment of an agreed mechanism for adjusting the minimum wage and subsequently adjust the minimum wage in a timely manner with a view to correcting the economic and social problems identified by the Ministry of Labour and Social Policy. The ILO does not prescribe one single indicator for use in minimum wage adjustments but factors that are relevant and used in many other countries include changes in the price level (CPI), movements in the average wage level, and an assessment of the income required to lift workers above the subsistence level.

One important and innovative policy development was the introduction of 'minimum insurable earnings' in 2003. This has involved the Government and social partners defining a large number of economic sectors (now 85) and a smaller number of occupations (now 9) and then negotiating a notional 'minimal insurable earnings' level for each sector or occupation. This is then used to calculate the minimum social insurance contributions that must be paid regardless of the prevailing wage level claimed by employers and employees.

The initial objective of this reform was to reduce the size and the informal economy and prevent evasion of social insurance contributions. Over time the minimum insurable earnings are becoming an unofficial "minimum wage" for different sectors and professions in the country. At the time of writing negotiations had been concluded in roughly 50 sectors for 2012. This innovative approach appears to be successful and it would be desirable to finalise negotiations in the remaining sectors or implement the law which provides for an extension of the average increase in the sectors where negotiations have been concluded to those that have failed to conclude negotiations.

4.4 Real wages and productivity trends

Average wages in Bulgaria are also well below the levels prevailing in other EU countries, including all the EU-NMS. Figure 30 shows average monthly wages for a broad cross section of EU countries as of 2009 (this year was used to provide the widest possible country

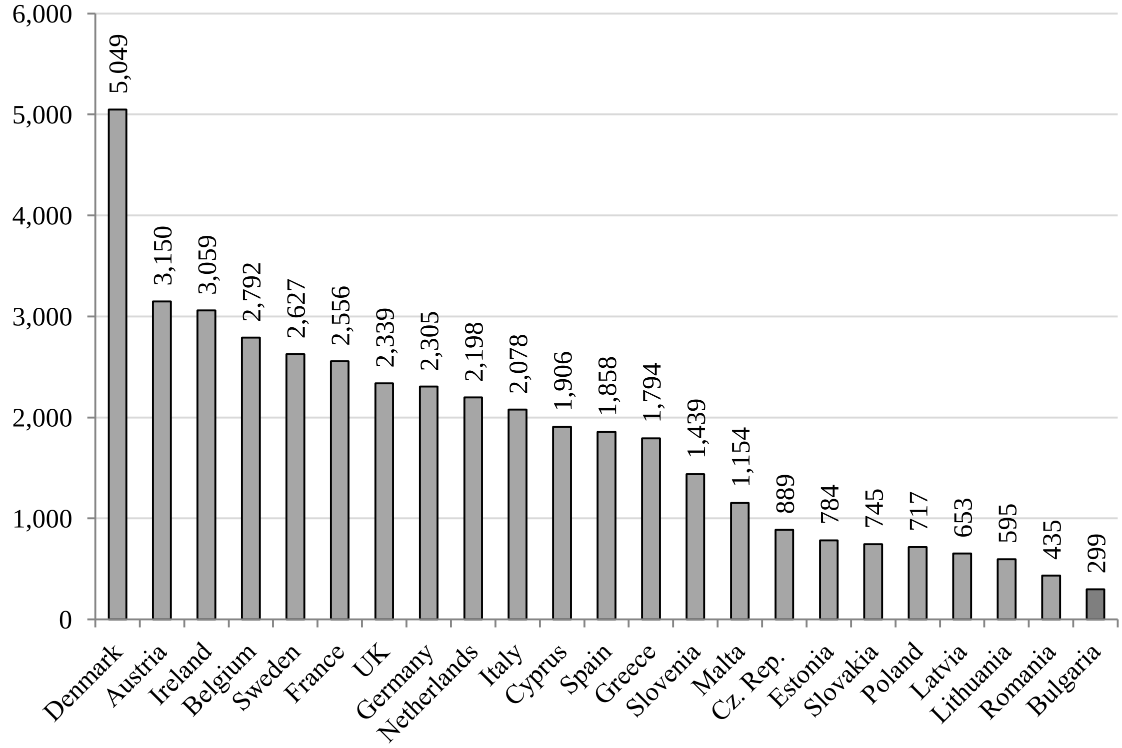
[37] Ministry of Labour and Social Policy, Brief analysis and estimates concerning the fixing of the minimum wage, unpublished monograph, November 2011, p. 2.

[38] Ibid., p. 4.

[39] See Action Plan annexed to the National Reform Programme of the Republic of Bulgaria (2011 – 2015), April 2011, p. 107.

coverage). As can be seen average wages in Bulgaria are a mere fraction of those prevailing in the advanced countries of Europe. But Bulgarian workers also earn less than workers in the other EU-12 countries. For example the average wage in Poland is nearly two and a half times that in Bulgaria. Even in Romania the average wage is some 45 % higher than in Bulgaria.

Figure 30: Average monthly wages across Europe in 2009 in Euro

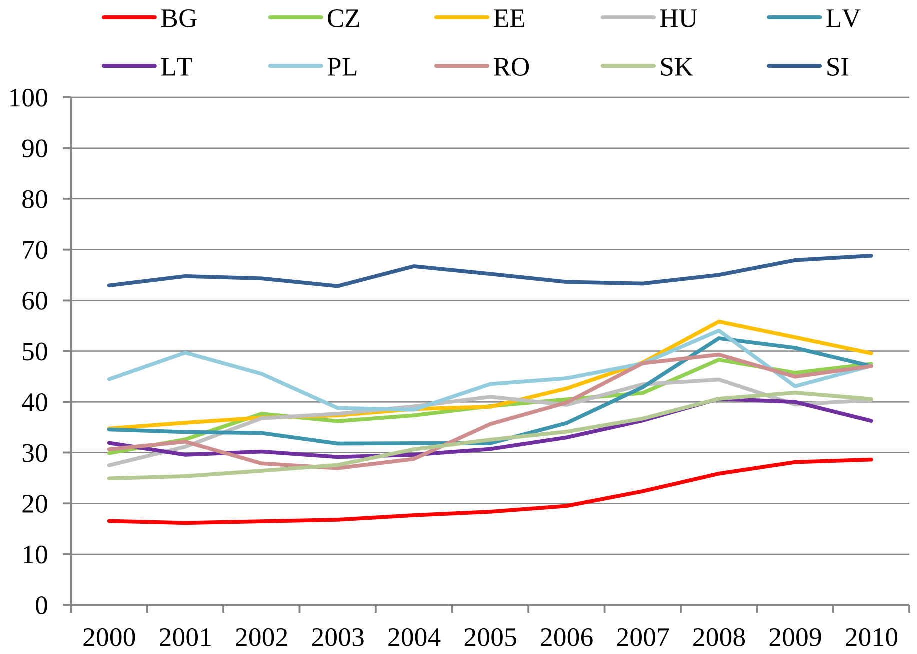


Note: Calculation was based on the coverage of total employee in all countries but methodology could differ in terms of the inclusion of part-time workers and regarding firm-size coverage.

Source: ILO Global Wage Database.

As a result of low average wages, Bulgaria enjoys substantially lower unit labour costs then all EU countries, including a substantial differential with the other EU-NMS. In fact, as can be seen in Figure 31 – which presents the ratio of unit labour costs in a range of EU-NMS with a common base (which is Austria) – despite a pick-up in average wage growth between 2006 and 2009 the differential in unit labour costs between Bulgaria and the other EU-NMS has remained substantial.

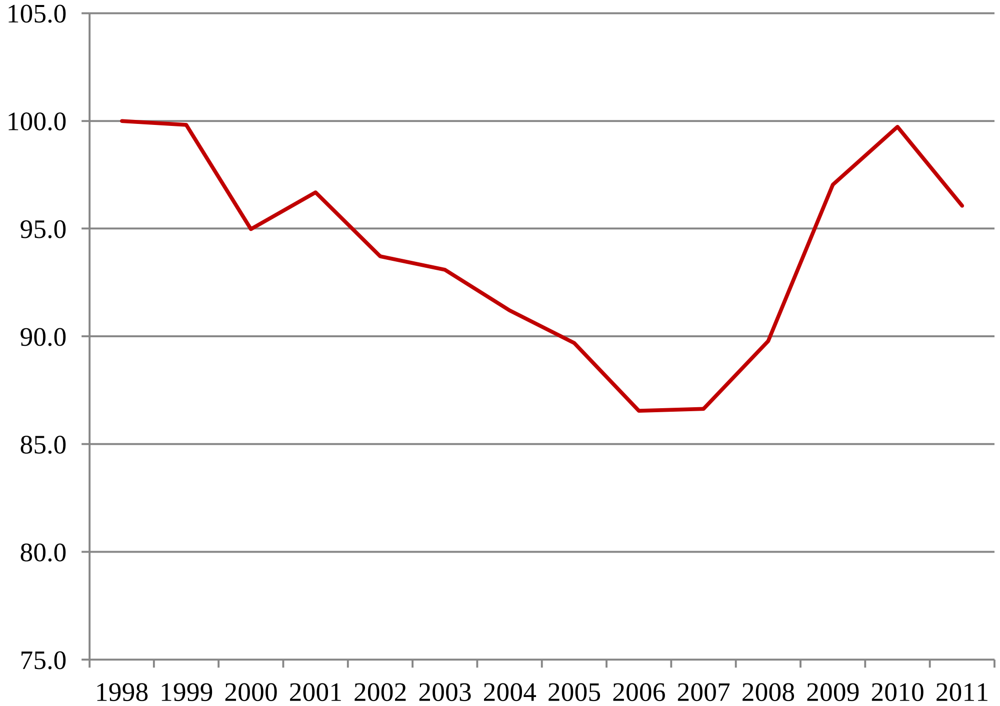
Figure 31: Development of ULC with Austria=100



Source: wiiw Database incorporating Eurostat statistics.

Figure 32 presents trends in real unit labour costs in Bulgaria since the late 1990s. Between 1999 and 2006 real unit labour costs declined sharply before recovering in the period 2006-2009 and then falling again over the last two years. It is notable that at the end of 2011 real unit labour costs were well below the level that had prevailed in the late 1990s.

Figure 32: Trends in real unit labour cost in Bulgaria (1998=100)

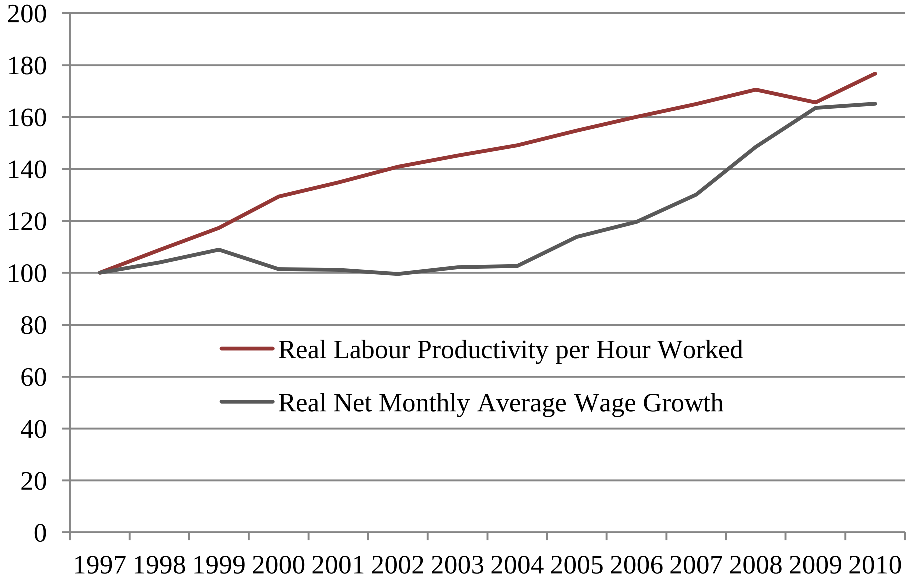


Source: Eurostat statistics.

The acceleration in real wage growth in the pre-crisis period must also be seen in perspective. Throughout most of the 1990s and for significant periods during the last decade the growth in real wages failed to match the growth in productivity (see Figure 33). In fact the IMF stated in 2001 that:

> *"In Bulgaria, the average real wage took the brunt of the adjustment throughout the transition, dropping significantly faster than productivity. This decline in real wages up to 1997 of more than 50 percent, is one of the steepest among EU applicants."*[40]

Figure 33: Development of real labour productivity and real net monthly average wage growth



Note: Real Net Monthly Average Wage was deflated by the Eurostat HICP for Bulgaria.
Source: Eurostat statistic.

The failure of real wages to increase in line with productivity improvements throughout the 1990s and the early 2000s resulted in a substantial decline in the wage share of GDP. As can be seen in Table 7 the wage share fell from 48.5 % in 2001 to 42.3 % in 2006.

Table 7: Adjusted Wage Share in Bulgaria (GDP at market prices)

1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
53.2	50.1	47.0	48.5	47.0	47.1	45.6	43.4	42.3	44.1	47.3	50.2	49.7

Source: National Statistic Institute.

As noted previously this was a period of relatively rapid economic and employment growth. But real wages clearly failed to grow in line with productivity improvements and consequently profits soared. This process was reversed in the lead-up to the 2008 recession. The acceleration in real wage growth from the mid-2000s can be attributed to relatively rapid economic growth which led to tight labour market conditions. The employment rate increased from 55.8 % in 2005 to 64 % in 2008 while the unemployment rate fell from 10.2 % to 5.6 %

[40] IMF, Labor Markets in Hard-Peg Accession Countries: The Baltics and Bulgaria, Country Report No. 01/100, July 2001, p. 26.

over this same period.[41] This environment proved conducive for real wage ‘catch up’ after the prolonged period of restraint.

It is notable that the acceleration in wage growth took place after the above mentioned reforms to the labour legislation, the decline in trade union density and the weakening of collective bargaining. Similar labour reforms are currently being advocated in other European countries will a view to depressing labour costs. Experience from Bulgaria would tend to suggest that more coordinated collective bargaining and effective social dialogue may be more effective than reforms designed to promote labour market flexibility in ensuring that real wages move in line with productivity improvements.

It should also be noted that during the period of relatively rapid economic growth prior to 2008 productivity growth in Bulgaria was only moderate by comparison with other EU-NMS. As can be seen in Table 8 over the period 2000 to 2007 average annual productivity growth in Bulgaria was 3.2 %. Only Hungary and Poland had slower productivity growth in this period.

Table 8: Average Annual Growth between 2000 and 2007 in Eastern Europe

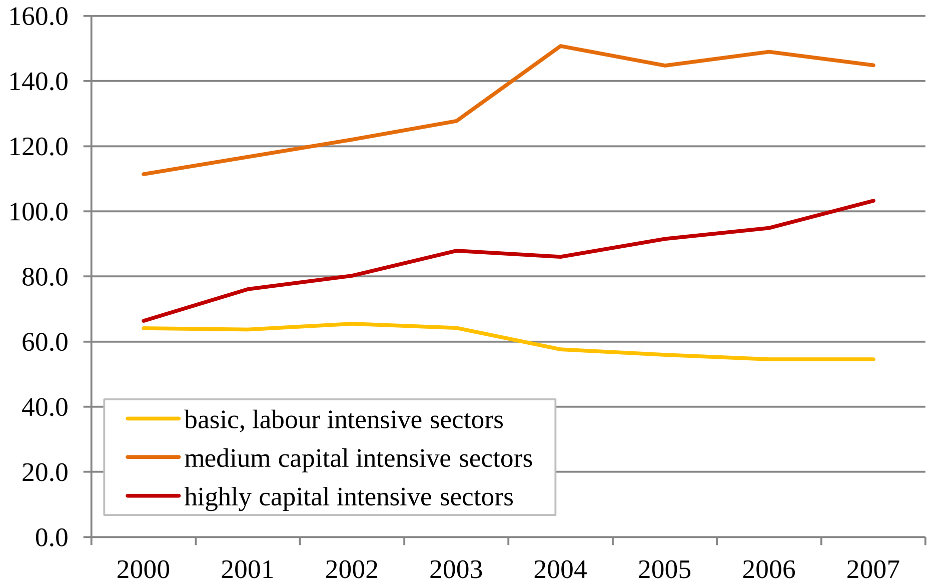
Country	**GDP**	**Employment**	**Productivity**	**Real wage**
Czech Republic	4.5	0.8	3.8	4.7
Hungary	3.7	1.1	2.0	4.3
Poland	4.1	0.6	2.6	1.1
Slovenia	4.4	0.9	3.3	3.0
Slovakia	6.2	1.0	5.9	3.3
Estonia	8.1	1.7	6.4	8.6
Latvia	9.0	2.4	5.7	9.9
Lithuania	8.1	1.3	5.6	8.5
Bulgaria	5.6	2.0	3.2	4.0
Romania	6.1	-0.8	5.5	9.3

Source: Onaran, Fiscal Crisis in Europe or a Crisis of Distribution?, Political Economy Research Institute, WP No. 226, 2010.

Figure 34 shows labour productivity trends for various segments of the Bulgarian manufacturing sector. Productivity performance was particularly poor in the low paid sectors of manufacturing such as the food sector and clothing, textiles and leather.

[41] National Statistic Institute, Labour Force Survey.

Figure 34: Pre-crisis development of labour productivity in industries with different degrees of capital intensity in Bulgarian manufacturing



Note: Basic production includes Food, Textile and Leather (DA-DC);
Medium: Rubber and plastic, other non-metallic minerals, basic metals and metal products (DH-DJ);
High: Machinery and equipment n. e. c., electrical, optical and transport equipment (DK-DM);
Source: wiiw Database.

The failure of productivity to grow more rapidly in Bulgaria may be attributed to various factors including the skill profile of the workforce. But Bulgaria also appeared slow to adopt new technologies and work processes. A recent European Working Conditions Survey asked employees across European countries if new processes or technologies had been introduced in the working place during the past three years. Bulgaria was among the countries with the lowest level of investment in new technology or work processes. Investments by enterprises in job training and retraining is also very low in Bulgaria particularly among manual workers (see Table 9).

Table 9: Result of the European Work Condition Survey 2010 for Bulgaria (Percentage of polled persons answering No/Yes)

Over the past 12 months, have you undergone any of the following types of training to improve your skills or not? Training paid for or provided by your employer or by yourself if self-employed.

		2000		2005		2010	
		No	Yes	No	Yes	No	Yes
Clerical	high-skilled	84.2	15.8	85.0	15.0	83.1	16.9
	Low-skilled	87.8	12.2	93.0	7.0	87.4	12.6
Manual	High-skilled	95.4	4.6	96.4	3.6	96.8	3.2
	Low-skilled	93.4	6.6	93.7	6.3	96.2	3.8
Total		89.9	10.1	92.3	7.7	90.6	9.4

Source: Eurofound, European Work Condition Survey 2010.

4.5 Pensions

The Bulgarian pension system has also undergone significant reform over the last decade. It currently has the following three-tier structure: a State pension system which provides pensions for about 2.2 million persons financed from social security contributions paid by both employers and employees as well as from the State budget; mandatory supplementary pensions; and, voluntary supplementary pension funds. Despite the introduction of this three tier structure, the State pension remains by far the dominant feature of the system and accounted for nearly 90 % of total social security expenditure in 2010 according to the National Social Security Institute (NSSI).

During the process of economic and political transition in the 1990s, the financial situation of the pension system deteriorated due to the provision of early retirement and invalidity pensions to a large number of retrenched workers. Consequently for the last decade the social security fund has incurred a deficit which has been covered by a transfer from the State budget. Moreover, Bulgaria is undergoing rapid demographic change with the fastest-ageing economy in the EU and this will generate additional pressure on the financing of pensions in the future.[42] These demographic pressures result from falling fertility rates, increased life expectancy, and substantial outward migration of young adults in search of higher incomes and better working conditions.

Despite these well documented concerns about the financial viability of the State pension system, the overall social contribution rate was dramatically reduced over the last decade. In fact the total contribution rate was halved; falling from 32 % in 1999 to just 16 % in 2007, before increasing to 17.8% in January 2011 (see Table 10). It can also be seen from Table 10 that the contribution for the first tier of the pension system (the State pension system) fell even more dramatically due to the introduction and subsequent increases in the contribution rates for the mandatory private pension funds (the second tier). In other words resources were transferred from the first tier to the second tier despite the deficit in the State pension system. As we will see later this second tier performed poorly during the recent recession and provides little income security for pensioners.

Table 10: Contribution Rate Changes since 2000 (concerning persons born after 1959)

Year	Measure	Resulting Contribution Rates		
		PAYG* tier	Saving tier	Total
1999		32		32
2000	Reduction of 3 percentage points (pp)	29		29
2001	Transfer of 2 pp to private scheme	27	2	29
2004	Transfer of 1 pp to private schemes	26	3	29
2006	Reduction of 6 pp and transfer of 1 pp to private fund	19	4	23
2007+	Additional reduction of 7 pp, transfer of 1 pp to private scheme	11	5	16
2011	Increase by 1.8 pp in public scheme	12.8	5	17.8

** Pay-As-You-Go*

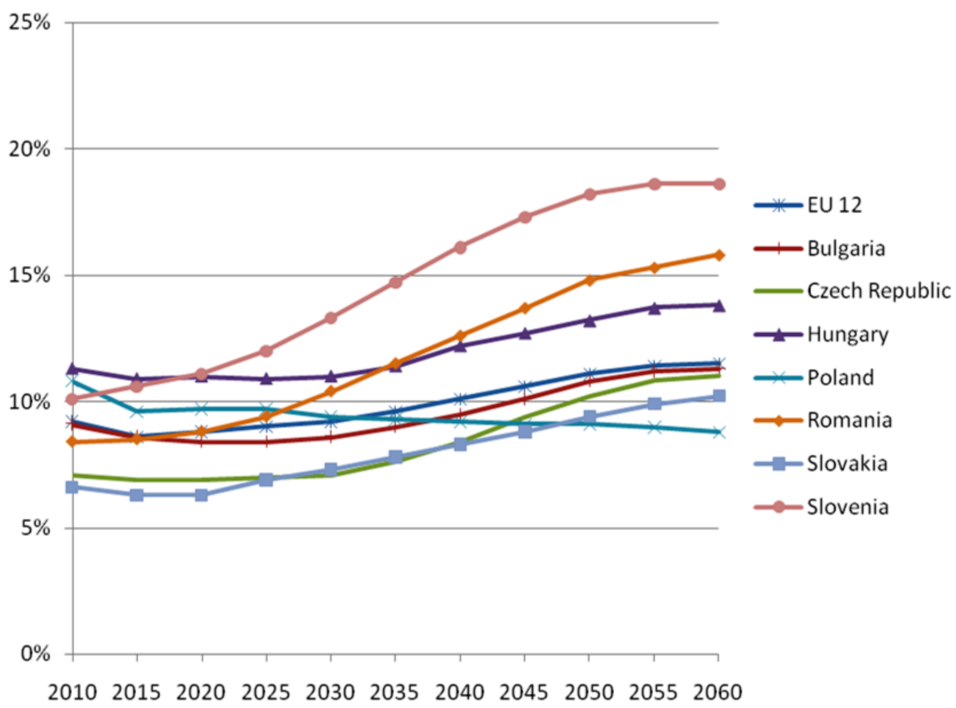
Source: Michael Cichon, 'Income security through social security in Bulgaria?', Presentation at the International Conference: Jobs and Incomes – A better Deal for Bulgaria, March 2012.

42 Se2007+e results of the 17th Population and Housing Census in Bulgaria, July 2011.

Governments in many countries have attempted to stimulate employment through a reduction in taxes on employment, or the so-called tax wedge. Bulgaria by cutting pension contribution rates has also followed this path. However, it is hypocritical to dramatically reduce taxes on employment (including the pension contribution rates) and to siphon off contributions from the State system into private pension schemes, as occurred in Bulgaria on a significant scale, and then complain that the State pension system is facing a large deficit. This flawed financing strategy has in turn resulted in adverse pressure on pension benefit levels and retirement ages.

Although the Bulgarian pension system has a significant deficit and the country faces major demographic challenges the proportion of GDP devoted to pensions is moderate by comparison with other NMS and is expected to remain within tolerable proportions in the period ahead (see Figure 35). Moreover, important reforms to the pension system have been negotiated in recent years. The Government established a Consultative Council on Pension Reform made up of a small number of experts to discuss pension reform. This led to discussions at the National Council for Tripartite Cooperation and the tripartite stakeholders reached agreement in December 2010 on a comprehensive set of reforms to improve the financial viability of the State pension fund. This reform package was endorsed by the Prime Minister. The agreed reforms are outlined in Appendix C

Figure 35: Projected cost development in percentage of GDP



Source: Michael Cichon, 'Income security through social security in Bulgaria?', Presentation at the International Conference: Jobs and Incomes – A better Deal for Bulgaria, March 2012.

The reforms agreed in December 2010 aimed to eliminate the pension system deficit, ensure the medium-term financial stability of the system and improve the adequacy of benefits in light of demographic change. It was estimated that the agreed reforms would return the State pension system to a surplus between 2019 and 2038. However in November 2011 the

Government decided to withdraw its support for the above tripartite agreement and start the increase in the retirement age in 2012, nine years earlier than the schedule agreed in 2010. This subsequently led to major protests and a further deterioration in the climate for social dialogue. In early 2012 the parties have reopened negotiations on reforms to the pension system.

Although much attention has recently been devoted to the deficit facing the State pension fund and the reforms required to make it financially more secure insufficient attention has been devoted to two other important issues. The first issue is the low level of pensions and the living standards of those attempting to survive on such incomes. With an average old age pension of just 230 BGN (or 118 Euro) per month, which is just 19 BGN above the official poverty line, and a social pension of just 100 BGN (51 Euro) per month the plight of pensioners in Bulgaria warrants more focus.[43] Anecdotal evidence of pensioners going without basic medicines and adequate food abound. Such conditions require urgent upgrading if the European Union is to preserve its reputation for proving a suitable Social Protection Floor.

Before pension payments, around 41 % of the population were at-risk-of-poverty in 2010, but when pension payments are taken into account this figure declines to 27 %.[44] Pensions therefore play an important role in income redistribution and reducing poverty. Despite this, the proportion of elderly people living close to or below the poverty line has increased significantly in recent years. From Table 11 it can be seen that in 2003 just 17 % of persons aged 65 or older where considered to be at-risk-of-poverty. But this ratio rose dramatically to reach 44 % in 2009 before moderating somewhat in 2010. It would appear that the proportion of pensioners at-risk-of-poverty in Bulgaria significantly exceeds that in other EU-NMS and is roughly double the comparable ratio in Romania.

Table 11: Percentage of Population aged 65 or over considered to be at-risk-of-poverty after pension payments

Country	2003	2004	2005	2006	2007	2008	2009	2010
Bulgaria	15	17	20	29.1	27.6	41.0	44.0	37.7
Slovenia	20	--	32.7	32.0	30.0	32.9	31.6	32.1
Latvia	--	--	26.7	33.3	36.9	53.3	49.4	24.0
Romania	23	22	--	--	34.7	30.1	24.5	19.6
NMS 12	--	25.4	19.4	20.7	20.5	22.4	22.0	18.4
Estonia	22	25.4	22.4	27.9	35.7	41.3	36.4	17.7
Poland	--	--	10.9	11.7	11.6	14.8	17.3	17.5
Lithuania	--	--	19.7	25.8	33.5	32.4	29.3	13.3
Czech Republic	--	--	11.2	13.3	12.1	14.4	14.5	12.6
Slovakia	--	--	12.4	13.8	13.3	14.6	14.4	11.9
Hungary	8	--	11.5	13.7	10.9	9.5	9.3	8.6

Source: Eurostat statistics (SILC).

[43] National Social Security Institute, Statistical Bulletin: Pensions up to 30.IX.2011. Status and movement of the number and expenditure for pensions up to 30.IX.2011, 2011.

[44] Eurostat, people are defined as being at-risk-of-poverty if their income is equal to or less than 60% of the median income of the population.

The second issue that has received insufficient attention is the performance of the second and third tiers of the pension system in recent years. Privately managed pension funds have been adversely affected by the decline in the stock market. Global deleveraging by foreign institutional investors led to a withdrawal of their holdings from the Sofia stock exchange, leading to a sharp fall in stock market prices. The total net assets of the voluntary pension funds declined by 29 % in 2008, while their investment in equities declined by over 53 %. The financial crisis also decreased the value of the supplementary pension funds and exposed their sensitivity to volatile market conditions. According to the Financial Supervision Commission, the average rate of return in 2008 was -20 % for the Universal Pension Fund, -23 % for the Professional Pension Fund, and -25 % for the Voluntary Pension Funds. Thanks to a rebound in equity prices 2009 and 2010 the asset values of these pension funds rebounded. However, as noted previously equity prices fell sharply again in 2011 and this has probably had adverse implications for the second and third tiers of the pension system. As a result there is considerable volatility and uncertainty associated with the second and third tiers of the pension system. In addition the second and third tiers of the pension system are not expected to made any direct impact on poverty or income inequality in the decades ahead.

Similar problems have emerged in many other countries, including a variety of countries in Central and Eastern Europe. As a result several countries in the region have re-examined their commitment to mandatory private pension schemes and have cut contribution rates for these second tier schemes. Table 12 provides details. Bulgaria may also want to re-examine its commitment to the second tier and re-direct resources back into the State pension system.

Table 12: Recent changes in second-tier systems in Central European Countries

	Change in contribution rate diverted to second tier		*Change in state mandate to invest contributions in privately managed individual accounts*
	Previaous rate	*Adjustment of rate*	
Hungary	*8 % of earnings*	*Reduced to zero (Dec. 2010)*	*Mandate repealed*
Poland	*7.3 % of earnings*	*Reduced to 2.3 % of earnings (2011), rising to 3.5 % in 2017*	…
Estonia	*6 % of earnings*	*Suspended (June 2009- Dec. 2010); restored to 3 % (2011)* *Planned to increase to 6 % (2012) and 9 % (voluntary) depending on GDP growth (2014-2017)*	…
Latvia	*8 % of earnings*[a]	*Reduced to 2 % (2009)* *Planned to increase to 6 % by 2013, if financial conditions permit*	…
Lithuania	*5.5 % of earnings*	*Reduced to 2 % of earnings (2009)*[b]	*Government proposed worker option to withdraw from second tier; currently before Parliament*
Romania	*2 % of earnings*	*Frozen at 2 % (May 2008-March 2010); raised to 2.5 % (March 2010)*	…
Slovak Republic	*9 % of earnings*	*N/A*	*Existing account holders could opt out of second tier (Nov. 2008-June 2009); second tier made voluntary for new hires (since 2008)*

Source: Michael Cichon, 'Income security through social security in Bulgaria?', Presentation at the International Conference: Jobs and Incomes – A better Deal for Bulgaria, March 2012.

4.6 Social assistance

Bulgaria spends about 1.3 % of GDP on social welfare programmes, compared to an OECD average of 2.5 %. The main social assistance benefits are the Guaranteed Minimum Income (GMI) and the Heating Allowance (HA). These programmes provide cash benefits to the poor and vulnerable households whose income falls below a certain minimum level. This minimum income level is established every year by the Council of Ministers. Its level is lower than the minimum wage, social pension or the minimum unemployment benefit.

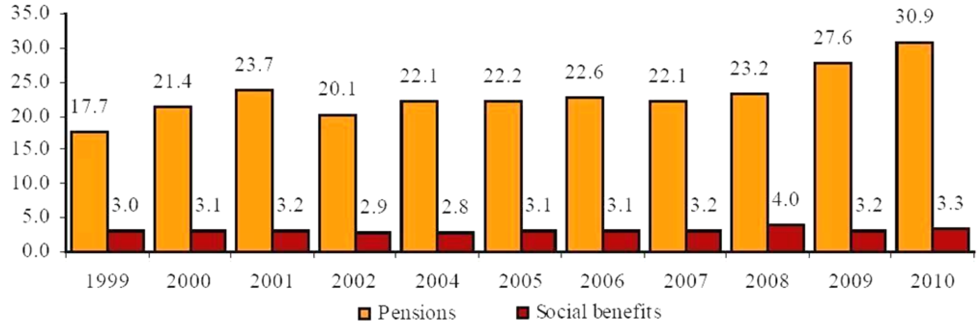
The GMI programme is means-tested. Eligibility depends on the income and assets of the household, family size, health, employment status, age, and other requirements stipulated in the Social Assistance Act. The amount of the minimum income is determined by age, family size, composition, and other circumstances. The GMI benefit is calculated as the difference between the adjusted minimum income and the actual income of the beneficiary household.

Research has demonstrated that a large portion of the GMI resources reached the poor and vulnerable population groups, particularly the Roma who account for almost 75 % of the GMI beneficiaries. Despite the efficiency in benefit targeting, these programmes have a limited impact on poverty reduction due to the low benefit levels and their limited coverage of the poor. For example in 2009 the GMI was increased by 18 % in nominal terms to 65.8 BGN which amounts to 33.6 Euro per month or just over one Euro per day. Prior to 2009 the GMI had been frozen for 4 years and it has not been increased again since 2009. The GMI is received by only about 4 % of the population.[45]

As indicated previously the estimated incidence of people-at-risk-of-poverty in the absence of any social transfers was 41 % in 2010. This was substantially decreased to 27 % as a result of income transfers via the pension system. But the impact of other social transfers including the GMI and the HA reduced the incidence of poverty by only an additional 6 percentage points to 21 %. Figure 36 sheds some light on why social assistance has only a limited impact on poverty. Since the crisis in 2008, the share income derived from pensions in total household income increased from around 23 % to about 31 %. This is mainly the result of a significant decline in income derived from wages and salaries. However the proportion of total income provided by social assistance declined from a moderate 4 % in 2008 to just 3.3 % in 2010 despite a significant increase in discouraged workers who in normal circumstances would swell the ranks of those on social assistance.

[45] World Bank, Social Assistance Programmes: Cost, Coverage, Targeting and Poverty Impact, Report No. 47793-BG, September 2009, p. v-x.

Figure 36: Relative share of income from pensions and other social benefits as percentage of total household income



Source: National Statistic Institute.

In recent years, the government has tightened the eligibility conditions for these social assistance benefits. From July 2006, the maximum duration of GMI benefits for an able-bodied working age beneficiary was reduced to 18 months. The beneficiaries cannot re-apply for the benefit within 12 months of the expiry of the GMI benefit, although they can enrol in employment training programmes. This measure has been strictly enforced since January 2008, resulting in a substantial drop in the number of beneficiaries from around 60,000 to below 50,000 in just two months. Moreover and despite deteriorating economic conditions, the maximum duration of GMI benefits was further reduced to 12 months from July 2008 and then cut to only 6 months in early 2009.[46]

The EU Commission stated in response to these reforms that:

> *"the overall philosophy behind this reform was essentially a philosophy of the unworthy poor, who don't want to work. The inspiration for these reforms came from neoliberal think tanks and economists, who also advocated for the flat tax."*[47]

Following more recent observations by the European Committee of Social Rights that the tightening of eligibility conditions for social assistance was in violation of the European Social Charter, the Government has amended the legislation.

Despite a dramatic increase in the need for social assistance since the start of the economic crisis the resources made available for such programmes remain inadequate. It has been suggested that GMI may discourage active employment search. However a benefit level that amounts to just one Euro per day can hardly be considered generous in a country that belongs to the European Union. Moreover, at present with an unemployment rate around 12 % and the recent high level of redundancies among skilled and semi-skilled workers it is unlikely that recipients of the GMI - who tend to be from the Roma population with limited education and no formal employment history- will find jobs.

While job search activation policies remain important in all countries there also needs to be a degree of realism about what can be achieved through such policies. Bulgaria has imposed a very strict and rather short limit on the period of GMI benefits. This is contrary to the policy

[46] European Commission, Analysis of the Situation in Relation to Minimum Income Schemes in Bulgaria, April 2009, p. 3ff.
[47] European Commission, Analysis of the Situation in Relation to Minimum Income Schemes in Bulgaria, April 2009, p. 18.

in many EU Member States which provide more discretion to the appropriate authorities in determining if and when social assistance should be cut or extended and which take into account the need for these programs to be anti-cyclical. This approach encourages greater cooperation between the job seeker and the authorities responsible for administrating social assistance and the employment services. It may be appropriate to reassess this policy and to expand the coverage, benefit level and duration of these benefits.

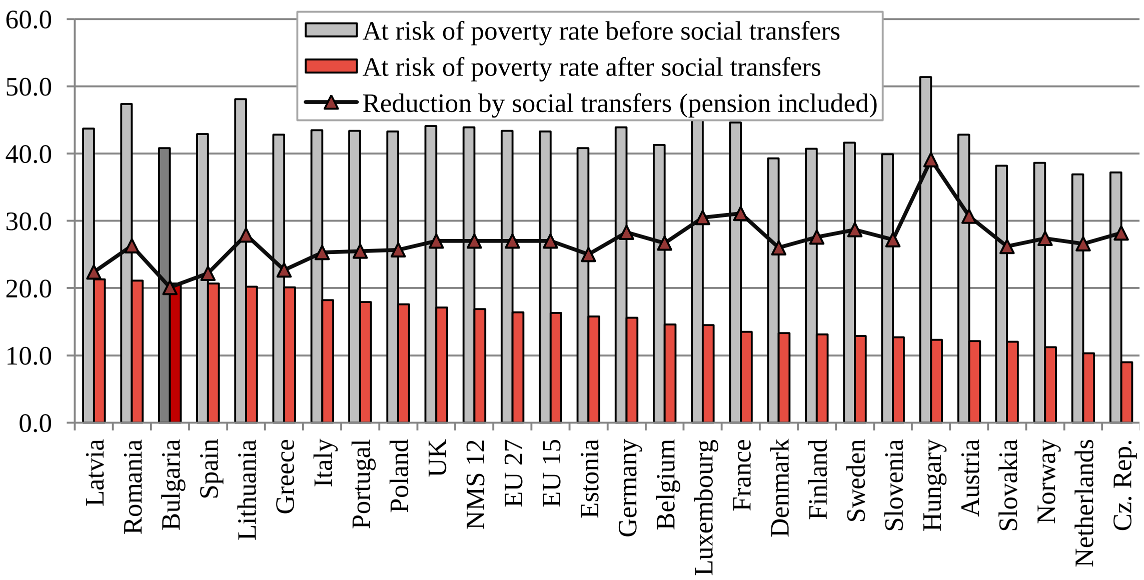
Finally, it would appear that in Bulgaria there is inadequate coordination between the authorities responsible for the Employment Services and those administrating the social assistance system. Increased cooperation and perhaps integration of these services may prove beneficial (see below for further details on the activities of the Employment service).

4.7 Poverty and living standards

Bulgaria introduced an official monthly poverty line of 152 BGN (78 Euro) per household in 2007. The poverty line has been up-rated in most years since then by decision of the Government following discussion within the National Council for Tripartite Cooperation. The Government recently announced a new monthly poverty line for 2012 at BGN 236 (120 Euro) per household. This is 196 Euro below the average household total monthly expenditure costs. Thus families living on anything above 4 Euro per day in 2012 will be considered to be above the poverty line. As this 'poverty line' is the result of negotiation it reflects to some degree the general economic situation and the fiscal space the Government considers is available to support vulnerable social groups. These economic and political judgements are subjective.

An alternative indictor of 'poverty' is the 'people-at-risk-of-poverty' measure referred to previously.[48] Figure 37 provides data on this poverty measure for the EU-27 countries.

Figure 37: People at-risk-of-poverty in percentage of population across Europe in 2010



Source: Eurostat statistics (SILC).

48 Eurostat provides data on this measure.

As noted previously the proportion of people in Bulgaria at risk of poverty after taking into account social transfer is 21%. This is somewhat above the EU-27 average but not significantly out of line with several other countries (see Figure 37). However when this data is disaggregated for different household types Bulgaria appears to have a more pronounced problem with poverty among people living alone, particularly elderly people (see Table 13).

Table 13: People at-risk-of-poverty by household type in 2010

	Bulgaria	**NMS 12**		**EU 27**	
	% of Pop.	% of Pop.	Difference to Bulgaria	% of Pop.	Difference to Bulgaria
Single Person older than 65	61.6	24.3	-37.3	23.7	-37.9
Single Person	50.9	24.3	-26.6	23.7	-27.2
Single person with dependent children	42.3	34.6	-7.7	36.9	-5.4
Two adults	19.9	10.9	-9.0	11.3	-8.6
Two adults with two dependent children	16.3	18.0	1.7	14.9	-1.4

Source: Eurostat statistics (SILC).

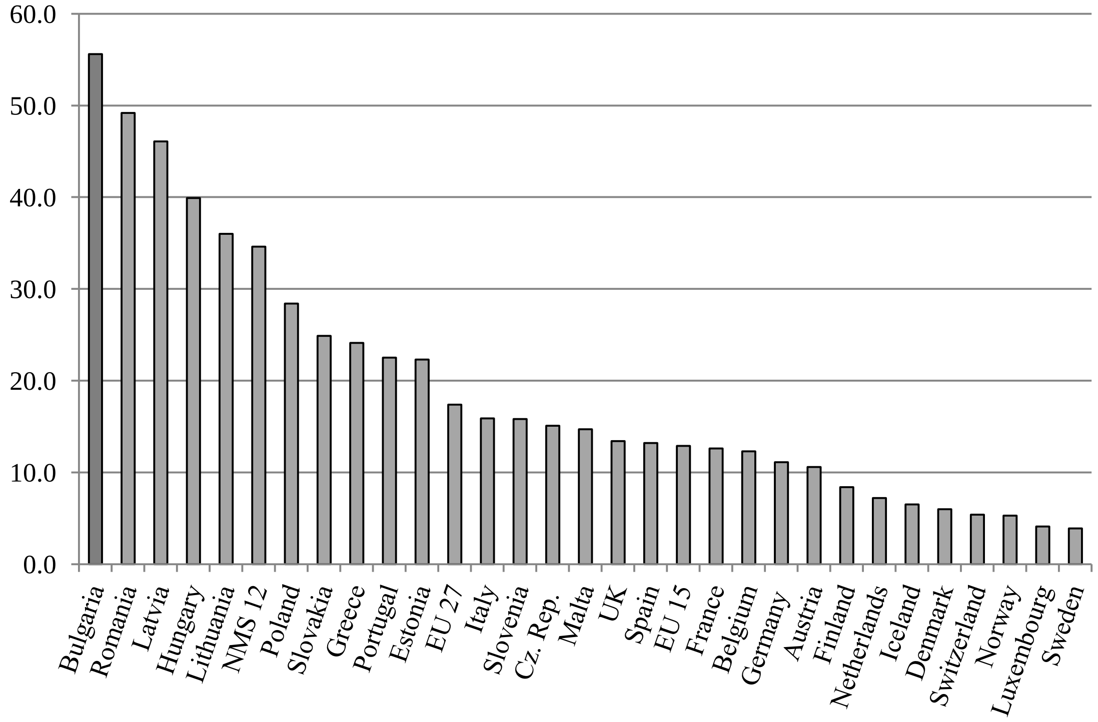
While at the aggregate level the incidence of poverty in Bulgaria may not be significantly out of line with several other countries there is considerable variation when the poverty line is measured in Euro. For example, the poverty line in Bulgaria in Euro terms is 2.8 times lower than the average of EU-12 countries and 13 times lower than the average of EU-15 countries. When measured in purchasing power parity (PPP) terms, the difference in the poverty line narrows considerably. But even in PPP terms, the poverty line in Bulgaria is two times lower than the EU-12 average and about 5 times lower than the EU-15 average. Given this it is therefore not surprising that the day-to-day living standards of low income groups in Bulgaria is significant worse than low income groups in other EU countries.

Figure 38 provides comparable data on the proportion of the population considered to be 'materially deprived', which is one important indicator of living standards across EU countries.[49] In Bulgaria it is estimated that 55 % of population were materially deprived while 35 % of population were considered to be severely materially deprived. On this measure living standards among the poor in Bulgaria would seem to be worse than in all other EU countries. Moreover the gap between Bulgaria and Romania in respect of this measure is a cause for concern. In terms of housing deprivation 15.4 % of the total population in Bulgaria had neither a bath, nor a shower in their dwelling in 2010 while 25 % had no indoor flushing toilet according to Eurostat (SILC) data.

[49] **Material deprivation** refers to a state of economic strain and durables strain, defined as the enforced inability (rather than the *choice* not to do so) to pay unexpected expenses, afford a one-week annual holiday away from home, a meal involving meat, chicken or fish every second day, the adequate heating of a dwelling, durable goods like a washing machine, colour television, telephone or car, being confronted with payment arrears (mortgage or rent, utility bills, hire purchase instalments or other loan payments).

The s**evere material deprivation rate** is defined as the enforced inability to pay for at least four of the above-mentioned items.

Figure 38: Percentage of population materially deprived in 2010
(lack of at least three items)



Source: Eurostat statistics (SILC).

4.8 Labour market programmes and the employment services

The economic reform agenda of the last decade has also involved extensive changes in Government rhetoric concerning employment policies which unfortunately has not been matched by the required public resource allocation. Bulgaria, like many other countries, embarked on an employment activation strategy in the 2000s. The main goal of this strategy was to significantly reduce the proportion of the long-term unemployed receiving social assistance. The stated objective was to provide incentives for such people to accept temporary employment opportunities, to improve employability of low skilled persons and facilitate transition of young people from school or inactivity to work.

In the mid 2000s this resulted in Bulgaria devoting a relatively high proportion of fiscal resources to Active Labour Market Policies (ALMPs). As can be seen from Table 14 in 2004 Bulgaria was devoting almost 0.5 % of GDP to ALMPs which was comparable with average expenditure among the EU-27 countries and was high by comparison with the EU-12 countries. During this period Bulgaria made significant progress in expanding employment and reducing unemployment. It would seem reasonable to conclude that ALMPs made an important contribution to this success. Unfortunately despite the stated objectives mentioned above fiscal expenditure on labour market policies began to decline after the mid-2000s. In fact as a percentage of GDP it was more than halved over the next five years, falling to just 0.2 % of GDP in 2009 which was less than half the EU-27 average (see Table 14).[50]

Table 144: Public expenditure on labour market policies, by type of action in percentage of GDP

Active LMP

Total LMP measures (categories 2-7)

	2003	2004	2005	2006	2007	2008	2009
European Union (27)	.	.	0.510	0.503	0.462	0.463	0.551
Bulgaria	.	0.453	0.406	0.370	0.286	0.253	0.224
Greece	0.088	0.141	0.057	0.144	0.152	0.142	0.212
Spain	0.561	0.549	0.582	0.627	0.627	0.605	0.652
Latvia	0.084	0.080	0.162	0.186	0.108	0.078	0.272
Lithuania	0.152	0.154	0.146	0.177	0.228	0.139	0.200
Poland	.	.	0.356	0.359	0.404	0.468	1.157
Portugal	0.495	0.525	0.501	0.441	0.372	0.407	0.629
Romania	0.109	0.101	0.108	0.100	0.076	0.060	0.041
Slovenia	.	.	0.194	0.175	0.111	0.093	0.230
Slovakia	.	0.072	0.168	0.143	0.116	0.150	0.150

Passive LMP

Total LMP supports (categories 8-9)

	2003	2004	2005	2006	2007	2008	2009
European Union (27)	.	.	1.266	1.124	0.951	0.959	1.395
Bulgaria	.	0.254	0.201	0.174	0.144	0.150	0.383
Greece	0.367	0.405	0.408	0.381	0.334	0.466	0.687
Spain	1.453	1.491	1.449	1.427	1.443	1.869	2.961
Latvia	0.369	0.377	0.312	0.290	0.287	0.347	1.027
Lithuania	0.156	0.110	0.122	0.124	0.113	0.154	0.614
Poland	.	.	0.857	0.711	0.513	0.349	0.337
Portugal	1.155	1.199	1.279	1.194	1.049	0.989	1.308
Romania	0.524	0.486	0.393	0.277	0.227	0.174	0.383
Slovenia	.	.	0.390	0.383	0.299	0.267	0.633
Slovakia	.	0.337	0.266	0.339	0.363	0.433	0.670

Source: Employment Agency, Yearbook, 2010.

[50] However, state budget allocations for ALMP were supplemented with resources from municipal budgets and foreign resources. In 2008 these additional resources (excluding the European Social Fund (ESF) allocation) amounted to more than one-third of the total transfer from the state budget for ALMP.

While some reduction in labour market expenditure may have been expected as labour markets tightened in the period prior to 2008, the most extreme cuts in Government expenditure on ALMPs took place after the onset of the recession when labour market conditions deteriorated rapidly. In fact expenditure from the State budget on ALMPs were initially reduced slightly in 2009 and then cut severely in 2010 as part of the fiscal austerity measures.[51]

Despite being among the countries in Europe with the worst labour market performance in recent years these trends have continued. In the first nine months of 2011, BGN 40.6 million was spent on ALMPs from the State budget which was 21 % lower than the amount spent in the corresponding period of 2010. In addition, funding of ALMPs from other resources (excluding the European Social Fund (ESF)) was also sharply cut to BGN 18.6 million in 2009 and 9.2 million in 2010. The reduced funding for active policies has been combined with administrative reforms that have decreased the number of staff in the National Employment Agency (NEA).

The reduced spending on ALMPs has been reflected in significantly lower participation of registered jobseekers in ALMPs. In fact between 2009 and 2010 the number of participants in active labour market programmes fell by almost 50 %. The sharpest reduction has taken place in programmes assisting the most vulnerable persons – low skilled, long-term unemployed, persons with disabilities or Roma. As noted previously access to social assistance benefits have also been tightened in recent years in order to encourage labour market participation, yet simultaneously Government resources for skill development and retraining has been severely reduced. The net result will be a further increase in poverty and social exclusion.

It is of particular concern that labour market programmes for unemployed youth aged 15-29 have been reduced given the recent explosion in youth unemployment and past experience with hysteresis and social dislocation resulting from high and prolonged youth unemployment. The absolute number of young people participating in ALMPs fell by around 50 % between 2008 and 2010, just as the crisis was intensifying. In the past programmes for youth that were focussed on supporting the transition of school leavers to employment through internship, subsidized first employment combined with training and support for business start-ups, appeared to be well targeted with reasonable rates of return.

It is important to acknowledge that in addition to the national funding of ALMPs, the ESF also supports ALMPs in Bulgaria through two large and well resourced programmes.[52] The programme participants include both employed and unemployed persons and the main focus is on building or improving their skills in appropriate education and training courses offering both technical and ‘soft’ skills through a voucher system. The number of beneficiaries has increased recently in response to the deepening crisis. These programmes have been especially important for young people, with the number of youth participating in the schemes increasing from 1,542 in 2009 to 28,646 in 2010. Consequently the expansion in ESF

[51] The state budget allocation on ALMP originally given in the National Employment Action Plan was one-fifth higher than the amount actually spent in both 2008 and 2009.

[52] These programmes are the Operational Programme on Human Resource Development and the Operational Programme on Administrative Capacity.

activities in the employment field has to a degree compensated for the reduction in activities funded by the State.

The potential scale of these programmes is impressive. Nevertheless, actual participation is lagging well behind the original targets. According to the 2010 annual progress report, 100,000 people were expected to receive mediation services however the actual number benefiting from these activities was just 11,930. Similarly 100,000 persons were expected to receive professional education and 200,000 training for obtaining or increasing professional qualifications, while the actual numbers participating in these two programmes was only 8,877 and 37,791 respectively. As of 31 October 2011, (slightly more than two years before the programme's completion date) plans existed for spending only 56 % of total available funds and a mere 14 % of funds had actually been utilised. Moreover, no evaluations have been made on these programmes. So no information is available on the impact of participation in the programmes on employment and incomes. So it is difficult to assess the impact on skill mismatches or long-term unemployment. Employers in Bulgaria, as in many countries, complain that they have difficulties attracting workers with the required skills despite the deterioration in the labour market. Skill mismatches are therefore often cited as a significant factor of structural unemployment. Reference has already been made to the low level of investment in on-the-job-training in Bulgaria and the high rates of outward migration of workers in search of better wages and employment conditions. Another possible cause of skill mismatches could be deficiencies in the formal education and training systems. For example, it has been suggested that there is an excessive focus on 'soft' skills and short-term schooling while extensive in-depth professional education and training remains under resourced.

Table 14 also shows public expenditure on passive labour market policies which is the payment of unemployment insurance. Since the onset of the recession the number of beneficiaries has doubled and the average level of benefits has increased as a percentage of the minimum wage. Despite this the unemployment insurance scheme only covers 75% of all employed persons and provides benefits to only 32% of the unemployed.

5 Conclusions and issues for discussion

Despite having by far the lowest labour costs in the EU, and it can be argued the most flexible labour market, Bulgaria has experienced a fall in employment since the end of 2008 that is disproportionate to its decline in output. Clearly, the answer to Bulgarian labour market problems does not rest with further deregulation or wage restraint. Rather, the key short term challenge in Bulgaria is to boost economic growth to levels that are compatible with improving the current dire state of the labour market to provide relief to those most affected by the crisis and poverty. Over the medium term the priority must be to move decisively towards a society that reflects the social values and living standards expected in an advanced economy within the European Union. A commitment to these goals and some tangible progress towards them is required to build a more cohesive society and avoid an escalation of the social tension and strikes which spread in the latter months of 2011.

This will be no easy task in the current global economic environment and in particular the expectation of recession – or at best extremely slow growth – in 2012 throughout the advanced European economies. These external economic constraints make it all the more important that key interests groups in Bulgaria are involved with the Government in dialogue and debate over the parameters of economic and social policy. The main trade union centres and employers' associations in Bulgaria are highly representative and respected organisations. They reflect the views of workers, pensioners, the unemployed and the real economy. They are organisations that have devoted time and resources to economic research and the development of coherent policy proposals. They are also key players influencing the political and social discourse and thus the sustainability of economic policy. If a degree of tripartite consensus can be developed over the broad parameters of economic policy Bulgaria will enhance its reputation for stability and reliability in the troubled times ahead in Europe.

Unfortunately recent experience with social dialogue in Bulgaria has been problematic. As noted previously the failure to implement agreements that resulted from detailed and balanced negotiations among the social partners has cast a shadow over social dialogue and the good reputation Bulgaria has established for transparent tripartite decision making. These signed agreements concerned several of the most significant economic issues confronting Bulgaria: policy responses to the economic crisis; long term adjustments to the pension system; and, staged structural reforms in the railways and other public enterprises. Reneging on such ratified agreements engendered tension and distrust leading to mass protests. Any further deterioration in employment relations will exacerbate investor and consumer confidence leading to a deeper economic contraction. **However, these problems can be ameliorated and trust restored if the political will exits to honour past agreements and there is a degree of flexibility on all sides with preconceived policy preferences. In early 2012 some progress was made in restoring trust. The international conference on 'Jobs and Incomes – A Better Deal for Bulgaria' which involved representatives of trade unions, employers' organisations, the Bulgarian Government, academics plus the ILO and IMF helped generate greater consensus about the economic and social polices required for the future. These conclusions of this conference are attached in Appendix A.**

Bulgaria needs to diversify the drivers of growth it relies upon. In 2010 and the early part of 2011 exports were the main factor supporting recovery. But this source of growth faded as global growth slowed in the second half of last year and cannot be relied upon in the near future given the expected recession, or at least very slow growth, in the advanced countries of Europe in 2012. Similarly a return to the levels of foreign capital inflow that characterised the pre-2008 period is highly unlikely and would be undesirable if it merely boosts private debt levels and rekindles asset bubbles without any tangible benefits for the traded goods sector.

Most indicators suggest that economic recovery slowed dramatically after the first quarter of 2011. The outlook for private domestic investment will remain very subdued in the near future due to a severe debt overhang among non-financial corporations, high real interest rates, liquidity problems in the banking sector and a lack of certainty with credit conditions as well as weak demand. Private consumption has been low and is expected to remain so due to high unemployment, employment insecurity, the relatively low level of wages compared to other EU countries and the extremely low incomes for those depending on transfer payments for survival.

In these circumstances it would be at least reasonable to consider and openly debate the space available for a modest and carefully selected stimulus package. The existing macroeconomic policy mix remains to a large extent a legacy of the deep crisis in 1996-1997. It has been sustained for fear of repeating such a crisis if monetary and fiscal constraints are relaxed. While this policy did help restore macroeconomic stability in the decade prior to the 2008 recession it also contributed to a significant misallocation of resources as exemplified by the asset bubble and unsustainable external imbalances. Consequently some adjustments to macroeconomic policy parameters warrant discussion. However, given lingering concerns about the consequences of policy in the late 1990s it would seem that political obstacles exist to removing the currency board arrangement. In light of this if there is to be any flexibility with macroeconomic policy it is more likely to be found on the fiscal rather than the monetary front.

Given the existing public debt to GDP ratio which remains below 20 % and an expected structural fiscal deficit of 0.7 % in 2012 it could be argued that the Government has scope for a degree of counter-cyclical fiscal policy. Moreover in current circumstances - despite increases in bond spreads elsewhere in Europe in late 2011 and the potential for contagion - it would be reasonable to assume that borrowing costs for the Government of Bulgaria can be kept below the nominal GDP growth rate. In fact borrowing costs for Bulgaria have been rather at 5 % up to now. This is admittedly a result of the conservative macroeconomic policies of recent years.

But it is not necessary to sacrifice Bulgaria's reputation for sound macro policy in order to marginally boost government expenditure. If nominal growth of GDP could be kept above 5 %, which seems possible, it is hard to see why interest rates on newly issued government bonds should be priced at a much higher interest rate than is currently the case. This means that even with some small increase in the fiscal deficit the public debt to GDP ratio can remain very low by comparison with other EU countries. It is rightly argued that calculations of fiscal space are more complicated than this and must also take into account fiscal risks, such as contingent liabilities to households, corporations and the banks. But these risks will decline with a faster recovery. As long as GDP and growth remain below potential, fiscal risks are higher and fiscal space is narrow.

An open debate concerning fiscal space and the scope for a limited and well targeted stimulus package would therefore seem desirable. No one party participating in this conference has a monopoly on wisdom concerning the appropriate stance of macroeconomic policy and a frank exchange of views may help to build consensus and community support for policy choices in the difficult circumstances ahead. If this debate leads to the conclusion that some limited additional fiscal space does exist the real issue becomes what should the government spend money on?

Increased public spending should be beneficial provided it is directed towards efficient public investment. One target could be increased investment in physical infrastructure that supports recovery in the construction industry. These projects could be based on public and private partnership in order to assure efficiency and better management. Well-targeted infrastructure and similar investments can also make a positive contribution to export capacity if it reduces the significant fixed costs that particular industries face when starting-up investments. Public investments of this nature need not have negative effects on structural fiscal balances. **There are a wide range of possible priorities if resources were available for some increase in public infrastructure investment and participants may wish to discuss which potential targets would be most beneficial from both economic efficiency and social equity perspective.**

Although the current employment crisis is due to a negative demand shock, some structural adjustments will be necessary in the labour market because the drivers of growth will have to change in the period ahead. Consequently, increased government investment in human capital development would also be highly desirable. In particular there is a pressing need to remobilize government expenditure on ALMPs. In the early to mid 2000s Bulgaria was making a significant public investment in employment programmes and these measures appeared to be reasonably well targeted and efficient. Consequently, the infrastructure for and the experience with ALMPs does exist and could be rapidly reactivated. Reliance in recent years on external resources from the EU for employment programmes has proven inadequate given the magnitude of employment losses during the recession. **Participants may wish to discuss which particular programmes should be expanded in order to help integrate young people in the labour market and prevent an expansion in the social problems that inevitably accompany high youth unemployment.**

Another target for increased government expenditure could be some support for the restructuring of the corporate sector. Some of that should happen within the corporate sector itself through mergers and acquisitions. But some additional support for industry policy including research and development would be desirable. To date Bulgaria has failed to adequately develop export industries that specialise in high value added products and has relied too heavily on primary industries and labour intensive manufacturing sectors. **Participants may wish to discuss what type of incentives or support is required to boost research and development expenditure in Bulgaria.**

One factor potentially influencing the Bulgarian export structure as well as FDI inflows in the pre-2008 period was the comparative advantage Bulgaria had with very cheap labour, at least by European standards. This paper has highlighted the low level of the minimum wage despite recent adjustments and the small percentage of workers directly affected by the minimum wage as well as the relatively low level of average wages and unit labour costs in Bulgaria. Although wage growth did accelerate in period immediately prior to the 2008 crisis this clearly represented catch-up for the prolonged period in which real wages failed to grow in line with productivity improvements. This has coincided with a decline in the coverage of collective bargaining and trade union density plus wide ranging reforms to make the labour market more flexible. The dramatic and prolonged decline in employment since the onset of recession has recently been reflected in further wage restraint and this will depress aggregate demand in the period ahead.

Participants may wish therefore to discuss how low labour costs influenced the growth strategy in Bulgaria over the last decade. For example, the extent to which relative low labour costs encouraged investment in low value added manufacturing activities and the relationship this may have had to the vulnerabilities that emerged in the balance of payments prior to 2008. For example, have low labour costs discouraged capital/labour substitution and prevented Bulgaria moving into industries and products that utilise the latest technology?

Second, participants may also wish to discuss the implications of low average wage levels and low unit labour costs for investment in skills and human capital development more generally. Is there a relationship between relatively low labour costs and the observed low level of on-the-job training in Bulgaria? Are low domestic wages also a factor explaining rapid outward migration? Are these factors an important explanation of the skill shortages that employers often cite?

Third, the relationship between low wages, the need for workers to undertake multiple jobs to survive and the failure of government policies to reduce the size of the informal economy requires careful review. Very low and flat income taxes plus a progressive reduction in taxes on labour have failed to permanently reduce the magnitude of the informal economy. In fact evidence suggests the informal economy has been expanding rapidly in the last three years. In light of this participants may wish to discuss alternative policies to effectively tackle the informal economy including the possibility for closer cooperation between the social partners on this issue.

Fourth, it must always be remembered that wages play a dual role in the economy. While employers focus on the role of wages as a cost of production they are also the main source of income for workers. This paper has highlighted that poverty and low living standards remain pervasive problems in Bulgaria. **Participants may therefore wish to discuss reforms to wage and income policies that will help ensure that real wages are adjusted in a timely manner to reflect productivity improvements.** For several years the Government has been committed to adopting a consistent methodology for adjusting the minimum wage. Progress on this front is long overdue.

In the last few years the Minister for Employment and Social Policy has on a few occasions made use of the powers invested in him to extend collective agreements throughout a sector or industry. More regular recourse to such action may be desirable to ensure real wage levels are commensurate with productivity improvements and contribute to a decisive reduction in poverty.

Fifth, adequate pensions, social assistance, unemployment benefits and other social security benefits play a critical role in reducing poverty and providing the aged and marginalised groups with an appropriate standard of living. At present vast numbers of the poor in Bulgaria are expected to survive on just a few Euro per day and their living conditions are by far the lowest in the EU. There is no effective basic income security system in Bulgaria, the unemployment benefit system and social assistance schemes do not reach the majority of the needy.

Finding necessary funding for pensions, social assistance and similar provisions is often difficult. In Bulgaria this process has been aggravated by large reductions in contribution rates which were designed to reduce taxes on employment but which has compounded the deficit facing the State pension system. The introduction of second and third tiers to the pension system, which have no impact on poverty or inequality, have exacerbated the financial problems of the State pension system. **Several other countries in Central and Eastern Europe have recently reduced the role of the mandatory private pension tier and participants may wish to discuss if similar reforms are warranted in Bulgaria.**

Access to social assistance has been tightened significantly. If fiscal space of about 1% of GDP was available it would be possible to increase social assistance expenditure by almost 75%. **Participants may therefore wish to discuss such options and consider what constitutes a suitable Social Protection Floor in a country that is part of the European Union.**

Employers in Bulgaria firmly believe that private domestic investment could be supported by measures that bring down nominal interest rates. In the past, interest rates have been remarkably stable and often negative in real terms due to high inflation. Prior to 2008 this encouraged the rapid growth of corporate debt – domestic, but also increasingly foreign. This failed to boost exports but instead fuelled the asset bubble. This is not uncharacteristic of countries operating a currency board regime. The opposite developments can be expected if access to credit remains low as it has been since the crisis. With the reduction in inflation, real interest rates have risen making the process of deleveraging in the corporate sector even more difficult. It is also highly likely that private investment is being inhibited by the high credit costs. Measures that are intended to strengthen the balance sheets of the banks and those that increase competition in the financial market may lead to a decline of interest rates as inflation decelerates. But additional support should be provided including through programs to support borrowing by small and medium size enterprises that tend to be especially adversely affected by low credit supply. **Participants may wish to discuss these and other measures that may help reduce interest rates.**

Appendix A: Conclusions of the ITUC/KNSB/Podkrepa Conference 'Jobs and Incomes – A better deal for Bulgaria' held at the 8th and 9th of March 2012

Attended by over 80 participants, the conference was opened by Sharan Burrow, General Secretary of the International Trade Union Confederation with a panel of 8 international and Bulgarian speakers representing the Bulgarian government, unions, employers, the ILO and IMF.

Four sessions followed, each with a panel of Bulgarian and international speakers addressing macro economic policy, industrial policy, labour market and wages policy and finally pensions, social protection and social dialogue.

The following conclusions were presented to the floor of the conference.

1. Macroeconomic policy

The predicted growth rate of only 1.2 % in 2012 is an indication of the difficulties and constraints that Bulgaria, like many EU countries has to face.

The core principle relating to current economic policies that speakers came back to again and again is that austerity must be shared equitably, with the twin goals of equity and fairness and burden sharing. Sharan Burrow expressed this very clearly in her opening remarks saying "There must be no fiscal austerity without a credible growth plan".

It is essential to think towards the longer term with policies supporting education, regulation, innovation and infrastructure. The IMF introduced a four-point framework for medium term growth that set the tone of the debates over the next two days. The immediate question raised was how do you pay for that increased investment and social assistance.

Conditions are difficult, but there is scope for fiscal expansion in Bulgaria. The government initiated restrictive spending policies between 2008 and 2011 when the crisis began, so there is scope for expansion now. Now is the time to scope resources for investment to boost the economy stimulate short-term economic stimulus.

There is scope to reduce the high interest rates that are crippling business expansion and causing bankruptcies. Increased credit is essential for business survival and investment, especially for SEMs. Every employer mentioned the crippling impact of rates in the country. It drives enterprises out of business and makes it impossible to invest. It hurts the small and medium sector in particular what they need in an increase in credit to enable businesses to survive and invest. Credit to small and medium size enterprises is often seen as a credit risk and credit is denied.

The answer to this lies in looking at the banking sector as various speakers mentioned. The general view is that interest rates are incredibly high at 10%, yet inflation is now much lower than when they were set. Interest rates can be reduced without undermining monetary policy. Indeed the only people who benefit from the interest rates are the banks themselves, when we should be looking for opportunities for business people and ordinary people to benefit.

Tax policy must be on the table, to enable an increase in government revenues. They are among the lowest in the EU as a percentage of GDP – and it’s now time to start to move away from a flat tax system.

An immediate step would be to introduce a tax-free threshold for lower paid workers. A tax-free threshold for low paid workers doesn’t exist in Bulgaria, but exists in other European countries, as part of a more progressive system. This needs particular attention, as we need to remember inequality in Bulgaria is the 3rd highest in the EU.

There should be a more efficient and equitable tax system, the current emphasis on consumption taxes, which are inherently inequitable, needs to be replaced by a move to progressive income taxes and financial sector taxes including an FTT, so the highly paid an contribute too. The FTT would also help provide resources for the economy.

This should be combined with a clampdown on tax evasion, illegality and corruption. Tackling the grey economy would further generate more fiscal resources and greater capacity for education and infrastructure spending.

2. Industrial Policy

There was consensus on the need for Bulgaria to modernize its infrastructure and the skills and mobility of the labour force and the need for Bulgaria to diversity its drivers of growth.

There was very broad consensus that the low wage low tax model of successive governments has failed. After 10 years it has resulted in low wages insecurity and migration. This is supported by the fact that 55% of exports are of low skill content. The low wage tax model is not a rational basis for longer term economic growth policy. 16% of the population has migrated, another 20% would like to. This brain drain deprives the recovery of the economy.

Instead, Bulgaria needs to develop industries with higher valued added, and higher productivity requiring more skills and education.

According to the ILO, 95% of workers had no training in the past ten months, while levels of R&D were the lowest in the European Union. Major investments are needed.

But how to pay ? External sources of financing were mentioned, including the EC Structural Funds and EIB, as well as EBRD, and World Bank should also be tapped.

There was a very significant debate over the question of the government's ability to select the beneficiaries of industrial investments successfully. Clearly if the government gets it wrong these are irreplaceable national resources that are lost, perhaps devoted to interest groups close to the government rather than spent rationally. What is needed is an open, transparent, tripartite process to undertake discussion and examine options on the basis of research and sustainability impact assessments, and reach consensus to determine which sectors to choose and how to invest in them.

Some of the major sectors identified are transport, especially railways, tourism, pharmaceuticals, food and the green economy.

3. Labour Market and Wages Policy

Labour market and wages policy is a central question for both long term and short term policies.

Bulgaria needs a high skill high productivity economy, which requires a higher wage workforce.

In the short term higher wages will have the immediate benefit of stimulating higher consumption and income led growth.

We need to establish a strong wage/productivity link in Bulgaria.

The answer is categorically not in more labour market flexibility. Attacking collective bargaining will lower wages, growth and reduce productivity, and worsen the situation. In fact greater income led growth and stronger collective bargaining will lead to a better relationship between wages and productivity.

Minimum wages must be raised and benefit more people. The minimum wage in Bulgaria is incredibly low – lower than in urban China. Even employers agreed that the level is extremely bad. It needs to be raised and to reach more than just the 210,000 people who currently benefit. All of those people live below the poverty line.

The gender wage gap of 18-19% must also be tackled.

Workers in the 'Grey Economy' – or 'Undeclared work' as the EU calls it, need to be brought into the formal system. Wage payments need to be formalized through the banking systems. We need to bring more people, not less, into the formal system to experience its benefits.

Finally, unemployment must be tacked through an expansion of training and labour market centres, especially for young people. There is a need to increase the coverage of benefits so it reaches workers who are unemployed, particularly young people and the long term unemployed. This group has doubled in the last two years, with grave repercussions for the economy. Once people are unemployed they tend to stay unemployed.

What is needed to address the group of 30% of the population who are unemployed is more training and apprenticeship schemes, part time employment, workplace rotation, work sharing and labour market centres.

4. Pensions, Social Protection and Social Dialogue

Bulgaria needs a strong social protection floor. The level of poverty in Bulgaria is 40%, the worst in the EU. There is no basic protection and income system. Bulgaria needs a social protection floor to which the EU is committed in its development policy. But it must having meaning here in the EU as well as beyond.

The unemployment insurance system has to reach a greater proportion of the unemployed. Norms and criteria are needed for increased social assistance, bringing all people above the poverty line, and allowing people to live a life with dignity.

Guarantees for health care for all citizens are part of such efforts. This means investments in what we call the 'care economy' – otherwise known as 'white jobs' – social services especially in depressed regions.

This requires attention to old age pensions and a renewal of the 2010 agreement that had been reached. The financing of the pension system has to be revitalized, and the diversion of contributions to private salaries has to be re-examined.

The question of broken agreements is fundamental, and it brings us to the 'social dialogue' part of the last session.

All agreements must be respected by all partners if they are to be effective. If workers and employers accept austerity (in the short term) and agree on reforms in areas like fiscal policy, there must be trust that the government will respect its side of the agreement.

A strong National Sustainable Development Council needs to be established. Tripartite agreements will take the country through this difficult period of austerity, to invest and tackle poverty, agree policies and to plan for the future. This is perhaps a concluding thought from our part.

The international conference on jobs and income, was hosted by the International Trade Union Confederation (ITUC) the Confederation of Independent Trade Unions in Bulgaria (CITUB) and the Confederation of Labour (Podkrepa) supported by the Friedrich-Ebert-Stiftung foundation.

Appendix B: Ratified ILO Conventions by the Republic of Bulgaria

Member since 1920 99 Conventions ratified (80 in force)

C. 1	Hours of Work (Industry) Convention, 1919, 14.02.1922
C. 3	Maternity Protection Convention, 1919, 14.02.1922
C. 6	Night Work of Young Persons (Industry) Convention, 1919, 14.02.1922
C. 8	Unemployment Indemnity (Shipwreck) Convention, 1920, 16.03.1923
C. 11	Right of Association (Agriculture) Convention, 1921, 6.03.1925
C. 12	Workmen's Compensation (Agriculture) Convention, 1921, 6.03.1925
C. 13	White Lead (Painting) Convention, 1921, 6.03.1925
C. 14	Weekly Rest (Industry) Convention, 1921, 6.03.1925
C. 16	Medical Examination of Young Persons (Sea) Convention, 1921, 6.03.1925
C. 17	Workmen's Compensation (Accidents) Convention, 1925, 5.09.1929
C. 18	Workmen's Compensation (Occupational Diseases) Convention, 1925, 5.09.1929
C. 19	Equality of Treatment (Accident Compensation) Convention, 1925, 5.09.1929
C. 20	Night Work (Bakeries) Convention, 1925, 5.09.1929
C. 21	Inspection of Emigrants Convention, 1926, 29.11.1929
C. 22	Seamen's Articles of Agreement Convention, 1926, 29.11.1929
C. 23	Repatriation of Seamen Convention, 1926, 29.11.1929
C. 24	Sickness Insurance (Industry) Convention, 1927, 1.11.1930
C. 25	Sickness Insurance (Agriculture) Convention, 1927, 1.11.1930
C. 26	Minimum Wage-Fixing Machinery Convention, 1928, 4.06.1935
C. 27	Marking of Weight (Packages Transported by Vessels) Convention, 1929, 4.06.1935
C. 29	Forced Labour Convention, 1930, 22.09.1932
C. 30	Hours of Work (Commerce and Offices) Convention, 1930, 22.06.1932
C. 32	Protection against Accidents (Dockers) Convention (Revised), 1932, 29.12.1949
C. 35	Old-Age Insurance (Industry, etc.) Convention, 1933, 29.12.1949
C. 36	Old-Age Insurance (Agriculture) Convention, 1933, 29.12.1949
C. 37	Invalidity Insurance (Industry, etc.) Convention, 1933, 29.12.1949
C. 38	Invalidity Insurance (Agriculture) Convention, 1933, 29.12.1949
C. 39	Survivors' Insurance (Industry, etc.) Convention, 1933, 29.12.1949
C. 40	Survivors' Insurance (Agriculture) Convention, 1933, 29.12.1949
C. 42	Workmen's Compensation (Occupational Diseases) Convention (Revised), 1934, 29.12.1949
C. 43	Sheet-Glass Works Convention, 1934, 29.12.1949
C. 44	Unemployment Provision Convention, 1934, 29.12.1949
C. 45	Underground Work (Women) Convention, 1935, 29.12.1949
C. 49	Reduction of Hours of Work (Glass-Bottle Works) Convention, 1935, 29.12.1949

C. 52 Holidays with Pay Convention, 1936, 29.12.1949

C. 53 Officers' Competency Certificates Convention, 1936, 29.12.1949

C. 54 Holidays with Pay (Sea) Convention, 1936, 29.12.1949
Convention not in force

C. 55 Shipowners' Liability (Sick and Injured Seamen) Convention, 1936, 29.12.1949

C. 56 Sickness Insurance (Sea) Convention, 1936, 29.12.1949

C. 62 Safety Provisions (Building) Convention, 1937, 29.12.1949

C. 68 Food and Catering (Ships' Crews) Convention, 1946, 29.12.1949

C. 69 Certification of Ships' Cooks Convention, 1946, 29.12.1949

C. 71 Seafarers' Pensions Convention, 1946, 29.12.1949

C. 72 Paid Vacations (Seafarers) Convention, 1946, 29.12.1949
Convention not in force

C. 73 Medical Examination (Seafarers) Convention, 1946, 29.12.1949

C. 75 Accommodation of Crews Convention, 1946, 29.12.1949
Convention not in force

C. 77 Medical Examination of Young Persons (Industry) Convention, 1946, 29.12.1949

C. 78 Medical Examination of Young Persons (Non-Industrial Occupations) Convention, 1946, 29.12.1949

C. 79 Night Work of Young Persons (Non-Industrial Occupations) Convention, 1946, 29.12.1949

C. 80 Final Articles Revision Convention, 1946, 7.11.1955

C. 81 Labour Inspection Convention, 1947, 29.12.1949

C. 87 Freedom of Association and Protection of the Right to Organise Convention, 1948, 8.06.1959

C. 94 Labour Clauses (Public Contracts) Convention, 1949, 7.11.1955

C. 95 Protection of Wages Convention, 1949, Excluding Article 11 by virtue of the ratification of Convention No. 173 (acceptance of Part II), 7.11.1955

C. 98 Right to Organise and Collective Bargaining Convention, 1949, 8.06.1959

C. 100 Equal Remuneration Convention, 1951, 7.11.1955

C. 102 Social Security (Minimum Standards) Convention, 1952, Has accepted Parts II, III, V, VI, VII, VIII and X, 14.07.2008

C. 105 Abolition of Forced Labour Convention, 1957, 23.03.1999

C. 106 Weekly Rest (Commerce and Offices) Convention, 1957, 22.07.1960

C. 108 Seafarers' Identity Documents Convention, 1958, 26.01.1977

C. 111 Discrimination (Employment and Occupation) Convention, 1958, 22.07.1960

C. 113 Medical Examination (Fishermen) Convention, 1959 , 2.03.1961

C. 116 Final Articles Revision Convention, 1961 , 3.10.1969

C. 120 Hygiene (Commerce and Offices) Convention, 1964, 29.03.1965

C. 122 Employment Policy Convention, 1964, 9.06.2008

C. 124 Medical Examination of Young Persons (Underground Work) Convention, 1965, 3.10.1969

C. 127 Maximum Weight Convention, 1967, 21.06.1978

C. 138 Minimum Age Convention, 1973, Minimum age specified: 16 years , 23.04.1980

C. 144 Tripartite Consultation (International Labour Standards) Convention, 1976, 12.06.1998

C. 146 Seafarers' Annual Leave with Pay Convention, 1976, Length of annual leave specified: 30 days, 12.06.2003

C. 147 Merchant Shipping (Minimum Standards) Convention, 1976, Has ratified the Protocol of 1996, 24.02.2003

C. 156 Workers with Family Responsibilities Convention, 1981, 3.04.2006

C. 163 Seafarers' Welfare Convention, 1987, 1.03.2004

C. 164 Health Protection and Medical Care (Seafarers) Convention, 1987, 24.03.2005

C. 166 Repatriation of Seafarers Convention (Revised), 1987, 30.07.2003

C. 173 Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 Has accepted the obligations of Parts II and III with the exclusion, with regard to the latter, of: 1) associated partners in the trade corporation, 2) members of the management and control bodies of the trader, 3) spouses and relatives in direct line of the descendant of the trader or of the persons under items 1 and 2., 28.09.2004

C. 177 Home Work Convention, 1996, 17.07.2009

C. 178 Labour Inspection (Seafarers) Convention, 1996, 9.06.2005

C. 179 Recruitment and Placement of Seafarers Convention, 1996, 12.06.2003

C. 180 Seafarers' Hours of Work and the Manning of Ships Convention, 1996, 24.02.2003

C. 181 Private Employment Agencies Convention, 1997, 24.03.2005

C. 182 Worst Forms of Child Labour Convention, 1999, 28.07.2000

C. 183 Maternity Protection Convention, 2000 Period of maternity leave: 135 days, 6.12.2001

Appendix C: Tripartite agreement of reform of the State pension fund

1. On 1 January 2011 the contribution rate was increased by 1.8 percent. Hence, the total pension contribution rate has been increased from 16 percent to 17.8 percent. (The 12 percent State contribution continues to be paid.)

2. From 1 January 2011, higher penalties are applied to non-compliant employers and workers to improve the collection of contributions.

3. Early retirement pensions for workers in the first and second labour categories will continue to be paid from the State Pension Fund until the end of 2014. The individual account balances of these early retired workers will be transferred from the Professional Fund to the State Pension Fund. Starting on 1 January 2015, early retirement pensions for these workers will be paid from the Professional Fund.

4. Starting on 1 January 2012, the insurance period required for a pension (currently 37 years for men and 34 years for women) shall be extended by four months every year until reaching 40 years for men and 37 years for women by 2020. Persons who do not have sufficient insurance periods may purchase periods up to five years.

5. Starting on 1 January 2021, the pensionable age (currently 63 years for men and 60 years for women) will be increased by six months per year until reaching 65 years for men and 63 years for women. The difference in the pensionable age between men and women will thus be narrowed to two years.

6. Employer contributions for guaranteed receivables of workers and employers (the contribution rate of which is now 0.1 percent) shall be suspended from 2011 to 2013.

7. Starting on 1 January 2017, the accrual rate applied in the pension formula will be increased from 1.1 percent to 1.2 percent per insurance year.

8. Starting on 1 January 2017, the contribution rate for the Universal Pension Fund will be increased from 5 percent to 7 percent.

9. Starting on 1 January 2014, there shall be no maximum amount for newly granted State pensions. Through the end of 2013 the current maximum pension of 700 BGN will be indexed in line with the increase in the maximum insurable wage.

10. Starting on 1 January 2012, employers will only pay the first day of sickness benefits. The benefits shall be 100 percent of the employee's salary.

11. The indexation of pensions will be frozen until 2012.

12. As of 1 September 2011, the amount of supplements paid to pensions of surviving spouses was increased from 20 percent to 26.5 percent of the deceased spouse's pension.