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WORLD BANK GROUP + BULGARIA

10 AVENUES TO FOSTER SMART SUSTAINABLE AND INCLUSIVE GROWTH

IN PARTNERSHIP WITH THE WORLD BANK GROUP

JULY 2013
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About this Note

Bulgaria has made great leaps forward in the past 20+ years.

Development is about a nation’s individual and collective CHANCES, the CHOICES made, and the CHANGES that result.

Development is about CHANCES. The dramatic changes in the late 1980s opened up new historic chances for Bulgaria’s development. Twenty years ago, it was unimaginable that Bulgaria would be part of the European Union (EU) in the near future.

Development is about CHOICES. Sometimes leaders need to make difficult choices for the sake of a better future. Bulgaria’s decision to adopt the currency board in 1997 is a good example, as this decision, made in difficult circumstances, helped promote Bulgaria’s growth and stability in the ensuing years.

Development is about CHANGES. Transformation and visible results do not happen overnight. They require sustained effort and extensive experience, knowledge, and skills accumulated over many years. Thanks to persistent reform efforts, Bulgaria has managed to rapidly increase the population’s income and make impressive progress on economic convergence with the EU, resulting in a rise in the country’s per capita income levels from 28 percent of the EU average in 2000 to 46 percent 11 years later.

Bulgaria is at a crossroads again today.

Bulgaria’s new government is confronted with substantial challenges that need to be turned into opportunities. Despite rapid progress, Bulgaria remains the poorest country in the EU, and growth prospects in Bulgaria—like those in the rest of Europe—remain subdued. The country’s competitiveness as measured by the World Economic Forum is lagging behind, its business environment is weak compared to its EU peers, its energy intensity is four times higher than the EU average, and its population is declining more rapidly than in any other nation.

For the past more than 20 years, the World Bank Group (WBG) has been privileged to partner with Bulgaria. As Bulgaria developed, the partnership with the WBG evolved. Today, the relationship is a knowledge-based partnership of choice that supports Bulgaria’s convergence with EU standards, anchored in the National Reform Program that is Bulgaria’s response to the Europe 2020 strategy.

The objective of today’s partnership is to support Bulgaria in strengthening institutions and policies to achieve smart, sustainable, and inclusive growth by (i) providing knowledge and advisory support for policy reforms to implement select areas of the National Reform Program and to strengthen institutions and capacity to accelerate EU funds absorption; and (ii) providing complementary and selective financing to support the implementation of complex reforms and to leverage EU funds as well as financing from European and international financial institutions (IFIs).

This note outlines 10 avenues to foster smart, sustainable, and inclusive growth in key areas of Bulgaria’s current partnership with the WBG. It does so by identifying (i) CHANCES—the opportunities and challenges; (ii) CHOICES—the policy options; and (iii) CHANGES—the expected results. The note also provides a brief overview of today’s partnership in the 10 areas and presents a number of possibilities to further deepen the collaboration in support of the Government of Bulgaria’s efforts to maximize opportunities and address challenges, identify the most effective policy options, and ensure effective implementation to achieve the expected results for the benefit of all its citizens.
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1. Major Determinants for Smart, Sustainable, and Inclusive Growth

1.1 Maintaining Macroeconomic Stability, Boosting Growth, and Utilizing EU Funds

Boosting growth requires continued sound macroeconomic management. Prudent fiscal policy has resulted in low public debt levels and stability in uncertain times, but it needs to contribute more to long-term growth. Key levers to achieve this are:

- Revamping the current public investment management system (that is, planning, monitoring, and implementation) to scale up public investments. Fiscal adjustment over the last several years has disproportionately affected public investment, with a potential negative impact on growth. Full utilization of European Union (EU) grant funds should have first priority, while maintaining the quality of investments and considering lifetime costs.
- Improving budget management (for example, the medium-term fiscal framework and performance budgeting) to facilitate a reallocation of scarce public resources from consumption to productivity-enhancing activities such as education and innovation.
- Managing the contingent liabilities coming from subsovereign guarantees such as in the power sector, and in the longer term, from aging-related spending such as pensions. These could significantly destabilize the fiscal and macroeconomic framework.
- Modernizing public administration to enable it to deliver on an ambitious reform program to boost growth and competitiveness.

Reinvigorating structural reforms is key to growth and job creation and for accelerating income-convergence with the rest of the EU. Since the 2008–09 financial crisis, strong exports and external capital flows, key drivers of the convergence process in Bulgaria, have slowed significantly. Weak external demand depressed exports in 2012, resulting in only slight positive growth (0.8 percent). Economic growth prospects for 2013 and 2014 remain subdued at about 1.2 and 2.1 percent, respectively. In the meantime, unemployment continues to rise, reaching 13.8 percent in the first quarter of 2013, and the economy is generating fewer jobs (employment fell from 3.21 to 2.82 million between the first quarter of 2009 and the first quarter of 2013). Bulgaria’s exports are still dominated by natural resource-based and unskilled labor-intensive commodities; moreover, firms in Bulgaria are only just beginning to build linkages with producer-driven networks, and there is still unused potential in trade in services.

The increased absorption of EU funds will enhance Bulgaria’s fiscal management and growth prospects. In the 2007–13 programming period, Bulgaria has access to €9.3 billion of EU grant funding. As of March 2013, nearly 39 percent of the funds had been disbursed, supporting important upgrades in physical, human, and natural capital. Despite recent improvements in absorption rates, Bulgaria still needs to absorb €5.7 billion in the next 2.5 years to use all the allocated EU funds. This will require a substantial mobilization of efforts at all levels of government to ensure the effective supervision and monitoring of contracted projects. In addition, Bulgaria needs to effectively prepare for the next financing period, 2014–20, at the strategic and project levels (including implementation arrangements and monitoring and evaluation systems), to maximize EU funds and avoid delays in implementation. The country will need to strengthen significantly the institutions responsible for quality oversight to ensure that EU and public funds are spent to deliver results for all citizens. Funding from international financial institutions (IFIs) should be strategically used to complement and leverage EU funds.
1.2 Mitigating the Economic Impact of Aging

Bulgaria is undergoing a profound socioeconomic transformation brought about by extraordinary demographic change. A steep decline in population from 8.8 million in 1990 to 7.5 million in 2010, driven by low birth rates, high mortality rates, and to a larger extent, emigration, radically changed the country’s age structure. Bulgaria today has the third-highest median age in the EU, surpassed only by Germany and Italy, and as a result, is heading for the steepest decline in the working-age population of any EU country. By 2050, one in three Bulgarians is projected to be older than 65 and only one in two will be of working age.

The higher the economic growth, the easier it will be for Bulgaria to manage this demographic challenge. Given its declining working-age population, Bulgaria will have to rely on productivity growth to sustain growth in aggregate income. As output per worker increases, fewer workers will be required to manage the existing health sector, pension, and long-term care liabilities. Higher growth is also likely to generate better employment opportunities, inducing more workers to participate in the labor force and to stay in or move to Bulgaria. A rise in household savings is also required, as these savings are needed to ensure that the elderly can afford a decent standard of living. Productivity-enhancing measures would need to encompass policies in favor of strengthening Bulgaria’s business climate, innovation, infrastructure, and education. These measures would not only support productivity growth but also positively affect labor demand, which, combined with active policies in support of higher labor force participation, will be necessary to stem the workforce decline.

Population aging is likely to increase fiscal pressures. Public health expenditures can be expected to increase as the elderly have a higher demand for ambulatory, inpatient, and chronic care. Demand for long-term care services is also bound to increase significantly as the population ages, and ensuring an equitable and sustainable pension system will pose a challenge in the future. Going forward, it is projected that the state contribution to the pension fund will increase to 0.9 percent as a share of GDP, while pension benefit levels relative to the average insured wage and pension coverage are expected to decline. Fiscal pressures from age-sensitive expenditures on health, long-term care, and pensions also bear the danger of crowding out productivity-enhancing public investment. Under optimistic estimates, Bulgaria’s aging related expenditures debt-to-GDP ratio is projected to increase from 18 to 51 percent between 2012 and 2050. Scenario analyses show that the downside risk is high and that debt could go beyond 60 percent of GDP by 2050.

While demographic change poses different challenges and opportunities for each economic sector, several reform options are likely to allow for the exploitation of synergies. Further increases in the retirement age, for example, could support higher labor force participation among elderly workers, reduce public transfers to the pension fund, and encourage household savings. Well-targeted, strategic health sector reforms could help improve not only citizens’ well-being, but also the efficiency of public health spending; health outcomes; the labor supply, especially among elderly workers; and financial protection. Well-designed investments in education could raise labor force participation, including among the Roma population, make it easier to retrain workers at a later stage of their life, foster innovation, and contribute to a better health status for the population. Designing reforms with a view to exploiting these synergies, combined with strengthening longer-term fiscal planning, can provide important opportunities for addressing the economic impact of Bulgaria’s demographic change.

1.3 Tapping Greening Opportunities

Greening the economy would improve the trade balance and enhance the ability of households and enterprises to respond to energy-related shocks. Bulgaria’s economy remains energy intensive; despite the closure of the most inefficient industrial plants early during the transition (its use of energy per euro of GDP stands at four times the EU average). Since the country imports most of its gas and petroleum and one-quarter of its solid fuels, a reduction in energy intensity will enhance the country’s ability to respond to world price fluctuations. At the same time, high energy use makes Bulgarian firms less
competitive than others in Europe because they cannot adjust to energy-related shocks. Finally, at the household level, high energy expenditures mean that households (especially among the poor and middle class) are highly vulnerable to price fluctuations.

**Adopting a low-carbon growth path makes economic sense for Bulgaria.** Investments in this area could potentially pay for themselves, especially when externalities like health benefits are considered. To move to a low-carbon path will require directing public and private investments toward the transformation of power generation and energy efficiency, industrial production, city living, and farming practices, all while making efforts to protect the poor.

The upcoming 2014–20 EU budget round, which envisions that 20 percent of the total EU budget will be spent on climate action, provides an opportunity for Bulgaria to locate financing for the investments that are needed to green Bulgaria’s economy, enhance the competitiveness of firms, and reduce household energy consumption.
2. Smart Growth

2.1 Increasing the Quality and Efficiency of Preuniversity and University Education

Context

Investment in education is vital to sustaining Bulgaria’s long-term growth, both through increasing labor productivity and as a spur to innovation. Reducing the convergence gap between Bulgaria and the rest of the EU will require sustained and marked improvements in productivity and a shift to economic activities with higher value-added potential, generated by highly skilled employees.

Efficiency reforms in preuniversity education have been successfully implemented, but substantial quality and equity concerns remain. Bulgaria has implemented reforms granting more autonomy and decision-making powers to school principals, and made the system more efficient by optimizing the network of schools in line with the decreasing school-age population. However, lingering concerns remain about education quality and equity. Although the reading, mathematics, and scientific literacy of 15-year-olds (9th graders) improved in 2009 over 2006, as measured by the Program for International Student Assessment (PISA), students from small schools, rural areas, and linguistic minorities remained excluded from these positive developments, leaving approximately 41 percent of the students functionally illiterate. Over the past three years, the government has held extensive professional and public stakeholder discussions on developing an entirely new framework for preuniversity education, focusing on quality and accountability for results.

Higher education has been expanded but needs to tackle quality, efficiency, finance, and accountability for results. Higher education in Bulgaria has seen significant quantitative expansion over the past decade, both in terms of the number of private and public higher education institutions (totaling 51) and with respect to enrollment and graduation rates. However, higher education in Bulgaria continues to face challenges relating to quality, efficiency, finance, and accountability for results. Reaching the Bulgaria 2020 target of ensuring that 36 percent of those aged 30–34 have a higher education may be a challenge. In 2011, 85.5 percent of Bulgarians aged 20–24 had completed secondary education, but only 42.6 percent continued their studies. This discrepancy is largely explained by the ever-expanding share of secondary graduates who prefer to complete their tertiary education abroad, in addition to the increasing share of young people who enter the labor market as soon as they finish secondary education.

Chances

Preuniversity education: Adopting and enforcing the long-debated draft Law for Preschool and School Education will shift the focus to quality and accountability. This will come about by enabling the introduction of stronger quality assurance and monitoring systems at the school, local, and national levels, blending different approaches to monitoring, measuring quality, and incentivizing teacher effectiveness and school and student performance.

Higher education: Selectively prioritizing the components of higher education reform will focus attention and resources to maximize impact, particularly with regard to finance and quality. Concerning finance, there is a need to further increase the share of performance-based financing and use it as a tool for achieving long-term strategic policy objectives. At the same time, funding arrangements should ensure equal access to higher education and adequate incentives for top performing students. The quality of higher education would receive a significant boost if EU resources in the 2014–20 programming period were used to support carefully selected, high-impact interventions,

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1 Bulgaria has participated regularly in the Program for International Student Assessment (PISA) of the Organisation for Economic Co-operation and Development (OECD) since 2000.
among them: (i) funding world-class researchers and academics to participate in the evaluation and accreditation of higher education institutions conducted by the National Evaluation and Accreditation Agency or by international accrediting institutions, and (ii) enhancing the research capacity of Bulgaria’s tertiary education institutions.

**Choices**

*Preuniversity education: Developing, adopting, and enforcing a comprehensive framework of policies and instruments can bring improvements* that promote highly effective Bulgarian teachers and strong and professional school leadership, supported by a robust framework for the assessment and evaluation of educational outcomes. This assessment and evaluation framework should include, as a minimum, a comprehensive teacher evaluation system complemented by a set of indicators for measuring school performance, including indicators that measure the value added of schools.

*Higher education: Developing a higher education strategy and introducing performance contracts with public higher education institutions are essential steps.* The Ministry of Education may consider initiating and participating in, together with all relevant higher education stakeholders, a strategic planning process to develop a vision and strategy for the future of higher education—and higher education institutions—and an actionable program for the strategy’s implementation. The country should consider utilizing the current key performance indicators of the Bulgaria University Ranking System as indicators to measure the performance targets included in the multiannual performance contracts with public higher education institutions. Thus, instead of rewarding past performance, the identified performance indicators could be used to provide incentives for future improvements in all higher education institutions and faculties.

**Changes**

*Preuniversity education: Improved teaching and school management.* Compelling research evidence shows that effective teaching and good management of schools are the two strongest factors leading to better quality education. Strengthened policies and programs that improve teacher effectiveness and school leadership, combined with a robust framework for the monitoring, assessment, and evaluation of teacher and school performance, will lead to better accountability mechanisms and a broader information base for defining and implementing targeted school improvement plans. These can be elements of an overall system for the quality assurance of schools, linked to well-defined incentives.

*Higher education: Performance-based funding.* The most powerful lever to improve higher education quality is to tie funding for public higher education institutions to their performance. Having a strategy for the entire higher education sector will provide a unified vision of the sector’s collective goals, as well as a plan for how each institution would be able to contribute. Such a strategy also provides clarity to the mission and goals of the sector, allowing for institutions to (re)establish their niche within the broader academic context, perhaps even including areas of lifelong learning. A clear and transparent strategy would provide the necessary foundation for potentially difficult decision making if, in the end, institutions and/or programs need to be closed or repurposed to meet the strategically assessed needs of the sector.

**World Bank Group (WBG) Partnership**

Successive governments have actively reached out to the World Bank for an intense policy dialogue. The most recent World Bank reports on Bulgaria include “Review of the Bulgaria School Autonomy Reforms,” “Assessing Quality of Education in Bulgaria Using PISA 2009,” and “Strengthening Higher Education in Bulgaria.” Currently, two notes on improving teacher effectiveness and developing measures for assessing school contributions to learning outcomes are being completed. Thus far, all knowledge and advisory services have been financed by World Bank resources. Looking ahead, the World Bank stands ready to scale up the knowledge partnership on both preuniversity and tertiary education.
2.2 Strengthening Innovation and Research

Context

Improving the competitiveness of Bulgaria’s economy and increasing its knowledge intensity is a priority of the National Reform Program. This directly addresses the fact that Bulgaria’s performance in the areas of innovation and research has fallen short of expectations. The European Commission’s (EC) Innovation Union Scoreboard 2013 places Bulgaria in last place among EU members. Improving the business environment and strengthening the country’s skills and technological capabilities would encourage Bulgarian firms to develop new products and invest in efficient production processes, increasing the share of high value-added products and services in total exports and improving the country’s competitiveness.

Research and development (R&D) expenditures, both private and public, are well below the EU average. Bulgarian firms spend four times less on R&D than firms in other EU member states (0.3 percent of GDP in Bulgaria compared to the EU average of 1.27 percent), while the government spends 0.26 percent of GDP compared to an EU average of 0.75 percent. The programs cofinanced by EU funds provide a unique opportunity to increase investments in R&D in line with Europe 2020 targets. This would foster better linkages between research and the needs of the productive sector, and build on Bulgaria’s positive innovation dynamics, such as the increase in patenting attributed to international collaborations and foreign direct investment (FDI) and the proliferation of innovative start-ups stimulated by Bulgaria’s accelerators and seed funds.

Chances

Innovation and high-impact entrepreneurship. Within the EU 2014–20 financing framework, Bulgaria has the opportunity to stimulate business innovation by ensuring that the new operational program on Innovation and Competitiveness: (i) directly addresses the needs of the private sector; (ii) has simple but effective application procedures with relevant criteria and the right profile of evaluators; and (iii) introduces a streamlined process for administering the funding. This should lead to an increase in absorption and ensure that high-impact innovative firms receive funding. Furthermore, it will be critical to develop linkages between universities and industry, to ensure that graduates enter the labor market well prepared for industry and to upgrade vocational and professional training to better serve the needs of business.

Coordination among governmental bodies. There is currently no effective central body in charge of the innovation and research agenda; instead, responsibilities are dispersed among multiple ministries and agencies, leading to a dilution and duplication of efforts. Better coordination of government policies would remove the financing, human capital, and business environment bottlenecks that slow down innovation in Bulgaria’s high potential industries. It would also encourage universities and public research institutions to collaborate actively with the private sector.

Accountability for results. Rigorous and constant monitoring and evaluation of results, specifically taking advantage of impact evaluation techniques to adjust programs and financing instruments during the implementation stage, would substantially increase the impact of national and EU programs to support research and innovation.

Choices

Implementing critical reforms to be outlined in the Smart Specialization Strategy (3S). Developing the 3S is an ex ante conditionality to access EU funds in the 2014–20 cycle, and should serve as the impetus for upgrading Bulgaria’s research and innovation capabilities and transitioning the country to a knowledge-based economy. The 3S would outline the much-needed reforms to unleash Bulgaria’s innovative potential, with a focus on improving governance, reforming the way that research
institutions are funded and evaluated, providing suitable financing instruments, and investing in innovation flagship projects.

**Designing an effective operational program “Innovation and Competitiveness 2014–2020.”** This program would efficiently allocate resources (for example, cut red tape, engage independent innovation experts, assign funds for large innovation flagships, and so forth) and ensure that funding is aligned with and complementary to the envisioned operational program “Education and Science.” Funding should be channeled through programs that address market and coordination failures and strengthen private incentives to invest and collaborate.

**Enacting a new innovation law to strengthen the institutional setup, address coordination failures, and speed up program delivery.** In particular, the new law would establish a National Innovation Board, which would be a coordination body at the cabinet level that includes members from the private sector and academia to oversee overall innovation policy implementation. International good practice shows that coordination bodies should include robust transparency and accountability mechanisms and separate implementation from policy making to prevent interference in the allocation of public funding. The innovation law would also create an independent specialized agency that counts on experienced staff to design and implement a new generation of innovation programs and instruments.

**Changes**

**Increased value-added exports of products and services.** Bulgaria’s exports grew quickly during the boom years to reach 60 percent of GDP; however, less than 3 percent of Bulgaria’s exports are high-technology products, significantly below the EU average of 16 percent. By creating a better framework to stimulate and support innovation, Bulgaria’s export basket will diversify and include a higher share of innovative products, strengthening the country’s competitiveness and creating jobs.

**Improved commercialization of research and technology diffusion** by upgrading the national research and innovation infrastructure (such as technology transfer, business incubators, business-led research, innovation clusters, and networks). This will ensure that young Bulgarian innovators can become entrepreneurs and see their inventions turn into commercial products, adding value to the economy and creating new employment opportunities in the high-tech and service industries, which in turn, will help reverse the chronic Bulgarian brain drain.

**Enhanced research excellence and participation in international research networks to accelerate Bulgaria’s integration in the European Research Area.** Countries like Malaysia, Singapore, and more recently India have been successful in harnessing the power of their diaspora, and like these countries, Bulgaria would greatly benefit from intensifying the connections with the scientific and research diaspora given its tremendous experience, significant resources, and valuable business linkages.

**WBG Partnership**

Consecutive governments have reached out to the WBG and sought Bank-financed policy dialogue on innovation and competitiveness. In 2012, the World Bank presented a country flagship report “Going for Smart Growth: Making Research and Innovation Work for Bulgaria.” Since July 2012, the World Bank has been providing reimbursable knowledge and advisory services to support the preparation of the 3S strategy, the design of the operational program “Innovation and Competitiveness 2014–2020,” and the creation of an effective institutional setup; this assignment will end in December 2013. Looking ahead, the World Bank stands ready to continue and expand its advisory services on innovation and competitiveness.
2.3 Improving the Business Environment

Context

An improved business environment is closely linked to job creation and economic growth. Unfortunately, the pace of business environment reforms has slowed, and the measures introduced relate mainly to the adoption of national strategic documents, such as the Program for Better Regulation 2010–2013 and the Action Plan for a Reduction of the Administrative Burden. The result is that Bulgaria’s Doing Business ranking has progressively declined since 2007, when it was a top reformer, and in 2013, Bulgaria fell to the 66th position, well below most EU countries. Scaled-up actions to decrease the regulatory and administrative burden faced by the business community would promote entrepreneurship, attract new FDI, strengthen competition, and encourage innovation.

There is a wide variation in the way administrative regulations are applied at the local level, adding an additional burden to business. Bulgaria’s private sector would like to deal with uniform administrative procedures, submit the same documents, pay fees based on the cost-recovery principle, and receive standard service quality from local authorities across the country. However, there are multiple inconsistencies in the implementation of municipal administrative procedures. A survey of the administrative services of 11 municipalities coupled with subsequent interviews revealed (i) a wide regional variation in service delivery; (ii) a wide variation in administrative costs and a failure to apply the cost-recovery principle with regard to service fees; (iii) no apparent link between the amount of work required and the time it takes to deliver the service; (iv) a lack of transparency in the administrative process; and (v) the low utilization of e-government.

Chances

Create a favorable business environment at the national level. Improving Bulgaria’s business environment implies better management, monitoring, and control of business regulation. There is an opportunity to strengthen intergovernmental coordination and coordinate efforts by establishing a strong Better Regulation Unit at the Council of Ministers Administration that conducts the Regulatory Impact Assessments, stipulated by law, and oversees the implementation of the Better Regulation Program.

Address the obstacles highlighted in the Doing Business 2013 assessment. Such efforts will serve to improve Bulgaria’s international image as an attractive investment destination. In order to boost its standing in the Doing Business ranking, Bulgaria would need to focus on improving access to electricity, paying taxes, dealing with construction permits, resolving insolvency, and enforcing contracts. E-government and electronic filing systems would also improve the efficiency of public service delivery.

Remove additional costs and delays at the municipal level. This would stimulate small and medium-sized enterprise (SME) development as well as job creation. There is an opportunity to substantially improve systematic municipal-level service delivery and the quality of regulations and procedures that so far negatively affect business start-ups as well as existing businesses.

Choices

Setting up a strong Better Regulation Unit at the Council of Ministers and creating the capacity to monitor and manage the implementation of Better Regulation policies. This unit would take the initiative in terms of streamlining and improving regulations; consulting the private sector to identify reform opportunities; monitoring the reduction of the administrative and regulatory burden; and conducting regulatory impact assessments for new legislation.

Simplifying the regulatory regime and improving frequently used administrative procedures at the national level. Dealing with such issues as construction permits, trade across borders, access to electricity, tax payments, insolvency, and contract enforcement is still a huge challenge for potential
investors and entrepreneurs. These should all be priority areas for government reform. More active use of e-government and an electronic filing system could relieve bottlenecks and improve efficiency.

**Providing hands-on support for key municipalities to streamline their administrative system and reduce the administrative burden for businesses.** There is widespread variation between municipalities in the way they administer procedures that concern business activities. A peer-to-peer learning process whereby the best municipalities share their experiences with others could help bring lagging regions up to the national average.

**Changes**

**Reduced red tape in public administration and enhanced administrative efficiency.** To grow quickly and create new jobs, the business sector would be supported by effective and efficient public administration. ICT tools would play an important role in improving administrative efficiency, including in the area of e-procurement.

**Improved local business environment as municipalities compete for investment.** A national scorecard would track increased transparency and the time and cost taken to complete basic business regulatory functions at the municipal level, as well as the increased use of e-government services.

**Improved Doing Business ranking for the country.** While the Doing Business ranking assesses only a specific part of a country’s business environment, which is important but not sufficient for the business environment, it has a critical international image and communications effect. Therefore, improvements in the Doing Business ranking would not only create benefits for companies already operating in Bulgaria, but would contribute to the better positioning and marketing of Bulgaria as a country to invest in.

**WBG Partnership**

The WBG has been partnering with Bulgaria on improving the business environment and reducing the administrative burden for several years. The most recent World Bank-financed reports include “Bulgaria: Administrative Barriers to Businesses at the Municipal Level” and “Better Regulation for Higher Growth: Bulgaria’s Business Regulation - Achievements and Recommendations.” Looking ahead, the World Bank stands ready to provide targeted knowledge and advisory services through its own funding, potentially scaled up through reimbursable advisory services.
CHANCES

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SUSTAINABLE

GROWTH
3. Sustainable Growth

3.1 Promoting Energy Affordability, Reliability, and Efficiency

Context

Affordable, reliable, and environmentally sustainable energy provision, as well as efficient energy use, is key to Bulgaria’s economic development and political stability. In February 2013, the government resigned amid dramatic street protests sparked by complaints about high winter utility bills. Since then, the energy sector has been placed high on the political agenda, and the caretaker government approached the EC and the World Bank with a request to carry out rapid reviews of Bulgaria’s power sector.

The main findings of the May 2013 World Bank rapid diagnostic assessment of Bulgaria’s power sector can be summarized as follows: (i) There is dwindling public confidence and trust in the management of energy companies and the government’s oversight of the sector, and Bulgarian Energy Holding is an unnecessary level of state oversight. (ii) The sector has large financial deficits (projected to range from BGN 5 billion to BGN 20 billion by 2030) that represent rising contingent liabilities to the state budget. The high cost structure stems from flat energy demand, poorly regulated growth in renewable energy production and the misuse of incentives for cogeneration, long-term contracts, and inefficient trade/export incentives. (iii) Declining levels and coverage of social assistance benefits have made energy less affordable for the poor (61 percent of households are considered energy poor). As a result of the large declines in expenditures and beneficiaries of the Guaranteed Minimum Income and Heating Allowance programs, more than 78 percent of the poor are not protected by targeted safety nets. (iv) Household energy consumption is high and inefficient.

Gas is supposed to play an increasingly important role in Bulgaria’s energy mix, but the current high dependency on a single source and supply route calls for diversification. Currently, natural gas plays a lesser role in Bulgaria’s energy mix (about 14 percent of primary energy consumption), and the country is highly dependent on a single source (Russian gas) and supply route (through Ukraine and Romania), and hence is highly vulnerable to disruptions that threaten the country’s overall security of supply. Bulgaria was affected the worst of any EU country by the Ukraine-Russia gas dispute in January 2009. At the same time, one or more of the cross-border transmission routes for Caspian gas to Western Europe are expected to cross Bulgaria, whose strategic location indicates growing opportunities to benefit from investment in interconnectors and supporting infrastructure to foster regional gas trade.

Chances

Recent public discontent creates an opportunity to comprehensively address accumulated energy sector issues. This would include substantial improvements of governance in the energy sector, including governance of state-owned enterprises and the strengthening of the regulatory agency.

Fair and affordable energy prices are needed, as are tackling the unsustainable cost structure, moving toward a cost-recovery principle, and ensuring adequate social protection. Currently, the power sector cost structure is unsustainable, as it involves a high-cost generation mix, the inefficient operation of the system, and the poorly regulated growth of the renewable energy supply. Inadequate social protection and high and inefficient electricity consumption severely affect the poor in particular.

There are significant energy-efficiency potentials, especially in residential and public sector buildings. Bulgaria’s overall low energy-efficient building stock is an important contributor to the country’s poor energy-efficiency performance (energy intensity relative to GDP is four times higher than the EU average). This provides significant energy savings potential with a win-win-win strategy—good for homeowners, good for business, and good for the environment.
Strategic expansion of gas infrastructure and the diversification of gas supply are essential. The increasingly important role of gas in Bulgaria’s energy mix and the country’s vulnerability to gas supply disruptions due to gas infrastructure bottlenecks provide an opportunity for diversifying gas supply and supporting regional gas trade.

**Choices**

**Improving governance** by (i) ensuring that state officials and senior employees disclose their financial interests in the energy sector to eliminate conflicts of interest, (ii) dissolving Bulgaria Energy Holding to increase the transparency and accountability of state-owned enterprises, and (iii) granting financial and decision-making independence to the regulator as per EU directives to enhance its credibility and independence, and establishing a plan to build its technical capacity.

**Addressing growing financial deficits** that arise from the off-take of renewable energy, cogeneration, long-term contracts, and failed investments in an equitable way: (i) eliminate the abuse of preferential pricing for cogeneration, (ii) ensure that the National Electricity Company and the Ministry of Finance equitably address financial liabilities; and (iii) reduce costs by improving the allocation of generation quotas in the regulated market and ensuring economic dispatch.

**Making energy affordable to the poor** by increasing budgetary funding to expand the level and scope of targeted social assistance for vulnerable consumers and scaling up and consolidating energy-efficiency programs in the residential sector.

**Developing gas infrastructure in a cost-effective manner** to diversify supply sources and routes and to realize commercial benefits from increased regional gas trade.

**Changes**

**Regained public confidence by emphasizing transparency.** Transparency can start at the highest levels in the procurement of energy generation and the regulation of the sector right down to simpler billing for consumers. The latter represents a quick win and a tangible benefit to the customer and is a way to rebuild trust and confidence in the sector.

**Improved financial viability by addressing growing deficits in the sector.** Reversing the trend of accumulating deficits will require implementing structural changes, reducing costs, improving the efficiency of the operators, and rethinking the role of the Bulgaria Energy Holding company.

**Affordable energy services for the poor and substantially improved energy efficiency of residential buildings.** The number of vulnerable consumers who are protected by targeted safety nets and who can afford environmentally sustainable and reliable electricity services would be increased.

**Improved energy security.** Bulgaria will be less vulnerable to gas supply disruptions and will benefit from the regional gas cross-border transmission and trade.

**WBG Partnership**

In the recent past, energy dialogue between Bulgaria and the World Bank has concentrated on the security of gas supply, which led to the “Options to Improve Security of Gas Supply.” At the request of the caretaker government, the World Bank undertook a “Rapid Assessment of Bulgaria’s Power Sector” in May 2013. The International Finance Corporation (IFC) has invested in the renewable energy sector. Looking ahead, the World Bank stands ready to expand the partnership on energy, including social protection to make energy more affordable for the poor.
3.2 Improving Water Supply and Wastewater Infrastructure and Services

Context

Coverage of the water supply in Bulgaria is very high and drinking water quality typically meets EU standards, but water losses (non-revenue water) are higher than in other EU countries. Water loss (60 percent) is a waste of resources, and breakages may contribute to poor water quality. Consumers do not consider the quality of water supply to be satisfactory, according to a survey done for the Ministry of Environment and Water for the National Water Strategy in 2012. Water utilities could do much more to reduce water losses, satisfy consumers, and communicate the quality of service provision.

Wastewater collection and treatment needs to be extended. Only 66 percent of the population is connected to a wastewater collection network, and an even lower 50 percent is connected to a wastewater treatment plant. Among EU member states, only Romania and Cyprus collect a lower share of their pollution load than Bulgaria. Bulgaria has a final deadline of December 31, 2014, to meet its obligations under the EU accession treaty in relation to wastewater. While some additions have taken place, the level of capital investments in the sector has recently been below what is needed to maintain the existing infrastructure, let alone to expand it. For example, in 2012, only one wastewater treatment plant (Targovishte) was completed. As a result, Bulgaria is set to miss the 2014 deadline for compliance.

There is a huge potential for improved efficiency compared to European peers, yet average water and wastewater tariffs in Bulgaria are lower than in most other European countries. The annual cost of water in Bulgaria is equivalent to less than 0.3 percent of GDP at the purchasing power standard of EUROSTAT, while in Poland, France, and Germany, for example, the annual cost is equivalent to between 0.3 and 0.4 percent of GDP. This reflects the fact that (i) wastewater collection and treatment are still not fully expanded; and (ii) tariffs on average cover operational expenditure but provide little or no contribution on average to the renewal and replacement of water and wastewater systems.

Chances

Sustain and improve water supply and wastewater services by substantially scaling up investments and effectively drawing on EU funds. A large amount of EU funds are available but they need to be complemented both by national cofinancing and national funding for other capital investments, such as the renewal of water supply networks.

Promote long-term sustainable service provision by moving toward full-cost recovery and proper protection of vulnerable groups. Sustained investments in the renewal of networks and enhanced wastewater services will increase costs. Social policies are needed to protect vulnerable groups.

Create satisfied consumers and efficient service provision in line with good European practice. A consolidated water sector is necessary to achieve this. Only larger utilities will have the financial and technical strength to perform as wastewater treatment operators, and recent requirements have raised the demands on the sector. A more effective water regulator is another key element to improving the performance of the sector. The regulator needs to enhance its capacity, understanding, and ability to work with water utilities in achieving development outcomes while avoiding abuse of its monopoly position.

Choices

Allocating sufficient central government expenditures as part of a credible strategy. Since EU grants are likely to cover only 30–40 percent of total investment needs, municipalities are constrained, water utilities have little or no cash as a result of existing tariffs, and regulatory and Ministry of Finance policies take back 80 percent of profits, sufficient allocations will require much higher central government expenditures than in the recent past.
Designing and implementing social policies to protect vulnerable groups. This can initially be done by expanding the system used today to support heating expenditures, but a major review and revision of social policies in the context of the burden of utility expenditures could be considered.

Addressing key deficiencies in the current legal and regulatory setup. The draft Water Act that was submitted to Parliament in 2012 addresses many of these deficiencies and could be resubmitted to Parliament as a matter of urgency.

Changes

Reduced legal actions and financial penalties by the EC. The adoption and implementation of a credible and fully funded water and sanitation strategy would facilitate the government’s dialogue with the EC and facilitate EU compliance.

Increased willingness of consumers to pay for water supply and wastewater services in response to improved services. A combination of improved services, more customer-oriented utilities, and additional information provided to customers will increase consumers’ willingness to pay.

Improved, well-functioning regulator with clear mandate effectively contributes to an efficient and service-oriented provision of water and wastewater services. A strengthened regulator would have an enhanced capacity, understanding, and ability to work with water utilities in achieving development outcomes while avoiding abuse of its monopoly position. A consolidated water sector is also necessary, as only larger utilities will have the financial and technical strength to effectively meet future requirements, including those for wastewater treatment.

WBG Partnership

There is a strong World Bank partnership with the Ministry of Regional Development and Public Works. The ministry has been partnering with the World Bank on establishing water master plans for the whole country and the rehabilitation and completion of four dams through the Municipal Infrastructure Development Project. Through reimbursable knowledge and advisory services, the ministry is supported in preparing a Water and Sanitation Sector Strategy and Action Plan. Recently, the ministry and the Water Regulatory Commission have requested additional advisory services to support the regulator in enhancing its capacity to work with water utilities. Terms of reference for such support have been developed.
3.3 Strengthening Agriculture’s Competitiveness, Sustainability, and Climate Resilience

Context

Agriculture and rural development hold tremendous potential for Bulgaria. The country has considerable endowments of arable land, fertile soils, and diverse agro-climates that could sustain highly productive agriculture. Farming represents 5.4 percent of GDP, utilizes a total area of 5.5 million hectares of land, and secures 20 percent of total employment. EU Common Agricultural Policy (CAP) resources, complemented by national budget allocations, can help unleash Bulgaria’s agricultural potential but: (i) these funds need to be programmed and delivered more effectively, and (ii) reforms are needed to improve service delivery and attract greater private sector investment.

Agriculture is the least productive sector of the economy. Gross value added generated per worker in the agriculture sector is less than one-third of the economy’s overall GDP per worker. A lack of strategic positioning of Bulgaria’s agriculture in a European context, the fragmentation of land ownership (an average holding of 0.6 hectares), a highly polarized farming structure, the aging of farmers, difficulties in accessing credit, and the insufficient development of supporting infrastructure all limit the country’s ability to achieve its full agricultural potential.

Irrigation, which is essential to support highly productive agriculture, needs urgent attention in Bulgaria due to its very poor condition. In the 1980s, 1.25 million hectares of productive land was equipped with irrigation facilities, but this has dramatically dropped to just 40,000–45,000 hectares today. The increased and effective use of irrigation is also critical in order to mitigate Bulgaria’s serious climate change vulnerability and to build a more climate-resilient agriculture sector.

Chances

The EU CAP financing envelope for 2014–20 provides an enormous opportunity. The new programming period presents a chance to better position and strengthen Bulgaria’s agriculture from a competiveness and environmental sustainability point of view.

The growing global demand for food (expected to double by 2050) provides long-term opportunities, provided that the structural deficiencies that today limit productivity and competitiveness are addressed. Pragmatic and comprehensive adjustments and strong government leadership is needed in order to achieve well-managed agricultural diversification and land consolidation, and to attract youth to the rural sector.

The CAP is increasingly focusing on developing tools and earmarking resources to support climate change adaptation and mitigation. Under the rural development pillar, at least 25 percent of the financial allocation will need to be dedicated to agri-environmental measures. As the rural development policy will increasingly be linked to climate action, strong incentives will be created for farmers to deliver EU public goods and improve the uptake of efficient technology for a greener and more climate-friendly and resilient agriculture. Further, the greening of the direct payments to farmers will be one of the major elements of reform of the CAP. Beyond existing cross-compliance, 30 percent of the payments to farmers will be contingent upon sound environmental practices to achieve the EU’s climate objectives.

In the hydro-melioration sector, it is essential to rehabilitate and modernize strategic parts of the deteriorated hydraulic infrastructure, including dams, canals, pipes, pumping stations, and on-farm water-saving equipment, to increase agricultural production and adapt to climate change. While the CAP and the European cohesion policy provide ample financial opportunity to support this, the main challenge lies in the definition of an integrated programmatic approach to sustainable land and water management across the various funding sources.
Choices
Developing a compelling agriculture strategy and undertaking institutional and legal reform to increase the value added, competitiveness, and environmental sustainability of Bulgaria’s agriculture, in particular to address fragmented landholdings and improve farming technology. The consolidation of land parcels on the basis of rightful land ownership and sustainable land management is critical to achieving substantial economic welfare gains.

Improving the climate resilience of the agriculture sector by fully taking advantage of the opportunities provided under the new CAP framework and strategically incorporating climate change action. This would also need to be embedded in the country-wide climate adaptation strategy, including assessing the exposure to climate change (temperature and rainfall variability) as well as strengthening adaptive capacity. Hydro-melioration will be a critical element of climate resilience.

Preparing a convincing hydro-melioration strategy and plan for the revitalization of hydro-melioration infrastructure and respective investments. The country’s future hydro-melioration investment programs need to be inclusive of a diverse set of stakeholders, ranging from financially strong large farmers who have sufficient resources for making investments, to groups of smallholders and others who produce under resource-poor and drought-prone conditions. Hydro-melioration development projects and programs would need to be integrated into river basin management plans.

Changes
Revived and strategically positioned agriculture creates jobs, in particular for young people, and revives rural Bulgaria, as national policies focus on improving the competitiveness and efficiency of the sector and ensuring long-term climate resilience and environmentally sustainable agriculture.

Consolidated farm holdings on the basis of rightful land ownership and sustainable land management concepts achieve efficiency and economies of scale. These measures also lead to a narrowing of the urban-rural income gap.

A revised trend of depleting irrigation infrastructure. Full alignment of irrigation development with the concept of integrated water resource management at the river basin ensures the sustainable use of available water resources while meeting the environmental objectives and targets of water quality and soil conservation. This leads to the enhanced attraction and absorption of EU funds for hydro-melioration. The assured availability and reliability of water delivery leads to an improvement in agricultural productivity—and hence competitiveness—and to a reduced vulnerability to climate change shocks.

WBG Partnership
IFC has made several investments in the agriculture sector, including an equity investment to support the expansion of a company investing in agricultural land and promoting land consolidation. A World Bank hydro-melioration reimbursable advisory service agreement was negotiated in May 2013 and is aimed at supporting the government with (i) the formulation of a draft hydro-melioration sector strategy; (ii) a proposal of amendments for institutional and regulatory frameworks; (iii) the definition of a programming and prioritization framework for funding, and (iv) the preparation of integrated investment plans, programs, and flagship projects at catchment level. In addition, initial policy dialogue has taken place on how Bulgaria could best utilize 2014–20 EU funds to strengthen agriculture competitiveness, environmental sustainability, and climate resilience. Through World Bank-financed knowledge and advisory support, a proposal on how climate change-related insurance could be applied in Bulgaria, including for farmers, is currently being developed. Looking ahead, the World Bank stands ready to expand the partnership on agriculture and climate action, and IFC will seek opportunities to work with financial intermediaries to provide financing to farmers and SMEs in the agriculture sector.
3.4 Promoting Sustainable Transport

Context

Promoting sustainable transport infrastructure is fundamental to strengthening Bulgaria’s competitiveness and providing better service for citizens. Enhancing administrative capacity, improving the rehabilitation and maintenance of the national and TEN transport infrastructures while further investing in new infrastructure, and reducing greenhouse gas emissions and decarbonizing Bulgaria’s transport sector are all key. The main challenges are related to (i) road transport, which captures most of the traffic and is growing, and (ii) railways, with sharply decreasing traffic and major financial sustainability challenges.

Balancing new investments with the proper maintenance of existing roads infrastructure is critical. Bridging the corridor construction gap will still be the key priority for EU funding in 2014–20. However, this needs to be balanced with the critical need to maintain the existing road network. Currently, over half of the municipal road system and 35 percent of the republican system is in poor or unpaved condition. To achieve European integration, these roads have to be maintained at a level that ensures proper connection and sustainability.

Improving railway services is also critical, as is adjusting network needs to current and future demands. The public rail operator Bulgaria State Railways (BDZ) faces bankruptcy, as its market shares and traffic have decreased significantly. The infrastructure manager, the National Railway Infrastructure Company (NRIC), is being kept afloat by increasing subsidies while managing an aging infrastructure. Although a 2011 reform program has helped decrease the costs of railway operators and cut some uneconomic services, Bulgaria’s railways system in its current form remains financially unsustainable.

Chances

Comprehensive multi-modal transport strategy. A road strategy has been prepared under the leadership of the Ministry of Regional Development, and a transport strategy is under implementation, spearheaded by the Ministry of Transport. A comprehensive transport strategy would form the basis for an effective multi-modal transport planning, conducive to both investment prioritization and resource allocation in the sector. However, transport sector planning is constrained by a partial lack of tools and data.

Clarification of the role, size, and public funding of Bulgaria’s railways transport. Today’s rail network is almost the same size it was when the transition started, but in the meantime, Bulgaria’s population and the number of passengers have substantially declined. Tackling the severe challenges in the railway sector, including addressing the rapidly increasing financial liabilities, would ensure the sustainability of Bulgaria’s railways.

Effective use of scarce public resources to strengthen transport infrastructure and services. Concerning roads, sustaining today’s financing levels will not allow the maintenance of the network in its current condition, and EU financial incentives to focus on motorway construction might crowd out resources for the rest of the network. With regard to railways, BDZ is in major financial difficulties, and its situation has a cascading effect on the rest of the sector, especially NRIC, the infrastructure manager that has not been fully paid by BDZ for track usage. Effectively using EU and public resources and addressing the roads and railways challenges represent important opportunities to create a modern and sustainable transport sector.

Choices

Strengthening evidence-based transport sector planning and programming. Sector planning and programming would be strengthened by reducing the silos around each mode of transport, focusing on the broader institutional structure and governance framework, and promoting fully evidence-based
decision making. This would require a major effort to collect and maintain quality data in collaboration with local governments.

**Improving governance for better service delivery.** It may be advisable to rethink the role of the Road Infrastructure Agency (RIA), given the creation of the National Infrastructure Project Company, and the role of municipalities in order to undertake a reform of all the steps in project cycle processing and assets management to increase flexibility and accountability. While motorways are an obvious target for such rethinking, municipal roads and their maintenance, funding, and management are critical aspects for the overall roads sector. In the railway sector, the modernization of NRIC does not require an institutional change but a rethink of priorities and processes. BDZ Freight needs to be managed along commercial lines.

**Reforming transport financing, based on an updated strategy and sector governance reform.** Also needed is increased resource allocation for the medium term, once the strategy and reform are in place in the road sector. In the rail sector, there is a need to design an immediate financing rescue plan.

**Changes**

**Effective multi-modal planning and improved road and rail infrastructure.** The Ministry of Transport’s national transport strategy and master plan would drive priorities in road, rail, and other subsectors and ensure a strategic and comprehensive development of the country’s transport infrastructure.

**Enhanced governance and service delivery for end users.** Strengthened governance would lead to more effective management of transport assets and reduced costs for the taxpayer, as well as improved services for the consumer.

**Better use of available financial resources and public subsidies, increased absorption of EU funds, and enhanced utilization of IFI funds.** The provision of public subsidies to the transport sector would be matched with public sector objectives such as improved customer services and green growth goals. Inefficient subsidies would be phased out quickly.

**WBG Partnership**

In the road sector, the World Bank has been supporting Bulgaria to reduce road transport costs by improving the condition and quality of the roads network through the Road Infrastructure Rehabilitation Project. The current knowledge partnership is based on reimbursable advisory services provided to RIA in support of finalizing the road sector strategy and strengthening RIA’s capacity. In addition, under the Second Trade and Transport Facilitation Project, the World Bank provides support to improve the capacity, efficiency, and quality of services at selected border crossings, with particular focus on the Trans-European Transport Network. Concerning railways, the World Bank is finalizing a brief policy note. Looking ahead, the World Bank stands ready to continue transport sector policy dialogue and scale up its support, building on the services and financing currently provided.
CHANCES
CHOICES
CHANCES

INCLUSIVE
GROWTH
4. Inclusive Growth

4.1 Making Safety Nets and Activation Policies More Effective

Context

Reform of social protection and the integration of social benefits with employment services are both critical and urgent. Real household income declined by 4.6 percent on average between 2009 and 2010, and declined by 12.6 percent for the poorest quintile. Unemployment has more than doubled in four years, increasing from about 5.8 percent in the second quarter of 2008 to 13.8 percent in first quarter of 2013. The EC forecasts that the number of employed persons will continue to decline in 2013, and a real recovery in jobs and employment is expected to occur only in 2015.

In the face of a bleak labor market and declining household income, well-targeted safety nets can help families cope until robust growth leads to increases in household welfare, including for the poorer segments of society. Improving the effectiveness of social benefits and employment service provision, and a reallocation of resources within the social protection system toward programs for the poor, can help individuals cope with a downturn while the government maintains fiscal discipline and macroeconomic stability.

Chances

Proper social protection for the vulnerable will improve the coverage and generosity of well-targeted programs. This would include the Monthly Benefits to Individuals and Families program, which is Bulgaria’s Guaranteed Minimum Income program, heating allowances, and the targeted child allowance programs. Programs targeted at the vulnerable, such as the Monthly Benefits to Individuals and Families program and heating allowances, have seen substantial declines in expenditure and coverage. Improving the coverage and generosity of well-targeted programs would improve protection for the long-term unemployed and for the vulnerable while maintaining fiscal discipline. Improving and simplifying the design of Bulgaria’s social protection system and connecting beneficiaries to employment services would ensure adequate protection for the vulnerable while also encouraging people to work when work is available.

Higher labor force participation and employment rates will advance growth. Inactivity rates among the working-age population in Bulgaria are among the highest in the EU, with only 66 percent of the population between the ages of 15 and 64 participating in the labor market in 2011. Bulgaria has the second largest number of citizens in the EU who are not employed or in any education or training program, including 22 percent of youth between the ages of 15 and 24. Increasing labor force participation and employment rates are very important for increased growth and prosperity, particularly given an aging population. Understanding who the inactive and unemployed are and the barriers they face, and mitigating those barriers to improve labor market inclusion and increase labor force participation and ultimately employment, are crucially important steps.

Coordination between safety nets and employment services is critical. Many countries in Western Europe, such as Germany and the United Kingdom, have moved toward one-stop-shop models that integrate the provision of cash benefits, employment services, and social services. In Bulgaria, employment benefits are provided by the Public Employment Services, while social welfare centers provide cash benefits and social services. A person wishing to apply for a cash benefit might have to provide information several times and at several different places. While some information is shared across these various units, there is much more that could be done to move toward the integrated provision of these services. Further, Public Employment Services often do not see those who get social benefits as clients, and may prioritize other, sometimes better-skilled beneficiaries. By revamping information systems, business processes, and strategies, Bulgaria would be able to offer its citizens
seamless and integrated social safety net benefits as well as social and employment services through a one-stop-shop model.

**Choices**

**Increasing the coverage and size of selected social benefits and reducing fragmentation.** Bulgaria could increase the eligibility threshold and the amount of benefits provided, such as the Monthly Benefits to Individuals and Families, the heating allowance, and child benefits. It could also reduce fragmentation by decreasing the overall number of programs, consolidating less-effective programs, simplifying the design of programs, and moving toward a more efficient and effective provision of safety nets.

**Reforming public employment services.** This would serve to better identify the inactive and unemployed in order to offer them targeted and individualized services and provide them with well-designed training and other active labor market programs that make the inactive and unemployed more employable.

**Integrating the provision of social safety nets, social services, and employment services in one-stop shops and setting up an automated national registry.** Integration would ensure that services are provided seamlessly, offering citizens adequate protection when needed but also helping them find employment. Setting up an automated national registry of applicants to and beneficiaries of various types of cash transfer programs that is connected to other databases would significantly improve the governance, transparency, and credibility of such programs. It would also facilitate the movement toward a one-stop-shop model.

**Developing a coherent error, fraud, and control strategy, and a system for monitoring and evaluation.** No benefit system is immune from error and fraud. Reducing these obstacles will improve the use of public resources, ensure increased resource flow to those in need, and enhance the credibility of the program and its support among the public.

**Changes**

**Improved and cost-effective protection for the vulnerable.** Those who are in need would be covered by social safety nets and receive adequate support. The leaking of social benefits would be substantially reduced, and the proper provision of social services would be ensured even in an economic environment that requires tight fiscal policy.

**A reduced burden on the citizen, and the improved and integrated provision of social safety nets, social services, and employment services.** This would provide for the improved placement of the inactive and unemployed in jobs when robust job creation resumes in Bulgaria.

**Improved monitoring and evaluation of what works and what does not, and improved reporting so as to enable evidence-based policy making** in the sphere of social safety nets and employment services. An improved error, fraud, and control strategy would result in greater support from the public for targeted programs.

**WBG Partnership**

Over the past year, the World Bank has been providing knowledge and advisory support financed by its own resources on the optimization and integration of social safety nets and employment services. Looking ahead, the World Bank stands ready to scale up its partnership with the government.
4.2 Strengthening Social Inclusion and Social Equity

Context

The National Reform Program calls for a reduction in poverty and the promotion of social inclusion. The program highlights the fact that in 2010, the percentage of people living in poverty or social exclusion was 49.1 percent, and people at risk of poverty accounted for 22.3 percent, or 1.673 million people. The program targets a reduction in the number of people living in poverty by 260,000 by 2020, and to achieve this, it calls for more effective outcomes in the fight against poverty. In addition, given the particular poverty and exclusion among Roma, Bulgaria has prepared the National Roma Integration Strategy 2012–2020.

The recent May 2013 European Council Recommendations on Bulgaria’s National Reform Program underscore these needs, pointing out that Bulgaria suffers from below average and declining employment as well as high unemployment disparities across regions and population subgroups. The financial crisis has had a particularly strong impact on low-skilled workers and has significantly raised youth unemployment.

Chances

Social inclusion and social equity in areas of high impact are critical. These areas include early childhood development, active inclusion in the labor market, improved access to social and health services, and the construction of social housing with a special focus on youth.

Inclusion of Roma creates social and economic benefits. Ensuring the systematic delivery of the measures outlined in the National Roma Integration Strategy will close the gap on social indicators between Roma and other citizens.

EU Structural Funds provide a sizable opportunity to scale up social inclusion measures, including Roma inclusion. However, effective use has been limited so far. Communities most in need often face the greatest challenges in benefiting from Structural Funds, as they tend to lack sufficient capacity and financial resources to prepare and initiate projects.

Choices

Strengthening the design of policies and programs that aim at reducing poverty and promoting inclusion. This could be accomplished by building on rigorous analytics, institutional reviews, and global good practices in key areas, including the design of cost-effective active labor market programs, early childhood development programs, and integrated housing solutions.

Strengthening the results focus of poverty reduction and social inclusion policies and programs. The government might consider (i) institutionalizing program results frameworks that clearly identify inputs, activities, outputs, and ultimate program outcomes; (ii) monitoring program outputs and outcomes, potentially including a “mapping for results” tool that shows which projects are implemented where and achieving which kinds of outputs; and (iii) designing and implementing selected rigorous counterfactual impact evaluations to demonstrate what works to reduce poverty and promote inclusion, and to increase public support for scaling up proven programs.

Strengthening the absorption and cost-effective use of EU Structural Funds at the local level. The government might consider setting up a Community-Led Local Development Support Unit, which would provide technical and financial assistance to communities in need to help them develop projects and apply for EU Structural Funds. Such a support structure would be especially valuable in light of EU plans to enable the financing of community-led development projects by all Structural and Cohesion Funds in the upcoming 2014–20 programming cycle.
Changes

Better designed and more effective policies and programs reduce poverty and promote inclusion in the National Reform Program focus areas, including those that are underscored by the May 2013 Country Specific Recommendations.

A strengthened focus on the results of poverty reduction and social inclusion policies and measures shifts emphasis and public discussion from inputs to measurable results, leading to improved monitoring, heightened accountability, and greater public support for proven programs.

The enhanced absorption and cost-effective use of EU Structural Funds at the local level for poverty reduction and inclusion, including Roma inclusion, would be realized, as well as the greater use of funds for community-driven initiatives.

WBG Partnership

Social inclusion has been a priority area of Bulgaria’s partnership with the World Bank for many years. Most recently, the World Bank has been supporting the government through the Social Inclusion Project, which aims to develop and deliver early childhood education services for children from disfavored social groups, including Roma children and children with disabilities. In addition, World Bank-financed knowledge and advisory services on Roma inclusion provide support to regional and local planning and a design monitoring and evaluation framework for the implementation of the National Roma Integration Strategy. The World Bank stands ready to further leverage its global and regional experience on social inclusion and scale up its partnership with Bulgaria.
4.3 Strengthening Health Care Efficiency, Effectiveness, and Service Quality and Equity

Context

Although the provision of health care has undergone significant transformations since the transition, large performance gaps remain. A recent World Bank health sector policy note highlighted the fact that significant performance gaps persist, and that reforms have been unable to reverse the problem. In particular, (i) health status in Bulgaria is improving at a slower pace than in other EU countries, and the burden of noncommunicable diseases is particularly high; (ii) coverage of preventive services is low and Bulgarians are much more frequently hospitalized than other Europeans, a sign that the system may not be producing the right mix of services; (iii) Bulgarians are among the least satisfied Europeans when it comes to their health care services; and (iv) total health expenditure is comparable to that of countries with similar income, but the out-of-pocket share is disproportionately large and has grown over time, and the financial protection provided is incomplete.

While more public expenditure on health will be needed, any increases should be accompanied by improvements in efficiency and effectiveness in order to make the best use of resources and ensure the delivery of better health outcomes. The modernization of the health sector is needed to face the emerging needs of an aging population and to catch up with European standards. A comprehensive national health care strategy would need to guide the further development of and public investments in health care.

Chances

There is a significant amount of agreement among technical experts on how to improve the performance of health care service delivery, a prerequisite for successful reform.

Achieving better health outcomes will require strong, consistent, and strategic leadership at senior government levels and the involvement of all major stakeholders. An open discussion to establish a realistic vision and explicitly articulate priorities would ensure the needed ownership for required changes. This is particularly important in light of past instability in government leadership and only scattered reform efforts.

Important levers for reforms exist. The growing dissatisfaction of the public with health services and the opportunity to secure EU funding for the sector provide important points of leverage to move ahead with key reforms.

Choices

Implementing a needs-driven hospital rationalization plan to support the reorganization of the hospital sector and the creation of referral networks while maintaining physical access to care. In this context, the National Health Insurance Fund needs to be able to purchase services selectively, that is, it should be allowed to decide which entities it wants to contract with. To support this process, information on quality of care needs to be generated, collected, and publicized. The Clinical Care Pathways generate a host of poor incentives. The implementation of a modern payment system based on Diagnostic-Related Groups (DRGs, for example, standardized classifications of patients that use hospital data to match diagnoses to appropriate clinical services) has been under consideration for many years, but efforts to implement this have not prevailed. The introduction of DRGs should be accompanied by expenditure caps to avoid a further escalation of costs.

Strengthening alternatives to hospital-based care. The capacity of primary care health professionals to manage the prevailing burden of disease and to play an active role in the coordination of their patients’ care needs to improve. In particular, an effective and attractive continuous medical education curriculum should be developed in light of the current burden of disease. Regulatory standards would
need to be adjusted to expand the list of conditions that can be managed fully in primary care. Stronger incentives and accountability mechanisms would also need to be put in place to increase the management of chronic diseases at the primary care level (pay for performance). Emergency care reforms may also be required to improve the continuity of and access to care. Long-term care remains largely publicly provided and underresourced, lacking a coherent strategy and vision for long-term care services and often falling into a gap between medical and social care. This leads both to the delivery of the wrong type of care and expensive inefficiencies. A modern long-term care sector would require more community-based services provided either in the patient’s home or in day centers, and less institutional care.

**Improving financial protection.** Providing financial protection to all—so that no one falls into poverty due to health care costs—is a core objective health care provision. There are significant gaps in the financial protection provided by the National Health Insurance Fund, and between 10 and 20 percent of the population is not covered. A 2008 survey showed that most of the uninsured come from disadvantaged socioeconomic backgrounds and tend to belong to ethnic minorities. They lack access to outpatient care and typically enter the health system through emergency departments. It is important to note that both large out-of-pocket expenditure on drugs, which are more problematic for the poor and the elderly, and exclusions from the regular insurance structure lead to inefficient health care provision. Indeed, patients who forego care or do not manage their existing conditions are at higher risk of complication and ultimately require more public resources. Hence, in addition to being more equitable, improving financial protection is also more efficient.

**Changes**

**Establishment of a patient-centric health care system.** In the short to mid-term, reforms would increase the patient’s satisfaction and help reduce the financial vulnerability of some patients to the cost of care.

**Reformed hospital network.** Reforming service delivery would bring about efficiency gains and help curb the anticipated growth in public health expenditure by reducing the cost of the hospital network and increasing the reliance on ambulatory care.

**Reduction in noncommunicable diseases.** Improved service delivery, for example, in cardiovascular diseases, would help put Bulgaria on a path to convergence on health outcomes.

**WBG Partnership**

A World Bank-financed health sector policy note “Bulgaria Health Sector Diagnosis” was recently completed, and terms of reference have been developed with the caretaker government concerning the provision of World Bank reimbursable knowledge and advisory services. The objectives of this envisioned partnership are to support the government in (i) elaborating a comprehensive strategy to improve the efficiency and equity of the health system and to meet current and future challenges, (ii) preparing action plans for priority reforms under this strategy to be supported by EU projects, and (iii) developing a master plan. IFC continues to seek opportunities to invest in private providers of health care services, including investments in health insurance.
SNAPSHOT
OF WORLD BANK GROUP CURRENT PARTNERSHIP WITH BULGARIA
5. Snapshot of Current World Bank Group Engagement

5.1 World Bank

Smart Growth

- Education sector knowledge and advisory services to support the design and implementation of accountability and quality-focused reforms in preuniversity and tertiary education (ongoing, World Bank-financed)

- Innovation reimbursable advisory services to support the preparation of a “Smart Specialization” strategy, the revision and simplification of innovation institutional setup, and the design of innovation flagship projects for the 2014–20 programming period (ongoing, closing December 31, 2013)

- Regulatory reform: administrative barriers to businesses at the municipal level, knowledge and advisory support for the continued improvement of the business environment (just completed, World Bank-financed)

- Financial Consumer Protection knowledge and advisory services to support enhancing the capacity of the Financial Supervision Commission (ongoing, World Bank-financed)

Sustainable Growth

- Rapid diagnostic assessment of selected issues in the power sector, short-term advisory support responding to the caretaker government’s request (just completed, World Bank-financed)

- Security of Gas Supply Study knowledge and advisory services outlining options to address gas security supply issues (ongoing, World Bank-financed)

- Municipal Infrastructure Development Project (US$118.7 million), assisting local governments across the country in investment planning for the water sector and in improving the reliability and quality of water provision in four regions (closing December 31, 2015)

- Water sector reimbursable advisory services to support the preparation and implementation of a water supply and wastewater strategy and respective institutional reforms. Discussions are underway to expand the current scope of work to provide capacity support to the regulator (ongoing, closing August 15, 2014)

- Climate Change Adaptation knowledge and advisory support on the potential role of insurance to protect against climate change-related weather risks (ongoing, World Bank-financed)

- Forestry Sector Institutions Reform Support Institutional Development Fund (IDF) grant (US$0.430 million, closing August 4, 2013)

- Strengthening the National Trust Eco-Fund financing and implementation capacity IDF grant (US$0.203 million, closing December 8, 2014)

- Improving roads sector performance, capacity, and EU funds absorption reimbursable advisory services to support the finalization of a road sector strategy and the strengthening of the Roads Infrastructure Agency (ongoing, closing April 30, 2014)

- Road Infrastructure Rehabilitation Project (US$122.5 million), aims to reduce road transport costs by improving the condition and quality of the roads network during the first years of EU accession (closing June 30, 2013)
- *Railways Policy Note* to take stock of current sector status and the ongoing reform program and to provide options for ways forward, at the request of the caretaker government (ongoing, World Bank-financed)

- *Second Trade and Transport Facilitation Project* (US$50.9 million) to improve the capacity, efficiency, and quality of services at selected border crossings, with a particular focus on the Trans-European Transport Network (closing December 31, 2013)

- Mitigating the Economic Impact of an Aging Population: Options for Bulgaria knowledge and advisory services with focus on the macro-fiscal implications of Bulgaria’s demographic change and exploration of possible mitigation mechanisms (ongoing, World Bank-financed)

**Inclusive Growth**

- Optimizing and integrating social benefits and employment services provision knowledge and advisory services (ongoing, World Bank-financed)

- *Social Inclusion Project* (US$59 million), aims to develop and deliver early childhood education services for children from disfavored social groups, including Roma children and children with disabilities (closing October 31, 2013, extension possible)

- Roma Integration knowledge and advisory services to support regional and local planning and a design monitoring and evaluation framework for the implementation of the National Roma Integration Strategy as well as an analysis of gender-specific challenges (ongoing, World Bank-financed)

- Health sector knowledge and advisory services - *Bulgaria Health Sector Diagnosis* policy note (just completed, World Bank-financed)
5.2 International Finance Corporation

Overview of Operations

Since the start of operations in Bulgaria in 1991, IFC has invested a total of US$895 million in 37 projects, including US$198 million mobilized from partners, supporting approximately US$2.6 billion in investment. IFC’s Committed Portfolio in Bulgaria stands at US$296 million (US$231 million outstanding), plus committed mobilization of US$117 million committed (US$91 million outstanding). The portfolio composition is 89 percent loans, 9 percent equity, and less than 1 percent guarantees.

IFC has played an active crisis response role in Bulgaria. Since 2009, IFC has invested approximately US$336 million of its own funds and mobilized an additional US$137 million in nine projects in various sectors. Particular support was provided to the energy (wind and solar, oil and gas), retail, and manufacturing (glass, steel) sectors, as well as to the banking sector in the form of trade finance.

While vulnerabilities from the Eurozone crisis and global economic downturn persist, IFC will continue playing a countercyclical role through selective private sector investments. In the financial sector, this includes the provision of short-term liquidity; in the real sector, this includes support for projects that contribute to the growth and competitiveness of local firms in promising sectors such as agribusiness and infrastructure (power generation, water), and that improve resource efficiency. IFC will be investing increasingly selectively as vulnerabilities related to the Eurozone crisis recede.

Fiscal Year 2013 (FY13) commitments to date total US$107.2 million, in two projects: a trade finance line with EFG Postbank and an approximately US$92 million A & B loan package to support the expansion of discount grocery retailer, Lidl, which is expected to build strong local linkages, create employment, and demonstrate the advantages of resource-efficient construction. In addition, IFC committed US$100 million to a regional project with Petroceltic International, of which US$25.5 million will support the development of Bulgaria’s oil and gas resources.

IFC has completed six advisory services projects, addressing barriers to competition in the power and high-tech sectors, developing a national corporate governance code of best practices, and tackling administrative barriers relating to on-site inspections and construction procedures. In 2012, IFC concluded an advisory project to develop public-private partnerships (PPPs) in the water and wastewater sector.

Strategy

Short-Term Strategic Priorities are focused on: (i) crisis response and recovery, including support to clients in the banking sector through the provision of short-term finance to address immediate liquidity concerns, as well as mezzanine and equity investments to strengthen bank capitalization and micro, small, and medium-sized enterprise (MSME) finance to sustain funding to the most vulnerable businesses; and (ii) the second Vienna Initiative—jointly with other IFIs—which, if needed, would provide additional liquidity to subsidiaries of Western European banks.

Long-Term Strategic Priorities are focused on: (i) support for the development of renewable energy and climate change-related infrastructure, (ii) the growth and competitiveness of the manufacturing sector, and (iii) private investment in social sectors and agriculture.

Agriculture: IFC has made only a few investments in the agriculture sector, including an equity investment to support the expansion of a company investing in agricultural land and promoting land consolidation. IFC will seek opportunities to work with financial intermediaries to provide financing to farmers and SMEs in the agriculture sector, which has been largely neglected by commercial banks. More generally, IFC will help develop the country’s competitive advantages in the sector through selective investments in primary production, food and beverage processing, and retail.
Health: While prospects remain limited, IFC will continue to seek opportunities to invest in private providers of health care services, including investments in health insurance.

Infrastructure: IFC is focused on addressing bottlenecks to growth and improving access to markets, goods, and services through infrastructure investments, particularly in the energy sector. In FY09 and FY12, IFC made sizable investments in renewable energy in Bulgaria (wind and photovoltaic power), and pending resolution of certain regulatory questions, will seek additional investment opportunities aiming to reduce carbon emissions and make progress toward renewable energy targets under the EC framework. IFC is also seeking to invest in subnational infrastructure, including through PPPs, building on a recently completed advisory project in the water and wastewater sector.

Financial Markets: While IFC has been less active in the banking sector due to a more limited role, demand for IFC investments in Bulgaria’s financial markets is increasing. IFC’s longer-term strategy is to work with local banks to strengthen their capacity to provide loans to underserved sectors, such as MSMEs and agribusiness, and to promote products such as renewable and energy-efficiency finance, where it currently has a project in development with First Investment Bank. IFC is also looking at potential investments in the private health insurance and pension industries.