



CENTER FOR
THE STUDY OF
DEMOCRACY

THE COMPETITIVENESS OF THE BULGARIAN ECONOMY 2019

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Competitiveness profile and macroeconomic overview

In 2019, Bulgaria has regained one position compared to the previous year in the economic competitiveness ranking of the World Competitiveness Yearbook (WCY), published by the Institute for Management Development (IMD). Bulgaria's Center for the Study of Democracy (CSD) is IMD's partner for the country. **Bulgaria ranks 48th out of 63 economies. This is only a marginal improvement and remains significantly lower compared to its pre-crisis achievement of 2009 (38th place)** (Figure 1). Despite being among the least competitive economies surveyed, Bulgaria fares relatively better than other South-East European countries such as Romania (49th), Slovakia (53th), Greece (58th), Ukraine (54th), and Croatia (60st).

The top 10 most competitive economies ranked in the World Competitiveness Yearbook exhibit similar characteristics. Eight out of the top 10 countries are also listed in the top 10 in terms of institutional framework while seven out of the top 10 countries have the most business-friendly legislation. All top

KEY POINTS

- Bulgaria ranks **48th** in the World Competitiveness Yearbook 2019 – a modest year-on-year improvement.
- **Structural reforms need to be reinvigorated** for Bulgaria to impress with its growth rate and/or its competitiveness score. Its current growth looks too dependent on EU market dynamics and funds.
- The **Bulgaria's educational system and management education remains inadequate** in meeting the needs of the business community and providing a pool of skilled labour. This is going to remain a serious drag on competitiveness for decades to come as the country has only just stabilized at one of Europe's weakest education performances after years of decline according to the OECD's PISA.
- The **inadequate tax structure exacerbates poverty and social disparities** and perpetuates the delivery of **low-quality infrastructure**, including health care and education. It **contributes to persistent informal economy**.
- **Reforms in the energy sector should be strengthened**. The government's continued interference in regulation, electricity generation and distribution remains a major obstacle for manufacturing firms.

¹ CSD would like to thank Mr. Julien Trehet for drafting this policy brief. It has been edited and completed by the CSD team and any responsibility for errors and omissions remains with the organization.

positions are occupied by economies which have high-quality infrastructure.

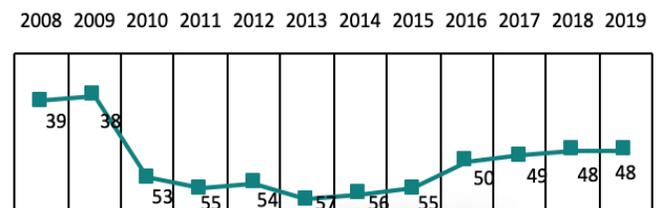
Due to their robust government efficiency, Singapore and Hong-Kong occupy the first and second places, respectively. Both countries overtook the United States (3rd) and Switzerland, which drops to the 4th place. With its strong economic performance and high business and government efficiency levels, **the Netherlands (6th place) remains the most competitive economy in the European Union.** The Netherlands dropped to the 6th place from last year's ranking (4th) and is now behind Switzerland and the United Arab Emirates, both occupying the 4th and 5th positions, respectively. Nonetheless, the language skills and international experience of the Dutch labour force, as well as the high standards of primary and higher education, allow the Netherlands to meet the needs of a competitive economy on a global scale. Other EU countries should take note, provided the continent's dependence on exports and sluggish overall performance in the past decade.

Among **Central and Eastern European countries, Lithuania is the front-runner**, reaching the 29th place, followed by Czech Republic (33rd), Estonia (35th), Slovenia (37th) and Poland (38th). Lithuania secures the 29th position in the ranking, due to very high scores in International Trade and Management Practices (ranking 9th for both), which makes it a particularly good example for Bulgaria that ranks 36th in terms of International Trade and 55th in management practices. Moreover, the Czech Republic has benefited in recent years from a stable macro-economic environment and a steady improvement in the provision of banking and financial services. The performance of the Czech economy also highlights improvements in the delivery of

infrastructure, as shown in the country's strong ratings in terms of access to health care and primary education.

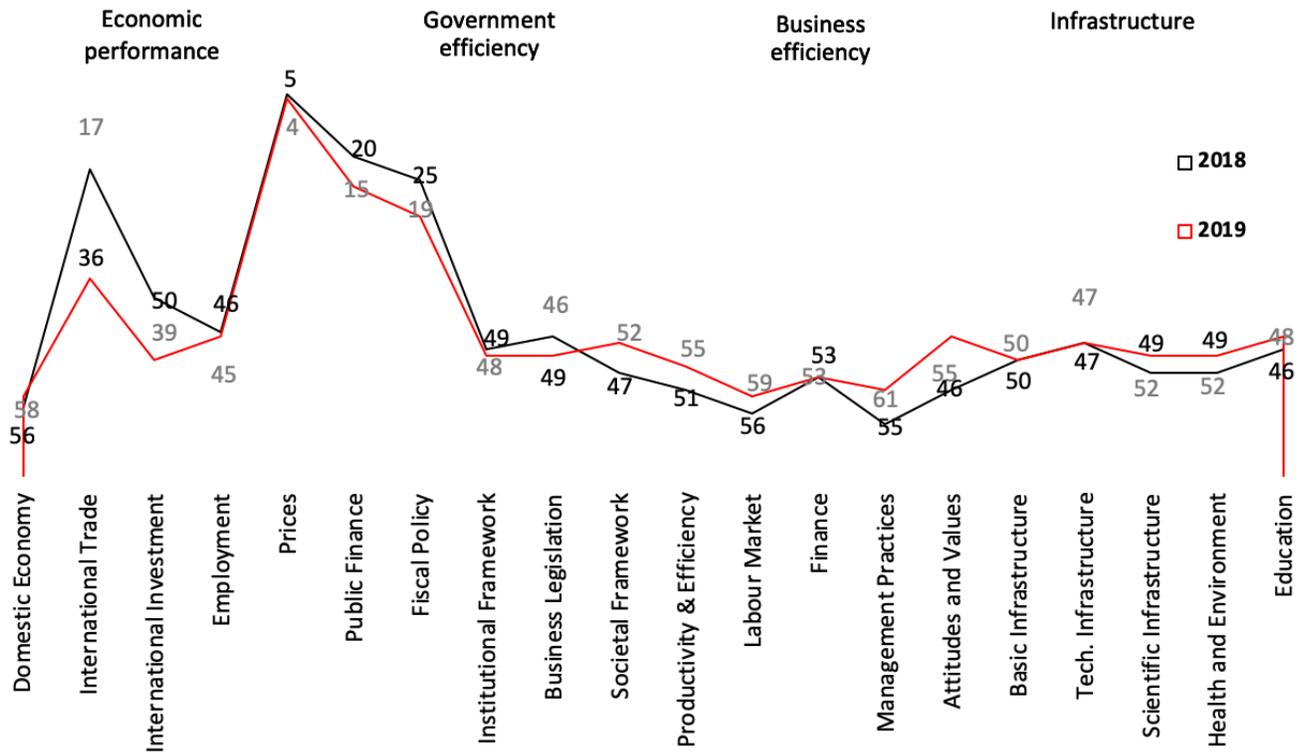
Bulgaria could also follow the example of successful economic policies from the Czech Republic and Poland, ranked 33th and 38rd respectively. Croatia (60st), another South-East European country assessed in the IMD World Competitiveness Yearbook, offers an interesting point of comparison for interpreting Bulgaria's performance in the regional context. Both countries benefit from relatively high levels of direct investment (as % of GDP), low levels of inflation and cost competitiveness factors which have allowed for Bulgaria's and Croatia's increased participation in international trade. However, a relatively low level of taxation and a growth-friendly tax structure as well as a slight but steady improvement in the quality of its infrastructure in recent years have resulted in higher productivity levels in Bulgaria. On the other hand, the Croatian government has been slow in undertaking judicial reforms related to the economy, particularly with regards to its fiscal framework and property registration. Bulgaria continues to also have rule of law issues in particular related to corruption but it has considerably reduced the dependence of its business turnover on the slow and inefficient judiciary.

Figure 1: Overall ranking of Bulgaria



Source: IMD WCY 2019

Figure 2: Competitiveness landscape of Bulgaria 2018 – 2019



Source: IMD WCY 2019

Among the 34 countries included in the overall ranking which have a **population of less than 20 million, Bulgaria occupies 28th place** for the second consecutive year. **Bulgaria ranks in 14th place out of the 30 countries with a GDP per capita of less than \$20,000** (gaining one place from 2018). This places Bulgaria closer to its 2009 performance, where it was ranked 13th out of 29 in the GDP per capita of less than \$20,000 category. **Bulgaria also ranks 33rd among 40 economies in the EMEA region.**

Bulgaria’s competitiveness landscape (figure 2) shows that despite a slight improvement in economic performance, there remain significant long-term hurdles in government and business efficiency ratings as well as in the

delivery of infrastructure. **The country’s overall competitiveness score has been steadily improving since its 2013 all-time low performance.** While the Bulgarian economy grew by 3.8% in 2017, due in part to a strong domestic demand, more efforts are needed in order to improve the business environment and its competitiveness score. Moreover, **structural reforms need to be reinvigorated** if the country is to surpass current growth rates and increase its convergence prospects. The latter remains one of the weakest among new EU member states, with Bulgaria’s GDP per capita standing at 49% (PPP-adjusted) of the EU average². As reported in the latest EBRD 2018-2019 Transition Report³, **bureaucratic processes remain one of the main impediments** to doing

² Eurostat (2018). National Accounts (including GDP) database. Brussels: Eurostat, <https://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tec00114&plugin=1>.

³ EBRD (2018). Transition Report 2018-2019: Work in Transition. London: EBRD, <https://www.ebrd.com/cs/Satellite?c=Content&cid=1395277901932&d=&pagename=EBRD%2FContent%2FDownloadDocument>.

business while **access to skilled labour is a growing challenge**. Government efforts need to focus on the continuously reforming and digitalising of the business environment, retaining qualified workers and improving the skills of the existing labour force.

While the improved global economic environment contributed to Bulgaria's economic growth, the continued reliance of the Bulgarian economy on narrow cost competitiveness makes it vulnerable to weaknesses in major trading partners in the EU and Turkey. The total volume of private foreign direct investments (FDIs) accrued to USD 19 billion for the 2009-2017 period⁴ while approved EU funds for the 2014-2020 period amount to over USD 11 billion⁵.

Domestic demand was the main engine of growth in 2017-2018 and is expected to remain so in 2019 and 2020. The use of EU investment funding provided a boost to both private and public investments. However, there are growing signs that grant and guarantee programmes are displacing private investment and are sometimes promoting "hollow commitments" of private sector money, which are reported but are not actually expensed (e.g. through the artificial augmentation of the EU projects' values). At the same time, the improved absorption of funds under EU-funded operational programmes for the 2014–2020 period will be reflected in increased EU fund inflows and

growing annual capital account surplus as a share of GDP. This will in turn improve the country's attractiveness to investors and its competitiveness, as grants from the operational programme Innovation and Competitiveness mainly benefit SMEs for investment in machinery, innovation and energy efficiency⁶.

The effective delivery of infrastructure, from quality education to access to affordable health care, still presents serious challenges to the Bulgarian economy. The **low level of the quality of education** remains among the most pressing problem as reflected in its below-average PISA performance⁷. The WCY attributes the lowest scores to Bulgaria concerning its educational system, its financial literacy rate among adults, and highlights the inadequacy of management education in Bulgaria to meet the needs of the business community. Access to skilled labour is a growing challenge for the competitiveness and productivity of firms.

Adding to existing problems in the labour market is the pervasiveness of the informal economy. The lack of viability for low-wage earners in the formal economy and the 50% to 70% loss incurred by formalising their income prompts many firms to remain unregistered⁸. The tax structure and low satisfaction with the quality of infrastructure provide overriding incentives for citizens to avoid paying taxes which in turn severely hinders the competitiveness of the Bulgarian economy.

⁴ World Bank (2017). World Development Indicators. Washington, D.C.: The World Bank, <http://data.worldbank.org/data-catalog/world-development-indicators>.

⁵ European Commission (2016). European Structural and Investment Funds, Bulgaria Country Factsheet. Brussels: European Commission, https://ec.europa.eu/regional_policy/sources/policy/what/investment-policy/esif-country-factsheet/esif_funds_country_factsheet_bg_en.pdf.

⁶ European Commission (2018). Country Report Bulgaria 2018. Brussels: European Commission, <https://ec.europa.eu/info/sites/info/files/2018-european-semester-country-report-bulgaria-en.pdf#page34>.

⁷ OECD (2016). PISA 2015, Student Results by Country: Bulgaria. Retrieved on 05/06/2019, <http://gpseducation.oecd.org/CountryProfile?primaryCountry=BGR&treshold=10&topic=PI>.

⁸ EBRD & World Bank (2017). Business Environment and Enterprise Performance Survey (BEEPS V), <https://ebrd-beeps.com/reports/beeps-v/bulgaria/>.

Bulgaria **performs relatively well** in certain aspects of judicial capacity and public communication but still lags behind in public perception of the control of corruption and judicial independence as well as in the rate of resolving cases. Assessments by the World Bank and the IMF⁹ also show that Bulgaria does not compare well with peers in public procurement and state-owned enterprises governance, the latter being a key component for the accession of Bulgaria to the ERM II mechanism. Strengthening governance and institutional reforms could stimulate key drivers of growth, namely productivity, investment and labour and thus is a key factor in improving Bulgaria's competitiveness. This is particularly true for the energy sector.

Reforms in the **energy sector** have continued in 2018 and 2019, with the expansion of an independent energy exchange for intraday trading (IBEX) and the strengthening of the authority of the energy regulatory. However, the state's continued interference in regulation, electricity generation and transmission¹⁰ inhibits the development of open price competition and represents a major obstacle for manufacturing firms. In this regard, strengthening the pace of liberalisation reforms in the energy sector represents a major step in improving the country's competitiveness.

Competitiveness challenges and policy recommendations

The Center for the Study of Democracy has identified the following five key challenges, which hinder the competitiveness of the Bulgarian economy:

- Economic institutions lack a strong judicial system and control of corruption.
- Further efforts should be made to curb the informal economy.
- Structural reforms to join ERM II and the Banking Union are slow.
- Insufficient action in reforming the energy sector.
- Access to skilled labour is a growing challenge.

Addressing these challenges has the potential of improving the competitiveness profile of the Bulgarian economy with regards to public administration efficiency, education, energy security and corruption in the private and the public sector. This would require sustained collective efforts and common vision among government, nonprofit and business leaders in the next decade.

⁹ IMF (2019). IMF Country Report No. 19/84: Selected Issues in Bulgaria. Washington, D.C.: IMF, <https://www.imf.org/~media/Files/Publications/CR/2019/1BGREA2019002.ashx>.

¹⁰ Balkan Green Energy News (2019). 'Bulgaria: The drive for full liberalisation of the energy market and the upcoming change', <https://balkangreenenergynews.com/bulgaria-the-drive-for-full-liberalization-of-the-energy-market-and-the-upcoming-changes/>.