

UNICE TASK FORCE ON ENLARGEMENT

**2002 REPORT ON CANDIDATE COUNTRIES' PROGRESS
TOWARDS EU ACCESSION**

BULGARIA

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Executive Summary

Bulgaria has made considerable progress in preparations for EU membership.

The country continues to experience strong economic growth, reaching 4.0% in 2001 and also expected to be higher than the candidate-country average in 2002 and 2003. The foundation for these sustained high economic growth rates is undoubtedly macro-economic stability (based on currency board and low budget deficits). Progress has been made regarding the privatisation of key sectors; transparency and equal treatment in the privatisation process have been improved. Most tariffs on goods have been abolished and state aid has been further reduced.

Bulgaria has made significant progress with adopting and applying new legislation. There have been a number of positive developments regarding the taxation system (e.g. VAT) and promising plans related to the reform of customs. There are credible and visible attempts at reducing red tape including the abolition of a vast number of licensing requirements for business. Some progress has been made with fighting corruption.

However in many areas substantial difficulties still remain. Lack of administrative and judicial capacity and the still widespread corruption are key obstacles to further rapid progress. Further areas for which serious difficulties for business have been reported include, for example, intellectual property rights, public procurement, certification/licensing requirements (and bureaucratic procedures in general) and the labour code.

As a result, a majority of companies, both domestic and foreign, do not believe that Bulgaria could be ready to join the EU before 2007.

Actions recommended

- Step up efforts to improve the functioning of the judiciary, including reform of the apparatus and training of staff.
- Apply renewed and invigorated efforts to strengthen administrative capacity including further training of staff.
- Pursue the positive developments in the reform of customs.
- Make the procedures and practice of privatisation and public procurement more transparent.
- Take the political initiative in the protection of intellectual property rights, by providing the powers and resources needed to tackle the resurgent problem.
- Simplify the taxation system, including combating the grey economy with more credibility.
- Implement further reform of the labour code (finding a better balance between the protection of the individual and businesses).
- Acknowledge that corruption remains a major problem and an obstacle to economic integration, and implement a realistic plan to tackle it.
- Continue to restructure state-owned companies, making liberalisation of energy markets a priority.

1. Introduction

(a) Preface

This report provides a business point of view on Bulgaria's progress towards meeting the accession criteria. It analyses to what extent commitments made in the Europe agreements are being met and how well Bulgaria is not only adopting but also implementing and enforcing EU legislation. The report does however also look into key obstacles businesses are confronted with when trading with or investing in Bulgaria.

The report is based on interviews and a written survey with international and domestic businesses and representative business organisations carried out in March/April 2002. It is an update of the report released in July 2001.

The report does not seek to repeat the Commission's Regular Report, but is an input to this report by condensing the views of business and business representations in relevant areas.

(b) General political context

General elections in June 2001 resulted in the appointment of a new government led by the former king and new Prime Minister Simeon Saxe-Coburg-Gotha. However, after being in office for less than a year, the Prime Ministers' popularity is at its lowest level as he distances himself more and more from election promises of quickly raising the standard of living and the situation regarding social security. As a first result of decreasing popularity, Bulgarians did not re-elect the outgoing President Stoyanov who was supported by the Prime Minister in the November 2001 elections. There are no signs however that the Prime Minister's drop in popularity will in any way derail Bulgaria's efforts to meet the requirements for joining the EU.

Public opinion remains clearly in favour of accession as soon as possible to the EU, Bulgaria remains strongly committed to the process of preparing for accession. The government clearly continues to pursue EU membership as its prime medium- to long-term objective.

Relations with the EU continue to be excellent. Moreover, Commissioner Verheugen has confirmed several times in recent months that Bulgaria had increased the tempo of its efforts in accession preparations. Bulgaria had by April 2002 provisionally closed 17 negotiating chapters. There do however remain several issues of importance such as the difficult requirement of closing down the Kozloduy nuclear power station stated by the EU as a prerequisite to EU membership. While the Bulgarian government has made some progress on the issue, the debate both internally and with the EU still has some time to run before it can be considered solved by both sides. It is widely recognised that Bulgaria continues to face a large number of difficult tasks and decisions on the road to accession.

2. Economic context and developments - Investment climate

- Economic context

Albeit from a low starting baseline, Bulgaria continues to experience strong economic growth reaching 4.0% in 2001 after peaking at an impressive rate of 5.8% in 2000. Among the group of 13 candidate countries, only Estonia and Latvia grew faster on average over these two years.

Also in 2002 and 2003, Bulgaria is expected to be among the fastest growing economies of Central and Eastern Europe and this despite of a significant slowdown in exports.

One of the cornerstones for these sustained high economic growth rates is undoubtedly the macro-economic stability achieved notably by establishing a currency board and by keeping budget deficits under 1%.

Although inflation has decreased from 10% in 2000 to 4.8% at the end of 2001, it is still significantly higher than in the euro-zone. Although some of this seems mainly due to rising energy prices, this could lead to a worsening of Bulgaria's international competitiveness.

While increasing only modestly in 2001, due to a slowing down of imports, Bulgaria's current account deficit remains high at 6.8% of GDP in 2001.

One of the main problems of Bulgaria's economy is the continuing high unemployment, which is currently at 18% and which is only expected to decrease slightly from 2003. The unemployment levels are very much a result of Bulgaria having delayed for many years the restructuring of its industry, and although much has been done over the last four years there is still a need to continue the restructuring of key industries, e.g. steel and energy sectors. This will further increase the pressure on the labour market.

- Progress in meeting the economic criteria

Functioning market economy

Bulgaria has made further progress towards a functioning market economy. As stated above, it continues to benefit from a stable macro-economic context, high growth rates, a low budget deficit and relatively low inflation.

Progress has been made regarding privatisation with the four main Bulgarian banks purchased by foreign investors. Both the Bulgarian Telecom Company and Bulgartabac (production of cigarettes) are currently up for sale. A law was recently passed, which improves equal treatment in and transparency of the privatisation process (see also chapter 3 below). In relation to the energy sector, however, difficulties remain. Bulgargaz, the state-owned gas distribution company, should be slated for sale within the next two years, but the success of this sale is considered extremely difficult as the company continues to make huge losses and is burdened by high bad debts.

Post-privatisation obligations, such as the obligation to maintain a certain level of staff and certain activities or making specific investments during a certain period, are widely used. This reduces the interest of foreign investors for certain companies and is slowing down much needed restructuring.

There are still a number of administered prices including notably electricity. Dual pricing, for domestic and foreign users, is still applicable in certain areas, e.g. hotels.

While ownership of land is still restricted to Bulgarian nationals or companies, this is not considered a great problem for investors as these can circumvent it by purchasing land through a domestic company. More problematic remains still fragmented land ownership.

Access to finance remains a serious problem, notably for domestic SMEs. Ensuring collateral for business as well as the clear ownership of collateral for banks prove to be important

obstacles. Other problems relate for example to the bad application of the insolvency law with bad debtors finding it relatively easy to delay and appeal.

As stated in chapter 3 below, there are still serious difficulties with the respect of intellectual property rights; standards and certification procedures are also of concern to business. More importantly, the judiciary is not yet functioning effectively, a sine qua non if a serious effort is to be made in attracting larger amounts of foreign direct investment.

Capacity to face competitive pressures

A large majority of former state-owned companies are now in private hands. With mainly utilities/municipal-owned companies to be privatised, there remains a doubt that the buyers of many of these companies have either the financial means or business acumen to ensure on-going competitiveness. The energy sector is extremely inefficient where any serious efforts at re-structuring have so far still to be made.

Tariffs have been abolished in most sectors. State aid is limited, but not yet sufficiently transparent.

Regrettably, domestic investment remains low, as does foreign direct investment. Investment in notably training and research from both the private and public sector is still at a very low level.

- Investment climate

The investment climate has not improved since 2001. Corruption, despite the efforts of the Prime Minister remains high and pervasive. Opaque political decision-making procedures as well as a lack of genuine dialogue with potential investors adversely influence business decision-making. The parlous state of the judicial system contributes to the difficulties facing investors. The lack of a properly functioning administration also reduces the attractiveness of Bulgaria as an investment location.

3. Progress in adoption, implementation and enforcement of the Acquis

3.1 General

Bulgaria has made significant progress in adopting and applying new legislation in line with the Acquis as reflected in the closure of 17 chapters by April 2002 (as a comparison, this is the number of chapters Poland had provisionally closed in September 2001).

However, in many policy areas substantial difficulties still remain and as rapid progress as in the last months on a number of chapters seems unlikely. Overriding difficulties highlighted earlier such as considerable lack of administrative and judicial capacity and widespread corruption are likely to hamper advancement.

With regard to administrative and judicial capacity, there is in many areas an acute need for further specialised training of staff and a better equipping of specific offices/agencies. Much good work has been done in this area by the EU and by individual EU countries on a bilateral basis. Now is the time however to accelerate this reform and assistance. It is crucial that this aid effort is well coordinated.

Linked to this, slow and unwieldy bureaucratic procedures and the often capricious enforcement of laws such as bankruptcy, IPR protection, debt recovery and taxation put an additional burden on business (i.e. court cases are often long, costly and frequently non-conclusive).

3.2 Specific policy areas

- Tariffs - Customs

UTFE 2001 Report recommendations: Customs organisations need further strengthening and training to be able to service an open trade policy.

Progress made: Since 1 January 2002, Bulgaria has abolished most tariffs on goods imported from the Union as established under the Europe Agreements. This has facilitated trade and customs procedures. The abolishment of tariffs has also contributed to a slight improvement with regard to corruption in customs offices. Further customs reform is underway and external consultants, Crown Agents, have recently been appointed to provide technical assistance for a radical overhaul of customs structures and procedures and the training of staff. The political will this displays in wanting to tackle this difficult area has to be welcomed and applauded.

Existing problems contribute to low government revenues: Bulgaria's customs offices still lack the administrative and technical capacity to service an open trade policy. Customs regulations remain complicated and lack internal consistency. This can be a source of delay and potentially of fraud (e.g. double invoicing) and corruption. Customs are not able to verify conformity of standards/certification. The rotation system with customs officers does not work effectively, staff still lack adequate training and salaries are not sufficient. Badly functioning customs procedures lead to substantial losses in the collection of VAT and excise duty.

- Privatisation - Public procurement

UTFE 2001 Report recommendations: The Privatisation Agency needs to be more transparent and treat foreign and domestic bidders equally.

Progress made: A new privatisation law was passed in March 2002, which abolishes the preferential treatment for management buy-outs and introduces a new agency for the monitoring of privatisation deals and which abolishes the possibility for deals/agreements to be reopened. The new act aims to produce more transparency in procedures.

Notably international public procurement tenders are considered more transparent and fairer now than in the past.

Remaining problems: One of the main problems with public procurement remains the lack of indigenous capacity and experience in carrying out transparent and efficient tendering procedures. This includes lack of both administrative and technical know-how in preparing but also in evaluating bids. There are cases of bidders complaining about the lack of technical feasibility of chosen bids or of allegations of tailor-made tender descriptions. Although less than in the past, different forms of corruption are still influencing the outcome of tenders. In several cases, significant delays in tendering procedures have been reported. Furthermore, a new public procurement act is currently under discussion, which seems to give preference to domestic companies in certain cases. Any such move would be contrary to the spirit of creating an open market.

- Intellectual Property

UTFE 2001 Report recommendations: More efforts are needed to apply the protection of Intellectual Property Rights.

Progress made: Intellectual property right legislation is largely in line with international patent and copyright laws.

Lack of ability to apply the laws remains a major issue: Progress in relation to the enforcement of legislation with regard to intellectual property rights has been patchy at best, often on a one step forward two steps backwards basis. There are still a number of infringement cases which are pending for many years for which courts have not been able to provide judicial remedy. Software and audiovisual piracy has re-emerged as a serious problem. The political will to tackle this issue remains unclear.

- Licensing, standardisation and certification

UTFE 2001 Report recommendations: The global approach in standards should be promulgated, together with a further strengthening of the technical inspectorate. International standards in the accountancy sector should be adopted.

Progress made: The government set up an inter-ministerial working group to look into the reduction of red tape for business and more specifically in the reduction of the large number of existing licensing requirements. There has already been progress in reducing the very high number of licensing requirements. Improvements in relation to licensing procedures are underway, e.g. automatic granting of licences in the case of no reply and introduction of some one-stop shops.

Remaining problems: Despite some improvements, licensing requirements and procedures are still a problem. They continue to represent a hurdle notably for small companies and investors. The requirements are often complex and procedures time-consuming. Setting up a company is still difficult and slow.

Certification legislation/requirements are not in line yet with the Acquis. Despite plans to negotiate rapidly a Protocol to the Europe Agreement on conformity assessment and acceptance of industrial products (PECA), no visible progress has been made. As a result CE-certified products still need to undergo time-consuming and costly certification procedures. Lack of technical equipment also is a major obstacle for the proper functioning of the certification body.

- Taxation

UTFE 2001 Report recommendations: The problems with tax collection are being addressed, but further efforts are needed. More training in this area is required.

Progress made: The tax on profit as well as the highest rate of personal income tax were reduced significantly. The legal deadline for VAT refunding was further reduced from 4 to 3 months in January 2002. With the creation of a Tax Policy Division, there is now a clear separation between policy drafting and tax administration.

The progress does not outweigh the remaining problems: While in legal terms the deadline for VAT refunding has been reduced, in reality there are a lot of cases reported of non-respect of deadlines. Systematic checks and unjustified and sometimes multiple reviews of tax declarations put a heavy burden on business. There is a huge grey economy estimated at 15-25% of the total Bulgarian GDP. No progress has been made in curbing significant tax revenue losses, notably with regard to VAT in exporting activities. Low salaries of staff in the tax administration still lead to a difficult fight against corruption. Frequently changing tax legislation (changing sometimes 12 times in a year) is problematic notably for SMEs.

- Labour law – vocational training

UTFE 2001 Report recommendations: The government should be encouraged to open a dialogue with business on the need for vocational training.

Progress made: Much discussion on this issue and plans have been drawn up. Little however has been done on the shape of a consistent policy together with a realistic assessment of how such a strategy could be funded.

The existing labour laws compound the skills deficit. Although recently revised, the Labour Code is still very outdated and puts a heavy burden on employers. Redundancy procedures are very restrictive for business and redundancy payments in terms of monthly salaries much higher than elsewhere in Europe. The labour code is also very restrictive as regards short-term labour contracts (e.g. for seasonal work) or overtime/prolonged working time regulation. Application of health and safety standards is limited.

- Corruption

UTFE 2001 Report recommendations: Business should help the government in its efforts to tackle corruption.

Progress made: It is broadly accepted that some progress has been made with fighting corruption. Different anti-corruption measures have been introduced, which have led to some limited results. Nevertheless, the government has yet to set up a true dialogue with business that provides the confidence businesses need to face down corruption. It is only when corrupt individuals can be denounced without this then reverberating badly on the business doing the denouncing will true progress be made. There should be a forum of trust between business and government that demonstrates the government's ability and willingness to act upon cases of reported fraud.

4. Conclusions and recommendations

Bulgaria has made considerable progress in accession negotiations and in overall preparations for EU membership.

Bulgaria continues to experience strong economic growth reaching 4.0% in 2001. Also in 2002 and 2003, Bulgaria is expected to be among the fastest growing economies of Central and Eastern Europe. The foundation for these sustained high economic growth rates is undoubtedly the macro-economic stability achieved notably by establishing a currency board and by keeping budget deficits under 1%.

Progress has been made regarding the privatisation of key sectors; transparency and equal treatment in the privatisation process have been improved. Most tariffs on goods have been abolished and state aid has been further reduced.

Bulgaria has made significant progress with adopting and applying new legislation. There have been a number of positive developments regarding the taxation system (e.g. VAT) and promising plans related to the reform of customs. There are credible and visible attempts of reducing red tape including the abolishment of vast number of licensing requirements for business. Some progress has been made with fighting corruption.

However in many areas substantial difficulties still remain. Lack of administrative and judicial capacity and the still widespread corruption are key obstacles to further rapid progress. Further areas for which serious difficulties for business have been reported include for example intellectual property rights, public procurement, certification/licensing requirements (and bureaucratic procedures in general) and the labour law.

As a result, a majority of companies, both domestic and foreign, does not believe that Bulgaria could be ready to join the EU before 2007.

Main recommendations from a business point of view are as follows:

- Step-up efforts to improve the functioning of the judiciary, including reform of the apparatus and training of staff.
- Apply renewed and invigorated efforts to strengthen administrative capacity including further training of staff.
- Pursue the positive developments taken in the reform of customs.
- Make the procedures and practice of privatisation and public procurement more transparent.
- Take the political initiative in the protection of intellectual property rights, by providing the powers and resources needed to tackle the resurgent problem.
- Simplify the taxation system including combating the grey economy with more credibility.
- Implement further reform of the labour code (finding a better balance between the protection of the individual and businesses).
- Acknowledge that corruption remains a major problem and an obstacle to economic integration, and implement a realistic plan to tackle it.
- Continue to restructure state-owned companies, making the liberalisation of the energy markets a priority.

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