PEST Analysis of Bulgaria

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Introduction
This report aims at providing an overview of the current political, economic, social and technological factors that affect conducting business in Bulgaria.

Political Factors

Bulgaria’s Trajectory after 1989
Bulgaria’s transition from a communist regime to democracy and from central planning to free market economy was difficult and prolonged. In the first few years after the end of communist rule in 1989 the country was politically unstable – governments changed quickly and few reforms were introduced. The economy was hit hard by the dissolution of the COMECON – an economic agreement between Eastern Bloc countries that guaranteed the export of industrial and agricultural products, irrespective of their quality. Bulgarian companies (still mostly state-owned) were not competitive on the global markets and high inflation subdued domestic demand. A pivotal moment in the transition was the overthrow of the BSP (Bulgarian Socialist Party) government in the winter of 1997, instigated by month-long mass civil protests after the country experienced hyperinflation, bank failures and even grain shortage. The new right-wing government entered negotiations with the IMF and introduced a currency board system that stabilized the economy, eased inflation and gradually restored confidence in the banking system. This government also turned Bulgarian foreign policy course westwards and initiated the accession process to NATO and the EU – the country joined both organizations in 2004 and 2007 respectively. Following the political upheaval and economic crisis of 1997 Bulgaria achieved political stability – all governments thereafter served full terms, in contrast to their predecessors between 1990 and 1997. At the same time the country enjoyed stable growth, fall of unemployment, a spike in foreign investments and significant increase in earnings and living standards until the global financial crisis of 2008. The current centre-right government implemented some budget cuts and the economy returned to modest growth in 2010 and 2011, led by strong exports.

Political System and Current Government
The Republic of Bulgaria is a parliamentary democracy with a unitary system of government. The most important political office is that of the Prime Minister, who is usually the leader of the party with largest representation in parliament. The 240 members of the unicameral parliament are directly elected for four-year terms using proportional representation system. Parties and coalitions need to win at least 4% of votes to gain parliamentary representation.

The President serves as Head of State and is directly elected for a maximum of two five-year terms but has largely ceremonial functions. Nevertheless, he can exercise certain political influence through several channels: he has a mandate to conduct foreign policy and appoints and recalls Bulgarian ambassadors; he can veto legislation, however, the parliament can overturn the veto with simple majority; he is the supreme commander of the military and appoints the commanding army officers.

The judiciary is independent of the executive and the legislature and uses the continental civil law system. The Supreme Judicial Council organizes the judiciary and appoints all judges, prosecutors and senior magistrates. The Council consists of 25 members – the parliament and the judiciary each elect 11 members for five-year terms, while the chairmen of the two Supreme Courts and the Prosecutor General are members

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1 http://www.state.gov/r/pa/ei/bgn/3236.htm
2 http://news.bbc.co.uk/2/hi/europe/country_profiles/1059735.stm
by law. The Constitutional Court interprets the constitution and constitutionality of laws and treaties and is separate from the judiciary system. It is composed of 12 members who serve nine-year terms. The parliament, the president and the Supreme courts appoint 4 members each.

Last parliamentary elections in 2009 were won by the centre-right CEDB (Citizens for European Development of Bulgaria) with 116 out of 240 MPs. The socialist party, which dominated the coalition that formed the previous government, took a heavy defeat after failing to seriously tackle corruption and organized crime. CEDB decided not to enter a coalition with other centre-right parties but received their support in parliament and formed a minority government. In time the party practically attained a majority after a number of MPs defected from other parliamentary groups and declared support for CEDB. The Prime Minister is the leader and founder of CEDB – Boyko Borissov, former Mayor of the capital city of Sofia.

The President of Bulgaria since January 2012 is Rosen Plevneliev, former Minister of Regional Development and Public Works in the government of CEDB. He succeeded Georgi Parvanov, former leader of BSP, who served two terms between 2002 and 2012.

**Domestic Politics**

Last decade saw the breakup of the traditional left / right political model with the return of the ex-king Simeon Saxe-Coburg-Gotha, who formed a party – National Movement Simeon II (NMSS), just two months before the parliamentary elections in 2001 and won 120 out of 240 seats in parliament. Despite the economic stabilization after the crisis of 1997, Bulgarian people were disillusioned with the right-wing UDF (Union of Democratic Forces) government due to corruption allegations and limited progress with the reforms. Simeon Saxe-Coburg-Gotha stated that he will improve living standards significantly in 800 days, which combined with his image of well-spoken person not mired in Bulgarian politics won him the popular support. Although his centre-right government pressed ahead with market reforms and completed the negotiations with the EU, it did not fully meet people’s expectations and the party’s support declined – it had 50 MPs in the 2005 parliament and lost its parliamentary representation after the 2009 elections.

UDF also gradually lost public support. Some of its leaders formed their own parties and despite the union of the largest of them in the “Blue Coalition” before the 2009 elections, they won only 15 seats in parliament.

UDF’s traditional rival – BSP (Bulgarian Socialist Party, the former communist party) fell out of favour after their economic policies led to the crisis in 1997. The party returned to power in 2005 and together with their coalition partners – NMSS and MRF, completed the EU accession process. However, the coalition failed to combat corruption and organized crime, which led to freezing of EU funds and BSP’s election defeat in 2009. BSP has a wide membership base and network of formal structures and can rely on the loyal support of its core constituency. The socialists are a key player on the political arena – with 40 MPs they are the largest opposition party in parliament and the major opponent of CEDB. BSP traditionally maintains close ties with Russia. The party leader is Moscow-educated Sergey Stanishev, 45, who has chaired the party since its previous leader, Georgi Parvanov, was elected President in November 2001. After Mr. Parvanov served

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3 Constitution of the Republic of Bulgaria (http://www.parliament.bg/en/const);
4 http://rezultati.cik2009.bg/elected/index.html
5 http://www.novinite.com/view_news.php?id=125095
6 http://www.nationsencyclopedia.com/Europe/Bulgaria-POLITICAL-PARTIES.html
7 http://bnt.bg/bg/news/view/6846/flameCandle70x80px.swf
8 http://www.capital.bg/politika_i_ekonomika/bulgaria/2005/03/05/230327_bsp_-_na_krachka_ot_uspeha_i_provala/
9 http://polisci.berkeley.edu/people/faculty/FishM/FishBulgarianParties.pdf
10 http://www.economist.com/node/15213116
up his second term in January 2012, he implied he will run for leader of BSP at the next party congress in May.\textsuperscript{12}

The third partner in the previous coalition government – the Movement for Rights and Freedoms (MRF), represents Bulgaria’s 750,000 ethnic Turks and has been led by former dissident Ahmed Dogan since he founded the party in 1990. MRF also participated in NMSS’s coalition government in 2001 – 2005 and in the eight years it stayed in government has amassed considerable influence. The party can firmly count on the votes of Bulgarian Turks – despite the electoral defeat of its coalition partners in the 2009 elections, MRF increased its parliamentary presence from 34 to 38 MPs.\textsuperscript{13} \textsuperscript{14} \textsuperscript{15} \textsuperscript{16}

The ruling party CEDB was founded in 2006 by then Mayor of Sofia Boyko Borissov, who entered politics in 2001 when he was appointed chief secretary of the Ministry of Interior in the government of Simeon Saxe-Coburg-Gotha.\textsuperscript{14} In June 2005 he was elected Member of Parliament from NMSS but decided to stay chief secretary of the Ministry of Interior rather than enter parliament.\textsuperscript{17} A few months later he was elected Mayor of Sofia, a feat he repeated in 2007.\textsuperscript{18} His party won a major victory in the 2009 parliamentary elections – 39.7% of the popular vote with a turnout of 60%. CEDB’s government runs centre-right policies – pro-European orientation, low taxes and tackling corruption and organized crime.\textsuperscript{14} \textsuperscript{15}

The last party currently represented in parliament is nationalist movement Ataka, led by Volen Siderov, former journalist aligned with the UDF. The party’s radical discourse appeals to voters disillusioned with mainstream political parties. Ataka won 21 seats in parliament at the last elections but later six MPs left its political group.\textsuperscript{14} \textsuperscript{15} One more party entered parliament after 2009 elections – centre-right Order, Law and Justice (OLJ), which barely overcame the threshold of 4% and won 10 seats. However, its parliamentary group disbanded when an MP left and became independent (minimum size of a parliamentary group is 10 MPs).\textsuperscript{20} Chart 1 shows the distribution of seats in parliament after the last elections in 2009.

\begin{center}
\textbf{Chart 1. Distribution of Seats in Parliament after the 2009 Elections.}\textsuperscript{4}
\end{center}

\textsuperscript{11} \texttt{http://dariknews.bg/view_article.php?article_id=186827}

\textsuperscript{12} \texttt{http://www.dnevnik.bg/bulgaria/2012/01/22/1750475_v_bsp_chakat_sreshta_purvanov_stanishev_na_4_fevruari/}

\textsuperscript{13} \texttt{http://www.2005zbori.org/results/index.html}

\textsuperscript{14} \texttt{http://www.economist.com/node/11612095}

\textsuperscript{15} \texttt{http://www.economist.com/node/13996439}

\textsuperscript{16} \texttt{http://www.capital.bg/politika_i_ekonomika/bulgaria/2005/03/26/230589_dps_veche_se_oglejda_za_vtori_mandat_vuv_vlastta/}

\textsuperscript{17} \texttt{http://www.dnevnik.bg/bulgaria/2005/11/05/98500_boiko_borisov_shte_e_noviat_kmet_na_sofiia/}

\textsuperscript{18} \texttt{http://www.dnevnik.bg/bulgaria/2007/11/05/394746_v_oblastnite_centrove_bsp_ima_11_kmeta_gerb_-_10/}

\textsuperscript{19} \texttt{http://www.dnevnik.bg/bulgaria/2011/12/20/1730277_otceplite_se_ot_ataka_sa_kradci_na_partiini_pari/}

\textsuperscript{20} \texttt{http://www.dnevnik.bg/bulgaria/2010/03/22/877065_deputatite_ot_listata_na_rzs_podpisah_deklaracija_za/}
Bulgaria and the EU

Bulgaria has been allocated almost €7 bln between 2007 and 2013 under the Structural funds and Cohesion fund. These funds are mainly used to finance major infrastructural projects – construction of highways and water treatment facilities, extension of Sofia subway network, building a second bridge across the Danube River, etc.\(^\text{21}\) In July 2008, the European Commission suspended €500 mm under the PHARE, SAPARD and ISPA pre-accession programs after investigations by the European Anti-Fraud Office indicated that funds had been misused. The new CEDB government received wide support among EU officials and the three programs were restarted at the end of 2009 but a large part of the funds were permanently lost.\(^\text{21, 22}\) At the end of 2011 the absorption rate of EU funds reached 19%, while contracted but not yet paid funds were 65%. The Minister in charge of European Funds Management, Tomislav Donchev, recently stated that the country will manage to contract 90% of the funds in the 2007 – 2013 period and will push for €8 bln to be allocated to Bulgaria in 2014 – 2020.\(^\text{23, 24}\)

Although Bulgaria is a full member of the EU, nine EU countries impose restrictions on the right of Bulgarian workers to work there (e.g. work permits), which will continue until 2014.\(^\text{25}\) In addition, Bulgaria is still waiting to be accepted in the Schengen Area, EU’s passport-free travel zone. The country meets the technical requirements for entry but the Netherlands is blocking its bid because of worries about corruption.

Economic Factors

Economic Growth

Bulgaria is classified by the World Bank as an upper middle-income economy and is in the group of high human development countries according to the United Nations Human Development Index (HDI).\(^\text{26, 27}\) It is the poorest member of the EU with a per capita income of only 41% of the EU average ($13,500 in 2011 based on purchasing power parity).\(^\text{28}\) The economic transformation from central planning to free market capitalism that the country underwent after 1989 was difficult and resulted in a serious decrease in living standards – the country ranked 27th in the HDI index in 1990 but dropped to 69th in 1997, while currently it is placed 55th. Central planning and guaranteed exports had created an economy poorly suited for open competition on the global markets – many companies manufactured large volume of low-quality products that were not competitive. After the 1997 economic crisis led to the introduction of currency board under the guidance of the IMF, the economy gradually gathered pace. Privatization of state assets picked up tempo and foreign direct investments increased along with the EU accession process. The currency board brought monetary and fiscal stability and laid the ground for rapid economic growth between 2000 and 2008. Driven by growing bank lending, domestic consumption and FDI, growth averaged 6% per annum, more than double the EU average.\(^\text{28}\) Having achieved macroeconomic stability, Bulgaria experienced a sharp drop in unemployment and fairly low levels of inflation in the last decade.\(^\text{29}\)
The financial crisis of 2008 saw the EU – Bulgaria’s primary export market, fall into recession, and an abrupt credit squeeze which translated in a 5.5% contraction of Bulgarian gross domestic product (GDP) in 2009. As the EU countries recovered from the crisis, the Bulgarian economy returned to modest growth in 2010 and 2011, led by strong exports. Still, as credit became scarcer after the financial crisis and unemployment rose, domestic demand remains depressed. In 2011 GDP grew by 1.7% year-on-year and totalled €38.5 bln. The service sector contributed 63.2% of GDP, industry – 31.2% and agriculture – 5.6%. The IMF estimates Bulgarian GDP will grow by 2.5% in 2012 and 3% in 2013, while the European Bank for Reconstruction and Development (EBRD) forecasts growth of 1.2% in 2012 and the Ministry of Finance expects 2.9%. These figures are not only lower than pre-crisis levels but well below the growth rate needed to catch up with other EU countries. According to EBRD, the ongoing Eurozone debt crisis will pose a major risk for the economy as the EU accounts for about 60% of Bulgarian exports, which make up 55% of GDP. Exports declined by 10% in January 2012, which may indicate a weaker than expected growth in 2012. The country’s close economic and financial ties with Greece might also have a negative influence due to Greece’s fiscal and debt problems and unstable banking system. Economic growth will depend on improving labour and credit markets, which in turn will bolster private consumption and investment. The speed of recovery in important trade partners will also play a major role, while fiscal tightening will put a drag on growth. Chart 2 displays the real GDP growth rate (accounting for inflation) between 1990 and 2013 (including IMF estimates for 2012 and 2013).

**Balance of Payments and Trade**

The growing current account deficit and the resulting need to attract external financing have been major concerns to policymakers in Bulgaria before the global financial crisis of 2008. In 2007 Bulgaria reported a

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30 World Bank database
31 http://www.nsi.bg/otrasal.php?otr=10&a1=813&a2=814&a3=815#cont
32 http://www.dnevnik.bg/biznes/finansi/2012/03/06/1781458_ikonomikata_na_bulgaria_e_narnalna_s_17_prez_2011_q/
33 http://www.dnevnik.bg/biznes/2012/01/24/1751829_ebvr_svali_prognozata_si_za_rasteja_na_bulgariia_do_12/
34 http://www.dnevnik.bg/biznes/2011/10/18/1180662_diankov_prognozira_29_rust_na_ikonomikata_dogodina/
35 http://www.capital.bg/politika_i_ikonomika/bulgaria/2012/03/12/1786101_dvigateliat_vremenno_ne_raboti/
36 http://www.nsi.bg/otrasal.php?otr=60&a1=992&a2=993&a3=994&a4=996#cont
record current account deficit – 30.2% of GDP (IMF data) or 25.2% according to the National Statistical Institute (NSI) (€8.7 bln or €7.3 bln respectively). The global economic slowdown rapidly narrowed the current account deficit as the shrinking domestic demand reduced imports much faster than lower foreign demand reduced exports – a monthly surplus was registered for the first time in five years in September 2009. In 2011 the annual current account was in surplus for the first time in 14 years (1.6% of GDP). The IMF expects the country will return to current account deficits in 2013 (1.5% of GDP) but in the next few years the deficit will stay well beneath pre-crisis levels. Chart 3 below provides a picture of Bulgarian current account since 2003, including IMF forecasts for 2012 and 2013.

The EU is the most important external market for Bulgaria – comprising about 60% of exports and imports. Among EU countries the primary trading partners are Germany, Italy, Romania and Greece, jointly making up 37% of exports and 31% of imports. Neighbouring Balkan countries (including EU members Greece and Romania) account for 30% of exports and 20% of imports. Bulgaria imports oil and gas from Russia, which makes it the largest exporter to Bulgaria with €4 bln in 2011. Charts 4 and 5 below present the distribution of exports and imports across geographical areas (Greece and Romania are counted in the Balkan countries category and excluded from EU).  

40 http://www.nsi.bg/otrasal.php?otr=60
In 2011 Bulgarian exports totalled €21.2 bln and imports amounted to €23.3 bln. Exports surpassed the pre-crisis level in 2010, while imports are yet to reach the level of 2008. The country exported a record amount of electricity in 2011 – over 10 bln kWh, a 30% annual increase.  

Bulgaria chiefly exports machinery (17% of exports in 2010), fuels (14%) and food and livestock (11%). Major imports include fuels (23% of imports in 2010), machinery (23%) and chemical products (12%). Chart 6 displays the amount of imports and exports, as well as the trade balance in 2003 – 2011.

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**Business Climate, Industrial Output and Private Consumption**

Business climate in Bulgaria levelled off in 2011 – the country maintained its rank (51) in the Doing Business survey published by the World Bank. The country ranked highest in ease of getting credit (7th) and paying taxes and lowest in dealing with construction permits and getting electricity. Bulgaria was placed 6th in the list of countries with highest improvement in paying taxes. Industrial confidence was rising before the global financial crisis in 2008, plummeted in 2009 and rebounded slightly afterwards. This trajectory is visualized in Chart 7 below.

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41 http://www.capital.bg/politika_i_ikonomika/bulgaria/2011/11/24/1212118_bulgariia_beleji_rekord_v_iznosa_na_tok/
42 http://www.doingbusiness.org/~/media/fdkm/doing%20business/documents/annual-reports/english/db11-fullreport.pdf
43 http://www.nsi.bg/EPDOCS/KeyInd2011-12_en.pdf
Private consumption, which formed 69% of GDP in 2011, experienced similar dynamics – sharp decline in 2009 followed by growth around zero in 2010 and 2011, which is shown in Chart 8 below.\(^{43, 44}\)

Foreign Direct Investment

Foreign direct investment (FDI) was one of the driving forces of the rapid economic growth before 2008. Since 2000, FDI was growing steadily, peaking at €9 bln (31% of GDP) in 2007. Investments have been stimulated by favourable fiscal policy, flat corporate tax rate of 10% (lowest level in the EU) and 0% for reinvested earnings in 142 municipalities with high unemployment (see Map 1 below), and low operational costs.\(^{45, 46}\) Other incentives include VAT exemption on equipment imports for investment projects over €5 mm and treaties for double taxation avoidance with 61 countries.\(^{47}\) Following the financial crisis of 2008 foreign investors quickly pulled out and investments decreased sharply – by 64% in 2009 and by 50% in 2010. In 2011 FDI remained at a low level (€1.34 bln), growing by only 11%. Last data from the Bulgarian

\(^{43}\) http://www.nsi.bg/otrasal.php?otr=10&a1=813&a2=814&a3=817#cont
National Bank (BNB) shows that FDI decreased 4 times on a monthly basis in January 2012, dropping to €44 mm.\(^{48}\) Chart 9 below presents the FDI dynamics in 2003 – 2011.

Between 1996 and 2008, Austria was the largest foreign investor in the country, having invested €5.4 bln (16% of total investments), followed by the Netherlands (€4.1 bln) and Greece (€3 bln). The real estate sector attracted the highest amount of FDI – 22% of total investments, followed by the financial sector.\(^{50}\) In 2011 the Netherlands overtook Austria to become the largest investor in Bulgaria, displayed in Chart 10.

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\(^{48}\) [http://www.dnevnik.bg/biznes/finansi/2012/03/15/1788323_prekite_investicii_ot_chujbina_namaliavat_chetiri_puti/](http://www.dnevnik.bg/biznes/finansi/2012/03/15/1788323_prekite_investicii_ot_chujbina_namaliavat_chetiri_puti/)

\(^{49}\) [http://www.bnb.bg/Statistics/StExternalSector/StDirectInvestments/StDIBulgaria/index.htm](http://www.bnb.bg/Statistics/StExternalSector/StDirectInvestments/StDIBulgaria/index.htm)

Taxes

Income and corporate taxes are flat at 10%. A special tax rate is applicable to the insurance and gambling industries. A foreign resident working in Bulgaria pays tax only on income earned in Bulgaria.

Value added tax (VAT) in Bulgaria is 20%. Firms with annual revenue higher than €25,000 must register under the VAT Act. Exempted from VAT are exports, income from financial services and legal advice, and imports for investment projects larger than €5 mm. The finance minister recently announced that VAT might be cut to 19% in 2012.

Property tax for non-residential buildings is 0.15%. The tax rate on residential buildings is determined by local tax laws.

The transfer tax rates for real estate and motor vehicles are 2% - 4%.

Inflation

Rising inflation had become a major concern for the Bulgarian economy before the outbreak of the global financial crisis, reaching 12.3% in 2008 (second highest in the EU). Price growth was driven by rising nominal wages in a tight labour market, increasing domestic demand and the food and energy price hikes in 2008. Inflationary pressures abated in the recessionary environment of 2009, further helped by weaker fuel and food prices. In 2011 NSI registered inflation of 2.8% and the IMF estimated it was 3.7%. Inflation is forecast to stabilize at about 3% in 2012 – 2013 according to the IMF. Chart 11 shows the inflation trend in 2003 – 2011 and the IMF forecast for 2012 – 2013.

http://www.investbg.government.bg/?sid=18&ssid=45&c=77
http://www.capital.bg/politika_i_ekonomika/bulgaria/2012/03/10/1784924_diankov.dds_moje_da_bude_namalen_oshte_tazi_godina/
http://www.economist.com/countries/bulgaria/profile.cfm?folder=Profile-Economic%20Data
http://www.nsi.bg/otrasal.php?otr=14&a1=177&a2=180&cnt
Employment and Average Wage

Up to the global financial crisis Bulgaria maintained one of the highest employment levels in the EU, reaching about 64% in 2008. Since the economic slowdown in 2009 the unemployment rate soared to more than double the level in 2008. At the same time employment fell significantly – from 3.37 mm people in 2008 to 2.9 mm in 2011. In the last quarter of 2011 the unemployment rate climbed to 11.4% (380,000 people), an annual increase of 0.2 percentage points. The number of inactive people aged 15 – 64 (neither working nor looking for a job) reached 1.7 mm (33.7% of the labour force) in Q4 2011. The tightening labour market is illustrated in Charts 12 and 13, showing respectively the unemployment rate and the annual growth rate of employment.


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56 http://www.dnevnik.bg/biznes/companii/2012/02/03/1758774_vseki_treti_nito_raboti_nito_tursi_rabota/
57 http://www.nsi.bg/otrasal.php?otr=26&a1=708&a2=711&a3=713#cont
58 http://www.nsi.bg/otrasal.php?otr=26&a1=735&a2=736&a3=739
The rapid economic growth and falling unemployment before the recession of 2009 resulted in a considerable rise in nominal wages (about 50% only in 2007). Part of this growth is attributable to the introduction of flat income and corporate tax rate of 10%, which caused many people to declare their official income and reduced the so-called “grey” economy. The growth in wages continued after 2009 despite rising unemployment. Still, wages remain far from the average EU levels – average wage in 2011 was €361 per month. The IT, energy and finance sectors traditionally offer the highest wages – €803, €749 and €723 per month respectively in 2011. The lowest-paid jobs are in administrative support, hotels and restaurants and construction – €229, €231 and €269 per month respectively. Having the lowest labour costs in the EU remains a competitive advantage for Bulgaria and many multinational companies have established local branches or outsourced activities. Chart 14 demonstrates the recent growth of the average wage. 

Government Finances

Since 1997 the Bulgarian economy has operated under a currency board, which pegged the Bulgarian lev (BGN) to the Deutsche mark (DEM) at 1:1 exchange rate. Since 1999 the lev is fixed to the euro at 1.95583 BGN / EUR (equal to the fixed exchange rate DEM / EUR). The currency board requires the central bank (BNB) to maintain foreign currency reserves enough to cover all currency in circulation. The aim of the currency board was to stabilize inflation and prepare the country for eventually adopting the euro. There is

http://www.nsi.bg/otrasal.php?otr=26&a1=708&a2=715&a3=716#cont
firm political commitment to maintain the board until Bulgaria enters the Eurozone. The currency board has strong support – foreign currency reserves rose by 3.7% year-on-year in February 2012, reaching €12.8 bln, while monetary base coverage remained stable at 171%. The country was expected to enter ERM II (a “waiting room” mechanism preceding Eurozone entry) in 2011 – 2013 but the fiscal deficits between 2009 and 2012 and especially the uncertainty surrounding the Eurozone since the sovereign debt crisis flared up in 2011, postponed this step until after 2015.

The recent economic crisis poses tough challenges to the government – it has to deal with rising unemployment and accelerate investment in infrastructure but cannot consistently run fiscal deficits. The budget surpluses during the economic boom before 2008 were followed by a fiscal deficit of 4% in 2009, which was reduced later but the government still plans to run a 1.3% deficit in 2012. Taking into account the increase in social spending and the need to co-finance EU projects, reducing government spending will be difficult without reforms in the pension, health care, public administration and education systems. Some changes in the pension system were introduced in December 2011 – the retirement age will start increasing in 2012 by 4 months per year until it reaches 63 years for women and 65 for men (currently it is 60 and 63 years, respectively). Despite recent budget deficits, on a macro level Bulgaria is one of the most fiscally disciplined countries in the EU - public debt to GDP ratio was 15.8% in January 2012 (the EU average is around 80%) and the government’s reputation for fiscal prudence is strong. Also, a fiscal reserve amounting to €2 bln in January 2012 is in place. The commitment to fiscal consolidation is broadly supported by the desire to maintain the currency peg. The fiscal discipline practiced by the current government resulted in the country’s credit rating being raised one notch to Baa2 by Moody’s in July 2011. The finance minister suggested in 2011 the introduction of fiscal prudence rules in the Constitution, setting limits of 2% of GDP for the fiscal deficit and 40% of GDP for public debt. Around €800 mm of government debt matures in January 2013 and the cabinet plans to use external financing to pay up the principal.


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62 www.minfin.bg/document/10606
63 http://bnr.bg/sites/radiobulgaria/Lifestyle/Bulgaria_EU/Pages/BG%20v%20evrosonata%202015.aspx
64 http://bnt.bg/bg/news/view/63372/simeon_djankov_budjet_2012_e_naj_dobrijat_v_uslovija_na_kriza
65 http://www.dnevnik.bg/biznes/linhi_finansi/2012/03/26/1741936_pensioniraneto_-_kakvo_novo/
68 http://www.dnevnik.bg/biznes/finansi/2012/01/27/1754183_djankov_ne_se_bezpokojim_za_evroto_zashteto_levut_e/
Banking, Credit Market and Risk

The banking sector in Bulgaria is stable and banks remained profitable even after the global financial crisis of 2008 – €316 mm and €299 mm of profits were registered in 2010 and 2011 respectively (compared to €709 mm profit in 2008). Banks are well protected against future shocks as they did not pay dividends over the last 3 years but retained their profits as buffers for unexpected losses (capital reserves exceeded regulatory capital by €1.5 bln at the end of 2011). As of January 2012 bank assets increased by 0.8% year-on-year to €39.5 bln, of which credits to firms and individuals totalled €27.7 bln. A possible threat for the banking system is the large percentage of Greek-owned banks (30% by assets) – Greek parent banks are in a precarious situation and have been pulling out significant amounts of funds from their Bulgarian subsidiaries ($1.8 bln in the 2nd and 3rd quarter of 2011 alone). However, BNB remains committed to ensuring the stability of the banking system.

Credit growth plummeted after the financial crisis from 60% per year in 2007 to single digits in 2009, 2010 and 2011 (see Chart 17). Banks tightened their lending as the credit boom before 2008 resulted in an increasing percentage of bad credits once incomes fell in 2009. Also, the real estate prices took a serious plunge which led to souring mortgage debt. At the end of February 2012 bad and restructured credits amounted to €4.7 bln (22.6% of credit portfolio) after increasing by 22% year-on-year. The uncertainty that the Eurozone debt crisis creates discourages investing in real businesses and leads to a rise in bank deposits – household savings increased by 13.2% on the year and reached €16 bln, while corporate deposits grew by 10.7% to €6.9 bln in February 2012.

69 http://www.capital.bg/biznes/2012/02/29/1777780_dvuclifren_rust_na_pechalbata_na_bankite/
70 http://www.investor.bg/ikonomika-i-politika/332/a/pechalbata-na-bankite-namalava-s-21-do-617-mln-lv-za-2010-g,111783/
71 http://bnr.bg/sites/en/Economy/Pages/1003GreekCrisisandBanks.aspx
72 http://www.dnevnik.bg/biznes/2012/02/01/1757030_chujdite_banki_produljavat_da_iztegliat_kapital_ot/
73 http://www.capital.bg/biznes/2012/03/25/1794894_vse_poveche_depoziti_i_vse_po-malko_krediti/?ref=novo24
Shrinking local credit demand and the new Basel III capital requirements led Western European banks to pull out capital from their Bulgarian subsidiaries. Investment bank Nomura forecasts that €1.4 bln might be pulled out of Bulgaria by parent banks in 2012.  

As demand for credit slowed down significantly, interest rates dropped by several percentage points. Interest rate levels are indicated by SOFIBOR – an index of quotations for unsecured BGN deposits offered on the Bulgarian interbank market. The chart below reveals the decrease in SOFIBOR from 7% to less than 4% since 2008.

Ample supply of foreign credit in the pre-crisis years led to an alarming rise of Bulgarian gross foreign debt, reaching €37.6 bln (111% of GDP) in 2009. Lower credit demand since 2008 has reduced the debt level – in 2011 it dropped by 10.7% to €35.4 bln (92% of GDP).

Social Factors

Demographics

Bulgaria faces a demographic problem – its population has been declining for the past two decades at a rate of -0.8% (2011 estimate) and equals 7.4 mm people (as of February 1, 2011) after a peak of about 9 mm in

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74 http://www.capital.bg/politika_i_ikonomika/bulgaria/2011/11/06/1197508_iaponskata_nomura_bulgariia_e_nai-zaplashena_v_regiona/
Negative natural growth rate contributes 2/3 to the annual decrease and immigration accounts for 1/3 (net migration rate equalled -2.8 migrants per 1,000 people in 2011).\(^{77}\) Chart 19 presents the population dynamics in 2001 – 2011.

Chart 19. Population (in thousands) in 2001 – 2011\(^{78}\)

Another important demographic trend is urbanization. It began after World War II and by 2011 72.5% of the population (5.3 mm people) live in urban areas.\(^{76}\) Around one third of the population lives in the seven biggest cities. Official data claims 1.3 mm people (17.5% of population) live in the capital city of Sofia but many people do not change their address registration when they come to live in the city. In the last 10 years the number of people officially living in Sofia has increased by 10.3%. Urbanization is explained by the considerable difference in living standards and working conditions between urban and rural areas. This process can be observed in many other developing economies. In the last few years, however, the trend slowly reversed – the rate of urbanization between 2010 and 2015 is estimated to be -0.3% annually.\(^{77}\)

Another important demographic factor is the aging population. The share of people below the age of 15 decreased from 15.3% in 2001 to 13.2% in 2011, while the share of people above 65 increased from 16.8% in 2001 to 18.5% in 2011. In 2011 the birth rate was 9.3 births per 1,000 inhabitants (compared to EU average of 10.7) and the death rate – 14.3 deaths per 1,000 inhabitants (EU average of 9.7).\(^{79}\) The birth rate is expected to decrease in the next 15 years as the childbearing age population will shrink during that period. This trend is expected to lead to a future decrease in the workforce. As of 2011, the median age of the population is 42 years.\(^{77}\) The number of working-age people is 4.6 mm (62.2% of the total). Men account for 52.5% and women – for 47.5% of population.

The population decline will continue in the future according to the NSI. In the worst-case scenario the population will drop to 5.2 mm people by 2060, whereas in a more positive socio-economic scenario it will decrease to 6.1 mm.

**Ethnic Groups**

The major ethnic groups in Bulgaria (as of 2011) are: Bulgarian (84.8%), Turkish (8.8%) and Roma (4.9%). The percentage of Roma people is supposedly higher than the official census figures. The Turkish population is concentrated mostly in the south-eastern and north-eastern parts of the country. About 0.5% of


\(^{77}\) [http://www.indexmundi.com/bulgaria/demographics_profile.html](http://www.indexmundi.com/bulgaria/demographics_profile.html)


the population (36,723 people) are foreign citizens, of which the largest groups are Russian (65.1%), Ukrainian (16.6%) and Macedonian (5.9%) citizens. The ethnic situation in the country is stable, although in October 2011 there were significant ethnically-charged street protests after a 19-year-old man was killed by an associate of a local Roma leader.

Languages
The official language in the country is Bulgarian, which is the first language of 85.2% of the population (as of 2011). Other languages include Turkish (9.1%) and Roma (4.2% but believed higher).

Religion
Most Bulgarians define themselves as East-Orthodox (76% as of 2011). There are also Muslims (10%), Protestants (1.1%) and Catholics (0.8%). Atheists account for 4.7%, while 7.1% do not identify themselves with certain religion.

Education and Literacy
Bulgaria has a high literacy rate, estimated at 98.5% in 2011 – a clear indication that the country has high educational standards. This is supported by the increasing number of people with secondary and higher education. As of 2011, 19.6% have completed some form of higher education (an increase of 5.5 percentage points over the last 10 years). In addition, 43.4% of the population have secondary education. About 92% of eligible children were enrolled in primary education (the lowest level in the last 10 years – previously the indicator was above 95%). Another important recent trend is Bulgarian students going abroad for their higher education, especially after the EU accession eased the process. The most popular destinations for Bulgarian students are the U.S. and the UK, followed by Germany, France, the Netherlands, Spain, and Italy.

Welfare
The number of Bulgarians living in poverty has decreased by more than 60% between 1999 and 2011, as a result of sustained economic growth and improving social policies. Still, the poverty rate (20.7% in 2010) is greater than the EU average (16.4%). It is highest in the rural areas of the country. As of 2009, 14.7% of Bulgarians are at risk of poverty but do not live below the poverty threshold (which was €120 per month per person in November 2011).

Technological Factors
R&D and Innovation
Investment in research and development (R&D) in Bulgaria is among the lowest in the EU at 0.53% of GDP in 2009, i.e. around 4 times less than the EU average. The very low level of private R&D investment in the economy (0.16% of GDP) is particularly worrying and can be attributed to the prevalence of low technology...
sectors in the economy. A substantial increase in R&D spending will be instrumental for raising economic competitiveness and the government has set a national target of 1.5% of GDP for 2020.85

Energy Efficiency
Bulgarian economy is the most energy intensive in the EU – 854 kg oil equivalent per €1,000 GDP compared to EU average of 168 kg oil equivalent per €1,000 GDP.86 There are significant opportunities for improving the energy efficiency of the economy.

As Bulgaria needs to meet the requirements of the EU 20-20-20 directive (achieve 16% share of renewable energy by 2020), the government firmly supports alternative energy projects by offering to purchase the electricity they generate at preferential prices for a fixed period of time – 12 years for wind projects, 15 for hydro plants and 20 years for solar and biomass energy. The preferential prices are about €130 – 220 for electricity from biomass projects, €60 – 110 for hydro, €90 for wind and €250 – 300 for photovoltaic plants.87

Use of Internet and Mobile Technology
Use of Internet is relatively high – at the end of 2011 there were about 3.5 mm Internet users (49% of population) and 45% of households had broadband access (up from 30% in 2009).88 89 Social media are very popular, especially among young people – there were about 2.3 mm Facebook users at the end of 2011. Average download speed in Bulgaria is the 3rd fastest in the world (1.6 MB/s), behind South Korea and Romania.90 However, only 14.4% of regular internet users aged 16 – 74 have made online purchases in 2011 – an annual increase of 2.2 percentage points.91 As of January 2011, 87% of firms had Internet access. E-government is relatively developed - many firms submit their administrative forms online (66%) and about 90% submit VAT and social security declarations online.92

In 2010 there were 10.5 mm cell phones (141% of the population).93 The share of smartphones reached 9.4% in 2011 and is forecast to go up to 22.4% in 2016.94 95 The leading mobile operator is currently testing a 4G network.96

87 http://www.dker.bg/NPDOCS/Reshenie_preferencialni_tocni_ot_VEI_31032011.pdf
89 http://www.dnevnik.bg/tehnologii/2011/09/21/1161123_bulgariia_e_v_chelnata_troika_na_stranite_s_nai-burz/
91 http://www.nsi.bg/otrasal-eventen.php?n=1183&otr=48
96 http://www.dnevnik.bg/tehnologii/2011/12/30/1736532_mobitel_puska_testova_4g_mreja_ot_1_januari/
# Key Highlights

## Political Factors
- Bulgaria is a parliamentary democracy currently governed by a centre-right cabinet led by former Mayor of Sofia Boyko Borissov
- Ruling party CEDB runs a minority government but is supported by a few independent MPs, which gives it parliamentary majority in practice. Next elections are planned for 2013
- The President is directly elected but has largely ceremonial functions. CEDB candidate Rosen Plevneliev was elected President in November 2011
- The political climate in the country is stable
- Since 2001, Bulgaria has implemented numerous market reforms and has achieved stable economic growth, fall of unemployment and significant increase in living standards
- The country is a member of NATO since March 2004 and of the EU since January 2007

## Economic Factors
- Bulgaria is an upper-middle-income developing economy
- The nation is still ranked as the lowest income member of the EU, with GDP per capita standing at 40% of the EU average
- The economy grew by about 6% annually before the crisis of 2008, driven by rising FDI and a credit boom, declined by 6% in 2009 and posted modest growth afterwards, led by strong exports
- Fiscal position is strong, with low public debt and fiscal deficits
- Current account deficit reached 23% of GDP in 2008 but dropped sharply after the global financial crisis, turning into surplus of 1.6% in 2011
- Banking system is stable and overcapitalized but is exposed to the risks of worsening credit portfolios and Western European parent banks pulling out liquidity

## Social Factors
- Population is 7.4 mm people and comprises Bulgarians (85%), Turks (9%) and Roma (5%)
- Population has been declining for the past two decades due to negative natural growth and emigration. It is expected to continue shrinking by about 40,000 people per year
- Despite recent ethnically charged protests, people in mixed areas have lived together in peace for a long time and ethnic violence is not expected
- The number of people living in poverty has decreased by 60% between 1999 and 2008 but the poverty rate is still high at 21%

## Technological Factors
- The energy intensity of the economy is the highest in the EU, 5 times the EU average
- Government supports investments in renewable energy projects by purchasing the energy they generate at a preferential price for a fixed period of time
- While Internet penetration is fairly high and connection speed is excellent, relatively few people shop online and e-government is not fully developed