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BULGARIA – REVIEW OF PROGRESS ON POLICY MEASURES RELEVANT FOR THE CORRECTION OF MACROECONOMIC IMBALANCES

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Executive summary

This is the third specific monitoring report under the Macroeconomic Imbalance Procedure (MIP) for Bulgaria, which in the 2016 European Semester was identified as experiencing excessive macroeconomic imbalances. The report reviews the latest developments and policy initiatives undertaken by the authorities relevant for the correction of the imbalances identified in the 2016 Country Report and targeted by the 2016 country-specific recommendations for Bulgaria. The cut-off date for this report is 9 November 2016.

Efforts to tackle the imbalances identified in the in-depth review have continued, supported by an improved macroeconomic environment. The authorities have followed up on their commitments to address the excessive macroeconomic imbalances in most areas. Better-than-expected growth driven by strong domestic demand has supported their efforts. The fiscal position has remained stable and consolidation appears to be on track.

Building on progress so far, further steps are needed to ensure the robustness of the banking sector and the credibility of the supervision. The completion of the asset quality review and stress tests did not indicate systemic weaknesses. Nevertheless, some institutions warrant close attention, including one systemic bank. The exercise needs to be followed-up appropriately to ensure that weaknesses in business practices and capital levels are addressed. Efforts in improving the quality of banking supervision are in the process of implementation.

Completing the non-banking financial sector reviews to a high international standard and taking decisive follow-up measures, as needed, remains a key priority. The reviews are under way. The aim is to provide an independent view on the state of the insurance and pension funds markets. Important risks concerning related-party investments and concentration are also being examined. Swift and targeted follow-up actions will be crucial, addressing both the possible weaknesses among market participants and those of the supervisor.

Important insolvency framework reforms are lagging behind. Legislative changes aimed at improving the insolvency framework have been delayed. Tangible effects of those reforms would only be visible once implementation is well under way. Challenges to implementation, including the qualification and training of judges and the capacity of courts, also remain to be addressed.

Steps to improve the functioning of the labour market are pending. A transparent mechanism for setting the minimum wage and rules for administrative increases of the minimum social security thresholds remain to be introduced. Measures to enhance the employability of the unemployed and to increase access to related services were adopted. A comprehensive methodology for monitoring the impact of active labour market policies in the long run would help to address the ongoing challenge of optimising their targeting and funding.

In conclusion, the Bulgarian authorities have advanced with their reform efforts even if significant challenges remain in some areas. Fiscal consolidation has progressed. The follow-up actions in the financial sector will have to reflect the determination of the authorities to fully restore market confidence. Improved labour market conditions should help sustain the reform efforts. Further attention needs to be devoted to address shortcomings in the insolvency framework and overall judicial system.

Table 1: Key findings on implementation of policy reforms [1]

On track	Wait-and-see	Action wanted
• Fiscal consolidation in 2016 • Asset quality review and stress test of the banking sector were completed • Comprehensive tax compliance strategy	• Measures following the results of the banks' asset quality review and stress tests are addressed to the credit institutions • Independent review of the pension funds and insurance companies • Follow up on the financial sector reviews addressing their results • Strengthen financial sector supervision • Amendments to the law on employment promotion • Implementation of the package of ALMP measures	• Amendments to the Social Security Code • Mechanism for setting the minimum wage • Mechanism for administrative setting of the social security thresholds for activities with no agreement • Methodology for monitoring of ALMP • Amendments to the Commercial Code and Pledge Registry, a new law on financial auditing companies and measures to improve the insolvency framework

[1] The table classifies reforms under review on the basis of their respective adoption and implementation process and their credibility and level of detail. “On track” are measures for which the legislative or implementation process has been completed or is progressing well according to the foreseen timeline, and which are expected to be sufficiently effective. “Wait and see” are measures for which the legislative process is on-going, but is still in a relatively early phase, or measures for which there is still uncertainty on the complete implementation and effectiveness. “Action wanted” are measures for which limited or no action has been taken, or measures that have been announced but which are not sufficiently detailed yet to be assessed.

1. Introduction

On 26 November 2015, the European Commission presented, in the context of the Macroeconomic Imbalance Procedure (MIP), its fifth Alert Mechanism Report[2] to underpin the selection of Member States requiring an in-depth investigation into the existence and extent of macroeconomic imbalances. The subsequent In-Depth Review in the Country Report on Bulgaria – published on 26 February 2016[3] – examined the nature, origin and severity of macroeconomic imbalances and risks in Bulgaria. In its Communication published on 8 March 2016[4], the Commission concluded that "Bulgaria is experiencing excessive macroeconomic imbalances". In particular, the Commission emphasised the remaining fragilities in the financial sector and high corporate indebtedness in a context of high unemployment. In April 2016, Bulgaria submitted its Convergence Programme[5] and National Reform Programme (NRP)[6], respectively outlining fiscal targets and policy measures to improve its economic performance and unwind imbalances. On the basis of an assessment of these plans, the Commission proposed four country-specific recommendations (CSRs)[7], which were subsequently adopted by the Council on 12 July 2016[8]. The CSRs addressed to Bulgaria concern: sustainable public finance, strengthening supervision of the financial sector, improvements to the insolvency framework and labour market and social policy issues. All of the CSRs were considered to be MIP relevant.

The present report assesses the latest key policy initiatives[9] undertaken by Bulgaria[10]. For this purpose, a specific monitoring mission to Bulgaria was conducted on 3-5 October 2016.

2. Outlook and recent developments on imbalances

Recent economic developments and outlook

After a strong growth performance of 3.6% in 2015, Bulgaria's economy is forecast to grow by 3.1% in 2016. A substantial revision of national accounts data lifted real GDP growth figures from 3% to 3.6% for 2015. Private consumption growth, driven by rising consumer confidence, was particularly buoyant at 4.5%. In the autumn forecast, the Commission expects a small moderation of growth to 3.1% at end 2016, followed by 2.9% and 2.8% in 2017 and 2018, respectively.[11] For 2016, private consumption growth is forecast to be the key growth driver. Net exports contribute positively to growth. However, this is expected to quickly wane in 2017 due to expected rising import growth and energy prices. While average inflation is forecast to be negative in 2016 with close to -1%, it is expected to pick up pace to reach 1% in 2017, driven by domestic demand as well as recovering energy prices. The unemployment rate is set to further decrease from 9.2% in 2015 to 8.1% in 2016 and to 7.1% in 2017.

[2] http://ec.europa.eu/europe2020/pdf/2016/ags2016_alert_mechanism_report.pdf
[3] http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_bulgaria_en.pdf
[4] http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_comm_en.pdf
[5] http://ec.europa.eu/europe2020/pdf/csr2016/cp2016_bulgaria_en.pdf
[6] http://ec.europa.eu/europe2020/pdf/csr2016/nrp2016_bulgaria_en.pdf
[7] http://ec.europa.eu/europe2020/pdf/csr2016/csr2016_bulgaria_en.pdf
[8] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2016.299.01.0032.01.ENG&toc=OJ:C:2016:299:TOC
[9] Details on the policy measures taken can be found in the overview table in the Annex
[10] The previous MIP specific monitoring report was published in December 2015. See http://ec.europa.eu/economy_finance/economic_governance/documents/20160118_bg_imbalances_epc_report_en.pdf
[11] http://ec.europa.eu/economy_finance/eu/forecasts/2016_autumn/bg_en.pdf

Investment is expected to be subdued in 2016 followed by a strong recovery in 2017. Gross fixed capital formation (GFCF) growth is forecast to contract by 0.8% due to the sharp slowdown in EU funds absorption following the end of 2007-2013 programming period. GFCF is projected to gain momentum in 2017 with a growth of 3.2% as more projects under the new, 2014-2020, programming period are likely to be implemented. In general, the continuing but necessary deleveraging process, an unsupportive business environment and restrained foreign capital inflows are likely to weigh on investment growth. Overall, risks to the growth outlook appear balanced.

The fiscal deficit is decreasing faster than expected but with some risks. For 2016, the authorities expect the fiscal deficit to improve to 0.8% of GDP, from 1.7% of GDP in 2015. The authorities target a balanced budget by 2020. The Commission autumn forecast points to a slightly higher deficit of 0.9% of GDP in 2016, decreasing to 0.8% and 0.7% in 2017 and 2018, respectively. Public debt is projected to increase to 29.4% of GDP in 2016, mainly driven by the decision to temporarily increase cash buffers and then forecast to decline to 26.3% of GDP in 2017 and 25.9% of GDP in 2018. The fiscal outlook faces some negative risks, in particular from the high level of contingent liabilities of public and other entities, including the envisaged state aid to the national energy company.

Developments as regards imbalances

In March 2016 Bulgaria was found to be experiencing excessive macroeconomic imbalances. The imbalances relate to the remaining fragilities in the financial sector and high corporate indebtedness in a context of high unemployment. Below is an update of developments as regards these imbalances.

<u>Financial sector</u>

Aggregate banking sector profitability improved, while liquidity remained high. The banking sector reported an average return on equity of 10.1% in the first nine months of 2016, with aggregate profit growing by 33.5% y-o-y. The improvement was broad based, benefitting also from significant one-off factors. Lending remained subdued on aggregate mainly due to continued low demand. The deposit base grew by 5.2% y-o-y, which contributed to a further increase in the aggregate ratio of liquid assets. Nevertheless, the market retains a degree of heterogeneity as funding costs in some institutions remain well above the average, although overall the degree of dispersion is decreasing.

The results of the completed asset quality review (AQR) and stress tests (ST) of the banking system do not point to systemic weaknesses, but some banks warrant close attention. According to the published results, additional provisioning needs arising from the AQR amount to BGN 665mn, or 1.3% of the aggregate risk-weighted assets of the participating banks. No bank had a common equity Tier 1 capital ratio lower than the regulatory minimum of 4.5% of risk-weighted assets. However, the capital ratios of two banks, First Investment Bank (a systemically-important institution) and Investbank, failed to meet the systemic risk (3 percent) and capital conservation (2.5 percent) buffers required by the BNB. Also, under the baseline scenario of the stress test, Investbank would end up with negative capital in 2018, while another two banks would fail to meet the additional capital buffers. Under the adverse scenario four banks would fall below the minimum capital requirement, two of which would have negative capital. Three of these are domestically-owned institutions.

The insurers and pension funds faced significant challenges in 2016. The independent reviews of both sectors are currently under way. In addition, pension funds had to prepare for the possibility of transfers of accounts from the Pillar 2 funds to the state-operated pay-as-you-go Pillar 1, which were allowed by legislative amendments in 2015. Statistics show that less than 1% of the account holders have taken advantage of the transfer option in the first year of its existence. The insurance market faced the additional challenge of implementing Solvency II rules, which were transposed into the national legislation in late December 2015 and April 2016 (regarding own funds).

In terms of market-driven developments, the Pillar 2 pension funds market remained overall stable in the first half of 2016. The net assets of the funds increased by 12.6% to just over 9% of GDP. The realised return on assets was 1.8% (annualised, for July 2014 to June 2016) compared to 4.9% twelve months ago, reflecting lower bond yields as well as a slump in the domestic stock exchange in the past year. Transfers of accounts between the pension funds continued at an increased pace with 2.8% of all participants changing their Pillar 2 fund, compared to 2.3% in H1 2015. The overall tendency remains to transfer pension assets to pension funds owned by foreign financial groups with operations across the Bulgarian financial market.

On the insurance side, market penetration has continued with Gross Written Premiums (GWP) growing by 4.6% by July 2016 for the general insurance market and by 9.9% for the life insurance market, compared to the same period of last year. The difference in growth indicates a possible rebalancing between life and non-life markets. The life insurance market remains relatively underdeveloped compared to other Member States and represents less than 25% of the insurance sector in Bulgaria in terms of GWP. Gross claims paid decreased by 4% for general insurance and increased by 26% for life insurance.

Corporate debt and deleveraging

While the slow but orderly deleveraging process is continuing, high private sector indebtedness remains of concern, in particular for non-financial corporates (NFCs). Debt of NFCs has been on a declining path. In 2015, it decreased by 11.7 pps. to around 89% of GDP on the back of the continuing deleveraging path and reduction of cross-border intra-company loans. The banking sector non-performing loans (NPLs) ratio for corporates has continued to decrease but remains elevated at nearly 16.3% as of Q3 2016. Any deleveraging pressures may weigh not only on investment and growth in the short term but also on medium-term growth prospects. The authorities do not plan any further government measures to address corporate indebtedness following the reform to the insolvency framework.

Labour market

While the unemployment rate and youth unemployment have been decreasing, persistent structural issues continue to impact the functioning of the labour market. The unemployment rate dropped to 9.2% in 2015, from a peak of 13% in 2013. In the same period, youth unemployment dropped from 28.3% to 21.6% in 2015. Both continued to shrink in the first half of 2016. Long term unemployment, however, is proving more resilient. Despite recent improvements, in the first half of 2016 more than 60% of those unemployed have been in this situation for more than a year, one of the highest incidences in the EU. Low labour market participation, as well as skills, sectoral and geographical mismatches also hinder a balanced labour market adjustment.

3. Policy implementation and assessment

3.1. Public finances

The fiscal adjustment seems to be on a good track with the budget in 2016 expected to overshoot the deficit target. The 2015 deficit (in ESA terms) was revised from 2.1% of GDP to 1.7% of GDP in the 2016 autumn notification in light of updated data on tax revenues. The structural deficit was thus revised from 1.9% to 1.4% of GDP. For 2016, the Commission autumn forecast points to a deficit of 0.9% of GDP, only slightly higher than the authorities' projection of 0.8% of GDP. Both projections reflect mainly two developments. First, a strong increase in revenues as compared to the same period last year in light of better macroeconomic developments and some signs of enhanced tax compliance. Second, public investment lags behind the initial plans.

Fiscal consolidation is expected to continue in the medium term reflecting developments on both revenue and expenditure sides. These include: (i) some revenue increasing measures (including rise of the excise duties), (ii) the expected recovery of EU-funding and the decline of public investments from domestic resources, and (iii) a prudent management in current expenditures according to the plan of the government to keep their ratio broadly unchanged. The authorities have initiated a spending review in cooperation with the World Bank. Their intention is to first implement a comprehensive strategic expenditure review of two types of major expenditures (maintenance and operating expenditures and compensation of employees) at least in seven line ministries and their second level spending units and in 21 municipalities. On the basis of the strategic diagnostic two or more sectors/programmes will be identified for a deeper analysis. The first tangible results of the planned spending reviews could be incorporated in the 2019 budget.

Contingent liabilities pose a downside risk to fiscal performance. The most immediate one is related to the compensation to the Russian Atomstroyexport by the National Energy Company (NEK) in light of the cancelled Belene project, as decided by the International Court of Arbitration. At the end of September, the parliament approved state aid to NEK in the form of an interest-free unsecured loan. The measure has been notified to the Commission services in end-September 2016 and is under assessment. The final amount of the compensation might exceed 1.5% of GDP, depending on the payment schedule, due to penalties that the company will need to pay according to the court decision. A first tranche of the compensation is expected to be paid by mid-December. Upside risks include a better than expected performance in revenues as a result of the continued efforts to combat informal economy and to improve collection.

A number of measures to improve tax compliance and reduce informal economy are being implemented. Many of the measures included in the single national strategy[12] and its action plan have been mobilised, while for some of them some first results are already

[12] The "Single national strategy for improving the tax collection, tackling the shadow economy and reducing the compliance cost 2015-2017" was adopted in October 2015 by the government.

evident. These include improvements in the control system for high tax risk goods, changes in VAT collection systems for liquid fuels and introduction of reverse VAT charge mechanism for grain and industrial crops, improvement of monitoring and collection system of overdue liabilities including the obligation of information exchange between tax authorities and budget units for the collection of arrears from public sector contractors. Concerning undeclared work, since 2015 labour inspections based on risk criteria have been increased.

Overall, the fiscal position remains stable and does not seem to pose an immediate risk.

3.2. Banking sector

The asset quality review and stress tests of the banks were completed on time. The results were published on 13 August 2016, as initially announced by the authorities. The exercise was ambitious in terms of scope, covering all 22 banks (only the five foreign branches were excluded) with aggregate asset coverage of nearly 60% of the in-scope risk assets. The very wide scope of the exercise provided a very good basis for a comprehensive screening of the sector. The methodology of the asset quality review was to a large extent based the one established by the ECB in the 2014 Comprehensive Assessment of the euro-area banks. Deviations from this methodology, generally needed in view of the different size and nature of banking activities in Bulgaria relative to the euro area, were published by the BNB.[13] Unlike other country-specific banking reviews in the EU, [14] the Bulgarian AQR/ST was led by the banking supervision department, with the external consultant having an advisory, coordinating and quality-assurance role. The methodology for the stress tests was devised by the BNB, assisted by the selected external consultant. The scenarios (baseline and adverse) were designed by the BNB: the baseline scenario corresponds to the BNB macroeconomic forecast as of March 2016 and the adverse scenario is based on hypothetical but plausible economic and financial market developments. The capital level of each participating bank was subjected to a three-year baseline and an adverse scenario. The banks calculated the impact of the scenarios on their balance sheets using parameters derived from AQR findings and applying models and guidelines that were centrally provided by the BNB. Therefore, the stress tests were not bottom-up, which would have required banks to develop their own internal models for projecting their capital positions. At the end of the exercise, the BNB announced that the stress tests would not be of pass/fail nature as was foreseen from the onset.[15] This meant that the results would not directly lead to capital requirements. Appointed representatives of the European Commission and the European Banking Authority were kept informed throughout the process. The final publication provided results on a bank-by-bank basis, but the level of detail did not match that of previous exercises across the EU, which to some extent diminished the effort to achieve transparency. Going forward, enhanced transparency and strong commitment to tackle connected lending and exposures to hard-to-value assets will be key to address the remaining vulnerabilities of the sector.

Follow-up to the completion of the AQR/ST is at early stages of implementation. The BNB addressed follow-up recommendations to each participating bank, including preparing for the implementation of the IFRS 9 accounting standard in 2018. Institutions that showed a

[13] Documentation related to the exercise is available on the website of the BNB's Banking Supervision department http://www.bnb.bg/BankSupervision/index.htm

[14] The majority of other country-specific AQR/ST exercises across the EU were done in the context of macroeconomic adjustment programmes.

15 In taking the decision to change the approach, the authorities also took into account the 2016 EU-wide stress tests done by the EBA.

significant decline of their capital adequacy in the stress tests were asked to enhance their policies, procedures and internal rules and to review their business plans in order to enhance resilience to shocks. The published information, however, was not t accompanied by specific details or deadlines and at this stage it is not clear how they will be followed up. The two banks that needed to strengthen their capital buffers after AQR adjustments, First Investment Bank and Investbank, received detailed instructions through a variety of measures, including sale of assets and raising fresh capital, by April 2017. Attracting new bone fide investors would help address governance issues, particularly in institutions with history of problems. The authorities need to stand ready to act in case the planned measures fail to be fully implemented.

The banking supervisor has progressed with implementing its reform plan, ahead of the planned review by the IMF/WB. The BNB has achieved some progress with its Plan to Reform and Develop Banking Supervision[16] although there are delays relative to the original timetable, reflecting also the significant resources allocated to the AQR/ST exercises. Staff capacity remains to be further strengthened to ensure further enhancement of the supervisory process. Meanwhile, work is ongoing on setting up the bank recovery and early intervention frameworks and on revising the banking supervision manuals and standards, with a view to align them with the findings and recommendations of the Basel Core Principles Assessment conducted by the IMF and the WB, and with EBA guidelines. The planned review under the Financial Sector Assessment Program by the IMF and the WB is to provide further guidance in terms of improving banking supervision, while also reviewing other parts of the financial system.

Overall, the AQR and ST exercise was completed and the required follow up will be assessed in the next monitoring period. Enhancements to the supervisory process are in progress.

3.3. Non-banking financial sector

The reviews of insurance companies and private pension funds are progressing well but pertinent challenges to the timeline remain. The reviews were announced in the 2015 NRP and recommended by the Council in both 2015 and 2016. An external consultant was hired to coordinate the reviews in January 2016 following a public tender procedure.[17] The assessed entities selected independent external reviewers in Q2 2016. Field work started in July 2016. First results are expected from the consultant in late November and the final report on the results and follow-up actions to be published by the Financial Supervision Commission (FSC) in December 2016. Following the 2016 CSR to include stress tests for the insurance companies, a public tender for a consultant was launched in August 2016. The results of the stress tests are expected to be released together with the results of the reviews.

Despite some serious difficulties encountered, the authorities aim to complete the reviews on time, by end-2016. A serious obstacle to the reviews was the recently uncovered case of misrepresented information provided by one of the independent external reviewers hired by several insurance companies and pension funds. Following the exclusion of the reviewer, work had to restart for a number of companies, causing delays and increased costs

[16] Annual Review of the Implementation of the Plan on Reforms and Development of Banking Supervision. http://www.bnb.bg/bnbweb/groups/public/documents/bnb_pressrelease/pr_20161103_a1_en.pdf

[17] The consultant is guided in its work by a Steering Committee composed of the FSC and EIOPA as voting members with equal weight and also includes observers from the EC, ESMA, Ministry of Finance and the national central bank.

to the industry and supervisor alike. Nevertheless, the swift action of the supervisor, supported by the Steering Committee, has preserved the overall high level of ambition in terms of quality and timeliness of the reviews as a whole.

Legislative amendments aimed at reinforcing supervision are under way but require further efforts. The FSC plans to increase the fees due by the supervised entities as of 2017 with the aim to increase its independence from the state budget. In addition, amendments to the Social Insurance Code aimed at improving governance and updating the investment regime of private pension funds have been approved by the Council of Ministers and are pending readings in parliament towards the end of 2016. An agreement between all stakeholders has proven difficult and some of the planned legislative changes – those developing the pay-out phase for the Pillar 2 funds – have been excluded from the draft law submitted to parliament. Further amendments are likely to be needed to fully implement the intended reform, in line with the 2016 NRP, where the authorities have qualified the current regulation to be "not fully in line with the rules established in theory and international practice".

An independent assessment and implementation of international good practices could be useful for strengthening supervision. The authorities have committed in the 2016 NRP to an independent assessment of non-banking supervision by an external body with high reputation (private sector consultant and/or international institution). Such an assessment of the legislated supervisory powers as well as supervisory practices, internal processes and systems for checks and controls would be essential to analyse the state of play and to identify possible weaknesses and ways of improving the functioning of the supervisor.

Solvency II entered into application and implementation will have to be monitored closely. The completeness of the transposition of Solvency II by all Member States is currently being examined by the Commission services, so no conclusions can be drawn for Bulgaria at this stage. Regarding implementation, according to the FSC, insurers have overall implemented the reporting and governance requirements of Solvency II. However, some market participants have faced more difficulties regarding implementation of Solvency II quantitative requirements. In this respect, the independent balance sheet review is helping them get to terms with these requirements.

Overall, important steps to identify problems in the non-bank financial sector have been taken and are expected to be completed in the coming months, followed by the appropriate measures. Also, the reviews in the insurance and pension funds sectors would help identify ways to strengthen supervision.

3.4. Insolvency framework

Overall, there has been little progress in implementing the commitments on the insolvency framework. The Bulgarian insolvency framework is characterised by high complexity, lengthy and delayed procedures and burdensome requirements. The insolvency system does not ensure that debtors pay their obligations. The government decided to speed up the procedures in 2015, as part of their commitments in the National Reform Programme, aiming to ensure a level playing field for creditors and debtors and to reduce the high level of corporate indebtedness and NPLs. To this end, the World Bank was commissioned to perform a study of the existing framework and come up with recommendations for improvement, drawing on international good practices. However, the reform momentum seems to have stalled after a first draft of proposed amendments to the Commercial Act was tabled by the Council of Ministers in late 2015.

Two legislative amendments are expected to be adopted by end-2016. Amendments of the Commercial Code and of the Pledge Registry have both passed first reading in Parliament and await final adoption. In addition, a new law on supervision of financial auditing companies is expected to be adopted by Parliament soon. In parallel, the government aims to enhance the judicial system by, for instance, upgrading the court document management system or improving the capacity of the judges. Once legislated, a sound implementation of these measures would be very important to address the identified weaknesses.

Overall, improvements to the insolvency framework remain to be both legislated and implemented.

3.5. Labour market

Existing active labour market policies (ALMP) are being implemented and new ones are planned but a comprehensive monitoring methodology to see the results of policy measures in long run is still lacking. The continued programmes, measures and schemes target the long-term unemployed and young NEETs through vocational training, re-skilling and temporary employment. Given the strong dependence on EU funding for ALMP, and at the same time the shift of focus of the European Social Fund away from merely substituting state funding, the optimisation of funding becomes paramount.

Measures to enhance the employability of the unemployed and to increase access to services were introduced with legislative amendments to the Employment Promotion Act. These measures include increased support for labour force mobility, better quality of information on the local labour force needs of employers, and improving access to the services delivered by the Employment Agency. The proposed changes were adopted by Parliament on 27 October 2016. Further legislative amendments are detailed in Annex 1.

A transparent mechanism for setting the minimum wage (MW) remains to be developed. Bulgaria has announced limited steps forward, including a consensus between and with the social partners that the mechanism for determining the minimum wage should be developed in accordance with the requirements of the Convention Nº 131 of the International Labour Organisation, i.e. taking into account objective economic and social indicators. The social partners have also agreed on the use of the following indicators: (i) poverty line for the country; (ii) size and dynamics of the average wage; (ii) the consumer price index; (iv) labour productivity (gross value added per employee); (v) number of employees by primary economic activity. The authorities plan to have a developed mechanism for determining the minimum wage by end 2016, to enter into force in early 2017 based on a Council of Ministers act.

The authorities still need to introduce rules for administrative increases of the minimum social security thresholds (MSST) for activities for which no agreement is reached and possibly assess the low rate of success of bilateral negotiations of the MSST. An important task is to establish rules for setting the MSST that properly takes into account their impact on job creation and competitiveness as well as on the phenomenon of undeclared work**.** Shortcomings in the process are apparent and underline the need for such a mechanism, as four out of five nationally representative employers organisations have officially announced their position to not partake in the current round of negotiations, and actually insist on removing the system of MSST. In addition, even after extension of the deadline by a month to 15 October, the authorities reported that there were agreements signed for only 5 economic activities (out of 85)[18]. Moreover, it is expected that the 9.5% increase in the MW as of 2017 will have a lifting effect on the MSST for some activities and professions, given that the MW is the floor for any MSST. This raises the pressure on some low-skilled workers and generally limits the options for labour market adjustment. The mechanism for bilateral negotiations may benefit from an assessment, given that in a substantial number of activities no bilateral agreement is reached (44% for 2016 and 100% so far for 2017).

Overall, ALMP appear to have positively influenced the labour market. At the same time, the rules for taking administrative measures linked to the minimum wage and MSST remain to be introduced.

[18] According subsequent information from the employers' organisations, even these agreements were withdrawn.

Annex 1: Overview of MIP-relevant reforms

Ensure stable public finances			
Public finances and taxation			
Fiscal policy & fiscal governance			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in December 2016: The 2017 state budget to be adopted by parliament.	**October 2016:** 2017 budget was adopted by the government. Headline deficit target for 2017 is 0.7% of GDP. The government envisages a structural improvement of about 0.6% of GDP in line with the Council recommendation.	**February 2016:** Improvement of framework for the implementation of controls in high risk products. **April 2016:** Government approved the first evaluation report of the implementation of the Single National Strategy for improving the tax collection, tackling the shadow economy and reducing the compliance cost 2015-2017. **July 2016:** Improvements on mechanism to collect overdue payment from public sector contractors. **August 2016:** Changes of VAT mechanism in the trade of fuels. **Continues in 2016:** Better monitoring of the debtors with high overdue liabilities, increased tax and labour audits.	CSR (1) – 2016 "Achieve an annual fiscal adjustment of 0,5 % of GDP towards the medium-term budgetary objective in 2016 and in 2017. Further improve tax collection and take measures to reduce the extent of the informal economy, including undeclared work."
Stabilise the banking and non-banking financial sector			
Financial sector			
Financial services			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in December 2016: Amend the Social Insurance Code to strengthen	**August 2016:** The BNB issued follow-up actions for some banks, on the basis	**August 2016:** The BNB published the results of the AQR/ST.	CSR (2) – 2016 "By the end of 2016, finalise the asset quality review and

supervision and improve governance of private pension funds. **Expected in December 2016:** Finalise the reviews of insurance companies and private pension funds, assisted by an external consultant and in cooperation with international partners. **Expected in December 2016:** Publish the results of the insurance and pension fund reviews and stress tests together with the necessary follow up measures. **Expected in December 2016:** Adopt rules to increase the resources available to strengthen non-bank financial supervision. **Expected in Q1 2017:** Appoint external body to review the supervision practices as well as the internal processes, checks and controls of the non-bank supervisor. **Expected in Q1 2017:** Develop the pay-out phase for private pension funds. **Expected in Q4 2016 and Q1 2017:** The authorities will be subjected to a review by the International Monetary Fund and the World Bank under the Financial Sector Assessment Program.	of the AQR/ST results. Two banks were asked to replenish their capital buffers by April 2017. **December 2015:** Solvency II directive was transposed into national law. **April 2016:** Secondary legislation regarding Solvency II transposition was adopted. **October 2015:** BNB adopted a Plan for Reforming and Developing Banking Supervision based on the recently-published Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision. The Plan is in the process of implementation.	**January 2016:** The FSC hired an independent consultant for the reviews of insurers and private pension funds. **July 2016:** The FSC appointed independent external reviewers to perform the field work of the reviews. **August 2016:** The FSC launched a public tender for selecting an independent consultant for the stress tests of insurance companies.	stress test of the banks. By the end of 2016, complete the balance-sheet review and stress test of the insurance companies and the review of private pension funds' assets. Take, as necessary, follow-up actions in all three sectors and continue to improve banking and non-banking supervision." NRP – 2016 - AQR/ST of the entire banking sector - Improving banking supervision NRP – 2016 Pension funds "…developing the pay-out phase as far as the current regulation is to some extent in contradiction with rules established in the theory and the international practice" NRP – 2016 "Forwarding of an invitation to the external consultant or other companies with high internationally recognized reputation and/or EIOPA to perform a review of the legislation in force on the powers of FSC…for the purpose of preparing proposals for strengthening supervision" Law on Recovery and Resolution of Credit Institutions and Investment Firms, Transitional and Final Provisions, Art. 9 (1) "… the BNB shall conduct an asset quality review of the banking system, including review of the quality and adequacy of estimates used to value assets, collateral received, impairment and provisioning practices with

			involvement of independent external persons with high professional reputation. (3) "… the BNB shall conduct stress tests of the banking system …" (4) "Based on the results of the review under paragraph 1 and the stress tests under paragraph 3, the BNB shall take all the necessary measures within its legal powers to ensure coverage by the banks of its potential capital shortfall…" Law on Recovery and Resolution of Credit Institutions and Investment Firms, Transitional and Final Provisions, Art. 10 (1) "… the Financial Supervision Commission shall conduct a review of pension fund assets and balance sheets of insurers with the participation of independent external persons and institutions with high professional reputation."
Competitiveness, business environment and institutional capacity			
Labour market policies			
Wages and wage setting			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in December 2016: A developed mechanism for determining the minimum wage, agreed on by the social partners. **Expected in beginning of 2017**: The developed mechanism for determining			CSR (3) – 2016 " […] In consultation with social partners establish guidelines and criteria for setting the minimum wage. "

the minimum wage to enter into force based on a Council of Ministers act. **Expected in Mid-2017:** On the basis of the adopted mechanism, the Parliament to adopt an elaborated Law ratifying Convention 131 of the International Labour Organisation.			
Active labour market policies (ALMP)			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in December 2016: New national program for training and employment "Work", targeted at the most vulnerable groups among the unemployed, as well as towards activation and inclusion in employment of economically inactive people.		**October 2016:** Schemes for training and employment of young people and long-term unemployed are being implemented, benefitting from EU funding.	CSR (3) – 2016 "Reinforce and integrate social assistance, including relevant social services, and active labour market policies, in particular for the long-term unemployed and young people not in employment, education or training." NRP – 2016 "For improving the employability for the long-term unemployed and low-skilled persons existing measures and programs for training and employment will continue to be applied, new measures envisaged in EPA, as well as new projects financed under OP Human Resources Development 2014-2020, a large portion of which are aimed at labour market integration of disadvantaged groups, including long-term unemployed and low skilled individuals."
Public administration and business environment			

Insolvency framework			
Announced measures	*Adopted measures*	*Implemented measures*	*Sources of commitment*
Expected in December 2016: Adopt amendments to the Commercial Code aiming to introduce a pre-court insolvency procedure for companies facing financial difficulties. **Expected in December 2016:** Adopt amendments to the pledge registry. **Expected in 2016:** Draft a new Law on independent financial audit, which will transpose Directive 2014/56/EC. **Expected by 2018:** Complete interconnectivity between the Commercial Registry and the document management systems of the courts, enabling the automatic submission of documents in insolvency procedures.			CSR (4) – 2016 "Reform the insolvency framework to accelerate recovery and resolution procedures and improve their effectiveness and transparency. Increase the capacity of the courts regarding insolvency procedures."