

## Economic Program

In 2006, the Economic Program focused its work on three thematic areas: informal economy, VAT fraud and corruption - bridging criminal and economic

policies; innovation and knowledge economy; European integration and competitiveness.

### 2006 Highlights

- The Economic Program continued to monitor the economic aspects of informal economy and **anti-corruption policies and practice** in Bulgaria and the European Union. Its policy analysis and advice contributed to the introduction of new anti-fraud measures in the Bulgarian VAT system and provided innovative economic instruments to complement criminal justice policies in combating **organized crime** in the enlarged European Union.
- CSD coordinated the work and contributed for a second year to the annual report *Innovation.bg 2007*, which analyzes the functioning of the national innovation system and makes recommendations for enhancing the innovation performance of the Bulgarian economy. CSD continued its work on the elaboration of a **Regional Innovation Strategy** for the South West Planning Region in Bulgaria.
- As a specific effort to improve Bulgaria's capacity in managing EU Funds and reduce corruption incentives in public procurement CSD has started an initiative on better regulation of **public-private partnerships (PPP)** in Bulgaria. The initiative aims to make a comparison between existing legislative practice on PPP in Europe and the United States and propose an effective PPP solution for Bulgaria.
- **European integration and competitiveness** was an important focus of the Economic Program in 2006. Through CSD contribution Bulgaria was included for the first time in IMD's Competitiveness Yearbook – the most comprehensive reference book on competitiveness for international investors. CSD representatives contributed to the second annual Report for the Bulgarian President *Bulgaria 2006: Convergence and European Funds*. CSD explored the necessary national instruments for effective management of EU funds in the first years after accession and the trends in the international competitiveness of the country.
- In 2006, CSD continued to offer useful knowledge through the **Bulgarian Distance Learning Center** of the World Bank's Global Development Learning Network. CSD became a regional coordinator for South-East Europe for some of the programs offered by the network.

## I. Informal Economy and Anti-Corruption

In 2006, the Economic Program continued its work on policy assessment and advice on the issues of informal economy and anti-corruption focusing on specific issues such as VAT fraud, informal labor, measurement, etc. In its brief *A Painful Shift in Bulgarian Anti-Corruption Policies and Practice* CSD recaps Bulgaria's track record in anti-corruption policies and lists the remaining and new challenges in this area after the country's accession to the European Union in 2007. The brief underlines that the most important shift

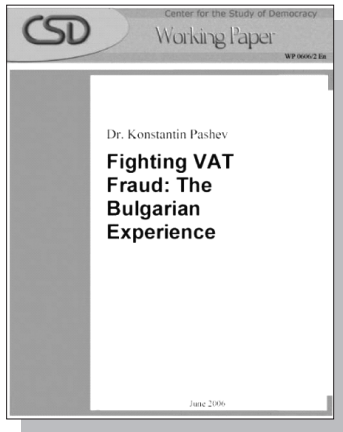
in Bulgaria's anti-corruption policies in the run-up months to EU accession is the move from "soft" (awareness-raising) campaigns to "hard" (prevention and sanctions oriented) measures with immediate anti-corruption effects. The brief outlines two areas of outstanding challenges: VAT fraud and corruption in public-procurement. Success in these areas require commitment on the side of the Bulgarian government to independent oversight and better coordination of anti-corruption policies between the legislature, the government and the judiciary.

The Bulgarian government should work on its good progress in improving the internal (within the executive) and external (to the judiciary and the legislature) **coordination of anti-corruption measures**. The complexity of the coalition government creates additional possibilities for watering down political and administrative accountability, hence the increased need for coordination between different anti-corruption agencies and players. In this regard the government's Commission for Prevention and Countering of Corruption remains understaffed and has yet to demonstrate capacity to **pro-actively generate anti-corruption policies**.

Two **areas** remain **critically important** to curbing political corruption in Bulgaria in the long-run:

- **public procurement** – the European Bank for Reconstruction and Development and the World Bank have recently confirmed the findings of national organizations that public procurement remains the most corruption vulnerable area in the economy.
- **VAT fraud** – According to different estimates the Bulgarian government loses up to € 450 – 500 million in VAT fraud annually. While these numbers may be low compared to similar estimates in Germany (€ 18 – 20 billion) or Great Britain (€ 10 billion) they represent a much higher share of annual VAT revenues in Bulgaria (25 – 30%) than in these EU countries (5 – 6%).

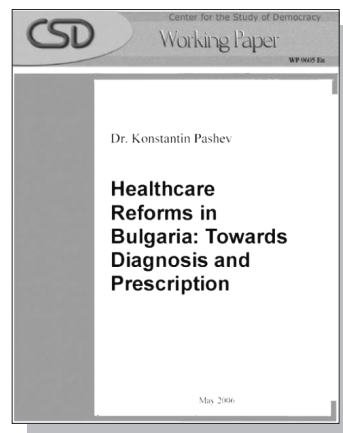
Source: CSD Policy Brief No 10 *A Painful Shift in Bulgarian Anti-Corruption Policies and Practice*, 2006.



As a specific effort to improve Bulgaria's capacity in managing EU Funds and reduce corruption incentives in public procurement CSD has started an initiative on better regulation of public-private partnership (PPP) in Bulgaria. The initiative aims to make a comparison between existing legislative practice on PPP in EU countries, the United States and Canada and propose an effective PPP solution for Bulgaria. CSD has held consultation on prospective PPP regulation with the Bulgarian Ministry of Finance, the main body managing EU Funds spending in Bulgaria and the Bulgarian Parliamentary Combating Corruption Committee, which has set public procurement and PPP as a focus of its work in 2007.

The Economic Program continued to explore anti-corruption and informal economy in 2006. It identified the types and modus operandi of **VAT fraud** – primarily the abuse of tax credit. The CSD working paper *Fighting VAT Fraud: the Bulgarian Experience* analyses the elements of tax design permissive to VAT abuses and discusses the possible solutions in the light of the international and domestic experience and the capacity of the Bulgarian tax

administration. The study concludes that the possible solutions lie with optimizing risk management and the principle of joint liability rather than with tighter controls at entry and on the conduct of business. The Bulgarian Parliamentary Commission for Prevention and Countering of Corruption invited CSD experts to testify on hearing on countering VAT fraud and to present the main conclusions and recommendations from the CSD report *Corruption and Tax Compliance: Policy and Administration Challenges*. Most of the recommendations outlined in the report were implemented in policy and legislative changes by the end of 2006.



Another area of research related to better governance and started by the Economic Program in 2006 was *Healthcare Reforms in Bulgaria*. The CSD working paper shows that low compliance by both customers (contributors) and service-providers (contractors with the National Health Insurance Fund) in Bulgaria leads to excessive regulation and control, crowding out of the private sector and an increase in the incentives for corrupt behavior. The outcome is a system that is increasingly driven by administrative controls at the expense

of market incentives. Based on this analysis the paper identifies the relevant policy implications and opportunities for moving the stalled health reforms out of the institutional impasse and improving the system's governance. CSD will publish an extended analysis on anti-corruption policy alternatives for the Bulgarian healthcare system in 2007.

On 23-24 June 2006 the Center for the Study of Democracy organized an international conference "Corruption and Organized Crime: Bridging Criminal and Economic Policies." The conference aimed at reviewing the range of effective policy instruments and proposing integrated solutions to governments, international institutions and civil society. The discussion focused on the use of socio-economic policies against organized crime.

In October and November CSD experts were invited to participate in the design of an EU-wide feasibility study on monitoring informal labor. CSD's system for monitoring the dynamics of informal economy in Bulgaria developed and tested in the period 2002 – 2006 was approved by the working group on the feasibility study as one of the model-studies.

## II. Innovation and Knowledge Economy

In 2006, CSD continued to promote and support policy-making in the area of innovation and knowledge economy. CSD representatives took part in the elaboration of the *Innovationbg* Report, which analyzes the national innovation system and makes recommendations for enhancing the innovation performance of the Bulgarian economy. The latest edition of the report made a review of the European innovation policy and

the opportunities for development it offered to Bulgaria. The report was enhanced with the elaboration of a special Innovation Index of the Bulgarian enterprises, based on the results of the annual surveys of the Innovation Relay Center, Sofia and with a profile of the Bulgarian innovative companies based on panel data and in-depth statistical analyses. The Innovation Index of the Bulgarian enterprises indicated that most of them (over 65%) had not implemented any innovation during the period 2005 - 2006. The index showed that Bulgarian companies have low ability to combine several types of innovation and that their innovations have low degree of novelty compared to EU levels.



CSD took an active part in the work on elaborating a Regional Innovation Strategy for the South West Planning Region in Bulgaria (RIS BRIDGE) in 2006. A cornerstone in this work was the exchange of practical ideas on developing a workable regional innovation system. Between 28 and 30 May 2006 representatives of the Center for the Study of Democracy, the Applied Research and Communications Fund, and the governors of Sofia, Blagoevgrad

and Pernik Districts of Bulgaria, the deputy governors of Kyustendil and Blagoevgrad Districts, as well as representative of the Bulgarian Ministry of Regional Development and Public Works took part in a study visit to Thessaloniki, Greece. The Bulgarian governors got exposure to both practical policy advice on developing regional innovation policy and specific examples of results from projects financed under the EU funds – a university technology transfer office and an innovation business incubator and technology park in Thessaloniki.

CSD further explored the relationship between competitiveness and innovation in a discussion "Ireland's Road into the EU", held on 1 June 2006, with guest speaker Mr. Andrew McDowell, Chief Economist and Manager of the Competitiveness Division of Forfas – the Irish government's policy and advisory board for enterprise, trade, science, technology and innovation. Mr. McDowell's speech focused on

Ireland's policies of using EU funds to propel the economic and technological development of the country from the last to one of the first places in Europe. He highlighted the EU impact on Ireland's economic transformation in areas such as macroeconomic stability, investment climate, implementing effective competition and regulatory reform, as well as achieving improvements in governance. Bulgarian guests, among which MPs and former deputy-prime minister, were particularly interested to understand the institutional and administrative processes Ireland used to improve its competitiveness in Europe.

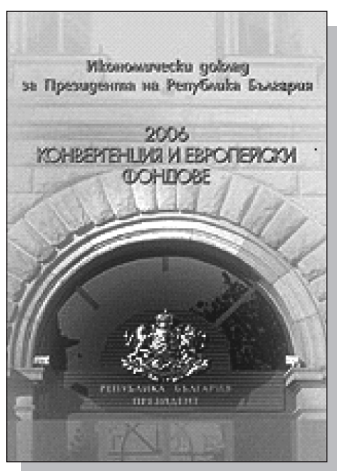
### III. European Integration and Competitiveness

Another highlight on CSD's agenda in 2006 was the support to Bulgaria's European integration process. CSD representatives contributed to the elaboration of the second Report for the Bulgarian President *Bulgaria 2006*:



*Prof. Giorgios Tsiotras, Secretary General, Regional Authority of Central Macedonia (left) and Mr. Todor Modev, Governor of the Region city of Sofia and Chairman of the Steering Committee of the Regional Innovation Strategy for the South-West Planning Region during an interview in Greece, May 2006*

*Convergence and the European Funds.* The report was officially presented on 22 January 2006. It focuses on the influence of the European Funds on the Bulgarian economy regarding the convergence of the Bulgarian with the European economy, and on the possibilities for decreasing regional discrepancies in the country. CSD contributed in two important areas – improving governance and the development of a knowledge based economy in Bulgaria's regions.



On 10 May 2006 the Center for the Study of Democracy organized in the Bulgarian Parliament a round table "Effective Management of EU Funds in Bulgaria - Necessary National Instruments in the First Years after the Accession." During the event members of parliament, ministers and high-ranking administrative officials discussed the financial instruments and measures needed for increasing the capacity of Bulgarian organizations for preparing competitive bids under the EU funds. The low level of readiness of the small Bulgarian municipalities and firms to prepare projects, and hence to use effectively the 7 bln. euro envisaged for Bulgaria through the EU's Structural and Cohesion Funds for the period

2007-2013, proved to be the major problem in this context.

Mr. Plamen Oresharski, Bulgarian Minister of Finance highlighted the necessity of strengthening and stabilizing the Bulgarian budget in 2007 to guarantee, finance and support for the elaboration and implementation of projects under the European funds. He underlined the importance for Bulgaria's competitiveness of good coordination between financial instruments, directed towards the development of science and innovation at national and European level – the National Innovation Fund, the National Science Fund, EU Structural and Cohesion Funds, the Seventh Framework Programme for Science, Technological Development and Demonstration and the Competitiveness and Innovation Program of the EU.

Ms. Lidia Shouleva, Member of the Economic Policy Committee and the Budget and Finance Committee of the Bulgarian Parliament, and Observer in the European Parliament proposed the establishment of a national fund to support project development at Bulgarian municipalities, which would ensure the equal participation and access to EU funds of the underdeveloped municipalities. She also proposed the establishment of similar project facilities for support of SMEs.

With the partnership of CSD Bulgaria was included for the first time in the world's oldest and most comprehensive annual report on the competitiveness - the World Competitiveness Yearbook of IMD (International Institute for Management Development). In the Yearbook Bulgaria was ranked 47th among 61 other national and regional economies – scoring better than Italy, Romania, Poland and Croatia. The comparative advantages of the Bulgarian



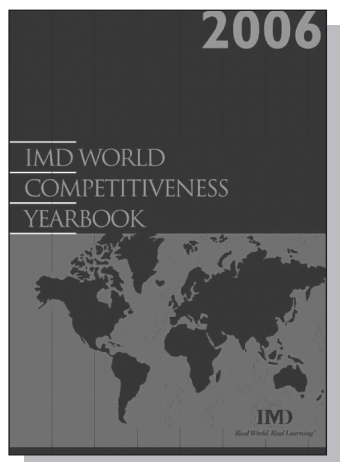
*Ms. Lidia Shouleva, Member of the Economic Policy Committee and the Budget and Finance Committee, and Observer in the European Parliament and Mr. Plamen Oresharski, Minister of Finance*

economy (positions among the first ten) were the stable macroeconomic environment, high per capita economic growth, low taxes, export of services, budget balance, remuneration of labor, unit labor cost and investment in telecommunications as percent of GDP. In May 2006, CSD together with the Bulgarian Small and Medium Enterprise Promotion Agency and the Invest Bulgaria Agency organized a press conference to present Bulgaria's position in the Yearbook.

#### **IV. Distance Learning**

In 2006, CSD continued its work with the Global Distance Learning Network (GDLN) through its Distance Learning Center. The Center carried out videoconferences on a number of topics: social entrepreneurship, industrial clusters, accounting and auditing, global issues, development of SMEs and access to finance, review of regional competitiveness and investment climate improvement.

The Center stayed committed to promoting civil society development in Bulgaria and in Europe. In the framework of the DLC on 30 May 2006 the Center for the Study of Democracy organized a round table discussion on the past, present and future of civil society. Guest speakers at the event were Mr. Michael Edwards, Director of Civil Society and Governance at Ford Foundation and Mr. Martin Butora, Honorary President of the CEE Trust for Democracy. Later on CSD organized within the GARNET network of excellence a workshop (10 - 12 November 2006) to present the role of non-state actors and civil society in the global regulatory framework. The objective of the workshop was to examine the global public sphere and the global civil society.



IMD's World Competitiveness Yearbook 2006 highlights the areas, in which Bulgaria urgently needs to implement adequate measures in order to improve its position:

- Investments in infrastructure and energy efficiency;
- Encouragement of innovation and high-technology export;
- Implementation of long-term national policy for development of human capital, focusing on the reforms in healthcare and education;
- Resolving chronic problems with administrative discretion, red tape and corruption.