

# Economic Program

In 2015, the Economic Program focused its work on the following areas:

- **Energy security and sustainable development.** In 2015, CSD continued to analyze the deficits in the energy sector governance and in particular the corporate governance of state-owned enterprises (SOEs), the practices applied in public procurement and the implementation of large infrastructure projects. The Economic Program organized a policy forum in Brussels to discuss the main obstacles to the future of the European Energy Union and raised key questions about its sustainability. The event provided a platform for discussion of the future market integration opportunities in Southeast Europe, the challenges posed by mismanagement in the sector, and the creation of a Regional Energy Strategy.
- **Anticorruption and good governance.** The Economic Program supported the efforts of the civil society in the SEE region in evaluating the impact of the national anti-corruption measures. It elaborated and presented, in collaboration with CSO partners from eight other countries, the SELDI Regional Anti-Corruption Report (RAR): *Anti-Corruption Reloaded: Assessment of Southeast Europe*. CSD was also able to contribute to important debates on EU-level, such as the Union's enlargement policies, the EU's Cooperation and Verification Mechanism (CVM), and the second *EU Anti-Corruption Report*, forthcoming in 2016.
- **Hidden economy.** In cooperation with the Macedonian Centre for Research and Policy Making (CRPM), CSD applied its innovative *Hidden Economy Index* to track the dynamics of the hidden economy in Macedonia. The report *Monitoring the Hidden Economy in Macedonia: Trends and Policy Options* made possible for the Macedonian government and its European partners to follow the impact and assess the effectiveness of their policies.
- **Competitiveness and knowledge economy.** The Economic Program contributed to the development of the 2015 IMD World Competitiveness Yearbook, analyzing the barriers to the Bulgarian business and providing recommendations for improvement of the overall economic competitiveness. The annual publication *Innovation.bg* assessed the innovation potential and developments in Bulgaria, and provided key recommendations for improved national innovation policy.

## I. Energy security and sustainable development

In 2015 the Economic Program continued to analyze the deficits in the en-

ergy sector governance. The most serious threats to the energy security of the countries of Central and Eastern Europe and the Black Sea region include dependence on one source of energy, lack

of adequate measures for diversification of supplies, and limited development of own production. On the demand side, these countries are characterized by high shares of energy poverty among the population, high energy demand, and low energy efficiency. The Policy Tracker: *EU and Russia's Energy Policy at the Backdrop of the South Stream Pipeline* presents in detail the obstacles to the common European energy policy. Among the challenges are the enormous need of investment resources to expand regional gas links and the establishment of a common gas purchasing mechanism that takes into consideration the different ability of EU member states to pay for their gas imports.

CSD organized a policy forum to discuss the main obstacles before the creation of the EU Energy Union and raised key questions about its sustainability on 24 February 2015 in Brussels. The event served as a platform for discussion of the future options for energy market integration in Southeast Europe, the challenges of local bad governance, and the barriers before a regional energy strategy. Mr. Vladimir Urutchev, MEP, Committee on Industry, Research and Energy, underlined that the two natural gas crises in 2006 and 2009 were a wake-up call for the EU to elaborate mechanisms for gas supply disruption mitigation. He suggested the expansion of investment in regional energy market integration infrastructure. According to him, the successful implementation of the Energy Union will be most beneficial to the countries in Southeast Europe where energy security risks could undermine their political cohesion and economic development. Dr. Edward Chow, Senior Fellow, Energy and National Security Program, Center for Strategic and International Studies, gave an overview of the global energy developments by discussing the prospects for the unconventional revolution in the US at the backdrop of lower

oil prices. Dr. Chow dismissed the notion that lower oil prices will drive shale producers out of the market. Dr. Jean-Arnold Vinois, Adviser on European Energy Policy, Notre Europe – Jacques Delors Institute, pointed to the inter-governmental agreements (IGAs) struck between Gazprom and the member-states participating in the South Stream projects for containing provisions that directly violate the Third Energy Liberalization Package. He maintained that by ensuring transparency of the member-states' deals with third parties, the Commission would enforce compliance with the internal energy market more easily. Mr. Reinis Āboltiņš, Senior Policy Researcher, Centre for Public Policy PROVIDUS, expressed his conviction that in the long term, the shale gas revolution in the US would also lead to a reduction of regional gas prices in Europe.

In continuation of the discussion, the anti-corruption initiative SELDI, coordinated by the Center for the Study of Democracy held a workshop in Belgrade, Serbia dedicated to the link between corruption and energy governance on 28 April 2015. The event was co-hosted by the "Transparent Energy Governance in CEE" project, funded by the Alumni Engagement Innovation Fund of the U.S. State Department. The Economic Program noted that the report *Anti-Corruption Reloaded: Assessment of Southeast Europe* identifies the energy sector as one of the highest corruption risk areas in the region. State capture threats have raised concerns about the region's capacity to implement EU energy-sector regulations, and have also made the countries vulnerable to illegitimate and/or criminal inside and outside pressure. Representatives of the Serbian Anticorruption Agency, Center for Liberal-Democratic Studies, Romanian Academic Society (SAR), Partnership for Social Development (PSD), Croatia, Open Society Foundations (OSF), Hungary, Romania



*The participants in the policy forum Good Governance Agenda for Southeast Europe: Risks and Challenges Towards an EU Energy Union, Brussels*

Energy Center (ROEC) and Center for Investigative Reporting (CIN), Bosnia and Herzegovina took part in the event and discussed the problems of the energy sector, the corporate governance of state-owned enterprises (SOEs), the practices applied in public procurement, and the implementation of large infrastructure projects.

The Economic Program launched a public opinion survey on the main factors determining Bulgaria's energy security, the pattern of energy sector governance and the ultimate beneficiaries of the large energy infrastructure projects. The results showed that the public is generally aware of the main energy security risks to the country, and has identified nuclear energy as the best long-term solution to energy security vulnerabilities. The survey results confirmed that energy poverty remains the single most alarming energy security risk in Bulgaria. The majority believes there is a risk of state capture, saying that important decisions in the national energy policy are

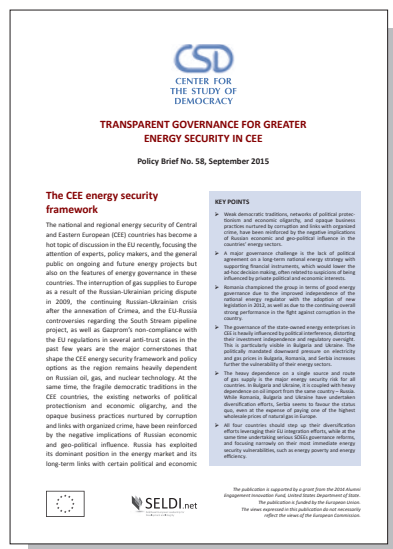
being taken under pressure from local private or foreign state interests. Similarly, close to 40 % of the people list the foreign influence over the government as one of the most important factors that prevent the Bulgarian state from actively trying to win the Belene arbitration case brought by Rosatom. About 65 % of the people agree that the South Stream gas pipeline project will benefit merely the Russian state and/or Gazprom, but not Bulgaria.

Four country fact-sheets entitled *National Energy Security Indicators and Policy Challenges* presented a critical review of the energy security governance in Bulgaria, Romania, Serbia, and Ukraine, and mapped the main policy challenges faced by these countries in facilitating more transparent and data-driven decision making.

CSD Policy Brief No 47: *EU and NATO's role in tackling energy security and state capture risks in Europe* analyses the Crimean crisis and the continuing in-

stability in Eastern Ukraine that have turned into a rude wake up call for Europe's energy security vulnerabilities. According to the authors, despite its efforts to increase its competencies on the energy security issues, NATO remains a military alliance. Yet, it could cooperate with the EU on solving some of the most critical energy security risks for its member-states. NATO can facilitate dialogue by implementing solidarity-building measures in times of energy crises. Apart from the four energy security dimensions (availability, reliability, affordability, and sustainability), the policy should take into consideration the horizontal aspect of good governance, and the detrimental effect of state capture. Despite the activism of international organizations, the countries in the region still pursue mostly a bilateral approach to energy security, which is insufficient for the development of a strategic regional energy system. The latter erodes efforts for a comprehensive, multilateral (pan-regional) approach to the region's energy challenges, and puts at stake Europe's opportunity to diversify its energy supply. The consequences for countries in Central and Eastern Europe are that they remain victims of political pressure from the largest energy suppliers, which leverage their quasi-monopoly status on European energy markets to promote specific political objectives. In that sense, there is a need for developing a common understanding for the constraints stemming from the current segmented approach to energy security issues in the region and the identification of the multilateral mechanisms that can be utilized to strengthen the overall energy security architecture.

In a consequent analysis, the *CSD Policy Brief No. 58: Transparent Governance for Greater Energy Security in CEE* made an overview of the challenges in four selected CEE countries, two energy poor – Bulgaria and Serbia, and two energy-



resourced – Romania and Ukraine, and assessed the factual situation per se and the transparency and accountability of energy policy governance in the region.

The article (in *Südosteuropa Mitteilungen*) *Bulgaria and the South Stream Pipeline Project: At the Crossroad of Energy Security and State Capture Risks* highlights the development of the Gazprom-led project in Bulgaria by taking stock of the country's energy security situation and shedding light on state capture risks related to the pipeline. The experts from the Economic program stated that the governance deficits in the Bulgarian energy sector have ultimately limited Bulgaria's bargaining power on the project, worsening the country's overall energy security position and putting an additional strain on public finances. Bulgaria's commitment to South Stream has been in conflict with Bulgarian and EU energy priorities, as well as with European Commission competition and liberalisation principles. Bulgaria has started the project's implementation without independent planning and cost-benefit analysis. The focus on the project has diverted attention and resources from priority energy



The Economic Program recommended the enhancement of the energy sector governance in CEE including the functioning and management of the state-owned energy enterprises by:

- Reducing direct involvement of political leadership in the operational management of energy enterprises.
- Improving the long-term strategic planning, with supporting financial instruments to lower ad-hoc decision making in order to ensure non-selective and consistent implementation of energy sector reforms.
- Tackling state capture and improving transparency and accountability in the sector through provision of public data and widening information disclosure mechanisms.
- Increasing administrative and financial capacities of the controlling and regulatory state authorities, especially where monopolistic or oligopolistic national markets exist.
- Introducing compulsory corporate governance standards following the best international principles such as the OECD Guidelines on Corporate Governance of State-Owned Enterprises.
- Enlarging the existing and introducing new long-term programs for improving the energy efficiency in residential and public sectors, as well as the reduction of the energy intensity.
- Shift in national energy policies away from developing new generating capacities and towards the fulfillment of EU 2020 targets as a goal in itself towards ensuring the stability and security of energy supply, including through diversification of supply sources and routes.
- Introducing decision-making procedures for prioritization and selection of large investment projects.
- Increasing the institutional capacity of the national energy regulators and their independence from political and private economic interests.
- Speeding up the liberalization of national wholesale and retail energy markets in order to improve the long-term financial stability of state-owned energy enterprises, as well as implementing the EU Third liberalization package.
- Increase the regional coordination and cooperation in the design and implementation of energy policy in CEE through the expansion of the scope of the High Level Group on Gas Connectivity in Central and South East Europe to issues regarding electricity infrastructure and regional energy markets.
- Lowering administrative, regulatory and political burdens at national level to speed up those energy infrastructure projects, which may have regional and European effect, such as the gas interconnectors between Bulgaria, Romania and Greece as part of the Southern Gas Corridor.
- Establishment of a regional power exchange (e.g. the South East European Power Exchange).

*Source: CSD Policy Brief No. 58: Transparent Governance for Greater Energy Security in CEE, CSD, September 2015.*

security investments, such as gas interconnectors and storage facilities, gas

and power exchanges, energy poverty as well as energy efficiency.

The Economic Program released the media note *Energy Poverty – Risk to Bulgaria's Energy Security*. According to a survey among 956 respondents, more than 43% of the households were deprived of normal heating and use of electrical appliances after the last increase in the electricity price by 10% in October 2014. This measure was taken in attempt to stabilize the financial state of the National Electricity Company after a period of artificially fixed prices. The effect proved to be particularly strong among the vulnerable groups (unemployed, pensioners, students).



In 2015, the CSD team continued to facilitate the participation of social science and humanities experts in the design and implementation of the national regulatory policy on nuclear waste management through supporting the networking activities among the non- and technological experts. The work is part of the PLATENSO project's efforts to build a platform for enhanced societal research related to nuclear energy in eight countries from Central and Eastern Europe. The analysis of existing options for participation of social science

and humanities experts in the nuclear policy covered three possible scenarios – commercial use of nuclear power, phasing out nuclear power, and development and implementation of future (Generation IV) reactors.

Experts from the Economic Program presented the political risks stemming from the governance deficits and state capture mechanism channeling the Russian economic and political influence in the energy sector participated at the public hearing on the PAKS II project at the European Parliament. The event was hosted by the EP Greens / EFA group and organized by the Energiaklub, Hungary on 19 March 2015 in Brussels, Belgium. In addition, CSD continued to provide input to the International Monetary Fund and the World Bank during their annual mission to Bulgaria. The focus of the discussions was explicitly on energy governance issues.

In 2015, CSD continued its research on territorial governance scenarios for the future economic and social development of Europe until 2050. CSD conducted two case studies on viable policy-making initiatives to counter future energy security challenges and accelerate the development of the ICT infrastructure. The case studies involved around 30 stakeholders from leading business, academic and government organisations, who developed possible visions for the Bulgarian territorial governance. The outcome of the focus groups were two reports mapping the current challenges and identifying possible solutions.

## II. Regional and European cooperation in the fields of good governance and anti-corruption

In 2015, the **Southeast Europe Leadership for Development and Integrity (SELDI)** initiative entered its second



*Policy Forum Good Governance Agenda for Southeast Europe: the Role of Civil Society and the European Institutions, Brussels*

phase of implementation and was able to further its influence and impact the SEE region. On 24 and 25 February 2015 SELDI presented the key findings and policy recommendations from the first two years of the initiative in Brussels. The conclusions from the SELDI Regional Anti-Corruption Report (RAR): *Anti-Corruption Reloaded: Assessment of Southeast Europe* were discussed with representatives of the civil society and the European Commission. Given the major significance of the good governance and anti-corruption issue in Southeast Europe and the prospects of the countries from the region of joining the EU, the event aimed to contribute to promoting the civil society – state dialogue in identifying effective counter-measures and possibilities for future collaboration among all stakeholders. The forum charted the needed governance reforms to prepare the countries for accession once the enlargement freeze of the EU is lifted.

Mr. Ruslan Stefanov, Coordinator of SELDI, and Director of the Economic



Program, presented the main findings, conclusions, policy and practical recommendations of the RAR, underlining the importance of the collaboration between CSOs and governmental actors at the local level. Mr. Stefanov highlighted three main anti-corruption measures featured in the *SELDI Regional Anti-corruption Report*: delivery of effective prosecution of high-level corruption, adoption of an independent corruption and anti-corruption mechanism, and focus on critical sectors when applying anti-corruption measures. The key recommendations were further communicated to various stakeholders during a number of regional events. In addition to the *Regional Assessment Report*, a total of nine *National Corruption Assessment Reports* were published and presented by the SELDI members at the beginning of 2015.



In 2015 CSD continued to expand its research and policy analysis capacity at national, regional and European levels. As part of the ANTICORRP project, the biggest anti-corruption effort of the EU's FP7,

CSD developed an analysis of the **Bulgarian public procurement market** and more specifically, the corruption risks associated with the construction sector. The analysis was incorporated into volume 3 "Government Favouritism in Europe" of the *ANTICORRP Anticorruption Report* in 2015. A forthcoming publication reviews to what degree the existent EU conditionalities and financial assistance have contributed to improved public governance and enhanced anti-corruption track record in Bulgaria. Additionally, as part of the network of local correspondents at DG Home of the European Commission, CSD continued working on the Bulgarian section of the upcoming in 2016 second *EU Anticorruption Report*.

The challenge of corruption stands high on the political agenda, both in Bulgaria and on EU level. Experience shows that successful action against corruption is not preceded by improvement of economic conditions, on the contrary – de-



*Round table discussion Making Bulgaria's Anticorruption Policy Work: Sharing Experiences from European Success Stories, Sofia*





*SELDI Conference Enhancing CSOs Advocacy Efforts for Countering Corruption in Critical Sectors in SEE: Leveraging the EU Accession Process and State of the Art Research, Podgorica*

signing and implementing effective anticorruption policies is the precondition for economic growth. The good news for Bulgaria is that it can be done relatively easily, and with notable success implementing a **number of instruments for analysis of corruption risks, which could contribute to improvement of governance**. These are some of the main conclusions from the 28 July 2015 round table discussion hosted by the Center for the Study of Democracy. Among others, participants included the Deputy Prime Minister Meglena Kuneva and leading academics and experts from Europe's largest research project on anticorruption – ANTICORRP.

On 29-30 October 2015 the SELDI and ANTICORRP initiatives organized a one and a half day conference in Podgorica, Montenegro to discuss with local and

regional stakeholders the **best methods for transforming the existing cutting-edge anti-corruption and good governance research into efficient policy and advocacy tools**. The participants focused on the role of the civil society in evaluating the impact of current anti-corruption measures and stressed the need for stronger collaboration with the public institutions, the media, and the general public.

The Center for the Study of Democracy and the Turkish Economic and Social Studies Foundation (TESEV) held a workshop: *State Capture: Drivers, Outcomes and Measurement* in Istanbul, Turkey, on 3-4 December 2015 with the support of the Think Tank Fund of the Open Society Foundations. The workshop gathered leading European and US anti-corruption and good governance



*The participants in the workshop State Capture: Drivers, Outcomes and Measurement in Istanbul, Turkey*

experts to refine the definition of state capture and identify potential ways to measure the phenomenon, including in particular sectors such as energy, banking, telecommunications, etc. The main focus of the discussion was on ways to provide practical metrics of the risks and impact of state capture in transition countries – new member states, candidate, and prospective EU candidate countries.

State capture refers to the situation when private interests use corruption to mold institutions in such a way as to preserve a monopoly on resources in key economic sectors. They often use the system of public funds allocation to sustain otherwise largely uncompetitive businesses in strategic economic sectors, where clientelistic networks can exploit enormous rents from the corporate governance of SOEs, the

management of large-scale projects, and the allocation of public procurement. Foreign governments or international companies can also use their dominant economic position to capture elites and, hence, to directly influence decision-making – sometimes at a catastrophic cost for the political stability and territorial integrity of a country.



A number of related anti-corruption and good governance initiatives further contributed to CSD's influence on the national and regional level. The "Law, Economy, Competition, and Administration – Developing a Multidisciplinary Approach in the Fight against Pub-

lic Procurement Criminality (LECA) project is an attestation to this fact due to its underlying objective for increasing the institutional capacity and cooperation of Romanian and Bulgarian authorities to prevent and combat public procurement criminality. The LECA initiative addresses the need to combat public procurement criminality, with a focus on improving the understanding of corruption vulnerabilities such as economic loopholes, bureaucratic standstills, competition infringements, legal weaknesses, and poor inter-stakeholder cooperation and mutual understanding. In 2015, through collaboration between CSD and its Romanian partners from governmental and non-governmental organizations, a number of Bulgarian experts from prosecutors' offices, the judiciary and the public administration participated in workshops and seminars dedicated to understanding and tackling the existing corruption challenges in the public procurement sector.

The Economic Program supported the implementation of the USAID Macedonia Anti-Corruption Program through exchange of experience and provision of corruption monitoring methodology to the Macedonian Center for International Cooperation. The Bulgarian and Macedonian partners met on 20 June 2015 to discuss the possible implementation in Macedonia of CSD's *Judicial Anti-Corruption Program*, developed in 2003 with the support of eminent Bulgarian lawyers, magistrates, and experts from CSD. The partners also planned a representative survey among a wide sample of judges, prosecutors, and investigators.

Through its long-lasting experience and insights into the region, CSD was also able to contribute to important debates on the EU-level, such as the Union's enlargement policies and the EU's Cooperation and Verification Mechanism (CVM). On 12 February 2015 the Euro-

pean Commission's DG Neighbourhood and Enlargement Negotiations (DG NEAR), in collaboration with the European Institute, organised a policy forum addressing the role of the European Union in the Western Balkans. The event was part of the DG NEAR's information campaign in the Balkans aimed at informing relevant stakeholders about the Instrument for Pre-Accession (IPA), the new financial framework (IPA II), and the successful implementation of some selected projects. Mr. Ruslan Stefanov, Director of the Economic Program, presented the main findings and impact of the SELDI anti-corruption initiative and discussed the work and benefits that IPA provides to the West Balkans.

The Committees on Budgetary Control at the European Parliament held a **Hearing on "Cooperation and Verification mechanism (CVM) with regard to Bulgaria and Romania"** on 14 April 2015. The objective was to allow a deep discussion at the European Parliament level to assess how Bulgaria and Romania are implementing the commitments to a judicial reform, fighting against corruption and organised crime. Mr. Ruslan Stefanov, Director of the Economic Program, reviewed the successes and failures of the CVM since its introduction upon Bulgaria's accession to the EU in 2007. According to Mr. Stefanov, the results of the implementation of the CVM in Bulgaria have been mixed. The mechanism has helped the Bulgarian authorities to create a comprehensive set of institutions to improve transparency and accountability, and to tackle corruption and organized crime. But there has not yet been a breakthrough in any of the three sets of the so called "benchmarks" set by the European Commission in the CVM – on judicial reform, on corruption, and on organized crime. There are a number of improvements which can be introduced to the CVM to help Bulgaria boost its performance in im-



plementing its anti-corruption strategy, and in achieving tangible results:

- The CVM should be integrated into the wider EC efforts to help the convergence to higher rule of law standards in the EU;
- The CVM should offer tools for evaluating or measuring progress, as an integral part of the benchmarking instrument;
- The CVM should consider introducing more focused incentives and capacity building measures achieved through attaching a funding commitment to its implementation.

In August 2015, the Center for the Study of Democracy joined the project “Ask the Locals!” (<http://askthelocals.eu>), lead by Inter Alia, Greece. The goal of the project is to collect stories of ordinary people about their experiences and attitudes towards corruption and misuse of EU funds, which will be filmed and included in a documentary to promote awareness. ALO! maintains that promoting civic engagement and empowerment locally has important conceptual and methodological advantages in the process of EU integration as it fosters immediateness and easier mobilization and contributes to building a culture of participation at other levels. At the same time, it involves citizens and stakeholders who rarely have a chance to contribute in the process of building a Eu-

ropean narrative. CSD representatives, as well as participants from Italy, Macedonia, Romania, and Serbia, attended a capacity building activity held on 10-15 November 2015 in Skoulikaria, Greece.

In 2015 CSD continued to transfer knowledge and deepen its research expertise for analysing the **nexus between corruption and organised crime**, particularly in Macedonia and the Western Balkans region. The Macedonian Center for International Cooperation (MCIC) in collaboration with CSD organized in Skopje a workshop dedicated to this issue on 16 February 2015. The discussions stressed the need of stronger civil oversight both with regard to the existing links between corruption and organized crime, as well as to the institutional efficiency for tackling the challenge. Due to the globalization process, corruption has evolved into a complex national security issue. Weakened policy enforcement in one EU Member State, for example, could thus impact other countries. Moreover, in the last several years increasing varieties of crimes were observed. In that context, the issue should be dealt with in a systematic approach. The **organized crime threat assessment** mechanism presents a suitable instrument, which can analyse the origin and manifestations of the problem and present an early warning system. A more complex system for sharing information between the national authorities



*The participants in the capacity building visit to Skoulikaria, Greece*





*Workshop The links between corruption and organized crime, Skopje*

is needed to track criminals across borders, prevent VAT fraud schemes, tax evasion, etc.

As a follow up, on 17 February 2015 MCIC and CSD organized in Skopje a training on the **tools and methods for monitoring and analyzing the links between corruption and organized crime**. The participants included a group of public administration representatives responsible for anti-corruption and organized crime legislation and measures. Mr. Todor Yalamov, Senior Analyst at the Economic Program presented the experience and lessons from the *Coalition 2000* initiative. He stressed on the importance of developing a culture of accountability and integrity, reducing costs for formal business, and strengthening enforcement of the policies and legislation. He underlined that corruption is not a sickness, it is a symptom of the inefficiency of the system. He underlined that the legalization of the informal businesses is important, but it should not be selective

and benefitting only one monopoly. Mr. Yalamov underlined that public awareness campaigns could be very effective when targeting specific issues. He recommended the use of mirror statistics for civil control over the efficiency of the customs and warned about the possibility of emergence of quasi-NGOs after EU accession, based on the Bulgarian experience. He noted the role of CSD in limiting the influence of representatives of the public institutions over the civil sector.

Another successful CSD experience in the region was the project "Augmenting demand for anti-corruption and organised crime" (ADACTA). The Policy Forum within this initiative took place on 19 March 2015, in cooperation with Macedonian partners. Major findings of the survey and the *Corruption and Organized Crime Threat Monitoring Report* were presented at the event as a basis for discussion of plausible policy options to curb corruption and organized crime. The

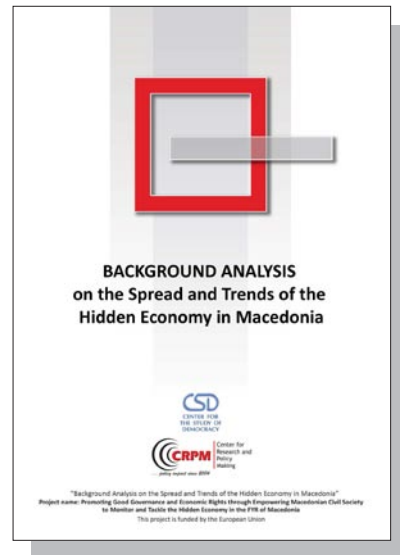


*Policy forum Augmenting Demand for Anti-corruption and Organised Crime, Skopje*

major goal of ADACTA was to transfer CSD's know-how in implementing Europol's model of OCTAs (organized crime threat assessments) and CSD's *Corruption Monitoring System*, applied to the business and the population.

### III. Monitoring and evaluation of hidden economy policies

In 2015 the CSD, in cooperation with the Center for Research and Policy Making (CRPM), Macedonia continued to research the **manifestations and causes of the hidden economy**. During the past few years, a renewed interest in the topic has led towards its more systematic treatment by institutions, but still largely based on approximations, lack of coordination between institutions, and under-evaluation of policy measures. This treatment of the problem opens the floor to many speculations regarding the effectiveness of policies and their actual impact on reducing the



size of hidden economy. In that regard, the *Background Analysis on the Spread and Trends of the Hidden Economy in Macedonia* made a review of existing reports on the phenomena in Macedonia, as well as the current and planned future policy

initiatives. The document aims to address some of the key issues through representing cross-sections of existing data and measures, summarizing the knowledge-base on the issue, and providing policy recommendations.

The two partners carried out a series of events, dedicated to the topic. During the workshop *Public Institutions' and CSOs' Role in Countering Tax Evasion and Fraud*, held on 18 February 2015, CSD presented its experience in monitoring the hidden economy at the national and regional level since 1998 to the audience of public authorities and representatives of the civil society in Macedonia. The experts from the Economic Program underlined that **analysing the phenomena is crucial due to three reasons**: (a) it shows the overall level of efficiency of the state and the trust between society and the institutions;

(b) the hidden economy affects the most vulnerable groups; and (c) not all of the hidden economy is negative and governments should not necessarily target the newly created businesses. The experts highlighted that the **hidden economy affects the most vulnerable groups such as the young unemployed, and the poor**. The tax evasion is evaluated at 1 trillion Euros in 2013 or 7.9 % of the EU-28 GDP. According to the survey, a third of the employed receive “envelope wages”, and more than half of the employed have “contracts with hidden clauses”. A total of 58.6 % of the business respondents recommend that more effective incentives for the business are applied in order to decrease the tax evasion and 60 % of the companies consider the taxes higher than they should be; 55 % of the respondents declare that sometimes or frequently the companies hide their turnover and evade taxes.



*The participants in the workshop *Public Institutions' and CSOs' Role in Countering Tax Evasion*, Skopje*



CSD Economic Program and the Center for Research and Policy Making suggested that governmental institutions and civil society in Macedonia reach consensus on hidden economy issues and express their joint view in the framework of one single body. During the conference *Establishment of Hidden Economy Task Force in Republic of Macedonia*, held on 19 June 2015, the participants noted that the hidden economy will be a policy concern in the decade to come. In that context, the role of the hidden economy task force will be to consider and promote not only punitive measures, but also motivational policies and incentives that can encourage positive economic growth. The generated recommendations and measures will be forwarded or presented to the Economic and Social Council at the Ministry of Labor and Social Policy. As a result of the discussion, as well as the two additional meetings held on 17 and 23 Sep-

tember 2015, twelve representatives of state institutions and the civil society signed a Memorandum of Understanding, establishing the Hidden Economy Task Force.

During a policy forum in Skopje on 13 October 2015, the Bulgarian and Macedonian partners presented the main findings of their analysis and the *Hidden Economy Index* – an innovative monitoring instrument which allows the tracking of the dynamics of the hidden economy and its main components in Macedonia and provides international comparison. The index, as well as the report *Monitoring the Hidden Economy in Macedonia: Trends and Policy Options* make possible for the Macedonian government and its European partners to follow the impact and assess the effectiveness of their policies. According to the data, the employment income of about 40 % of the



*The participants in the conference Establishment of Hidden Economy Task Force in Republic of Macedonia, Skopje*





cial security contributions whatsoever. The interviewed business representatives confirmed wide scale violations of the *Labour Code*. Tax avoidance is widespread among the poorest members of the society, which makes the underprivileged especially vulnerable as they may find themselves being criminally prosecuted for unpaid taxes or charged with paying large penalties. VAT returns are provided back to companies with significant time lags and represent additional burden for companies which are part of the formal economy. The issuance of cash register receipts also remains an issue, as only less than a half of the respondents claimed that they always received receipts when buying groceries.

Macedonian employees is at least partially undeclared. Moreover, 7 % of all Macedonian employees work without a contract and are not being paid any so-

On 15 and 16 October 2015 CSD organised a visit of the **Swiss Federal Tax Authority** (FTA) experts in Bulgaria. The tax experts took part in the An-



*Policy forum Tackling the Hidden Economy: Employing Best EU Policy Practices for Growth and Jobs, Skopje*



*The participants in the Annual Meeting of the National Revenue Office in Stara Zagora (photo to the left), and the Swiss Federal Tax Authority meeting with the Executive Director of the National Revenue Agency on 16 October 2015 in Sofia*

annual Meeting of the National Revenue Office, giving a lecture on 15 October 2015 to an audience of 50 tax office directors, senior inspectors from the regional offices and the central office leadership, followed up by a working meeting with the directors of the risk assessment and policy analysis directorates. In addition, the FTA experts had a separate meeting on 16 October 2015 with the Executive Director of the National Revenue Agency (NRA) of Bulgaria for a follow up discussion on future cooperation. A separate discussion was held with the internal control directorate. CSD also held a data confrontation seminar on 16<sup>th</sup> of October with leading academic representatives and tax officials, including NRA, to discuss direct and indirect methodologies to measure and assess hidden economy in Bulgaria. The Swiss experts had the opportunity to meet some of the participants in the data confrontation seminar after the discussions at NRA.

As part of the research effort to develop **capabilities for tackling undeclared work in Bulgaria, Croatia and FYR of Macedonia**, CSD experts contributed to the development of a series of reports. The working paper *Designing Focus Groups and Experiments to Evaluate Policy Approaches and Measures for Tack-*

*ling Undeclared Work* issued in February 2015, presents the methodology, advantages, and limitations of conducting focus groups as research instrument. The working paper *Designing Survey Methods to Evaluate the Undeclared Economy: a Review of the Options*, October 2015, analyses the key variations in the design of surveys of undeclared work, while a third analysis in October 2015 puts the focus on evaluating policy measures to tackle undeclared work and the role of stakeholder collaboration in building trust and improving policy-making. Key findings were presented at the Bulgarian National Information Day about Marie Curie actions on 27 January 2015. The Marie Curie IAPP Summer School for Multiple Moralities and Shadow Economies in Post-socialism held on 30-31 August 2015 in Zagreb was attended by 25 young researchers. They shared experience on monitoring the phenomena, and discussed the spread of undeclared work, the role of informal institutions in the business start-ups, the Ethics of Tax Evasion, etc. During the International Workshop *Tackling Undeclared Work – Asymmetry between Formal and Informal Institutions* held on 1 September 2015 in Zagreb, the participants discussed various policy measures for countering the problem in terms of feasibility of transferring them to Bulgaria,

Croatia, and Macedonia. Prof. Friederich Schneider, a key speaker at the event, highlighted the morals of (not) paying taxes and receiving benefits, as well as the related economic, institutional, and psychological factors illustrated in the cases of Austria, Belgium, Spain, and Switzerland.

In 2015 the Center for the Study of Democracy provided support to its Albanian partner, the Albanian Center for Economic Research, in analyzing the hidden economy and in the formation of a business coalition for improving the entrepreneurship environment in the country.

#### IV. Competitiveness and the knowledge economy

In 2015, CSD continued its work on the study of the competitiveness of the Bulgarian economy and on strengthening and encouraging the development of the potential of the Bulgarian national innovation system. CSD is an institutional member of the Consultative Council at the National Revenue Agency.

Experts from the Economic Program contributed actively in the development of the annual publication *Innovation BG*. The key recommendations for the national policy in the field of innovations can be summarized as follows:

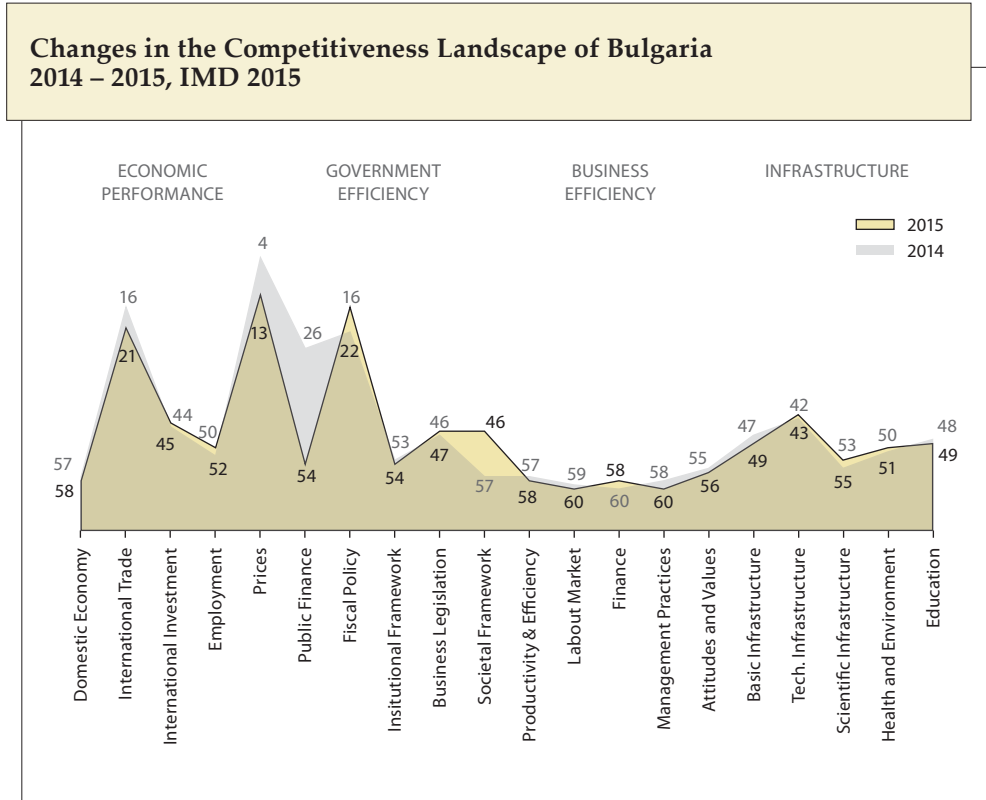
- improving the accountability of the R&D system, to avoid for example underestimation of the Bulgarian enterprises' investments in R&D expenditures and personnel;
- establishing common registers at the ministries and institutions (including the Patent Office of the Republic of Bulgaria and the National Statistical institute);
- creating a single center (ministry, agency) for management and coord-

dination of science, technology and innovation;

- creating a strong mediating infrastructure;
- building online platforms for the transfer of new or improved technology products;
- introduction of an accreditation system for the business clusters in Bulgaria.



The Economic Program continued analyzing the **barriers to the Bulgarian business** and provided **recommendations for improvement of the overall competitiveness landscape**. CSD is the official partner for Bulgaria of the World Competitiveness Center at IMD (International Institute for Management Development), Switzerland, which publishes the *World Competitiveness Yearbook*. The Yearbook has had a direct impact on the Bulgarian competitiveness policy-making. International investors monitor very closely the IMD competitiveness ranking. The *IMD World Competitiveness Yearbook 2015* assessed Bulgaria's competitiveness in comparison to 61 leading national and regional economies.



CSD presented the results of the *IMD World Competitiveness Yearbook 2015* during a press conference on 28 May 2015. **In 2015 Bulgaria remained among the most uncompetitive countries** (ranking 55<sup>th</sup> out of 61 economies), with only Croatia and Ukraine having lower scores in Europe. The country remains far from its best achievement (38<sup>th</sup> place in 2009) – a sign that the Bulgarian government and business leaders still fail to define and implement coherent policies tailored to the national interests, needs, and competitive factors. The main advantages of the Bulgarian economy remain associated with the low prices, which makes the country vulnerable to changes in the international environment. The major challenges facing the country in 2015 include optimizing the performance of

the public administration, tackling energy poverty, and enhancing the fight against corruption. It should be noted that among the factors that improve the overall competitiveness of Bulgaria is the growth of business spending on science and innovation.

CSD published a Policy Brief presenting the conclusions of the *2015 IMD World Competitiveness Yearbook*. As expected, the bank crisis of 2014 and high government expenditures had a negative impact and weakened the competitive position of the country. At the same time, the unemployment rate remains high, despite a slight decrease. Long-term competitiveness factors – environmental protection, education, infrastructure and overall healthcare, as well as the business efficiency indicators (such as





level of performance and quality management practices) are among the ones

evaluated as lowest by the *IMD Yearbook*, and continue to stand as a challenge. The Bulgarian competitiveness is in decline. In practice, during the first eight years of its EU membership, the country has failed to close the gap with the other Eastern European countries. In its policy brief CSD highlights several key recommendations for increasing the competitiveness of the Bulgarian economy:

- tackle high level corruption and state capture;
- modernize public administration and strengthen independent regulators;
- adopt education for innovation-based growth;
- tackle energy poverty, energy intensity and supply dependency;
- improve the country's branding.