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## **LABOUR MARKET AND SOCIAL POLICY IN BULGARIA**

**Seminar held in Sofia on 5 March 1998**

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## FOREWORD

The costs of resistance to reform in Bulgaria have been prolonged and painful. GDP declined substantially in the initial years of the transformation from a command to a market economy -- a common phenomenon during the early stages of transition, but one that was more pronounced in Bulgaria than elsewhere. After a short and fragile burst of growth in 1994 and 1995, in late 1996 the Bulgarian economy relapsed into deep recession, hyper-inflation re-emerged, and the currency collapsed. The crisis persisted through 1997 and precipitated a radical change in the country's approach to reform -- and an improved prognosis for economic and political stability.

Although this report was drafted prior to the implementation of emergency measures to help stabilise the Bulgarian economy, the discussion of labour market and social policy issues in this report remains valid. These stabilisation measures resulted in a modest improvement in economic performance by the first two quarters of 1998, but the level of most economic indicators remained below those of the period that preceded the crisis. Moreover, major structural reforms have yet to be implemented.

Nor are the hardships faced by individuals and households likely to be eliminated rapidly. The fall in employment, real wages, the erosion in the value of the public benefits, and the growth in the size of the population in severe poverty have been substantial, and more job losses are likely as enterprise restructuring accelerates. Moreover, economic stabilisation measures compel the government to adhere to a very tight fiscal envelope, with limited flexibility to respond to social needs.

This report reviews the macroeconomic context in Bulgaria since the early years of the transition process, documents the situation in labour market, and the efficacy and costs of the system of social protection. It examines possible policy and administrative changes which could improve the results obtained -- without significant increases in expenditure.

The report is part of the programme of assistance which the OECD has been providing to economies in transition since 1990. This programme is managed by the Centre for Co-operation with Non-Members, in collaboration with the various bodies of the Organisation, including the Directorate for Education, Employment, Labour and Social Affairs which was responsible for this project. The report was discussed with the Bulgarian authorities in March 1998 at a meeting of the Employment, Labour and Social Affairs Committee in Sophia.

Elizabeth Duskin was the main contributor to this report, in collaboration with Nils Bjorksten and Stojan Zavisic. Hartmut Lehmann and Tito Boeri contributed to the report as Consultants; the expert assistance of Georgi Shopov, Jordan Hristoskov, Theodora Noncheva, and Stephan Ivanov is gratefully acknowledged.

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## SUMMARY AND CONCLUSIONS

The transition to a market economy in Bulgaria has been unusually slow and extremely arduous. After a 25 per cent fall in GDP between 1989 and 1993, the moderate but fragile economic growth in 1994 and 1995 ended abruptly in late 1996 with a severe economic crisis and further declines in output. Since the beginning of the transition, real GDP declined by nearly 30 per cent -- a situation which is worse than in most other Central European transition economies. The outlook for the Bulgarian economy appears increasingly positive, but the challenges to be overcome in 1998 remain as formidable as those that were faced in 1997.

### **The labour market**

Bulgaria has experienced deep and prolonged labour market difficulties. Employment fell by nearly one-third by 1995, a steeper and more rapid decline than in most other transition economies. The aggressive shedding of labour in the early years of the transition, however, does not mean that Bulgaria engaged in more rapid restructuring than did other transition economies. Instead, employment losses were largely related to the collapse in demand, and to the lack of competitiveness of Bulgarian enterprises with the advent of trade liberalisation.

Much of the labour released in 1991 flowed into inactivity rather than into higher measured unemployment. While this has softened the impact on unemployment, it has shifted some of the burden to pensions and other income transfers. Unemployment nevertheless remains a central problem for Bulgarian policy makers. The rate of registered unemployment jumped to more than 16 per cent by the end of June 1997 -- close to the peak rate reached in 1993. Nearly two-thirds of the unemployed had spells exceeding one year by 1996.

Since 1993, labour shedding in industry also has been accompanied by very substantial falls in real wages. Both the downsizing of the industrial sector and the decreases in real wages have contributed to a deep fall of national income giving the government little room for manoeuvre in the area of labour market policies.

### ***Passive labour market policies***

Both "active" and "passive" labour market programmes have played a relatively modest role. Total spending in 1996 was only 0.5 per cent of GDP, of which less than 0.2 per cent was spent for active measures.

Declining numbers of the registered unemployed receive cash unemployment benefits each year -- only one-third by 1994. This is largely because of the spread of long-term unemployment, and the exhaustion of benefit eligibility. The average duration of benefits also is relatively low: 25 years of recorded service are required to receive benefits for a full 12 months. The minimum duration of benefits was six months until January 1998, when it was reduced to four months for workers with three or fewer years of work; voluntary quits; and the unemployed who have had a previous unemployment spell within

the past three years. The restriction on the latter group may be an attempt to limit the effects of “financial churning”, that is, the shifting of responsibility by municipalities from locally-financed social assistance to benefits financed from the extra-budgetary Unemployment Fund for the unemployed who become requalified through public works activities. This problem reflects the difficulties in the allocation of financing responsibilities among levels of government, and cannot be resolved by changes in the unemployment benefit system alone.

A special long-term unemployment assistance programme was implemented in 1995. It provided up to 6 months of flat-rate means-tested assistance in the amount of 60 per cent of the minimum wage, financed by the Unemployment Fund. Eligibility required a worker be registered as unemployed for twelve months and household income be below the social assistance eligibility threshold. It effectively duplicated the function of social assistance provided and paid for by municipalities, and was eliminated in April of 1997. In its place, workers who remained unemployed six months after they have exhausted benefits now were eligible for a benefit in the same amount, but without a means-test. The duration of eligibility was reduced to three months in August 1997. In effect, the unemployment benefit period was selectively extended by three months at a reduced flat-rate amount. It is of advantage only to those households which are not eligible for social assistance, and it adds unnecessary complications and costs to the benefit system.

In response to the economic crisis of 1996/97, and the planned speed up of enterprise restructuring, a temporary income support scheme was implemented until the end of 1997 to make it easier for workers to accept collective lay-offs. Workers made redundant because of a mass layoff could choose between standard unemployment benefits or a lump-sum severance payment. If the lump sum was chosen, a waiting period of 18 months was required before an unemployed worker could claim unemployment benefits. But not everyone will find a job quickly, and the waiting period of 18 months for unemployment benefit eligibility may be too severe for the long-term unemployed.

### *Active labour market policies*

Despite limited resources, a broad array of active labour market policies exists in Bulgaria, including most programmes in place in OECD countries. The largest programmes concern retraining and temporary job creation. Evaluation of active measures in OECD countries suggests that not all measures work equally well, but it is generally believed that counselling and job search assistance are effective for most groups; the effects of training programmes are less certain. Moreover, the ability of active measures to help very large numbers of the unemployed is limited. Therefore particular care in targeting is needed to avoid wasting the limited resources available for active measures. The scale and severity of the labour market problems in Bulgaria suggest that the potential success of active labour market policies may depend in large part on improved labour market performance more generally.

### **The social protection system**

The social insurance system is comprehensive -- and expensive relative to what Bulgaria can currently afford, despite the severe erosion of real benefits across programmes. Contribution rates are disturbingly high; in part, the erosion of the tax base and tax compliance problems are at fault. But this is symptomatic of even larger difficulties encountered in the transition to a market economy in Bulgaria. Eventual achievement of a sustainable growth path obviously will help to alleviate many problems, but the transition process and the well-being of individuals and families in the interim could be helped by improvements in the system of social protection. Solutions, however, should not be for expedience alone; they must be consistent with longer term interests as well.

Benefits are not unusually high relative to OECD experience; in an absolute sense, they are low. Therefore, caution is needed in the way expenditures are restrained. A general problem is that access to benefits, particularly pensions, is too easy. The cost of easy access is low benefits. Moreover, the benefit system is complex, difficult to administer, and, at times, unfair. Simplification is needed to avoid duplication and high administrative costs, and to enhance the public's understanding and perception of fairness.

### ***Pensions***

Under the pension system as currently structured, there are numerous ways to limit eligibility and increase fairness: by raising the standard age of entitlement to full benefits to a uniform age for everyone; eliminating categorical eligibility to early retirement without reduced benefits, but permitting everyone limited earlier retirement with actuarial reductions in benefits; and increasing the years of service for a full pension to a uniform requirement. Consideration should be given to shifting financing responsibility for earlier retirement for special occupational categories to employers. Benefits should be indexed, but should reflect the capacity of the economy to pay for benefit increases by the use of movements in total wages rather than average wages. What should be of less concern is the dispersion of benefits. Changes in the dispersion of the wage distribution will increase the distance between the lowest and highest benefits in a way that is less costly than changing the structure of the system to increase benefit differentiation.

### ***Sickness benefits***

Sickness benefits provide a clear case of the need for change: there is no limit on the duration of benefits; benefits are close to previous wages; eligibility is lax and is open to manipulation by workers and by employers. Employer responsibility to pay for the early days of sick leave, and a maximum number of paid sick days permitted per year would limit abuse of the system.

### ***Family benefits***

Family benefits (maternity and parental leave, birth grants, and child allowances) for an employed parent are paid for from an extra-budgetary fund [social insurance fund (SIF)]; a parallel system, paid for by municipalities, provides the full range of benefits to uninsured families if both parents (or a lone parent) are (is) unemployed or not in the labour force. Registration at the employment office is required if both parents are unemployed.

Expenditure on family benefits at all levels of government is relatively low -- 1.0 per cent of GDP in 1996, of which central expenditures accounted for the large majority. Spending on child allowances dominated central spending; parental leave accounted for three-fourths of local spending on this benefit category. Benefits are not means-tested at either level of government. It is effectively a single benefit system that is virtually universal, but which is administered and financed in a fragmented manner.

Child allowances often are held to be an effective tool in alleviating poverty. But the evidence in Bulgaria suggests that they are only slightly redistributive, even when a *per capita* measure which exaggerates the importance of household size is used to rank households by income. The potential for child allowances to ameliorate low income also is constrained by the small and declining amounts of expenditure, which is spread across all families with children. Yet it may not be politically feasible to eliminate them, nor would it be feasible to apply a means-test because of the potentially large number of



applicants and the high administrative cost. It would be more efficient to have state financing of all child allowances, and to include them in the taxable income of a parent<sup>1</sup>.

Maternity and parental leave partially replaces earnings lost because of child-birth or child care responsibilities. These benefits provided at the local level to individuals without earnings are not appropriate, and should be eliminated. Support for poor parents can be provided by means-tested social assistance.

## **Social assistance**

There has been a dramatic increase in poverty in Bulgaria since the beginning of the transition. Most of the responsibility for assisting low-income households has been shifted to municipalities-- means-tested cash transfers, non-means tested family benefits for the uninsured, and in-kind benefits, all of which are considered social assistance. Nevertheless, as all public benefits eroded in value, and as real wages declined and jobs were lost, it is troubling that the role of means-tested social assistance for the poorest households did not become a larger share of local social spending.

That the global grant from the state budget to municipalities is not of sufficient help in equalising their capacity to meet benefit promises is one explanation. A bloc grant earmarked for specified social purposes, with an improved allocation formula, matching requirements, and maintenance of effort provisions, would increase the accountability of local authorities and their incentive to use the moneys efficiently.

Second, increases in unemployment have raised the share of total family benefits paid for by municipalities, which, in turn, has crowded out spending on means-tested cash benefits.

But spending more on the poorest households inevitably means spending less on others -- although all who receive help from local authorities undoubtedly suffer from some degree of material hardship. Nevertheless, extensive use of means testing is not a feasible solution. The sophisticated information required to determine eligibility, and to subsequently monitor family circumstances generally is not available in most transition economies, including in Bulgaria. The existence of a sizeable shadow economy, and a culture of non-compliance with income reporting requirements and tax regulations also mitigates against widespread use of means testing. The most helpful change would be to minimise the resources that are lost because of unnecessary complexity and duplication in the mix of programmes and in their financing. Despite the fiscal stringency that is unavoidable in the face of economic crisis, a general reduction in benefit levels for low-income households does not appear to be justified.

The effect on work incentives of social programmes is important for those unemployed for whom a job is a viable option. But the returns to work are the most important influence on them. When both wages and benefits are low, the incentive is to engage in informal (and untaxed) activities -- even when receiving public income support. Thus, there is a cost to society of low benefits and low wages. A more competitive labour market and higher wages are an important part of the solution to both work incentives and income adequacy. Appropriate macroeconomic policy and structural reforms are as important to the objectives of social policy as they are to the economy at large.

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1. The individual rather than the family is the unit of taxation in Bulgaria. If child allowances were included in the income of the higher earner, a majority of families would be affected since the taxable income threshold of 600 000 Lev per annum in 1997 represented only about 29 per cent of average wages.

## CHAPTER 1

## THE MACROECONOMIC CONTEXT

## Introduction

Progress in the transition to a market economy in Bulgaria has been slower than in many other economies in transition. Some of the costs of resistance to reform became more apparent in late 1996, when the economy relapsed into a deep recession, hyperinflation re-emerged, and the currency collapsed (Table 1.1). These dramatic developments precipitated a radical change in the country's approach to reform, and rapid moves have begun to stabilise the economy and to lay a foundation for sustainable growth in the future.

Table 1.1 **Main economic indicators, 1993-98**  
Annual percentage change

	1993	1994 <sup>a</sup>	1995	1996	1997 <sup>b</sup>	1998 <sup>c</sup>
GDP (growth in %)	-1.5	1.8	2.1	-10.9	-7.5	3.0
Consumption (growth in %)	-3.6	-4.5	-2.9	-7.4	-6.0	0.0
Fixed capital investment (growth in %)	-17.5	1.1	8.8	-13.5	-9.0	5.0
Inflation (CPI Dec./Dec. in %)	64	122	33	311	579	20
Registered unemployment (%)	16.4	12.8	10.8	12.5	13.7	14.0
Consolidated government budget balance (in % of GDP)	-11.0	-6.0	-6.0	-10.0	-2.8	-3.0
Trade balance (US\$ million) <sup>d</sup>	-885	33	131	188	396	300
Current account balance (US\$ million)		-153	-30	82	446	500

a) The NSI began excluding holding gains from GDP figures only in 1994.

b) Preliminary.

c) Projections.

d) Reported on a fob-fob basis.

Sources: National Statistical Institute (NSI); Ministry of Finance; Bulgarian National Bank (BNB); OECD.

While the outlook for the Bulgarian economy appears increasingly positive, the challenges to be overcome in 1998 remain as formidable as those that were faced in 1997. Recent improvements in the macroeconomic environment, together with an ambitious agenda for banking and state enterprise reform, should enable Bulgaria to climb out of the steep economic decline suffered during the past two years. The initial results of the recent stabilisation and reform programme have exceeded earlier expectations.

However, sufficient time for the effective implementation of the new policy agenda must be allowed before a reliable assessment of its achievements can be made.

Among the challenges facing the government is the need to maintain the momentum for change. After years of preserving and protecting loss-making enterprises, the government now finds itself severely pressured from two directions. First, real incomes have declined, poverty has increased, and unemployment is likely to rise further as enterprises finally engage in restructuring under conditions of severe credit tightness. Second, macroeconomic stabilisation measures compel the government to adhere to a very tight fiscal envelope, with limited flexibility to respond to social needs. The difficult challenge therefore entails ameliorating economic hardship in a way that is perceived as fair -- without significant increases in expenditure.

Total social expenditure declined from a peak of 26 per cent of GDP in 1993 to a low of 16 per cent of GDP in 1996 -- despite the dramatic decline in output recorded in that year (see Table 3.2.). Expenditure on the major benefit categories had been reduced to modest levels compared with most middle-income countries by 1996 (Table 1.2) in large part because of the severe erosion of real benefits. It is unlikely that this trend can be sustained politically: it contributes to the very fragile nature of the current policy environment.

Table 1.2 **Selected social expenditures in Bulgaria as a per cent of GDP compared with CEE countries, circa 1996**

	Bulgaria <sup>a</sup>	Romania <sup>a</sup>	Slovakia <sup>b</sup>	Czech Republic <sup>b</sup>
Pensions <sup>c</sup>	7.3	6.7	8.5	8.6
Health	3.2	2.8	6.1	7.6
Family <sup>d</sup>	1.0	0.7	2.7	2.2
Housing	..			
Unemployment <sup>e</sup>	0.5	0.6	1.3	0.3
Total	12.2	10.8	18.6	18.7

a) 1996.

b) 1995

c) Pensions include old age, disability and survivors benefits.

d) Includes only cash expenditures.

e) Unemployment includes all active programmes and unemployment compensation.

Memorandum items: GDP per capita in US\$ using PPPs.

Bulgaria (1996) = 3 750

Romania (1996) = 3 674

Slovak (1995) = 4 953

Czech Republic (1995) = 9 932

Sources: OECD Social Expenditure database; Bulgarian Ministry of Labour and Social Affairs; UNICEF TransMonee database.

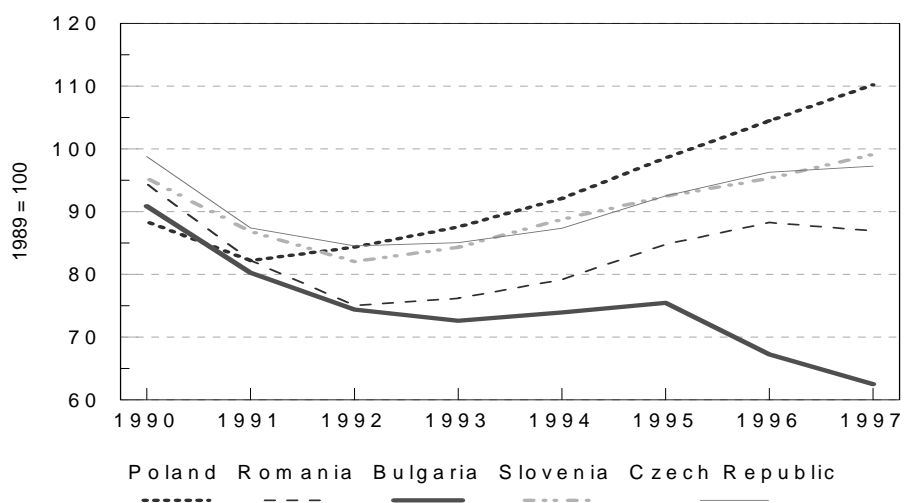
## Recurrent crisis

Despite above-average living standards relative to many other centrally planned economies in Central and Eastern Europe at the outset of the transition, the inherited conditions of Bulgaria were worse than average with regard to fiscal and financial institutions, the accumulation of bad debt, and confidence in economic policy. Bulgaria also was more highly integrated into the distortionary Comecon trading system than any other country, with the ratio of Bulgarian CMEA-related imports plus exports to GDP being over 60 per cent. The deterioration and collapse of Comecon markets, and the breakdown of the payments systems in the 1980s, contributed to severe disruptions in Bulgarian industry, with associated declines in output and employment. A policy of foreign borrowing in the late 1980s, which tripled gross foreign debt from USD 2.9 billion in 1984 to USD 10.7 billion in 1989 even as exports stagnated, led to a debt crisis. Encumbered with a foreign debt burden of well over 100 per cent of GDP in 1990, Bulgaria suspended the servicing of foreign debt.

The initial macroeconomic crisis of the early 1990s was dealt with through bold stabilisation and price and trade liberalisation measures, which are documented in the 1992 OECD publication, *Bulgaria: An Economic Assessment*. Privatisation and the building of institutions required for a market economy subsequently led to a reorientation of trade toward OECD countries, and to a private sector which, despite its modest size, was responsible for close to 50 per cent of value added in the economy.

Bulgaria also has suffered from considerable political instability throughout the transition period. Rapidly changing governments during the course of the transition have led to policy inconsistencies and reversals. Political changes impeded implementation of difficult reform measures, such as the restructuring or liquidation of loss-making enterprises, reform of the banking sector, privatisation of many state assets, and attraction of foreign investment. With little progress made in these crucial sectors, budgetary pressures grew and macroeconomic stability proved to be unattainable. After an initial 25 per cent drop in GDP between 1989 and 1993, the moderate economic growth in 1994 and 1995 (1.8 and 2.1 per cent, respectively) ended abruptly with a severe economic crisis and further declines in output. Since the beginning of the transition, real GDP was estimated to have declined by 38 per cent, although revised data suggest that the fall in real GDP was about 27 per cent. Nevertheless, this situation was worse than in most other Central European transition economies (Chart 1.1).

Chart 1.1 GDP growth in Bulgaria and in selected CEE countries, 1990-97



Source: EBRD.

Bulgaria remained one of the most heavily indebted countries in the region in early 1996, with foreign and domestic debt at 80 and 35 per cent of GDP, respectively. Fiscal plus quasi-fiscal deficits totalled around 15 per cent to 18 per cent of GDP, as the National Bank increasingly provided credits to problem banks without requiring collateral (European Bank for Reconstruction and Development Transition Report, 1997). Although the current account was roughly in balance, a lack of confidence emerged in the ability of the government to refinance the maturing foreign debt. Associated losses of international reserves and runs on the banks and the currency precipitated a complete collapse of macroeconomic stability and a crushing decline in real GDP by almost 11 per cent in 1996, continuing into 1997 with a further 10 per cent decline during the first half of the year. The Lev plummeted from Lev 70 to the Dollar at the start of 1996 to a depth of Lev 3000 to the Dollar in early 1997, with slight recovery by the end of 1997 at under Lev 2000 per Dollar. Prices rose in parallel to hyperinflationary levels and effectively wiped out large amounts of savings.

The government announced its resignation in December 1996. In early 1997, under pressure from opposition parties as well as country-wide protests and strikes, new parliamentary elections were called and a caretaker government was formed under the initiative of the newly-elected President. April parliamentary elections resulted in a strong victory by the opposition, and the new government proceeded to implement a comprehensive stabilisation programme which had been negotiated between the caretaker government and the International Monetary Fund (IMF). A fundamental element of this programme, the introduction of a currency board (implemented on 1 July, 1997), had a dramatic impact on inflationary expectations. While cumulative annual inflation in September stood at 561.8 per cent, June inflation was 0.8 per cent; it increased to between 3.6 per cent and 5.5 per cent in subsequent months, before subsiding again to 0.5 per cent in October and November<sup>2</sup>. Consumer price inflation was projected to be in the range of 16 per cent on an annual basis at the end of 1997 and remain in this range for 1998<sup>3</sup> -- a dramatic stabilisation after a year-on-year rate of 826 per cent in October (see Table 1.1).

### **Fiscal policy and the budget envelope**

This method of stabilisation can carry a considerable cost, however. The currency board arrangement effectively prevents discretionary monetary policy, which places a much heavier burden on the management of government spending. The fiscal regime since the implementation of the currency board is necessarily highly disinflationary, requiring, in Bulgaria's case, a rapid balancing of the consolidated budget. The 1997 budget deficit was estimated to be about 2.8 per cent of GDP. The main sources of financing for this deficit are expected to be privatisation revenues and net external finance, thus allowing for a potential slight reduction of government debt in 1997. The 1998 budget frame, agreed in October with the IMF, envisages a 2.7 per cent deficit in the consolidated budget, and the government plans to have a balanced budget in 1999 (Reuters, 20 October 1997).

In the short term, the pressure on public expenditure has been reduced by the recent sharp drop in interest payments due on public debt. The government plans to rationalise public administration, and to invite private participation in the crucial education and health sectors in order to ease future public expenditure constraints. In 1997 alone, around 60 000 jobs in public administration, education and health care were scheduled to be cut. Nevertheless, with 1997 tax revenue at less than 20 per cent of GDP,

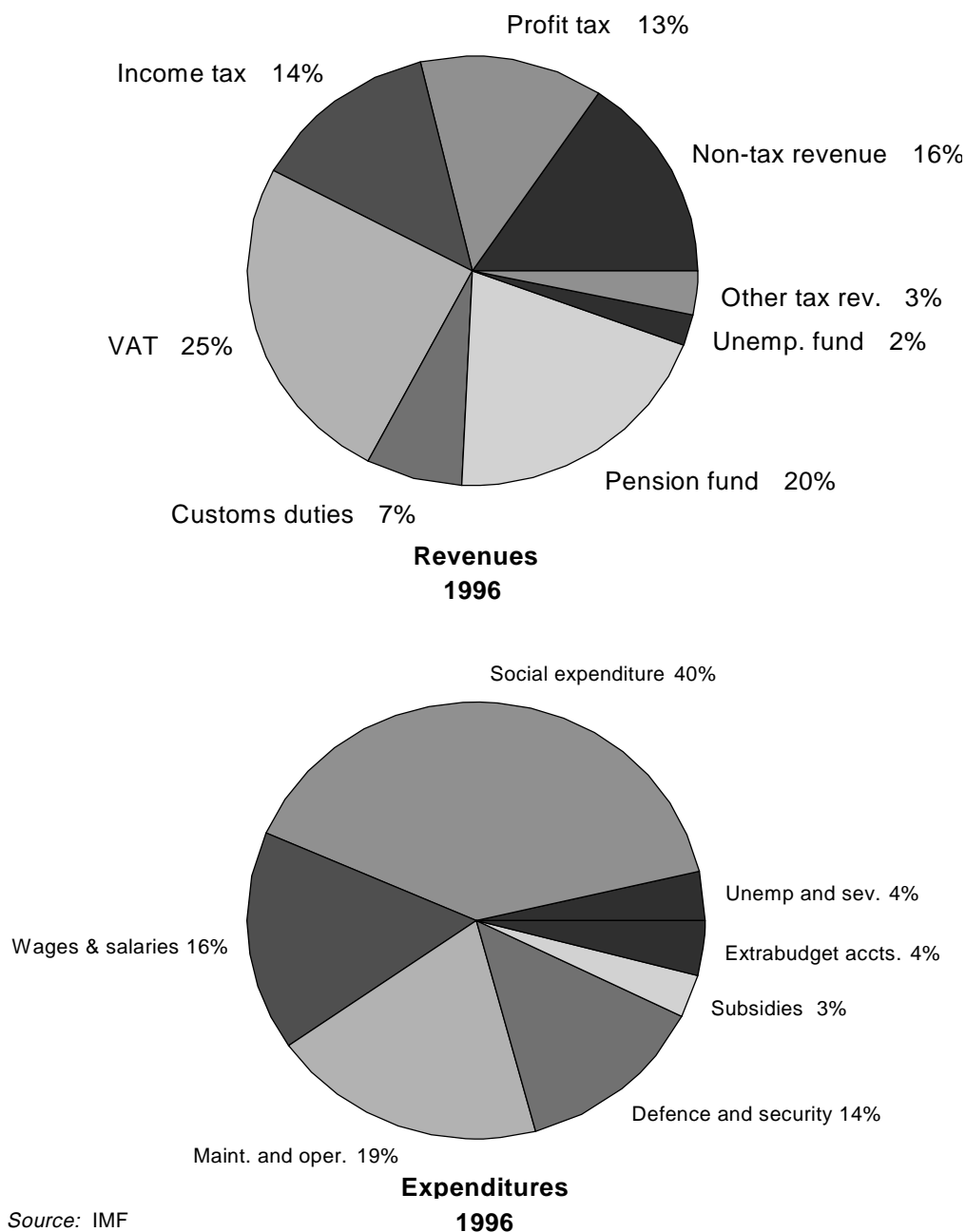
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<sup>2</sup> The temporary surge in inflation is believed to have resulted from an administrative increase in utility prices in August, a depreciation of the DM relative to the US Dollar in July/August, as well as acute shortages of some basic foods.

<sup>3</sup> The Bulgarian authorities and the IMF agreed in October 1997 on a target rate of inflation of 16.4 per cent in 1998.

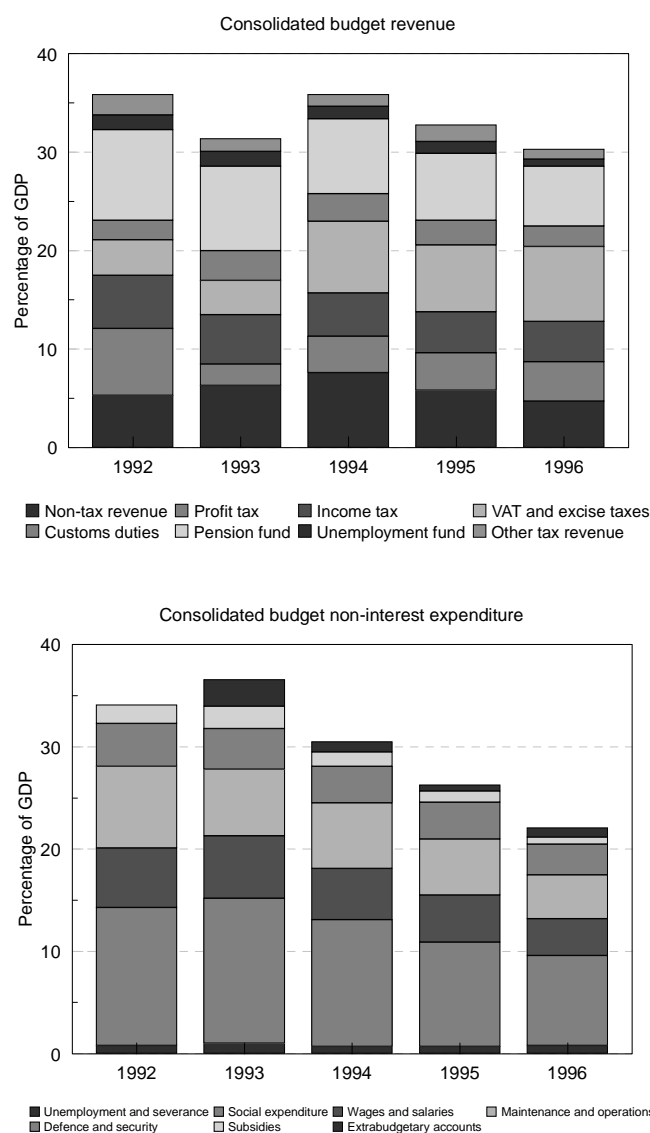
annual debt servicing requirements of around 10 per cent of GDP<sup>4</sup>, and the necessity to resolve past quasi-fiscal deficits, there is little room for manoeuvre by simply adjusting the public expenditure structure (see lower panel of Chart 1.2 and, for a historical perspective, see also lower panel of Chart 1.3.).

Chart 1.2 **Consolidated budget revenue and expenditure structure, 1996**



<sup>4</sup> Although the domestic currency debt was eroded by the 1997 hyperinflationary episode, much of the debt was denominated in foreign currency. Nonetheless, interest payments on government debt alone reached 20 per cent of GDP in 1996 because of risk-associated high interest rates and the devaluation of the Lev. These problems were alleviated with the implementation of the currency board.

Chart 1.3 Consolidated budget revenue and expenditure structure, 1992-96



Easing the tight fiscal envelope will require increased revenue collections, in large part through a reduction of the substantial shortfalls which occur in the collection of planned revenue. This has been accorded a high priority by the Bulgarian government. The “hidden” economy, composed for the most part of small family firms, also poses a major barrier to effective tax collection. The size of the shadow economy is estimated by the Ministry of Finance to be as much as 20 to 25 per cent of GDP (see upper panels of Charts 1.3 and 1.4 for a description of the revenue structure).

Acceleration of the inflow of revenues from privatisation also would help to ease fiscal constraints, but only in the short term. Given recent turbulence in international debt markets, as well as Bulgaria's recent financial crisis and remaining high debt levels, further borrowing on international markets is not likely to take place on a large scale in the near future.

In conjunction with raising revenues from privatisation, the government is actively working to encourage foreign direct investment for at least three reasons. First, there are very few domestic buyers for several large industries because of the difficult domestic credit situation. Second, foreign capital inflows are

needed to finance an expected growth in imports as enterprises engage in (overdue) restructuring, and to provide the economy with more liquidity. Finally, it is believed that foreign investment will provide valuable technical and managerial expertise, as well as increased competition in several sectors. Compared with most other transition economies, Bulgaria has not been successful in attracting much foreign direct investment, largely because of the slow pace of reforms.

Privatisation is critical, not only because it is a pivotal element in the transition process, but also because it will be used to finance over half of the budget deficit. As a pre-condition for the World Bank's Financial and Enterprise Sector Adjustment Loan (FESAL), Bulgaria agreed to privatise 40 per cent of the assets of the public enterprise sector by the end of 1997. (For the purposes of FESAL monitoring, privatisation requires the sale of at least 67 per cent of a firm's assets.) Bulgaria divested only 18 per cent of state-owned long-term assets to the private sector by November 1997, of which one half were sold through the mass privatisation programme. This is nonetheless a substantial increase from the 6 per cent divested by the end of 1996.

## **Structural reform**

### *Domestic priorities*

While inflationary pressure has been reduced and increases in the fiscal deficit have been contained, the macroeconomic situation remains fragile. A particularly high priority has been placed on rapid privatisation and restructuring in order to consolidate progress into a sound basis for sustainable future growth. The recent crisis has served to highlight the close linkages between long-term macroeconomic stability, progress in market-oriented industrial and institutional restructuring, and the well-being of the Bulgarian people.

The privatisation of state enterprises and financial sector reform are key elements of structural reform. Consistent with practices in other transition economies, the Bulgarian Ministry of Industry will directly privatise smaller firms, that is, those with less than a 70 million Lev asset base at the 1991 valuation. The Agency for Privatisation will handle large state enterprises, including public utilities. Presently, 71 large state enterprises account for over 80 per cent of the total losses incurred by public enterprises. Enterprise restructuring will remain the responsibility of new owners, as will dealing with past debt. The government has also appointed a number of working groups to study restructuring problems in difficult industries -- primarily steel, mining and heavy metallurgical concerns.

An important new departure in Bulgarian privatisation is the use of outside commercial agents to handle the sale of 96 large firms on a no-return basis. Contracts have already been signed with agents who will be handling the privatisation of 30 enterprises, which is expected to be completed by the end of 1998. The full privatisation of the 30 largest companies would account for about 13 per cent of long-term assets of state owned enterprises, and the privatisation of the remaining 66 companies for about 6 per cent. In 1998, a new wave of mass privatisation is planned.

The government also has decided to liquidate several enterprises. Liquidation is expected to affect 28 per cent of total losses of the state enterprise sector, and will significantly ease the budgetary burden of financing the continued operation of these enterprises.



### ***External policies***

The Bulgarian economy has retained its orientation toward a high volume of foreign trade. Despite the collapse of traditional export markets in the early stages of the transition, a preliminary forecast of foreign trade turnover in 1997 indicated that it would represent about 84 per cent of GDP. Increases in exports played a key role in the revival of moderate output growth prior to the 1996/1997 crisis, and are expected to remain an engine for growth in the foreseeable future.

A growing share of Bulgarian trade has been oriented to OECD countries, which now account for roughly one-half of all imports and exports. The Russian Federation remains Bulgaria's largest trading partner and primary supplier of energy imports. Community of independent states (CIS) countries, and particularly Russia, have accounted for roughly 80 per cent of imports and 50 per cent of exports to central and eastern European countries.

In the longer term, success in industrial restructuring will be crucial to the resumption and sustainability of economic growth. While initial steps taken are promising, serious challenges remain because of the relatively undeveloped system of commercial and property law and a limited administrative capacity to implement legislation. The importance of rapid progress on these fronts is enormous, as large inflows of foreign capital are less likely to occur and to establish deep roots in the local Bulgarian economy until commercial risks have been reduced.

### **Labour market and social policies**

The adverse economic circumstances in Bulgaria, aggravated by earlier resistance to change, have had disastrous social costs. These costs have been borne by the large majority of the Bulgarian population.

A striking feature of the transition process in Bulgaria is the very long average duration of unemployment and the prevalence of long-term unemployment. More than two-thirds of the unemployed were without work for more than one year by 1996. This gives Bulgaria the unfortunate distinction of being the leader among transition economies in this category. Bulgaria also has the distinction of sharper declines in employment than in most other transition economies.

Poverty, no matter how it is measured, increased dramatically, and disparities in income widened. The fall in GDP was accompanied by a decline in real income *per capita* of nearly 50 per cent between 1989 and 1995 [National Statistical Institute (NSI), 1996]. The recent economic crisis brought further declines, particularly as inflation accelerated to hyperinflationary levels in the early months of 1997 (Table 1.1). Real incomes are estimated to have fallen by an additional 26 per cent in 1996 alone. This decline appears to have been partially reversed by the end of 1997 when average wage rates rebounded to a level equivalent to approximately USD 100 per month from an average of USD 30 in 1996.

The income distribution also widened. The gini coefficient rose steadily from 0.217 to 0.378 between 1989 and 1995 (NSI, 1996) -- higher than the average income inequality in OECD countries. The ratio of income received by the richest 20 per cent of the population relative to the lowest quintile climbed from 3.5 to 6.5, and surpassed the ratio in Japan and in most of the countries in Western Europe. The result of the decline in real incomes and the changes in its distribution has been the emergence of widespread poverty, with about one-third of the population currently subsisting on a purchasing power of less than 4 USD per day [United Nations Development Programme (UNDP), 1997, reported in the European Bank for Reconstruction and Development (EBRD) Transition Report 1997].

And the Bulgarian population is ageing and shrinking (see Box 1 and Chart 1.5). Although this long-term demographic trend is not related to the economic and social difficulties associated with the transition process in Bulgaria, it will not help them either. Population ageing is likely to affect pension and health care costs, potential labour supply, and other aspects of the economy -- often in unfavourable ways.

The current fragile macroeconomic context complicates the role of labour market and social policies. These policies by themselves cannot solve the basic problems related to maintaining a reasonable standard of living for everyone during the course of the transition -- when the poor state of the economy is a large part of the difficulty. But they can help to ameliorate hardship, encourage and reward self-sufficiency through work, and facilitate the necessary structural reforms by making it easier for the Bulgarian people to accept temporary, short-term disruptions. The following chapters review existing labour market and social policies, and consider the changes that might improve their performance -- within the budgetary limitations that must be respected.

### **BOX 1. 1 Demographic Characteristics of the Population**

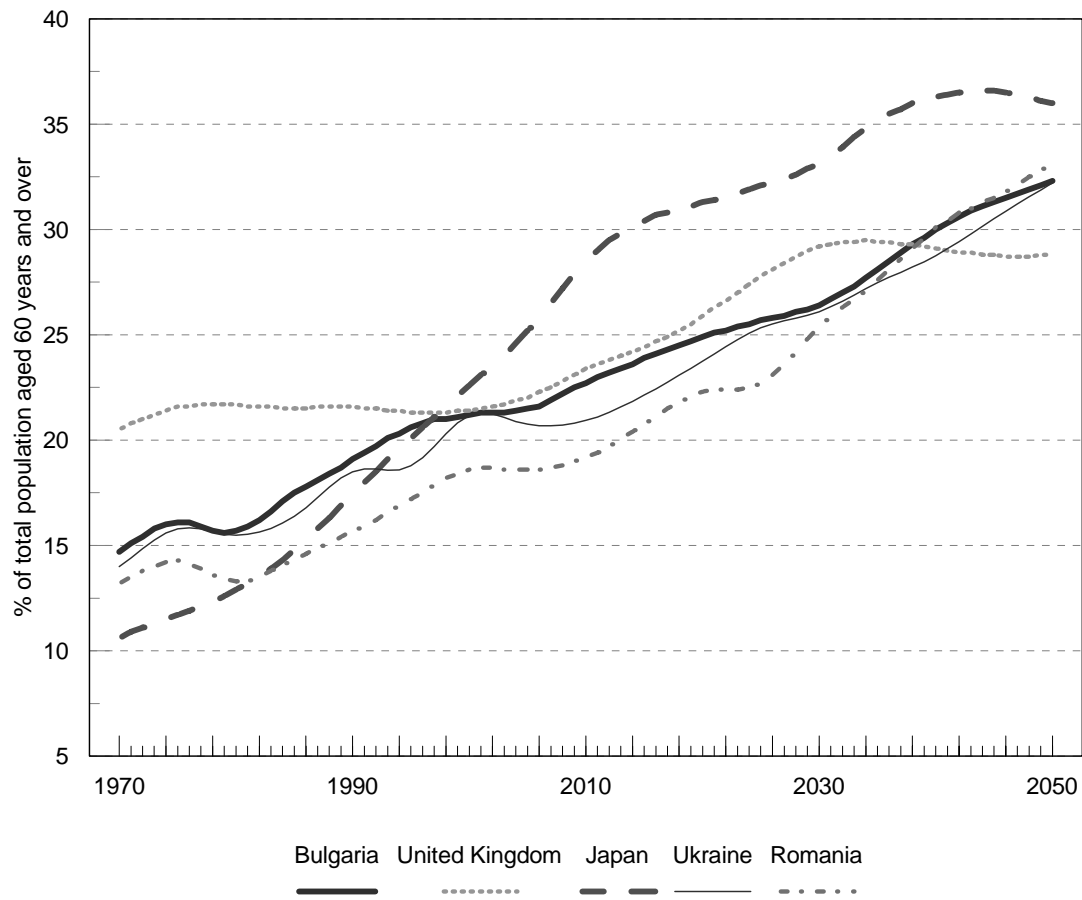
The population of the Republic of Bulgaria is ageing and declining in absolute numbers. This is attributable to decreases in the fertility rate, and increases in the mortality rate. The total fertility rate in 1996 of 1.24 was lower than that of OECD countries and well below the rate needed to stabilise the population. Life expectancy at birth for a man in 1996 was 67.1 years (1.3 years less than in 1990); for a woman, 74.6 years (0.3 years less than in 1990). As of the end of 1996, there were 8.34 million people. This represented a decline of nearly 45 000 inhabitants in only one year.

The composition of households in 1996 reflects the ageing of the Bulgarian population. Of the total number of households (2.8 million), 60 per cent contained no children; 20.6 per cent included one child under 18 years of age; 17.1 per cent contained two children aged less than 18 years; only 2.1 per cent of households included three or more children under age 18. The average household size was 2.95.

Chart 1.4 shows that slightly more than one-fifth of the Bulgarian population was over age 60 in 1996, but nearly one-third of the population is projected to be over this age by 2050. The demographic path is similar to that of the Ukraine, but the share of the population over 60 years of age in Bulgaria exceeds that of Romania until after the year 2030 when convergence occurs. The speed of the ageing process is less dramatic than in Japan (the most rapidly ageing OECD country), but is taking place more rapidly than in the United Kingdom, where the rate of change is modest compared with other OECD countries.

Source: Statistical Yearbooks, National Statistical Institute, Sofia

Chart 1.4 **Share of population aged 60 years and over, 1970-2050**



Data for the years 1970 to 1990 are United Nations demographic estimates.  
 Data for the years 2000 to 2050 are from United Nations Population Division's medium variant population projections.

Source: World Population Prospects 1950-2050 (1996 revision).

## CHAPTER 2

### LABOUR MARKET TURBULENCE

The difficulties which can affect the labour markets of countries that move from a centrally planned system towards a market economy have all occurred in Bulgaria: sharp losses in employment, high unemployment, low turnover among the unemployed, increasing long-term unemployment, and declining real wages. These adverse developments in the labour market have been particularly deep and prolonged, and have contributed to the impoverishment of large sections of society since reforms began in 1991.

#### **Employment and unemployment**

##### *Labour shedding*

Total employment fell precipitously, from an annual average of more than four million employed in 1990 to slightly over three million by 1995 -- more than a 25 per cent decline. No other country in transition, apart from Romania, experienced a fall in employment on such a large scale. The more aggressive shedding of labour, however, does not mean that Bulgaria has engaged in more rapid restructuring than other transition economies. Instead, it is in large part related to a collapse in demand across all sectors because of strong exogenous shocks (see Chapter 1).

Labour shedding is continuing, but as a matter of policy. The Bulgarian government elected in the Spring of 1997 intends to speed up the pace of enterprise restructuring and privatisation. A 10 per cent staff reduction in the budgetary sphere was planned as of September 1997. Additional mass layoffs involving about 25 000 workers are expected in loss-making state enterprises.

As Table 2.1 shows, gross flows into unemployment were large from the beginning of the transition period -- almost twice as large as in other economies in transition. But only a fraction of the large employment losses were reflected in the flows into unemployment. Gross job destruction rates also were significantly above those of other Central and Eastern European countries in the early 1990s, and separation rates involved about one-third of workers in state enterprises. The massive labour shedding was a result of the severe difficulties encountered by state-owned enterprises during the initial phase of reforms in 1991 and 1992: direct subsidies were virtually eliminated and trade liberalisation coincided with the break-up of the Former Soviet Union (FSU) and the disruption of CMEA links and of trading routes to the West.

Table 2.1 Labour shedding in Bulgaria, 1990-97

	1990	1991	1992	1993	1994	1995	1996	1997 <sup>a</sup>
Change in employment <sup>b</sup>								
Bulgaria	-6.1	-13.0	-8.1	-8.5	-4.2	5.7	1.2	
CCET <sup>c</sup>	-2.7	-7.4	-1.6	-1.5	-0.9	-0.1	1.0	
Unemployment inflows as percentage of working age population								
Bulgaria		17.4	14.4	11.2	10.5	11.2	12.8	18.9
CCET <sup>d</sup>		9.1	6.9	8.4	8.3	8.9	8.8	9.0
Job destruction rates <sup>e</sup>								
Bulgaria		13.2	15.2	10.7	6.5	..	..	..
CCET <sup>f</sup>		9.1	8.1	8.5	6.6	..	..	..
Separations as a percentage of state sector employment								
Bulgaria <sup>g</sup>		36.2	30.8	29.1	24.8	22.1	26.2	

a) Secretariat estimates.

b) Balance of labour resources data prior to 1992 for Bulgaria, the Czech and Slovak Republics and prior to 1991 for Hungary and Poland. Labour force survey data were used after these dates.

c) CCET includes the Czech Republic, Hungary, Poland, and Slovakia.

d) Hungary excluded from 1991 and 1992 figures; Poland excluded from 1991 figures.

e) Job destruction rates are defined as the sum of employment contractions in shrinking units as a per cent of total employment in the initial year. The rates are estimated based on data from comparable establishment surveys from Bulgaria, Hungary, Poland and Romania. (Konings et al. 1996).

f) Sum of first differences in employment levels of shrinking units as a percentage of the beginning of the period employment. (Estimated on the basis of an enterprise survey carried out in Bulgaria, Romania, Poland and Hungary).

g) Figure for 1996 is a Secretariat estimate; public sector only.

Sources: OECD-CCET Labour Market database for data on employment and unemployment.

The dramatic decline in the employment rate was accounted for in part by the significant drop in the activity rate of Bulgarian women. However, only about 36 per cent of employment losses appeared as an increase in unemployment, compared with 72 per cent of such losses showing up as unemployment in other transition economies (see Table 2.2). Obviously, the majority of workers released from state enterprises left the labour force -- or they left recorded employment in the informal economy for employment in the informal economy.

A 1.0 per cent decline in GDP was associated with almost a 9 per cent decline in employment in Bulgaria compared with an average elasticity of 6 per cent in other Central and Eastern European countries. The greater responsiveness of employment to output changes in Bulgaria may be facilitated by the less restrictive Bulgarian Labour Code<sup>5</sup> the weak enforcement of regulations, and the heavy use of "civil contracts" which can be terminated at the discretion of the employer<sup>6</sup>.

5. The 1994 Labour Code requires advance notice of layoffs only in the case of mass redundancies; the notice period of 30 to 90 days is shorter than in many other countries; statutory redundancy pay also is lower than in most other transition economies and is unrelated to seniority. See OECD, 1994 for discussion of regulations on collective redundancies in transition economies.

6. "Civil contracts" accounted for 10 per cent of employment in some years. Until March 1995, payment of social security contributions was waived for this type of employment contract.

Table 2.2 **Trends in employment, unemployment and labour force participation, 1989-1996**

	Employment as a % of the working- age population		Unemployment as a % of the labour force	Labour force participation rate	Unemployment- employment variation <sup>a</sup>
	1989	1996	1996	1996	1996-90
Bulgaria					
Female	70.3	49.2	15.1	57.9	
Male	68.9	56.6	15.4	66.9	
Total	69.6	52.9	15.3	62.4	0.36
CCET <sup>b</sup>					
Female	62.6	57.8	10.3	64.4	
Male	74.7	72.0	8.6	78.7	
Total	68.6	64.8	9.3	71.5	0.72
Middle-income countries		57.9	5.6	63.5	

a) Change in unemployment from 1990 to 1996 divided by the change in employment from 1990 to 1996.

Employment data for 1996 are from labour force surveys; data for 1990 are enterprise survey data.

b) Includes the Czech Republic, Hungary, Poland, Romania and the Slovak Republic.

Sources: National statistical yearbooks; OECD-CCET Labour Market database; ILO Yearbook of Labour Statistics, several issues.

### The composition of employment change

Almost all sectors experienced employment reductions until 1992, after which the pattern of growth and decline by sector became more divergent. Declines were most heavily concentrated in industry, where employment fell by nearly one-half by 1995 (Table 2.3). This sector accounted for one-third of total employment in 1990. Financial services showed growth over the period, but this sector was virtually non-existent earlier -- it accounted for less than 1 per cent of employment in 1990.

Labour was shed in agriculture on a large scale between 1989 and 1991, but employment later recovered to its 1990 level. Privatisation of collective farms was slow: a restitution scheme was used which was very time consuming, and ownership of a large part of arable land remained uncertain for some time (Bobeva and Hristoskov, 1995). By 1994, however, 70 per cent of all arable land was privately owned. Despite the substantial early declines in agricultural employment, the share of employment in the agricultural sector increased from 18.5 per cent in 1990 to 23.3 per cent by 1994. The rising employment share in agriculture was attributable to large declines in other sectors, rather than to significant growth in the agricultural sector itself. Although probably a transitory phenomenon, it does suggest that agricultural employment was used to absorb some redundant workers in the initial years of transition, that is, some workers shed by industry returned to their place of origin to find employment on farms. The evidence, although scant, seems to support this hypothesis. Since agricultural exports decreased and real incomes fell dramatically after 1989, additional output must have been consumed by producers.

Table 2.3 **Employment by sector, 1989-1995<sup>a</sup>**  
Annual growth rates

Economic activity	Stock (000s)							Percentage change
	1989	1990-89	1991-90	1992-91	1993-92	1994-93	1995-94	1995-1989
Agriculture	814	-7.0	-8.1	-0.4	2.7	5.5	4.2	-3.8
Industry	1646	-9.0	-19.2	-14.2	-6.6	-4.4	-2.2	-44.0
Construction	361	-6.8	-25.0	-19.1	2.3	-8.1	-2.4	-48.1
Trade and catering	395	-5.8	-8.0	-4.0	0.9	11.1	-3.3	-9.7
Transport and communication	290	-1.3	-6.7	-11.4	1.8	-3.5	7.9	-13.5
Financial services	26	-3.7	10.0	29.8	5.1	19.4	16.0	100.3
Health and education	491	0.5	-3.7	-1.7	-0.9	-2.8	-0.1	-8.5
Public administration	61	-10.1	-7.4	2.6	29.7	12.1	1.1	25.5
Other services	281	-2.8	-18.5	-15.4	-3.8	1.6	11.4	-27.0
Total	4365	-6.1	-13.0	-8.1	-1.6	0.6	1.3	-24.8
Coefficient of variation								
of growth rates across nine sectors <sup>b</sup>								
Bulgaria		0.7	1.1	4.0	3.2	2.6	1.9	
CCET <sup>c</sup>			1.1	10.9	4.5	3.7	2.1	

a) Enterprise survey data.

b) The standard deviation of growth rates across sectors as a percentage of the average growth rate across sectors.

c) An average of the Czech and Slovak Republics, Hungary and Poland; Hungary excluded from 1991 average.

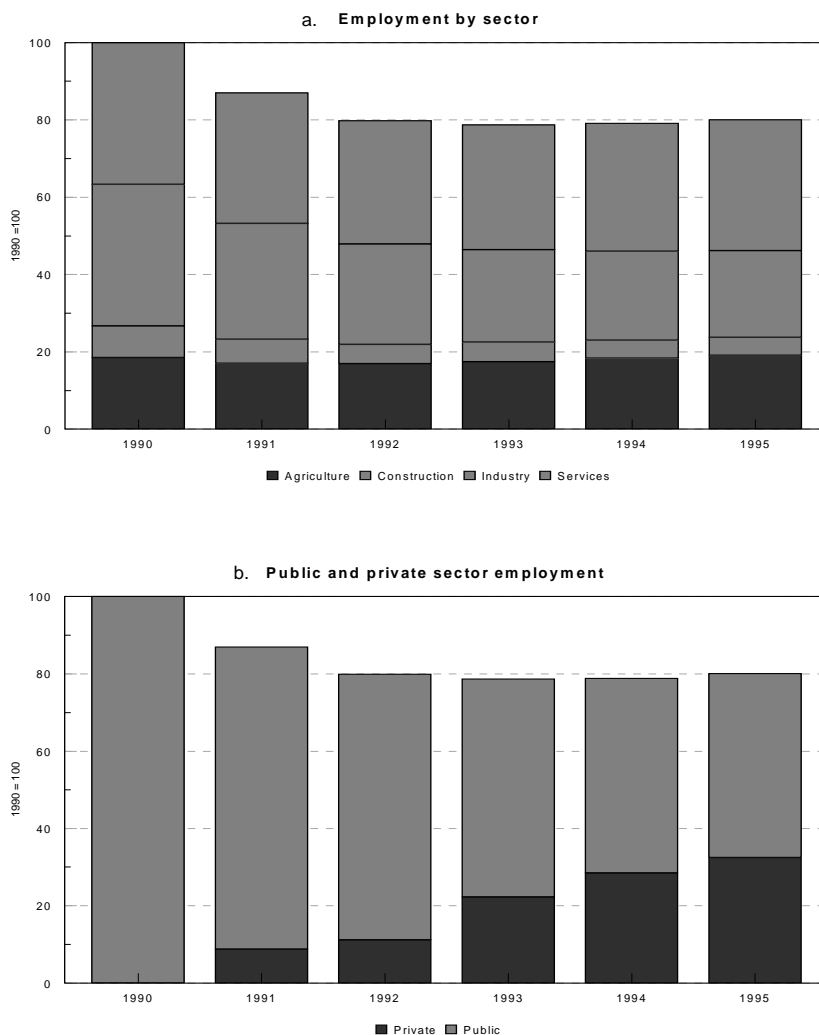
Sources: Bulgarian Statistical Yearbook, 1996.

The large fall in employment in construction is unusual for transition economies where this sector is generally quite viable. The contraction apparently occurred because of the general decline in economic activity and reduced state funds for maintaining and improving the public infrastructure.

Differences in the extent of employment losses across sectors also translated into shifts in employment shares (Chart 2.1). There was a substantial decline of the employment share in industry and construction, while the shares of the agriculture and service sectors increased slightly. The shifts are not particularly large relative to employment shifts in other transition economies.

The reallocation of labour from the state to the private sector also proceeded more slowly than elsewhere. About 40 per cent of the workforce (and slightly less than 50 per cent of value added) was employed in the private sector compared with well over 50 per cent private sector employment recorded in the other transition countries. The state also has maintained significant minority ownership in many privatised enterprises, which leaves the actual size of the private sector in Bulgaria unclear (Konings *et al.*, 1996).

Chart 2.1  
Changes in employment structure in Bulgaria, 1990-1995



Source: Bulgarian Statistical Yearbook.

In sum, the changes in the composition of employment in Bulgaria have not always been related to longer-term structural objectives. The speed of structural change has been slower than in other economies in transition, and the potential for growth has not yet been fully exploited.

### Wages, productivity and unit labour costs

Bulgarian industrial enterprises currently have lower unit costs than they did at the outset of transition (Table 2.4). The reduction was not driven by gains in average labour productivity: it was actually lower in 1996 than it had been at the start of transition. The reduction in unit labour costs was driven by declines in real wages. The declines were concentrated at initial stages of the transition and during the episodes of hyperinflation in late 1996 and early 1997 (Chart 2.2). As inflation slowed, real wages partially recouped earlier losses by the third quarter of 1997.



Table 2.4 **Wages, productivity and unit labour costs, 1996**

(1990 = 100)

	Bulgaria	CCET <sup>ab</sup>
Average labour productivity	94.1	112.3
Real consumption wages	35.1	94.8
CPI/GDP deflator wedge	208.5	122.2
Employers' contributions	107.0	104.1
Real production wages <sup>bc</sup>	78.3	119.7
Unit labour costs <sup>bc</sup>	83.3	107.7

a) Includes the Czech and Slovak Republics, Hungary and Poland; base year is 1989 for Poland.

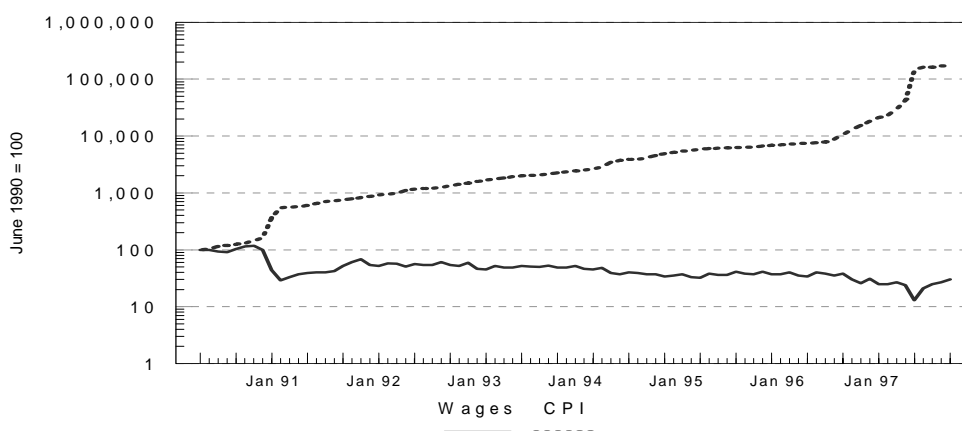
b) Using GDP deflator.

c) Changes in employers' contributions have only taken into account contribution rates to unemployment benefits.

*Sources:* Secretariat estimates based on data in Havlik, Peter, "Labour Cost Competitiveness of Central and Eastern Europe", The Vienna Institute for Comparative Economic Studies (WIIW), forthcoming.

Only a fraction of real wage declines affected unit labour costs, and hence improvements in profitability. Producers' prices rose much less than the Consumer Price Index (CPI)<sup>7</sup>; the increase in social charges increased the wedge between total compensation and take-home pay. Because of these factors, there was only a 20 per cent decline in wages paid by employers at the end of 1996 relative to 1990, compared with a 65 per cent reduction in consumption wages (see Table 2.4). Labour costs remain favourable in Bulgaria compared with the situation in other central and eastern European countries, but the favourable position could deteriorate. Larger gains in productivity and containment of increasing social charges would help to maintain Bulgaria's comparative advantage.

7. The wedge between the CPI and the GDP deflation increased dramatically in 1997 before the institution of the currency board. One interpretation of the large wedge between the CPI and the GDP deflation in Bulgaria is that it reflects a hidden transfer mechanism to the private sector (Miller, 1994). Most private firms are in the trade sector, while state enterprises are concentrated in industry.

Chart 2.2: Real wages and the consumers price index <sup>a</sup>, 1991-1997

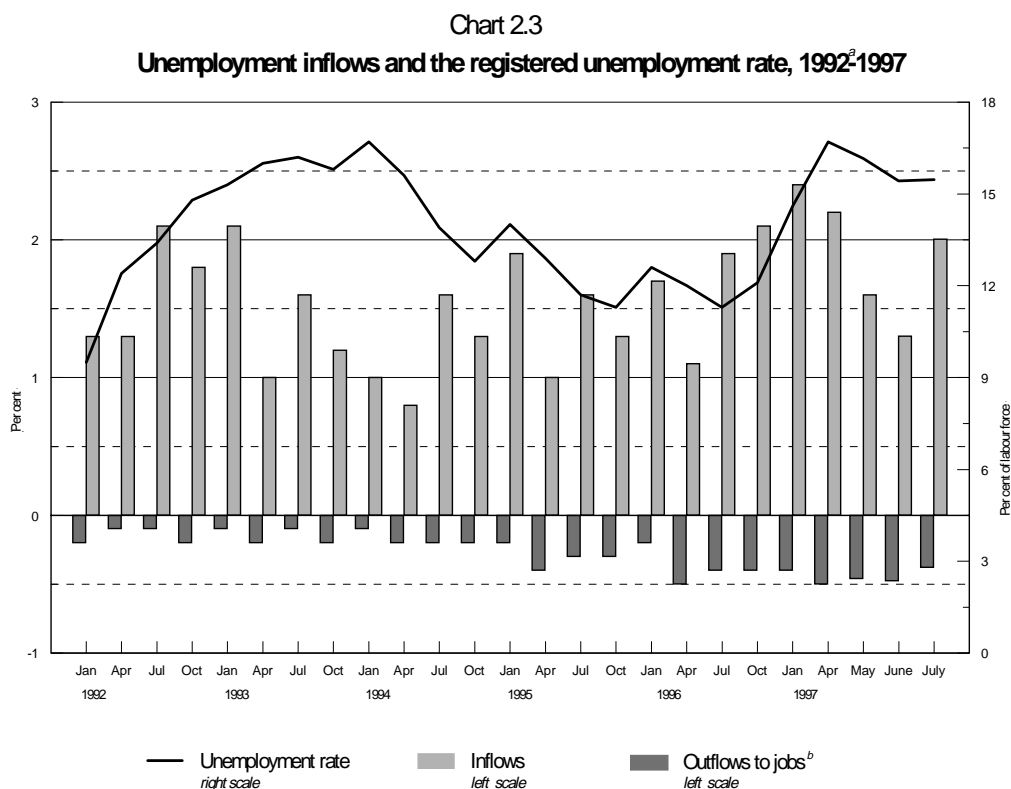
a) Real wages are defined as average gross monthly wages deflated by the CPI.

Sources: Short-term Economic Indicators database; OECD-CCET Labour Market database.

### *Unemployment and labour market flows*

From virtual full employment at the beginning of the transition, registered unemployed rose steeply to over 16 per cent by the end of 1993 -- the highest unemployment rate among the Central and Eastern European countries in transition (Chart 2.3). Registered unemployment subsequently fell to slightly over 11 per cent by 1995, but again jumped to more than 15 per cent by the end of June 1997. Labour force survey data show a similar pattern of unemployment, but suggest that unemployment, measured according to the International Labour Organisation (ILO) definition, was up to five percentage points higher in some years than registered unemployment. The gap between labour force survey (LFS) and registered unemployment in Bulgaria is gradually closing, however.

Reductions in registered unemployment, as mentioned previously, are explained for the most part by increased flows out of the labour force rather than flows into employment. Outflows to formal employment were low throughout the period -- on average, they accounted for only 16 per cent of total outflows.



a) The above rates have been estimated by the OECD Secretariat using estimated monthly labour force figures, whereby end-of-year estimates are based upon the sum of end-of-year employment and unemployment. Within-the-year labour force estimates are derived from the linear interpolation of the end-of-year figures.

b) Outflows to jobs are represented in negative percentages.

Source: OECD-COET Labour Market database.

Not all types of individuals are equally likely to move into or out of a given labour market state. Characteristics such as age, sex and education can make a difference. Transition probabilities, that is, movements of individuals, between their original state and employment (E), or unemployment (U), or inactivity (N) over a four-month period in 1995 using data drawn from matched records across labour force surveys are examined in Table 2.5. The results show that the probability of moving from one state to another within a four month period is small for most groups. Approximately 90 per cent of those who were employed or inactive remained so, regardless of gender, with only slightly more variation by age and level of educational attainment. More than one-half of the unemployed remained in that state, except for those aged 55 and over who were significantly more likely than others to leave the labour market.

Bulgarian women are not more likely to lose their jobs than are men -- a result common to virtually all countries in transition. But they do have worse job prospects once they become unemployed, and are slightly more likely than men to leave the labour market. The flow of women from unemployment to inactivity, however, is not large enough to compensate for the much lower female flows relative to males from unemployment to employment. As a consequence, more women remain in unemployment longer than men. Men also are slightly more likely than women to return to the labour market from inactivity.

Table 2.5 Labour market transition probabilities by sex, age, and education

June to October 1995

	EE	EU	EN	UE	UU	UN	NE	NU	NN
Gender									
Total	92.4	2.8	4.8	22.5	59.1	18.4	3.8	2.7	93.5
Male	92.7	2.9	4.4	26.2	57.0	16.9	4.2	3.1	92.8
Female	92.0	2.7	5.2	18.4	61.5	20.1	3.4	2.5	94.1
Age									
15 to 24	84.3	6.5	9.2	16.8	60.2	22.9	3.6	5.2	91.2
25 to 39	93.7	3.0	3.3	25.6	60.0	14.4	14.2	11.4	74.4
40 to 54	95.0	2.3	2.8	24.6	59.6	15.8	13.9	10.4	75.7
55 and older	78.4	1.2	20.4	14.9	42.6	42.6	1.6	0.3	98.2
Educational attainment									
Higher	97.3	0.6	2.2	32.2	55.9	11.9	5.7	2.6	91.7
Secondary vocational	95.4	2.1	2.6	25.7	60.9	13.3	8.0	5.0	87.0
Secondary general	92.9	3.3	3.8	25.2	57.1	17.7	6.1	4.7	89.2
Primary and less	86.5	4.4	9.1	18.4	60.1	21.5	2.6	2.1	95.3
Regions									
Sofia metropolitan area <sup>a</sup>	94.9	2.0	3.2	25.2	62.8	12.0	2.2	3.0	94.8
Russe <sup>b</sup>	92.4	1.8	5.8	28.6	51.5	19.9	5.2	2.5	92.3
Montana <sup>c</sup>	92.6	3.6	3.8	17.1	68.1	14.8	3.5	2.7	93.7
Rest of Bulgaria	91.7	3.2	5.1	21.4	58.7	19.9	3.7	2.7	93.5

a) Includes the okrugs of Sofia, Sofia city and Pernik.

b) Includes the okrugs of Russe, Razgrad and Silystra and Targoviste.

c) Includes the okrugs of Montana, Vidin and Vratza.

Note: E = employment, U = unemployment and N = Not in the labour force

Origin stock: Male: E = 5951, U = 1032, N = 4766; Female: E = 5105, U = 912, N = 6307.

15-24: E = 860, U = 493, N = 2087; 25-39: E = 4311, U = 723, N = 739.

40-54: E = 5052, U = 633, N = 864; 55+: E = 833, U = 94, N = 7383.

Higher: E = 2110, U = 118, N = 614; Secondary vocational: E = 2497, U = 338, N = 802.

Secondary general: E = 3156, U = 571, N = 1758; Primary: E = 3293, U = 917, N = 7899.

Source: Bulgarian labour force survey.

Bulgarian prime-age workers, as in most other countries, enjoy greater employment stability and labour force attachment than other age groups. Older workers have separation rates three times as high as prime-age workers, and virtually all older workers leave the labour force when they lose a job. This accounts for the low unemployment rate among older workers.

Younger workers also have higher separation rates than prime-age ones. Many younger workers become unemployed, but even more leave the labour force. This, too, is common in other transition countries. In contrast with other countries, the hiring rates of young unemployed in Bulgaria are eight percentage points lower than those of prime-age workers, and their flows from unemployment to inactivity are relatively high. Large inflows into education are a partial explanation, but flows into the informal economy probably are significant as well.

Transition probabilities by educational attainment show a common pattern: the higher the level of educational attainment, the less likely is a job loss, and if unemployed, the easier it is to become employed. Particularly striking, however, is the gap between individuals with primary education or less and the higher educational levels. Those with the lowest level of educational attainment are the most likely to lose their job and least likely to re-enter employment by a significant margin. Because they have a higher probability of leaving the labour force, individuals with low educational attainment have an

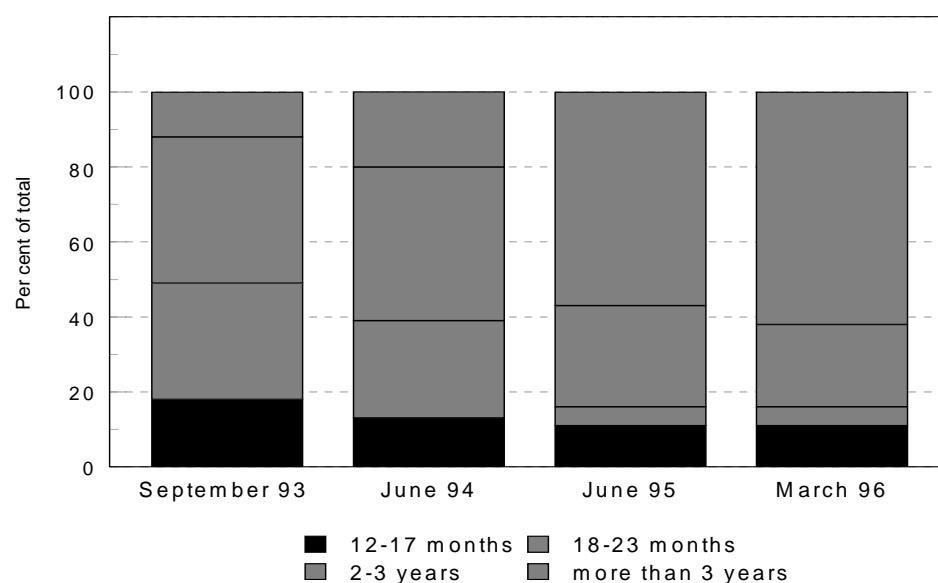
average completed duration of unemployment that is only marginally higher than other unemployed. In absolute numbers, however, the least educated are disproportionately represented among the unemployed.

### *Long-term unemployment*

Bulgaria has a high and growing share of long-term unemployment (Chart 2.4). The share rose from about one-half in 1993 to nearly two-thirds of total unemployment by 1996, substantially more than in many other transition economies. The pattern of exit probabilities from unemployment across durations is not surprising: more than half leave unemployment within the first two months (28 per cent of the total stock leave for employment, 23.8 per cent leave the labour force). The large proportion who leave the labour force makes the Bulgarian case unusual. The duration category six to 12 months shows higher exit probabilities than the category three to five months, but this can be explained by the average duration of unemployment benefit receipt of about seven months. As in most countries, the long-term unemployed, that is, those with an unemployment spell of more than one year, have lower exit probabilities than the short-term unemployed.

There are significant variations in the share of long-term unemployment among different groups of unemployed in Bulgaria because of differences in the strength of their attachment to the labour force and their chances of moving into employment. Although the difference in the shares of long-term unemployment by sex were small in 1996, differences in shares by other characteristics were large (see Table 2.6.). Despite relatively better prospects among prime-age workers of finding a new job, nearly 60 per cent of them who became unemployed remained so for more than one year -- a proportion that was substantially higher than that of any other group in Bulgaria. (By 1996, the proportion of this age group who remained unemployed for more than one year in Hungary and Poland ranged from about 9 to 11 per cent, respectively.) This picture reflects the generally unfavourable labour market conditions in Bulgaria six years after the beginning of the transition.

Chart 2.4  
Long-term unemployment by duration, 1993-96  
LFS data



Memorandum item:

	Stock of LTU (000s)	Incidence of LTU (%)
September 1993:	427.6	52.5
June 94:	431.1	58.7
June 95:	371.4	65.8
March 96:	334.2	62.3

Source: Bulgarian labour force survey.

Table 2.6 Characteristics of the unemployed, 1996

LFS data

	Bulgaria		Hungary		Poland		Slovak Republic	
	Rate of unemployment	Share of LTU	Rate of unemployment	Share of LTU	Rate of unemployment	Share of LTU	Rate of unemployment	Share of LTU
Female	14.1	46.7	8.8	35.7	13.9	56.4	12.5	50.4
Male	14.2	53.3	10.9	64.3	11.0	43.5	10.0	49.6
Youth <sup>a</sup>	34.4	21.7	19.2	20.2	28.5	21.2	20.6	22.4
Prime-age <sup>b</sup>	12.2	57.9	8.8	..	11.1	..	9.8	68.4
Older <sup>c</sup>	9.5	4.3	6.2	9.0	7.2	9.5	5.9	7.9
Higher education	5.1	6.1	2.8	..	4.2	..	2.7	1.8
Secondary general education	13.9	28.7	7.2	..	11.6	..	12.7	4.8
Vocational education	11.1	15.4	11.7	..	15.3	..	9.9	55.1
Primary education or less <sup>d</sup>	23.3	49.9	15.7	77.6	13.7	26.6	25.0	38.3
Total	14.1	100.0	10.0	100.0	12.3	100.0	11.1	100.0

a) 15-24 years old.

b) 25-49 years old.

c) 50 to retirement age.

d) Primary education and less figures include vocational long-term unemployed for Hungary and Poland.

Source: OECD-CCET Labour Market database.

### ***Regional differences***

In Bulgaria, as in other Central and Eastern European countries, there are large regional differences in labour market performance. The situation in selected regions (*oblasts*) is shown in Table 2.5. The city of Sofia has a much lower unemployment rate than the rest of the country. Its U/V ratio also is substantially lower than those of other regions. The inverse of this ratio is a rough measure of the average re-employment probability of an unemployed person, and Sofia apparently offers more job opportunities to the unemployed than any other part of the country. It has a relatively dynamic labour market with a large (privately owned) service sector where most job creation occurs during the initial phase of economic transition). In contrast, Montana, Plovdiv and Russe have higher unemployment than most regions and the highest U/V ratios in the country. They have a high share of employment in agriculture (Montana) or industrial employment in declining sectors of heavy industry (Plovdiv and Russe). Areas with such an employment structure adjust more slowly to the shocks brought about by the collapse of the former regime, and the introduction of liberalisation and stabilisation policies by reform governments.

Since the beginning of the reforms, the dispersion of regional unemployment rates has been increasing, even during periods when the national unemployment rate was declining. The continued increase, largely because the regions Montana and Russe did not experience as large a reduction in unemployment rates as the other regions, is unusual for transition economies. The dispersion of U/V ratios rose as well through 1995, even though the overall ratio fell after 1993, again because of the poor performance of Montana and Russe. Montana and Russe clearly are the two regions with the worst labour market prospects in Bulgaria.

There also are important differences in labour market adjustment between the four geographic regions in Bulgaria: the metropolitan area of Sofia, the *oblasts* Russe and Montana, and the rest of the country. Five years into the transition, the labour markets of the metropolitan area of Sofia and Russe had relatively low inflows into unemployment and high job accession rates. In contrast, the labour market of the *oblast* of Montana seems to be plagued by large inflows into unemployment and by greater difficulties for the unemployed to find work than in the rest of the country.

### **Labour market policies**

Both “active” and “passive” labour market programmes have played a relatively modest role. Total spending in 1996 was only 0.5 per cent of GDP, of which 0.1 per cent was spent for active measures. This is far less than is spent in most Central and Eastern European countries other than Romania.

The National Employment Service (NES) was established in 1989 with 122 local employment offices across the country. The main functions of the NES are the registration of the unemployed, counselling, and job brokerage. Its responsibilities were enlarged in 1993 to include participation in the development of labour market policy and other administrative tasks. The NES initially was responsible for the disbursement of unemployment benefits, but payments now are made by mail.

An extra-budgetary fund, the Professional Training and Unemployment Fund (hereafter referred to as the “Unemployment Fund”) was established in December 1989 to finance active and passive labour market policies. The NES administers the fund. Revenues came from compulsory employer contributions until 1998, when employees were required to participate; transfers from the central budget, while foreseen, have not occurred thus far (see Chapter 3).

*Passive policies*

The unemployment benefit system has undergone important changes since 1989, most of which have tightened access and benefit levels. Because of more strict eligibility requirements, shorter benefit duration, and the spread of long-term unemployment, the share of the unemployed who receive benefits has been declining. By the end of 1994, less than one-third of the registered unemployed were receiving unemployment benefits.

The standard unemployment benefit amount is 60 per cent of the average of gross monthly earnings over the last nine months. Minimum and maximum benefits are 85 and 140 per cent of the minimum wage<sup>8</sup>. The maximum duration of benefits of 12 months requires over 25 years of service. The minimum duration is four months, subject to the general requirement of) at least nine months of service during the last 15 calendar months (see Chapter 3 for further details).

In January 1995, a special long-term unemployment assistance (LTUSA) scheme was implemented. It offered up to six months of flat-rate means-tested assistance to eligible households containing an unemployed person who had been registered for at least 12 months. This introduced a complicated sequence of potential eligibility for income support: centrally-financed unemployment benefits for up to 12 months; for the majority of unemployed workers who have a shorter period of eligibility, locally-financed means-tested social assistance until 12 months of registered unemployment had been completed; centrally-financed LTUSA up to its maximum duration of six months; and if eligibility for means-tested social assistance continued, a return to locally-financed income support. LTUSA was phased out in April 1997 by a decree of the then caretaker Government, and was replaced by an allowance of the same amount as the former LTUSA for a duration of three months instead of six months, available to every unemployed person who had exhausted their individual maximum benefit duration -- without a means-test. In effect, it became an extension of the unemployment benefit system at a reduced, flat amount for all the unemployed. However, it did not remove all of the problems and costs associated with recurrent flows into and out of multiple benefit regimes. (This process is discussed in greater detail in the following chapters.)

The economic crisis which emerged in 1996 and persisted into 1997 provided a clear signal that more rapid restructuring of inefficient enterprises was needed. A temporary income support scheme until the end of 1997 was implemented to make it easier for workers to accept the collective layoffs that accompany firm restructuring or liquidation. Workers made redundant could choose between standard unemployment benefits or a lump-sum severance payment, which was initially established at 250 USD -- roughly three times the average wage in July 1997. It was increased to a maximum of the Lev equivalent of 380 USD in September 1997, with the amount dependent upon previous gross wages, job tenure, and age of the worker. If the lump-sum is chosen, there is a waiting period of 18 months before an unemployed worker can claim unemployment benefits.

One of the desirable features of a lump-sum payment from a policy perspective, and from the perspective of the recipient, is that as long as the full amount may be retained even if a job is found, there is a strong incentive accept the payment and to find work quickly. But not everyone will find a job quickly, and the waiting period of 18 months for unemployment benefit eligibility may be too severe for the long-term unemployed.

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8. The minimum benefit was 90 per cent of the minimum wage prior to August 1997.



### *Active policies*

A broad menu of active labour market policies (ALMP) exists in Bulgaria, including most programmes in place in OECD countries. But the scale of active measures is extremely modest. Many programmes, such as the measure to start a business, mobility grants, and wage subsidies have very few participants. The largest programmes concern retraining and temporary job creation, particularly in crisis regions. Since April 1997, grants to facilitate greater geographic mobility among the unemployed have been introduced. The grants cover up to 50 per cent of transportation costs for a maximum of six months if the workplace is far from home. There also is a subsidy for the unemployed who must relocate to a different region to work, up to a maximum amount of twice the minimum wage. Evidence from OECD countries on the effectiveness of efforts to enhance mobility has not been encouraging: the schemes often are not sufficiently generous to substantially relieve the costs incurred in moving -- or they are open to abuse.

Retraining programmes in Bulgaria suffer from a common problem: candidates who have the best chance of finishing the course usually are chosen<sup>9</sup>. Courses are offered after skill profiles desired by local enterprises have been determined. Therefore, it is not surprising that the unemployed who have participated in a retraining course have higher re-employment probabilities than those who have not participated (Jones and Kato, 1993). Bearing the cost of such training through the public purse at a time when firms may not be able to provide training in the workplace could be constructive. But selecting the unemployed most likely to succeed also is controversial: they might have found employment without the training, and the costs of training may not bring commensurate benefits. But it also may be sub-optimal to spend scarce resources on individuals who may not be hired, even with the training.

Temporary job creation is the largest programme<sup>10</sup>. It was initially targeted on the long-term unemployed, but the unemployed who have a continuous spell of more than six months now are included. Initially, only the municipality or a firm financed from the municipal budget could participate, but it was extended in 1996 to state and private firms which fire workers to engage in "socially useful activities". According to regulations in existence since 1994, the Unemployment Fund pays the minimum wage and social security contribution for workers hired under this programme. The jobs created under the scheme are intended to be short term (up to five months), with only one additional month of work required to re-qualify participants for unemployment compensation rather than social assistance paid for by the municipality. In this sense, the temporary job creation programme provides income support which is analogous to social assistance; only the financing source is different<sup>11</sup>.

There have been no attempts to evaluate the direct impact of the scheme on outflows from unemployment into regular employment. However, experience in Hungary, Poland, and the Czech Republic indicates that the chance of getting a regular job often is lowered by participation in public works. One explanation relates to the effects of stigma<sup>12</sup>.

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9. In all the labour offices visited by the OECD mission, this pattern of choosing course participants was dominant. Kotzeva *et al.* (1996) also find such "creaming" in retraining programmes.

10. The average number of participants per month in the job creation programme between June 1994 and September 1995 was nearly 17 times larger than the number of participants in training measures (26 030 versus 1 548, respectively).

11. Staff in local employment offices and in local social care centres indicated that the programme was targeted on ethnic minorities whose probability of finding regular employment was small, and whose need for income support was large.

12. An overview of evaluation studies in these countries is given in Lehmann (1995).

Public works nevertheless are believed to encourage the labour market attachment of marginalised groups. They also respond to equity concerns: individuals who are particularly disadvantaged in the labour market receive earnings, albeit temporarily.

A primary objective of active labour market policies is to facilitate stable re-employment for unemployed workers. Evaluation of active measures in OECD countries suggests that not all measures work equally well, or affect all types of participants in a consistent way (Fay, 1996). It is generally believed that counselling and job-search assistance is effective for most groups, but the effects of training programmes are less certain. The gains to individuals often are modest. Moreover, the ability of active measures to help large numbers of the unemployed is limited. Therefore, particular care in targeting is needed to avoid wasting the limited resources available for active measures. The scale and severity of the labour market problems in Bulgaria suggest that the potential success of active labour market policies may depend in large part on improved labour market performance more generally.

## CHAPTER 3

### THE SOCIAL PROTECTION SYSTEM

The turbulent process of transformation to a market economy in Bulgaria has resulted in significant declines in real household income. Since the beginning of the reforms in 1991, the level and duration of open unemployment has increased, employment has fallen dramatically, and real wages have eroded in value. While the economic status of a small minority of people may have improved, poverty (however measured) has become more prevalent. As result, reliance on social transfers increased at the same time as the revenue capacity of the state and tax collections declined. Although the value of social transfers as a share of average household income grew, reaching over 20 per cent by 1994, their purchasing power fell dramatically.

This chapter looks at the social protection system and the issues that have emerged: reductions in income security, increased pressures on social expenditures and social charges, and the structural reforms that might help to smooth the transition process and improve the efficiency and effectiveness of social expenditures. The new group that is swelling the ranks of the poor, the long-term unemployed, are a particular focus.

#### **Household income**

All households have been affected by some combination of a drop in real wages, a loss of earnings, declines in the real value of public income transfers, and the removal of price subsidies. The most dramatic declines in household income occurred during 1996, with some improvement noticeable by the fourth quarter of 1997. The value of the average wage declined by more than 60 per cent by the end of 1996, but subsequently rose from 40 to 75 per cent of the level of real wages in 1991. Other income sources fared worse: the average pension in 1996 was worth only one-third as much as in 1991, and showed only a slight improvement in 1997; the child allowance fell to one-quarter of its earlier value; the value of unemployment benefits eroded by more than one-half (Table 3.1).

The composition of household income also changed. Wages and salaries as a share of average gross household income declined from about 57 per cent in 1990 to 38 per cent by 1994, and rose to 44 per cent by 1997. Although unemployment benefits were a negligible part of average household income in all income deciles, they became relatively more important as a component of income in the lowest deciles. The distribution of unemployment benefits, however, does not reflect the incidence of unemployment or the severity of its effects: only about one-quarter of the registered unemployed are eligible to receive benefits; even fewer receive them for the full 12 month period of eligibility. In addition, most of the unemployed had exhausted their benefits (more than one-half of the unemployed by

1994; two-thirds by 1996), or were registered as unemployed but were not receiving benefits, or were not registered.

One way in which households are attempting to cope with declines in purchasing power is through supplementing income by informal and/or unrecorded activities. For example, income from household plots grew by 300 per cent between 1992 and 1994 and were a particularly important share of the income of households headed by a pensioner. But other informal and unrecorded activities may be even more important, as suggested by the large outflows from state-sector employment which did not show up as inflows into employment elsewhere (see Chapter 2).

**Table 3.1 Household monthly income, earnings and cash benefits, 1991-1997<sup>a</sup>**

	1991	1992	1993	1994	1995	1996	1997
<b>Wages<sup>b</sup></b>							
Nominal average wage	1856	2785	3642	6248	8612	19833	172683
Real average wage	1856	1552	1238	957	993	557	714
Nominal minimum wage	620	850	1414	2143	2760	5500	45500
Real minimum wage	620	474	481	328	318	154	188
<b>Pensions<sup>c</sup></b>							
Nominal average pension	501	741	1247	1909	2755	6015	54000
Real average pension	501	413	424	292	318	169	223
Nominal minimum pension	403	450	880	1296	1780	3148	28890
Real minimum pension	403	251	299	199	205	88	119
Nominal maximum pension	815	1350	1941	3037	4200	8764	86700
Real maximum pension	815	752	660	465	484	246	359
<b>Unemployment benefits</b>							
Nominal average benefit	413	484	894	1316	2916	5971	41699
Real average benefit	413	270	304	202	336	168	172
Nominal minimum benefit	371	243	273	181	302	151	155
Real minimum benefit	371	436	804	1184	2624	5374	37529
<b>Child allowances</b>							
Nominal (1 child)	145	185	251	372	480	925	8555
Real (1 child)	145	103	85	57	55	26	35
<b>Minimum subsistence level</b>							
Nominal	403	500	885	1225	1421	3250	27000
Real	403	279	301	188	164	91	112
CPI I/91	100	180	294	653	868	3564	24183

a) Year end data.

b) Public and co-operative sectors only.

c) Old-age, survivors and disability pensions only.

Source: Ministry of Labour and Social Affairs.

## Social expenditure, revenue collections and contribution rates

Social expenditure pressures escalated sharply after 1991. Yet these pressures were not fully reflected in the pattern of expenditure growth between 1991 and 1996. Total social expenditure peaked in 1993 at 26 per cent of GDP, but fell to a modest 16 per cent of GDP by 1996 -- well below the 1991 level of 23 per cent. Virtually all benefit categories exhibited a similar pattern. Even pension costs, which are very sensitive to increases in the size of the pensioner population, declined to 7 per cent of GDP in 1996 after peaking at nearly 11 per cent of GDP in 1993<sup>13</sup>, (Table 3.2).

Several trends underly this growth path. Real social spending had declined by 1996 to about 60 per cent of the 1991 level; no benefit category had kept pace with inflation (Table 3.3). However, GDP also declined over the five-year period by 14 per cent. If real GDP had remained at its 1991 level, social expenditures as a share of GDP in 1996 would have been substantially lower. Therefore, the measure of social spending as a share of GDP understates the actual size of the decline in social spending.

**Table 3.2 Social expenditures in Bulgaria as a per cent of GDP, 1991-1996**

	1991	1992	1993	1994	1995	1996
Pensions <sup>a</sup>	9.1	9.9	10.9	9.7	8.1	7.3
Sickness	0.5	0.6	0.6	0.5	0.5	0.4
Health	4.4	5.5	4.9	4.2	3.8	3.2
Means tested benefits <sup>b</sup>	0.1	0.3	0.4	0.2	0.2	0.2
Social care services and institutions	0.4	0.4	0.4	0.4	0.3	0.2
Goods and services	0.1	0.1	0.1	0.1	0.0	0.0
Family <sup>c</sup>	3.2	2.4	2.1	1.7	1.4	1.0
Unemployment <sup>d</sup>	0.5	0.6	1.0	0.7	0.6	0.5
Education	5.1	6.1	5.7	4.8	4.1	3.4
Total	23.4	25.8	26.1	22.3	19.1	16.3

a) Pensions include old age, disability, survivors and occupational injury and disease.

b) Means-tested benefits include local expenditures on poor households and energy subsidies.

c) Family benefits include both local and central budget expenditures.

d) Unemployment expenditures include all active programmes and unemployment compensation.

Sources: OECD Social Expenditure database; Bulgarian Ministry of Labour and Social Affairs; Ministry of Finance and UNICEF.

The growth path therefore is a reflection of sharp output declines over the period, and fiscal constraints (as well as policy restraint) which did not permit adjustment of transfer payments for the full effects of inflation. It also reflects lax benefit eligibility requirements, particularly for pensions, and growth in the numbers of new entrants to the pension system. But this accounts for only a part of the story: contributors declined as the pension population grew.

13. The erosion of real pension amounts was the major factor in the fall in pension spending, but the drop in life expectancy during the 1990s also was a contributing factor.

Table 3.3 **Real social expenditures in Bulgaria 1991-1996 (1991 levs)**

	1991	1992	1993	1994	1995	1996	1996/91 % change
Pensions <sup>a</sup>	12 352	11 104	11 099	7 815	8 084	3 406	-72.4
Sickness	722	699	617	433	483	179	-75.2
Health	5 919	6 126	5 004	3 361	3 829	1 510	-74.5
Means-tested benefits <sup>b</sup>	172	318	396	182	159	108	-37.5
Social care services and institutions	560	429	390	284	301	116	-79.3
Goods and services	83	76	74	56	41	14	-83.7
Family <sup>c</sup>	4 310	2 737	2 179	1 365	1 406	484	-88.8
Unemployment <sup>d</sup>	718	692	970	568	628	248	-65.4
Education	6 980	6 784	5 829	3 837	4 096	1 559	-77.7
Total	31 815	28 965	26 558	17 901	19 027	7 623	-76.0
CPI/91	100	180	294	653	868	3564	

See Table 3.2 for notes and sources.

As Table 3.4 shows, the ratio of pensioners to contributors rose dramatically from 53 per cent in 1989 to a peak of 82 per cent in 1994, and declined slightly in subsequent years. Changes in the number of contributors to the pension system were the dominant factor underlying the trends both before and after 1994. Between 1989 and 1994, the number of pensioners grew by 10 per cent, and the number of contributors declined by 30 per cent; between 1994 and 1996, the pensioner population declined by 3 per cent, while contributors increased by 6 per cent.

Table 3.4 **Public pension dependency ratios in Bulgaria, 1989-1996<sup>a</sup>**

1989	1990	1991	1992	1993	1994	1995	1996
52.8	55.1	64.9	78.0	80.5	82.3	77.9	76.4

a) Number of pensioners as a per cent of the total number of pension contributors.

Source: World Bank, Social Challenges of Transition database.

Reduced revenue collections because of declines in employment and earnings, coupled with the existence of a shadow economy and tax compliance problems<sup>14</sup>, created a vicious circle: as the revenue base shrank, social security contributions<sup>15</sup> had to be raised; this discourages employment and encourages tax avoidance and evasion, which, in turn, creates pressure for further rate increases.

Contribution rates were increased from 26 to 35 per cent in 1991, and higher rates were implemented for occupations with earlier retirement privileges at 45 per cent and 50 per cent.

14. Revenue collection declines were reinforced by the practice of permitting some enterprises to forgo payment of social charges. The effects of this practice cumulated with the declines in revenue resulting from the growth in short-term "civil" contracts, under which employers were exonerated from paying social charges (see footnote 5). As a result, firms in difficulty were effectively being subsidised by the social insurance system.
15. In addition to pensions, social insurance contributions are used to finance work injury, sickness, family benefits, among other benefits. A separate contribution rate is earmarked for unemployment benefits.

Nevertheless, deficits in the Social Insurance Fund (SIF) persist: they reached more than 10 per cent of expenditures in 1993, and remained close to that level in subsequent years. Payment of benefits required infusions from general tax revenues and from the surplus revenues of the Unemployment Fund. Contribution rates were again raised in 1996, to 39 per cent (49 per cent to 54 per cent of payroll for the one-third of workers entitled to earlier retirement)<sup>16</sup>.

The separate contribution rate for the Unemployment Fund was reduced from 7 per cent to 5 per cent in 1996, and to 4.5 per cent in 1998 -- 3.6 per cent to be paid by the employer; 0.9 per cent, by the employee (effective as of 1 July). Contribution rates therefore range from 44 per cent to 59 per cent of total payroll until mid-1998 when they are set to decline by 0.5 per cent. They nevertheless remain alarmingly high relative to most other countries (see Table 3.5).

Table 3.5 Social security contribution rates in Bulgaria and in selected OECD countries, circa 1995<sup>a b</sup>

	Employee	Employer	Total
Bulgaria <sup>c</sup>			
Total	2.9	40.6 - 55.6	43.5 - 58.5
Pensions	2.0	37 - 52	39 - 54
Czech Republic			
Total	13.3	35.3	48.5
Pensions	6.8	0.0	6.8
Hungary			
Total	11.5	48.2	59.7
Pensions	6.0	24.5	30.5
Austria			
Total	18.2	24.3	42.5
Pensions	10.3	12.6	22.8
France			
Total	24.3	37.8	62.1
Pensions	6.6	8.2	14.8
Germany			
Total	19.7	19.7	39.3
Pensions	9.3	9.3	18.6
Portugal			
Total	11.0	23.8	34.8
Sweden			
Total	4.0	30.5	34.5
Pensions	1.0	19.1	20.1
United Kingdom			
Total	12.0	10.2	22.2
Pensions	10.0	10.2	20.2

a) Contribution rates in Bulgaria finance old-age, survivors, disability, work injury and most family benefits.

b) Maximum contribution rates are presented except in Bulgaria where the minimum and maximum are given.

c) Rates effective as of 1 July 1998; total rates were 0.5 per cent higher until that date.

Sources: Ministry of Labour and Social Affairs, *OECD (1998), The Tax/Benefit Position of Employees 1995-1996*.

## Overview of the benefit system

Bulgaria currently provides a comprehensive system of social insurance and social assistance (see Annex, Table A.1) In the former regime, guaranteed employment for people of working age was the

16. Contribution rates for 1996 and after include a 2 per cent levy on employees. In earlier years, only employers contributed.

primary mechanism for income protection, and pensions for those not expected to work were available, along with an array of family benefits and other income support and goods and services provided by the state as employer. These benefits exist today, although some changes have occurred. In the post-1989 period, unemployment and social assistance benefits were added or altered with the disappearance of employment guarantees. Other benefits were modified or eliminated, or new ones created, often in response to immediate problems, either through direct policy measures or from the effects of inflation. Among the benefits eliminated were an array of price subsidies.

Most social insurance benefit entitlements are related to employment. They are financed largely by employer contributions, and since 1996, by employee contributions of 2 per cent of earnings to the SIF. The global contribution rate is intended to finance all but unemployment benefits, for which a separate contribution is paid to the Unemployment Fund. No specific assignment of revenues to benefit sub-categories is made.

These Funds, however, are not independent of the state budget, nor of each other: interest-free transfers from the state budget and from the Unemployment Fund to make up shortfalls in the SIF have occurred repeatedly in recent years; transfers of surplus moneys in the Unemployment Fund to the state budget to finance unrelated spending also have occurred.

Most benefits for low-income households are administered and paid for by local government. This includes the responsibility for delivery and financing of family benefits for uninsured parents. Local revenue in almost all municipalities, however, includes a global transfer from the central budget; the tendency to earmark central funds for a particular benefit has emerged in recent years.

Further reforms in benefit structures and their financing are desirable, not only because of the need for fiscal restraint, but also because the benefit system and its financing has become unnecessarily complex, administratively cumbersome, and inefficient. As a consequence, it is difficult monitor programme performance, to satisfy the need for public understanding of individual and family entitlements, or to maintain a high level of public satisfaction.

### *Pensions*

The pension system provides old-age, survivors, disability, and work injury pensions and covers all occupations and sectors of the economy. Many features of the system favour easy and early eligibility for benefits. The resulting widespread distribution of pensions, among other factors, has led to higher costs than might otherwise be the case and to low benefits. Further ageing of the population will exacerbate this situation over the longer term, unless reforms are introduced quickly.

A comprehensive pension system should set the stage for equitable access to the replacement of earnings that are lost because of retirement, disability, or death of a family provider. In practice, old-age pensions are effectively composed of multiple systems which treat occupational categories differently according to the risks to health of working conditions or the arduous nature of the job. Occupations are classified according to three categories: the more risk associated with an occupation, the lower the age and the years of service required for entry into retirement. Although not an uncommon feature of pensions in former command economies, it defines early retirement as a privilege for certain workers and invites abuse, particularly since benefits are not reduced on an actuarial basis when lower age or years of service are permitted<sup>17</sup>, (see Table 3.6).

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17. An increase in retirement age is under consideration by the Parliament.



Table 3.6. **Old-Age Pension Rules in Brief, 1996**

Criteria and Element	Treatment																
<i>Eligibility</i>																	
Covered employment	All																
Age	Varies by occupational risks to health: Category III, age 60 for men and age 55 for women (changes in the labour code as of January 1996 permit three years more work); Category II, age 57 for men and age 52 for women; Category I, age 52 for men and age 47 for women.																
Early Retirement	Selected professions (e.g. teachers)																
Required years of service	Category III, 3 to 25 years; Category II, 2 to 20 service years; Category I, 1 to 15 years. Proportionately reduced pension if at least one-half of service period completed. Certain activities counted as years of service (e.g. time spent in child care for mothers of three or more children.																
<i>Benefit Determination</i>																	
Covered earnings	Gross earnings of wage and salary workers; contract and self-employed workers may elect to have from one to eight times the minimum wage covered.																
Length of included earnings histories	High three consecutive years of earnings out of the last 15 years; from January 1997 one year will be added each sequential year until full contribution period is included.																
Indexing of earnings histories	Indexed by individual coefficient- the ratio of worker's average monthly earnings for the three year period selected to national monthly earnings for the same period.																
Replacement rate	55% of average earnings of three consecutive years.																
Benefit accrual rate	By Occupational Category: <table style="margin-left: 40px; border-collapse: collapse;"> <thead> <tr> <th colspan="4" style="text-align: center;"><i>Years of service</i></th> </tr> <tr> <th style="width: 10%;"></th> <th style="width: 20%; text-align: center;">III</th> <th style="width: 20%; text-align: center;">II</th> <th style="width: 20%; text-align: center;">I</th> </tr> </thead> <tbody> <tr> <td>27.5% at</td> <td style="text-align: center;">12.5</td> <td style="text-align: center;">10</td> <td style="text-align: center;">7.5</td> </tr> <tr> <td>55% at</td> <td style="text-align: center;">25 (men) 20 (women)</td> <td style="text-align: center;">20 (equal for both sexes)</td> <td style="text-align: center;">15 (equal for both sexes)</td> </tr> </tbody> </table> plus 2% per year of service beyond those required	<i>Years of service</i>					III	II	I	27.5% at	12.5	10	7.5	55% at	25 (men) 20 (women)	20 (equal for both sexes)	15 (equal for both sexes)
<i>Years of service</i>																	
	III	II	I														
27.5% at	12.5	10	7.5														
55% at	25 (men) 20 (women)	20 (equal for both sexes)	15 (equal for both sexes)														
Reduction factor for early retirement	-0-																
Minimum "social" pension: (Age 70)	2 921 BGL																
Minimum pension: (Less than 1/2 required years of service)	3 148 BGL (28 890 BGL in 1997) 3 067 BGL (105% of social pension)																
Minimum pension: (at least 1/2 of required years of service)	3 229 BGL 3 067 BGL (105% of social pension)																
Maximum pension	8 764 BGL (86 700 in 1997) (3 X Social Pension)																
<i>Work Test</i>	Earnings of pensioners above twice the minimum wage are reimbursed to the SIF																
<i>Tax treatment</i>	Pension income not taxable.																
<i>Indexing of benefits</i>	Three methods have been used: full or partial indexing based on changes in the CPI; flat-rate "compensation" payments; indexing by changes in average wages over previous three years multiplied by "individual coefficient". (see "indexing of earnings histories".)																
<i>Contribution base</i>	Total wages, no ceiling. (General revenues of government also are used in event of a revenue shortfall.)																
<i>Contribution rate</i> (Finances all social security benefits except unemployment)	Employers: Category III: 37% Category II: 47% Category I: 52% Employees: 2% Self-employed: 32% (all risks); 22% (old-age, survivors, and disability only)																

Source: Bulgarian authorities.

*Retirement age and early retirement*

The standard age of entitlement to full benefits at retirement for “normal” (Category III) occupations is low (age 60 for men; age 55 for women) relative to those of most OECD countries, but not in comparison to most Central and Eastern European countries in transition, (Table 3.7).

**Table 3.7. Standard age of retirement in Bulgaria and in selected countries, by sex, 1997**

	Men	Women		Men	Women
Bulgaria	60	55	Iceland	67	67
Poland	65	60	Ireland	66	66
Romania	62	57	Italy <sup>b</sup>	63	58
Australia	65	61	Japan <sup>c,d</sup>	60	58
Austria	65	60	Luxembourg	65	65
Belgium	65	61 <sup>a</sup>	Netherlands	65	65
Canada	65	65	New Zealand	61	61
Czech Republic	60	53-57	Norway	67	67
Denmark	67	67	Portugal	65	62 <sup>e</sup>
Finland	65	65	Spain	65	65
France	65	65	Sweden	65	65
Germany	65	65	Switzerland	65	62
Greece	65	60	United Kingdom	65	60
Hungary	60	56	United States <sup>f</sup>	65	65

a) Will be raised to age 65 by the year 2009.

b) Will be raised by one year every two years until age 65 for men and age 60 for women are attained in 2001.

c) The age for women will be raised to 60 years by the year 2000.

d) Earnings-related scheme only; age of eligibility for flat-rate scheme is 65.

e) Will be raised to age 65 in 1999.

f) Will be raised to age 67 between the years 2000 and 2027.

*Source* : OECD-CCET Labour Market database.

As in other countries, there is no minimum age requirement for disability or work injury benefits<sup>18</sup>. The effective age of retirement, however, is well below the standard one in Bulgaria. This is in part because of the earlier retirement permitted the two high-risk occupational categories (age 57 for men and age 52 for women; age 52 for men and age 47 for women). In addition, the Labour Code specifies that individuals who have reached, or are close to the age of eligibility for a pension, must be the first selected for involuntary retirement if a layoff occurs. Additional efforts also were made in the early 1990s to facilitate earlier retirement in order to offset burgeoning unemployment: an *ad hoc* change in 1991

18. The disability pension population is relatively old, since disability is highly correlated with age. The modal age bracket of disability pension beneficiaries in 1995 was age 50 to age 60. Required years of service vary with age, from zero years up to age 20 to 15 years above age 55.

gave the right to early retirement at age 57 for men and age 52 for women to everyone dismissed because of closure or a risk of closure of an enterprise. Benefits were reduced by 10 per cent of the amount that would have been received at standard ages. However, the increase in pensioners forced the government to eliminate the provision barely one year later. The age of eligibility for occupations in the first two categories also was raised by two years to their current levels in 1992 in order to stem the inflows.

The numbers of old-age pensioners grew by 12 per cent between the mid-1980s and 1996. The peak size of the pensioner population occurred during 1991 to 1993 -- a period of massive labour shedding; it declined slightly after 1993, in large part because of the eligibility changes made in 1992<sup>19</sup>.

In contrast to old-age pension inflows, disability pensions have not been a major path into early retirement. A relatively small proportion of the pensioner population receives disability benefits (about 7 per cent in 1996), and no increase occurred in the stock of disability pensioners in the post-1990 period. The special categories of early retirement, however, may serve as a *de facto* substitute for disability pensions.

### *Years of service*

The number of years of work needed to qualify for a full pension at retirement in normal occupations is 25 years for men and 20 years for women (Category III); 20 and 15 years in categories II and I, respectively, without any distinction by sex. At least one-half of the required years of service in each occupational category is needed to receive a proportionately reduced pension. Vesting requirements of 15 to 25 years are not uncommon elsewhere, but there is diversity across countries: from 40 to 45 years (for example, Belgium) to as few as three years (for example, Canada). But the length of the average work-life generally exceeds 30 years<sup>20</sup>. Moreover, the tendency in OECD countries has been to move towards longer vesting periods (for example, in France, Hungary, Sweden, and the United States).

A relatively short vesting period allows near-universal eligibility, but at the cost of high expenditures or low benefits -- or, as in Bulgaria, both. A longer work requirement reduces both the eligible population and costs. It does this by indirectly raising the standard retirement age, since individuals with shortfalls in vesting requirements can acquire the needed years of work by retiring later.

The average length of service required of old-age pensioners in Bulgaria is well below 25 years. In part, this occurs because of the preferential treatment of certain occupational groups. (About 30 per cent of employees in the state sector have jobs which allow for early retirement.) But it is also reduced by permitting partial pensions with reduced years of service. The option of a partial pension as low as one-half of the full amount has an added disadvantage -- lowered monthly benefits for all the years of retirement.

Although some flexibility in the age of retirement is desirable, it need not be done at the high cost that results from a very short vesting period in the primary pension system. It may be helpful, even necessary, to facilitate an exit from unemployment for people who are near retirement age when labour market conditions are bad. But using the pension system as an extension of unemployment benefits is not

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19. The growth in the number of pensioners from 1991 to 1993 relative to 1990 exceeded that of the population aged 60 years and over by about 5 per cent.

20. In Hungary, for example, the average worklife for employed men in 1992 was 36 years, and one-half of them worked more than 40 years; for women, the average was 28 years of work (OECD, 1995).

appropriate: it is too difficult (and unfair) to change pension policy frequently, and short-term policies that are not consistent with long-term considerations, such as population ageing, may alleviate one problem at the cost of creating another. As mentioned previously, this was the reason why the option to retire three years below the standard age of eligibility, enacted for labour market reasons in 1991, was eliminated in 1992.

The alternative could include the creation of a temporary programme for redundant workers, who are near retirement age and who have poor labour market prospects, to help them bridge the gap until retirement. The eligibility conditions should be stringent, and the benefits should be less generous than retirement pensions. This, in combination with social assistance for families with inadequate income, would be a more efficient use of limited resources.

#### *Determination of benefit amounts*

Before January 1997, benefits were determined on the basis of an average of three consecutive years of highest earnings out of the previous 15 years of work. After that date, the averaging period will increase each year so that an individual's full contribution period eventually will be included. This will provide a better reflection of average earnings; minimise the sometimes inequitable influence of differences in employment patterns on benefit amounts; and limit the possibilities of collusion with employers to gain higher pension amounts.

The pensioner receives 55 per cent of the average wage calculated over the relevant period if all conditions relating to age and years of service are satisfied; an additional amount of 2 per cent per year of service beyond those required is granted. The "social" pension defines the minimum; the maximum is three times the minimum (see Table 3.6).

All three categories of occupations, despite differences in requirements with respect to age and years of service, have the same formula applied to determine benefits. In practice, this means that the underlying benefit accrual rates per year of service differ substantially among categories of workers. The effective accrual rates are 2.20 per cent per year with 25 years of service (men, category III); 2.75 per cent per year for 20 years (women category III, men and women, category II); 3.67 per cent per year for 15 years (category I). In that further years of work are valued at a lower yearly accrual rate of 2 per cent, the incentive to work beyond the required years also is reduced, particularly in the privileged categories. The higher costs associated with elevated accrual rates are reflected in the higher contribution rate paid by employers for higher risk categories. But this differentiation does not change the work incentives of individuals since they pay a uniform contribution rate in all occupational categories.

The concerns are not limited to the cost of earlier retirement and to work disincentives: the fairness of the procedure is arguable. A pension system which recognises privileged categories can damage taxpayer support, and it reinforces pressures to extend privileges to other job categories. If some working conditions pose a risk to health, the incentive to improve those conditions will be increased if the employer bears the full cost for earlier retirement rather than workers or taxpayers<sup>21</sup>.

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21. In Poland, for example, transfer of the responsibility for special occupational categories with early retirement privileges to employer-sponsored pension plans in the private sector has been proposed. To the extent that the employer cannot shift costs through lower wages or higher prices, earlier retirement could be reduced. This result also depends upon integration rules between public and private pensions (see OECD, 1992a).

*Pension indexing*

Indexing earnings histories, benefits when awarded, or benefits in payment were not major concerns before the 1990s: the wage-averaging period was only three years, and inflation was not a problem. With the upsurge of inflation and the rapid erosion of real benefits, indexing became critical. Flat-rate “compensation” for inflation was added to pension benefits several times after the inflationary shock of 1991. This resulted in compression of the benefit distribution. Periodic attempts were made to directly increase the benefit dispersion by formulae, which raised the ratio between minimum and maximum benefits. However, neither the goal of increased benefit differentiation, nor the goal of protection against benefit erosion was well served. The benefit dispersion remained narrow, and by 1996, the average pension had declined in real terms by two-thirds, and the minimum pension, by nearly 80 per cent. The benefit dispersion, in particular, became a source of policy concern.

In 1996, the decision was taken to recalculate pensions by an “individual coefficient” which reflects movements in average wages. The change was more significant than an adjustment for inflation. This procedure may avoid any further compression of the benefit distribution, and may permit even further benefit dispersion as the variance of the wage distribution itself increases. But it does not adequately address the issue of the capacity of the economy to pay for such increases.

The extent to which benefits should be indexed, the mechanism for doing so, and the extent to which indexation should be automatic is a difficult decision. Since 1991, growth in real expenditure on transfers in Bulgaria has been restrained by partial indexing of benefits. The disadvantage of this has been, of course, that many of those reliant on benefits have experienced considerable hardship. But fully automatic indexation of benefits may be inappropriate: inflation can be a symptom of a general excess demand on a nation's resources, and pensioners cannot be immune in all circumstances from the need to reduce those demands.

Moreover, neither indexing based on changes in consumer prices nor on average wage movements operate as intended under all circumstances. Movements in wages generally are related to the way pensions are financed, and therefore may be the more stable option - but only if indexing is related to the total wage bill and not simply to average wages. Total wages reflect both movements in the average wage and in the level of employment, both of which are important elements of the capacity of the economy to pay for benefit increases.

*Unemployment benefits*

The unemployment benefit system, modified several times by decree since 1989, has now been codified in the Unemployment Security and Employment Incentives Act of 1997, effective as of 1 January 1998. Several significant changes in the unemployment benefit programme were made in addition to the reduction in the contribution rate and, for the first time, requires employees to contribute.

Previous employment of at least nine months during the last 15 calendar months is required, or if in seasonal employment, six months during the previous year, registration at the local labour office, and willingness to accept training and a job, if offered. (Old-age and disability pensioners are not eligible for unemployment benefits.) The current provisions continue the basic benefit amount of 60 per cent of the worker's previous gross wage if unemployment is involuntary. An additional allowance of 60 per cent of the unemployment benefit is granted for time spent in training (slightly more than previously offered). Workers entitled to unemployment benefits who accept part-time employment at less than the minimum wage are entitled to receive one-half of their unemployment benefit.

There is no waiting period, and the duration of benefits is between 4 and 12 months, with the maximum requiring at least 25 years of recorded service. The former requirement was a seven-day waiting period; the minimum benefit duration was six months. Workers who voluntarily quit their jobs or who are dismissed for breach of discipline are provided benefits for a maximum of four months at 80 per cent of the minimum wage after a waiting period of three months.

If previous entitlement to an unemployment benefit occurred within the past three years, the current duration of entitlement is limited to a maximum of four months regardless of years worked. The intent of this provision is puzzling, particularly since an even more restrictive provision exists which addresses voluntary quits. Speculatively, the limitation on unemployment benefit duration when repeated spells occur may be an attempt to restrict local avoidance of financial responsibility for the long-term unemployed. The flow of responsibility between the resources of the state (unemployment benefits financed from the Unemployment Fund) and of municipalities (social assistance financed from the local budget) creates an incentive for financial “churning”. Conversations with local employment and social assistance office staff indicated that there is a strong incentive on the part of municipalities to foster public works programmes, not simply for their potential value to the community, but often to requalify the unemployed for benefits paid from the Unemployment Fund rather than from local resources.

An “unemployment allowance” provides a second benefit tier for workers who remain unemployed six months beyond the expiration of unemployment benefits. The flat-rate allowance is 60 per cent of the minimum wage and is available for a maximum of three months. It replaced the means-tested “unemployment assistance” benefit of the same amount which was paid for up to six months. The change removed some of the administrative complexity and cost associated with means-testing; the requirement that a worker remains unemployed for six months after the expiration of unemployment benefits may be an effective substitute. The new condition also is an improvement on the uniform requirement that eligibility commence after 12 months of registered unemployment, given that the duration of the unemployment benefit itself is not uniform for all of the unemployed. However, it does not resolve the difficulties associated with discontinuous periods of time without benefits, and potential repetitive movement into and out of social assistance benefit rolls. Nor does the change in structure remove the effective duplication of function between the unemployment allowance and social assistance. It is difficult to justify this allowance, just as it was difficult to justify the former programme of unemployment assistance.

Some benefits and provisions in place prior to passage of the new Act were eliminated. The 10 per cent benefit supplement per child for up to two children under 16 years of age is no longer offered. This benefit also was difficult to justify, since it duplicated the function of child allowances and created inequities. The unemployed who became entitled to benefits prior to the implementation of the new law in January 1998, however, retain a right to those benefits and provisions which are most favourable to them.

### ***Sickness benefits***

Sickness benefits cover short-term incapacity to work. Eligibility criteria are generous: only three months of continuous employment are required, except if illness results from an accident in the workplace; eligibility continues for 45 days after termination of employment. There is no limit on the duration of benefits. Benefits are relatively close to previous wages: they range from 70 to 90 per cent of the basic wage depending on the length of service; if the illness lasts for more than 15 days, benefits are increased slightly up to the maximum permitted. If leave is taken to care for a sick child under nine years

of age, 100 per cent of basic pay is guaranteed for up to 60 days per year<sup>22</sup>. If less strenuous employment at reduced pay is called for, part of the earnings reduction is compensated for up to six months.

Since the insurance period covers the first day of illness, the frequency of cases is relatively high. Although the frequency fell from 85 to 75 cases per 100 workers during the massive job losses during 1991, it rose to 88 per 100 workers by 1994. This suggests that employers took advantage of the system to save wage expenditures during a difficult period (Noncheva, 1995). Given the low ages of eligibility for retirement pensions and favourable sickness benefit levels relative to unemployment benefits, sickness benefits not only serve as a substitute for short-term layoffs, but also to bridge the gap until retirement for some workers.

The incentives for employers to abuse the system are obvious. If employers had to bear the cost of several early days of sick leave, fewer claims would be submitted. (This is the trend in OECD countries, for example in Germany and Sweden.) If the duration of benefits were limited by imposing a maximum number of days with pay per year, benefits for extended incapacity to work would be subject to the more stringent eligibility determination process of long-term disability or work injury benefits.

### *Family benefits*

The loss of guaranteed employment after 1991 also broke the link between the workplace and eligibility for family benefits. The traditional broad eligibility for such benefits was maintained, however, by requiring localities to provide comparable benefits for the uninsured at local expense. Benefits for insured individuals (those who are employed or whose insured status derives from an employed family member) are a national responsibility and are financed from the SIF; benefits for the uninsured (households with two unemployed parents or an unemployed lone mother) are the responsibility of local budgets and are considered to be part of social assistance although there is no means-test. The system had not actually been reformed: it had been fragmented.

### *Maternity and parental leave, and birth grants*

Maternity leave benefits are provided for insured women by the Labour Code. The benefits include a guarantee of 100 per cent of earnings 45 days prior to delivery and up to 180 days after birth, depending on the number of children<sup>23</sup>. Parental leave for insured and uninsured mothers is provided by the 1968 Decree for Encouraging the Birth Rate<sup>24</sup>; the benefits are equal to the minimum wage, which is paid until the child reaches two years of age. Parental leave benefits commence at the end of maternity leave for insured mothers, and 45 days before the birth of the child for uninsured mothers. A third year of leave without pay and with guaranteed re-employment rights is available for insured mothers. In practice,

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22. Sick leave to care for a child may be taken by either parent or by grandparents.

23. For uninsured mothers, the Labour Code provides 120 days of paid leave for the first child; 150 days for the second child; 180 days for the third child; 45 days of leave may be taken prior to delivery. The duration of leave extends until a child reaches two years of age for each of the first three children, and until ten months of age for each subsequent child. The allowances is 100 per cent of earnings for the first three children; the minimum wage is paid if there are subsequent children.

24. Uninsured mothers include non-working women who give birth within six months after terminating student status or an employment contract, or who are lone mothers.

although not *de jure*, a benefit in the amount of the child allowance compensation amount is paid to the uninsured in the third year of parental leave (Noncheva, 1997).

Lump-sum birth grants are made at the birth of a child in increasing amounts for the first through the third child, 1.0, 2.0, and 2.5 times the minimum wage, and in the amount of the minimum wage for each subsequent child.

### *Child allowances*

Eligibility for child allowances is not universal. Only families with insured (employed) parents, those who are pensioners, and those with two unemployed parents are eligible to receive benefits. Certain other categories of non-working mothers also are entitled to receive child allowances<sup>25</sup>. Monthly child allowances are paid in amounts which vary by family size and employment status. In principle, allowances per child increase up to the third child, and decline per additional child, but in practice, benefits now are virtually uniform per child because of periodic flat-rate compensation for inflation<sup>26</sup>.

Parents of disabled children as of 1996 receive 36 per cent of the minimum wage -- nearly double the standard amount (Act for Protection, Rehabilitation and Social Integration of Disabled People). If only one parent works, the allowance per child is increased. Families which are uninsured and eligible, that is, in which both parents are unemployed and registered at the labour office, receive child allowances from a parallel system paid for by localities. Unemployed families headed by lone mothers also are covered by the local system.

Family benefits therefore are not uniform. Nor are some of the current provisions logical. For example, maternity leave benefits are intended to replace earnings lost by absence from work because of child-birth. This type of benefit is not generally considered relevant for individuals without current employment. Parental leave also is an earnings replacement scheme; those without current employment should not qualify. Yet the unemployed and non-participants receive a benefit comparable to maternity leave in the amount of the minimum wage, which is extended to cover the period of paid parental leave granted to the insured. The intent may be to provide a source of income support for individuals without a job, but this is also the aim of unemployment benefits and means-tested social assistance<sup>27</sup>.

Child allowances often are believed to be a valuable tool in alleviating poverty on the assumption that low-income families have more children than higher income families. But the tendency for families with numerous children to be concentrated in lower deciles of the income distribution is exaggerated by the use of per capita income to rank households. The use of an "equivalent" income schedule, which compensates for economies of scale with increases in family size, attenuates this result.

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25. Non-working mothers who are eligible for parental leave also are eligible for child allowances. See footnote 23.

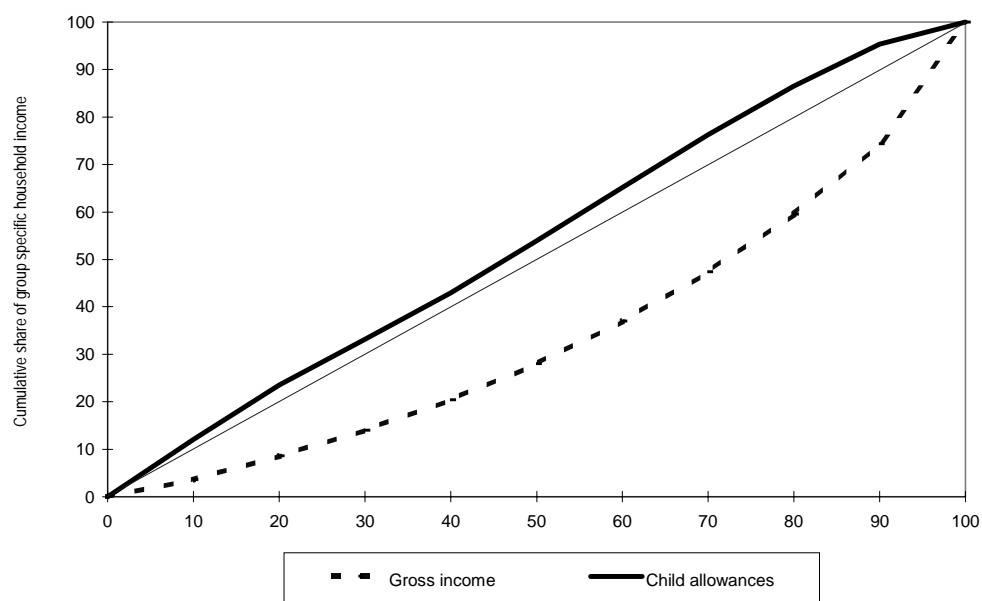
26. The total flat-rate compensation payments for inflation reached 8 540 Lev by October 1997; the basic amounts remained at 15, 30, and 55 Lev for the first through the third child and 15 Lev for each subsequent child.

27. A second and important advantage acquired from parental leave granted to individuals without work is that the benefit years are counted as years of service for pension purposes. The same objective can be achieved more directly without the payment of parental leave benefits: certain years of child care can be counted as years of service at designated earnings such as the minimum wage, or a specified number of years of low or zero earnings may be dropped from the base period used to calculate benefits.



Nevertheless, even when per capita household income is used, the distribution of child allowances is only slightly redistributive (Chart 3.1 shows that the distribution is nearly equal by household income decile. Perfect equality is indicated by the diagonal line). The potential for child allowances to ameliorate low income also is constrained by the small and declining amounts of money spent on this benefit category, which are spread across the entire income spectrum (Table 3.2).

**Chart 3.1 Distribution of child allowances by household income, 1995**  
Averages per household



Source: Bulgarian Statistical Yearbook, 1996.

### How generous are benefit levels?

The generosity of benefit levels usually is approximated by the ratio of the average benefit (assuming it is not taxed) to the average net wage. This provides a rough indication of the value of the benefits relative to previous earnings, and on average, the incentive to work -- if a job is available. It also is used as an indicator of benefit generosity, that is, the extent to which a previous or an adequate standard of living could be maintained if there is no other income. Many other factors affect work behaviour and the ability to maintain a previous standard of living, so the measure must be interpreted with some caution.

Replacement rates in Bulgaria are relatively modest and, given the dearth of job vacancies, there is little reason a priori to fault average benefit levels as a significant disincentive to work. The replacement rates of benefits in Bulgaria are not high when compared with other transition countries, nor are they high relative to OECD countries. The average pension was 37 per cent of the average wage in 1994, rose to 45 per cent in 1996, and dropped to 30 per cent by October 1997<sup>28</sup>. (Most pension beneficiaries, two-thirds in 1996 and nearly one-half by late 1997, received less than the average amount. See Table 3.8.). In 1997, the replacement rate was 50 per cent for the maximum pension. The replacement rate of the maximum unemployment benefit was 60 per cent; the average unemployment

28. The year-to-year volatility of this and other replacement rates reflects the larger changes in real wages compared with changes in benefit values. See Table 3.1

benefit, about 25 per cent; and the minimum unemployment benefit, less than 24 per cent. The allowance for each child provided about 5 per cent of the average wage.

**Table 3.8. The distribution of pensioners,  
by monthly pension amounts, 1994, 1996 and 1997**

Pension amount (Levs)	Per cent of pensioners	Pension amount (Levs)	Per cent of pensioners
<b>1994</b>			
Total	100	1811-1910	10.8
0 - 1210	2.3	1911-2010	10.5
1211-1310	3.8	2011-2110	12.3
1311-1410	3.2	2111-2275	14.7
1411-1510	2.8	2276-2440	4.5
1511-1610	7.7	2441-2605	1.7
1611-1710	12.8	2606-2770	0.8
1711-1810	9.7	2771-3028	2.4
<b>1996</b>			
Total	100	4891-5240	5.4
0 - 2867	2.3	5241-5590	5.5
2868-3148	2.2	5591-5940	5.0
3149-3490	4.8	5941-6500	7.8
3491-3840	8.0	6501-7070	7.5
3841-4190	7.8	7071-7635	5.5
4191-4540	7.1	7636-8200	4.4
4541-4890	9.7	8201-8764	12.6
		8765-	4.5
<b>1997</b>			
Total	100	59 001-63 000	6.8
0-36 010	2.9	63 001-67 000	5.8
36 011-38 900	2.5	67 001-71 000	5.3
38 901-43 000	7.6	71 001-76 000	5.9
43 001-47 000	18.3	76 001-81 000	4.4
47 001-51 000	11.1	81 001-86 000	3.6
51 001-55 000	6.2	86 001-91 000	2.7
55 001-59 000	6.3	91 001-96 700	7.2
		96 701 or more	3.4

Memorandum item: Monthly average pension amounts:

1994 = 1909 levs

1996 = 6015 levs

1997 = 54 000 levs

*Sources:* Ministry of Labour and Social Affairs and National Social Security Institute.

However, comparisons of benefit replacement levels in Bulgaria with those in other countries, particularly higher income OECD countries, as a basis for indicating the relative adequacy of benefit amounts can be misleading. Average wages (the denominator of the ratio) vary considerably across countries, and therefore do not represent an equivalent standard. This means that the amount of money a benefit replacement rate provides in a middle-income country may not buy as much as could be paid for in a different country with the same replacement ratio: a replacement rate that is comparatively "high" in a middle-income country may not provide a market basket of items which is deemed socially desirable or essential for life.

Therefore, gross replacement rates in Bulgaria which are within the range of OECD experience nevertheless may provide low benefits in an absolute sense. This is illustrated by comparing Bulgarian benefit levels with average wages elsewhere. Table 3.9 shows what replacement rates in Bulgaria would be if average wages were at the purchasing power parity levels that exist in selected middle or high-income countries. Replacement rates in Bulgaria drop dramatically in these scenarios. For example, the replacement rate of the average pension declines by about one-fifth when the average wage in the Slovak Republic or Poland is substituted; by nearly one-fourth when the net wage levels of the Czech Republic or Hungary are substituted; by one-half using net wages in Portugal, and by three-fourths when the average wage level in Germany is used. Similar results obtain with respect to other benefit replacement rates. Therefore, despite serious concerns about the manageability of current expenditure levels in Bulgaria, caution is needed in the way they are restrained.

**Table 3.9. Simulated gross replacement rates in Bulgaria relative to the purchasing power of average wages in selected countries, 1994**

	Minimum wage	Average unemployment benefit	Average pension	Average old-age pension	Average disability pension	Maximum pension
Bulgaria	37.8	42.6 <sup>b</sup>	36.6	38.9	44.1	59.6
Czech Republic	26.1	29.4	25.3	26.9	30.5	41.2
Hungary	26.1	29.4	25.3	26.8	30.4	41.1
Poland	30.2	34.1	29.2	31.1	35.2	47.6
Portugal	18.7	21.1	18.1	19.2	21.8	29.4
Germany	9.4	10.6	9.1	9.7	11.0	14.9
Slovakia	31.1	35.1	30.1	32.0	36.3	49.0

a) The numerator in every case is the amount of each benefit in US dollars for Bulgaria; the denominator is the average wage in US dollars adusted using purchasing powers of parity for the country mentioned.

b) The number of unemployment benefit recipients was estimated using the 1995 ratio of UB recipients to those eligible to receive both UBs and social assistance.

Memorandum item:

Per capita GDP in US dollars in 1994 using PPPs:

Bulgaria - \$2 548

Czech Republic - \$8 965

Hungary - \$3 579

Poland - \$3 900

Portugal - \$12 140

Germany - \$ 19 735

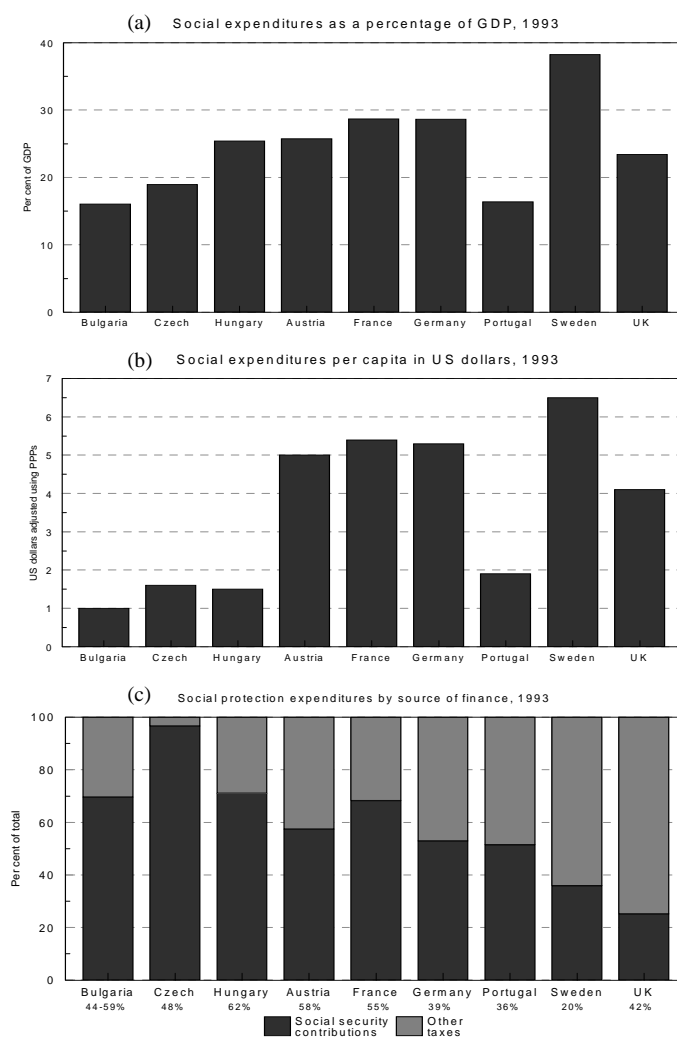
Slovakia - \$5 772

Source : Ministry of Labour and Social Affairs; *OECD Short-term Economic Indicators* .

## Social expenditures, benefit generosity and financing revisited

A synthesis of the situation is shown by Chart 3.2., panels (a), (b), and (c). Panel (a) shows the level of social expenditures<sup>29</sup> in Bulgaria as a per cent of GDP at its peak level in 1993<sup>30</sup> and those of selected OECD countries in the same year. Expenditure in Bulgaria as a share of GDP is shown to be relatively modest: at its peak, it was only slightly higher than the shares in the Czech Republic and in Portugal, and was substantially below expenditure shares in other countries.

**Chart 3.2** Comparative social expenditures, benefit generosity and financing in Bulgaria and selected countries, 1993



29. Education expenditures are excluded to maintain comparability across countries.

30. The peak expenditure year of 1993 was used because the most recent year for which four quarters of data are available, 1996, may not be a representative year. The low social spending in 1996 (10 percentage points below that of 1993) in large part reflects exceptional economic circumstances.

Panel (b) indicates the level of social expenditures per capita (in USD) to permit comparisons of the real level of the benefit packages across countries. The benefit package in Bulgaria is the least generous one; it has a lower purchasing power than that of Portugal which spends less as a per cent of GDP than does Bulgaria. Benefit values per capita between Bulgaria and other countries differ more than do the expenditure ratios shown in Panel (a): for example, although Sweden spends more than twice as much as Bulgaria's GDP share, the value of the per capita benefit package in Sweden is more than six times higher.

Finally, panel (c) looks at the financing of benefits by source of revenue, and shows total social security contribution rates for each country. Contribution rates in Bulgaria are relatively high, as is the share of social expenditures financed by this revenue source -- roughly comparable to the picture in France. Only Hungary had a higher contribution rate in 1993, and only in the Czech Republic did contributions from earnings provide nearly all of the required revenues.

Looking across all of the charts, what is striking is that Bulgaria's high level of tax effort -- as indicated by the high contribution rate, is unable to provide sufficient revenues to support benefits that are commensurate with that tax effort. This conundrum relates to underlying differences in the tax base, in tax compliance, and in revenue collection efforts. If problems with respect to earnings reporting and tax collections could be resolved, Bulgaria would have a much more manageable situation: it is this governance problem and not overly generous benefits which are the key to the current crisis.

## CHAPTER 4

### **SOCIAL ASSISTANCE: LOCAL PROVISIONS AND RESPONSIBILITIES**

Prior to 1991, extreme economic hardship was limited by employment guarantees. Social assistance had a relatively small role: it catered for the needs of the “socially disadvantaged” who were not expected to work -- the elderly and disabled with low income, and children at risk. When the transition to a market economy produced growing unemployment and declining real incomes, the focus of social assistance on inactive groups proved insufficient. As a result, the provision of monthly cash benefits for all households with income and assets below a specified level was added to the existing responsibilities of local government.

Local responsibility was further extended because of a particular problem created by the advent of open unemployment. Not only could a worker lose a job and earnings, but if there were children in the household and both parents were unemployed, family benefits linked to the workplace also were lost -- as discussed in Chapter 3. The problem of loss of benefit coverage was resolved by the creation of parallel benefits for the uninsured provided at the local level of government. National and local provisions, in principle, are part of a single system: the benefits provided by each level of government are the same; neither the benefits at the national level, nor those provided by localities are means-tested. Nevertheless, the same benefits received under the same conditions by the employed (financed by employer contributions to the SIF), or by those who are not employed (financed by local budgets), are distinguished as social insurance or social assistance -- not because of different financing, but to justify that difference. The partnership between the state and localities in the provision of family benefits is an awkward one.

The tendency since the early transition years has been to try to retain wide access to all existing benefits and to address problems by the creation of new programmes. The result has been duplication of programme functions, rather than selective additions or reforms. Moreover, the multiple programmes with a shared objective of reducing hardship often serve the same client groups. The resulting inefficiency is an important issue in light of severe resource constraints. But rationalising the benefit menu is not simply a matter of removing programme duplication. Which programmes to alter or eliminate are not necessarily obvious; the most obvious candidates may not be politically viable options.

Which level of government should pay for benefits, is a separate issue from deciding on the affordable level of benefits. In the face of high social charges and a growing budget deficit, financing responsibility for many new benefits devolved to local government. Most localities, however, cannot afford added responsibility without receiving transfers from central government in amounts that will help

to equalise their capacity to meet benefit promises. This suggests that the central authorities cannot avoid sharing the financing burden without impeding benefit entitlements.

But local dissatisfaction rests not only on financing issues: new mandates may not be consistent with local social policy priorities. At the same time, there is potential for the exercise of local discretion to clash with the intent of central laws and decrees. The relative responsibilities of central and local authorities suffer from lack of clear and logical assignment of the authority to make policy, the duty to implement and administer it, and the obligation to pay for it -- and to enforce accountability for the results.

Changes in a benefit system are always contentious. Nevertheless, changes that lead to more effective use of resources and to improved public understanding of rights and obligations are essential. The tolerance for further structural reforms in the near term may well depend in part on the ability of the system of social protection to cope with serious hardship, and to do so within the boundaries of existing fiscal constraints.

### **The growth of poverty**

Poverty increased dramatically in Bulgaria during the 1990s. A variety of measures suggest that the size of the poverty population grew at least threefold by the mid-1990s; by some estimates, economic deprivation affected the majority of the population. This situation was aggravated by the economic crisis which emerged in late 1996 and persisted into 1997.

An almost threefold increase in poverty between 1992 and 1995 (from 12 to 30 per cent of households) was estimated by Dobrinsky (1996), using an absolute poverty line fixed in relation to 1992 median household income. Similar increases were found over a range of poverty thresholds and equivalence scales. Milanovich (1996) estimates a larger increase in poverty in Bulgaria, from 2 per cent in 1989 to 33 per cent by 1993/94<sup>31</sup>.

Shopov (1993) reports that the share of the population with less than 50 per cent of average income in Bulgaria rose between 1990 and 1992 from 8 to 13 per cent. The share with incomes below the "social minimum" rose from 29 per cent in 1989 to more than 70 per cent by the end of 1992; by the beginning of 1992, over one-third of the population had an income below the "existence minimum"<sup>32</sup>. Moreover, the income share of the poorest 10 per cent of all households declined continuously. Poverty not only became wider, but also deeper.

A survey of Bulgarian households indicated that by 1995, 18 per cent reported they were "in dire need", 36 per cent were in "difficult" circumstances, 44 per cent had "satisfactory" circumstances, while 2 per cent said they were in a "very good" situation (UNDP, 1996, Chart 10.1).

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31. The poverty line used was an annual amount of \$120 *per capita*, adjusted by purchasing power parities in 1990 prices. By this measure, in comparison with Bulgaria, the increase in poverty in, for example, Poland, Hungary, and the Czech Republic during the same period, was much smaller, while the Russian Federation and the Ukraine experienced sharper increases.

32. The "social minimum" (SM) is defined by the income level at which expenditures on food accounts for 50 per cent of income. The "existence minimum" (EM) is an absolute measure based on a market basket of goods and services deemed essential for survival. The monthly EM in October 1997 was 78 766 Lev; the SM is estimated by the Secretariat to have been about 110 000 Lev (monthly). Neither is an official measure of poverty.

In sum, while a precise estimate of the population in poverty at present cannot be made, there is no doubt that a large and growing proportion of the Bulgarian population is experiencing hardship.

### **The composition of poverty<sup>33</sup>**

There are at least two ways in which the composition of the population in poverty can change. The first is related to changes in the incidence of poverty within groups such as the unemployed, pensioners, or households with children. The second concerns changes in the size of the contribution of different groups to the total poverty population. This distinction is important for policy purposes, since a large group with a low or declining poverty rate nevertheless may constitute a large proportion of the total poverty population. This means that the size of a group is important, as well as the average risk faced by members of the group of being poor.

Changes within groups since 1992 have been significant<sup>34</sup>. Among pensioner households, 30 per cent were poor in 1992, but the proportion declined to 20 per cent by 1995. Households with children fared worse in 1995 than in 1992: 15 per cent were poor in 1992, compared with 20 per cent in 1995. There was a higher rate of poverty among households with an unemployed member than in households with children or in pensioner households over the entire period, and their prevalence among the poor grew between 1992 and 1995: about 9 per cent of poor households contained an unemployed member in 1992, but increased to 15 per cent by 1995.

A different picture emerges when the size of the contribution of each group to the poverty population is considered. In 1992, pensioners were the largest proportion of the poverty population; the second-largest group were households with children, and households with an unemployed member ranked third in size among the poor. In 1995, the rankings remained similar to the 1992 pattern<sup>35</sup>.

### **The evolution of social assistance**

The starting point for the response to increasing poverty after 1991 was the benefit system for the disadvantaged that had been in place for 40 years. Low income determined eligibility, with wide latitude for local discretion. There was no assets test. The benefits included occasional cash assistance and free or subsidised goods and services, such as drugs, transportation, meals, and access to a network of institutions for the aged and disabled. The modifications and additions to these benefits -- and policy learning -- have followed a winding road.

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33. The results reported are those of Dobrinsky *et al.*, 1996.

34. These groups are not mutually exclusive.

35. After 1992, the prevalence of poverty within groups of different size changed, and the rankings became more sensitive to how poverty is measured. A *per capita* income scale exaggerates poverty in larger households, that is, those with children. If it is used, households with children dominate pensioner households as contributors to poverty. If a different equivalence scale is used which takes account of economies of scale when living arrangements are shared (for example, 1.0 for the first adult; 0.7 for the second adult; 0.5 for each child under 14 years of age), pensioners remain the largest group in poverty in most years. Regardless of the scale used, pensioners were the dominant group in the bottom decile.



The 1951 social assistance law is still in force<sup>36</sup>; all additions and changes to the benefit system for low-income households have been made by decree. In 1991, central decrees established monthly cash benefits for poor households, financed by municipal budgets, and set eligibility criteria and benefit levels. Per capita income of 65 per cent of the minimum wage and specified limits on property ownership defined the eligibility threshold. Municipalities retained authority to set priorities and conditions for other cash and in-kind benefits. Responsibility for the network of social welfare institutions and social services for the elderly and disabled was transferred from the Ministry of Health to the Ministry of Labour and Social Affairs. Benefit administration, controls and financing remained largely within the domain of municipalities.

Shortly thereafter, a link was made between the cost of certain necessary consumption items for an adult and a monthly benefit per capita, converted into a percentage of the minimum wage. The benefit for the household was differentiated according to its size and age composition. The relationship to the minimum wage was intended to serve as an *ad hoc* automatic indexation mechanism which was absent with the previous flat amount per family member. Assets were extended to include potential income-producing property such as rentable living space, and the unemployed were required to register with the local employment service. But linking eligibility and benefit amounts to the minimum wage led to problems: not only did real benefits erode as the minimum wage declined in value, but the eligibility threshold as a proportion of the minimum wage also increased because of rising consumer prices. Particularly troubling was the increase in eligibility among unintended beneficiaries, such as students.

The link to the minimum wage was discarded in 1992, in part to curtail inflows. In its place, a basic minimum income (BMI) for an adult was introduced as a more stringent benchmark for determining eligibility and monthly benefit amounts. The BMI was not intended as an official poverty line. The BMI is based on the cost of a limited market basket of essential food and energy products and is below the “existence minimum” (the amount needed to purchase items deemed essential for survival), the minimum wage, and the minimum unemployment benefit (Table 4.1). The BMI is adjusted by family size and composition to obtain the differentiated minimum income (DMI), that is, the total benefit for a family. The “individual coefficients” or weights used to calculate the family benefit also have been changed since the BMI was introduced.

Monthly benefits are intended to serve as a minimum income floor, but benefits are not actually guaranteed to all who are eligible. The Local Social Assistance Centres (LSACs) do not always have resources sufficient to pay full benefit amounts and since, a decree does not have the full force of law, they can, for example, substitute in-kind benefits, pay less than the full benefit amount, or delay payment. Deficits in social assistance budgets emerged for the first time in 1993, and amounted to 14 per cent of awarded benefits by 1996 (Noncheva, 1997).

In addition to monthly cash benefits, the network of institutions and social care services and cash benefits established by the 1951 social assistance law remain available. According to rules in force since November 1997, periodic cash payments (up to three payments a year), one-time lump sums for emergency needs, and free or subsidised goods and services are provided at the discretion of municipalities. Eligibility for monthly cash assistance is not a requirement for short-term cash or non-cash benefits.

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36. New social assistance legislation will be considered in 1998.

Table 4.1 Minimum incomes as a percent of the "existence minimum" in Bulgaria, 1992-97<sup>a</sup>

	Basic minimum income (B M I)	Minimum unemployment benefit	Minimum wage
1992	48	75	80
1993	53	76	84
1994	39	60	66
1995	32	49	55
1996	33	51	57
1997 <sup>b</sup>	34	52	58

*Memorandum items:* In October 1997 the B M I was 27000 levs; the minimum unemployment benefit was 40950 levs; and the minimum wage was 45500 levs.

a) The "existence minimum" is based on the cost of a market basket containing items essential for survival. It is not an official measure of poverty. In 1997 it was 78766 levs.

b) October 1997.

*Source:* Ministry of Labour and Social Welfare.

### Local expenditure on social assistance<sup>37</sup>

The trend in local expenditure on social assistance as a per cent of GDP has followed a path similar to the national one, but at relatively low levels of spending. Spending peaked in 1993 at just over 1 per cent of GDP, and declined by 1996 to 0.7 per cent of GDP -- slightly below the 1991 level. Real social spending by localities declined by nearly 70 per cent between 1991 and 1996 -- a larger fall than that recorded for combined social spending at all levels of government (see Table 4.2).

37. Local social assistance expenditure includes means-tested cash transfers, non-means-tested family benefits to the uninsured, and in-kind benefits.

**Table 4.2 Local social assistance expenditures, 1991-96**  
(Billions of levs, 1991 levs for real series)

	1991	1992	1993	1994	1995	1996	1996/91 % change
<b>Total</b>							
Nominal	1074	1936	3464	5018	6975	11919	
Real	1074	1079	1177	769	804	334	-68.9
% of GDP	0.79	0.96	1.16	0.95	0.80	0.72	-9.3
<b>Uninsured parents<sup>a</sup></b>							
Nominal	259	459	935	1610	2630	3464	
Real	259	256	318	247	303	97	-62.5
% of GDP	0.19	0.23	0.31	0.31	0.30	0.21	9.3
<b>Poor households</b>							
Nominal	172	571	1164	1189	796	1132	
Real	172	318	396	182	92	32	-81.5
% of GDP	0.13	0.28	0.39	0.23	0.09	0.07	-46.2
<b>Social care services and institutions</b>							
Nominal	560	770	1146	1856	2612	4140	
Real	560	429	390	284	301	116	-79.3
% of GDP	0.41	0.38	0.38	0.35	0.30	0.25	-39.6
<b>Goods and services</b>							
Nominal	83	136	219	363	357	483	
Real	83	76	74	56	41	14	-83.7
% of GDP	0.06	0.07	0.07	0.07	0.04	0.03	-52.4
<b>Energy allowance<sup>b</sup></b>							
Nominal					580	2700	
Real					67	76	
% of GDP					0.07	0.16	
<b>CPI/91</b>	100	180	294	653	868	3564	
<i>Memorandum items:</i>							
<b>Long-term unemployment assistance (Financed from Unemployment Fund)</b>							
Nominal					0.42	0.66	
Real					0.05	0.02	
% of GDP					-	-	
<b>Unemployment benefits (Financed from Unemployment Fund)</b>							
Nominal	0.72	1.16	2.05	2.66	2.86	4.17	
Real	0.72	0.65	0.70	0.41	0.33	0.12	-83.7
% of GDP	-	-	-	-	-	-	-52.4
<b>Other unemployment cash benefits (Financed from Unemployment Fund)<sup>c</sup></b>							
Nominal			0.30	0.31	0.68	1.29	
Real			0.10	0.05	0.08	0.04	
% of GDP			-	-	-	-	
<b>Family benefits (Financed from Social Insurance Fund)</b>							
Nominal	3.96	4.45	5.48	7.38	9.49	13.28	
Real	3.96	2.48	1.86	1.13	1.09	0.37	-90.6
% of GDP	-	-	-	-	-	-	-72.6

- Less than 0.01 per cent.

a) Financed from an extra-budgetary fund as of 1997.

b) Financed from an extra-budgetary fund as of 1996.

c) Includes mainly unemployment assistance for school leavers, child supplement to the unemployment benefits and severance pay.

d) Includes child allowances, maternity benefits, parental benefits, birth grant and benefits for care of sick child.

Sources: Ministry of Labour and Social Affairs; Ministry of Finance.

Most local social assistance expenditure has not necessarily been focused on the poorest households. In 1996, the largest share (35 per cent) was spent on social care institutions and services created in earlier years, with a client population composed for the most part of the elderly and disabled, and the determination of need at the discretion of municipalities. Almost one-third of the total was spent on family benefits for the uninsured, without the requirement of a means test. More than one-fifth was consumed by the energy allowance, with eligibility at a higher income threshold than applicable for monthly benefits. Monthly, occasional, and emergency cash benefits for the poorest households accounted for only 10 per cent of total local spending on social assistance. Nor did expenditure on long-term unemployment assistance, with eligibility determined by the same criteria as monthly benefits, change the picture significantly. Expenditure from the Unemployment Fund on this benefit was less than one-half of the amount spent by municipalities for the poorest households.

Changes in expenditure patterns between 1991 and 1996 also may have adversely affected spending on the poorest households. As the economic situation worsened, there was a shift from expenditure on family benefits for insured parents financed from the SIF to local expenditure on uninsured parents. The local share of spending on family benefits as a per cent of total spending at all levels of government rose from 6 per cent in 1991 to over 20 per cent in 1995 and 1996. The pressure for relatively more spending on benefits for uninsured parents created budgetary pressures which affected other benefits provided by localities. Although the number of poor households also was rising, there was a fall in real spending for these households which was much larger than the real decline in spending on uninsured parents. According to Noncheva (1997), a possible reason why the poorest households fared worse than uninsured parents relates to the administration of eligibility criteria: while a degree of subjectivity can and often does affect the determination of eligibility for means-tested benefits, there is little room for manoeuvre in the determination of eligibility for family benefits.

Those who receive benefits from local authorities undoubtedly suffer from some degree of material deprivation, which is why they are deemed eligible for help. Nevertheless, as the real value of all public benefits declined, and as real wages declined and jobs were lost, it is very surprising that means-tested social assistance did not become a larger share of social spending<sup>38</sup>.

### **Assessment of benefit regimes**

Local expenditure of less than 1 per cent of GDP for low-income individuals and households is relatively very low, but there are problems of affordability nevertheless -- as demonstrated by significant arrears in monthly benefit payments. Nor are benefits high: in absolute terms, minimum benefit amounts are disturbingly low. But low benefit levels and severe fiscal constraints make it even more important to assess how efficiently and effectively the limited resources are used to meet the basic social policy objective of alleviating poverty.

### ***Benefit levels versus the financial returns to work***

An area of concern frequently raised is the work incentive effects of benefit regimes. In order to arrive at a considered response, these effects cannot be assessed by examining each benefit programme in isolation. A benefit usually interacts with other sources of household income and with earnings and the

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38. A significant but temporary increase in means-tested spending occurred in the context of the energy allowance during the crisis of 1996/1997. It was financed by the PHARE programme of the European Commission.

rules of the tax system, and may vary according to family size and composition. Work incentive effects depend upon the combined results.

A useful way to explore how benefit regimes work is to examine their effect on the income of families in varied situations. Table 4.3 depicts several family types which differ by the number of working-age adults, the presence of children, and family size; each row follows the changes in household income for a specific family type with changes in earnings level, employment status, and income source; each column depicts the variations in income of different types of families with the same income source<sup>39</sup>. Table 4.4 presents similar information in the form of net replacement rates: it shows household income from cash-transfers relative to the income the household would have if earnings were the main source of income.

The first observation from Table 4.3 is that working at the average wage, regardless of family size or composition, is substantially superior to the other situations depicted. Working at the minimum wage, however, can be less advantageous than receiving unemployment benefit.

**Table 4.3 Potential net monthly household income<sup>a</sup>, by household type and income source, October 1997**

	Average wage	Minimum wage	Unemployment benefit Minimum	Unemployment benefit Average	Unemployment assistance / Unemployment allowance	Social assistance
<i>One adult</i>						
no children	143 040	45 500	38 675	43 743	27 300 <sup>f</sup>	27 000 <sup>f</sup>
2 children <sup>b</sup>	160 180	62 640 <sup>f</sup>	63 550 <sup>f</sup>	69 632	44 440 <sup>e,f</sup>	67 500 <sup>f</sup>
			(55 815) <sup>d,f</sup>	(60 883) <sup>d,f</sup>		
3 children <sup>c</sup>	168 790	71 250 <sup>e,f</sup>	72 160 <sup>e,f</sup>	78 242 <sup>e,f</sup>	53 050 <sup>e,f</sup>	89 100 <sup>f</sup>
			(64 425) <sup>d,f</sup>	(69 493) <sup>d,f</sup>		
<i>Two adults</i>						
no children	286 080	91 000	77 350	87 486	54 600 <sup>f</sup>	51 300 <sup>f</sup>
2 children <sup>b</sup>	303 220	108 140	102 225	122 123	71 740 <sup>e,f</sup>	86 400 <sup>f</sup>
			(94 490) <sup>d</sup>	(104 626) <sup>d</sup>		
3 children <sup>c</sup>	311 830	116 750	110 835	130 733	80 350 <sup>e,f</sup>	108 000 <sup>f</sup>
			(103 100) <sup>d,e</sup>	(113 236) <sup>d</sup>		

a) Net wage levels in two-adult households assume that both work at the specified wage; benefit levels assume that both adults are unemployed. All benefit and wage amounts include any child allowances for which the family is eligible.

Income amounts at or below 50 000 Lev per adult are not taxable; all social protection benefits are excluded from taxable income.

b) Children of age 0-3 years and 3-7 years (.7% + .6% of BMI).

c) Children of age 0-3 years, 3-7 years and 7-18 years (.7% + .6% + .8% of BMI).

d) Includes child supplement of 10% per child, maximum of two children, plus child allowance of 17 140 Lev for two children; 25 750 Lev for three children. Figures in parenthesis show the hypothetical effects on 1997 unemployment benefits of a change in the law implemented as of January 1998 when child supplement is no longer in effect.

e) Eligible for social assistance; amount not included.

f) Eligible for heating assistance; amount not included.

Sources : Ministry of Labour and Social Affairs; Secretariat calculations.

39. See footnotes, Table 4.3 for assumptions underlying the determination of household income.

The child supplement to unemployment benefits resulted in higher household income for families with children when the adults were unemployed relative to working at the minimum wage. Suppression of the child supplement as of 1998 reduced replacement rates relative to the minimum wage to below 100 per cent (see figures in parentheses, Table 4.4). But a second problem area remains. Monthly social assistance in lone-parent households is more generous than working at the minimum wage and receiving standard child allowances. There are two explanations for this unemployment trap. One relates to the higher weight or "individual coefficient" given to a head of household who is a lone parent (1.2 instead of 1.0). If, however, the standard individual coefficient for an adult of 1.0 were used, there is less financial gain to receiving a benefit instead of working at the minimum wage, but the advantage does not disappear. The way in which the child allowance is calculated for monthly social assistance benefits also creates a significant bias, since the amounts calculated are more than double the standard allowance per child<sup>40</sup>. The bias exists for all household types, but is magnified in lone-parent households because the child benefit represents a larger share of household income.

**Table 4.4 Net<sup>a</sup> benefit replacement rates by household type and income source, October 1997**

	Unemployment assistance /				Unemployment benefit			
	Social assistance		Unemployment allowance		Minimum		Average	
	% of minimum wage	% of average wage	% of minimum wage	% of average wage	% of minimum wage	% of average wage	% of minimum wage	% of average wage
<b>One adult</b>								
no children	59.3	18.9	60.0	19.1	85.0	27.0	96.1	30.6
2 children	107.8	42.1	70.9	27.7	101.5 (89.1) <sup>a</sup>	39.7 (34.8) <sup>a</sup>	111.2 (97.2) <sup>a</sup>	43.5 (38.0) <sup>a</sup>
3 children	125.1	52.8	74.5	31.4	101.3 (90.4) <sup>a</sup>	42.8 (38.2) <sup>a</sup>	109.8 (97.5) <sup>a</sup>	46.4 (41.2) <sup>a</sup>
<b>Two adults</b>								
no children	56.4	17.9	60.0	19.1	85.0	27.0	96.1	30.6
2 children	79.9	28.5	66.3	23.7	94.5 (87.4) <sup>a</sup>	33.7 (31.2) <sup>a</sup>	112.9 (96.8) <sup>a</sup>	40.3 (34.5) <sup>a</sup>
3 children	92.5	34.6	68.8	25.8	94.9 (88.3) <sup>a</sup>	35.5 (33.1) <sup>a</sup>	112.0 (97.0) <sup>a</sup>	41.9 (36.3) <sup>a</sup>

See notes, Table 4.3.

a) Figures in parenthesis show the hypothetical effects on 1997 unemployment benefits of a change in the law implemented as of January 1998 when child supplement is no longer in effect.

Source: Secretarial calculations derived from Table 4.3.

40. The standard child allowance for one child in 1997 was 8 555 Lev per month with equivalent amounts for additional children. The monthly child benefit based on the BMI for a child aged 0-3 was 18 900 Lev; for a child aged 3-7, 16 200 Lev; and for a child aged 7-18, 21 600 Lev. The disparity between the two types of child allowance calculations was aggravated by the increase in the individual coefficient for children from 0.4 to the current levels of 0.6 to 0.8 depending on age, although the previous coefficient of 0.4 also resulted in a child benefit higher than the standard one.

Table 4.4 also shows that both minimum and average unemployment benefits provide an income level very close to what earnings at the minimum wage would provide. Monthly social assistance benefits, although not as high as unemployment benefits, also have high replacement rates relative to the minimum wage for families with children. But a high replacement rate does not necessarily indicate that benefit levels are the primary problem. In Bulgaria, low returns to work may be the most important influence on work incentives, and concern a larger share of the population than the share which receives public income transfers.

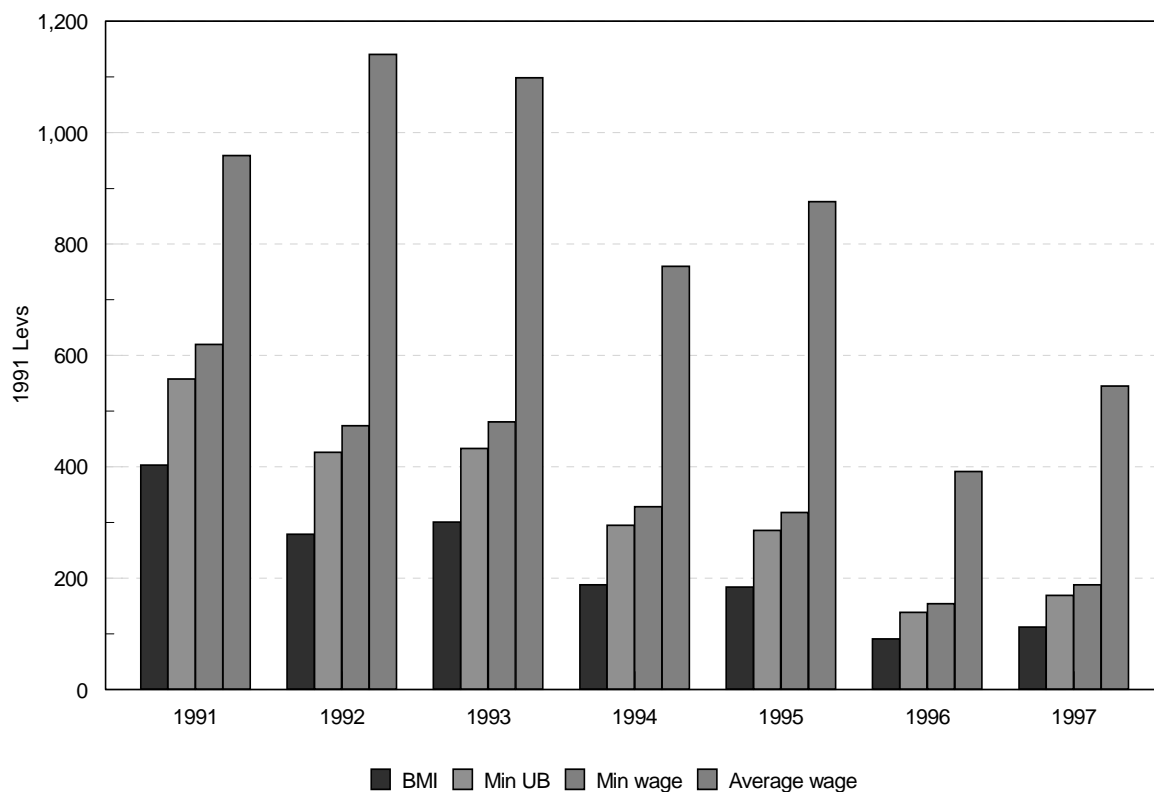
Benefit levels that are high, relative to wages, can make not working more attractive, particularly for workers who can command only low wages. But low wages (and low benefits), particularly if they are not adequate to pay for the basic needs of life, can affect work behaviour in other undesirable ways. They can lead to unrecorded (and untaxed) earnings or to illegal activities, not only instead of low pay in the formal economy, but also as a supplement to it or to benefits from public income support schemes. Thus, the disadvantages to individuals of low wages or benefits can redound upon society.

For example, social assistance benefit amounts for a household with two adults, with or without children, are higher than the income the household would receive if one adult worked for the minimum wage and the other was inactive (Table 4.3). But a simple conclusion that the absolute level of the benefit is too high is difficult to justify. The monthly minimum wage in October 1997 (45 500 Lev), although slightly less than the benefit that a couple without children would have received from social assistance (51 300 Lev), was sufficient to purchase, for example, no more than a few loaves of bread a day. The minimum wage and other minimum income measures are below the "existence minimum" -- the amount required to purchase items deemed essential for survival (Table 4.1).

A household with two adults and only one earner may be unusual in practice, particularly if there are no children. Nevertheless, a household may be better off with only one recorded earner even at low wages, and another with unrecorded and untaxed income. In addition, receipt of a means-tested benefit inhibits the formal work effort of a second household earner because of the marginal benefit reductions when earnings are present. This suggests that there may be an important work disincentive, but it is most likely to be related to work in the formal economy. And the cause may be low wages per se, not simply high taxes or high benefit replacement rates. Under such circumstances, reducing replacement rates only by cutting benefit levels might not achieve the desired results.

The alternative of reducing replacement rates by increasing wages would be optimal, but only if it is pursued through the restructuring of uncompetitive firms. To counter the erosion of the real value of wages and benefits (Chart 4.1), reliance on the vicious circle of wage and benefit indexing in the face of galloping inflation is not helpful. Instead, it is essential to implement policies which improve the performance of the economy. Appropriate macroeconomic policy and structural reforms clearly are as important to the objectives of social policy as they are to the economy at large.

Chart 4.1  
Trends in real monthly incomes measures, 1991-97



Source: Ministry of Labour and Social Affairs.

### *Targeting benefits*

The mix of social programmes that are the responsibility of localities is targeted on individuals and households with low incomes, but only loosely so. Eligibility criteria for the various cash and in-kind benefits vary. There is a stringent means test for access to monthly cash benefits, and a similar procedure with a higher income threshold to obtain eligibility for the energy allowance; eligibility for family benefits for uninsured parents is categorical and without a means-test; local discretion prevails with respect to eligibility for the variety of social care services and access to the network of institutions and to other goods and services. Although these latter benefits account for more than one-third of total local expenditure on low-income households, their distribution by income category is uncertain. It is not uncommon to have less demanding benefit eligibility requirements for priority groups, for example, the aged and the disabled. It is a problem, however, when there are severe fiscal constraints and expenditure on benefits for the poorest households is crowded out, as has occurred in Bulgaria.

Spending more on the very poor in the presence of severe fiscal constraints requires that less be spent elsewhere. But significant increases in the use of means-testing is not a feasible solution. Not only would the administrative costs be high, but the reliability of means-testing is questionable. The sophisticated information required to determine eligibility, and to monitor family circumstances subsequently is not available in Bulgaria. The existence of a sizeable shadow economy, and a culture of non-compliance with income reporting requirements and tax regulations mitigates against widespread reliance on means-testing, particularly if the number of poor households is large. But reliance on means-testing to determine eligibility for some benefits is inevitable. The main concern, however, is not simply



how to target resources on the poor with greater accuracy within the current array of programmes -- it may not be possible to achieve more than "rough justice" under existing circumstances. The most helpful change would be to minimise the resources that are lost because of unnecessary complexity in the mix of programmes and in their administration and financing, such as the provisions for maternity and parental leave, among others. More assistance then would be available for the poorest households.

Parental benefits, which account for three-quarters of local expenditure on family benefits, are intended to replace earnings lost because of child-birth or child-care responsibilities for the unemployed. Earnings replacement, however, makes little sense for a person without a job and, therefore, without earnings. Poor families can apply for monthly cash benefits; for those eligible, the amount of assistance is reduced by the amount of other benefits received. Therefore, nothing extra is received by the poorest because of family benefits, and only those who are not eligible for monthly cash assistance gain from them. Consideration should be given to eliminating parental benefits for the unemployed.

Despite the limited redistribution achieved by child allowances (Chart 3.1), it may not be desirable to eliminate them because of the large number of households involved, and the potential effects on confidence in government. Nor would it be efficient to means-test child allowances, again because of the large number of households that might apply and the high administrative costs. It would be more efficient to have all child allowances provided from central resources, and when feasible, subject to income taxation<sup>41</sup>.

Consideration of possible changes in the mix of cash and in-kind benefits also might lead to greater efficiency in the allocation of resources. For example, expenditure on institutional care for the ill, the aged, and the disabled is partially supply-driven. This is because central transfers to localities are mainly determined by the need to match the costs of existing institutional capacity, rather than demand factors. This, in turn, is not independent of the many difficulties in the fiscal relationship between central and local government, which is discussed below.

### **Financing responsibility for local social expenditure**

The share of total local expenditure in the consolidated budget was 20 per cent in 1991, and increased to nearly 30 per cent in 1992; by 1996, it had fallen to less than 15 per cent. Local social spending also declined, despite the devaluation of responsibility to localities since 1991 to help poor families. Severe declines in the state of health of the economy is an important reason why local social spending fell, but it may not be the only one.

There are wide variations in the economic base of municipalities, in social needs, and in the consequent availability of local revenues to pay for social programmes. Central mandates to localities to provide certain benefits therefore have not always been matched by the ability of local authorities to finance them<sup>42</sup>. Transfers from the central budget do help to reduce revenue disparities among

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41. Experience reported in Hungary, where means-testing of child allowances was implemented, suggests that the savings from taxing benefits would have been equivalent to the savings from means-testing them. This is because of the high administrative costs of means-tests.

42. One problem is the as yet incomplete evolution of local tax and spending structures: clear and workable lines of demarcation between central and local rights and responsibilities to tax and spend have yet to be drawn.

municipalities in the aggregate, but less can be said about their effect on disparities in social welfare spending capacity (see Box 4.1).

#### **BOX 4.1. Local budgets and central transfers**

Local revenues are derived from three main sources: own (local taxes and user fees), which usually are a minor component of the local budget, revenues from the company profit tax and the personal income tax, which are shared with the central government<sup>43</sup>, and subsidies from the central government.

In the large majority of municipalities, central transfers in 1996 accounted for more than one-third of local revenues -- significantly more in some cases<sup>44</sup>. Local budgets and their responsiveness to changing needs are influenced by the central government in other ways as well.

A global municipal budget is negotiated with the Ministry of Finance by each municipality and determines, *inter alia* the amount of any transfers from the central budget. Revenue and expenditure estimates for the forthcoming year are made by the municipality, but are subject to revision by the Ministry of Finance. (The Ministry of Social Affairs does not have control over programme moneys, except for administrative expenses.) A formula is applied to determine the central government subsidy, but it is biased towards supply factors, which reflect the legacy of previous years rather than demand factors. The formula is:

- Subsidy = C1 + C2 + A + C3, where
- C1 = share of previous year's subsidy
- C2 = need for public services to all municipalities assessed on the basis of 21 variables, (*e.g.* hospital beds, places in institutions for the aged and disabled, number of pupils in kindergarten, housing units, number of cash benefit recipients, etc.)
- A = Adjustment factor (*per capita* revenues relative to national average)
- C3 = transfers for capital investment (at discretion of central government)

Current service capacity also has a strong influence in the formula. This can lead to the inefficient use of resources by, for example, encouraging admissions to hospitals and institutions for the aged and disabled, which can limit the ability of municipalities to meet competing social needs.

The "objective" factors in the allocation formula are intended to reflect "need"; they have grown in number from five to 21, in an attempt to improve the accuracy of the measure of need. Instead, the application of the formula has become complicated and difficult to administer. This deficiency and the rapidly changing national and local circumstances have led to "manual steering" and an allocation largely based on the principle of "a little for everybody", (Ivanov *et al.*, 1997).

The capacity of municipalities to pay for all obligations, roughly measured by own-source revenues per capita, is very unevenly distributed: nearly three-fourths of the municipalities had per capita own-source revenues which were at or below the average in 1996. Less than 60 per cent of municipalities, however, received transfers from central government that were above the average per capita level. Yet the

43. The tax base and tax rates for own and shared revenues are set by the central government. See, for example, Martinez-Vazquez, 1996, for a description of the intergovernmental tax structure in Bulgaria and the relevant public finance issues.

44. Data from the Ministry of Finance indicate that only two out of 255 municipalities received no central subsidy in 1994 (Devnya and Radnevo); in 1996, seven municipalities received no central subsidy (Devnya, Radnevo, Etropole, Mirkovo, Bobovdol, Galabovo, and Beloslav), of which six made transfers to the national budget.

distribution of the 255 municipalities according to the size of the per capita transfers received from central government and the level of their own local per capita revenues does show that some redistribution is taking place<sup>45 46</sup> (see Table 4.5). As the difference in the distributions of revenues and transfers suggest, there also are striking exceptions: six municipalities with low own revenues per capita received below-average levels of per capita transfers, while eight municipalities with above-average per capita own revenues received transfer amounts that were above average. In addition, the importance of transfers from the central government to local budgets has been changing. As local responsibilities for the poor increased, the tax base narrowed and transfers from central government as a share of municipal budgets declined from 44 per cent in 1994 to 33 per cent in 1996. During the same period, the dispersion of transfers as a share of municipal budgets increased.

**Table 4.5 Distribution of municipalities by size of transfers and of own revenues per capita, 1996**

	Number of municipalities				Total
	<i>Own revenues per capita</i>				
	0-3258	3259-6517	6518-9777	9778+	
<i>Transfers per capita (Levs)</i>					
≤0	0	0	0	7	7
1 - 2918	0	0	0	12	12
2919 - 5835	6	39	33	13	91
5836 - 8754	54	54	6	1	115
8755 - 15115	16	13	1	0	30
Total	76	106	40	33	255

	Per cent of municipalities			
	<i>Own revenues per capita</i>			
	0-3258	3259-6517	6518-9777	9778+
<i>Transfers per capita (Levs)</i>				
≤0	0.0	0.0	0.0	2.7
1 - 2918	0.0	0.0	0.0	4.7
2919 - 5835	2.4	15.3	12.9	5.1
5836 - 8754	21.2	21.2	2.4	0.4
8755 - 15115	6.3	5.1	0.4	0.0

*Memorandum item:*

Average per capita revenue was 12354 levs, of which:

average per capita own revenues was 6518 levs.

average per capita transfers were 5836 levs.

*Sources:* Data from the Ministry of Finance; Secretariat calculations.

45. The correlation between transfers and own revenues was -0.89.
46. Own revenue, unfortunately, is a flawed indicator of capacity to raise revenue and of the willingness to do so on the part of municipalities in Bulgaria. Municipalities have extremely limited discretion in determining revenue sources and tax rates.

The global allocation is intended to serve multiple purposes, some at the discretion of the Ministry of Finance, and others according to national mandates and local preferences. Strict equalisation of per capita revenues therefore is not the appropriate objective. Nor might it serve the purpose of enabling and encouraging municipalities to spend for social purposes in accordance with national priorities and local needs. The recent proposal to create an extra-budgetary fund for family benefits for uninsured parents, and to channel moneys from central budget revenues directly to Local Social Assistance Centres (LSACs) to pay for these benefits, clearly was intended to remove this programme from municipal control. But the amount of the earmarked bloc grant to the LSACs is to be determined by the process which determines the global transfer, with the global transfer reduced by the same amount. The allocation of transfers therefore is unlikely to change. But the priority enforced on municipalities to provide these family benefits also has affected social spending for other purposes in unintended ways: it has crowded out spending on the poorest households, as discussed previously.

There are alternative ways of centralising some control over the provision of social welfare benefits, encouraging municipalities to meet the needs of the poor and other groups, and enabling them to do so. A global allocation for all purposes of local government is not the best mechanism. A bloc grant, earmarked for specified social purposes, would increase the accountability of local authorities while permitting a desired degree of local discretion within the boundaries of the grant. The allocation across municipalities could be simplified and made more transparent by replacing the current multiple and often inappropriate criteria. For example, a measure of the proportion of the local population in poverty (however measured), adjusted by the size of the target population, could be used.

Efficient use of the resources provided by the bloc grant should be encouraged. This requires that the resources of both the central and municipal governments be involved. Therefore, consideration should be given to an earmarked grant with matching requirements. The matching requirements need not, and probably should not, be uniform in order to accommodate the local capacity to pay<sup>47</sup>.

The bloc grant should be designed so that the money provided from the central budget does not substitute for resources spent voluntarily by municipalities. The municipalities with above-average social spending include both wealthy municipalities which can afford to spend more, and poor municipalities with high needs. A requirement that certain municipalities maintain some level of previous social spending in addition to the spending financed by the bloc grant would be appropriate.

But little will be accomplished if other transfers are reduced by the amount of the earmarked bloc grant, or if the array of programmes which help to prevent or ameliorate poverty are not rationalised.

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47. The measurement of the capacity of a municipality to pay requires information on *potential* rather than actual revenues. This requires data on the income and wealth of the residential and business community in the taxing jurisdiction and local discretion in designating the tax base and rates.

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## ANNEX 1

Table A.1. Institutional description of main social protection programmes in Bulgaria 1997

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
<b>Pensions</b>			
<ul style="list-style-type: none"> <li>• Old-age pension</li> </ul>	<p>- Standard retirement age (category III) is 60 years for men and 55 for women. Required years of service is 25 years for men and 20 years for women.</p> <p>Persons working in selected occupations can retire earlier:</p> <p>- Category I: retirement age is 57 years for men and 52 years for women, if 20 years of service;</p> <p>- Category II: retirement age is 52 years for men and 47 years for women if 15 years of service;</p> <p>- Military personnel can retire after 20 years of service;</p> <p>- Pilots, divers and navy personnel can retire after ten years of service.</p>	<p>55% of average monthly gross earnings from three best consecutive years: from January 1997 one year will be added each sequential year until full contribution period is included. For service longer than vesting requirement, the pension is increased by 2% for each extra year of service. Minimum old-age pension is 115% of social pension; maximum pension is three times social pension.</p>	<p>1. Pensions are paid from Social Insurance Fund (SIF), and State budget.</p> <p>2. Contribution rates: Employers pay: - 37% of payroll; - 47% of payroll (if category II); - 52% of payroll (if category I). Employees pay 2% of earnings.</p>
<ul style="list-style-type: none"> <li>• Disability pension</li> </ul>	<p>Insured employees with full or partial loss of work ability, depending on age and length of service:</p> <p>- All insured up to 20 years are eligible;</p> <p>- Employees in the age 20-25 years are eligible if they have at least three years of service;</p> <p>- Employees older than 25 years are eligible if they have at least five years of service.</p> <p>For certain professional occupations, eligibility depends on age and length of service.</p> <p>The loss of work ability must have occurred during or up to two years after employment period. Disability pensions are divided into three categories; category I is the highest degree of work incapacity.</p>	<p>Pensions are based on average monthly gross earnings during the last 12 months before losing work ability.</p> <p>- Category I: 55%;</p> <p>- Category II: 40%;</p> <p>- Category III 25% .</p> <p>Minimum benefit is related to social pensions. It amounts to 140% for category I, 130% for category II, and 105% for category III workers. Pensions may be increased by 5% to 25% depending on length of service and degree of disability.</p>	

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
<ul style="list-style-type: none"> <li>Survivor pensions</li> </ul>	Surviving dependent persons: <ul style="list-style-type: none"> <li>- Children, brothers and sisters, and grandchildren aged under 18;</li> <li>- Aged or disabled parent or spouses;</li> <li>- Widowed parent caring for orphan aged under 16;</li> <li>- Needy grandparents.</li> </ul>	one survivor: 50% of disability pension; two survivors: 75% of disability pension; three survivors: 100% of disability pension.	
<ul style="list-style-type: none"> <li>Social pensions</li> </ul>	Income-tested: <ul style="list-style-type: none"> <li>- Unemployed more than three months due to liquidation of enterprise, over age 57 (men) or age 52 (women) and qualified for old-age pension;</li> <li>- Labour category III workers with annual income of household head less than 50% of minimum wage;</li> <li>- Over 70 years and annual income of household head less than 50% of minimum wage;</li> <li>- Disabled persons aged over 16.</li> </ul>	Determined periodically by government.	
Occupational injury & disease	All insured employees.	Benefits are based on average monthly gross earnings during the last 12 months before losing work ability. <ul style="list-style-type: none"> <li>- Category I: 70%;</li> <li>- Category II: 55%;</li> <li>- Category III: 35%.</li> </ul> Minimum benefit is related to social pensions. It amounts to 150% for category I, 140% for category II, and 115% for category III workers.	
<b>Sickness benefits</b>	All insured employees with at least three months of continuous employment (no minimum duration of employment required if under 18).	1. Benefit rates depend on length of service. During first 15 days, 70% of earnings if less than three months of service; 80% if three months to ten years of service; a maximum of 90% if more than 15 years of service.  2. Benefit rates for care of sick child under nine years are 100% of earnings. Duration: maximum 60 days per year.	1. Sickness benefits are paid from SIF.  2. Contribution rate: included in pension contribution rate above.
<b>Family allowances</b>			
<ul style="list-style-type: none"> <li>Child allowance</li> </ul>	All resident children under age 16 (18 if a student).	Base amounts are 15, 30, and 55 Levs for the first through the third child and 15 Levs for each subsequent child. Added to these amounts is an inflation compensation payment of 8 540 Levs (as of October 1997). Families with disabled children receive 36 per cent of the minimum wage.	1. Family allowances for the insured (employed) are paid from the SIF; local governments pay for benefits for the uninsured (both parents unemployed; lone mothers; students.)



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Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
<ul style="list-style-type: none"> <li>Maternity benefit</li> </ul>	Employed mothers.	100% of earnings. Duration: 45 days prior to delivery up to 180 days after birth, depending on number of children.	<ul style="list-style-type: none"> <li>- parental benefit: SIF (the insured) and local governments (the uninsured)</li> <li>- birth grant: SIF (the insured) and local governments (the uninsured)</li> </ul>
<ul style="list-style-type: none"> <li>Parental benefit</li> </ul>	Employed and uninsured (unemployed, single and full-time student) mothers.	Minimum wage. Duration: for insured mothers, parental benefits are paid after maternity benefits end and up to two years after birth. For uninsured mothers, 45 days prior to delivery and up to two years after birth.	2. Contribution rates: for the insured, see pension contribution above. Contributions for the uninsured are made out of general taxation.
<ul style="list-style-type: none"> <li>Birth grant</li> </ul>	Birth grant is provided for each child born.	1st child: one minimum wage; 2nd child: two minimum wages; 3rd child: 2.5 minimum wages; 4th and subsequent children: one minimum wage.	
<b>Unemployment</b>			
<ul style="list-style-type: none"> <li>Unemployment benefit</li> </ul>	<ul style="list-style-type: none"> <li>- Unemployed;</li> <li>- Minimum nine months of employment in the last 15 months;</li> <li>- Registration at local labour office;</li> <li>- Willingness to accept training or job, if offered.</li> </ul>	Full-time employment: 60% of average earnings during last six months. Not less than 85% not more than 140% of minimum wage. Part-time employment: proportionately reduced benefit. Special rules for students. Duration: 4-12 months depending on age and length of service.	<ol style="list-style-type: none"> <li>All unemployment programmes are paid from the Unemployment Fund.</li> <li>Contribution rates: employers pay 5% and employees pay 2% of payroll (3.6% and 1.9% as of July 1998)</li> </ol>
<ul style="list-style-type: none"> <li>Unemployment assistance for long-term unemployed (terminated 31.12.97)</li> </ul>	Means-test, after 12 months of unemployment and exhaustion of unemployment benefits.	60% of minimum wage. Duration: six months.	
<ul style="list-style-type: none"> <li>Unemployment assistance for school leavers (terminated 31.12.97)</li> </ul>	Unemployed with three months waiting period.	80% of minimum wage. Duration: three months for school leavers and six months for new graduates with skills or professional qualifications.	
<ul style="list-style-type: none"> <li>Unemployment allowance (implemented 1.1.98)</li> </ul>	Unemployed six months after expiration of unemployment benefits (no means-test)	60% of minimum wage. Duration: three months.	
<ul style="list-style-type: none"> <li>Child supplement (terminated in July 97)</li> </ul>	Households where both parents are unemployed received a supplement for the first two children.	10% of unemployment benefit per child, up to two children.	

Type of benefit	Eligibility criteria	Benefit formula and duration	Financing
<ul style="list-style-type: none"> <li>Severance payment</li> </ul>	Persons redundant from state-owned enterprises in liquidation and persons redundant from jobs in the budget sector.	Lump-sum: amount depending on age and work experience.	
<b>Support for low income families</b>			
<ul style="list-style-type: none"> <li>Monthly benefit</li> </ul>	Income and means-tested: average monthly income for the last six months lower than differentiated basic minimum income (DMI) <sup>1</sup> . Means-test requirements are: (a) no more than one dwelling; (b) maximum amount of savings equal to six basic minimum incomes (BMI); (c) no assets which can be profitable. Unemployed persons in active working age must also register in labour office at least six months prior to application.	Benefit equals the difference between DMI (see footnote 1) for the household and total income of the household.	Paid from local budgets.
<ul style="list-style-type: none"> <li>Occasional benefits</li> </ul>	Means-tested.	Vary, depending on the needs estimated by case worker.	
<ul style="list-style-type: none"> <li>Energy benefit</li> </ul>	Means-tested.	Provided as earmarked vouchers.	
<ul style="list-style-type: none"> <li>Free drugs</li> </ul>	Income-tested.	Free receipts for patients whose income is below BMI per person in household. Patients with income below 130% of BMI per person in household pay 50% of cost.	
<ul style="list-style-type: none"> <li>EC Phare emergency programme (March-June 1997)</li> </ul>	Same as energy benefits.	five ECU per child or handicapped person in a household.	
<b>Disability benefits</b>			
<ul style="list-style-type: none"> <li>Goods and services (cash and/or in-kind)</li> </ul>	Disabled persons older than 16 years.	Cash benefits are paid as a monthly allowance for social integration, which, depending on the degree of disability, amounts to 15-25% of minimum wage.	Programmes are paid from Rehabilitation and Social Integration Fund, State budget, Local budgets and other sources.

Note:<sup>1</sup> DMI is determined by the number of household members, their age and health condition. It is calculated by applying following coefficients to the basic minimum income (BMI):

- (a) 0.1 BMI for a single person;
- (b) 0.9 BMI for an adult living in the household;
- (c) 1.2 BMI for a single pensioner, single parent with children up to 16 years (18 if studying) and disabled children;
- (d) 0.7 BMI for a child up to three years of age;
- (e) 0.6 BMI for a child aged three to seven years;
- (f) 0.8 BMI for a child aged 7-16 years (18 if studying).