Bulgaria

Integrated State-Owned Enterprises Framework (iSOEF) Assessment

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The OECD Guidelines on Corporate Governance for State-owned Enterprises[1] and the World Bank Corporate Governance of State-Owned Enterprises: A Toolkit[2] are key sources and are drawn on throughout this Note. Other sources of research and guidance are referenced in this Note and reflected in the footnotes, where appropriate.

[1] OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015 https://www.oecd.org/corporate/guidelines-corporate-governance-soes.htm

[2] World Bank, Corporate Governance of State-Owned Enterprises: A Toolkit, Washington D.C. 2014 https://openknowledge.worldbank.org/handle/10986/20390

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ABBREVIATIONS AND ACRONYMS

BGN	Bulgarian Lev (currency)
CEO	Chief Executive Officer
CESEE	Central, East and South East Europe
CO2	Carbon Dioxide
EU	European Union
GDP	Gross Domestic Product
GVA	Gross Value Added
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
iSOEF	Integrated State-Owned Enterprise Framework
KPI	Key Performance Indicator
MOF	Ministry of Finance
NAO	National Audit Office
OECD	Organisation for Economic Co-operation and Development
PE Act	Public Enterprises Act
PECA	Public Enterprises and Control Agency
PFIA	Public Financial Inspection Agency
PPA	Public Procurement Agency
SCD	Systematic Country Diagnostic
SOE	State-Owned Enterprise

Executive Summary

i. **This report applies the new World Bank integrated State-Owned Enterprises Framework (iSOEF) to assess the Bulgarian state-owned enterprise (SOE) sector and help to identify ways to strengthen its corporate governance and performance**. The report provides one of the first comprehensive applications of the World Bank's new iSOEF in Eastern Europe. The report outlines the SOE landscape in Bulgaria and then assesses two key aspects: SOEs fiscal impact and their corporate governance and accountability mechanisms. Leveraging World Bank expertise, this multidimensional assessment looks at the interrelationships of the challenges and opportunities faced by Bulgarian SOEs to propose holistic and sequenced recommendations that aim to strengthen governance and performance. The primary audience of the iSOEF assessment is the Government of the Republic of Bulgaria, in particular the Ministry of Finance, the Ministry of Economy and Industry, the Public Enterprises and Control Agency (PECA), and other relevant stakeholders.

ii. **Bulgaria´s transition to a market economy involved massive privatizations over the past few decades, however the central government still retains a portfolio of 311 SOEs which includes some of the largest companies in terms of assets and revenues and dominates strategic sectors such as energy and transport.** By 2019, SOEs´ total assets reached 37.4 percent of the country´s gross domestic product (GDP). Three of the largest SOEs — Bulgarian Energy Holding, the National Electricity Company, and the National Railway Infrastructure Company — comprised more than one third (35.2 percent) of such assets. During the same year, 133,961 people — 4.1 percent of total employment — were registered as SOE employees, and the contribution of SOEs to the country´s Gross Value Added (GVA) was 6 percent.

iii. **In 2019 the government launched an ambitious SOE reform program, and in 2020, amidst the COVID-19 crisis, it promoted the expansion of state participation in selected markets.** The SOE reform program included the approval of a new Public Enterprises (PE) Act (2019) to more closely align SOE practices with international standards. The reform was based on recommendations received from the European Commission, the IMF, and the OECD. The COVID-19 pandemic contributed to the need to provide large capital support to the state-owned Bulgarian Development Bank in 2020 —BGN 700 million to support small business and households, and the government also expanded the SOE sector that year by creating new companies in selected markets —oil, water supply and sewerage, and health sectors. The total amount of state capital support for all above-mentioned initiatives reached Bulgarian lev (BGN) 2.016 billion (1.7 percent of 2020 GDP), and was covered by the central government budget.

Fiscal costs and risks of SOEs

iv. **The net flows between the central government budget and SOEs were relatively stable and under manageable ratios during 2017-2019, with transfers to SOEs surpassing SOE contributions by 1.32 percent of GDP (on average)**. Overall, budget revenues in the form of taxes and dividends were significantly surpassed by government direct transfers to SOEs. Direct fiscal support to SOEs varied from 0.73 to 1.13 percent of GDP in this period, while the indirect support was smaller, oscillating between 0.58 and 0.63 percent of GDP. Subsidies were stable during this period, averaging 0.43 percent of GDP. Most were allocated to three SOEs from the transport and communications sectors, to compensate them for public sector obligations. Capital transfers to SOEs represented on average 26 percent of the entire direct financing from the state budget during the same period. There were limited tax and dividend exemptions, although tax deferrals surpassed total subsidies.

v. **In 2020, direct transfers from the government budget to SOEs significantly increased, while revenues from SOEs to the government budget substantially decreased.** These changes were mainly related to measures introduced to cope with the economic consequences of the COVID-19 crisis. While subsidies and capital transfers remained almost constant as compared to 2019, equity investments increased by 1.8 percent of GDP. The direct fiscal support reached a record high of 2.54 percent of GDP in 2020 (BGN 3.048 billion). At the same time, due to weaker financial performance of SOEs in 2020, revenues from taxes and dividends decreased by 56 percent as compared to 2019, amounting to only BGN 88 million.

vi. **Fiscal risks have been relatively small until the recent past, but the growing debt of some of the largest SOEs, as well as the implicit obligations associated with increased capital investment required to maintain or improve the quality of public services in some sectors, calls for caution.** The high debt level of some SOEs in the energy, railway transport, water, and health sectors pose risks via their financial viability that may put pressure on the state budget for provision of further subsidies, capital transfers, or other forms of state support. Also, the delivery of public services in some sectors does not meet the high demand for better quality. Besides, limited fiscal space combined with constraints of a large part of the population to afford market prices of public services represents a long-term fiscal risk.

vii. **Other sources of potential fiscal risks associated with SOE performance are the European Green Deal obligations, and more specifically, the restructuring of the energy sector needed to reach the "Fit for 55" emission reduction targets in a context of energy price volatility.** The Bulgarian economy is expected to be one of the most affected by decarbonization and the green transition in the European Union (EU). The scope and time horizon of the associated fiscal burden is not clear yet, since it strongly depends on the political ambition to foster the restructuring. The most vulnerable is the energy sector, where the postponement of structural and green reforms over the last decade is expected to demand substantial public resources. While the increase of the price of energy (in particular electricity, but also gas) will position some of the loss-making SOEs in the energy sector in a better financial position, this effect will prevail only over the short term, since many of these companies will be subject to restructuring or have to close down soon due to their high carbon dioxide (CO_2) emissions. Furthermore, such price increase will significantly increase the financial risks associated with other SOEs from key sectors —in particular transport and industry.

Corporate Governance and Accountability Mechanisms

viii. **Bulgaria has embarked on a significant reform of the corporate governance framework of SOEs with adoption of the PE Act in 2019 and secondary legislation in 2020.** The reform was initiated as part of the government's action plan to prepare for applying to the Exchange Rate Mechanism II, also known as the "waiting room" prior to eurozone accession[3]. The PE Act established a solid legislative framework aligned to the OECD guidelines. The main provisions of the Law regulate the establishment of an ownership coordination unit, elaboration of an ownership policy, development of aggregate reporting to address the gap in accountability for SOEs performance, and a transparent SOE board nomination process. The Implementing Rules of the PE Act, adopted in May 2020, provided detailed instructions, including: (i) the content of the state ownership policy, and the procedure for its development, adoption, and updating; (ii) the activity of the PECA as a coordinating unit for SOEs; (iii) the framework for the competitive procedure for selection of the board of directors and executive

[3] https://ec.europa.eu/info/business-economy-euro/euro-area/introducing-euro/adoption-fixed-euro-conversion-rate/erm-ii-eus-exchange-rate-mechanism_en

management; and (iv) the scope for public disclosure of financial and non-financial information by public enterprises.

ix. **SOE ownership in Bulgaria has been traditionally decentralized, with recent progress towards an advisory model since the 2019 PE Act.** Ownership rights are assigned to the Council of Ministries and line ministries, according to their sectoral responsibilities. In 2019, the PE Act introduced the PECA as the ownership coordination unit, whose main functions were defined as: (i) developing and monitoring the implementation of the state ownership policy; (ii) assisting the authorities with exercising ownership rights in formulating the general strategic objectives of the SOEs, as well as related key financial and non-financial performance indicators; (iii) monitoring SOEs´ performance; and (iv) elaborating a yearly SOE aggregate report.

x. **From 2019 onward, Bulgaria is following an advisory model with PECA performing the centralized oversight and coordination of SOEs reporting**, while the main policy functions and decision-making remain with line ministries. This change follows broader trends in evolving SOE ownership models among OECD member states that suggest a more centralized or centrally coordinated SOE ownership model brings benefits through a coordinated oversight and a coherent approach to the SOE ownership function.

xi. **In part due to the COVID-19 induced crisis and the political instability throughout 2021, the implementation of the PE Act has been slower than expected.** In particular, the PECA is currently understaffed and has limited capacity to fulfill the tasks assigned to it by the PE Act. The Agency lacks the necessary resources, in terms of both staff and funding, to carry out all its tasks. It foresees a total number of 65 positions, of which only 40 are currently filled. The Agency also needs to strengthen its role as a coordinating agency by providing corporate governance guidelines to line ministries, which are expected to continue playing a main role in SOE management.

xii. **The PE Act and subsequent regulations provide for a solid SOE performance monitoring system, but the processes required for such a system take time and coordination efforts that are yet to be put into practice**. The PECA is expected to compare actual performance to a set of pre-defined goals by tracking profitability, efficiency, and level of risks for the entire SOE portfolio. However, SOE performance control and monitoring practices are highly heterogeneous in practice. In fact, performance indicators vary significantly from one line ministry to another, and they are often ignored in favor of volume targets such as total production or turnover.

xiii. **The Implementing Rules of the PE Act establish a competitive procedure for the selection and appointment of SOE board members, which has already been applied to 37 large SOEs.** The procedure applies to fully or majority-owned SOEs and should be conducted on the basis of pre-determined professional and personal criteria for candidates. The PECA is responsible for appointing a nomination committee consisting of nine members— three members designated by the body exercising the rights of the State, three PECA employees, and three independent experts.

xiv. **Overall, the PE Act creates a framework that empowers boards to be independent and professional.** First of all, it foresees that a competitive nomination process will become the norm for all SOEs. The foundational elements related to this include guidelines on the responsibility of SOEs when it comes to nominating and establishing the composition of boards. The Law imposes on board members the duty to act in good faith and in the best interests of the company and its shareholders, giving the state representatives the same rights and obligations as other board members. The Law establishes some independence requirements, most notably barring politicians from being board members.

xv. **As foreseen in the PE Act, the first annual aggregate report on SOEs was published by the PECA in 2020.** The establishment of aggregate reporting is a significant development to improve the state's accountability as a shareholder, and the PE Act's provisions are aligned with international best practices in this domain. The PECA´s first aggregate report (2020) contained a section on the envisaged implementation of the PE Act and the role of the Agency in the process. It presented broadly the overall SOE portfolio, consisting of 311 companies, but focused on the activity of 46 large SOEs. Although it is a very important step forward in the public reporting on SOEs, the aggregate report could be substantially improved in the future by including more detail on the performance of the entire SOE portfolio, as well as the implementation of the state ownership policy, which is yet to be developed and approved.

xvi. **Only some SOEs prepare their financial reports according to International Financial Reporting Standards (IFRS)**. A total of 113 of the 311 SOEs owned by the central government reportedly prepare their financial reports according to IFRS accounting standards, in line with the Accountancy Act (2015) and the EU Directive 2013/34.

xvii. **In compliance with applicable EU and national laws and regulations, SOEs are subject to annual external independent audit.** Both the Accountancy Act and the PE Act specify that the external auditor needs to be appointed by the general meeting (at the recommendation of the audit committee for those companies with such a committee). The Independent Financial Audit Act regulates the execution of external audit. The requirements for external auditors are the same as for private companies, including those regarding rotation, independence, and nomination.

xviii. **SOEs are subject to external control by the National Audit Office (NAO).** The NAO, Bulgaria's supreme audit institution, is independent of the executive and reports to the National Assembly on the lawful and efficient execution of state budgets. In the area of SOEs, the subjects of its audit activities include public undertakings that are fully owned by the state, companies where state participation exceeds 50 percent of the equity, and entities whose debts are secured by government guarantees or collateralized by state assets. NAO audit reports are publicly available, and generally contain recommendations for the auditees (including SOEs) and a deadline for taking remedial actions.

xix. **The Bulgarian Public Procurement Act (2016) provides for non-discrimination in the awarding of public contracts, in line with EU rules, and establishes a number of procedural requirements to ensure fair competition among potential contractors, including SOEs.** The Act transposes EU Directives on public procurement in general, and also in the water, energy, transport, and postal services sectors, where SOEs are predominant. SOEs are only explicitly considered public contracting entities if they are incorporated as state enterprises or if they rely on state funding for over 50 percent of their revenues. SOEs acting as bidders for public procurement contracts do not benefit from any explicit exemptions from the rules established by the Law.

xx. **A sophisticated new e-Procurement platform was launched in 2019 and came into operation in stages during 2020.** Mandatory e-submission and e-invoicing were introduced from November 1, 2019, and starting from July 1, 2020, the provisions entered into force also for electronic tender evaluation, conclusion of a contract, ordering, invoicing, and payment. In 2020, the e-procurement system was further enhanced with four new modules: buyer's profile, dynamic purchase system, qualification system, and e-qualification, with ongoing upgrades continuing in 2021.

Options for Reform

xxi. **Recognizing the Government´s commitment to SOE reform, this iSOEF proposes recommendations to improve SOEs governance and performance, while limiting their fiscal costs and risks**. SOE reforms are multidimensional and require a holistic and integrated approach. As such, this iSOEF puts an emphasis on four main intertwined options for reform. Other relevant, complementary, reform options are explored and outlined in Chapter 5. The suggested reform options reflect careful consideration of recent legislative changes and analytical work on Bulgarian SOEs conducted by other institutions of the international community, in particular the OECD.

- **Accelerate implementation of the PE Act – prioritizing the development of state ownership policy and formulation of public service obligations for SOEs.** Considering the still-large presence of SOEs in the economy of Bulgaria and their impact on the budget, which increased markedly in 2020 for both current subsidies and equity injections/capital transfers, it is important that the government develops and disseminates a state ownership policy — as required by the PE Act — to define the rationale for state ownership based on explicit criteria. These priority actions would lay the ground for other important measures such as: allocation of subsidies in line with these objectives; incorporation of large state-owned limited liability enterprises into joint-stock companies; competitive selection of SOEs board members; hiring of professional independent board directors; development and launch of SOE performance monitoring and evaluation system.
- **Review and analyze the SOE portfolio.** Additional work needs to be done to further analyze the existing SOE portfolio. This would need to be based on the state ownership policy criteria (yet to be developed) to map out those SOEs that do not have a clear rationale for the continued ownership by the state, or those that do not perform their core activities. This exercise should cover the list of companies banned for privatization, appended to the Law on Privatisation and Post-Privatisation Control, which currently includes 174 companies. Some SOEs may be put forward for consolidation, optimization, closure, privatization or other forms of private sector participation, such as Public-Private Partnerships or concessions. The authorities may also consider listing minority stakes of SOEs on the Bulgarian Stock Exchange, which could bring tangible benefits for SOEs by inducing a corporate culture, strengthening corporate governance practices, and increasing their transparency, while also giving a boost to the local stock market.
- **Strengthen the PECA's capacity as the coordinating agency.** To strengthen SOE oversight and ensure a clear separation of SOE ownership and regulatory functions, the government should consider transferring the SOE oversight function from line ministries to the PECA. To fulfill the ambitious state-ownership coordinating role provided by the PE Act, the PECA needs to strengthen its capacity, acquire the economic, financial, and managerial resources to perform its tasks effectively. Developing relevant expertise and tools needed to monitor SOEs effectively will require technical assistance, training, and exchange of international best practices.
- **Further systematize SOEs' relationship with the budget to properly calculate and compensate them for their quasi-fiscal activities.** SOEs cannot become financially sustainable unless they are duly compensated —through direct on-budget transfers— for the actual cost of the public social obligations they deliver at below cost. The financial relationships between the Government and SOEs should be fully transparent, so that the magnitude of these transactions can be properly calculated, recorded, and disclosed. In cases where there is a public policy rationale for subsidizing goods and services provided by SOEs, such as for some SOEs in the transport and communication sectors, this should be stated explicitly in the budget, with these SOEs being fully reimbursed for the cost of providing such services through the subsidy.

1. Introduction

1. This report applies the new World Bank iSOEF, developed by the Equitable Growth, Finance and Institutions Practice Group, to comprehensively assess the Bulgarian SOE sector and its current reform trends. The report provides one of the first comprehensive applications of the new iSOEF in the Europe and Central Asia region. It outlines the SOE landscape in Bulgaria and then addresses two key aspects in detail: fiscal impacts and corporate governance and accountability mechanisms. Leveraging World Bank expertise, this multidimensional assessment looks at the interrelationships of the challenges and opportunities faced by Bulgaria's SOEs to propose holistic and sequenced recommendations to strengthen their governance and performance.

2. The main objective of this iSOEF is to inform the Government of Bulgaria, the World Bank, and other relevant stakeholders of the economic and fiscal impact of the SOE portfolio, and identify ways to strengthen the performance and corporate governance of SOEs. The primary audience of the iSOEF is the Government of Bulgaria, in particular the Ministry of Finance, the Ministry of Economy and Industry, and the PECA, as well as other relevant stakeholders such as the Ministry of Energy, the Ministry of Transport, Information Technology and Communications, the Ministry of Health, the Ministry of Regional Development and Public Works, and other ministries with an existing SOE portfolio.

1.1 Data Availability

3. A fairly comprehensive dataset, based on individual SOE annual financial reports, was used for most purposes during this assessment. Complete SOE financial information was available for the core period of analysis (2016-2019), as provided by the National Statistical Institute and drawn from the individual entity-level analysis of SOEs' financial reports, published on the United Portal for Request for Electronic Administrative Services of the Registry Agency of the Republic of Bulgaria.[4] Only partial and preliminary data was obtained for 2020, as the timeline for financial reports submission was delayed due to COVID-19. In particular, data on indirect fiscal support was missing for 2020. It is also worth noting that the fiscal support data used for this assessment does not include compensation received in 2020 from programs aimed at protecting employment during the COVID-19 crisis.[5]

1.2 Methodology

4. The report follows the modular structure of the iSOEF and its respective guidance notes.[6] The iSOEF's modular structure allows for flexible implementation of various modules depending on their relevance, existing analyses, and available resources. This iSOEF analyzes SOEs that are centrally owned at the national level; it does not cover municipal or other sub-national SOEs.

5. For the integrated assessment of the SOEs in Bulgaria, the World Bank has chosen to focus on the macro-fiscal impacts, corporate governance and accountability mechanisms. This assessment includes the overall landscape of the centrally-owned SOEs and provides analysis based on two iSOEF modules capturing key aspects of the SOE sector, namely: iSOEF Module 2 on fiscal impact, which offers an assessment of the main fiscal costs and risks stemming from the SOE sector in Bulgaria; and iSOEF Module 4 on corporate governance and accountability mechanisms.

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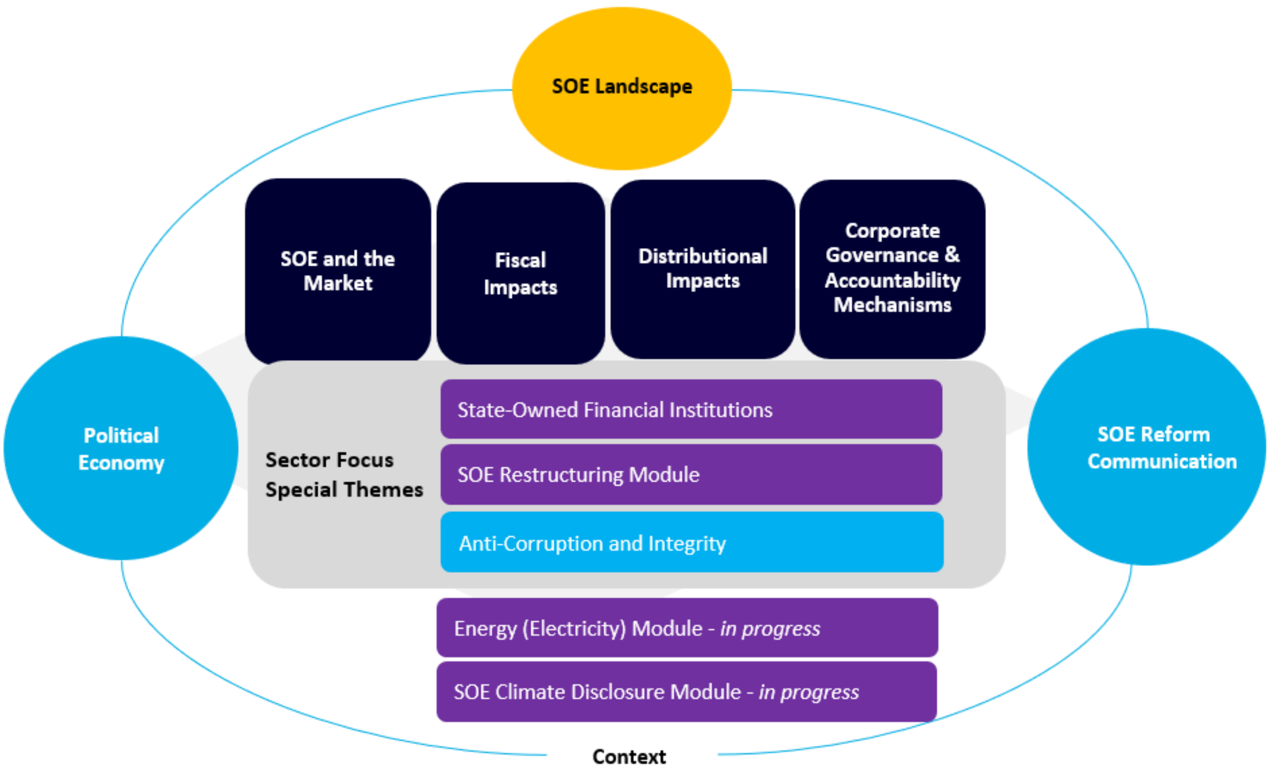
[4] https://portal.registryagency.bg

[5] SOEs took advantage of the 60/40 compensation scheme available for all companies. Three SOEs are among the largest recipients of financial support, which helped them to maintain staff employment and prevent massive lay-offs.

[6] The World Bank, Integrated State-Owned Enterprise Framework (iSOEF), Washington D.C, June 2019.

Figure 1: Integrated SOE Framework (iSOEF)



1.3 Structure of the Report

6. The report is structured around the following 5 Chapters:

- Introduction (this Chapter).
- Landscape of the SOE Sector in Bulgaria (Chapter 2).
- iSOEF Module 2: Assessment of the SOE Sector Fiscal Costs and Risks (Chapter 3).
- iSOEF Module 4: Corporate Governance and Accountability Mechanisms (Chapter 4).
- Options for Reform (Chapter 5).

2 The SOE Landscape

2.1 Background and Recent Developments in the SOE Sector

7. The long and uneven transformation of SOEs in Bulgaria began in 1990, after the initiation of transition towards a market economy. Measures for decentralization have been undertaken with the aim of demolishing large state-owned monopoly associations. Several SOEs became independent business units, which after the adoption of the Commercial Act in 1991 began to register as commercial companies. However, by the end of 1996, the SOE sector still comprised around 10,000 SOEs, and significant challenges remained.

8. A strong privatization process took place after a deep financial crisis that ended in 1997. Nearly 90 percent of total assets subject to privatization had been privatized by the end of 2004. The Bulgarian model of privatization combined mass and cash privatization, and was applied to more than 5,000 companies. However, the stock exchange was not used frequently as a relevant intermediary for strengthening transparency and good governance during SOE mass privatizations.

9. Over the last sixteen years the privatization process almost stopped. The main reasons for this were the lack of attractive SOEs for privatization and the existence of a long list of SOEs "forbidden for privatization" by the government, integrated in the Law on Privatisation and Post-Privatisation Control. At present, the said list contains 174 SOEs with about half of these being either Water and Sewerage companies (27) or hospitals/medical establishments (69). As a result, only a few partial privatizations took place, and real estate property of some SOEs was sold to the private sector. Although privatization lost its pace, further transformation of SOEs into commercial companies continued. Since 2007, for example, all state-owned hospital facilities have been transformed into commercial companies.

10. Following the country's accession to the EU in 2007, the government took steps to improve the corporate governance and performance management of remaining SOEs, although progress was limited. As part of these efforts, a dedicated unit was established within the Ministry of Finance for monitoring and control of the financial performance of SOEs, aimed to oversee the 114 biggest SOEs. These SOEs were required to submit quarterly and annual financial reports to the Ministry of Finance, which was in turn responsible for their publication on its official website. Progress was limited. As reported by the OECD database, Bulgaria obtained in 2013 the lowest score on the indicator "Management of state-owned enterprises", which characterized the degree of isolation of SOEs from the market, weaknesses in financial discipline, and political interference in their management.

11. Since 2019, the government has launched an ambitious reform program, including approval of the PE Act, to better align SOE practices with international standards. The reform was based on recommendations received from the European Commission, the IMF, and the OECD. The PE Act was adopted in 2019, with technical assistance from the OECD, laying out the foundations of modern ownership mechanisms and management of SOEs. The PE Act established the PECA as the central coordinating entity responsible for SOE oversight and set the foundation for effective and autonomous SOE boards.

12. In 2020, the government also promoted the expansion of state participation in selected markets. The COVID-19 pandemic called for fiscal measures in support of local businesses and the state-owned Bulgarian Development Bank was used as one of the main tools by the government to provide liquid support to local businesses and individuals via commercial banks. For that purpose, the government increased the capital of the Bulgarian Development Bank by BGN 700 million in 2020. The government also invested further in the water supply and sewerage sector by creating Bulgarian ViK Holding. The total amount of state capital support for the above-mentioned initiatives and a few other equity investments by the government reached BGN 2.016 billion (1.7 percent of 2020 GDP), and was covered by the central government budget. The resulting increase in public expenditure — including those for equity investment — led to additional borrowing and increase of public debt in 2020.

13. Given the considerable challenges and the adverse external factors stemming from the COVID-19 pandemic, the pace of SOE corporate governance reform has been slower than expected. The implementation of the main provisions of the PE Act has been slow, partly due to the pandemic, and partly due to the limited capacity of the PECA. The key pending issues can be summarized as follows: (i) lack of policy on state participation in public enterprises (required by art. 10 of the PE Act)[7]; (ii) no clear definition of the public sector obligations of SOEs, which would allow their realistic costing; (iii) lack of analysis of the missions of all statutory SOEs, which would provide the rationale for their operation under state ownership; (iv) selection of new board members for all SOEs not yet in line with the new law's provisions; and (v) preparation of uniform templates for SOE reporting not yet established. In 2021, the caretaker government raised a number of questions regarding the accountability of SOEs, including their contracting of other companies, and the transparency in their management. Procedures were initiated for selection of new executive directors of some SOEs, and the selection of independent board members. These changes are expected to lead to greater accountability of the SOE management and further professionalization of boards.

2.2 The SOE Portfolio

14. The SOE sector continues to play a significant role in the Bulgarian economy. In 2019, the central government owned 311 SOEs, compared to 350 SOEs reported in 2016. SOEs' total assets reached 37.4 percent of GDP, and their capital reached BGN 22.5 billion in 2019. 133,961 people were employed by SOEs, which represented 4.1 percent of total employment, and the contribution of SOEs to the country´s GVA was 6.0 percent in 2019,[8] a slight increase over the 5.4 percent contribution registered in 2016.

15. In comparison to peer countries, the footprint of Bulgaria's SOEs ranks close to middle of the regional distribution.[9] For SOEs' share of total employment, the OECD (2017)[10] as quoted by the IMF (2019), finds that that the average for Central, Eastern and South Eastern Europe (CESEE) approximates 3.5 percent of total employment, placing Bulgaria only marginally above the average. The number of SOEs stands at some 127 SOEs per million people based on the IMF's estimate of 900 SOEs in Bulgaria (2016), ranking the country closer to the lower end, with Latvia and Lithuania showing the lowest values in the region with their less-than-50 SOEs per million. SOEs' contribution to Bulgaria's total value added is, again, close to the average in the region with just below 10 percent (2016), and similar to Slovenia, Romania,

[7] According to information provided by the MOF during the consultation of this note, the Public Enterprises and Control Agency (PECA) has requested from all line ministries information on the preparation of a draft Policy on State Participation in Public Enterprises; such a draft Policy has been prepared and agreed with OECD, in the framework of the jointly implemented OECD Support Project in the area of state-owned enterprise governance aimed to support the state reform in the SOE sector of Bulgaria, and is to undergo a relevant procedure in view of its approval by the Council of Ministers. In addition, the elaboration of analyses of the state-owned enterprises, established under special laws, that are aimed to clarify the nature of their activities, was started by a Council of Ministers' Decision on March 18, 2021. Under this decision, ministers exercising the powers of the state in state-owned enterprises had to prepare a functional analysis of each SOE in their portfolio and table proposals for transformation of the respective enterprises. In the summer of 2021, the MOF initiated a series of meetings with representatives of ministries in charge of state-owned enterprises, in order to speed up the process of analyses' preparation. Based on the prepared functional analyses, action has been taken towards transformation of some of the state-owned enterprises, whereas with regard to others the motives, set out by their line ministers for preserving their legal and organizational form, have been taken into account.

[8] As mentioned, in 2020 the state-owned sector further expanded, due to equity investments of the central government in some SOEs.

[9] IMF, Reassessing the Role of State-Owned Enterprises in Central, Eastern and Southeastern Europe, 2019, #11/19

[10] OECD, The Size and Sectoral Distribution of State-Owned Enterprises, 2017, Paris: OECD Publishing

Latvia, Lithuania and Hungary where the SOEs contribution fluctuates between 5 and 10 percent of the economy's value added. Finally, a regional comparison in terms of SOE asset size shows that Bulgaria ranks in the lower half of the CESEE distribution with SOE assets standing below 40 percent of GDP, or the 6th lowest rank out of 16 economies for which data was available. Noteworthy, the IMF (2019) notes that in the CESEE region, SOEs today account for a smaller share of economic activity than a decade earlier and for a smaller share of employment than they did in the mid-2000s. Bulgaria is no exception to this trend.

16. **Similarly to most SOE sectors in the region, the SOE portfolio in Bulgaria covers a range of diverse economic sectors but is highly concentrated in natural monopoly sectors such as energy and transport.** As of end 2019, the energy sector comprised 54.1 percent of total SOE assets, followed by the transport sector, which contributed with another 21 percent. The shares of the healthcare, water supply and sewerage, and special purpose manufacturing (military) sectors were quite small in this year — less than 3 percent each, see Table 1. The assets of "other sectors" gradually expanded during the 2016-2019 period.

17. **The SOE portfolio includes several of the largest companies in the country.** As of end-2019, the total assets of the top three largest SOEs — Bulgarian Energy Holding, the National Electricity Company, and the National Railway Infrastructure Company — comprised 35.2 percent of total SOE assets. Four Bulgarian SOEs, all operating in the energy sector, were featured in the Coface ranking of the top 500 Central and Eastern European companies, according to their turnover in 2020: Bulgarian Energy Holding was in 35th position, while the National Electricity Company, the Kozloduy nuclear power plant, and Bulgargas (gas import and transportation company) were among the largest 400 companies.[11] Four SOEs were ranked among the top 100 Bulgarian companies according to their net revenues in 2019 by the Bulgarian Chamber of Commerce and Industry: Bulgargas, the Kozloduy nuclear power plant, Maritza Iztok Mines (a coal mining company), and Bulgartransgas.[12]

Table 1: Total Assets of SOEs by Sectors (million BGN)

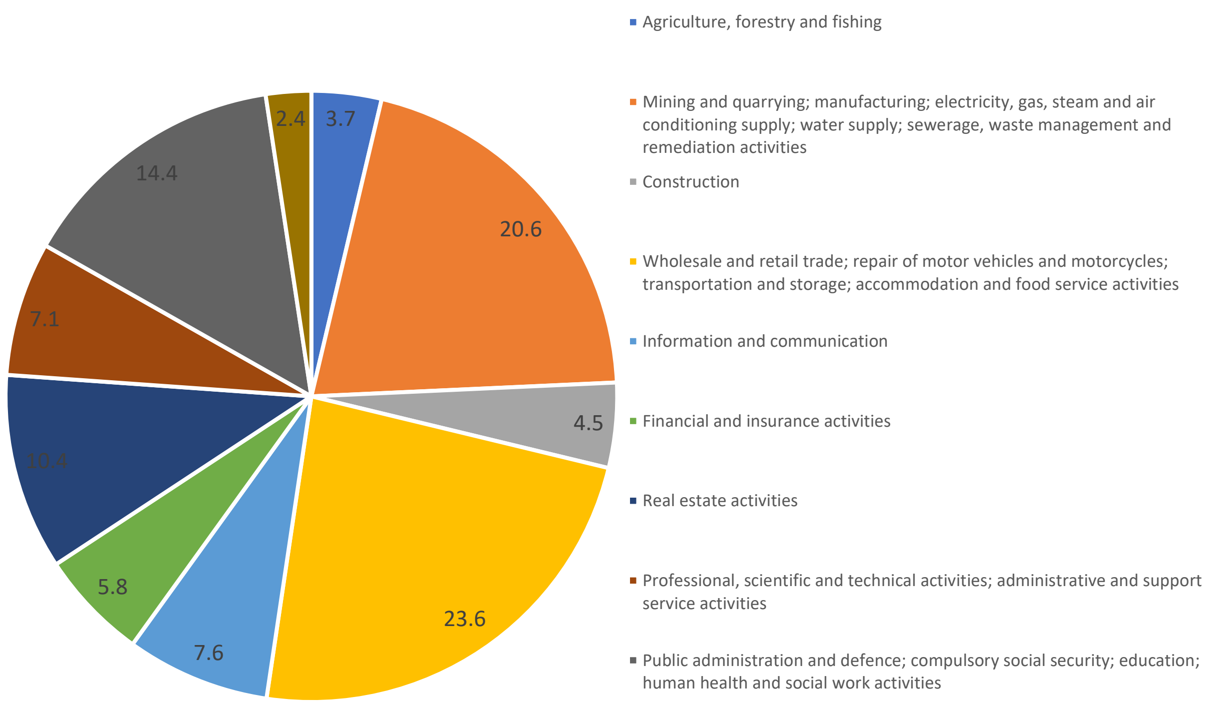
	2016	2017	2018	2019	% of total assets (2019)
Energy	23,223.44	23,369.25	23,123.56	24,353.13	**54.1**
Transport	7,942.77	7,988.96	9,264.09	9,470.63	**21.0**
Healthcare	1,145.14	1,144.59	1,203.51	1,219.72	**2.7**
Special purpose manufacturing	842.71	599.20	586.72	637.86	**1.4**
Water supply and sewerage	470.20	462.44	472.79	484.36	**1.1**
Other	4,855.60	6,403.34	7,944.07	8,832.46	**19.6**
TOTAL	**38,479.86**	**39,967.78**	**42,594.73**	**44,998.16**	**100.0**

Source: SOE financial statements (https://portal.registryagency.bg).

18. **The contribution of SOEs to the country´s GVA varies across sectors**. The largest contribution to GVA in 2019 was made by SOEs operating in the energy sector (23.5 percent of the total SOE contribution to GVA); transport (21.9 percent); finance and insurance (15.9 percent); and healthcare (13.1 percent).

[11] http://img.go.coface.com/Web/COFACE/%7B459d4721-e8f8-4649-9077-e3ad41e18ebe%7D_Coface_CEE_Top_500_Ranking_2020_FINAL.pdf
[12] https://www.bcci.bg/top-100-bg.html

Figure 2: Distribution (relative share) of GVA, generated by SOEs by sectors, 2019



Source: National Statistical Institute

19. **The state fully owned sixteen financial sector enterprises in 2019.** Their capital was relatively stable during 2017-2019. In 2019 it reached BGN 785.9 million, with the bulk of it being the capital of the Bulgarian Development Bank (Table 2). The state-owned financial companies provide a broad range of financial services, including direct lending, bridge financing, guarantees, trade finance, etc. In 2019, the liabilities of financial SOEs represented 2.01 percent of GDP.

Table 2: State owned financial sector entities, share capital (thousand BGN)

Name	2017	2018	2019	2020
Bulgarian Development Bank*	601,774	601,774	601,774	1,301,774
Fund for Local Authorities and Governments	90,000	90,000	90,000	90,000
Fund for Sustainable Urban Development	5,000	5,000	5,000	5,000
National Guarantee Fund	80,000	80,000	80,000	80,000
Fund Manager of Financial instruments	1,224	1,442	1,436	1,297
Micro Financing Institution JOBS	7,643	7,643	7,643	7,643

Source: SOE financial statements (https://portal.registryagency.bg).
Note: * The Bulgarian Development Bank became fully owned by the state in 2021.

20. **In 2020, the Bulgarian government substantially increased its investments in the financial sector.** The state provided large capital support —BGN 1.84 billion (1.5 percent of GDP)— to two financial sector SOEs. In particular, the state increased the capital of the state-owned Bulgarian Development Bank by injecting BGN 700 million as one of the COVID-19-related measures to support businesses and

households. An additional BGN 140 million of equity support was provided by the state budget to the Bulgarian Development Bank in order to acquire 18.35 percent of the shares of First Investment Bank. This followed a European Central Bank asset quality review and stress test of some Bulgarian banks prior to Exchange Rate Mechanism II entry, which identified First Investment Bank as one of two local banks with a capital shortfall and recommended a capital increase, carried out with the help of the above-mentioned transaction via the Bulgarian Development Bank.

2.3 Performance of the SOE Sector

21. This section provides analysis of the financial, operational, and service delivery performance of the SOE sector in Bulgaria. The financial performance analysis is based on data provided by the National Statistical Institute and annual financial reports of all SOEs for the period 2016-2019, complemented in some cases by preliminary 2020 data from SOE annual financial reports.

Financial Performance

22. SOEs´ net profits are highly concentrated in a few large companies. The total net profit of profit-making SOEs peaked at BGN 947.5 million in 2019. The top ten enterprises — ranked by their profits — contributed 86 percent of this result (Table 3). There was a substantial profit increase from the Kozloduy nuclear power plant, which boosted its profits over 100 times in recent years as a result of the energy market liberalization. Overall profits of the energy sector during 2016-2019 — despite the inclusion of some loss-making enterprises — compensated for losses made in other sectors, such as transport which had persistent losses during these years.

23. There are several reasons for fluctuations in the profits of the top profit-making SOEs in recent years. SOEs in the energy sector have seen increased profits as a result of higher market prices for power to businesses, compared to the regulated electricity prices for households. For SOEs in the defense industry (VMZ and Kintex), the fluctuation of their profit is influenced by external demand.

Table 3: Profit, Top 10 Profit-Making SOEs* (2016-2020, BGN thousand)

SOE name	Sector	2016	2017	2018	2019	2020
Bulgarian Energy Holding	Energy	124,603	105,430	364,165	584,225	157,201
Kozloduy nuclear power plant	Energy	2,677	118,346	163,546	324,892	276,273
Bulgartransgas	Energy	66,342	61,416	47,138	104,654	72,478
Bulgarian Development Bank	Finance	42,920	20,680	39,567	40,168	N/A
Bulgargas	Energy	36,683	9,466	-31,978	34,429	39,657
Electricity System Operator	Energy	73,676	28,491	32,238	24,045	50,736
Bulgarian Air Traffic Services Authority	Transport	18,636	27,745	30,884	18,252	2,552
Sofia Tech Park	Services	-2,150	-6,269	-3 345	13,838	-31
Sofia Airport	Transport	-13,828	11,407	12,635	12,889	-1,662
Kintex	Defense	79,803	16,485	21,624	12,273	20,611

Source: SOE financial statements (https://portal.registryagency.bg). Data for 2020 is preliminary.
* Sorted by 2019 net profits.

24. During 2016-2019, loss-making SOEs were mainly concentrated in the energy and transport sectors. The main reasons behind the losses of SOEs differ but are usually related to sector regulations, underestimation of public service obligations (where such are mandated to an SOE) and companies' management lacking linkages between performance and management remuneration. In such cases, a purely administrative approach to running a company does not offer incentives to SOE management for improving its financial performance (a more detailed analysis of governance gaps is presented in Chapter 4). The top loss-making company in 2019 —as in previous years— was Maritsa East-2 thermal power plant, due the heavy toll of costly CO2 emissions on its income statement, followed by the chronically loss-making National Railway Infrastructure Company (Table 4). With regard to the latter, long-standing structural issues impede its ability to turn to profits. These include incomplete restructuring, insufficient current subsidies and capital transfers from the state budget, public service obligations that impose low fares for access to the railway infrastructure as compared to the company's costs, unresolved corporate governance issues, and other. The COVID-19 pandemic deteriorated further these structural issues and greatly impacted most of the top ten loss-making SOEs, as these operate in sectors that were heavily hit by COVID-19 restrictions, such as railways (Box 1).

Table 4: Loss, Top 10 Loss-Making SOEs* (2016-2020, BGN thousand)

SOE Name	Sector	2016	2017	2018	2019	2020
Maritsa East-2 Thermal Power Plant	Energy	-98,525	-163,520	-331,894	-169,421	-330,187
National Railway Infrastructure Company	Transport	-28,285	-50,686	-51,707	-23,001	-75,229
Bulgarian State Railways Holding	Transport	-31,349	-16,574	-9,376	-16,817	-12,880
Project Company Oil Pipeline Burgas-Alexandroupolis	Energy	-71	-69	-124	-16,200	N/A
National Palace of Culture - Congress Center Sofia	Services	-8,613	-11,556	-12,357	-11,050	-9,238
General Directorate of Construction and Recovery	Constructi on	3,743	3,846	2,481	-8,967	-11,019
BDZ Cargo	Transport	-433	-6,203	-277	-7,604	N/A
Bulgarian Toto (Bulgarian Sports Totalizator)	Other (Gambling)	-7,794	-10,678	-10,210	-7,139	-7,561
Port Infrastructure	Transport	-9,006	4,448	-12,744	-6,656	-11,281
Aleksandrovska University Multi-Profile Hospital	Health	-4,921	-6,562	-6,386	-6,097	-2,537

Source: SOE financial statements (https://portal.registryagency.bg). Data for 2020 is preliminary.
* Sorted by 2019 net losses.

25. In the 2016-2019 period, the dynamics of most key financial ratios of SOEs were largely positive. SOEs improved their performance on the key financial ratios such as return on equity, return on assets, return on sales, net income per employee, and leverage ratios by 2019, when compared to 2016. SOEs have also improved their performance in terms of total liquidity and labor productivity (Table 5). Liquidity ratios remain healthy at above 100 percent across all major sectors. Despite this overall improvement from 2016 to 2019, SOEs showed deterioration of the assets' turnover ratio during the same period. This would indicate that the positive developments on the key financial indicators can be explained by external rather than internal factors, namely the overall upward trend of the economy after the global financial crisis and prior to the breakout of the pandemic.

26. Even though SOE key financial ratios showed an improvement over the period of analysis, their individual levels varied significantly across sectors. For example, during the entire period of analysis the return on assets remained below 3 percent on a portfolio basis, while differentiating among sectors and individual SOEs (Tables 5 and 6). Table 6 shows average profitability ratios for SOEs operating in major economic sectors – energy sector SOEs showed the highest improvement in profitability due to market liberalization, while transport SOEs remained loss making during the entire period analyzed. Water sector SOEs were operating at a profit before 2019, when several largest water and sewerage companies across the country posted significant losses. Such results may be associated with the tendency of the government to keep regulated prices for public services below market prices, which weakens SOEs financially.

Table 5: Key Financial Ratios of SOEs, 2016-2019

Financial ratio	Unit	2016	2017	2018	2019
Return on equity	Percent	1.43	2.62	2.47	5.66
Return on assets	Percent	0.79	1.41	1.32	2.96
Return on sales	Percent	2.74	4.64	4.50	11.05
Leverage	Percent	35.94	47.62	54.54	52.19
Assets turnover	Ratio	0.29	0.30	0.29	0.27
Total liquidity	Percent	198.5	232.6	241.8	204.1
Labor productivity*	BGN thousand	76.84	84.54	85.12	83.32
Staff return**	BGN thousand	2.11	3.92	3.83	9.21

*Labor productivity – measured by dividing turnover by the average number of staff.

** Staff return is measured by dividing net income by the average number of staff.

Source: National Statistical Institute and World Bank calculations.

Table 6: Selected Financial Ratios of SOEs per Sector, 2017-2019

Financial ratio	Unit	2017	2018	2019
Return on equity (energy SOEs)	Percent	1.25	1.26	6.71
Return on equity (transport SOEs)	Percent	-1.02	-0.71	-0.89
Return on equity (water SOEs)	Percent	11.81	11.31	-2.98
Return on assets (energy SOEs)	Percent	0.75	0.73	3.73
Return on assets (transport SOEs)	Percent	-0.41	-0.26	-0.32
Return on assets (water SOEs)	Percent	2.30	2.34	-0.63
Leverage (energy SOEs)	Percent	68.13	73.57	82.96
Leverage (transport SOEs)	Percent	129.41	51.00	55.22
Leverage (water SOEs)	Percent	394.42	370.03	357.85
Total liquidity (energy SOEs)	Percent	124.01	145.26	136.90
Total liquidity (transport SOEs)	Percent	82.76	153.62	130.94
Total liquidity (water SOEs)	Percent	143.57	124.50	118.37

Source: National Statistical Institute and World Bank calculations.

27. **Deteriorating financial performance of some of the largest SOEs has led to a significant accumulation of debt**. While total liabilities of SOEs slightly decreased from 13.07 percent in 2016 to 10.53 percent of GDP in 2019, they remained significant at BGN 12,611 million. The ratio between SOE liabilities and their own capital in 2019 was 54 percent on a portfolio basis, with some SOEs significantly increasing their liabilities during 2020 (Table 7 and Box 1). The top ten non-financial SOEs—ranked by their total liabilities— accounted for 68.9 percent of total SOE liabilities. The largest accumulated debt was in the energy sector, followed by the transport sector.

Table 7: Top 10 SOEs with highest total liabilities (2016-2020, in BGN thousand)*

SOE Name	2016	2017	2018	2019	2020	Leverage
National Electricity Company	4,012,547	4,067,357	4,058,805	4,026,588	4,050,725	327%
Bulgartransgas	170,480	231,728	323,426	732,443	2,571,641	15%
Avtomagistrali	4,726	11,815	34,505	481,286	1,469,226	529%
Maritsa East-2 thermal power plant	855,987	1,023,084	1,288,982	1,569,354	1,324,129	1.474%
Kozloduy nuclear power plant	733,619	676,004	650,170	705,821	714,899	26%
Electricity System Operator	457,011	463,967	543,232	583,714	672,340	23%
Installations	2,437	3,555	115,272	466,106	537,041	Neg Equity
Bulgarian Posts	176,095	221,243	265,687	316,122	190,992	724%
Vazov Machine Works	152,693	92,213	171,156	164,640	170,170	54%
Sofia Airport	194,579	95,046	143,909	192,889	166,201	572%

Source: SOE financial statements (https://portal.registryagency.bg). Data for 2020 is preliminary.
* Sorted by 2020 liabilities, which include all debt: borrowings and trade accounts payable.

Box 1: SOE Financial Performance amidst the COVID-19 crisis*

- The COVID-19 crisis had a strong impact on SOEs' net profit. According to preliminary data, the total net profit of the SOE portfolio dropped to BGN 204.4 million in 2020 — a 79 percent decrease as compared to 2019. The impact of the crisis varied across different sectors and enterprises. For example, Sofia Airport, the Bulgaria Air Traffic Services Authority, and Sofia Tech Park were hit hard by COVID-19-related restrictions.

- Most of the top ten loss-making SOEs operate in sectors that were heavily hit by COVID-19 restrictions, such as energy and transport. The top loss-making company in 2020 —as in previous years— was Maritsa East-2 thermal power plant. Its loss reached a record high of BGN 330.2 million. Weak demand for electricity in 2020, CO2 emission prices together with low competitiveness led to a reduction in the company's activity to only a quarter of its full capacity and contributed to its significant negative result. The National Railway Infrastructure Company increased its losses from BGN 23 million (2019) to BGN 75.2 million (2020), while Port Infrastructure doubled its losses in 2020 as compared to 2019, reaching BGN 11.2 million.

- In 2020, SOE sector debt increased — Bulgartransgaz, Avtomagistrali, the National Railway Infrastructure Company, and Port Infrastructure increased their liabilities the most. This was associated with lower demand during the lockdown imposed in response to the COVID-19 pandemic.

Source: SOE financial statements (https://portal.registryagency.bg).

* Based on preliminary 2020 data.

Operational performance

28. The operating ratio shows the strong polarization of the biggest SOEs. By their operating ratio, the largest SOEs can be divided into two major groups. The first group includes six SOEs with an operating ratio below 1. These SOEs produced more operating revenue than expenditure and were profitable at the operational level. Apart from the Electricity System Operator, other SOEs from the first group had operational expenses varied between 35-68 percent of their revenue. The second group consists of four SOEs with an operating ratio above 1. These SOEs generated more expenses than revenue and were loss-making at the operational level. Among them, the National Railway Infrastructure Company was in the most difficult position (Table 8).

Table 8: Operating Ratio (operational expenditures/operational revenue) of top-10 SOEs*

SOE	2017	2018	2019
Bulgarian Energy Holding	0.55	0.46	0.43
National Electricity Company	1.11	1.42	1.80
National Railway Infrastructure Company	3.62	4.84	4.74
Kozloduy nuclear power plant	0.67	0.63	0.57
Bulgartransgas	0.55	0.41	0.68
Bulgarian Development Bank	0.35	0.51	0.57
Electricity System Operator	0.90	0.93	0.78
Maritsa East-2 thermal power plant	1.14	1.42	1.14
Bulgarian State Railway Holding	1.79	1.77	1.31
Port Infrastructure	0.42	0.45	0.44

Source: SOE financial statements (https://portal.registryagency.bg), and World Bank staff calculations.
Note: *Sorted by total assets.

29. Recent IMF analysis of SOEs' role in Central European countries[13] indicates that, on average, SOEs demonstrate lower profitability per employee than their private sector peers. On average, SOEs generate less revenue per employee than their private counterparts, as measured by the percentage of SOEs that were above the private firm median across all years and sectors. As the IMF analysis shows, this proportion was below 50 percent in all countries except Estonia with just some 30 percent of Bulgaria's SOEs being more profitable than private peers. For comparison, in most countries in the sample, the share is below 40 percent, and in a few cases nearly all of the SOEs perform worse than the median of their private sector counterparts (for example Ukraine, where only 10 percent are above the private sector median, and Poland with less than 20 percent).

30. SOEs also incur significantly higher costs per employee, as shown in the same IMF study. The share of wage costs in total operating revenue is significantly higher in SOEs than in private firms. On this indicator, Bulgaria performs particularly poorly, as it ranks at the 3rd worst position in the region (13 countries included in the sample) with close to 90 percent of SOEs being above the private sector median. As a result, SOEs are significantly less profitable than private sector peers, with Bulgaria's median return on equity for the SOEs sector being particularly low at less than 25 percent of the median for private sector peers. The analysis identifies the misallocation of resources and particularly labor as the main underlying factor contributing to the poor performance of SOEs, finding that the larger the SOE sector in a country is, the larger the misallocation.

[13] IMF, Reassessing the Role of State-Owned Enterprises in Central, Eastern, and Southeastern Europe (2019)

Service Delivery Performance

31. The authorities do not conduct surveys on the quality of services provided by SOEs. While incidental studies have been carried out by academia or non-governmental organizations, in most cases they assess the quality of services of the entire sector and not specifically the services provided by SOEs. The below benchmarking in service delivery is based on Bulgaria's performance in sectors with considerable SOE presence against service delivery indicators collected by reputable international organizations. Many of the findings below are drawn from the 2021 Bulgaria SCD Update, where they are described in greater detail.

32. Bulgaria´s energy sector is the largest segment in the country's SOE portfolio providing citizens with universal access to electricity. Six out of the top-ten SOEs in Bulgaria operate in the energy sector, with their total assets reaching BGN 22.5 billion (2019).[14] There is universal access to electricity across the country, placing Bulgaria in the 55th position out of 149 countries on electricity quality supply.[15] Bulgaria is currently implementing the final stages of energy market liberalization, and recently amended its Energy Act, planning to fully phase out regulated electricity prices by the end of 2025. Electricity tariffs are essentially aligned with the OECD average - USD 12.2 per kWh in Bulgaria compared to USD 12.4 per kWh in OECD (2019). During 2021, the residential sector still had access to regulated prices, after non-residential consumers were fully transitioned to the competitive retail market in October 2020.

33. Despite recent improvements and energy sector reforms, energy poverty remains high, generating fiscal costs and contingent liabilities from unpaid arrears. Bulgaria continues to report one of the highest levels of energy poverty in the EU, consistently ranking above the EU-27 average. In 2018, half of households with median income below 60 percent of the national average were not able to keep their home adequately warm,[16] and 47 percent had fallen into arrears on their utility bills.[17] During 2018-2019, households' expenditure on electricity alone constituted around 13 percent,[18] well above EU average of 8.3 percent. The main contributing factors to the energy poverty in Bulgaria are low-income levels and energy inefficiency in the housing stock. Several social support measures are presently in place to protect low-income households from high energy costs, but coverage remains insufficient. The social support measures will continue to be funded from the budget and may increase in scope and amount when regulated prices for households are phased out in 2025, which may lead to greater fiscal costs in the future. Moreover, utility arrears by households also pose risks to the budget as they continue accumulating on energy SOEs' balance sheets.

34. Bulgaria's second largest SOE segment is in the transport sector, covering roads, railways, and ports, all able to contribute to better connectivity and logistics and reduce regional disparities. Infrastructure SOEs are among the largest companies in Bulgaria. Four entities operate total assets each in excess of BGN 1 billion: National Railway Infrastructure Company (BGN 4.3 billion, 2019), Bulgarian State Railways Holding (BGN 1.4 billion, 2019), Port Infrastructure (BGN 1.2 billion, 2019), and Bulgarian State Railways - Passenger Services (BGN 1 billion, 2019). Despite significant investment in infrastructure

[14] The six largest energy sector SOEs include: Bulgarian Energy Holding, Bulgartransgas, Kozloduy nuclear power plant, Electricity System Operator, Maritsa East-2 thermal power plant, and National Electricity Company.

[15] World Economic Forum: Global Competitiveness Report (2019) https://www3.weforum.org/docs/WEF_TheGlobalCompetitivenessReport2019.pdf

[16] European Commission (2020): Energy prices and costs in Europe https://ec.europa.eu/energy/sites/default/files/documents/swd2020_951_-_1_en_autre_document_travail_service_part3_v1.pdf

[17] World Bank. Bulgaria SCD Update. Washington D.C., 2021

[18] European Commission (2020): European Union Statistics on Income and Living Conditions https://ec.europa.eu/energy/sites/default/files/documents/swd2020_951_-_1_en_autre_document_travail_service_part3_v1.pdf

services over the past two decades, bolstered by EU funds, further investments are still needed to improve the quality of roads, rehabilitate the rail network, and upgrade the rolling stock and intermodal transshipment platforms to enable better integration with the road and logistics infrastructure. Sub-optimal quality of logistic-related services prevents better connectivity, and Bulgaria still has room to improve its logistic infrastructure - the quality of trade and transport infrastructure received a score of 2.76 out of 5 in 2018, ranking lower than the EU average score of 3.46.[19] Better integration between the road and rail networks with intermodal transshipment platforms could improve logistics, connectivity, and further boost trade.[20]

35. Reducing Bulgaria's high carbon footprint and moving towards more sustainable energy generation constitutes a major challenge for both energy and transport services. Bulgaria ranks 36th in carbon intensity in the world[21] and is likely to struggle to meet its commitment to contribute to the EU-27 ambition for reduction of greenhouse gas emissions by 55 percent against 1990 levels in 2030. In energy services, there is a need to improve energy efficiencies and encourage renewable energy. For the transport sector, decarbonization of transport (both in terms of shifting from road to rail services and promoting the overall greening of transport) is one of the pressing needs to transition to a more sustainable development model and provide better and more environmentally friendly services.[22]

36. The quality of water services is sub-optimal and access to water remains uneven across the country. One of the strategic goals of the government is to guarantee quality water supply and sewerage services, while ensuring an acceptable price of the public services provided to consumers. Access to water remains uneven among the regions, with only 64 percent of households having access to safely managed drinking water.[23] The water sector consistently receives a high volume of citizens' complaints - 2019 was the year of the highest concentration of citizens' complaints received by the Energy and Water Regulatory Commission: 18 percent were received for disrupted water supply, with additional 1-2 percent of complaints related to other issues, such as high or low pressure, or drinking water quality.[24]

37. To address the issue of poor water services, the government established a new SOE. In January 2020, the government invested BGN 1 billion in the newly created Bulgarian VIK Holding. The company's goal is the long-term provision of a sustainable model for financing the water supply and sewerage sector. Bulgarian VIK Holding is the principal of all companies with state participation within the water supply and sewerage sector. While it is too early yet to see results, the mandate, activities, and performance of this SOE need to be closely monitored by the government to achieve the expected value-for-money and improve the quality and coverage of public water and sewerage services.

[19] Word Bank Logistics Performance Index, available at: https://data.worldbank.org/indicator/LP.LPI.INFR.XQ
[20] World Bank. Bulgaria SCD Update. Washington D.C., 2021
[21] Captured using CO2 per unit of GDP. World Development Indicators, excluding micro-island states. Including micro-islands, Bulgaria has the 42nd highest CO2 intensity.
[22] World Bank. Bulgaria SCD Update. Washington D.C., 2021
[23] World Bank. Bulgaria SCD Update. Washington D.C., 2021
[24] Energy and Water Regulatory Commission (2020)

3. iSOEF Module 2: Assessment of SOE Sector Fiscal Costs and Risks

38. Maintaining the currency board arrangement in the last twenty-five years has created fiscal discipline and set the ground for prudent fiscal policy, including during and after the global financial crisis and the COVID-19-induced crisis. Even if public debt increased to 24.7 percent of GDP in 2020, against 20.0 percent a year earlier (Eurostat), its level remains low by EU standards. The general government deficit reached 4.0 percent of GDP in 2020. Large equity investments by the government in SOEs in 2020 contributed to the increase of the fiscal deficit. Bulgaria's ambition to join the euro area, effective from Jan 1st, 2024, further limits the fiscal space, since it requires the general government deficit to be kept below 3 percent of GDP.

3.1 Fiscal Costs of SOEs

39. This section looks at the fiscal costs of SOEs (in net terms) by quantifying transfers between the state (central government budget) and SOEs. Despite the favorable economic environment in the four years prior to the COVID-19 pandemic, the central government continued supporting SOEs in a variety of forms. Direct support from the state to SOEs includes subsidies, capital transfers,[25] and equity investment to both financial and non-financial SOEs. Subsidies for current activities, including those for specific public policies, and capital transfers are approved annually with the state budget law and are typically processed in accordance with specific provisions in sectoral laws. The government may decide to allocate additional (unbudgeted) direct support to SOEs during the year. Public policies or public service obligations may include ensuring universal access to a public service, such as the one provided by Bulgarian Posts and BDZ-Passenger Transport or fulfillment of specific state-mandated obligations by a dedicated law, such as the Terem arms producer's obligation to maintain a certain amount of ammunition and weaponry. Other support to SOEs may take the form of equity investment as it happened during 2020 (detailed further).

40. Indirect state support includes deferred taxes and exemption from payment of dividends. The exact amount of SOE dividends, as a share of the company's profits, is approved every year by the Council of Ministers (CoM) and are typically set at 50 percent of the previous year's profits. The rates may differ for specific companies, some companies may be exempted from dividend payment. For instance, in 2021 dividend payment was waived for state-owned hospitals and regional Water and Sewerage companies – the former because of the pandemic crisis, and the latter – because of an ongoing investment programme. The previous year, the CoM mandated the state-owned Bulgarian Development Bank to pay a dividend of 80 percent of its 2019 profits. Deferred taxes on the other hand represent a timing or valuation difference between the carrying amount and tax base of assets and liabilities and carried-forward tax losses and credits. They do not indicate any tax preferences or exemptions, as in Bulgaria, SOEs are commercial entities and pay the same taxes as private companies. Capturing both the direct and the indirect state support is equally important for measuring the fiscal costs of SOEs, but reliable data on the latter is very difficult to obtain in Bulgaria. The following includes estimates based on data from state budget reports and SOEs' financial statements.

41. The net flows between the central government budget and SOEs were relatively stable and under manageable ratios during 2017-2019, with transfers to SOEs surpassing SOE contributions by 1.34 percent of GDP (on average for the period). Overall, budget revenues in the form of taxes and dividends were significantly surpassed by government direct transfers to SOEs. In 2019, the total revenue from SOEs was BGN 200.5 million while direct fiscal support amounted to BGN 882.4 million. Direct fiscal support to SOEs varied from 0.90 to 1.13 percent of GDP in this period, while indirect support was smaller, between 0.58 and 0.63 percent of GDP. Subsidies were relatively stable during this period, averaging 0.44 percent

[25] Capital transfers refer to acquisition and overhaul of long-term assets.

of GDP. Most were allocated to three SOEs from the transport and communications sectors — BDZ – Passenger Transport, State Company Railway Infrastructure, and Bulgarian Posts — to compensate them for public sector obligations, i.e., for providing services at below-market prices. Capital transfers to SOEs represented on average 25.5 percent of the entire direct financing from the state budget during the same period. There were limited tax and dividend exemptions, although tax deferrals surpassed total subsidies.

42. In 2020, direct transfers from the government budget[26] to SOEs significantly increased to BGN 3.0 billion, while revenues from SOEs to the government budget substantially decreased to BGN 87 million. These changes were mainly related to measures introduced to cope with the economic consequences of the COVID-19 crisis. While subsidies and capital transfers remained almost constant as compared to 2019, equity investments increased by 1.7 percent of GDP. The direct fiscal support reached a record high of 2.54 percent of GDP in 2020. At the same time, due to weaker financial performance of SOEs in 2020, revenues from dividends decreased by 21.5 percent as compared to 2019.

Table 9: Direct and Indirect Fiscal Support to SOEs (BGN million)

	2017	2018	2019	2020
Direct support				
Subsidies*	464.3	465.5	509.2	662.5
Equity investments*	293.1	571.2	1.3	2,016.1
Capital transfers/non-financial sector*	165.3	206.0	371.9	369.0
Total	922.7	1242.7	882.4	3047.6
Total (% of GDP)	**0.90**	**1.13**	**0.73**	**2.54**
Indirect support				
Deferred taxes**	626.1	631.9	665.0	n.a
Exempted dividends **	17.4	32.0	33.9	n.a
Total	643.5	663.9	698.0	n.a
Total (% of GDP)	**0.63**	**0.60**	**0.58**	n.a
Total direct and indirect support to SOEs (% of GDP)	**1.52**	**1.73**	**1.31**	n.a

Source: * Ministry of Finance, State budget reports.
** Data taken from SOEs´ annual financial reports. 2020 data is preliminary.

43. The ambitious SOE equity investments funded by the central government budget in 2020 have no precedent in recent fiscal history. The total amount spent reached BGN 2,016.1 million (1.68 percent of GDP).[27] These equity investments spanned several sectors, and in most cases took the form of a capital increase for existing SOEs. State hospitals received BGN 96.4 million, mainly due to their high-debt profile. Another BGN 840 million were provided for capitalization of the Bulgarian Development Bank – for both its anti-crisis liquidity support to individuals and businesses, and its acquisition of a stake in First Investment Bank. The government also increased by BGN 22.3 million the capital of BULBIO - NCIPD for financing investment projects related to the production of vaccines and biological products. Most

[26] Data for indirect support was not available for the 2020 period.
[27] For more information, please see the annual budget execution report for 2020, p. 175 at https://www.minfin.bg/upload/48709/doklad_otchet_budget_2020.pdf

importantly, the government invested BGN 1 billion in the establishment of Bulgarian Water and Sewerage Holding. A few smaller capital increases add up to the total sum of BGN 2,016.1 million.

44. Capital transfers, another form of direct fiscal support, also doubled over the past few years. The main beneficiaries of capital transfers were mostly SOEs that traditionally receive subsidies for their public service obligations on behalf of the government – in particular, Bulgarian State Railways Holding, National Railway Infrastructure Company, and Port Infrastructure.

45. Indirect fiscal support to SOEs amounted to 0.58 percent of GDP in 2019. The bulk of it consisted of deferred taxes, which were relatively stable between 2016 and 2019. Tax and dividend exemptions were limited, though. According to the Corporate Profit Tax Act, SOEs exempted from corporate tax payment are: collective investment schemes, national investment funds, and special purpose investment companies. Hospitals and water supply and sewerage companies, as well as the State Consolidation Company and National Company Industrial Zones are exempted from payment of dividends to the Treasury. The total amount of SOE exempted dividends in 2019 was only marginal (BGN 33.9 million).

46. Tax and dividend payments by SOEs to the central government budget were marginal, averaging 0.2 percent of GDP during 2016-2019. Although the economy expanded by 3.1 percent annually on average in that period, the financial performance of SOEs remained weak and their contribution to the state budget was not significant — SOE taxes and dividends peaked at BGN 296.5 million in 2018 (see Table 10). Excise tax revenues were small and remained almost constant during the period of analysis.[28] In 2017 and 2018 the payment of dividends by SOEs exceeded their contribution through tax revenues, while the opposite occurred in both 2016 and 2019.

Table 10: Revenues in the State Budget from SOEs (BGN million)

	2016	2017	2018	2019	2020
Profit tax**	76.4	59.8	89.6	115.4	20.6
Dividends*	38.6	93.6	105.6	84.1	66.0
Excise tax**	1.2	1.2	1.3	1.0	1.0
Total	116.2	154.6	296.5	200.5	87.6
Total (% of GDP)	0.12	0.15	0.27	0.17	0.07

Source: * Data taken from the state budget report.
**data from SOEs´ annual financial statements. 2020 data are preliminary.

47. The 2020 crisis had a clear impact on revenues from SOEs to the central government budget. The net profit tax paid to the central government budget decreased from BGN 115.4 in 2019 to BGN 20.6 million in 2020. Two main factors behind this performance were the weak financial performance of some SOEs due to the crisis and the loss registered by the Bulgarian Development Bank.

3.2 Fiscal Risks from SOEs

48. Fiscal risks are factors that may cause fiscal outcomes to deviate from expectations or forecasts. Fiscal risks emanating from SOEs can be organized in the following broad categories:

[28] The budget receives a small amount of concession fees from SOEs that extract natural resources, like mining.

- *Explicit liabilities* are those for which the state has contractual obligations. These can be further divided into:
    - (i) direct (e.g., subsidies); and
    - (ii) contingent, which depend on the occurrence of an event, such as for example an SOE defaulting on a loan guaranteed by the state,
- *Implicit liabilities* are those for which there is a moral or political obligation for the government to respond, even in the absence of a contractual obligation, to meet public expectations. Such implicit liabilities can also be divided into:
    - (i) direct (e.g., the government assuming the cost of social security payments for SOE staff); or
    - (ii) contingent (e.g., bankruptcy, expenses related to the sale/privatization of an SOE, etc.).

49. **Until 2019, fiscal risks emanating from SOEs were relatively small.** However, several direct and contingent risks materialized in 2020, which led to an increased fiscal burden and left SOEs operating in a highly uncertain environment. Materialized risks included those arising from pandemic-related measures and accumulated losses of SOEs. Since the onset of COVID-19, SOEs have been operating in a highly uncertain short and medium-term environment, which has leveraged existing fiscal risks and created new ones. The rising prices of power, petrol, metals, and other commodities impact on the competitiveness of SOEs and their financial performance and create pressure for greater fiscal support.

Table 11: A Framework for Mapping SOE-Related Fiscal Risks

STATE LIABILITIES	DIRECT	CONTINGENT
Explicit Obligations (direct government liability under law or contract)	Subsidies Capital transfers	State guarantees to SOEs´ debt in case of debt service default. Unpaid net debt of SOEs to the government (not covered by guarantees). Legal obligations to support the Bulgarian Development Bank if it suffers a capital gap. European Green Deal obligations. Possible restructuring of state-owned holdings.
Implicit Obligations *(moral obligation to meet public expectation or political pressure)*	Increased SOE borrowing to finance capital investment required to maintain access and quality of public services and meet growing demand, as well as EU requirements. Increased fiscal equity investment in SOEs to finance further investments in large infrastructure projects.	Unexpected rise of SOE liabilities associated with adverse shocks such as the COVID-19 pandemic. Financial support for SOEs in response to energy price volatility. Liabilities deriving from SOE restructuring as per European Green Deal obligations.

50. Fiscal risks to the budget have been relatively small until the recent past, but the growing debt of some of the largest SOEs calls for caution. The net fiscal balance between fiscal expenditures on SOEs and revenues from taxes and dividends was 1.33 percent of GDP in 2019. However, the high debt level of some SOEs in the energy and transport sectors poses a risk to their financial viability that may put pressure on the state budget for the provision of further subsidies, capital transfers, or other forms of state support. 2020 marked a notable increase in liabilities and debt for some of the most leveraged companies (Table 7), such as Bulgartransgas (where liabilities increased 15 times between 2016 and 2020 to reach BGN 2.6 billion or 2.1 percent of GDP), Avtomagistrali (where liabilities grew 311 times to 1.5 billion or 1.2 percent of GDP) and Maritsa-East 2 thermal power plant (a 1.5 time increase to 1.3 billion or 1.1 percent of GDP).

51. Implicit fiscal obligations associated with increased capital investment required to maintain or improve the quality of public services further suggest caution. Limited fiscal space combined with a large part of the population unable to afford market prices for public services represents a long-term fiscal risk. Maintaining relatively low prices for basic public services is less and less affordable for SOEs and increases the explicit and implicit burden on the state budget. In this context, increasing the prices of public services to a cost-recovery level may also increase the risk of non-payment and arrears, and lead to further worsening of the financial situation of certain SOEs.

52. State guaranteed debt of SOEs poses a relatively small fiscal risk. The state guaranteed debt of SOEs[29] decreased from BGN 155.4 million (0.15 percent of GDP) in 2017 to BGN 71.0 million (0.06 percent of GDP) in 2020.

53. Large fiscal obligations are expected to emerge from the restructuring of the economy as per the European Green Deal obligations that concern many SOEs. The Bulgarian economy is expected to be one of the most affected by decarbonization and the green transition. The scope and time horizon of the associated fiscal burden is not yet clear, since it strongly depends on the political ambition to foster the restructuring. Most vulnerable is the energy sector, where the postponement of structural and green reforms over the last decade is expected to demand substantial public resources.

54. Restructuring of the energy sector and the obligation to reach the "Fit for 55" emission targets would require financial support for SOEs. While ongoing and future increases in the price of energy (in particular electricity, but also gas) will position some of the loss-making SOEs in the energy sector in a better financial position, this effect will prevail only over the short term, since these companies will be subject to restructuring or have to close down soon due to their high CO2 emissions. Furthermore, such a price increase will significantly increase the financial risks associated with other SOEs in key sectors —in particular transport and industry.

55. The financing of large public-sector infrastructure projects such as the construction of new nuclear power capacities (if realized), the Hemus highway, gas transmission and storage systems, and others may create significant fiscal risks. This also applies to public-private partnerships (including infrastructure concessions) which may also create fiscal commitments and contingent liabilities. The construction of the Belene nuclear power plant, alone, if carried out as a project, is expected to cost more than EUR 10 billion spread over 10 years of construction. Finalization of the construction of several unfinished highways also requires significant funding, and thus can be associated with further fiscal risks.

[29] the cited data covers the sum of guarantees on loan obligations of public enterprises issued by the entire general government sector

56. Some implicit risks may occur if the government continues with the expansion of the SOE sector. Considering the recent expansion of the SOE sector during 2020, further fiscal risks may arise in case of a sustained policy towards creating new SOEs and increasing state participation in the economy.

4. iSOEF Module 4: Corporate Governance and Accountability Mechanisms

57. Good corporate governance is the foundation for stable, financially healthy SOEs. As mentioned earlier, the poor financial performance of some of the largest SOEs in Bulgaria is attributable to deep structural constraints, which also include lack of SOE accountability for their performance and corporate governance weaknesses. Compared with private sector companies, SOEs face distinct governance challenges that directly affect their performance. These challenges include multiple principals, competing goals and objectives, excessive protection from competition, undue political interference, and low levels of transparency and accountability. Facing such challenges and given SOEs' strategic role in providing key infrastructure and public services, it is vital to ensure that SOEs follow good corporate governance practices.

58. Following the iSOEF methodology, this chapter assesses six dimensions of corporate governance for Bulgarian SOEs. As stated in the iSOEF Overview Notes,[30] these six dimensions of SOE corporate governance are: (i) legal and regulatory framework; (ii) ownership and oversight function; (iii) performance monitoring; (iv) boards of directors; (v) transparency and disclosure; and (vi) procurement.

4.1. Legal and Regulatory Framework

59. In Bulgaria, SOEs' founding and functioning are regulated by a mixed legal regime consisting of commercial and public laws. The Commerce Act (1991) applies to different types of SOEs, as well as private-sector firms. Since 2019, SOEs have also been subject to the provisions of the PE Act and its secondary legislation. Additionally, the State must observe EU state aid rules to prevent SOEs from enjoying undue benefits as compared to private competitors that could affect competition.

60. According to the Commerce Act, SOEs must be incorporated as:

- single-owner limited liability companies,
- single-shareholder joint-stock companies, or
- state enterprises (to be established via specific statutory laws).

61. **Bulgaria has made significant progress in corporatizing its SOEs.** As of 2020, the majority (55 percent) of Bulgarian SOEs are joint-stock companies, 37 percent are limited liability companies, and the remaining 8 percent have the legal status of a state enterprise under special laws. The latter group cannot declare bankruptcy. Although the Commerce Act appears to limit the definition of SOEs to fully state-owned enterprises, other regulations consider any company in which the state is the majority shareholder as SOE, in line with the OECD definition.[31]

62. Since 2018, Bulgaria has embarked on significant reform of the corporate governance framework of SOEs and adopted the PE Act in 2019. The reform was initiated as part of the government's action plan to prepare for applying to the Exchange Rate Mechanism II. For this purpose, a technical assistance project with the European Commission and the OECD was launched in August 2018. The PE Act establishes a solid legislative framework aligned to the OECD guidelines. The main provisions regulate the establishment of an ownership coordination unit, elaboration of SOE ownership policy, development of

[30] The World Bank, Integrated State-Owned Enterprise Framework (iSOEF), Washington D.C, June 2019.

[31] Yet, nothing in the Commerce Act explicitly prohibits the inclusion of other shareholders in the capital of a state-owned joint-stock company or limited liability company once they have been created. Additionally, in practice, the Bulgarian state holds majority shareholdings in several commercial enterprises, which by OECD standards should be considered SOEs.

aggregate reporting to address the gap in accountability for SOEs performance, and a transparent SOE board nomination process.

63. **To support implementation of the PE Act, secondary legislation was adopted in 2020**. The Implementing Rules of the PE Act provide detailed instructions regarding: (i) content of the state ownership policy, and the procedure for its development, adoption, and updating; (ii) activity of the PECA as a coordinating unit for SOEs; (iii) framework for the competitive selection procedure of the board of directors and executive management; (iv) appointment of the board of directors and executive management and the procedure for determining their remuneration; (v) establishing medium-term goals and targets for SOEs; (vi) scope for public disclosure of financial and non-financial information by public enterprises in accordance with Article 28 of the PE Act.

Table 12: Main legislation applicable to SOEs in Bulgaria

Commerce Act (1991)	According to the Commerce Act, SOEs must be formed as: ● single-owner limited liability companies, ● single-shareholder joint-stock companies, or ● state enterprises (to be established via a separate law). For SOEs that operate as single-owner companies, the Commerce Act provides that the responsibilities usually granted to the general shareholders' meeting can be assumed directly by the single owner (in the case of an SOE, the line minister). Practically, this enables line ministers to make significant corporate decisions without the exact record-keeping requirements placed on the general shareholders' meeting in companies with more than one shareholder.
State Property Act (1996)	This regulates the acquisition, management, and disposal of state property, including real estate. Per this law, state and municipal ownership may be public or private. In particular, public state property is defined as: · The facilities and properties that the Constitution designates as being exclusive state property; the facilities, properties and movable properties designated by law or by an act of the Council of Ministers as being public state property; · Properties made available to agencies for fulfilling their duties; · Properties of national significance designated to serve public needs of national importance by public use, determined by the Council of Ministers; · Land properties subject to a zoning plan, assigned for border checkpoints, and the buildings erected on the said properties.
Accountancy Act (2015)	This regulates enterprises' accounting standards, practices, the content of financial statements and management reports, obligations for external audit, and the related responsibilities of enterprise managers. From January 1, 2017, all public interest entities (PIE) are required to apply the IFRS as endorsed by the EU. Public interest entities, regardless of their size, are defined as: (i) issuers of securities on a regulated market in an EU Member State;

	(ii) credit institutions; (iii) insurance companies; (iv) pension companies and funds managed by them; (v) state and national railways; and (vi) companies providing water and sewage services as a major activity. Statutory audit must be performed for the following entities (i) small entities that exceed at least two of the following—total assets are equivalent to BGN 2 million, total revenue equivalent to BGN 4 million, and an average number of employees of 50; (ii) medium and large entities and PIEs; (iii) medium and large groups, and groups which include PIE; (iv) joint-stock companies and limited partnerships with shares, except for the cases when companies had not conducted any activities throughout the year; and (v) consolidated financial statements and the financial statements of the entities included in the consolidation.
Independent Financial Act (2016)	The Independent Financial Audit Act (IFAA) sets out the general rules of communication between external auditors and the audited enterprise.
PE Act (2019)	This establishes a robust legislative framework that implements Bulgaria's governance and policy priorities. It brings national legislation closer to international best practices by establishing an ownership entity in conjunction with the elaboration of an ownership policy. This act enhances the Bulgarian legislative framework on SOEs by: ● establishing an ownership coordination unit to mitigate shortcomings of the decentralized ownership arrangements; ● developing an ownership policy and SOE objectives-setting mechanism; ● elaborating aggregate reporting to address gaps in accountability for SOEs' performance, corporate governance, and disclosure practices; ● introducing a harmonized SOE board nomination process requiring a minimum proportion of independent directors; and ● corporatizing commercially-oriented statutory SOEs (i.e. established under special laws) to level the playing field with private companies. The Act creates a level-playing field with private companies by gradually converting large state companies into joint-stock companies. Additionally, it establishes several principles that will ensure a level-playing field between the private sector and SOEs, such as the prohibition of unfair competition and monopoly abuse. The Act also imposes the requirement of financial and non-financial objectives for SOEs.
Council of Ministers Decree on Monitoring the Financial	Promulgated in June 2010, this decree establishes the requirements regarding the content and timing of regular reporting by SOEs to line ministries, by line ministries to the Ministry of Finance, and by the Ministry of Finance to the general public. Most provisions on reporting appear to mirror the requirements

Position of SOEs (June 2010)	established separately for enterprises (including at least some SOEs) via the Accountancy Act, although the Accountancy Act focuses on the standards of corporate reporting, whereas the Decree focuses more on the timeline for reporting this information to the relevant public bodies.
Procurement Act (April 2016)	The Public Procurement Act provides for non-discrimination in awarding public contracts, in line with EU rules, and establishes several procedural requirements to ensure fair competition among potential contractors. The Bulgarian authorities report that SOEs as bidders for public procurement contracts are generally subject to the same requirements as private operators, albeit with some exceptions in line with EU rules. The Public Procurement Act applies equally to SOEs held at the central government and municipal levels.

Source: Word Bank staff compilation.

4.2. Ownership and Oversight Function

64. **State enterprise ownership in Bulgaria has been traditionally decentralized, being managed and controlled by the relevant line ministries according to their sectoral responsibilities.** Ownership rights were assigned to the Council of Ministries and line ministries. In practice, only line ministries were involved in the management and performance of individual enterprises, with no coordination between the different institutions responsible for SOE ownership.

65. **From 2019 onward, Bulgaria is following an advisory model with PECA performing centralized oversight and coordination of SOEs reporting**, while the main policy functions and decision-making remain with line ministries. This change follows broader trends in evolving SOE ownership models among OECD member states that suggest a more centralized SOE ownership model brings benefits through a coordinated oversight and a coherent approach to the SOE ownership function.

66. **The majority of SOE capital is concentrated in the portfolios of the Ministries of Energy, Transport, and the Economy and Industry.** In 2019, 57 percent of state equity was concentrated in the energy sector, 20 percent in the transport sector, and economy has 11 percent, the remaining 12 percent of SOEs´ equity is held by other ministries. Ministries, in their capacity as principals, do not adhere to most of the OECD guidelines, mainly due to lack of institutional capacity and insufficient corporate governance systems.

67. **Following OECD recommendations, the PE Act introduced the PECA as an ownership coordination unit**. In accordance with the PE Act, the Agency is built on the previous Privatization and Post-Privatization Control Agency and reports to the Council of Ministers. The main functions of the PECA are defined as: (i) developing and monitoring the implementation of a state ownership policy; (ii) assisting the authorities exercise ownership rights in formulating the general strategic objectives of the SOEs, as well as related key financial and non-financial performance indicators; (iii) monitoring SOEs´ performance; and (iv) elaborating a yearly SOE aggregate report. Under this new setup, the Council of Ministers and line ministers are expected to continue to exercise their state ownership rights, with the option to delegate such functions to PECA.

68. **PECA is not yet operating as envisaged, it is understaffed and has limited capacity to fulfill the tasks assigned to it by the Law.** The Agency lacks the necessary resources, in terms of both staff and

funding, to carry out all its tasks. It foresees a total number of 65 positions, of which only 40 are currently filled. The Agency also needs to strengthen its role as a coordinating agency by providing corporate guidelines to line ministries, which still play the main role in SOEs management.

69. Until the adoption of the new regulatory framework on SOEs, the Ministry of Finance was the authority controlling SOEs' financial activity. At present, its objective is to sustain a transparent fiscal, monetary, and budgetary policy that complies with the governmental strategy for fully-fledged EU membership. The MOF is monitoring state participation in full or majority-owned SOEs in line with EU state aid legislation. Until PECA was set-up, the MOF was charged with collecting and publishing SOEs' quarterly financial reports and annual audit reports of individual SOEs on its website. The MOF also produced an annual analysis of the financial position of SOEs with over 50% of state ownership (and the companies they controlled). This analysis, according to information provided by the MOF, was considered at meetings of the Council of Ministers and provided to interested financial and international institutions but was not made public due to the absence of legal grounds for that. The Ministry also has three majority-owned SOEs under its purview: the Bulgarian Stock Exchange, the Fund Manager of Financial Instruments in Bulgaria (FMFIB)[32], and the Independent Bulgarian Energy Exchange (IBEX), for which it carries ownership functions.

[32] FMFIB was transferred to the portfolio of the newly established Ministry of Innovation and Growth with a decision of the Council of Ministers, dated December 30, 2021.

Box 2: The functions of the PECA

According to Article 12 of the Public Enterprises Act (PE Act), the PECA shall carry out the functions under Article 11 [1] by:

1. Developing the state ownership policy of public enterprises;
2. Monitoring implementation of the state ownership policy and its regular update;
3. Assisting the authorities exercising state ownership rights in formulating the general strategic objectives of their enterprises and the key financial and non-financial performance indicators included in their business programs;
4. Monitoring public enterprises and preparing an aggregate report covering their activity for the previous year in the format and scope defined by law;
5. Cooperating with other state administrations, and non-governmental and international institutions on issues related to the management of public enterprises;
6. Publishing updated information and reports on the activity of public enterprises, including financial and non-financial information on the enterprises;
7. Monitoring the competitive procedure for the selection and appointment of members of the management and control bodies of public enterprises;
8. Evaluating the implementation of the approved business programs of public enterprises and making proposals for improving their management;
9. Exercising the powers of the state in public enterprises when delegated by the Council of Ministers;
10. Upon request, assisting the municipalities with regard to the management of municipal public enterprises;
11. Preparing an assessment and analysis of the approved business programs of public enterprises and their implementation as well as recommendations regarding their impact on public finances, including the potential effects and risks for the consolidated debt and deficit/surplus indicators of the General Governance Sector;
12. Instructing on the application of the law.

Source: PE Act (2020).

4.3. Performance Monitoring

70. SOEs performance control and monitoring practices are highly heterogeneous and differ significantly from one line ministry to another. Most SOEs report to their respective line ministries on the implementation of approved "business plans" containing specific performance indicators such as profitability, productivity, sales volume, profits or loss reduction, new markets, use of facilities, investments, etc. Business plans are typically prepared by the SOE management for the medium term (3-5 years) and approved by the relevant line minister. As management remuneration depends on performance, the business plan and related key performance indicators (KPI) aim to drive performance up. However, performance indicators vary significantly from one ministry to another, and they are often ignored in favor of volume targets.[33]

71. The PE Act and subsequent regulations set the foundations for solid performance monitoring systems. SOEs are currently required to set up dedicated reporting systems to monitor and assess their performance, and the Act foresees the development of enterprise-specific financial and non-financial performance objectives, including public service obligations. The recently introduced reforms in the corporate governance of enterprises envision that the state, in its capacity as a shareholder, sets up

[33] IMF, Bulgaria: Selected Issues Paper, Washington D.C, November 2016.

general strategic goals during the annual general meeting of shareholders. Based on the state ownership policy, these strategic objectives will be measured by specific key indicators that will be approved through business plans. The PECA will measure SOE performance by comparing actual performance to the set goals by tracking profitability, efficiency, and level of risks. The PECA is expected to monitor the performance not only of large enterprises, but also of several micro, small, and medium ones.

4.4. Boards of Directors and Management

72. SOEs in Bulgaria have different board structures depending on their legal status. Statutory SOEs have a management board and a chief executive director (CEO). Limited liability companies do not have boards; their governing bodies are the general shareholders' meeting and the managing director who reports directly to the responsible line ministry. Joint-stock companies have either one-tier or two-tier boards. Fully corporatized SOE boards consist of 3-5 members, and the Council of Ministers can approve a larger number of members. In practice, however, a large majority of SOE boards have been rather small,[34] which in some cases may prevent them from carrying out their functions effectively.

73. According to the regulatory framework,[35] SOEs Boards are responsible for the overall management of the company, but they have had limited authority in practice. SOE boards have been rarely empowered, in practice, to appoint and/or dismiss the CEO, which makes it difficult for SOE boards to fully exercise their monitoring function and assume responsibility for SOEs' performance. In practice, SOEs' management is appointed by the line minister and its functions are set forth in management contracts concluded between each member of the management body and the line minister on behalf of the company, which may affect SOE autonomous decision-making.

74. The rules and procedures for nominating and appointing SOE boards had been generally unregulated and not based on pre-established professional criteria. Until 2019, the board nomination process was not explicitly regulated, thus remaining at the discretion of line ministries. In one-tier board systems, the general meeting of shareholders elected board members (and in the case of fully-owned companies, this was done by the line minister). In two-tier board systems, the government appointed the supervisory board, which set the management board. The absence of a transparent and competitive SOE board nomination procedure, together with the limited presence of independent directors on SOE boards, significantly limited SOE boards' ability to exercise objective and independent judgement without political interference.

75. The Implementing Rules, as stipulated by the PE Act, establish a competitive procedure for the selection and appointment of board members. The procedure applies to fully and majority-owned SOEs, and should be conducted on the basis of pre-determined professional and personal criteria for candidates. The Rules provide for specific procedures for selecting government representatives and independent members on SOE boards. They also provide for joint-stock companies with a two-tier management structure for the Supervisory Board to carry out a competitive procedure for the election of members of the Management Board.

76. A competitive procedure for selection and nomination of board members started in 2020 and has been completed for 37 of the 46 large SOEs. The selection was announced publicly on the websites of relevant ministries and consisted of three stages:[36] 1) submission of a standard set of documents needed to evaluate the eligibility of the candidates as board members; 2) submission of a letter of

[34] SOE boards were typically composed of up to three members, representing the line ministry (that executes ownership rights) and the company's executive management. Ministerial appointees included high-level civil servants, or in some cases deputy ministers, as well as independent directors.

[35] The provisions of the Commerce Act, company rules and regulations, as well as management contracts

[36] As provided in the Implementing Rules for the PE Act.

intention describing their management approach towards the respective company; 3) interviews. The PECA is responsible for appointing a nomination committee consisting of nine members— three members designated by the body exercising the rights of the State, three PECA employees, and three independent experts.

77. Overall, the PE Act creates a framework that empowers boards to be independent and professional. First of all, it foresees that a competitive nomination process will become the norm for all SOEs. The Law imposes on board members the duty to act in good faith and the best interest of the company and its shareholders, giving the state representatives the same rights and obligations as other board members. The Law establishes some independence requirements, most notably by barring politicians from being board members.

78. The PE Act introduces the requirement that "at least one-third but no more than half" of SOE boards consist of independent directors. It provides clear criteria for their independence, including from the shareholder and the company and its management. Boards of large SOEs must have an independent member as chair. Before this, SOEs did not have an obligation to include independent directors, except for listed companies. Thus, most SOE boards did not have independent board members and could not be considered to operate independently of company shareholders and management. Most committees were composed of representatives of their respective line ministry and senior management.

79. Directors' remuneration is capped, as legislation ties it to the country's average salary. This provision is problematic and not conducive to creating incentives for qualified and skilled candidates to join SOE boards, leading the change management strategy needed for turning the SOE operations into profits, sound financial standing and better service delivery for the citizens.

4.5. Transparency and Disclosure

80. The PE Act foresees the publication of an annual aggregate report on SOEs by the PECA. The establishment of aggregate reporting is a significant development to improve the state's accountability as a shareholder, and the Law's provisions are aligned with international best practices in this domain. The SOE aggregate report should contain information on the implementation of the state ownership policy and should review the business performance of all SOEs, sorted by economic sector and other categories (e.g., size-related). The report is to be submitted by the PECA to the Council of Ministers on 31 October each year, and should be submitted for approval to the national assembly within one month of its approval by the Council of Ministers. It should then be published on the Agency's official website (see Annex 3).

81. In 2020, the PECA published the first SOE aggregate annual report, based upon 2019 data.[37] The report contains a section on the envisaged implementation of the PE Act and the role of the Agency in the process. It presents broadly the overall SOE portfolio consisting of 311 companies but focuses on the activity of 46 large SOEs. Although the report is a step forward in the public reporting on SOEs, the report would need substantial improvement in presenting the performance of the overall SOE portfolio, as well as the implementation of the state ownership policy, which is yet to be developed and approved.

82. Only some SOEs prepare their financial reports according to IFRS. According to the Accountancy Act, from January 1, 2017 on, all public interest entities are required to apply the IFRS as endorsed by the EU. Public interest entities, regardless of their size, are (i) issuers of securities on a regulated market in an EU Member State; (ii) credit institutions; (iii) insurance companies; (iv) pension companies and funds managed by them; (v) state and national railways; and (vi) companies providing water and sewage services

[37] The 2019 Annual Report is accessible here: https://appk.government.bg/bg/55

as a major activity. A total of 113 SOEs owned by the central government (out of 311 in total) reportedly prepare their financial reports according to the IFRS accounting standards.

83. **In addition, all enterprises are required to prepare an annual management report**, and a non-financial declaration describing their policies on environmental and social issues, employees, human rights and anti-corruption. This practice is being followed by some of the largest SOEs—such as Bulgarian Energy Holding, as they prepare and disclose such non-financial reports as part of their annual reporting package.

84. **A recent requirement introduced by the PE Act is that SOEs, regardless of their size, must be audited by an independent "registered auditor," as defined by the Accountancy Act and the Independent Financial Audit Act, in strict accordance with international auditing standards.** Therefore, the requirement established by the Accountancy Act has a broader reach, requiring even small and medium SOEs to carry out such an audit. Before the PE Act came into force, many SOEs had an uncertain status regarding whether they were required, in part or in total, at municipal or national levels, to be audited. The registered auditors must give an opinion regarding the managers' report accuracy concerning the financial statements for the audited period and the conformity of the report and corporate governance statement with legal requirements. Additionally, the auditors must verify whether the non-financial declaration and government payment report follow the conditions imposed by the Accountancy Act.

85. **The external auditor needs to be appointed by the general meeting (at the recommendation of the audit committee for companies with such a committee.)**[38] The Independent Financial Audit Act regulates the execution of external audit. The requirements for external auditors are the same as in the case of private companies, including regarding rotation, independence, and nomination. The independent auditor must be an individual or an audit company registered with the Institute of Certified Public Accountants, and must confirm in the Independent Financial Audit Contract that the requirements of the Independent Financial Audit Act and the Ethics Code are met.

86. **At the same time, SOEs are subject to external control by the NAO.** The NAO, Bulgaria's supreme audit institution, is independent of the executive power and reports to the National Assembly on the lawful and efficient execution of the state budget based on the NAO Act and internationally agreed standards. The NAO can provide assessments on SOEs' economic effectiveness and social efficiency. The subjects of its audit activities include public undertakings that are fully-owned by the state, companies where the state participation exceeds 50 percent of the equity, and entities whose debts are secured by government guarantees or collateralized by state assets. NAO´s audit reports are publicly available.[39] Audit reports generally contain recommendations for the auditees (including individual SOEs) and a deadline for taking remedial action. If no corrective measure is taken, the Audit Office can report it to the National Assembly, Council of Ministers, or relevant line ministry.

87. **Most SOEs are subject to internal audit through dedicated internal audit units.** Although many SOEs are required to establish internal audit units, these units generally report to the shareholding ministry rather than to an audit committee of the board, which is not commonly in place. SOEs are also subject to inspections performed by inspectorates attached to each ministry. Established under the Administration Act, inspectorates directly report to the relevant line minister for the exercise of administrative control. The main role of inspectorates is to prevent administrative irregularities and to ensure that anti-corruption procedures are followed.

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[38] Audit committees used to be external supervision committees reporting to the ministry, exercising ownership rights, and not dedicated committees of the board of directors.

[39] Audit reports are available here: https://www.bulnao.government.bg/bg/

4.6. Public Procurement and SOEs

88. Public procurement, a crucial component of the SOE institutional framework, is paramount to SOE financial accountability and transparency. SOEs often receive different treatment in terms of public procurement. In some countries fully or majority state-owned enterprises are covered by the same public procurement rules as other state entities (e.g., central and sub-national government). In other countries, SOE procurement rules are defined as a separate category, and thus subject to specific legislation. The Bulgarian Public Procurement Act (2016) provides for non-discrimination in the awarding of public contracts, in line with EU rules, and establishes a number of procedural requirements to ensure fair competition among potential contractors. The Act transposes EU Directives on public procurement in general, and also in the water, energy, transport and postal services sectors, in particular.

89. The Public Procurement Agency (PPA), a body under the Ministry of Finance, is the owner of the procurement strategy. The PPA has put in place the legal, procedural, and technical structures required to deliver the legislation and is recognized by contracting authorities as the primary source of advice and guidance**.** The PPA undertakes both ex-ante and ongoing control of public procurement procedures, and maintains the e-procurement system.

90. The NAO and the Public Financial Inspection Agency (PFIA), through its central and territorial offices, perform *ex-post control* on the legality of the award and execution of public procurement contracts. The control carried out by the NAO is regulated by the National Audit Office Act, whereas the PFIA's mandate is defined by the Public Financial Inspection Act, effective from the date of entry into force of the Treaty of Accession of Bulgaria to the EU. The NAO audits state budget institutions only, whereas the PFIA is entitled to audit private entities or individuals as well. To improve the coherence between activities in the preliminary and subsequent control of public procurement contracts a cooperation mechanism between the PPA, PFIA, and NAO was set up under an Expert Cooperation Council.

91. SOEs are not explicitly treated as public contracting authorities as defined by the law. However, the PPA can determine that an SOE should be subject to the general government's public procurement procedures. SOEs are only explicitly considered public contracting entities if they are incorporated as state enterprises under a special law, or if they rely on state funding for over 50 percent of their revenue.

92. In addition to the category of public contracting entities, the Law establishes the category of "sector contracting entities", subject to specific public procurement procedures. The category of "sector contracting entities" includes state enterprises established under a special law, and state-owned monopolies (regardless of the legal form) operating in the following sectors: natural gas and heating, electricity, water, transport services, postal services, as well as concessioners of airports and ports, and contracted for oil, gas, and coal extraction. Sector contracting entities can be exempt from the specific applicable public procurement procedures if their activity is subject to competition and there are no market restrictions. SOEs acting as bidders for public procurement contracts do not benefit from any explicit exemptions from the rules established by the law. However, procurement by SOEs can be treated as in-house procurement if the SOE is controlled by the public contracting entity (e.g., line ministry).

93. **The public procurement legislation in Bulgaria mandates public announcement, in the Public Procurement Register, of all procurement procedures for supplies and services with estimated costs above BGN 70,000 and all procurement procedures for civil works estimated to cost above BGN 270,000.** Amendments to the Public Procurement Act (October 2018, in force as of November 2019) have also set a requirement for publication in the Public Procurement Register of the notices for collection of bids (for public procurement with cost estimates above BGN 30,000 for supplies and services and above BGN 50,000 for civil works). The law also provides for mandatory publication of the decision to open the procedure (an official document) at the procedure's launch. Thus, all competitive procedures are announced using two documents (a notice and a decision), while procedures like negotiations without publication of a notice are announced with the mandatory publication of the decision for opening of the procedure.

Box 3: Public Procurement Regimes Applied by SOEs

Four public procurement regimes and respective thresholds for public contracting authorities are applied by SOEs in Bulgaria:

1) Above the thresholds for publication in the Official Journal of the European Union. Follows EU rules and the type of procedures envisaged in the EU Directives.
2) Above national thresholds but below the thresholds for publication in the Official Journal of the European Union. Two national procedures envisaged in the legislation with the option to shorten the deadlines for bids submission (public competition (art. 178 -181 of the Public Procurement Act) and direct negotiations (art. 182 of the same Act).
3) Above direct contracting thresholds but below the national thresholds for the two national procedures. Minimum requirements set by law and substantial flexibility allowed – contracting authorities could use the collection of bids with advertisement (art. 187 of the Public Procurement Act) or direct invitation (art. 191). Those two are not strictly defined as procurement procedures by the legislation.
4) Direct contracting. As the cost estimate does not justify the expenditure of conducting a procedure and for preparation of bids, the law is flexible. For civil works, only signing of a contract is required below BGN 50,000, while expenditure on supplies and services with cost estimates below BGN 30,000 and social and other specific services (Annex 2 of the Public Procurement Act) with cost estimates below BGN 70,000 may be justified with only primary payment documents.

94. **The level of transparency is relatively high, with requirements set by the Public Procurement Act higher than those in EU Directives.** There is a requirement for contracting authorities to publish all documentation on their buyers' profiles, and to provide unrestricted, complete and free access to this. However, both companies and individual respondents to the surveys cited a perceived lack of transparency in public procurement arrangements as a major concern.[40]

95. **A sophisticated new e-procurement platform was launched in 2019 and has been enhanced in stages since.** Mandatory e-submission and e-invoicing were introduced from November 1, 2019, and starting from July 1, 2020, the provisions entered into force for electronic tender evaluation, conclusion of a contract, ordering, invoicing, and payment. According to the 2020 PPA annual report, four new modules of the e-platform were successfully launched in 2020 — buyer's profile, dynamic purchase system, qualification system and e-qualification. The platform has continued to be upgraded in 2021.

[40] The World Bank: Assessment of the Public Procurement System in Republic of Bulgaria. Washington D.C., 2019

5. Options for Reform

96. Recognizing the Government´s commitment to SOE reform, this iSOEF proposes recommendations to further improve SOEs governance and performance, while limiting their fiscal costs and risks. SOE reforms are multidimensional and require a holistic and integrated approach. As such, this iSOEF puts an emphasis on four main intertwined options for reform. Other relevant reform options are also explored in this chapter, as a complement. The selection of these reform options was undertaken after careful examination of recent legislative changes and consideration of analytical work on Bulgarian SOEs conducted by other institutions of the international community, in particular the OECD. These four critical areas are summarized below, and also presented as a prioritized summary in Table 13.

97. Bulgarian legislation has been revised to include the critical components of good corporate governance of SOEs, but implementation is slow. The PE Act covers the essential areas such as disclosure and transparency, ensuring competitive appointment of boards composed of members with expertise in their respective fields, performance management skills, experience with institutional oversight, and a focus on stakeholders' interests. However, implementation is slow, mainly due to recent political instability and the lack of a regular government, the ongoing COVID pandemic, and limited resources and capacity of the PECA. Thus, most of the recommendations related to SOE corporate governance are oriented to the achievement of a more consistent and robust application of the recently adopted legal provisions and mechanisms.

5.1 Main options for SOE reform

- **Accelerate implementation of the PE Act – prioritizing the development of state ownership policy and formulation of public service obligations for SOEs.** Considering the still-large presence of SOEs in the economy of Bulgaria and their impact on the budget (which increased markedly in 2020) in terms of both current subsidies and equity injections/capital transfers, it is very important that the government develops and disseminates a state ownership policy—as required by the PE Act— to define the rationale for state ownership based on explicit criteria. These priority actions would in turn lay the ground for other important measures such as: allocation of subsidies in line with these objectives and the state-aid rules; incorporation of large state-owned limited liability enterprises into joint-stock companies; competitive selection of board members of SOEs; hiring of professional and independent board directors; and development and utilization of a SOEs performance monitoring and evaluation system.
- **Further analyze the SOE portfolio.** Additional work needs to be done to further analyze the existing SOE portfolio. This work would be based on the state ownership policy criteria (yet to be developed), to map out those SOEs that do not have a clear rationale for their continued ownership by the state, or those that do not perform their core activities. This exercise should cover all entities, including those currently banned for privatization, as appended to the Law on Privatisation and Post-Privatisation Control, which currently includes 174 companies. As a result of this review, some SOEs may be put forward for consolidation, optimization, closure, privatization or Public-Private Partnerships (such as concessions).
- **Strengthen capacity of the PECA as a central coordinating agency.** To strengthen SOE oversight and ensure a clear separation of SOE ownership and regulatory functions, the government should consider transferring the SOE oversight function from line ministries to the PECA. In order to fulfill the ambitious state-ownership coordinating role provided by the PE Act, the recently set-up PECA needs to strengthen its capacity and acquire the economic, financial, and managerial resources and expertise to perform its tasks effectively. Developing relevant tools and the pool of experts

needed to monitor SOEs effectively will require technical assistance, training, and exchange of international best practices.

- **Systematize SOEs' relationship with the budget to properly calculate and compensate them for their quasi-fiscal activities.** SOEs cannot become financially sustainable unless they are duly compensated —through direct on-budget transfers— for the actual cost of the public social obligations they deliver at below cost. Financial relationships between the Government and the SOEs should be fully transparent, so that the magnitude of these transactions can be properly calculated, recorded, and disclosed. In cases where there is a public policy rationale for subsidizing goods and services provided by SOEs, such as some SOEs in the transport and communication sectors, this should be stated explicitly in the budget, with these SOEs being fully reimbursed for the cost of providing such services and getting the appropriate subsidy.

5.2 Other reform options

- **Strengthen SOE transparency by assuring compliance and reinforcing current reporting and disclosure, as well as external audit requirements.** In 2020, the PECA published the first SOE aggregate annual report, based upon 2019 data for a sample of 46 SOEs. This important initiative needs to be reinforced, by including the performance of the entire SOE portfolio, as well as a review of the implementation of the state ownership policy once the latter is approved (Annex 2). As a minimum, all large SOEs should report their financial statements in accordance with IFRS and be subject to the same disclosure standards as listed companies. Finally, regular independent audit of SOEs´ annual financial statements must be enforced, according to the new PE Act.
- **Further professionalize SOE boards of directors.** The competitive procedures used for selection and nomination of board members, started in 2020 and already completed for 37 large SOEs, should be extended to the entire SOE portfolio. The independence and professionalism requirements stated by the new PE Act should be adhered to, most notably by barring politicians from being appointed as SOE board members. Consideration should be given to attracting independent directors from other countries who may be able to strengthen SOE boards' skills sets and reduce the level of undue political influence on SOEs. Announcements for board positions could be published internationally and the selection process carried out in English.
- **Introduce and enforce SOE performance monitoring and evaluation**. Promote the signing of multi-year performance contracts between individual SOEs, PECA, and corresponding line ministries structured around relevant and measurable KPIs and associated targets. The results should be taken into account when deciding on additional incentives for the SOE management, or, in case of non-satisfactory results, corrective actions. Focus on the top ten SOEs in a first (pilot) phase and provide periodic follow-up and incentive mechanisms. Along with the introduction of multi-year performance contracts, incentives linked to SOEs' performance should be introduced for SOE executive management. Such incentives must link KPIs (both financial and non-financial) and associated targets to the SOE strategy and objectives and offer SOE management adequate compensation packages—e.g., shares listed on the stock exchange (Annex 1).
- **Establish a remuneration policy for SOE boards and executive management that would favor the long- and medium-term interests of the enterprise, attract and motivate qualified professionals**. In order to attract qualified candidates for board member positions, the current provisions regarding remuneration should be reviewed on the basis of an analysis of the remuneration practices in SOEs in Europe to be performed by an independent expert.

- **Build capacity of key participants in the SOE governance process.** This will be key to reform success and improving the implementation of SOE corporate governance in practice. Efforts should be stepped up to train and advise those charged with SOE governance, including but not limited to: SOE ownership entities, SOE boards and their committees, and SOE management. Training programs, peer exchanges, formal induction-orientation programs, and ongoing learning opportunities should be implemented for potential and existing board members, key expert-level staff at SOEs, and staff in the line ministries' SOE units.
- **Enhance reporting systems allowing the PECA to regularly monitor, audit, and assess SOE performance, and oversee and monitor their compliance with the PE Act.** The aggregate report prepared annually by the PECA on SOE activity could be further improved by providing more granular information on SOEs allowing for a comparative review of their performance, in a more visual dashboard. The dashboard could rank SOEs according to their performance and report on aspects related to compliance with corporate governance rules; financial performance; and quality of service delivery. The PECA should also evaluate implementation of the ownership policy by the ownership entities and SOEs and publish the results of the evaluation annually.
- **Consider listing minority stakes of SOEs on the Bulgarian Stock Exchange.** This step would be beneficial for market activity and for SOEs themselves, as it could bring tangible benefits by inducing a corporate culture, strengthening corporate governance practices, and increasing their transparency. Moreover, through listing of SOEs' minority stakes the local market may get an additional boost and thus attract more investors.

Table 13: Options for Reform

Reform Area	Recommendation	Priority
	MAIN RECOMMENDATIONS	
SOEs Corporate Governance: Ownership and Oversight Function	• **Develop state ownership policy and formulate public service obligations for SOEs, accelerate implementation of the PE Act** - Identify main strategic sectors in the economy to retain in state ownership, consider the still-large presence of SOEs and their impact on the budget. - Identify large SOEs pursuing important public policy objectives or addressing market failures. - Define the rationale for state ownership based on the identified explicit criteria. - Specify the respective roles of the state, line ministries, PECA, SOE boards & management, and independent regulators, to avoid the overlap of roles and responsibilities. - Disseminate such state ownership policy—as required by the PE Act.	Short term

SOE Landscape	• **Further analyze the SOE portfolio.** Additional work needs to be done to further analyze the existing SOE portfolio. - Based on the state ownership policy criteria (above, to be developed), map out SOEs according to a clear rationale: - Strategic rationale – retain ownership by the state, - No strategic rationale or SOEs not performing their core activities – consider consolidation, optimization, closure, privatization or other forms of private participation (public-private partnerships, concessions), - Include all entities, including those currently banned for privatization, as appended to the Law on Privatisation and Post-Privatisation Control.	Short term
SOEs Corporate Governance: Ownership and Oversight Function	• **Enhance PECA's capacity as a central coordinating agency.** - Strengthen PECA's capacity by ensuring proper staffing and training of its personnel, and dedication of relevant economic, financial, and managerial resources and expertise to perform its tasks effectively. Develop relevant policies and tools, and build a pool of experts to assist PECA in monitoring SOEs effectively.	Short to medium term
SOEs Fiscal Impact	• **Systematize SOEs' relationship with the budget to properly calculate and compensate for quasi-fiscal activities.** - Formulate a public policy rationale and a clear mechanism for subsidizing goods and services provided by SOEs so that SOEs are reimbursed for the cost of providing such services via well-estimated, appropriate and fair subsidies. - Calculate the cost of respective public policy objectives for each identified SOE and type of public service. - Duly compensate SOEs performing public policy objectives—through direct on-budget transfers— for the actual cost of public social obligations they deliver at below cost. - Increase transparency of financial relationships between the Government and the SOEs for proper calculation, recording, and disclosure of such transactions.	Short term

<table>
<tr><th colspan="3">OTHER IMPORTANT REFORM OPTIONS</th></tr>
<tr><td>SOEs Corporate Governance: Transparency and Disclosure</td><td>Strengthen SOE transparency by assuring compliance and reinforcing current reporting and disclosure, and external audit requirements.
- Strengthen enforcement over all large SOEs to be preparing their financial statements in accordance with the IFRS and be subject to the same disclosure standards as listed companies.
- Require and enforce regular independent audit of SOEs´ annual financial statements in line with the new PE Act.</td><td>Short to medium term</td></tr>
<tr><td>SOEs Corporate Governance: Ownership and Oversight Function</td><td>Strengthen PECA’s role in monitoring, oversight and public disclosure of the SOE portfolio’s performance.
- Consider transferring the SOE oversight function from line ministries to PECA to strengthen SOE oversight and ensure a clear separation of SOE ownership and regulatory functions.
- Reinforce and continue PECA’s practice of preparation and publication of an SOE aggregate annual report to include the performance analysis of the entire SOE portfolio.
- Evaluate the implementation of the SOE ownership policy once the latter is approved and publish the results of the evaluation annually.
- Introduce detailed overview of entity-based analysis for the largest SOEs allowing for a comparative review of their performance.
- Consider applying a dashboard approach by ranking SOEs by their performance, quality of service delivery, audit results, corporate governance implementation, other dimensions.</td><td>Short to medium term</td></tr>
<tr><td>SOEs Corporate Governance: Board of Directors Practices & Procedures</td><td>Further professionalize SOE boards of directors.
- Expand the competitive selection and nomination procedures for SOE board members beyond the already completed 37 large SOEs, eventually covering the entire SOE portfolio.
- Increase the independence and professionalism requirements in line with the PE Act to gradually decrease and phase out politicians from SOE board appointments.
- Consider attracting independent directors from other countries to strengthen SOE boards’ skill</td><td>Medium term</td></tr>
</table>

	sets and reduce the level of undue political influence on SOEs. For this, selection announcements and selection can be carried out locally and internationally. - Implement adequate training programs, peer exchanges, and learning opportunities for potential candidates and existing SOE board members.	
SOEs Corporate Governance: Performance Monitoring	• **Establish a remuneration policy for SOE boards and executive management to attract a skilled cadre and motivate qualified professionals.** - Review current remuneration policies, benchmark with same remuneration practices in selected EU countries (with the help of independent experts). - Align SOE board compensation with that of other EU countries to be based on fixed amount and aligned with the long- and medium-term interests of SOEs. - Link SOE management incentives and compensation to SOEs´ performance and KPIs, determining additional incentives for achieving the KPIs, or corrective actions in case of non-satisfactory results.	Medium term
SOEs Corporate Governance: Performance Monitoring	• **Introduce and enforce SOE performance monitoring and evaluation.** - Promote the signing of multi-year performance contracts between individual SOEs, PECA, and corresponding line ministries structured around relevant and measurable KPIs and associated targets.[41] - Link KPIs (both financial and non-financial) and associated targets to SOE strategy and objectives, to facilitate the measurement and evaluation of results.	Medium term

[41] Contracts for outsourcing relevant activities and services so far have been concluded between the government on one hand, and the National Railway Infrastructure Company (for a period of five years), BDZ-Passenger Transport (fifteen years) and local road transport service operators (where the counterparty is local governments), on the other. These contracts set indicators and obligations to be fulfilled by state-owned enterprises and provide for sanctions to be imposed in case of non-compliance. Obligations for performing the universal postal service and the service of general economic interest for distribution of periodicals are assigned to Bulgarian Posts EAD with the Postal Services Act and Council of Ministers Decree No 113/2020.

	- Prioritize top ten SOEs in a pilot phase, conduct necessary periodic review of such incentive mechanisms.	
SOEs Corporate Governance: Ownership and Oversight Function	• **Build capacity of key participants in the SOE governance process.** - Develop and roll out SOE governance capacity building program to train and advise those charged with SOE governance, including but not limited to: SOE ownership and oversight entities (PECA, Line Ministries, MOF), SOE boards and their committees, SOE management. - Consider all levels of participants (potential and existing SOE board members, SOE management, key expert-level staff at SOEs, staff in the line ministries' SOE units) for regular training programs, peer exchanges, formal induction-orientation programs, and ongoing learning opportunities.	Medium term
Private Sector Development in SOE Dominated Markets	• **Consider listing minority stakes of SOEs on the Bulgarian Stock Exchange.** - Develop a strategy for selected high-potential SOEs for listing their minority stake at the local market, detailing an action plan to strengthen their corporate governance practices, improve financial performance, increasing their transparency. - Consider approaching international financial organizations and investment advisors to assist with individual entity-level preparedness for selected SOEs and choice of right instruments.	Medium to longer term

Annex 1: Good Practices for SOE Performance Evaluation and Management

In SOEs, effective performance management must adopt elements from both public and private sector best practices. The OECD, through its corporate governance guidelines, has provided extensive suggestions regarding performance monitoring and management. Its fundamental principle is that the state must act as an informed and active owner, thus ensuring that SOEs' governance is transparent and accountable, with a high degree of professionalism and effectiveness. From this principle, further responsibilities of the state derive, such as:

1. setting and monitoring the implementation of broad mandates and objectives for SOEs;
2. creating monitoring systems that allow the ownership entity to audit and assess SOE performance;
3. establishing a board remuneration policy that will advance the long-and medium-term interests of the enterprise while attracting qualified professionals.

The first two are fundamental to performance management as a discipline, as they concern setting and monitoring operational objectives. The latter relates to how the ownership entity must incentivize the boards of directors by requiring the fulfillment of performance criteria.

Best practices for performance evaluation and management of SOEs include:

- **Formalizing performance evaluation systems through performance contracts and performance indicators.** Performance contracts (or equivalents such as agreements or memorandums) outline yearly performance targets and should be concluded between the boards of directors and executive management. However, in a number of countries (OECD, 2016) performance contracts are concluded between the ownership entity and executive management, departing from the OECD Guideline II.B. that stipulates the state should "allow SOEs full operational autonomy to achieve their defined objectives and refrain from intervening in SOE management". Performance indicators should be clearly defined and cover both financial performance and non-financial performance, such as the delivery of public service obligations.
- **Auditing and reporting on performance.** Reporting regularly on SOE performance at both the company level as well as the sector level through aggregate reports is critical for strengthening the accountability of the state as the owner and leads to improved performance. A good practice to ensure the quality of reporting and accuracy of information included in financial statements and annual report is to set up an internal audit function and appoint an external auditor that reports directly to the Board of Directors.
- **Linking evaluation of performance to executive incentives.** In line with OECD Guidelines, the SOE board should be responsible to oversee and incentivize the management. Explicit and published pay-scales linked to performance allow for increased transparency and enhance SOEs capacity to attract and retain appropriate managerial capacity.

Annex 2: Good Practices in Aggregate SOE Reporting

Several countries in Europe have developed thorough and reliable reporting on their SOE portfolios. Lithuania, Norway, and Sweden are often cited as examples of global best practice in SOE monitoring and disclosure. These countries provide comprehensive information on the entire SOE portfolio as well as individual SOE snapshots. They disclose a list of all SOEs, and the amount of subsidies/appropriations provided to them during the reporting year. They also report on the costs related to public policy objectives carried out by SOEs and the commensurate compensation provided by the state budget. The Netherlands provides an interactive online report on the SOE portfolio and individual SOEs that allows users to analyze the portfolio in different ways.

Lithuania
Periodic Reports: https://governance.lt/vkc-ataskaitos/#vvi-veiklos-ataskaitos

Norway
Annual Reports: https://www.regjeringen.no/en/topics/business-and-industry/state-ownership/id1336/

Annex 3: SOE Reporting Requirements as per the Implementing Rules of the Public Enterprises Act (PE Act)

The PECA shall maintain an electronic information system for public enterprises with the following data:

1. unique identification code;
2. name, legal form of the enterprise, seat and address of management;
3. field of operation of the enterprise and a four-digit code of principal economic activity under NACE.BG-2008;
4. capital, distribution of capital, amount of shareholding;
5. names of the members of the management and control bodies and of the persons representing the enterprise;
6. whether the enterprise is "large" within the meaning of the Accounting Act;
7. the accounting standards the enterprise applies;
8. the body exercising the rights of the state in the enterprise;
9. quarterly and annual financial statements, analysis, and reports on the activities of the public enterprises as well as other information under Article 61;
10. summary information by enterprise on the application of the rules and the existence of a concentration under Article 28, paragraph 5;
11. the approved business programs of public enterprises as well as reports on the degree of fulfilment of the indicators set in the business programs.

Public enterprises shall be obliged to provide information on updating the data under paragraph (1) within 5 business days after the change occurs. The PECA shall provide public access to the data under paragraph (1) points 1 through 10, on its website.

The PECA shall prepare an annual aggregate analytical report on the public enterprises, including (at least) information on:

1. the government portfolio in public enterprises (total value and structure);
2. the implementation of the policy of state ownership in public enterprises during the reporting period;
3. the financial and operational situation of the enterprises at the end of the reporting period;
4. the presentation of public enterprises and the fulfilment of the strategic goals and planned results;
5. the assessment of the degree of compliance of the activities of public enterprises with the applicable standards for corporate governance and disclosure;
6. the composition of the management and control bodies, their remuneration, and the changes made therein.

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