

## Bulgaria

### Political turmoil likely to have small long-term impact on the course of the economy

- Protests have caused a significant shift in support for the main parties.
- Under the most likely scenario, GERB (Citizens for European Development of Bulgaria) will remain the largest party in the next parliament. However, we expect the BSP (Bulgarian Socialist Party) to form the next coalition government.
- The BSP is likely to remove the flat personal income tax and increase pensions. This will support economic growth, as those at the bottom of income distribution will benefit most.
- Timely completion of large infrastructure projects and tax collections are risks worth watching if the BSP forms the next coalition government.
- A smooth absorption of the EU's anti-crisis funding would be crucial to ensure a strong and fast economic recovery.
- Irrespective of who wins the next election, Bulgaria is likely to end up pushing for more progress in fighting corruption and reforming the judiciary.

Although losing much of its momentum, protests against the government of Mr. Boyko Borisov continue. Mr. Borisov is prime minister of the Republic of Bulgaria and the leader of GERB, Bulgaria's largest parliamentary party.

The protestors continue to demand the resignation of both the prime minister and the chief prosecutor, Ivan Geshev, and the switch to an electronic voting system. They have no other specific demands.

The protestors have failed to articulate any alternative vision for the country's governance and socio- and economic development. President Rumen Radev, who was elected on the ticket of the BSP, has emerged as the main protagonist of the protests. Mr. Radev said he is ready with a comprehensive program for the country's governance, but will present it only after Mr. Borisov submits the resignation of his government and the parliament is dissolved. This would allow Mr. Radev to appoint a caretaker government and organize the next parliamentary election early next year.

In October, the number of those marching in the streets of Sofia has declined significantly compared to July, when the protests began. Public support for the protests also diminished and in the beginning of October was broadly equal to the cumulative support for the main opposition parties in the country. This slowly transformed the protests from a broad-based and popular anticorruption movement at the beginning into an organized attempt to topple Mr. Borisov's government and transfer political power in the hands of Mr. Radev and the opposition parties, led by the BSP.

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### **The protests have caused a significant shift in the popular support for Bulgaria's main political parties**

**Protests have led to increased support for anti-establishment parties**

The key beneficiary is the anti-establishment party "There Are Such People" led by Slavi Trifonov. Mr. Trifonov is a popular singer who runs his own TV show on his private TV channel. A public opinion poll conducted by Alpha Research shows that if elections had been held at the end of September, "There Are Such People" would have become the third-largest political player in parliament, with 14.9% of those willing to vote supporting the party.

Two other small political parties are likely to benefit from the protests and surpass the 4% threshold required to enter parliament. These are the right-wing "Democratic Bulgaria", whose leader, Mr. Hristo Ivanov, was a justice minister in the second government of Mr. Borisov, and the left-wing "Stand up. BG", of the former ombudsman and member of the BSP leadership, Mrs. Maya Manolova, who lost the 2018 municipal elections in Sofia to GERB's candidate, Mrs. Yordanka Fandakova.

**Support for the Socialists is little changed...**

Support for the BSP, the largest opposition party and the most vocal critic of Mr. Borisov, has increased only marginally since the protests began. Had elections been held at the end of September, the BSP would have gathered 19.6% of the votes, according to Alpha Research. Nevertheless, the current approval rating of the BSP is 8.3pp below the party's tally in the last parliamentary elections held in 2017.

**...and is down for the governing GERB**

The GERB has emerged as the main loser. Nevertheless, it is likely to remain the largest party in the next parliament, with 20.5% support in the Alpha Research poll, which we regard as the most reliable polling agency in the country. This is more than 12pp lower than the party's support gathered in the last parliamentary election in 2017.

At the same time, support for Bulgaria's ethnic Turkish party, The Movement for Rights and Freedoms (MRF), and for the nationalist parties' alliance, The Patriots, remained little changed, at 9.9% and 3.8% of likely voters, respectively.

### **The likelihood of early elections remains small**

**Early elections looks unlikely from today's perspective**

In our view, the likelihood of snap elections is relatively small from today's perspective. This is also the worst-case scenario, because if Mr. Borisov resigns, parliament is dissolved, and the president appoints a caretaker government, Bulgaria would remain without a working legislative branch of power in a very precarious moment, when well-coordinated and rigorous actions would be needed to address the country's worst recession since 1997.

### **Elections could result in a fragile governing coalition**

We do not predict an election outcome different from the key opinion polls available at the time of writing of this country note. However, we have to be cautious as the situation is very dynamic and could change significantly in the run-up to the election.

For BSP and the President Radev the aim would be to urge everybody to play against GERB. Their plan is to put GERB in isolation, thereby reducing the latter's chances to form the next country's government.

**The GERB is likely to remain the largest parliamentary party...**

As things stand now, the GERB is likely to remain the largest party in parliament. Six other political formations could pass the 4% threshold required to enter parliament. If this scenario materializes, it will produce a deeply fragmented parliament. Given how aggressive the election campaign is likely to be, it will be hard for the GERB to form a government with strong parliamentary backing. One way to break the deadlock is to nominate a PM other than Mr. Borisov. However, this outcome seems unlikely at this point, which suggests that the GERB would go into opposition.

**...but the BSP is likelier to form a coalition government**

Under the most likely scenario, the BSP and its allies from "Stand up. BG", together with the right-wing Democratic Bulgaria will join forces with the newcomers from anti-establishment party "There Are Such People" and form the next coalition government.

## Potential changes in economic policies after elections

At this stage, there are very few clues as to what the economic policy of the next government might be.

**The BSP supports progressive income taxes...**

The BSP supports the removal of Bulgaria's flat tax on personal incomes and wants to replace it with a moderately progressive tax scale, with the top tax rate probably close to 30%. This is in line with recommendations made by the managing director of the IMF, Kristalina Georgieva, that Bulgaria should consider abandoning its flat tax on personal incomes as part of the policy response needed to address elevated poverty. In addition, the BSP has voiced support for increasing pensions and social transfers to the most vulnerable Bulgarian citizens. These ideas are positive for economic growth and job creation because they are aimed at helping those at the bottom of the income distribution. The flipside is that, the BSP has never been specific with regard to the budgetary impact of changes in taxes and spending.

**...a mixed health care system...**

In our view, the BSP's vision on health care seems more pragmatic than GERB's one. The BSP wants to keep the single-payer state-owned system for the basic package of primary health care services, while supplementary insurance provided by private insurers on a voluntary basis will continue to cover health services not included in the basic package. To improve spending control, the BSP wants to tighten the process of accreditation of new hospitals (which makes sense to us because Bulgaria is one of the countries with the highest number of hospitals per capita in EU), introduce a centralized procurement system and expand the share of e-based services. GERB, on the other hand, has proposed replacing the state-owned single-payer system with a private health care insurance system. The problem is that GERB has failed to produce sufficiently strong evidence that this will improve cost control. The latter raises concerns that GERB wants to replace a poorly regulated state monopoly with an even-more-poorly regulated private oligopoly, which could result in higher health price inflation and even higher out-of-pocket payments, which in Bulgaria are the highest in the EU relative to public-sector payments. Unfortunately, the focus of the two main political parties remains almost entirely on how to improve spending control, while not addressing the need to increase health insurance contributions – a move that looks inevitable if Bulgaria wants to address the problem of inadequate funding being channeled to its health care sector.

**...and the nuclear power plant in Belene**

The BSP's other ideas are more problematic. For example, the BSP is committed to render the Belene nuclear-power-plant project irreversible. This is worrisome because Belene is a highly controversial project. The main weakness of the project is that there is no certainty as to whether there is a market for the electricity the plant will generate. The project uses obsolete technology, which raises security concerns, and will further strengthen Russia's dominant position in the local energy sector. Also, there are major concerns regarding the financial viability of the project. This is perhaps best signaled by the fact that Russia's Atomstroyexport is the only player interested in financing the project. The project was a source of corruption scandals in the past, and this is unlikely to change. At the same time, it should be noted that GERB also supports the project. Therefore, the composition of the next government is likely to matter little to the future of the Belene nuclear power plant.

**The BSP has a poor track record when it comes to EU fund absorption...**

Utilization of EU funds is one more area where the BSP's track-record has been poor. This is worrisome, since Bulgaria is entitled to receive a significant amount of funding (EUR 7.5bn in grants and EUR 4.6bn in low-cost loans) under the EU's Next Generation program. If, Bulgaria fails to absorb the bulk of this anti-crisis EU funding, the country's economic recovery from the coronavirus-caused recession could prove much slower and more painful.

**...fiscal restraint...**

If the past has any clues to offer, budget-implementation risks are likely to increase if the BSP wins, given its poor record in boosting tax collection. To make things worse, one of its likely junior coalition partners, Democratic Bulgaria, wants to abolish entirely Ordinance N18, which would entail backtracking on most of the progress that two consecutive GERB-led governments have made in improving tax collection and reducing the grey economy.

**...and public investment**

Timely completion of large infrastructure projects started by the previous administration is another source of risk worth watching in case a BSP-led government wins a mandate to run the country. This is another policy area where history is not on the BSP's side. The risk here is that the BSP might be tempted to scrap some of the public procurement that has already been awarded by the current government, similarly to what it did in 2013, after the first government of Mr. Borisov was forced to resign under broadly identical circumstances.

**A better chance to fight corruption...**

Both the BSP and GERB are likely to end up pushing for more progress in fighting corruption and organized crime, in our view. This is because neither party would dare risk losing access to EU funding from the Next Generation program, which would be key to the pace and strength of Bulgaria's recovery following the coronavirus-caused recession. In particular, we expect the Supreme Judiciary Council (SJC) to be split into two segments: one for judges and one for prosecutors. We expect parliament's quota for electing members to the SJC to be reduced, giving judges and prosecutors a bigger say in electing SJC members to thereby help boost the independence of the judiciary from political and business interests. Also, more efforts are likely to be made to ensure effective accountability and criminal liability on the part of the prosecutor general as per the Venice Commission's recommendations.

**...and to achieve judicial independence****The BSP's agenda may be altered by coalition negotiations**

Finally, the BSP may have to water down some of its election promises. This is because the BSP will have to become part of a very heterogeneous coalition, where its junior coalition partners are likely to have a higher number of MPs than the BSP itself. At this point, it is unclear which potential partners in a future government coalition would subscribe to the BSP's policy agenda, what concessions the BSP might have to make and what their red lines would be in the negotiations process.

**Policies will be shaped by Bulgaria's efforts to adopt the euro...**

The conclusion is that, while there will be some policy differences depending on who wins the next election, the course of the economy will most likely be little affected in the next four years. Preserving Bulgaria's strong fiscal metrics and labor competitiveness in the EU will be paramount if the country wants to join the eurozone. Smooth absorption of EU funds, at the same time, will be crucial to ensuring the strong and fast recovery of the economy from the coronavirus-caused recession. As access to EU funds will depend on ensuring the rule of law, efforts to reduce corruption and reform the judiciary are likely to take central stage in the policy agenda of the next government.

**...and reliance on EU funding**

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