

Trade Policy Review Body

TRADE POLICY REVIEW

BULGARIA

Report by the Secretariat

This report, prepared for the Trade Policy Review of Bulgaria, has been drawn up by the WTO Secretariat on its own responsibility. The Secretariat has, as required by the Agreement establishing the Trade Policy Review Mechanism (Annex 3 of the Marrakesh Agreement Establishing the World Trade Organization), sought clarification from the Government of Bulgaria on its trade policies and practices.

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SUMMARY OBSERVATIONS

(1) The Economic Environment

1. Bulgaria is currently on an economic recovery path, with rapid economic growth and low inflation. Fundamental macroeconomic and structural reforms, including in trade policy, have been undertaken; however, the structural reform process, though well advanced, remains to be completed.

2. During the early transition period, the economy suffered from a slow and erratic approach to domestic economic reform, with widespread rent-seeking, unsound credit policies, and rising budget deficits. Simultaneously, unfavourable external developments included the collapse of the Council for Mutual and Economic Assistance (CMEA) and the Gulf and Yugoslav crises. This combination of factors led to a severe economic crisis by the end of 1996, with hyperinflation, rapid depreciation of the lev, and closure of a third of the banking sector.

3. In response, the Government established a Currency Board Arrangement, tightened fiscal policy, and accelerated the pace of structural reforms. This resulted in a significant improvement in the macroeconomic environment, with real GDP growth averaging over 4% between 1998 and 2002, and annual inflation and interest rates averaging 9% a year and 4.6% respectively (and falling) during the same period.

4. The invitation to Bulgaria in 2000 to commence negotiations to accede to the European Union (EU), has spurred further reforms, including to its trade regime. EU accession is Bulgaria's principal foreign policy priority: its objective is to accede to the EU on 1 January 2007.

5. Foreign trade plays an important part in Bulgaria's economy. Trade in goods increased from 68% of GDP in 1998 to 87% in 2002. Export growth, which averaged 12.5% over 2000-02, was the main contributor to

growth in GDP in 2000 and 2001 and the second largest contributor in 2002. Annual import growth averaged 12.8% over the same period. The current account deficit, at 4.8% in 2002, is largely financed by foreign direct investment and other private inflows. Domestic consumption has picked up, averaging 5.8% growth annually over 1998-2002, and in 2002 was the principal contributor to economic growth. Investment is the most dynamic component of aggregate demand. Gross fixed capital formation, spurred by privatization, recorded average growth of 17% over 1998-2002, indicating renewed confidence in Bulgaria's economy due to the improved business climate, and holding hope for future sustained growth.

6. Notwithstanding these improvements to the economic environment, real GDP and consumption were in 2002 still below their pre-transition (1989) levels by 17% and 13% respectively. Employment in 2001 stood at 27% below its 1990 level. Furthermore, even though the situation has improved significantly since 1997, compared with the pre-transition period levels of poverty are still high; a World Bank study using a monetary poverty line of \$4.30 per day estimates that a third of the population were in poverty in 2001, and deep wells of unemployment and poverty remain.

7. To address these concerns further consolidation of reforms is required in areas where administrative capacity to implement and enforce legislative changes is weak, as well as acceleration of reform in areas where the speed has been slower, such as the judicial system and the energy sector. Further improvements to its trade regime by Bulgaria as well as by trading partners within the multilateral trading system would assist Bulgaria to achieve its economic goals.

(2) Trade and Investment Policy Framework

8. Bulgaria's overall trade policy objective is geared to the liberalization of its trade regime. This is being pursued at multilateral, regional, and bilateral levels.

9. Bulgaria's multilateral trade policy is focused on its commitments, and present negotiations, in the WTO. Bulgaria acceded to the WTO on 1 December 1996, and has accepted all multilateral and plurilateral agreements except the Agreement on Government Procurement, where it is an observer and where consultations on its membership are ongoing. It grants at least most-favoured-nation treatment to all WTO Members. On accession, it bound all its tariffs under GATT 1994, and has since reduced its bound rates in accordance with its Schedule of Concession and Commitments; in some cases it has undertaken autonomous liberalization beyond that required under its Schedule. Bulgaria has sought to bring its trade-related legislation into conformity with WTO provisions, including legislative reforms on anti-dumping and countervailing actions, safeguard actions, TBT and SPS measures, services, and TRIPS. It has also introduced new bankruptcy and competition laws. It has taken up further obligations on basic telecommunications and financial services.

10. Liberalization of Bulgaria's trading regime is by far the deepest and most comprehensive at the regional level, in particular with the EU. Under the Bulgaria/EU Europe Agreement (EA), dating from March 1993, all import duties and non-tariff measures on industrial goods have been eliminated on both sides. Liberalization of trade in agricultural products under the EA, although progressive, has been more selective than for industrial goods. Current efforts to accede to the EU by January 2007 are spurring further reforms in almost all spheres of the Bulgarian economy, including that affecting its trade-related legislation to ensure conformity with the EU *acquis communautaire*. Bulgaria also has preferential regional trade agreements with CEFTA and EFTA. In both agreements, trade in industrial products is free, and again there is more selective liberalization of trade in agricultural products.

11. At the bilateral level, Bulgaria has concluded reciprocal trade agreements with

seven countries, all of which have EAs with the EU: Croatia, Estonia, Israel, Latvia, Lithuania, Former Yugoslavian Republic of Macedonia, and Turkey. Once again, trade in industrial goods is free and agricultural trade is selectively liberalized.

12. Bulgaria also seeks to liberalize its investment regime. Current legislation guarantees equal treatment of domestic and foreign investors; no limitations on the amount of foreign participation in a newly formed or existing company; and unrestricted acquisition and transfer of funds abroad. The regime, however, restricts foreign investors (unless incorporated in Bulgaria) from acquiring land ownership title.

13. The above changes have had a profound impact on Bulgaria's trade performance. Apart from contributing to the increasing openness of the economy (as shown by the rise in trade shares), they have led to seismic changes in the product composition and direction of trade. Before the transition, over half of Bulgaria's foreign trade was with members of the CMEA: between 1995 and 2002, imports from preferential partners increased from 40% to 67% of the total, with the increased re-orientation of trade towards the EU accounting for most of this trend. In 2002, the EU accounted for 53% of Bulgaria's total trade up from 38.5% in 1995. In the pre-transition period Bulgaria was a major exporter of capital goods and processed food to the CMEA, it is currently a net importer of these products and is proving competitive in exports of footwear, textiles, and apparel. Given the differing scope and pace of liberalization pursued on the preferential and MFN fronts, it is not surprising that the bulk of Bulgaria's trade is currently undertaken on preferential terms.

14. Bulgaria's planned accession to the EU in 2007 would further alter its trade regime, with further implications for its trade performance, especially with respect to agricultural trade, as there already exists free-trade in industrial goods. The process of EU accession, and the accompanying reforms,

have contributed to improving the competitiveness of the economy and its recovery, including increased trade. Increased integration in future would further encourage trade between Bulgaria and its EU partners (including the ten countries to accede in 2004). Whether this process would be trade creating or diverting remains an open question, as the EU's CAP is still undergoing reforms. However, if, at the time of Bulgaria's accession to the EU, agricultural prices within the EU remain higher than those on world markets, this could well lead to trade diversion in agricultural goods.

15. Irrespective of the present or future consequences of Bulgaria's preferential arrangements, concerns of trade diversion would be minimized were Bulgaria to reduce the gap between its MFN and preferential rates. Not only would this increase the chances of trade creation, it would also further improve the competitiveness of the Bulgarian economy and engender more efficient allocation of resources and greater gains from trade.

(3) Trade and Related Policy Measures

16. Bulgaria's trade liberalization is confirmed by the fall in the average applied MFN tariff rate for all products from 17.2% in 1996, on accession to WTO, to 11.6% in 2003. Duties range from 0% to maxima of 40% in industrial and 80% in agricultural products. Industrial trade liberalization has progressed more rapidly than that in agriculture: in 2003 the average applied MFN rate for agricultural goods was 22.4% while that for industrial products was 8.7%. All duties on industrial products are ad valorem, while 16% of duties on agricultural goods are either specific, mixed, compound or seasonal duties. Average applied MFN tariff rates are well above preferential rates; the average preferential rates for all products range between 2.5% to 5.9% depending on the agreement.

17. Bulgaria bound all its tariffs at ceiling rates on accession to WTO. In 2003, the average MFN bound rate was 28.2%, with a

maximum of 200%. The wide gap between Bulgaria's applied and bound MFN rates could give it considerable latitude to increase tariff levels. A reduction in its bound rates would enhance the predictability of its trade regime.

18. Under its WTO Agriculture Schedule, Bulgaria applies MFN tariff quotas at zero or reduced duty rates. In 2003 there were 45 such quotas in place. In most cases, however, the applied rate of duty is lower than the bound rates at which the tariff quotas are opened. It also applies autonomous MFN tariff quotas at zero or reduced rates of duty; in 2003, 38 such tariff quotas were applied. In a few cases, tariff quotas are allocated between the EU and other suppliers; in all instances, quotas are allocated on a first come, first served basis. Except for a few products, most of these quotas are substantially underutilized. Some tariff quotas also apply under Bulgaria's free-trade agreements.

19. Bulgaria applies a 20% value-added tax on most goods and services, including imports. Exports and supplies of goods in custom warehouses and free zones do not attract VAT. Excise duties are levied on a limited number of products for mainly health and environmental reasons. Exports are again exempt from such duties.

20. Bulgaria has and is still undertaking extensive trade-related legislative reforms. These have been motivated by the need to bring its legislation into conformity with that of WTO requirements and, more significantly in recent years, to harmonize its legislation with that of the EU acquis..

21. The Customs Act, 1998 and its implementing regulations provide the main framework for Bulgaria's customs administration. Customs legislation is harmonized with that of the EU. Bulgaria is actively working to strengthen the capacity of its Customs Agency, with substantial external expertise and assistance. The aim is to facilitate trade through reductions in document processing time, enhance customs

revenue, and reduce problems of corruption and smuggling.

22. Bulgaria applies both non-preferential and preferential rules of origin. Preferential rules of origin apply to free-trade agreements and the GSP. Bulgaria is a participant in the Pan-European Cumulation System, which provides for a diagonal system of cumulation of origin with all of its major preferential trading partners.

23. Bulgaria's import licensing regime has been liberalized. It currently does not apply any automatic licences on imports. Remaining non-automatic licences are maintained in conformity with Bulgaria's commitments under various international agreements related to trade in arms, and protection of human, animal, and plant life.

24. During the process of its accession to the WTO, Bulgaria introduced new anti-dumping, countervailing and safeguard legislation, in conformity with WTO disciplines. Bulgaria has not introduced any countervailing measure. It has so far initiated one anti-dumping action, and six safeguard investigations, two of which have resulted in increased duties.

25. Bulgaria's government procurement legislation has undergone substantial reform since 1997 to open its market to foreign suppliers and to align the system with WTO and EU rules. There are preferences for small and medium enterprises and companies employing disabled people. New draft legislation currently in process will, inter alia, reduce preference levels and harmonize Bulgarian rules with EU rules in this area.

26. Bulgaria is harmonizing its national standards with international and regional standards, in particular those of the EU. Some 2% of standards in force are mandatory technical regulations. Currently, 52% of Bulgaria's standards are harmonized with those of the EU and it intends to achieve 80% harmonization by 2004.

27. Bulgaria is also harmonizing its sanitary and phytosanitary standards with those of the EU. Veterinary certificates are required for the importation of certain animals, foodstuffs, and raw materials of animal origin. Bulgaria maintains import bans on live cattle, sheep, and goats, and certain products from countries where BSE and foot and mouth disease are known. Most imports of live animals are subject to quarantine. Current reforms in plant protection law also seek to harmonize Bulgaria's legislation with EU directives and international rules. Under current regulations, import bans can be applied to plants and plant products with listed pests. Similar harmonization reforms are occurring in the area of marks and labelling; there is a move towards mutual recognition between Bulgaria and the EU for designated conformity assessment bodies.

28. Export procedures follow the Customs Act and its implementing regulations. Bulgaria no longer imposes duties, taxes or other charges on exports. Export restrictions mainly consist of a ban on the export of fire-burnt unsawn timber (to discourage deliberate burning of forests) and export licences are required in accordance with international treaties and conventions to which Bulgaria's is a signatory.

29. The Bulgarian Trade Promotion Agency gives exporters information on international markets, foreign trade and investment regimes, and runs training courses and seminars. The Bulgarian Export Insurance Agency covers short-term commercial and non-commercial risks related to Bulgarian investments abroad. Six free zones provide facilities for storage, warehousing and inward processing on a duty- and VAT-free basis.

30. In recent years, Bulgaria has strengthened its bankruptcy and insolvency laws, which are being harmonized with those of the EU. The changes have resulted in a steady increase in recorded insolvency or liquidation procedures. Similar reforms have taken place for competition policy. The

legislation provides detailed rules on monopolies, misuse of dominant positions, unfair competition, and other actions that may result in the prevention, restriction or breach of competition. Since 1998, the number of decisions made by the Commission on the Protection of Competition has been on the increase.

31. During its WTO accession process, Bulgaria committed itself to bringing the rest of its domestic legislation into compliance with the TRIPS Agreement. It has undertaken extensive reforms to its national laws with this aim, and to harmonize them with EU legislation. As a result its intellectual property legislation is considered to be amongst the most modern in Central and Eastern Europe. Bulgaria was removed from the USTR "Special 301 Watch List" in 1999.

32. The above measures and reforms have contributed significantly to improving the regulatory environment affecting trade. Nonetheless, there remain implementation and enforcement challenges.

(4) Sectoral Developments

33. The thrust of Bulgaria's agricultural trade policy, particularly since 1997, has been towards liberalization. Since 1997, licensing requirements for the import and export of agricultural products have been removed and by 1999, price controls had been lifted on all agricultural output prices, except tobacco. Currently the only import protection for agricultural products is through tariffs. In 2003, the average applied MFN rate for agricultural goods was 22.5%. However, there is wide dispersion of tariffs amongst agricultural products as the maximum applied rate is 80% and the maximum bound rate is 200%.

34. Bulgaria's total aggregate measure of support (AMS) has been increasing since 1997 and amounted to €26.03 million in 2003. However, this is well below its total bound AMS level. Overall, domestic support for agriculture remains low. The main domestic

support instruments include input subsidies, subsidies for interest rates, provision of guarantees and collateral to financial institutions, premium and buying-up provisions for tobacco, and bonuses on prices. In 2003, there were market interventions for tobacco (through minimum farm-gate prices) and wheat (through a system of warehouse receipts for grains).

35. One significant negative factor affecting Bulgaria's agriculture has been the process of land restitution. Though now completed, its implementation was disruptive and resulted in fragmented ownership, with many farmers lacking capital and the necessary investment to boost production. Efforts are currently under way to achieve land consolidation and stimulate a land market.

36. With agriculture contributing over a quarter of employment and with most of the rural poor engaged in this activity, improvements in this sector could enable Bulgaria to address some of the deep concerns of growth and poverty. Ongoing efforts to liberalize agricultural trade with the EU could help in this respect, via improved market access. An accelerated multilateral process could have even greater impact. Nonetheless, further domestic reforms, particularly by way of accelerating consolidation of agricultural lands and developing of a viable land market, are needed. Opening of the land market to foreign ownership may help in this respect and could serve to attract the investment needed to revitalize the sector.

37. Bulgaria's industrial landscape has also undergone significant transformation. Prior to the transition, Bulgaria was specialized in the production and supply of capital and machinery as well as processed food products for the CMEA market. The collapse of the CMEA, and trade liberalization and privatization reforms introduced in subsequent years, have led to significant changes in resource allocation, and consequent effects on the dynamics of trade specialization. Currently Bulgaria's major

industrial exports include textiles and apparel, non-ferrous metals, iron and steel, and footwear. In most industries, small and medium enterprises (SMEs) dominate; although few are involved in trade. Encouragement of SMEs is vital to Bulgaria's economic and trade development. Reduction of tax and administrative burdens will make an important contribution in this area.

38. The main trade policy instrument influencing the industrial sector is the import tariff. As noted, the average MFN tariff on non-agricultural goods in 2003 was 8.7%, with a maximum of 40%: however, under Bulgaria's preferential trade agreements, which account for the greatest part of trade in industrial goods, all industrial products enter duty free. Most Bulgarian manufacturers do not consider tariffs to be significant barriers.

39. Sales of state-owned enterprises in the manufacturing sector have been finalized. Privatization of state entities in the energy sector has not proceeded with the same speed, though there are ongoing restructuring and privatization efforts. Acceleration of such reforms would contribute towards improving the competitiveness of the Bulgarian economy via a more efficient and reliable supply of energy to industry.

40. The financial sector has been one of the main beneficiaries of privatization reforms in services. Overall, however, a considerable amount of services provision remains under government control, but in most cases plans are in being to privatize these enterprises, including in telecommunications and transport. Further opening of these sectors to private investment as well as increased complementary government infrastructural investment would improve the competitiveness of Bulgaria's business environment. One sector with great potential, and most likely to benefit from such reforms is tourism; its importance in the economy has revived in recent years but it still accounts for a small proportion of GDP. Among the factors that constrain the sector are lack of investment

needed for modernization and insufficient international advertising.

(5) Trade Policy and Foreign Trading Partners

41. Bulgaria has been an active participant in the WTO since its accession in 1996. During this period it has progressively liberalized its MFN trading regime. However, its main trade liberalization efforts have been pursued through a network of regional and bilateral agreements, the most important of which is with the EU. The goal of acceding to the EU by 2007 is the principal political and economic priority of the Government and in recent years has been the main driving force of Bulgaria's reform agenda including that of trade and trade-related policies.

42. By and large, these policies have improved market access opportunities for Bulgarian products in Europe, particularly for industrial goods, and have supported the transition of Bulgaria's economy from a centrally planned to a market-oriented economy. The process of accession has also anchored Bulgaria's reform efforts, thus creating confidence in the continuity of policy.

43. Nonetheless, Bulgaria still faces some challenges related to its trading regime. One is the wide disparity between its applied MFN and preferential tariff rates, which in effect accounts for the increasing share of trade carried out on a preferential basis, thus raising worries of trade diversion. Reductions in preferential margins would diminish the possibility of trade diversion and would be beneficial to Bulgarian producers and consumers, who would be able to access imported inputs and final goods at more competitive prices. It would also help the gradual transition of Bulgaria's tariff regime to that of the EU's Common External Tariff, as Bulgaria's tariffs are generally higher than the CET. In addition, Bulgaria could improve its trade environment by reducing the gap between its applied and bound rates, in order to improve the predictability of its trade regime.

44. *To implement and enforce the widespread legislative reforms undertaken as part of Bulgaria's accession to the WTO and the EU, further strengthening of Bulgaria's administrative capacity is required. This would enable Bulgaria to reap the widest benefits from the reform process: Bulgaria may benefit from further technical assistance in this respect.*

45. *Bulgaria is a small, open economy that has undertaken significant liberalization and reform of its trade policies. The benefits of these reforms would be significantly reinforced by improved market access provided by Bulgaria's MFN trading partners.*