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Bulgaria: First Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria—Staff Report; Staff Statement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Bulgaria

In the context of the first review under the Stand-By Arrangement and request for waiver of performance criteria with Bulgaria, the following documents have been released and are included in this package:

- the staff report for the first review under the Stand-By Arrangement and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on March 16, 2005, with the officials of Bulgaria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on April 26, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of May 18, 2005 updating information on recent developments.

- a Press Release summarizing the views of the Executive Board as expressed during its May 18, 2005 discussion of the staff report that completed the review.

- a statement by the Executive Director for Bulgaria.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Bulgaria*
Supplementary Memorandum of Economic and Financial Policies by the authorities Bulgaria*
*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

BULGARIA

First Review Under the Stand-By Arrangement and Request for Waivers of Nonobservance of Performance Criteria

Prepared by the European Department
(In consultation with Other Departments)

Approved by Ajai Chopra and Matthew Fisher

April 26, 2005

Contents | Page

Contents Page

Contents Page

Main Websites for Bulgarian Data

Data in this report reflect statistical information received by April 15, 2005.
More recent data can be obtained from the following internet sources:
National Statistical Institute....http://www.nsi.bg
Bulgarian National Bank....http://www.bnb.bg
Ministry of Finance....http://www.minfin.bg

Information on Bulgarian economic statistics can be found at the Fund's Special Data Dissemination Standard website:
http://dsbb.imf.org/Applications/web/sddscountrycategorylist/?strcode=BGR

ABBREVIATIONS AND ACRONYMS

BCC	Bank Consolidation Company
BNB	Bulgarian National Bank
BTC	Bulgarian Telecommunications Company
CAS	Country Assistance Strategy
CBA	Currency Board Arrangement
CIT	Corporate Income Tax
COM	Council of Ministers
CPI	Consumer Price Index
EU	European Union
EUR	European Department
FDI	Foreign Direct Investment
FMIS	Financial Management Information System
FRA	Fiscal Reserve Account
FSAP	Financial Sector Assessment Program
FSC	Financial Supervision Commission
GFS	Government Finance Statistics
IFS	International Financial Statistics
LOI	Letter of Intent
MEFP	Memorandum of Economic and Financial Policies
MOF	Ministry of Finance
NHIF	National Health Insurance Fund
NFA	National Framework Agreement
NRA	National Revenue Agency
NSI	National Statistical Institute
NSSI	National Social Security Institute
OED	Office of Executive Directors
PAL	Programmatic Adjustment Loan
PC	Performance Criterion
PDR	Policy Development and Review Department
PEIR	Public Expenditure and Institutional Review
PIP	Public Infrastructure Projects (company)
PIT	Personal Income Tax
PPI	Producer Price Index
REER	Real Effective Exchange Rate
ROSC	Report on the Observance of Standards and Codes
SBA	Stand-By Arrangement
SDDS	Special Data Dissemination Standard
SDR	Special Drawing Rights
SEBRA	System for Electronic Budgetary Payments
SMEFP	Supplementary Memorandum of Economic and Financial Policies
SOE	State-Owned Enterprise
VAT	Value-Added Tax

EXECUTIVE SUMMARY

- **Macroeconomic performance in 2004 exceeded expectations but there were some breaches of program conditionality**. Real GDP growth was 5.6 percent, inflation declined to 4 percent by year end, and the external current account deficit narrowed to 7.5 percent of GDP. However, credit growth failed to decline and private external debt surged, causing the gross external debt ratio to increase after several years of decline. The breaches of conditionality were generally minor or technical in nature or are being addressed as part of the program and staff supports waivers to the extent necessary.

- **With macroeconomic conditions expected to remain favorable, competitiveness at an adequate level, and a lower current account deficit, concerns about external vulnerability have lessened somewhat.** Nonetheless, policies must remain prudent and the program for 2005 envisages some fiscal easing, a slowdown in credit expansion, and reinvigorated structural reforms.

- **The fiscal program aims at a general government surplus of at least 1 percent of GDP**, following a surplus of 1¾ percent in 2004. To avoid procyclicality, an adjustor aims at saving one half of any revenue overperformance. In addition, the authorities agreed to tighten the fiscal stance at the time of the second review if external current account developments are weaker than expected.

- **The program envisages a slowdown in credit expansion to undergird the currency board arrangement**. As other measures have failed to reduce the annual rate of credit growth much below 50 percent, the monetary program relies on temporary direct controls to reduce credit expansion to 30 percent in 2005. The central bank will take measures to ensure that banks that ramped up credit before the measure took effect will not be able to benefit from a larger credit base.

- **Although the approaching mid-year election has temporarily slowed structural reform, reforms are expected to be reinvigorated once the new government has been formed**. Five prior actions aim at improving revenue administration, the business climate, and insurance sector supervision. In addition to seeking to ensure the prompt start-up of a unified revenue administration, structural conditionality in the fiscal area seeks to strengthen expenditure control, fiscal transparency, and local government finances. Other program conditions relate to progress in privatization and in making the labor market more flexible.

I. INTRODUCTION

1. **A staff team[1] visited Sofia during December 2-16, 2004 and March 10-16, 2005 for discussions on the first review under the Stand-By Arrangement (SBA)**. The 25-month SBA, equivalent to SDR 100 million (15.62 percent of quota), was approved on August 6, 2004 (see IMF Country Report No. 04/267 and Table 1). The authorities continue to treat the arrangement as precautionary and intend to make all outstanding repurchases to the Fund on the expectations schedule.

2. **Although several end-December 2004 quantitative and structural performance criteria (PCs) and benchmarks were not observed, their nonobservance was generally minor or technical in nature or is being addressed as part of the 2005 program** (Tables 2 and 3). Two quantitative PCs—the ceilings on general government expenditure and central government arrears—were missed. In the case of the former, this reflected a transfer of funds to a new state enterprise created for the purpose of infrastructure spending in 2005, which also resulted in the nonobservance of the structural benchmark proscribing the creation of state enterprises. On the missed arrears PC, the outstanding amount was less than 1/100 of 1 percent of GDP and not subject to day-to-day control of the government. Two structural PCs—on the incorporation of the judiciary's expenditure accounts in the budgetary payments system and the parliamentary adoption of the Bulstat number as the single identification for all tax and social security payments—were also missed (one of them partly), as were some structural benchmarks, for the reasons given in Table 2.

3. **Regardless of the outcome of the June 25 parliamentary election major policy slippages are unlikely given the broadly shared objectives to join the EU in 2007 and maintain the currency board arrangement (CBA)**. Pre-election political maneuvering has intensified. Prompted in part by the failed privatization of several cigarette companies (see paragraph 6), the opposition earlier this year succeeded in dismissing the speaker of parliament. However, ahead of a subsequent vote of no confidence, the governing coalition was broadened from two to three parties, restoring its parliamentary majority. Notwithstanding these upheavals, EU accession and maintenance of the CBA remain common goals across the political spectrum, reducing the potential for policy slippage.

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[1]Messrs. Flickenschild (head), Duenwald, Herderschee, and Ms. Rahman (all EUR), Mr. Mukhopadhyay (PDR), and Mr. Roaf (resident representative). The mission met with the Prime Minister, all key economic ministers, the governor of the Bulgarian National Bank (BNB), and representatives of parliament, the labor unions and the private sector, and collaborated closely with World Bank staff. Mr. Yotzov (OED) participated in the meetings.

II. Recent Economic Developments

4. **Macroeconomic performance in 2004 was stronger than expected, although private sector credit exceeded programmed levels and private external debt rose sharply**:

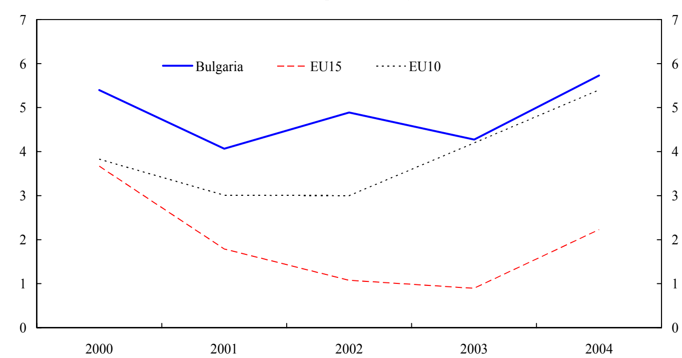
Text Table 1. Bulgaria: Selected Macroeconomic Indicators, 2003-04
(Annual percent change, unless otherwise stated)

	2003	2004	
	Act.	Prog.	Act.
Real GDP growth	4.5	5.2	5.6
CPI (average)	2.3	6.3	6.1
(end of period)	5.6	3.6	4.0
Current account (percent of GDP)	-9.2	-8.8	-7.5
Claims on nongovernment	48.3	33.0	48.7

Sources: Bulgarian authorities; and Fund staff estimates and projections.

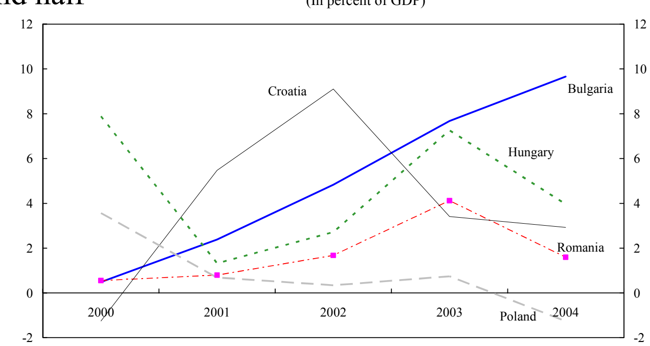
- Real GDP rose 5.6 percent, compared with 5.2 percent in the original program, the highest growth rate in recent history and higher than average growth in the new EU members (Table 4, Text Table 1, Figure 1, and Text Figure 1). Activity was buoyed by continued rapid growth in domestic demand (particularly investment), financed by bank credit, and a large reduction in the negative contribution of net exports. Strong output growth helped the unemployment rate fall to a five-year low of 11.7 percent in September, before increasing for seasonal reasons to 13.1 percent in February 2005.

Text Figure 1. Real GDP Growth
(Annual percent change)



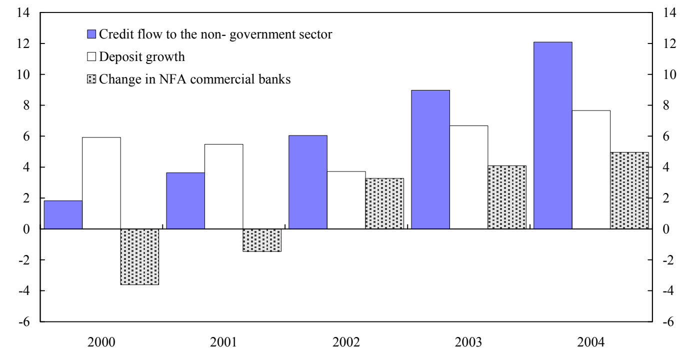
- Despite buoyant economic activity and surging oil prices, 12-month consumer price inflation fell steadily in the second half of the year as a sharp rise in food prices in the wake of a 2003 drought was reversed, with the euro's appreciation also dampening price pressures. CPI inflation averaged 6.1 percent, ending 2004 at 4 percent. Inflation remained below this level on average in the first three months of 2005. Real wages increased by less than 1 percent in 2004, but showed an increasing trend in the latter half of the year.

Text Figure 2. Change in Private Sector Credit
(In percent of GDP)



- Despite measures to reduce bank liquidity, credit to the nongovernment sector grew 48.7 percent in 2004, far exceeding program expectations. The rapid credit expansion—fast even by regional standards (Text Figure 2)—was funded by both strong deposit growth and a drawdown of banks' net foreign assets (mainly by foreign borrowing; Text Figure 3). While business credit remains around two-thirds of total credit, the most dynamic component has been household credit, particularly mortgages (Table 5, Figure 2). Bank asset quality has not yet shown any signs of deterioration, with the impaired loans ratio remaining at 7 percent, and system-wide capital adequacy at 17 percent (Table 6). Meanwhile, sovereign bond spreads narrowed, with the Bulgarian component of the EMBI+ currently at 98 basis points.

Text Figure 3. Credit to the Nongovernment Sector and Its Main Sources, 2000-04
(In percent of GDP)



- The external current account deficit was 7.5 percent of GDP, compared to deficits of 8.8 percent envisaged in the original program and 9.2 percent in 2003 (Table 7 and Figure 3).[2] At nearly 14 percent of GDP, the merchandise trade deficit was roughly as projected in the original program, as the effect of higher oil prices on import values was offset by higher export commodity prices (particularly metals and petroleum products). The better current account outturn reflected much stronger net services and transfers, owing partly to the growing attraction of Bulgaria's tourist destinations, and better recording of the flows. The financial account was stronger than in 2003, with lower net FDI and net portfolio investment more than offset by other private sector inflows.[3] Gross international reserves increased to 5.3 months of projected imports and cover nearly 200 percent of short-term debt. Gross external debt rose to 63.7 percent of GDP, as a sharp rise in private debt (by over 11 percentage points of GDP) more than offset a decline in public debt. Net external debt, however, declined 4 percentage points of GDP.

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[2] The 2003 deficit was revised from 8.6 to 9.2 percent of GDP based on complete data on reinvested profits. A revision may be made to the 2004 current account balance, when the relevant data become available in early 2006.

[3] 2004 FDI is exceptionally low for two reasons: first, a debt financed merger and acquisition transaction of a local mobile telephone company led to a sharp increase in its equity value, and a transfer of the realized capital gains abroad by the original owners. This resulted in a large (3⅓ percent of GDP) net FDI outflow, and an increase in gross external debt. Second, 80 percent of the proceeds of the late 2004 privatization of three electricity distribution companies (2¾ percent of GDP) has been recorded in early 2005.

- International competitiveness remains adequate. While Bulgaria's REER (CPI-deflated) appreciated modestly in 2004, unit labor costs fell and the share in EU imports continued to rise (Figure 4).[4]

5. **The general government recorded a much higher surplus than envisaged in the program** (Tables 8 and 9). The fiscal surplus was 1¾ percent of GDP, compared to 0.9 percent projected in the program, thanks largely to rapid growth in revenue occasioned by buoyant economic activity and improved compliance.[5] Despite the tax cuts, revenue was about one percentage point of GDP higher than in 2003, reaching 39.2 percent of GDP (0.8 percentage point higher than programmed). VAT, excise and fuel import duties, and social security contributions registered particularly sharp increases. Expenditure was 37.5 percent of GDP, ¾ percentage point lower than in 2003 because of lower subsidies owing to continued structural reform and lower social assistance and unemployment spending associated with reduced unemployment.

6. **Structural reforms have advanced on several fronts, although political indecision and a crowded legislative agenda have prevented progress in some areas**. The privatization of the Bulgarian Telecommunications Company (BTC) was completed with the sale of the remaining 35 percent on the stock exchange in January 2005. The electricity distribution companies were privatized in late 2004/early 2005. Significant restructuring has taken place in the railway sector, including closing inefficient lines, staff reductions, and improved financial management. However, the politically controversial sale of the cigarette companies of the tobacco monopoly Bulgartabac Holding (a missed structural benchmark for end-2004) had to be postponed again when the sole bidder withdrew in February. Efforts to improve the business climate—particularly shifting business registration from the courts to a central agency—have been hampered by political indecision. But efforts have continued to strengthen governance in the public sector, in accordance with the government's 2001 National Anti-Corruption Strategy.

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[4] Competitiveness has been analyzed in greater detail in the staff report for the 2004 Article IV consultation (IMF Country Report No. 04/176).

[5] In late 2004, the government established a public infrastructure projects (PIP) company to execute pre-electoral spending in 2005. An amount of BGN 340 million (0.9 percent of GDP) was initially transferred to PIP. This transfer counts as spending against the expenditure ceiling under the general government definition of the 2004 program. However, for analytical purposes (and under the 2005 program) staff has consolidated PIP with the general government.

III. The 2005 Program

7. **Discussions focused on the remaining vulnerabilities—related mainly to the external current account deficit—and how to address them in the context of the CBA**. With macroeconomic conditions expected to remain favorable and the current account deficit now projected lower than originally expected, staff's concerns about external vulnerability have lessened somewhat. However, buoyant real activity, continued rapid credit growth, and a jump in the gross external debt ratio pose new challenges. Moreover, electorally motivated spending pressures and a 25 percent increase in the minimum wage in early 2005 (see paragraph 14)—implemented against staff advice—provide additional procyclical demand stimulus, with risks for inflation and competitiveness. Discussions focused on the appropriate policy mix to contain these demand pressures and preserve competitiveness under the CBA: (i) the acceptable extent of fiscal easing in 2005; (ii) measures to reduce credit growth, as an offset to fiscal easing; and (iii) structural reforms to ensure strong FDI and medium-term fiscal sustainability. The discussions took place in a highly charged political atmosphere, with staff seeking to rein in the authorities' proclivity for populist measures ahead of the election.

A. Outlook and Risks

8. **With the policies outlined in the SMEFP, macroeconomic performance is expected to remain favorable and the external position sustainable over the medium term** (Tables 10-15; Figure 5):

- Staff has raised its projection for real GDP growth in 2005 to 5½ percent, largely reflecting a smaller negative contribution from net exports (Text Table 2). However, growth is still likely to be slightly lower than in 2004, as a result of lower credit expansion and higher oil prices. In the medium term, growth should stay around its estimated potential of 5½ percent.

Text Table 2. Bulgaria: Selected Macroeconomic Indicators, 2004-05
(Annual percent change, unless otherwise stated)

	2004	2005	
	Act.	Org. Prog.	Rev. Prog.
Real GDP growth	5.6	5.2	5.5
CPI (average)	6.1	3.6	4.0
(end of period)	4.0	3.6	3.5
Current account (percent of GDP)	-7.5	-8.3	-7.6
Claims on nongovernment	48.7	25.4	30.0

Sources: Bulgarian authorities; and Fund staff estimates and projections.

- Inflation projections have been raised somewhat on account of higher oil prices, but remain low at an average rate of 4 percent in 2005. In the medium term, inflation is expected to average 3½ percent, exceeding EU rates due to faster productivity growth and administrative price adjustments.

- Growth of nongovernment credit is projected to slow to 30 percent by end-2005, as the limits on credit expansion imposed by the BNB take effect (see paragraph 16). Over the medium term, credit growth should decline to more sustainable levels as household spending—and therefore credit—decisions will increasingly be based on actual income rather than on higher expected permanent income.

- The external outlook is more favorable than assumed in the original program. The current account deficit is projected at 7.6 percent of GDP in 2005, nearly ¾ percent of GDP lower than originally envisaged. However, the current account balance is now projected to deteriorate modestly relative to 2004, as the full impact of higher oil prices is felt. FDI is projected to exceed substantially the 2005 current account deficit. Beyond 2005, a gradual strengthening of private savings—partly reflecting financial deepening and structural reforms—would help finance higher investment and allow the current account deficit to decline to 4½ percent of GDP by 2010. Official reserves should remain at a comfortable level, at about twice short-term debt, while the gross external debt ratio is projected to resume its decline after its jump to 63.7 percent of GDP in 2004. External debt sustainability analysis suggests that, even in an alternative scenario featuring lower exports, higher imports, and smaller FDI inflows, the external debt ratio would still stabilize.

9. **This favorable scenario is subject to downside risks**. The key ones are that (i) a further rise in oil prices will generate a further widening of the current account deficit; (ii) credit growth will not slow as projected, thereby triggering persistently high current account deficits and threatening banks' asset quality; and (iii) FDI will not develop as anticipated, causing exports to suffer and debt dynamics to worsen. These risks underline the need for the authorities to maintain prudent fiscal and incomes policies, continue their efforts to rein in credit growth, and sustain the structural reform momentum.

B. Fiscal Policy and Reforms

10. **Staff and authorities agreed that a measured easing of the fiscal stance was acceptable in 2005, given the reduced external vulnerability** (¶ 4).[6] While staff would have preferred a tighter fiscal stance owing to remaining risks—including those introduced by rapid credit expansion and the minimum wage increase—it viewed an easing of about ¾ percent of GDP, to a surplus of 1 percent of GDP, as a prudent compromise (PC). Staff's position was based on the assumption that the BNB would take further measures to reduce credit growth as an offset to the stimulus provided by fiscal policy. The authorities were initially reluctant to accept staff's recommendation, arguing that a surplus closer to ¼ percent of GDP was sufficient given the improved external outlook. Staff acknowledged the lessening of external risks but viewed such a large fiscal easing as too risky, particularly given the private sector's continued access to financing from sources other than domestic banks. The authorities eventually accepted the need for a more prudent fiscal stance, including in light of the minimum wage increase. Through a combination of expenditure cuts (including scaling back of PIP spending) and a more realistic (higher) revenue projection

[6] Numbers in parentheses refer to SMEFP paragraphs.

(see paragraph 12), they aligned their fiscal projections with those of the staff. The authorities also agreed to tighten fiscal policy at the time of the second review if the current account position proved to be weaker than currently projected. Moreover, they agreed to save 69 percent of any cumulative quarterly tax revenue (excluding personal income tax) overperformance of the general government, with a corresponding adjustment of the PC on the fiscal balance, as a way of preventing revenue overperformance from generating correspondingly higher spending.[7]

11. **The revised 2005 fiscal program envisages a marginally larger surplus than the original program, but with higher revenue and expenditure** (Text Table 3):

Text Table 3. Bulgaria: Fiscal Position
(Percent of GDP)

	2003	2004		2005	
	Act.	Org. Prog.	Act.	Org. Prog.	Rev. Prog.
Revenue	37.8	38.4	39.2	37.3	38.8
Expenditure	38.2	37.5	37.5	36.3	37.8
Balance	-0.4	0.9	1.8	0.9	1.0

Sources: Bulgarian authorities; and Fund staff estimates and projections.

- Revenue is projected at 38.8 percent of GDP, 1½ percentage points higher than before, mainly because of the much stronger than expected 2004 outturn and an upward revision to underlying macroeconomic assumptions. Relative to 2004, however, the revenue ratio will decline by nearly ½ percentage point of GDP, principally reflecting tax policy changes: (i) an increase in the standard personal income tax deduction; (ii) a reduction of the personal income tax rates in all brackets; (iii) personal income tax breaks for families with children (with the effect felt in 2006); and (iv) a reduction of the corporate income tax rate from 19½ percent to 15 percent (with full effect in 2006). The tax losses will be mitigated by higher excises on alcohol and tobacco products in line with EU accession requirements, a slight broadening of indirect tax bases, and improved compliance. Nontax revenue is projected to decline somewhat, partly due to the loss of dividends from privatized SOEs. The tax policy changes are consistent with the authorities' long-standing goal of reducing direct taxes, and reducing the corporate tax rate should enhance compliance by aligning it with the withholding tax rate on profits transferred abroad.

- The expected rise in expenditure of 0.3 percent of GDP relative to the 2004 outcome partly reflects higher capital expenditure, thanks to spending by the PIP company and the consolidation with the general government of the state environment enterprise in line with Eurostat requirements (an equivalent upward adjustment was made on the revenue side). In contrast, the wage bill, maintenance and operations, subsidies, and interest payments are lower in relation to GDP (¶ 6). The budget retains spending flexibility of

[7] This is equivalent to 50 percent of general government revenue. Personal income tax collections were excluded as the central government does not control their use.

about 1¾ percent of GDP by withholding 7 percent of discretionary expenditure until the fourth quarter of 2005 and including budgetary contingencies.

- Staff urged the authorities to reexamine the economic justification of two large infrastructure projects, a major highway and a nuclear power project. The authorities reiterated their intention to go ahead with these projects. Indeed, the concession contract for the Trakia highway was signed with a Portuguese consortium in late March; staff will reevaluate the fiscal implications once more details become available. Overall, the authorities plan to minimize government financial involvement in both projects, including through public-private partnership structures. However, it appears that at least 51 percent of the financing for the nuclear project would be covered by government guarantees.

12. **Staff argued for greater transparency in budget preparation and a full accounting and better presentation of expenditure**. The authorities presented to parliament a budget showing a deficit of ½ percent of GDP in 2005, compared with a surplus of at least 1 percent of GDP in the program. This deficit was based on a very conservative revenue projection, reflecting the authorities' concern that presentation of a budget surplus would have encouraged parliament to propose expenditure increases that the (then) minority government would have been unable to resist. Staff noted that the budget excluded PIP spending, appeared to underestimate health spending, and assumed no payment of the customary year-end wage and pension bonuses. In response, the authorities said that the 2005 budget contained enough flexibility to accommodate unavoidable expenditure overruns (¶ 14). However, they would base the 2006 budget on realistic revenue and expenditure projections (¶ 8). A fiscal ROSC mission in March/April 2005 has provided specific recommendations on needed improvements in transparency, including with regard to data provision.

13. **To strengthen medium-term fiscal viability, the program envisages an acceleration of fiscal reforms** (¶ 7, 8). Given the importance of providing the legal base for its operation, three of the five prior actions of the program relate to the start-up of the National Revenue Agency (NRA), which is to unify the collection of taxes and social security contributions from January 1, 2006 (completion of the first reading of the NRA procedural code by parliament; enactment of legislation on the Bulstat number; and submission of new personal and corporate income tax, VAT, and excise tax laws). To enhance expenditure control and transparency, the authorities will incorporate, by September 30, 2005, the expenditure accounts of the judicial system in the budgetary payments system (PC); other budgetary entities completed this process last year. The Financial Management Information System (FMIS) is operating on a trial basis in the Ministry of Finance, and will be piloted in one other ministry and one agency next year. Program budgeting is being extended to four more ministries in 2005, and the 2006 budget report will be accrual accounting based. Finally, the authorities intend to make further progress in fiscal decentralization.

C. Incomes and Labor Market Policies

14. **The authorities acknowledge the critical importance of prudent incomes policies and flexible labor markets in the context of the CBA**. Staff expressed its concern about the 25 percent increase in the minimum wage in January 2005, given the likely adverse consequences for domestic demand pressures, competitiveness, and employment (Box 1). Noting that only a small fraction of workers genuinely earned the minimum wage,

Box 1: Analysis of the Minimum Wage Increase

Effective January 1, 2005 the authorities raised the monthly minimum wage, the lowest in the region, from BGN 120 to BGN 150. This increase resulted in the already high minimum-to-average wage ratio to rise further above 40 percent.

Regional Minimum and Average Gross Wages, 1999-04

	Minimum to Average Wage Ratio					Minimum Wage (euros)
	2000	**2001**	**2002**	**2003**	**2004**	**2003**
	(In percent)					
Bulgaria	34	35	39	40	41	51
public sector	29	30	31	32	35	51
private sector	39	43	46	44	46	51
Croatia	35	34	34	33	...	246
Turkey 1/	28	29	33	34	...	189
Poland	37	37	36	36	...	201
Romania	24	31	31	37	...	73
Hungary	29	42	41	39	...	212
Slovak Republic	38	37	38	40	...	133
Czech Republic	30	34	34	36	...	199

Source: National authorities and Fund staff estimates
1/ Gross wages in industry

Staff had argued against such a large increase, particularly given the short time frame for implementation and the estimated impact on domestic demand. Econometric analysis suggested that a 25 percent increase in the minimum wage increases the nominal wage bill by approximately 0.4-0.5 percent of GDP. Given a high marginal propensity to consume, domestic demand was calculated to increase by a similar magnitude while the associated current account deterioration was estimated to be 0.2 percent of GDP.

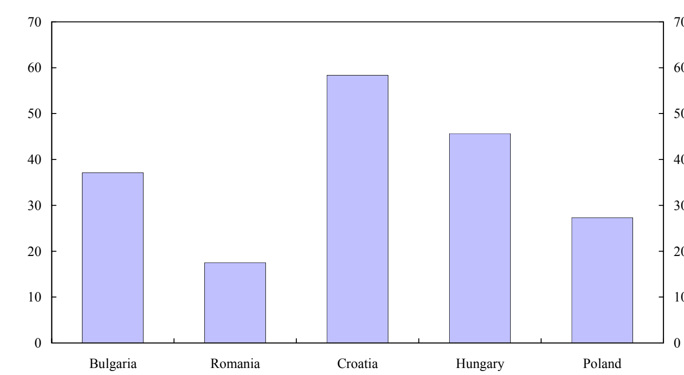
There is also considerable uncertainty regarding the broader macroeconomic effects and impact on the informal sector. Adverse labor market effects include employment losses, skills substitution and increases in the duration of unemployment contributing to greater rigidity. Associated risks include wage-ratcheting resulting in wage-push inflation and a loss of competitiveness as firms' input costs increase. These factors are particularly pertinent in a CBA where labor market flexibility and cautious macroeconomic policies are at a premium.

the authorities did not share staff's concern about knock-on effects on other wages; indeed, they expressed their intention to raise the minimum wage again in 2006 and 2007 (¶ 9). In this context, staff stressed the need for the authorities to signal wage restraint in the public sector, and the authorities agreed to tight budgetary and SOE wage bills (¶ 9). The budgetary wage bill will increase in mid-2005 by the projected inflation rate (3.6 percent), with individual wage increases limited to 5 percent. The increase in the aggregate wage bill of the 58 closely monitored SOEs that are monopolies, received subsidies, made losses or had arrears in the third quarter of 2004 is limited to 4 percent in 2005 (PC). The authorities also aim to strengthen labor market flexibility, including by eliminating the portability of the seniority bonus and increasing work-time flexibility.

D. Financial Sector Issues

15. **The authorities recognize the need to reduce bank credit growth to a more sustainable level and have implemented a series of measures to achieve this goal**. They have taken the liquidity-draining measures outlined in the original program. However, these attempts at reducing credit growth have been frustrated by the high degree of capital mobility, combined with the relatively high return on capital in Bulgaria. Even after the rapid increase in credit, Bulgaria's credit-to-GDP ratio remains about average in a regional context (Text Figure 4).

Text Figure 4. Nongovernment Credit to GDP Ratio, 2004 (In percent)



16. **The continuing high credit growth has prompted the adoption of a temporary measure that attempts to control more directly the quantity of bank credit extended** (¶ 10). Following Fund technical assistance on alternative responses to the credit boom, the BNB announced in February 2005 that, beginning with the second quarter of 2005, banks whose credit portfolio expands by more than 6 percent per calendar quarter will be subject to an unremunerated deposit requirement of twice the excess credit expansion, unless the ratio of their credits (including risk-weighted off-balance sheet items) minus capital to deposits, other than those by other financial institutions, is below 60 percent. Staff supported this measure—particularly as a counterweight to fiscal easing—but questioned two elements in its design: first, the credit-to-deposit criterion exempted 14 out of the 35 banks (including the largest one); and second, given that the measure had been announced over one month before coming into force, banks could boost lending in March so as to create a larger base from which to calculate growth rates.[8] Taking into account those loopholes, staff estimates that the credit expansion slows to 30 percent in 2005 (equivalent to a reduction of net credit

[8] This has indeed happened, but the BNB has announced that it will exclude from the base temporary credits extended in late March to large corporations.

expansion to 10 percent of GDP from 12 percent in 2004), but some of this slowdown is likely to be replaced by credit from nonbanks (especially leasing companies) and direct foreign borrowing. Partly for this reason, the authorities plan to enhance the monitoring of leasing companies (¶ 12).

17. **The broad objectives of the government's financial asset and liability management remain to reduce public external debt and deepen the domestic securities market** (¶ 13). The authorities have further reduced external public debt through the early redemption of US$938 million in Brady interest arrears bonds in January 2005. In addition, they are considering buying back or prepaying other external obligations equivalent to some 2½ percent of GDP, subject to maintaining an adequate level of reserves. The 2005 program contains ceilings on the contracting and guaranteeing of external public debt (PC) to safeguard external sustainability. Although government debt placements have been unsuccessful in reducing liquidity because of the open capital account, the authorities intend to sell government obligations from time to time to develop the domestic capital market.

E. Other Structural Reforms

18. **Progress in advancing structural reforms has been hampered by the recent political turmoil and the impending election**. In coordination with the World Bank, the program has been adapted to take into account the recent slippages, in part by converting some missed PCs or benchmarks into prior actions. Measures to boost the business climate remain at the center of the structural program (¶ 14). The authorities are planning to move business registration from the courts to a unified register under the Ministry of Justice, and a strategy to this end is expected to be approved by the council of ministers (prior action). A new law on mediation as an out-of-court alternative dispute resolution mechanism was enacted in December 2004. The authorities are also taking steps to fight corruption and to reform the judiciary (¶ 15).

19. **The authorities reiterated their commitment to continue restructuring the energy and railway sectors, and to implement their privatization strategy** (¶ 16 and 17). The mid-2004 tariff increases have strengthened the electricity and district heating companies, while the electricity market has been further liberalized by reducing the threshold for the right to free contracting. The authorities intend to further improve the railway sector's financial position and efficiency, including through cost reduction and public service contracts. On privatization, the authorities still plan to complete the privatization of the cigarette companies of Bulgartabac Holding by end-2005. Three large thermal electricity generation companies, the airline, the remainder of the river shipping company, and the maritime shipping company are all slated for sale by end-2005.

F. Program Conditionality and Waiver Requests

20. **Structural conditionality for 2005 consists of five prior actions, three PCs, and 10 benchmarks** (Text Table 4). As to the criticality of the three structural PCs,

- The NRA procedural code and the incorporation of the judiciary system's expenditure accounts into the budgetary payments system are crucial to ensure the program's fiscal objectives; and

- The privatization of the three electricity generation plants helps ensure the FDI coverage of the current account deficit in 2005–06.

Text Table 4. Bulgaria: Structural Conditionality in the SBA, 2005

Prior Actions	
Revenue administration	
(i)	Adoption of Bulstat number legislation
(ii)	First reading of NRA procedural code
(iii)	Submission to parliament of new PIT, CIT, VAT and excise tax laws
Business Climate	
(iv)	Cabinet approval of strategy to transfer business registration from courts
Financial Sector Regulation	
(v)	Appointment of deputy chairman of Financial Supervision Commission
Structural and Other Performance Criteria	
Public Finance	
(i)	Adoption of NRA procedural code
(ii)	Transfer of judiciary's expenditure accounts to SEBRA
Privatization	
(iii)	Selection of winning bids for sale of three electricity thermal plants
Other	
(iv)	Standard trade and payments clause
Structural Benchmarks	
Public Finance	
(i)	No new SOEs or extrabudgetary funds to be created
(ii)	MoF to use only the Financial Management Information System
(iii)	Submit legislation to allow municipalities to set their own tax rates
(iv)	Parliamentary approval of new PIT, CIT, VAT and excise tax laws
(v)	MoF to prepare an economic classification of government expenditure
(vi)	Government to update the property tax valuations
Business climate	
(vii)	Submit legislation to transfer business registration from the courts
Labor Market Reforms	
(viii)	Submission of legislation to redefine maximum working and regular hours
(ix)	Decree eliminating portability of seniority premium for unemployed
Financial Sector Regulation	
(x)	Approval of legal provisions increasing regulation of leasing sector

Note: For further details see Annex 1 of the SMEFP

21. **The conditionality under the 2005 program has been changed in four respects.**

- The general government expenditure ceiling has been replaced by an adjustor that allows programmed expenditure to be exceeded by up to 50 percent of any revenue overperformance.

- The central government arrears PC allows for a small amount of arrears because the Ministry of Finance cannot monitor the operations of the autonomous bodies on a day-to-day basis.

- The environment and PIP enterprises have been consolidated with the general government.

- One benchmark, the sale of the cigarette companies of Bulgartabac Holding, has been dropped for the time being, as progress on this front is impossible until after the formation of the new government.

22. **Staff supports the authorities' request for waivers for the nonobservance of the two quantitative and two structural PCs for end-December 2004**. The waiver for the nonobservance of the expenditure ceiling can be supported because it had no macroeconomic consequences, while the arrears PC was missed by a negligible margin (less than 1/100 of 1 percent of GDP) due to the Treasury's inability to monitor the autonomous bodies' arrears on a day-to-day basis. Regarding the nonobservance of the two structural PCs, staff supports the proposals of the authorities: the PC on incorporating the judicial system's expenditure accounts into the budgetary payments system—which has been delayed for technical reasons—will become a structural PC for end-September 2005; and the PC on the Bulstat number has been made a prior action. In addition, completion of the first reading by parliament of the NRA procedural code is now a prior action.

G. Data and Transparency Issues

23. **Data provision and quality are sufficient for program monitoring, and progress has been made in observing international standards and codes** (Appendix III). Bulgaria subscribes to the SDDS. The BNB is implementing the recommendations of the IMF safeguards assessment (¶ 11). A fiscal ROSC reassessment was conducted in March-April 2005, and the report is scheduled to be presented to the Board in August, before being published.

IV. Staff Appraisal

24. **Bulgaria's economic performance has been impressive, but concerns about external vulnerability remain**. GDP growth has been strong, even in the face of prolonged anemic economic activity in the EU. Unemployment and inflation have declined, while the external current account deficit has narrowed and gross international reserves are at a comfortable level. These positive developments are reflected in the sharp narrowing of sovereign bond spreads.

25. **At the same time, remaining macroeconomic risks—particularly those related to rapid credit expansion—call for continued prudent macro policies and structural reforms**. The continued vigorous growth of domestic demand, financed by stubbornly high credit growth, together with increased oil prices, is keeping import growth at a high level. The large increase in the minimum wage adds to these pressures, including by pushing up firms' costs. While FDI has remained strong, the external current account deficit remains high. Given those vulnerabilities and the constraints of the CBA, fiscal policy must remain prudent and flexible; measures to restrain credit growth must be rigorously implemented, in part as a counterweight to the easing of the fiscal stance; and structural reforms should be accelerated to prepare the economy for EU accession in early 2007. Such a policy package would contain inflationary pressure and preserve competitiveness.

26. **Fiscal policy was appropriately tightened in 2004, but—reflecting the improved current account—some loosening this year can be accepted subject to appropriate safeguards**. The measured fiscal easing to a surplus of 1 percent of GDP does not pose a significant macroeconomic risk in light of the better-than-programmed outlook for the

external current account, the low rate of inflation, and the expected slowdown of credit expansion. In addition, the program includes an adjustor that aims at saving about one-half of any general government revenue overperformance, ensuring an appropriately countercyclical stance of fiscal policy. The authorities have also reiterated their commitment to tighten fiscal policy at the time of the second review if external current account developments are weaker than currently expected.

27. **While government revenue has overperformed, the authorities should be cautious about further tax reductions**. Recent tax policy changes are in line with the authorities' aim to shift from direct to indirect taxation. These changes have come at the time of a cyclical boom which has masked the associated revenue losses. While trends in the region are also toward lower direct taxes, and strong revenue growth appears to provide some room, the authorities should be cautious about making tax policy changes that are not revenue neutral unless the corresponding expenditure savings have been agreed in advance.

28. **The shift toward more social and capital expenditure is welcome, but fiscal transparency needs to be strengthened**. The assessment of expenditure is hampered by an incomplete breakdown by economic category and by the underbudgeting of certain categories, including compensation. The increased capital outlays partly reflect extrabudgetary spending by the PIP company created in late 2004. The creation of special public enterprises to conduct spending outside the budget framework is not good fiscal practice. Greater transparency in the presentation of the budget, beginning with the 2006 budget, is urgently needed.

29. **Fiscal structural reforms need to be pursued more vigorously**. The government's medium-term fiscal strategy relies to a significant degree on its ability to improve tax administration and enhance the efficiency of public spending. In this context, the delay in enacting the new revenue agency's procedural code is regrettable, and the authorities are urged to ensure its passage within the program deadline. Similarly, efforts should be made to speed up and broaden the implementation of the electronic management and information system to complement the ongoing expansion of program budgeting.

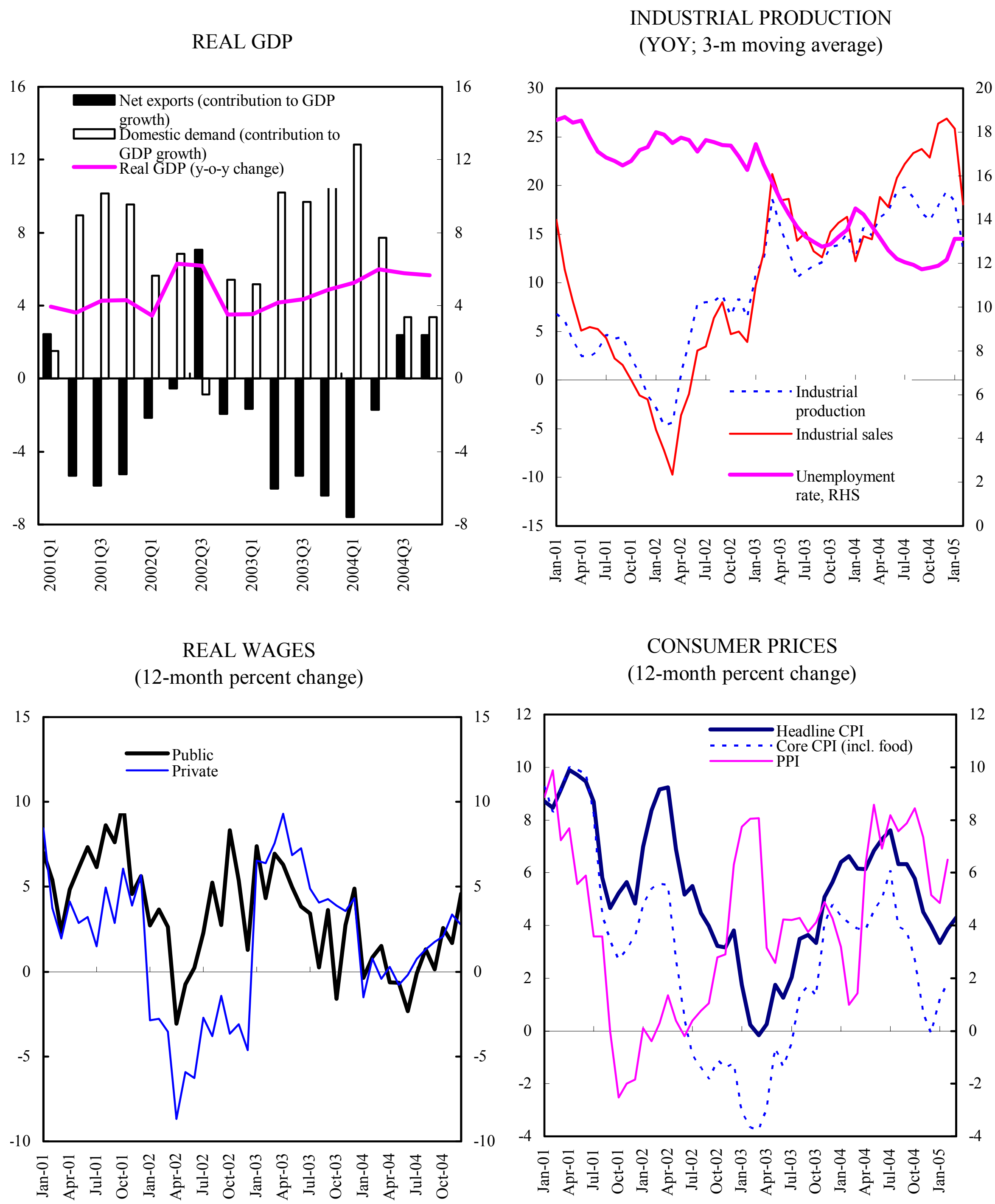
30. **The authorities are determined to reduce private sector credit expansion**. While increased financial intermediation is welcome from a structural perspective, the rate of credit expansion remains uncomfortably high on macroeconomic and prudential grounds. As other measures to slow down credit growth have been unsuccessful, the BNB had no choice but to impose temporary limits on credit expansion. The BNB's readiness to adopt additional measures to prevent banks from taking advantage of loopholes to evade the credit limits is welcome. It now must make good on this intention to ensure that credit growth slows as envisaged under the program.

31. **Regaining the structural reform momentum will be critical to improve competitiveness ahead of EU accession**. The delays of reforms aimed at strengthening the business climate—including those aimed at reducing the courts' role in business registration and strengthening the legal system—are regrettable. The authorities must make progress in this area to ensure a continued high level of FDI. Aside from the delays concerning

Bulgartabac, the privatization process has been on track. The pipeline for privatization in 2005 has been set, and it will be important for the authorities—the June parliamentary election notwithstanding—to press ahead on this front. Efforts to restructure the railway and energy sectors are bearing fruit as subsidies have begun to decline; however, more steps will need to be taken, particularly in the railway sector.

32. **Staff supports the authorities' request to complete the first review under the SBA**. The economic program for 2005 represents a credible effort to address the remaining external vulnerabilities. Although disappointed at the slippages in program implementation, staff can support the requests for waivers for the nonobservance of several end-December 2004 quantitative and structural PCs.

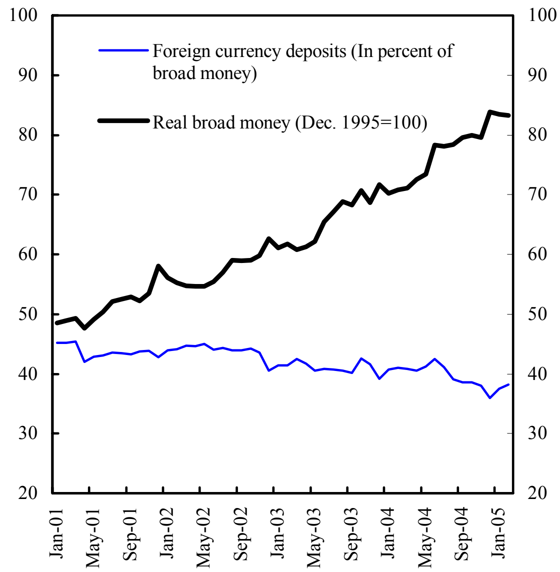
Figure 1. Bulgaria: Real Sector Developments, 2001-05



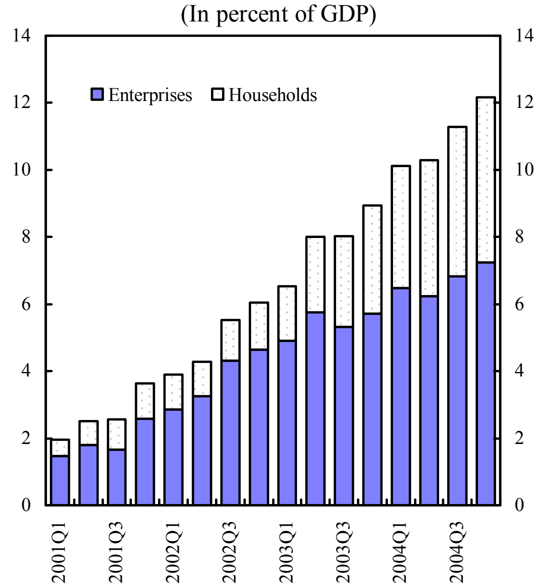
Source: Bulgarian authorities.

Figure 2. Bulgaria: Money and Financial Indicators, 2001-05

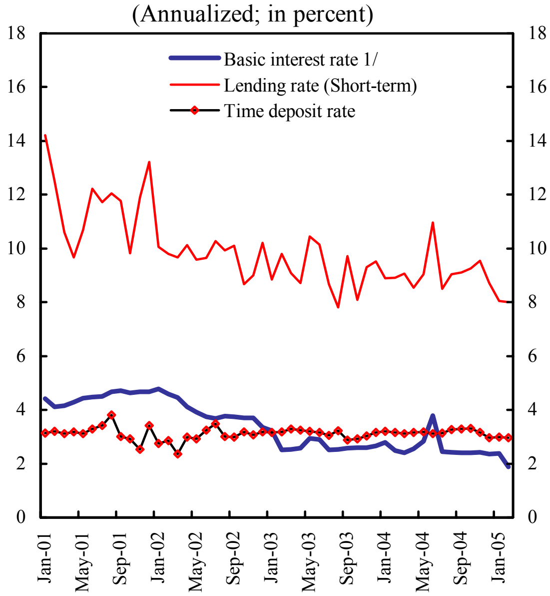
REAL MONEY STOCK AND
CURRENCY SUBSTITUTION



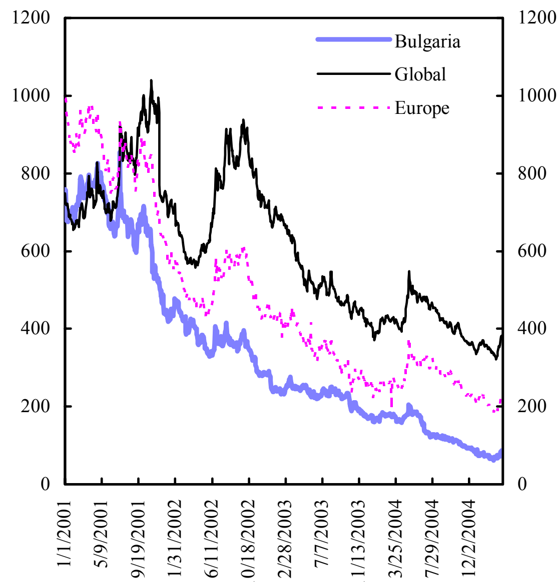
NON-GOVERNMENT SECTOR
CREDIT FLOW
(In percent of GDP)



INTEREST RATES
(Annualized; in percent)



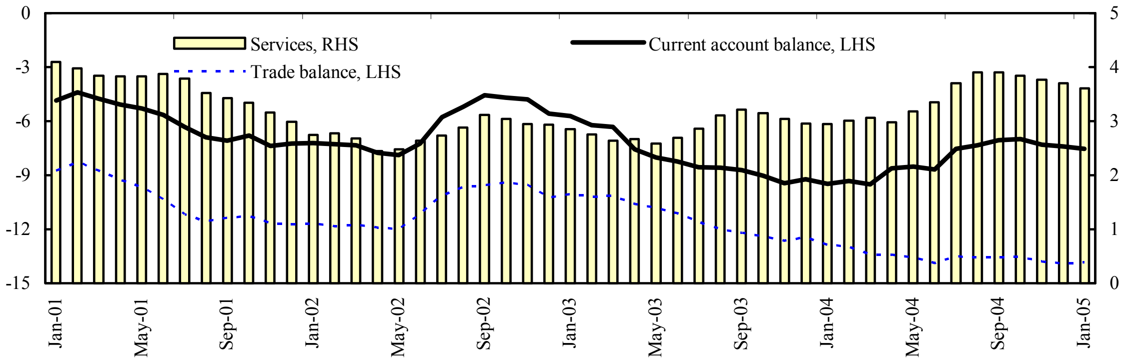
SOVEREIGN SPREADS
(EMBI global spreads; in basis points)



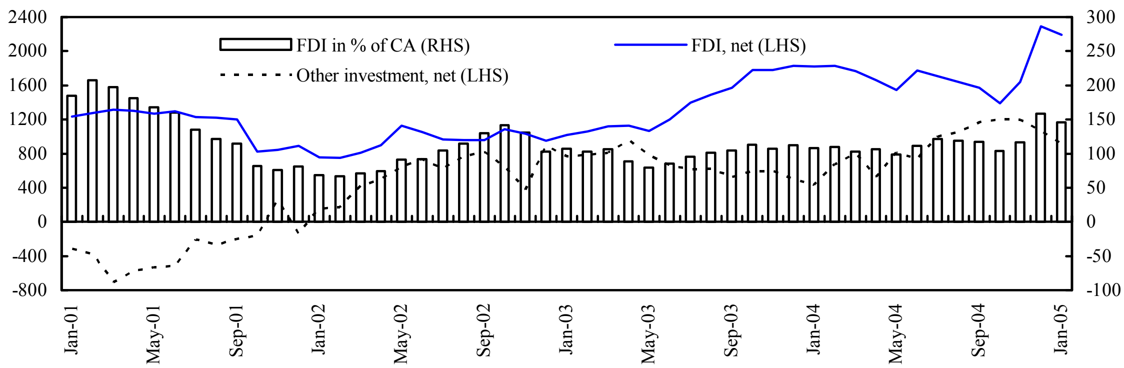
Sources: Bulgarian National Bank; Bloomberg; and Fund staff calculations.
1/ Basic rate is determined on the basis of the average annual yield achieved at the primary market for three-month government securities.

Figure 3. Bulgaria: External Sector Developments, 2001-05

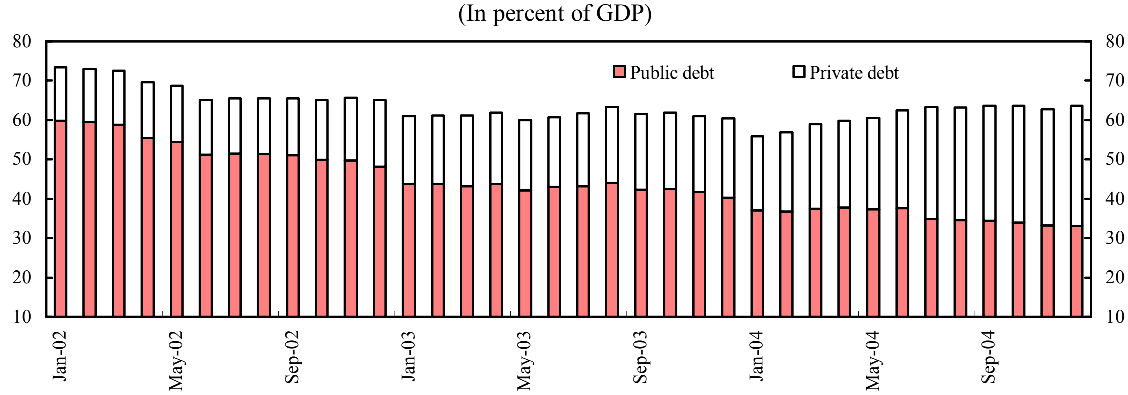
CURRENT ACCOUNT AND TRADE BALANCE
(12-month rolling; in percent of GDP)



FINANCIAL ACCOUNT
(12-month cumulative flows in millions of euros)

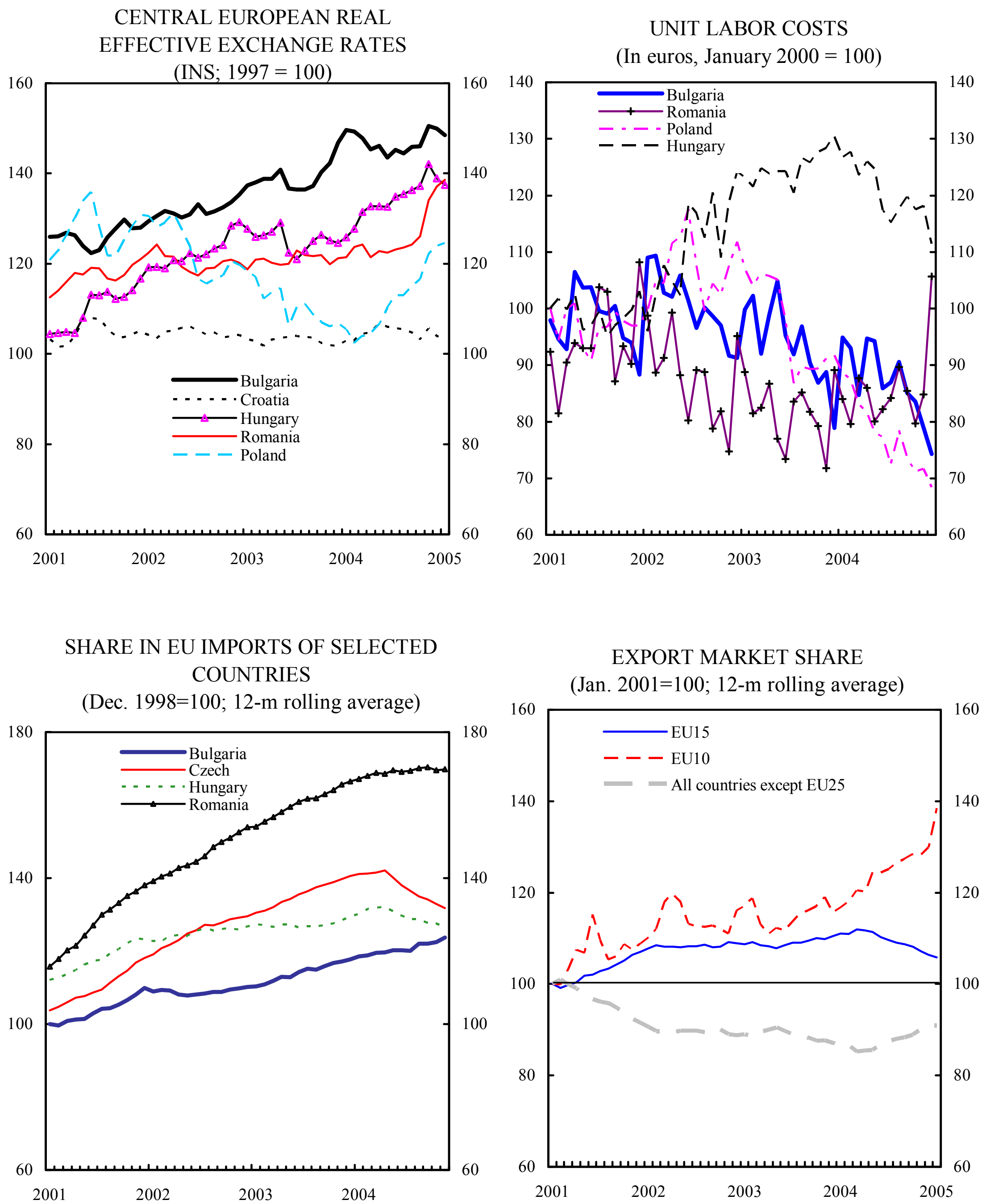


EXTERNAL DEBT
(In percent of GDP)



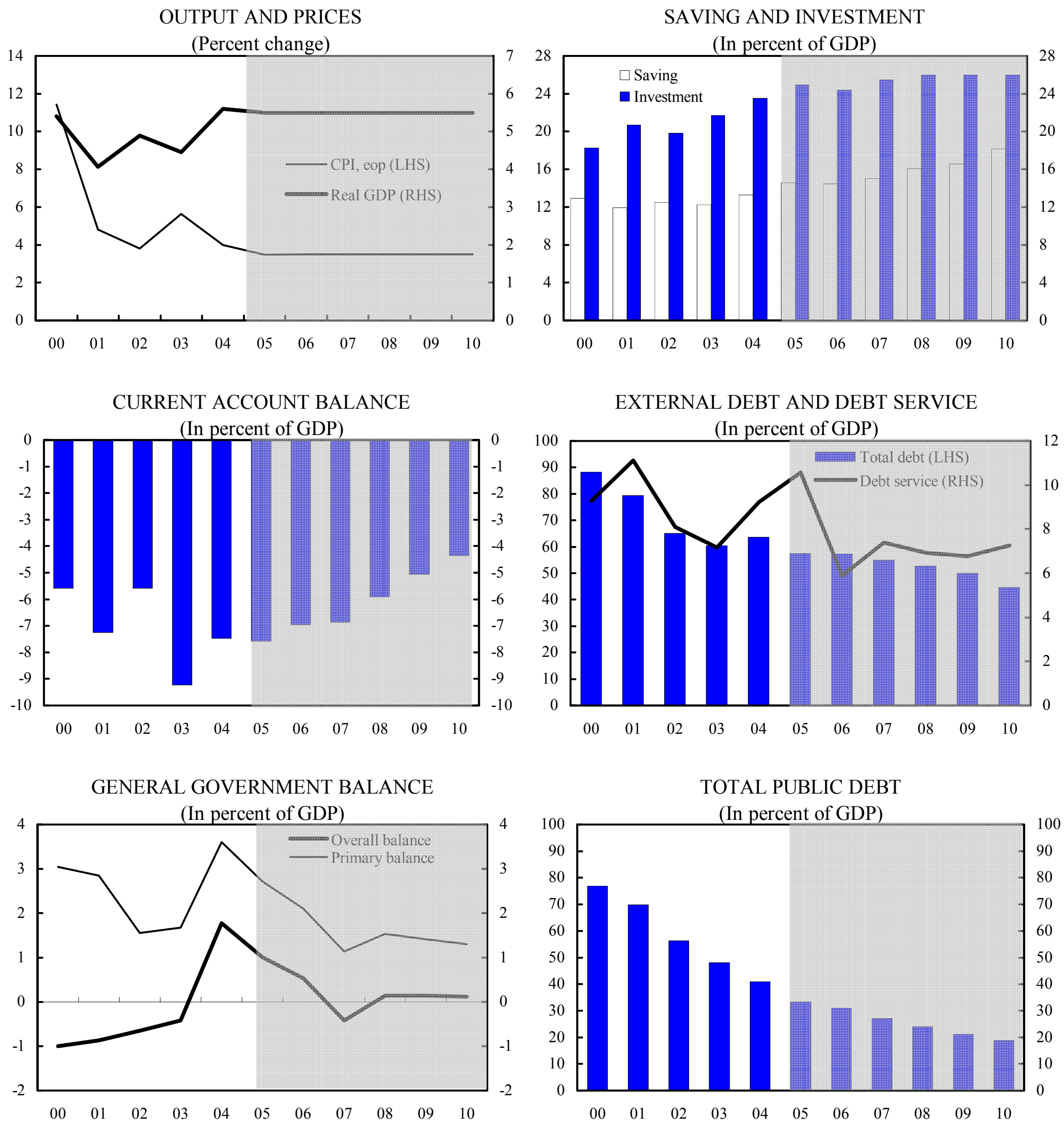
Source: Bulgarian authorities.

Figure 4. Bulgaria: Indicators of Competitiveness, 2001-05



Sources: National authorities; and INS.

Figure 5. Bulgaria: Baseline Medium-Term Projections, 2000-2010 1/



Sources: Bulgarian authorities; and Fund staff estimates and projections.

1/ 2005 onward: projections.

Table 1. Bulgaria: Schedule of Purchases Under the Stand-By Arrangement

Date	Amount of Purchase 1/		Conditions
	In millions of SDRs	In percent of quota	
August 6, 2004	12.0	1.9	Board approval of Stand-By Arrangement
December 15, 2004	11.0	1.7	Observance of end-September 2004 performance criteria
March 15, 2005	11.0	1.7	Observance of end-December 2004 performance criteria and completion of first review
September 15, 2005 2/	22.0	3.4	Observance of end-June 2005 performance criteria
December 15, 2005	11.0	1.7	Observance of end-September 2005 performance criteria and completion of second review
March 15, 2006	11.0	1.7	Observance of end-December 2005 performance criteria
June 13, 2006 3/	11.0	1.7	Observance of end-March 2006 performance criteria and completion of third review
September 5, 2006 4/	11.0	1.7	Observance of end-June 2006 performance criteria and completion of fourth review
Total	**100.0**	**15.6**	

Source: Fund staff calculations.

1/ Assuming maximum proposed access. The authorities plan to treat the arrangement as precautionary and do not intend to make any purchases.
2/ Includes access originally proposed to be available on meeting the end-March performance criteria. These performance criteria were to be set at the time of the first review, earlier envisaged to be completed before end-March 2005.
3/ Board date for 2006 Article IV consultation.
4/ Brought forward to include within the program period.

Table 2. Bulgaria: Observance of Structural Conditionality Under the Stand-By Arrangement in 2004 1/

Conditionality Met	Type 2/	Notes	
1. Selection of winning bids for the sale of seven electricity distribution companies.	SPC - September 30, 2004	Tenders selected on July 15, 2004 and July16, 2004.	
2. Reduction of the proportion of cash in vault usable for fulfilling reserve requirements to 50 percent.	SPC - October 1, 2004	Met on October 1, 2004.	
3. Approval of a law giving the NSSI authority from January 1, 2005 to have its own medical experts verify and recertify any disability certification issued before January 1, 2005; and requiring the NSSI to have its own medical experts recertify all disability certifications issued from this date.	SPC - December 31, 2004	Bill on the Budget of State Social Security for 2005 which proposes a supplement to the Social Security Code was passed on December 11, 2004 and enforced on January 1, 2005.	
4. No imposition of new or intensification of existing restrictions on the making of payments and transfers for current international transactions, nor introduction or modification of multiple currency practices, nor conclusion of any bilateral payments arrangements that are inconsistent with Article VIII of the IMF Articles of Agreement, nor imposition or intensifications of any import restrictions for balance of payments purposes, nor accumulation of any external payments arrears.	Other PC - Continuous		
5. Acquisition of an information technology system for the National Revenue Agency.	SB - September 30, 2004	Acquired on September 15, 2004.	
6. Transfer of the lev-denominated suspense accounts of the customs office to the BNB.	SB - October 31, 2004	Met on October 4, 2004.	
7. Preparation of a privatization plan that ensures revenues consistent with the 2005-06 balance of payments projections.	SB - November 15, 2004	Met. 2005 plan approved by Privatization Agency's Supervisory Board on October 7, 2004.	
8. Adoption of a law to base the annual adjustment of pensions on 75 percent of the increase in the average CPI in the previous year and 25 percent of the increase in the average insurable income in the previous year.	SB - December 31, 2004	Met. Bill on the Budget of State Social Security for 2005 which includes proposals for amendment and supplement to the Social Security Code passed on December 11, 2004 and implemented from January 1, 2005.	
Conditionality Met Partially or with Delay	**Previous Status 2/**	**Notes**	**Current Status 2/**
1. Incorporation into the Treasury Single Account (TSA) of the lev-denominated accounts of all autonomous budgetary entities currently outside the TSA (i.e. all entities of the judicial system, the teachers' pension fund, and all state universities).	SPC - December 31, 2004 Partially Met	All accounts except for the judiciary expenditure accounts have been incorporated. The latter have not due to initial opposition from the judiciary and the change in the banks handling these accounts.	SPC, September 30, 2005. Judiciary expenditure accounts to be incorporated into the budgetary payments system (SEBRA).
2. Full operationalization of the five modules of the Financial Management Information System in the Ministry of Finance.	SB - December 31, 2004 Met with 12 day delay	Lag due to technicalities associated with loading the end-2004 data into the system.	

Table 2 (continued). Bulgaria: Observance of Structural Conditionality Under the Stand-By Arrangement in 2004 1/

Conditionality Not Met	Previous Status 2/	Notes	Current Status 2/
1. Approval by parliament of legislation to use the Bulstat number as the single identification for all tax and social security payments.	SPC - December 31, 2004	Delays in parliamentary timetable. Draft law submitted to parliament on July 29, 2004 and first reading passed on March 30, 2005. The economic committee reviewed the law on second reading on April 13, 2005.	Converted to PA.
2. No new extrabudgetary funds or state-owned enterprises to be created during the program period.	SB - Continuous	On December 16, 2004 the COM set up the Public Investment Projects state-owned enterprise.	The 2005 program considers the enterprise to be a part of the consolidated general
3. Parliamentary approval of the NRA procedural code.	SB - November 15, 2004	Delay in parliamentary timetable. Draft code submitted to parliament. The parliamentary committee on budget and finance passed the NRA procedural code in first reading on April 12, 2005. It was to be disseminated to a group before submission for first reading.	First reading is PA and approval is SPC for September 30, 2005.
4. Adoption of a decree that eliminates the portability of the seniority bonus and submission to parliament of an amendment to the labor code that facilitates work outside regular hours.	SB - December 31, 2004	Working group comprising social partners has been set up but agreement is unlikely in the immediate future due to union opposition.	Eliminating portability of the seniority bonus for unemployed is now SB for December 31, 2005. Submission of draft legislation to parliament to increase working time flexibility is SB for September 30, 2005.
5. Submission to parliament of amendments to the companies law, the civil procedure code, and any other legal instruments necessary to transfer business registration to a nonjudicial administrative body and establish a unified national electronic register with limited judicial oversight and simplified administrative procedures.	SB - December 31, 2004	Delay due to opposition from the independent judiciary. COM plans to formally approve the strategy on April 28, 2005.	Interinstitutional working group strategy to be approved by the COM is PA and submission of laws to parliament is SB for September 30,
6. Sale of at least 5 tobacco companies representing at least 50 percent of the of the entities of the Bulgartabac holding identified as salable in the Phase I preparation	SB - December 31, 2004	Privatization of cigarette making factories terminated due to withdrawal of the only bidder and political infighting. To date, sales of five tobacco processing companies have been negotiated and finalization of an additional one awaits approval by Bulgartabac's supervisory board .	This benchmark has been dropped for the time being due to political problems which make progress impossible before the June 25, 2005 election.

1/ Details of the performance criteria and benchmarks are included in the Annexes to the Memorandum of Economic and Financial Policies, IMF Country Report No./04/267.
2/ SPC denotes structural performance criterion, PC denotes performance criteria, SB denotes structural benchmark, and PA denotes prior action.

Table 3. Bulgaria: Quantitative Performance Criteria and Indicative Targets Under the Stand-By Arrangement 1/
(In millions of leva, unless otherwise indicated)

		June 30, 2004 2/	Septembe 30, 2004	December 31, 2004	March 31, 2005 2/	June 30, 2005	Septembe 30, 2005	December 31, 2005 2/
I.	Floor on the overall fiscal surplus of the general government 3/							
	Target	699	403	0	198	383	605	417
	Actual 4/	810	1,247	332.6				
		111	844	332.6				
II	Ceiling on central government arrears 3/							
	Target	-9.8	-54.8	-54.8	5.0	5.0	5.0	5.0
	Actual 4/	-8.7	-44.2	-52.6				
		-1.1	-10.6	-2.2				
II	Expenditure ceiling 3/							
	Target	6,469	10,211	14,275	n/	n/	n/	n/
		6,407	9,729	14,583				
		62	482	-				
I	Ceiling on the wage bill of the selected SOEs 3/							
	Target 5/	283.0	404.3	525.2	95.0	189.9	284.9	379.9
		265.1	379.1	489.0				
		17.9	25.2	36.2				
V.	Ceiling on the contracting or guaranteeing of nonconcessional external public debt 6/							
	(i) 1 year and less than 3 years							
	Target	0	0	0	0	0	0	0
		0	0	0				
		0	0	0				
	(ii) Over 1							
	Target	150.0	390.0	390.0	38.0	229.8	229.8	229.8
		0	309.7	309.7				
		150.0	80.3	80.3				
	(iii) 1-5							
	Target	0	0	0	0	0	0	0
		0	0	0				
		0	0	0				

1/ Definitions of the performance criteria are included in the Annexes to the Memorandum of Economic and Financial Policies, August 2004 and the Supplementary Memorandum of Economic and Financial Policies, March 2005.
2/ Indicative limit or target.
3/ Cumulative change from January 1, 2004 for 2004 performance criteria and from January 1, 2005 for 2005 performance criteria.
4/ Includes reduction in central government arrears.
5/ Targets have changed compared to IMF Country Report No./04/267 due to the privatization of BTC in Q2 2004 and Balkan Mine 2000, Open coal mine, and Brikel SOEs in Q3 2004, and of Mina Zdravec EAD and Eood Central Base-Pernik in Q4 2004.
6/ In millions of euro. Cumulative change from December 31, 2004 for 2004 performance criteria and December 31, 2005 for 2005 performance criteria.

Table 4. Bulgaria: Selected Economic Indicators, 2001-2005

	2001	2002	2003	2004		2005	
				Original Prog. 1/	Act.	Original Prog. 1/	Revised Prog.
Output, prices, and employment				(Annual percent change, unless otherwise stated)			
Real GDP	4.1	4.9	4.5	5.2	5.6	5.2	5.5
Real industrial sales	2.8	1.3	17.4	...	23.6	...	...
Consumer price index (average)	7.5	5.8	2.3	6.3	6.1	3.6	4.0
(end of period)	4.8	3.8	5.6	3.6	4.0	3.6	3.5
Unemployment rate (in percent)							
Registered unemployment (average)	17.5	17.4	14.3	...	12.7	...	...
Labor force survey (average)	19.8	17.8	13.7	...	12.0	...	...
Real public sector wages (average)	6.3	2.5	3.9	...	0.7	...	...
Real private sector wages (average)	4.1	-4.1	5.7	...	0.9	...	...
General government				(In percent of GDP)			
Revenue	37.6	36.5	37.8	38.4	39.2	37.3	38.8
Noninterest expenditure	38.4	37.1	36.1	35.6	35.6	34.4	36.1
Primary balance	2.8	1.6	1.7	2.8	3.6	2.8	2.7
Interest payments	3.7	2.2	2.1	1.9	1.8	1.9	1.7
Overall balance	-0.9	-0.6	-0.4	0.9	1.8	0.9	1.0
Privatization receipts	2.9	0.9	1.1	3.4	3.1	2.5	4.3
External financing	-0.3	1.5	0.0	0.9	-1.6	0.3	-4.8
Domestic financing	-1.7	-1.9	-0.7	-5.2	-3.2	-3.8	-0.6
Public debt (end of period) 2/	69.9	56.2	48.1	44.3	40.9	41.7	33.3
Domestic public debt (end of period) 2/	6.2	6.5	6.5	7.2	7.0	7.7	6.8
Money and credit 3/				(Annual percent change, unless otherwise stated)			
Broad money (end of period; millions of leva)	11,499	12,867	15,558	19,778	18,926	22,635	22,668
Broad money (M3)	25.2	11.9	20.9	19.4	21.6	14.4	19.8
Claims on nongovernment	32.1	44.0	48.3	33.0	48.7	25.4	30.0
FX deposits (euro millions) 4/	2,508	2,659	3,110	3,830	3,470	...	3,716
FX deposits (percent of M3) 4/	42.7	40.4	39.1	37.9	35.9	...	32.1
Broad money to FX reserves ratio	1.4	1.4	1.5	1.7	1.4	...	1.6
Interest rates (annualized)				(In percent)			
BNB basic rate	4.7	3.4	2.7	...	2.4	...	...
Time deposits (leva)	3.4	3.2	3.2	...	3.0	...	...
Balance of payments				(In millions of euros, unless otherwise stated)			
Current account balance	-1,102	-926	-1,630	-1,719	-1,453	-1,755	-1,602
(In percent of GDP)	-7.3	-5.6	-9.2	-8.8	-7.5	-8.3	-7.6
Trade balance	-1,779	-1,692	-2,200	-2,659	-2,718	-2,800	-3,144
Exports, fob	5,714	6,063	6,668	7,881	7,994	8,589	9,252
Imports, fob	-7,493	-7,755	-8,868	10,540	-10,712	11,389	-12,395
Gross official reserves (end of period)	4,063	4,575	5,309	5,862	6,770	5,938	7,196
(In months of prospective imports of GNFS)	5.0	4.9	4.8	4.9	5.3	4.7	5.2
External debt (end of period) 5/	12,049	10,769	10,681	10,906	12,376	11,307	12,150
(In percent of GDP)	79.4	65.1	60.5	56.1	63.7	53.5	57.5
Exchange rates							
Leva per euro				Currency board, peg to euro at lev 1.95583 per euro			
Leva per U.S. dollar (end of period)	2.192	1.885	1.591	...	1.459	...	...
(yoy percent change, + means depreciation)	4.3	-14.0	-15.6	...	-8.3	...	...
REER (end of period; CPI based)							
(yoy percent change, + means appreciation)	3.7	5.7	8.4	...	2.6	...	...

Social Indicators 6/

Per capita GNI (Atlas method)**:** US $1770; **Population**: 7.8 million; **Urban population:** 67.5 percent;
Poverty (percent of population): 12.8 (national headcount index); **Life expectancy at birth:** 71.8 years; **Infant mortality** (per 1,000): 14
Child malnutrition (percent of children under 5): n/a; **Income/consumption distribution** (Gini index): 12.8;
Gross primary enrollment (percent of school-age group): 100 (male), 98.2 (female)

Sources: Bulgarian authorities, Fund staff estimates, and World Development Indicators database.

1/ As projected in the July 2005 Stand-By-Arrangement.
2/ Domestic debt as reported by Ministry of Finance and external debt as reported by BNB.
3/ Starting in 2002, a new format was adopted for monetary data resulting in revisions to historical series.
4/ Includes only foreign currency deposits in M3.
5/ Includes trade credits.
6/ 2001 figure for gross primary enrollment and income/consumption distribution. 2002 figure for per capita GNI, urban population, poverty rate, life expectancy, and infant mortality. 2003 figure for total population.

Table 5: Bulgaria, Monetary Survey, 2001-2006
(End-period; in millions of leva, unless otherwise stated)

	2001	2002	2003	2004	2005				2006
					Q1 1/	Q2	Q3	Q4	
					proj.	proj.	proj.	proj.	proj.
Broad money	11,499	12,867	15,558	18,926	19,506	20,665	22,225	22,668	26,452
Currency outside banks	3,081	3,335	3,874	4,628	4,415	4,612	5,040	5,364	5,996
Reserve money	4,033	4,482	5,266	7,058	6,844	7,091	7,666	8,179	9,252
Deposits	8,418	9,533	11,684	14,298	15,092	16,054	17,186	17,305	20,456
Lev	3,513	4,332	5,602	7,512	8,150	8,749	9,452	10,037	12,069
Foreign currency	4,905	5,201	6,082	6,786	6,942	7,304	7,734	7,268	8,387
Other longer-term liabilities (not incl. in broad money)	2,888	3,402	3,982	4,767	5,177	5,413	5,664	5,931	7,205
Deposits	21	110	256	571	645	723	809	906	1,327
Lev	12	79	123	225	252	289	324	363	531
Foreign currency	9	30	133	346	394	434	486	544	796
Capital and reserves	2,867	3,293	3,726	4,196	4,532	4,690	4,855	5,025	5,878
Net foreign assets	9,454	9,892	10,049	11,181	10,719	11,585	11,943	11,800	13,633
BNB	5,485	6,982	8,545	11,571	11,207	12,185	12,543	12,750	14,933
Commercial banks	3,969	2,910	1,504	-390	-488	-600	-600	-950	-1,300
Net domestic assets	4,934	6,378	9,491	12,512	13,965	14,494	15,947	16,799	20,024
Domestic credit	5,107	6,666	9,243	12,302	13,726	14,225	15,658	16,468	19,694
General government	664	269	-244	-1,808	-1,580	-2,067	-1,634	-1,881	-2,962
Non-government	4,443	6,397	9,487	14,110	15,305	16,292	17,292	18,349	22,655
Claims on non-financial corporations	3,450	4,909	6,731	9,306	...	...	...	...	...
Claims on households	934	1,385	2,502	4,374	...	...	...	...	...
Other items, net	-1,052	-1,239	-935	-1,127	-1,139	-1,150	-1,173	-1,174	-1,198
Fixed assets	879	951	1,183	1,337	1,378	1,419	1,461	1,505	1,528
				(12-month percentage change)					
Broad money	25	12	21	22	24	21	26	20	17
Currency outside banks	30	8	16	19	19	16	16	16	12
Reserve money	33	11	17	34	37	35	28	16	13
Claims on non-government	32	44	48	49	47	42	37	30	23
Claims on non-financial corporations	27	42	37	38	...	...	...	...	...
Claims on households	51	48	81	75	...	...	...	...	...
Deposits	24	13	23	22	26	23	30	21	18
Lev	26	23	29	34	46	50	46	34	20
Foreign currency	22	6	17	12	9	1	14	7	15
				(quarterly growth rates)					
Claims on non-government	10.7	10.9	11.9	11.5	8.5	6.4	6.1	6.1	5.4
Claims on non-financial corporations	11.2	10.8	10.3	9.8	...	...	...	...	...
Claims on households	8.3	11.1	16.0	14.9	...	...	...	...	...
				(In percent of GDP)					
Broad Money	38.7	39.8	45.0	49.8	50.4	52.4	55.1	54.9	58.8
Claims on Nongovernment	15.0	19.8	27.5	37.1	39.6	41.3	42.9	44.4	50.4
Claims on non-financial corporations	11.6	15.2	19.5	24.5	...	...	...	...	...
Claims on households	3.1	4.3	7.2	11.5	...	...	...	...	...
Memorandum items:									
Reserve money (leva, million)	4,033	4,482	5,266	7058	6,844	7,091	7,666	8,179	9,252
Banks' reserves (including cash in bank vault, Leva, million)	952	1,147	1,392	2431	2,430	2,479	2,627	2,815	3,256
Money multiplier (M3/reserve money)	2.9	2.9	3.0	3	2.9	2.9	2.9	2.8	2.9
BNB net foreign assets/Reserve money (in percent)	136.0	155.8	162.2	164	163.7	171.8	163.6	155.9	161.4
Foreign currency deposits (percent of broad money)	42.7	40.4	39.1	36	35.6	35.3	34.8	32.1	31.7
Commecial banks NFA/foreign currency deposits (in percent)	80.8	55.6	24.2	-5	-6.7	-7.8	-7.3	-12.2	-14.2
Claims on nongovernment/deposits (in percent)	52.8	67.1	81.2	99	101.4	101.5	100.6	106.0	110.8

Source: BNB, National Statistics Institute, and IMF staff estimates.

1/ Excluding fictitious credits to the non-government sector of an estimated Leva 1,516 million that were officially extended during March and deposited with commercial banks. The incentive for extending these credits was to circumvent the credit growth measures of the BNB.

Table 6. Bulgaria: Selected Vulnerability Indicators, 2001-2005

	2001	2002	2003	2004	2005 1/	
Key Economic and Market Indicators						
Real GDP growth (in percent)	4.1	4.9	4.5	5.6	5.5	Proj.
CPI inflation (period average, in percent)	7.5	5.8	2.3	6.1	4.0	Proj.
Short-term (ST) interest rate (in percent)	4.7	3.4	2.7	2.4		Dec-04
EMBI + secondary market spread (bps; end of period)	433	291	177	77		Dec-04
Exchange rate NC/US$ (end of period)	2.2	1.9	1.6	1.4		Dec-04
External Sector						
Exchange rate regime	Currency board, peg to euro at lev 1.95583 per euro					
Current account balance (percent of GDP)	-7.3	-5.6	-9.2	-7.5	-7.6	Proj.
Net FDI inflows (percent of GDP)	5.9	5.8	10.3	4.1	10.1	Proj.
Export growth (yoy, Euro value, GNFS)	6.3	5.5	10.7	20.1	15.9	Proj.
Real effective exchange rate (1995 = 100; end of period))	132.9	140.4	152.1	156.0		Dec-04
Gross international reserves (GIR) in Euro billion	4.1	4.6	5.3	6.8	7.2	Proj.
GIR in percent of ST debt at remaining maturity	179.9	190.1	164.6	133.1	163.0	Proj.
GIR in percent of ST debt at RM and banks' FX deposits.		92.4	101.4	87.0	86.3	Proj.
Net international reserves (NIR) in Euro billion	2.8	3.6	4.4	5.9	6.5	Proj.
Total gross external debt in percent of GDP 3/	79.4	65.1	60.5	63.7	57.5	Proj.
o/w ST external debt (original maturity, in percent of total ED)	11.5	16.5	21.2	27.9	32.4	Proj.
ED of domestic private sector (in percent of total ED)	18.7	26.1	33.6	48.1	55.8	Proj.
ED to foreign official sector (in percent of total ED)	32.2	30.4	29.6	28.6		Dec-04
Total gross external debt in percent of exports of GNFS	148.8	126.1	112.9	109.0	92.3	Proj.
Gross external financing requirement (in Euro billion) 2/	2.9	2.7	3.5	3.8	4.1	Proj.
Public Sector 3/						
Overall balance (percent of GDP)	-0.9	-0.6	-0.4	1.8	1.0	Proj.
Primary balance (percent of GDP)	2.8	1.6	1.7	3.6	2.7	Proj.
Debt-stabilizing primary balance (percent of GDP) 4/	...	...	...	...	0.5	Proj.
Gross public sector financing requirement (in percent of GDP) 5/	...	...	...	...	7.6	Proj.
Public sector gross debt (in percent of GDP) 6/	69.9	56.2	48.1	40.9	33.3	Proj.
o/w Exposed to rollover risk (in percent of total PSGD) 6/				12.3		Dec-04
Exposed to exchange rate risk (in percent of total PSGD) 7/	94.6	91.8	91.0	87.9		Dec-04
Exposed to interest rate risk (in percent of total PSGD) 8/				52.4		Dec-04
Public sector net debt (in percent of GDP) 9/	65.7	45.4	36.5	27.6		Dec-04
Financial Sector 10/						
Capital adequacy ratio (in percent)	31.3	25.2	22.0	17.1		Sep-04
NPLs in percent of total loans 11/	13.1	8.6	7.3	7.0		Sep-04
Provisions in percent of NPLs 11/	61.6	65.0	53.0	49.1		Sep-04
Return on average assets (in percent)	2.9	2.1	2.4	2.3		Sep-04
Return on equity (in percent)	20.2	14.9	22.7	21.6		Sep-04
FX deposits (in percent of total deposits)	52.8	49.6	48.0	46.9		Dec-04
FX loans (in percent of total loans)	35.5	41.3	42.8	47.5		Dec-04
Net open forex position (in percent of capital) 12/	-5.2	-4.2	-4.9	-5.9		Dec-04
Government debt held by FS (percent of total FS assets)	24.1	22.5	18.9	15.6		Dec-04
Credit to private sector (percent change)	32.1	44.0	48.3	48.7		Dec-04
Memo item:						
Nominal GDP in billions of euros	15.2	16.5	17.7	19.4	21.1	Proj.
Nominal GDP in billions of U.S. dollars	13.6	15.7	20.0	24.2	28.4	Proj.

Sources: Bulgarian authorities; and Fund staff estimates.

1/ Staff estimates, projections, or latest available observations as indicated in the last column.
2/ Current account deficit plus amortization of external debt at original maturity.
3/ Public sector covers central government, autonomous budgets, social security funds, municipal budgets, and extra budgetary funds.
4/ Based on averages for the last five years for the relevant variables (i.e., growth, interest rates).
5/ Overall balance plus debt amortization.
6/ Amorization on domestic and external debt (excluding external debt to official creditors) in 2005 divided by 2004 total debt stock.
7/ Debt in foreign currency or linked to the exchange rate, domestic and external. Does not exclude external debt on concessional terms.
8/ ST debt and maturing medium- and long-term debt at variable interest rates, domestic and external.
9/ Public sector gross debt minus balance of the fiscal reserve account.
10/ Financial sector covers banking sector only excluding insurance, pension funds and capital market institutions.
11/ Total loans exclude interbank loans. Non-performing loans including watch, substandard, doubtful, and loss.
12/ Does not include off-balance sheet items.

Table 7. Bulgaria: Balance of Payments, 2002-2006
(In millions of euros)

	2002	2003	2004				2004	2005	2006
			Q1	Q2	Q3	Q4			
			Act.	Act.	Act.	Act.	Act.	Projections	
CURRENT ACCOUNT	-926	-1,630	-499	-457	399	-896	-1,453	-1,602	-1,600
Trade balance	-1,692	-2,200	-508	-792	-460	-958	-2,718	-3,144	-3,323
Exports (f.o.b.)	6,063	6,668	1,719	1,899	2,189	2,187	7,994	9,252	10,097
y-o-y change (in percent)	6.1	10.0	5.1	17.5	24.9	31.4	19.9	15.7	9.1
Imports (f.o.b.)	-7,755	-8,868	-2,228	-2,691	-2,648	-3,145	-10,712	-12,395	-13,420
y-o-y change (in percent)	3.5	14.4	15.7	18.7	20.1	27.3	20.8	15.7	8.3
Services, net	486	523	-28	204	656	-108	724	939	1,038
Exports of NFS	2,479	2,791	494	841	1,413	614	3,362	3,913	4,238
Imports of NFS	-1,993	-2,268	-522	-637	-757	-722	-2,638	-2,973	-3,200
Of which: Exports of travel services	1,203	1,460	200	447	868	232	1,746	2,004	2,133
Income, net	-285	-566	-136	-50	-98	-63	-346	-408	-517
Of which: Income to direct investors	-242	-343	-45	-72	-77	-87	-281	-339	-475
Current transfers, net	566	613	174	180	301	233	888	1,011	1,202
CAPITAL AND FINANCIAL ACCOUNT	1,658	2,412	494	1,231	-270	1,510	2,965	2,233	2,715
Capital transfers, net	0	0	0	0	0	0	0	0	0
Foreign direct investment, net 1/ 2/	951	1,827	356	659	-604	379	790	2,132	1,696
Of which: Privatization receipts	144	323	46	197	0	0	243	916	550
Portfolio investment, net	-99	-191	-123	83	-518	1	-557	-1,247	46
Other investment, net	1,006	840	294	222	883	790	2,190	1,349	973
General government	-129	60	-29	5	102	35	113	141	326
Domestic banks	443	562	65	57	136	774	1,032	253	143
Other private sector	691	219	259	161	645	-20	1,045	955	504
Errors and omissions	-200	-65	-33	266	-31	340	543	0	0
OVERALL BALANCE	732	781	-5	773	129	614	1,512	632	1,115
FINANCING	-732	-781	5	-773	-129	-614	-1,512	-632	-1,115
Gross international reserves (increase: -)	-578	-817	-42	-741	-119	-592	-1,493	-425	-854
Use of Fund credit, net	-155	35	46	-32	-10	-23	-19	-206	-262
Purchases	117	128	62	0	0	0	62	0	0
Repurchases 3/	-271	-93	-15	-32	-21	-38	-106	-206	-262
Exceptional financing	0	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS									
Gross international reserves (stock, e.o.p.) 4/	4,575	5,309	5,366	6,111	6,219	6,770	6,770	7,196	8,050
In months of prospective GNFS imports	4.9	4.8	4.6	5.1	4.9	5.3	5.3	5.2	5.4
In percent of short-term debt	258.1	234.5	202.7	196.3	180.8	195.8	195.8	182.9	186.6
Excess international reserves (stock, e.o.p.) 5/	2,282	2,606	2,820	3,434	3,372	3,722	3,722	3,839	4,193
In percent of short-term debt	128.8	115.1	106.6	110.3	98.0	107.7	107.7	97.6	97.2
Current account + FDI	25	197	-143	202	-205	-517	-663	530	96
(in percent of GDP)	0.2	1.1	-0.7	1.0	-1.1	-2.7	-3.4	2.5	0.4
Current account (in percent of GDP)	-5.6	-9.2	-12.2	-10.2	7.3	-16.7	-7.5	-7.6	-7.0
Merchandise trade account (in percent of GDP)	-10.2	-12.5	-12.4	-17.6	-8.4	-17.8	-14.0	-14.9	-14.5
Merchandise exports (in percent of GDP)	36.7	37.8	42.0	42.2	40.1	40.7	41.1	43.8	43.9
Merchandise imports (in percent of GDP)	-46.9	-50.2	-54.4	-59.8	-48.5	-58.5	-55.1	-58.7	-58.4
Export volume (year-on-year change)	10.2	14.9	3.1	-0.9	7.7	19.5	8.5	12.8	12.8
Import volume (year-on-year change)	7.1	19.5	16.9	2.8	6.0	16.7	11.4	11.5	10.7
FDI (net) in percent of current account	102.7	112.1	71.3	144.2	151.4	42.3	54.4	133.1	106.0
Gross external debt (stock, e.o.p.)	10,769	10,681	11,449	12,129	12,354	12,376	12,376	12,150	13,176
(In percent of annual GDP)	65.1	60.5	58.9	62.4	63.6	63.7	63.7	57.5	57.3
Public	7,961	7,098	7,277	7,323	6,685	6,421	6,421	5,374	5,746
Private	2,808	3,583	4,172	4,806	5,669	5,955	5,955	6,776	7,430
Short-term debt (in percent of total debt, e.o.p.)	16.5	21.2	23.1	25.7	27.8	27.9	27.9	32.4	32.7
Net external debt (in percent of annual GDP) 6/	25.9	22.0	22.8	21.3	22.4	17.1	17.1	13.3	11.2
GDP	16,533	17,663	4,092	4,503	5,463	5,375	19,433	21,117	22,992

Sources: Bulgarian authorities, and Fund staff estimates.

1/ All FDI is assumed to be non-debt creating, except the 200 m euros inflow related to the acquisition of a local mobile telephone company (see below).
2/ The figures for the second and third quarters are influenced by a complex debt financed merger and acquisition transaction of a local mobile telephone company that led to a sharp increase in its equity value, and a transfer of the realized capital gains out of the country by the original owners. This resulted in a net FDI outflow of 650 million euros and an increase in gross external debt by 590 million euros.
3/ According to expectations schedule.
4/ Historical figures include valuation changes.
5/ Gross international reserves minus reserve money.
6/ External debt minus gross foreign assets of the banking system.

Table 8. Bulgaria: General Government Operations, 2001-2006
(In millions of leva)

	2001	2002	2003	2004 Org. Prog.	2004 Actual 1/	2005 Rev. Prog.	2006 Proj.
Total revenue and grants	11,164	11,799	13,053	14,605	14,917	16,037	17,168
Tax revenue	8,517	8,873	10,215	11,524	11,863	12,764	13,857
Profit taxes	1,150	976	1,032	1,088	973	981	1,068
Nonfinancial enterprises	812	871	899	953	853	856	932
Financial enterprises	339	105	133	134	119	125	136
Income taxes	1,063	1,052	1,140	1,204	1,248	1,196	1,349
VAT	2,454	2,688	3,101	3,666	3,891	4,317	4,681
Excise and fuel duties	1,107	1,314	1,544	1,829	1,881	2,057	2,170
Customs duties	195	188	231	285	292	278	281
Social insurance contributions	2,311	2,352	2,807	3,078	3,169	3,540	3,878
Pension and unemployment contributions 2/	1,822	1,839	2,193	2,395	2,454	2,750	3,018
Health Insurance Fund	489	513	614	683	714	790	860
Other taxes	236	303	359	374	409	395	430
Nontax revenues	2,284	2,625	2,527	2,637	2,599	2,754	2,713
BNB transfers	175	173	133	171	171	147	150
Other	2,109	2,452	2,394	2,466	2,428	2,607	2,563
Grants and donations	363	301	311	444	455	520	598
Total expenditure and net lending 3/	11,423	12,009	13,197	14,275	14,243	15,621	16,928
Noninterest expenditure, net lending, contingency	10,317	11,296	12,473	13,546	13,546	14,916	16,222
Current noninterest expenditure	8,812	10,061	11,190	11,930	11,932	12,633	13,848
Compensation	1,196	1,379	1,552	1,752	1,718	1,781	1,917
Wages and salaries	1,159	1,338	1,506	1,707	1,672	1,735	1,874
Scholarships	37	41	45	46	46	46	43
Maintenance and operations	1,876	2,200	2,389	2,389	2,690	2,623	2,878
Defense and security	957	1,066	1,107	1,221	1,160	1,330	1,439
Subsidies	709	772	887	783	868	747	764
Social expenditures	4,074	4,634	5,106	5,617	5,430	6,053	6,750
Pension fund	2,586	2,944	3,161	3,466	3,457	3,668	4,137
Assistance and unemployment	858	1,007	1,004	1,102	941	1,226	1,349
Health Insurance Fund	404	498	720	784	778	896	944
Other social expenditures 4/	225	185	221	265	254	264	320
Transfers 5/	...	...	149	167	68	100	100
Capital expenditures	1,198	1,046	1,189	1,416	1,479	1,856	2,024
Contingency	245	189	95	200	219	426	350
Enterprise restructuring	18	0	0	10	0	15	50
Budget	188	143	48	136	168	356	250
Natural disaster	39	46	46	54	51	56	50
Primary balance	847	503	579	1,059	1,371	1,122	946
Interest	1,106	713	724	729	697	705	706
External	853	544	561	543	517	507	552
Domestic	253	169	163	187	181	198	154
Overall balance	-259	-210	-145	330	673	417	240
Financing	259	210	145	-330	-673	-417	-240
Privatization 6/	861	286	387	1,294	1,178	1,791	1,076
External (net)	-96	481	-2	338	-622	-1,975	-256
Domestic (net)	-506	-623	-240	-1,961	-1,228	-233	-1,060
Memorandum item:							
Nominal GDP in millions of leva	29,709	32,335	34,547	38,046	38,008	41,302	44,968

Sources: Ministry of Finance; and Fund staff projections.

1/ In late 2004, a state enterprise for infrastructure projects ("PIP") was created, capitalized with BGN 340 million to execute spending in 2005. PIP is consolidated with the general government.

2/ Pension and unemployment contributions were combined in January 2002.

3/ From 2004, total expenditure is adjusted for clearance of arrears (net). Net arrears clearance in 2004 amounted to BGN -84.7 million, and is assumed to be zero thereafter.

4/ Includes additional compulsory social security contributions (for the second pillar of the pension system) for public sector employees.

5/ Under the 2003 and 2004 budgets, these transfers were envisaged to be made below the line for various purposes.

6/ Slight differences between privatization receipts in the balance of payments and the fiscal accounts are due to domestic privatization. In 2004, however, about BGN 500 million (1.3 percent of GDP) of previously completed bank privatizations was transferred to the government upon the closure of the Bank Consolidation Company.

Table 9. Bulgaria: General Government Operations, 2001-2006
(In percent of GDP)

	2001	2002	2003	2004		2005	2006
				Org. Prog.	Actual 1/	Rev. Prog.	Proj.
Total revenue and grants	37.6	36.5	37.8	38.4	39.2	38.8	38.2
Tax revenue	28.7	27.4	29.6	30.3	31.2	30.9	30.8
Profit taxes	3.9	3.0	3.0	2.9	2.6	2.4	2.4
Nonfinancial enterprises	2.7	2.7	2.6	2.5	2.2	2.1	2.1
Financial enterprises	1.1	0.3	0.4	0.4	0.3	0.3	0.3
Income taxes	3.6	3.3	3.3	3.2	3.3	2.9	3.0
VAT	8.3	8.3	9.0	9.6	10.2	10.5	10.4
Excise and fuel duties	3.7	4.1	4.5	4.8	4.9	5.0	4.8
Customs duties	0.7	0.6	0.7	0.8	0.8	0.7	0.6
Social insurance contributions	7.8	7.3	8.1	8.1	8.3	8.6	8.6
Pension and unemployment contributions 2/	6.1	5.7	6.3	6.3	6.5	6.7	6.7
Health Insurance Fund	1.6	1.6	1.8	1.8	1.9	1.9	1.9
Other taxes	0.8	0.9	1.0	1.0	1.1	1.0	1.0
Nontax revenues	7.7	8.1	7.3	6.9	6.8	6.7	6.0
BNB transfers	0.6	0.5	0.4	0.4	0.4	0.4	0.3
Other	7.1	7.6	6.9	6.5	6.4	6.3	5.7
Grants and donations	1.2	0.9	0.9	1.2	1.2	1.3	1.3
Total expenditure and net lending 3/	38.4	37.1	38.2	37.5	37.5	37.8	37.6
Noninterest expenditure, net lending, contingency	34.7	34.9	36.1	35.6	35.6	36.1	36.1
Current noninterest expenditure	29.7	31.1	32.4	31.4	31.4	30.6	30.8
Compensation	4.0	4.3	4.5	4.6	4.5	4.3	4.3
Wages and salaries	3.9	4.1	4.4	4.5	4.4	4.2	4.2
Scholarships	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Maintenance and operations	6.3	6.8	6.9	6.3	7.1	6.4	6.4
Defense and security	3.2	3.3	3.2	3.2	3.1	3.2	3.2
Subsidies	2.4	2.4	2.6	2.1	2.3	1.8	1.7
Social expenditures	13.7	14.3	14.8	14.8	14.3	14.7	15.0
Pension fund	8.7	9.1	9.2	9.1	9.1	8.9	9.2
Assistance and unemployment	2.9	3.1	2.9	2.9	2.5	3.0	3.0
Health Insurance Fund	1.4	1.5	2.1	2.1	2.0	2.2	2.1
Other social expenditures 4/	0.8	0.6	0.6	0.7	0.7	0.6	0.7
Transfers 5/			0.4	0.4	0.2	0.2	0.2
Capital expenditures	4.0	3.2	3.4	3.7	3.9	4.5	4.5
Contingency	0.8	0.6	0.3	0.5	0.6	1.0	0.8
Enterprise restructuring	0.1	0.0	0.0	0.0	0.0	0.0	0.1
Budget	0.6	0.4	0.1	0.4	0.4	0.9	0.6
Natural disaster	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Primary balance	2.8	1.6	1.7	2.8	3.6	2.7	2.1
Interest	3.7	2.2	2.1	1.9	1.8	1.7	1.6
External	2.9	1.7	1.6	1.4	1.4	1.2	1.2
Domestic	0.9	0.5	0.5	0.5	0.5	0.5	0.3
Overall balance	-0.9	-0.6	-0.4	0.9	1.8	1.0	0.5
Financing	0.9	0.6	0.4	-0.9	-1.8	-1.0	-0.5
Privatization 6/	2.9	0.9	1.1	3.4	3.1	4.3	1.7
External (net)	-0.3	1.5	0.0	0.9	-1.6	-4.8	-0.6
Domestic (net)	-1.7	-1.9	-0.7	-5.2	-3.2	-0.6	-1.7
Public debt	69.9	56.2	48.1	44.3	40.9	33.3	31.1
External	63.7	49.7	41.6	37.1	33.9	26.4	23.7
Domestic	6.2	6.5	6.5	7.2	7.0	6.8	7.4
Memorandum item:							
Nominal GDP in millions of leva	29,709	32,335	34,547	38,046	38,008	41,302	44,968

Sources: Ministry of Finance; and Fund staff projections.

1/ In late 2004, a state enterprise for infrastructure projects ("PIP") was created, capitalized with BGN 340 million to execute spending in 2005. PIP is consolidated with the general government.
2/ Pension and unemployment contributions were combined in January 2002.
3/ From 2004, expenditure is adjusted for clearance of arrears (net). Net arrears clearance in 2004 amounted to BGN -84.7 million, and is assumed to be zero thereafter.
4/ Includes additional compulsory social security contributions (for the second pillar of the pension system) for public sector employees.
5/ Under the 2003 and 2004 budgets, these transfers were envisaged to be made below the line for various purposes.
6/ Slight differences between privatization receipts in the balance of payments and the fiscal accounts are due to domestic privatization. In 2004, however, about BGN 500 million (1.3 percent of GDP) of previously completed bank privatizations was transferred to the government upon the closure of the Bank Consolidation Company.

Table 10. Bulgaria: Balance of Payments, 2001-2010
(In millions of euros)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
					Projections					
CURRENT ACCOUNT	-1,102	-926	-1,630	-1,453	-1,602	-1,600	-1,717	-1,611	-1,498	-1,407
Trade balance	-1,779	-1,692	-2,200	-2,718	-3,144	-3,323	-3,757	-3,921	-4,135	-4,124
Exports (f.o.b.)	5,714	6,063	6,668	7,994	9,252	10,097	10,767	11,955	13,211	14,698
y-o-y change (in percent)	8.8	6.1	10.0	19.9	15.7	9.1	6.6	11.0	10.5	11.3
Imports (f.o.b.)	-7,493	-7,755	-8,868	-10,712	-12,395	-13,420	-14,524	-15,876	-17,346	-18,822
y-o-y change (in percent)	14.7	3.5	14.4	20.8	15.7	8.3	8.2	9.3	9.3	8.5
Services, net	454	486	523	724	939	1,038	1,140	1,207	1,340	1,587
Of which: Exports of travel services	1,084	1,203	1,460	1,746	2,004	2,133	2,278	2,388	2,510	2,637
Income, net	-340	-285	-566	-346	-408	-517	-782	-861	-982	-1,088
Of which: Income to direct investors	-166	-242	-343	-281	-339	-475	-678	-712	-802	-844
Current transfers, net	562	566	613	888	1,011	1,202	1,681	1,965	2,279	2,217
CAPITAL AND FINANCIAL ACCOUNT	1,527	1,658	2,412	2,965	2,233	2,715	2,241	2,450	2,285	1,568
Capital transfers, net	0	0	0	0	0	0	0	0	0	0
Foreign direct investment, net 1/ 2/	893	951	1,827	790	2,132	1,696	1,258	1,477	1,620	1,715
Of which: Privatization receipts	21	144	323	243	916	550	0	0	0	0
Portfolio investment, net	94	-99	-191	-557	-1,247	46	-192	76	76	76
Other investment, net	-232	1,006	840	2,190	1,349	973	1,174	898	588	-223
General government	-341	-129	60	113	141	326	214	194	109	76
Domestic banks	-92	443	562	1,032	253	143	586	225	249	-1
Other private sector	201	691	219	1,045	955	504	374	478	231	-298
Errors and omissions	772	-200	-65	543	0	0	0	0	0	0
OVERALL BALANCE	426	732	781	1,512	632	1,115	523	840	787	160
FINANCING	-426	-732	-781	-1,512	-632	-1,115	-523	-840	-787	-160
Gross international reserves (increase: -)	-318	-578	-817	-1,493	-425	-854	-308	-655	-726	-140
Use of Fund credit, net	-185	-155	35	-19	-206	-262	-215	-185	-60	-20
Purchases	141	117	128	62	0	0	0	0	0	0
Repurchases 3/	-326	-271	-93	-106	-206	-262	-215	-185	-60	-20
Exceptional financing	78	0	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS										
Gross international reserves (stock, e.o.p.) 4/	4,063	4,575	5,309	6,770	7,196	8,050	8,358	9,012	9,739	9,879
In months of prospective GNFS imports	5.0	4.9	4.8	5.3	5.2	5.4	5.1	5.1	5.1	...
In percent of short-term debt	297.5	258.1	234.5	195.8	182.9	186.6	179.8	185.0	194.7	210.5
Current account + FDI	-209	25	197	-663	530	96	-459	-134	123	308
(in percent of GDP)	-1.4	0.2	1.1	-3.4	2.5	0.4	-1.8	-0.5	0.4	1.0
Current account (in percent of GDP)	-7.3	-5.6	-9.2	-7.5	-7.6	-7.0	-6.9	-5.9	-5.0	-4.4
Merchandise trade account (in percent of GDP)	-11.7	-10.2	-12.5	-14.0	-14.9	-14.5	-15.0	-14.4	-13.9	-12.8
Merchandise exports (in percent of GDP)	37.6	36.7	37.8	41.1	43.8	43.9	43.0	43.9	44.5	45.5
Merchandise imports (in percent of GDP)	-49.3	-46.9	-50.2	-55.1	-58.7	-58.4	-58.0	-58.3	-58.5	-58.3
Export volume (year-on-year change)	12.4	10.2	14.9	8.5	12.8	12.8	12.0	12.5	11.7	11.8
Import volume (year-on-year change)	19.2	7.1	19.5	11.4	11.5	10.7	12.9	11.6	11.1	9.8
FDI (net) in percent of current account	81.0	102.7	112.1	54.4	133.1	106.0	73.3	91.7	108.2	121.9
Gross external debt (stock, e.o.p.)	11,899	10,769	10,681	12,376	12,150	13,176	13,780	14,390	14,811	14,460
(In percent of GDP)	78.4	65.1	60.5	63.7	57.5	57.3	55.0	52.8	49.9	44.8
Public	9,670	7,961	7,098	6,421	5,374	5,746	5,773	5,996	6,195	6,373
Private	2,229	2,808	3,583	5,955	6,776	7,430	8,007	8,394	8,616	8,086
Short-term debt (in percent of total debt, e.o.p.)	11.5	16.5	21.2	27.9	32.4	32.7	33.7	33.9	33.8	32.5
Net external debt (in percent of annual GDP) 5/	35.9	25.9	22.0	17.1	13.3	11.2	11.5	10.4	8.5	6.3
GDP	15,184	16,533	17,663	19,433	21,117	22,992	25,032	27,254	29,673	32,307

Sources: Bulgarian authorities, and Fund staff estimates.

1/ All FDI is assumed to be non-debt creating, except the 200 m euros inflow related to the acquisition of a local mobile telephone company (see below).
2/ The figures for the second and third quarters are influenced by a complex debt financed merger and acquisition transaction of a local mobile telephone company that led to a sharp increase in its equity value, and a transfer of the realized capital gains out of the country by the original owners. This resulted in a net FDI outflow of 650 million euros and an increase in gross external debt by 590 million euros.
3/ According to expectations schedule.
4/ Historical numbers include valuation changes.
5/ External debt minus gross foreign assets of the banking system.

Table 11. Bulgaria: Macroeconomic Framework, 2001-2010

	2001	2002	2003	2004	2004	2005	2005	2006	2007	2008	2009	2010
				Prog.		Prog.	Rev. Prog.	Projections				
GDP and prices (annual percent change)												
Real GDP	4.1	4.9	4.5	5.2	5.6	5.2	5.5	5.5	5.5	5.5	5.5	5.5
GDP deflator	6.7	3.8	2.3	5.1	4.2	3.2	3.0	3.2	3.2	3.2	3.2	3.2
CPI (end of period)	4.8	3.8	5.6	3.6	4.0	3.6	3.5	3.5	3.5	3.5	3.5	3.5
(period average)	7.5	5.8	2.3	6.3	6.1	3.6	4.0	3.5	3.5	3.5	3.5	3.5
Monetary aggregates (annual percent change)												
Broad money (nominal, end of period)	25.2	11.9	20.9	19.4	21.6	14.4	19.8	16.7	16.4	11.7	11.0	9.6
Claims on non-government (nominal, end of perioc	32.1	44.0	48.3	33.0	48.7	25.4	30.0	23.5	15.7	9.0	8.9	9.0
Saving and investment (in percent of GDP)												
Foreign saving 1/	8.7	7.3	9.5	10.5	10.3	9.9	10.4	9.9	10.5	10.0	9.4	7.9
Gross national saving	13.4	14.2	12.5	13.8	16.0	14.9	17.4	17.4	18.6	20.1	21.0	21.6
Gross domestic saving 2/	12.0	12.5	12.3	12.1	13.3	13.3	14.5	14.5	15.0	16.0	16.6	18.1
Government	6.0	4.3	4.6	6.0	7.0	6.6	6.7	6.3	6.7	6.7	6.7	6.6
Non-government	5.9	8.2	7.6	6.1	6.2	6.7	7.8	8.2	8.3	9.3	9.9	11.6
Gross domestic investment	20.7	19.8	21.7	22.6	23.5	23.2	25.0	24.4	25.5	26.0	26.0	26.0
Government	4.0	3.2	3.4	3.7	3.9	4.1	4.5	4.5	6.0	5.6	5.7	5.7
Non-government	16.6	16.6	18.3	18.9	19.6	19.1	20.5	19.9	19.5	20.4	20.3	20.3
General government (in percent of GDP)												
Revenue	37.6	36.5	37.8	38.4	39.2	37.3	38.8	38.2	40.4	40.6	40.5	40.1
Non-interest expenditure	34.7	34.9	36.1	35.6	35.6	34.4	36.1	36.1	39.3	39.0	39.1	38.8
Primary balance	2.8	1.6	1.7	2.8	3.6	2.8	2.7	2.1	1.1	1.5	1.4	1.3
Interest payments	3.7	2.2	2.1	1.9	1.8	1.9	1.7	1.6	1.6	1.4	1.3	1.2
Overall balance (excluding external interest payme	2.0	1.0	1.2	2.3	3.1	2.5	2.2	1.8	0.7	1.1	1.0	0.9
Overall balance 3/	-0.9	-0.6	-0.4	0.9	1.8	0.9	1.0	0.5	-0.4	0.1	0.1	0.1
Total public debt	69.9	56.2	48.1	44.3	40.9	41.7	33.3	31.1	27.0	23.9	21.2	18.9
Of which : External	63.7	49.7	41.6	37.1	33.9	34.0	26.4	23.7	19.5	16.6	14.0	11.9
Balance of payments (in millions of euros)												
Current account	-1,102	-924	-1,630	-1,719	-1,453	-1,755	-1,602	-1,600	-1,717	-1,611	-1,498	-1,407
Trade balance	-1,779	-1,692	-2,200	-2,659	-2,718	-2,800	-3,144	-3,323	-3,757	-3,921	-4,135	-4,124
Exports	5,714	6,063	6,668	7,881	7,994	8,589	9,252	10,097	10,767	11,955	13,211	14,698
Imports	7,493	7,755	8,868	10,540	10,712	11,389	12,395	13,420	14,524	15,876	17,346	18,822
Services, net	454	486	523	612	724	702	939	1,038	1,140	1,207	1,340	1,587
Receipts	2,385	2,479	2,791	3,359	3,362	3,670	3,913	4,238	4,548	4,923	5,342	5,872
Payments	1,930	1,993	2,268	2,748	2,638	2,968	2,973	3,200	3,408	3,716	4,002	4,285
Income, net	-340	-285	-566	-376	-346	-512	-408	-517	-782	-861	-982	-1,088
Of which : Interest	…	693	647	608	608	564	564	600				
Memorandum items												
Gross official reserves (in millions of euros)	4,063	4,575	5,309	5,862	6,770	5,938	7,196	8,050	8,358	9,012	9,739	9,879
(in months of prospective imports of GNFS)	5.0	4.9	4.8	4.9	5.3	4.7	5.2	5.4	5.1	5.1	5.1	...
Current account balance (in percent of GDP)	-7.3	-5.6	-9.2	-8.8	-7.5	-8.3	-7.6	-7.0	-6.9	-5.9	-5.0	-4.4
External debt/GDP (in percent)	79.4	65.1	60.5	56.1	63.7	53.5	57.5	57.3	55.0	52.8	49.9	44.8
External debt/exports of GNFS (in percent)	148.8	126.1	112.9	97.0	109.0	92.2	92.3	91.9	90.0	85.3	79.8	70.3
External debt service/exports of GNFS (in percent	20.8	16.4	14.7	14.8	18.9	11.0	17.3	9.7	12.4	11.4	11.1	11.6
Export growth (percent change)	8.8	6.1	10.0	18.3	19.9	9.0	15.7	9.1	6.6	11.0	10.5	11.3
Import growth (percent change)	14.7	3.5	14.4	19.0	20.8	8.1	15.7	8.3	8.2	9.3	9.3	8.5
Terms of trade (percent change)	1.8	-0.6	0.1	1.4	1.9	-0.2	-1.1	-1.0	-0.7	0.8	0.6	0.7
Nominal GDP (in millions of leva)	29,709	32,335	34,547	38,046	38,008	41,305	41,302	44,968	48,959	53,305	58,036	63,187
Nominal GDP (in millions of euros)	15,184	16,533	17,663	19,452	19,433	21,119	21,117	22,992	25,032	27,254	29,673	32,307

Sources: Bulgarian authorities; and Fund staff projections.

1/ Net imports of goods and nonfactor services.

2/ Gross domestic saving equals gross national saving less net factor income and transfers from abroad. The government contribution to gross domestic saving equals revenues less current expenditures, excluding external interest payments.

3/ From 2003 onwards, includes below-the-line transfers. In 2003, balance excluding below-the-line transfers was 0.0 percent of GDP.

Table 12. Bulgaria: External Debt Sustainability Framework, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2000	2001	2002	2003	2004			2005	2006	2007	2008	2009	2010	
								I. Baseline Projections						**Debt-stabilizing non-interest current account 7/**
External debt	88.2	79.4	65.1	60.5	63.7			**57.5**	**57.3**	**55.0**	**52.8**	**49.9**	**44.8**	**-7.0**
Change in external debt	-1.2	-8.9	-14.2	-4.7	3.2			-6.1	-0.2	-2.3	-2.3	-2.9	-5.2	
Identified external debt-creating flows (4+8+9)	-12.6	-7.0	-5.0	-0.7	-1.9			-5.7	-3.3	-1.1	-2.3	-3.1	-3.5	
Current account deficit, excluding interest payments	1.5	3.4	3.4	7.1	5.7			6.0	5.3	5.0	4.0	3.0	2.2	
Deficit in balance of goods and services	5.4	8.7	7.3	9.5	10.3			10.4	9.9	10.5	10.0	9.4	7.9	
Exports	55.8	53.3	51.7	53.6	58.4			62.3	62.3	61.2	61.9	62.5	63.7	
Imports	61.2	62.1	59.0	63.0	68.7			72.8	72.3	71.6	71.9	71.9	71.5	
Net non-debt creating capital inflows (negative)	-8.3	-5.3	-4.2	-5.7	-3.9			-10.1	-7.4	-5.0	-5.4	-5.5	-5.3	
Automatic debt dynamics 1/	-5.8	-5.1	-4.2	-2.0	-3.8			-1.6	-1.3	-1.0	-0.8	-0.7	-0.4	
Contribution from nominal interest rate	4.1	3.9	2.2	2.1	1.7			1.6	1.6	1.9	1.9	2.0	2.2	
Contribution from real GDP growth	-4.3	-3.2	-3.6	-2.7	-3.1			-3.2	-2.9	-2.9	-2.8	-2.7	-2.5	
Contribution from price and exchange rate changes 2/	-5.5	-5.7	-2.9	-1.5	-2.4			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	11.3	-1.9	-9.2	-4.0	5.1			-0.4	3.1	-1.2	0.0	0.2	-1.7	
External debt-to-exports ratio (in percent)	158.0	148.8	126.1	112.9	109.0			92.3	91.9	90.0	85.3	79.8	70.3	
Gross external financing need (in billions of euros) 4/	2.7	3.8	3.3	4.2	5.5			7.0	6.5	7.5	7.7	7.8	8.1	
in percent of GDP	20.0	24.8	20.1	23.7	28.5			33.1	28.4	29.8	28.1	26.4	25.1	
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	5.4	4.1	4.9	4.5	5.6	1.5	4.9	5.5	5.5	5.5	5.5	5.5	5.5	5.5
GDP deflator in euros (change in percent)	6.6	6.9	3.8	2.3	4.2	6.4	13.4	3.0	3.2	3.2	3.2	3.2	3.2	3.2
Nominal external interest rate (in percent)	5.1	4.9	3.1	3.5	3.2	4.4	0.8	2.8	3.1	3.6	3.8	4.1	4.7	3.7
Growth of exports (Euro terms, in percent)	40.6	6.3	5.5	10.7	20.1	9.5	17.7	15.9	8.9	6.8	10.2	9.9	10.9	10.4
Growth of imports (Euro terms, in percent)	36.4	12.8	3.4	14.2	19.9	10.8	15.2	15.1	8.1	7.9	9.3	9.0	8.2	9.6
Current account balance, excluding interest payments	-1.5	-3.4	-3.4	-7.1	-5.7	0.4	6.3	-6.0	-5.3	-5.0	-4.0	-3.0	-2.2	-4.2
Net non-debt creating capital inflows	8.3	5.3	4.2	5.7	3.9	4.7	2.3	10.1	7.4	5.0	5.4	5.5	5.3	6.4
								II. Stress Tests for External Debt Ratio						**Debt-stabilizing non-interest current account 7/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 5/								**57.5**	**55.4**	**49.1**	**44.1**	**39.4**	**32.9**	**-5.8**
A2. Country-specific scenario -- Higher trade deficit and lower FDI 2005-2010 6/								**57.5**	**63.2**	**63.9**	**64.9**	**65.8**	**65.4**	**-5.8**
B. Bound Tests														
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								**57.5**	**58.8**	**57.8**	**55.4**	**52.4**	**47.1**	**-7.1**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**57.5**	**65.1**	**70.4**	**66.2**	**61.6**	**54.2**	**-9.1**
B3. Change in euro GDP deflator is at historical average minus two standard deviations in 2005 and 2006								**57.5**	**72.6**	**87.0**	**80.8**	**74.2**	**64.5**	**-11.4**
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								**57.5**	**64.3**	**69.0**	**66.1**	**62.6**	**57.0**	**-7.5**
B5. Combination of B1-B4 using one standard deviation shocks								**57.5**	**70.2**	**81.5**	**78.2**	**73.9**	**66.3**	**-10.3**
B6. One time 30 percent nominal depreciation in 2005								**57.5**	**79.6**	**74.3**	**69.6**	**64.4**	**56.4**	**-9.7**

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in euro terms, g = real GDP growth rate, ε = nominal appreciation (increase in euro value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; euro deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Nominal export growth at 95 percent of baseline scenario, nominal import growth at 105 percent of baseline scenario, net FDI at 75 percent of baseline scenario. Debt accumulation to maintain stocks of reserves at the same level as in baseline scenario.
7/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, euro deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 13. Bulgaria: External Debt Sustainability Framework--Gross External Financing Need, 2000-2010

	Actual					Projections					
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
I. Baseline Projections											
Gross external financing need in billions of euros 1/	2.7	3.8	3.3	4.2	5.5	7.0	6.5	7.5	7.7	7.8	8.1
in percent of GDP	20.0	24.8	20.1	23.7	28.5	33.1	28.4	29.8	28.1	26.4	25.1
II. Stress Tests											
Gross external financing need in billions of euros 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2005-09 3/						7.0	5.3	5.8	5.6	5.5	5.4
A2. Country-specific scenario -- Higher trade deficit and lower FDI 2005-2010 6/						7.0	7.1	9.0	10.1	11.5	13.2
A3. Selected variables are consistent with market forecast in 2005-09						7.0	6.5	7.5	7.7	7.8	8.1
B. Bound Tests											
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006						7.0	6.9	8.0	8.0	8.2	8.5
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						7.0	6.4	7.0	7.1	7.2	7.4
B3. Change in Euro GDP deflator is at historical average minus two standard deviations in 2005 and 2006						7.0	6.2	6.8	6.8	6.8	6.9
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006						7.0	8.3	10.2	9.3	9.6	10.0
B5. Combination of 2-5 using one standard deviation shocks						7.0	6.7	7.5	7.7	7.9	8.2
B6. One time 30 percent nominal depreciation in 2005						7.0	6.1	6.9	6.9	7.0	7.1
Gross external financing need in percent of GDP 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2005-09 3/						33.1	23.4	23.7	21.2	19.1	17.3
A2. Country-specific scenario -- Higher trade deficit and lower FDI 6/						33.1	30.7	36.1	37.1	38.8	40.9
A3. Selected variables are consistent with market forecast in 2005-09						33.1	28.4	29.8	28.1	26.4	25.1
B. Bound Tests											
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006						33.1	30.1	31.8	29.3	27.5	26.2
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						33.1	31.9	37.2	34.7	32.2	30.3
B3. Change in Euro GDP deflator is at historical average minus two standard deviations in 2005 and 2006						33.1	35.1	45.3	41.9	38.6	36.0
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006						33.1	35.9	40.8	34.2	32.3	31.0
B5. Combination of 2-5 using one standard deviation shocks						33.1	35.3	43.9	41.6	39.1	37.1
B6. One time 30 percent nominal depreciation in 2005						33.1	38.2	39.2	36.4	33.7	31.6

1/ Defined as non-interest current account deficit, plus interest and amortization on medium- and long-term debt, plus short-term debt at end of previous period.
2/ Gross external financing under the stress-test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.
3/ The key variables include real GDP growth; nominal interest rate; euro deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
4/ Nominal export growth at 95 percent of baseline scenario, nominal import growth at 105 percent of baseline scenario, net FDI at 75 percent of baseline scenario.
Debt accumulation to maintain stocks of reserves at the same level as in baseline scenario.

Table 14. Bulgaria: Public Sector Debt Sustainability Framework, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2000	2001	2002	2003	2004			2005	2006	2007	2008	2009	2010	
								I. Baseline Projections						Debt-stabilizing primary balance 11/
Public sector debt 1/	77.0	69.9	56.2	48.1	40.9			**33.3**	**31.1**	**27.0**	**23.9**	**21.2**	**18.9**	**0.5**
o/w foreign-currency denominated	73.3	66.1	51.6	43.7	35.8			28.3	25.7	21.1	18.2	15.6	13.4	
Change in public sector debt	-5.8	-7.1	-13.7	-8.1	-7.2			-7.6	-2.2	-4.1	-3.1	-2.7	-2.3	
Identified debt-creating flows (4+7+12)	-5.2	-5.5	-2.6	-2.0	-6.8			-7.3	-4.4	-1.0	-1.2	-1.0	-0.9	
Primary deficit	-3.0	-2.8	-1.6	-1.7	-3.6			-2.7	-2.1	-1.1	-1.5	-1.4	-1.3	
Revenue and grants	38.7	37.6	36.5	37.8	39.2			38.8	38.2	40.4	40.6	40.5	40.1	
Primary (noninterest) expenditure	35.7	34.7	34.9	36.1	35.6			36.1	36.1	39.3	39.0	39.1	38.8	
Automatic debt dynamics 2/	-5.1	-3.9	-3.5	-1.5	-2.5			-1.6	-1.1	-1.0	-0.8	-0.7	-0.5	
Contribution from interest rate/growth differential 3/	-5.1	-3.9	-3.5	-1.5	-2.5			-1.6	-1.1	-1.0	-0.8	-0.7	-0.5	
Of which contribution from real interest rate	-1.2	-1.1	-0.3	0.8	-0.1			0.5	0.5	0.6	0.6	0.5	0.5	
Of which contribution from real GDP growth	-4.0	-2.8	-3.1	-2.3	-2.4			-2.1	-1.7	-1.6	-1.4	-1.2	-1.1	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0			...	...	...	...	...	...	
Other identified debt-creating flows	3.0	1.3	2.5	1.2	-0.6			-3.1	-1.1	1.2	1.1	1.1	1.0	
Privatization receipts (negative)	-1.3	-2.9	-0.9	-1.1	-3.1			-4.3	-2.4	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	4.3	4.2	3.3	2.3	2.4			1.3	1.3	1.2	1.1	1.1	1.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-0.6	-1.6	-11.1	-6.1	-0.4			-0.3	2.2	-3.1	-1.9	-1.7	-1.4	
Public sector debt-to-revenue ratio 1/	198.9	186.1	154.1	127.4	104.2			85.7	81.4	66.8	58.9	52.2	47.2	
Gross financing need 6/	7.0	7.5	5.7	4.3	4.0			7.6	1.7	3.4	1.8	1.7	1.7	
in billions of euros	1.0	1.1	0.9	0.8	0.8	5-Year Historical Average	5-Year Standard Deviation	1.6	0.4	0.9	0.5	0.5	0.5	Projected Average
Key Macroeconomic and Fiscal Assumptions														
Real GDP growth (in percent)	5.4	4.1	4.9	4.5	5.6	4.9	0.6	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Average nominal interest rate on public debt (in percent) 7/	5.5	5.4	3.4	4.0	4.2	4.5	0.9	4.5	5.1	5.5	5.6	5.8	6.1	5.4
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-1.2	-1.3	-0.3	1.7	0.0	-0.2	1.2	1.5	1.9	2.3	2.4	2.6	2.9	2.3
Nominal appreciation (increase in euro value of local currency, in percent)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.7	6.7	3.8	2.3	4.2	4.7	1.9	3.0	3.2	3.2	3.2	3.2	3.2	3.2
Growth of real primary spending (deflated by GDP deflator, in percent)	5.4	1.3	5.5	8.0	4.2	4.9	2.4	6.9	5.4	15.0	4.7	5.8	4.5	7.0
Primary deficit	-3.0	-2.8	-1.6	-1.7	-3.6	-2.5	0.9	-2.7	-2.1	-1.1	-1.5	-1.4	-1.3	-1.7
								II. Stress Tests for Public Debt Ratio						Debt-stabilizing primary balance 11/
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 8/								**33.3**	**30.2**	**24.2**	**19.7**	**15.5**	**11.8**	**0.4**
A2. No policy change (constant primary balance) in 2005-09								**33.3**	**30.5**	**24.8**	**20.6**	**16.7**	**13.1**	**0.7**
A3. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation 9/								**33.3**	**31.1**	**27.0**	**23.9**	**21.2**	**18.9**	**0.5**
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006								**33.3**	**31.2**	**27.1**	**24.0**	**21.2**	**19.0**	**0.5**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**33.3**	**32.4**	**30.2**	**28.4**	**27.0**	**26.0**	**0.4**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006								**33.3**	**32.4**	**28.7**	**25.5**	**22.8**	**20.4**	**0.5**
B4. Combination of B1-B3 using one standard deviation shocks								**33.3**	**31.7**	**27.0**	**23.9**	**21.1**	**18.8**	**0.5**
B5. One time 30 percent real depreciation in 2005 10/								**33.3**	**44.7**	**40.2**	**36.7**	**33.6**	**31.0**	**0.2**
B6. 10 percent of GDP increase in other debt-creating flows in 2005								**33.3**	**41.1**	**36.7**	**33.3**	**30.3**	**27.8**	**0.3**

1/ This represents gross public sector debt, and thus is different from general government debt figures shown elsewhere.
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of euro).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ Derived as nominal interest expenditure divided by previous period debt stock.
8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
9/ The implied change in other key variables under this scenario is discussed in the text.
10/ Real depreciation is defined as nominal depreciation (measured by percentage fall in euro value of local currency) minus domestic inflation (based on GDP deflator).
11/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 15. Bulgaria: Public Sector Debt Sustainability Framework--Gross Public Sector Financing Need, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
I. Baseline Projections											
Gross financing need 1/	7.0	7.5	5.7	4.3	4.0	7.6	1.7	3.4	1.8	1.7	1.7
in billions of euros	1.0	1.1	0.9	0.8	0.8	1.6	0.4	0.9	0.5	0.5	0.5
II. Stress Tests											
Gross financing need 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2005-09 3/						7.6	0.5	1.0	-0.2	-0.6	-1.0
A2. No policy change (constant primary balance) in 2005-09						7.6	1.1	1.6	0.3	-0.1	-0.5
A3. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation 4/						7.6	1.7	3.4	1.8	1.7	1.7
B. Bound Tests											
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006						7.6	1.8	3.4	1.8	1.7	1.7
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						7.6	2.5	5.3	3.8	3.9	4.1
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006						7.6	3.1	4.1	2.0	1.9	1.9
B4. Combination of 2-4 using one standard deviation shocks						7.6	1.9	2.6	1.8	1.7	1.7
B5. One time 30 percent real depreciation in 2005 5/						7.6	2.6	5.6	3.5	3.4	3.5
B6. 10 percent of GDP increase in other debt-creating flows in 2005						7.6	2.3	5.0	3.1	3.0	3.0
Gross financing need in billions of euros 2/											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2005-09 3/						1.6	0.1	0.2	-0.1	-0.2	-0.3
A2. No policy change (constant primary balance) in 2005-09						1.6	0.2	0.4	0.1	0.0	-0.2
A3. Country-specific shock in 2005, with reduction in GDP growth (relative to baseline) of one standard deviation 4/						1.6	0.4	0.9	0.5	0.5	0.5
B. Bound Tests											
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006						1.6	0.4	0.9	0.5	0.5	0.5
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						1.6	0.6	1.3	1.0	1.1	1.3
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006						1.6	0.7	1.0	0.6	0.6	0.6
B4. Combination of 2-4 using one standard deviation shocks						1.6	0.4	0.6	0.5	0.5	0.5
B5. One time 30 percent real depreciation in 2005 5/						1.6	0.4	0.9	0.6	0.7	0.8
B6. 10 percent of GDP increase in other debt-creating flows in 2005						1.6	0.5	1.3	0.8	0.9	1.0

1/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
2/ Gross financing under the stress test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.
3/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
4/ The implied change in other key variables under this scenario is discussed in the text.
5/ Real depreciation is defined as nominal depreciation (measured by percentage fall in euro value of local currency) minus domestic inflation (based on GDP deflator).

Table 16. Bulgaria: Capacity to Repay the Fund, 2003-2010 1/

	2003	2004	2005	2006	2007	2008	2009	2010
Fund repurchases and charges								
In millions of SDRs	90.4	110.5	120.8	192.1	217.0	185.1	128.4	81.6
In millions of euros	112.2	131.4	139.9	222.6	251.2	214.1	148.4	94.1
In percent of exports of goods and NFS	1.2	1.2	1.1	1.6	1.6	1.3	0.8	0.5
In percent of total debt service	8.1	6.1	6.1	16.1	13.3	11.1	7.2	3.9
In percent of quota	14.1	17.3	18.9	30.0	33.9	28.9	20.1	12.7
In percent of gross international reserves	2.1	1.9	1.9	2.8	3.0	2.4	1.5	0.9
Fund credit outstanding								
In millions of SDRs	799.2	762.0	722.1	596.7	397.1	223.0	100.4	21.1
In millions of euros	954.1	875.4	836.6	691.2	459.7	257.8	115.9	24.3
In percent of exports of goods and NFS	10.1	7.7	6.4	4.8	3.0	1.5	0.6	0.1
In percent of quota	124.8	119.0	112.8	93.2	62.0	34.8	15.7	3.3
In percent of gross international reserves	18.0	12.9	11.6	8.6	5.5	2.9	1.2	0.2
Memorandum items:								
Exports of goods and NFS (in millions of euros)	9,459.1	11,355.7	13,164.4	14,335.1	15,314.9	16,877.8	18,553.7	20,570.2
Debt service (in millions of euros)	1,389.6	2,147.0	2,280.3	1,383.8	1,892.9	1,930.4	2,056.0	2,392.5
Quota (in millions of SDRs)	640.2	640.2	640.2	640.2	640.2	640.2	640.2	640.2
Quota (in millions of euros)	764.3	735.5	741.8	741.6	741.1	740.2	739.0	737.6
Gross international reserves (in millions of euros)	5,308.6	6,770.4	7,195.8	8,049.7	8,357.5	9,012.4	9,738.9	10,144.9
Euros per SDR (period avg)	1.24	1.19	1.16	1.16	1.16	1.16	1.16	1.15
Euros per SDR (eop)	1.19	1.15	1.16	1.16	1.16	1.16	1.15	1.15

Source: Fund staff calculations.

1/ Assumes purchases are made under the current precautionary arrangement, and repurchases made on obligations schedule.

Table 17. Bulgaria: Financial Relations with the Fund, 2000-2011

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
						(In millions of SDRs)						
Purchases												
SBA	0.0	0.0	84.0	104.0	52.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EFF	209.2	104.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Obligations schedule												
Repurchases	105.3	236.2	195.2	76.6	89.2	95.9	169.4	199.6	159.9	85.0	43.6	8.7
Charges and interest	33.8	36.7	18.1	13.8	21.3	24.2	20.3	14.0	7.8	3.4	1.2	0.1
Fund credit outstanding	1,014.6	883.0	771.8	799.2	762.0	666.1	496.7	297.1	137.3	52.3	8.7	0.0
Expectations schedule												
Repurchases	105.3	236.2	195.2	76.6	89.2	178.1	225.8	186.0	102.4	52.3	17.4	0.0
Charges and interest	33.8	36.7	18.1	13.8	21.3	23.5	16.6	9.5	4.3	1.6	0.3	0.0
Fund credit outstanding	1,014.6	883.0	771.8	799.2	762.0	583.9	358.1	172.1	69.7	17.4	0.0	0.0
						(In percent of quota)						
Purchases												
SBA	0.0	0.0	13.1	16.2	8.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
EFF	32.7	16.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Obligations schedule												
Repurchases	16.5	36.9	30.5	12.0	13.9	15.0	26.5	31.2	25.0	13.3	6.8	1.4
Charges and interest	5.3	5.7	2.8	2.2	3.3	3.8	3.2	2.2	1.2	0.5	0.2	0.0
Fund credit outstanding	158.5	137.9	120.5	124.8	119.0	104.0	77.6	46.4	21.4	8.2	1.4	0.0
Expectations schedule												
Repurchases	16.5	36.9	30.5	12.0	13.9	27.8	35.3	29.1	16.0	8.2	2.7	0.0
Charges and interest	5.3	5.7	2.8	2.2	3.3	3.7	2.6	1.5	0.7	0.3	0.0	0.0
Fund credit outstanding	158.5	137.9	120.5	124.8	119.0	91.2	55.9	26.9	10.9	2.7	0.0	0.0

Source: Fund staff calculations.

BULGARIA: FUND RELATIONS
As of February 28, 2005

I. **Membership Status**: Joined 09/25/1990; Accepted Article VIII 09/24/1998

II. **General Resources Account**:	SDR million	%Quota
Quota	640.20	100.00
Fund holdings of currency	1,354.45	211.57
Reserve position in Fund	32.85	5.13

III. **SDR Department**:	SDR million	%Allocation
Holdings	2.54	N/A

IV. **Outstanding Purchases and Loans**:	SDR million	%Quota
Stand-by Arrangements	211.00	32.96
Extended Arrangements	536.10	83.74

V. **Financial Arrangements**:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
Stand-by	08/06/2004	09/05/2006	100.00	0.00
Stand-by	02/27/2002	03/15/2004	240.00	240.00
EFF	09/25/1998	09/24/2001	627.62	627.62
Stand-by	04/11/1997	06/10/1998	371.90	371.90

VI. **Projected Payments to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):[9]

	Forthcoming				
	2005	2006	2007	2008	2009
Principal	163.21	225.76	186.01	102.39	52.30
Charges/Interest	17.68	17.44	10.17	4.71	1.82
Total	180.89	243.20	196.18	107.10	54.12

[9] On expectation basis.

VII. **Safeguards Assessment**:

Under the Fund's safeguards assessment policy, the Bulgarian National Bank (BNB) was subject to an assessment with respect to the SBA which was approved on February 27, 2002. The assessment, which was completed on June 12, 2002, identified certain weaknesses and made appropriate recommendations, as reported in IMF Country Report No. 02/174. An updated assessment which was conducted with respect to the current SBA and completed on November 23, 2004, found that the BNB's financial statements had been improved and earlier audit qualifications eliminated, the scope of the internal audit function had been widened and a risk-based audit methodology had been introduced. No major vulnerabilities in the safeguards framework were identified. The mission's recommendations to further solidify Bulgaria's safeguards are being implemented with full effect as of mid-2005.

VIII. **Exchange Arrangement**:

An amendment to the Law on the Bulgarian National Bank (BNB) effectively established a currency board arrangement from July 1, 1997. The deutsche mark was chosen at par as the peg currency, which has since been replaced with the euro at the rate of lev 1.95583 per € 1. The BNB is buying and selling euros in noncash transactions at the parity rate. In cash transactions it levies a commission of 0.5 percent on the selling side. Bulgaria has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

IX. **Article IV Consultation**:

The last Article IV consultation was concluded on June 14, 2004 (see IMF Country Report No. 04/176). Bulgaria is on a 12-month cycle. The Acting Chairman's summing-up of the discussion was circulated as SUR/04/60.

X. **FSAP Participation and ROSCs**:

Bulgaria participated in an FSAP held from October 29 to November 14, 2001. A follow-up to the FSAP update was conducted as part of the 2004 Article IV consultation mission. Table 18 provides information on the production of ROSCs.

XI. **Technical Assistance**

Table 19 provides information on IMF technical assistance activities since 1999.

Table 18. Bulgaria: ROSCs

Standard/code assessed	Date of issuance	Document number
ROSC – Detailed assessments using the data quality assessment framework	12/12/2003	IMF Country Report No. 03/393
ROSC update – Data dissemination and fiscal transparency	08/07/2002	IMF Country Report No. 02/172
ROSC – Monetary and financial policy transparency, banking supervision, securities regulation, insurance regulation, and payment systems	07/15/2002	IMF Country Report No. 02/188
ROSC update – Data dissemination, fiscal transparency, transparency of monetary and financial policies, banking supervision, deposit insurance, insurance supervision, securities market supervision	03/08/2001	www.imf.org
ROSC – Data dissemination, fiscal transparency, transparency of monetary policy, banking supervision, system of deposit insurance, insurance supervision, securities market supervision	03/17/2000	www.imf.org
Experimental ROSC – Data transparency, fiscal transparency, transparency of monetary policy, banking supervision, system of deposit insurance, insurance supervision, securities market supervision, insurance supervision, accounting and auditing practices	08/27/1999	www.imf.org

XII. **Resident Representative**:

Mr. James Roaf took up the resident representative position on August 24, 2003.

Table 19. Bulgaria: Technical Assistance, 1999–2005

Dept.	Subject/Identified Need	Action	Timing	Counterpart
MAE	Accounting	Expert	Jun. & Aug./Sep.99	BNB
MAE	Transparency Report/Based Core Principles	Mission	Jul. 99	BNB
MAE	Deposit insurance	Mission	Oct. 99	BNB
MAE	Accounting	Expert	Feb. 00	BNB
MAE	Payment system/liquidity management/ bankruptcy legislation	Mission	May 00	BNB
MAE	Bankruptcy legislation	Expert	Jun. 00	BNB
MAE	Foreign exchange	Mission	Nov. 00	BNB
MAE	Accounting	Expert	Nov.-Dec. 00	BNB
MAE	Short-term advisor payment system	Expert	Jun. 01	BNB
MAE	Accounting and Internal Audit	Expert	Apr. 02	BNB
MAE	Foreign Exchange	Expert	Apr. 02	BNB
MAE	Review of TA needs resulting from FSAP	Mission	May 02	BNB
MAE	Accounting	Expert	Aug. 02	BNB
MAE	Accounting	Expert	Oct. 02	BNB
MAE	Accounting	Expert	Mar.-Apr. 03	BNB
MFD	Accounting	Expert	Oct. 03	BNB
MFD	Accounting	Expert	Oct. 04	BNB
MFD	Policies and tools to manage rapid credit growth	Mission	Dec. 04	BNB
MFD	Financial Accounting and Information Systems	Mission	Apr. 05	BNB
MFD	Accounting and internal audit	Mission	Oct. 05	BNB
FAD	Budget General	Expert	Jun. 99	MOF
FAD	Tax administration	Expert	Jul. 99	MOF
FAD	Public Expenditure Management	Mission	Sep. 99	MOF
FAD	Budget General	Expert	Oct. 99–Oct. 00	MOF
FAD	Tax Administration	Mission	Jan. 00–Feb. 00	MOF
FAD	Tax Administration Advisor	Expert	Apr.–Jun. 00	MOF
FAD	Tax Administration	Expert	Apr.–May 00	MOF
FAD	Tax Administration	Expert	May–Jun. 00	MOF
FAD	Tax Administration	Expert	Jun. 00	MOF
FAD	Tax Administration	Expert	Sep. 00-01	MOF
FAD	Expert Installation mission/Tax Administration	Expert	Oct. 00	MOF
FAD	Tax Administration-Follow-up Mission	Mission	Jan. 01	MOF
FAD	Public Expenditure Management	Mission	Jan.–Feb. 01	MOF
FAD	Mission for Workshop	Mission	Jun. 01	MOF
FAD	Tax Administration Follow-up Mission	Expert	Sep. 01	MOF
FAD	Customs administration	Mission	Oct. 01	MOF
FAD	Tax policy	Mission	Jan. 02	MOF
FAD	Budget General	Expert	Apr. 02–Mar. 03	MOF
FAD	TA Expert Installation Mission	Expert	Apr. 02	MOF
FAD	Tax Administration Follow-Uup Mission	Mission	Apr. 02	MOF
FAD	Tax Administration	Expert	Sep.–Oct. 02	MOF
FAD	Budget General: Inspection	Expert	Jan. 03	MOF
FAD	Tax Administration-Installation Visit	Expert	Mar.03	MOF
FAD	Tax Administration	Expert	Mar.–Apr. 03	MOF
FAD	Public Expenditure Management	Expert	Apr–Sep. 03	MOF
FAD	Tax Administration	Mission	Apr. 04–May. 04	MOF
FAD	Accrual Accounting	Mission	Sep. 05	MOF
STA	BOP statistics	Mission	Jun.-Jul. 99	BNB
STA	GDDS	Mission	Jul. 99	BNB
STA	National accounts	Mission	Nov. 99	NSI
STA	Price statistics	Mission	Jun. 00	NSI
STA	BOP statistics	Mission	Dec. 00	BNB
STA	Producer prices	Mission	Nov. 01	NSI
STA	Producer prices	Mission	Apr. 02	NSI
STA	Price statistics	Mission	May 02	NSI
STA	Producer prices	Mission	Jan 03	NSI
STA	Data ROSC	Mission	Jan.03	BNB/MOF/NSI
STA	SDDS	Mission	Sep. 03	BNB
STA	Producer prices	Mission	Sep. 04	NSI

Bulgaria: IMF-World Bank Relations

A. Partnership in Bulgaria's Development Strategy

1. The government's economic program has been underpinned by a conservative fiscal policy and significant progress with structural reforms. So far Bulgaria has made substantial progress towards long-term macroeconomic stability—an important step along the way to its ultimate goals of improving living standards and accession to the EU. The wide-ranging reforms in the government's agenda hinge on the continuing challenge of macroeconomic stability in the context of the Currency Board Arrangement (CBA), sustaining structural reforms and establishing a business environment conducive to growth, together with improved governance, a deeper financial system, and investment in human capital and physical infrastructure.

2. The IMF has been leading in supporting Bulgaria's medium-term program in maintaining macroeconomic stability. Building on the achievements of the three-year Extended Fund Facility (EFF) arrangement with Bulgaria, in February 2002 the IMF Board approved a two-year Stand-By Arrangement (SBA) with Bulgaria. The SBA, with a reduced scope and detail of structural conditionality compared to the EFF, focused on medium-term fiscal challenges and structural reforms with significant macroeconomic, typically fiscal, implications. In August 2004, the IMF Board approved a 25-month precautionary SBA (ending September 2006) in an amount of SDR100 million.

3. The World Bank has been leading the policy dialogue in structural and institutional reforms aiming at (i) promoting competitive private sector-led growth; (ii) strengthening market institutions and improving both corporate and public sector governance; and (iii) mitigating the social impact of restructuring and delivering social services more effectively. In May 2002 the Board of Directors discussed the Country Assistance Strategy (CAS) of the Bank which outlined the roadmap for the Bank's country support for the period 2002–04. In addition to the Bank's ongoing lending operations in areas such as health, child welfare, water, trade and transport, environment, land registration and cadastre, the CAS includes a three-year programmatic adjustment lending (PAL) program of up to three PALs of up to US$150 million each. In February 2003, the Board of Directors approved the first PAL operation—it aimed at advancing structural, regulatory, and institutional reforms in the real and financial sectors. In June 2004, the Board of Directors approved the second PAL (PAL-2), which aims at supporting improvements in public sector governance. The third PAL (PAL-3) is currently under preparation with expected Board approval in June 2005. The Bank continues to undertake substantive country diagnostics providing a solid base for policy dialogue and design and implementation of its lending operations in Bulgaria.

B. IMF-World Bank Collaboration in Specific Areas

4. In general, the Bank has the lead on the dialogue on the core structural aspects of the reforms while the Fund has the lead on the dialogue on the macroeconomic, typically fiscal,

aspects of the reforms. There are a number of areas where the IMF leads and its analyses serve as inputs into World Bank policy formulation and advice, including policies to maintain macroeconomic stability, fiscal policies, income policies and external sector policies. There are other areas in which the Bank and the Fund share responsibility and are coordinating closely their policy advice to the Bulgarian authorities such as in the financial sector, public expenditure management and budgeting, and tax administration. In some areas, the Bank has taken the lead but its analysis, country diagnostic work, and policy recommendations served as inputs into the Fund's policy advice on the fiscal front such as education, health care, pensions, social protection, energy, and railways. In areas such as private sector development, strengthening market institutions (including entry and exit policies, regulatory reform to enhance the business climate, judicial reform, labor market reform), and improving governance the Bank has the lead and there has been little conditionality under Fund programs. In addition to consultations early in the process of formulating and adjusting each institution's program with Bulgaria, the Bank and Fund staff teams interact extensively during the review of the progress achieved in the country and coordinate closely their policy advice to the Bulgarian authorities.

B.1. Areas where the IMF leads and its analyses serve as inputs into the World Bank policy formulation and advice.

5. To achieve the objectives of their economic program, the Bulgarian authorities are fully committed to maintain sound and flexible macroeconomic policies centered on a Currency Board Arrangement (CBA) and implement an ambitious reform agenda. In particular, the authorities have maintained a very tight fiscal policy since 1998, attaining a surplus of 1.8 percent of GDP in 2004. The aim is to have at least one percent surplus in 2005, conduct fiscal policy flexibly in the face of shocks, and maintain a high level of fiscal reserve assets. Given the constraints of the CBA, the authorities see labor market policies as another key component of the broad policy strategy. A strict incomes policy for the state enterprise sector is enforced and measures aimed at facilitating the adjustment of labor markets are being implemented. The structural and institutional reforms, which constitute the third pillar of the policy strategy, are focused on creating a fully functioning market economy that is competitive and can flexibly adjust to shocks.

6. In the context of a 25-month Stand-By Arrangement that was approved in August 2004, the IMF continued to lead in assisting Bulgaria in safeguarding macroeconomic stability and promoting structural reforms in areas that are macro-critical and fall within the Fund's core expertise. To safeguard the CBA and ensure that it can continue to serve as the macroeconomic policy anchor, the IMF set a floor on the size of the overall surplus of the general government and a ceiling on central government arrears. To prevent threats to the currency board and macroeconomic stability that could arise from a loss in competitiveness or excessive external financing requirements, Fund conditionality also included ceilings on the wage bill of those state enterprises that have the largest losses and arrears, are monopolies, and receive subsidies, and on the contracting and guaranteeing of public sector external debt.

B.2. Areas of shared responsibility.

7. **Financial Sector.** In late 2001, staff of the two institutions carried out a joint IMF-World Bank *Financial Sector Assessment Program* (FSAP) for Bulgaria, providing a shared perspective on the development agenda of the country and on the prioritization and sequencing of reforms in the financial sector. Key findings of the FSAP are conditionalities on financial sector policies under both the SBA and the PAL program. The IMF has emphasized aspects related to the banking sector—mainly on policies under the mandate of BNB and supervisory agencies—while the World Bank is focusing on policies that affect market performance and development of the financial sector such as improving the legal and institutional framework for lending, restructuring of the banking sector, strengthening creditor rights, corporate insolvency and governance, and non-banking financial sector issues. A follow-up to the FSAP was undertaken by Fund staff in the context of the 2004 Article IV consultation mission in March–April 2004.

8. Since 1997, in the context of two Finance and Enterprise Adjustment Loans (FESALs), and now with the PAL program, the Bank has supported the government in sector restructuring of the financial sector. Privatization of commercial banks has been a major component of the FESALs, while the Fund provided support for the institution building efforts of the BNB and its Banking Supervision Department in particular. In the financial sector, the Bank has focused on banking, insurance, pension funds, and capital markets while the Fund has continued its focus on the BNB, banking supervision, and the payments system.

9. **Revenue Administration.** The IMF and the World Bank have been carrying out a joint effort since 1996 to assist Bulgaria in reforms aimed at the establishment of an efficient revenue collection agency. Diagnostics consistently pointed to revenue collection deficiencies including weak management, and problematic audit and enforcement of collection, which in turn facilitates low compliance. Supporting reform efforts, the World Bank implemented a project to modernize the Social Security Institute, including its revenue collection activities. The IMF provided a long-term advisor to the Ministry of Finance, and focused advisory services through consulting assignments. Joint World Bank-IMF efforts resulted in a proposal for "Implementing a Modern Revenue Collection Agency" in March 2000, which is now moving forward. The World Bank's Board approved on June 5, 2003 the Revenue Administration Reform Project (RARP, €31.9 million), developed with technical assistance of the IMF, to support the establishment of the national revenue agency (NRA), which seeks to maximize the level of voluntary taxpayer compliance, promote effectiveness and efficiency, establish a professional workforce and approach to collection, and help reduce the scope for corruption. To support the reform of the revenue administration, the IMF included in the current SBA as prior actions the parliamentary approval of the Bulstat legislation, the approval on first reading of the Tax and Social Contributions Procedural Code to Parliament, and the submission to Parliament of a package of new tax laws (Personal Income Tax Law, Corporate Income Tax Law, VAT Law, and Excise Tax Law). The approval of the Code is structural performance criterion, while the approval of the four tax laws is a structural benchmark in the current SBA.

10. **Public Expenditure Management.** The Bank has taken the lead in the dialogue on the efficiency and effectiveness of public expenditures and has outlined policy directions in the context of the Public Expenditure and Institutional Review (PEIR)[10] which are being further supported by the PAL program. The PEIR has also been a useful input to the IMF program. The PEIR notes that notwithstanding progress to date, important challenges remain in: (i) improving management and accountability in the use of public resources; (ii) restructuring and rationalizing intersectoral public expenditure—particularly energy and railways, economic services, defense and security, and general services; (iii) reallocation of intrasectoral priorities—especially in health, education, and social protection; and (iv) higher investment requirements in many sectors—infrastructure and environment—some of which are priorities for EU accession, and some of which should involve the private sector. The PEIR notes that Bulgaria's main fiscal challenges include working towards an improved allocation of expenditures, while gradually reducing the overall level of expenditures over the medium term in tandem with Bulgaria's fiscal targets of easing the overall tax burden, especially payroll taxes.

11. The IMF has provided long-term technical assistance on budgeting and expenditure management. To ensure the fiscal discipline necessary to support the CBA, the government has already initiated a number of public expenditure management reforms. New budget procedures were introduced in early 2002 and were implemented for the 2003 budget. Despite this important progress, the PEIR notes that there is a need to continue and broaden the reform effort—capital expenditure proposals should be prepared under hard budget constraints and as an integral part of the medium-term budget frameworks; and the financial management at the local level should be strengthened. These reforms are also supported by the Bank through the PAL program.

B.3. Areas where the World Bank leads and its analyses serve as inputs into the IMF policy formulation and advice.

12. **Energy sector.** The Bank has played the lead role in assisting the government in the design of the reform program in the sector, and more importantly on its implementation. After the completion of the Energy Project at end-2000, the Bank has continued to support the developmental objectives of the sector to increase the energy efficiency. Under the PAL program, the government has strengthened the legal and regulatory framework, removed major price distortions and initiated steps to enable the private sector to assume an increasing share of commercial risks. Policy recommendations have been outlined in the Bank Energy and Environment Review completed in 2002, which aimed at also evaluating alternative strategies to balance the need for economic development and environmental protection. In June 2003 the Bank's Board approved two district heating projects to support the rehabilitation of the Sofia and the Pernik District Heating Companies. The Fund's and the

[10] The PEIR is entitled *Bulgaria: Public Expenditure Issues and Directions for Reform*, August 2002, The World Bank, (Report No. 23979-BUL)

Bank's teams have worked collaboratively in close consultations with the government, and the previous SBA included a performance criterion focusing on implementation of the schedule for bringing electricity prices to full cost recovery level, and two benchmarks—one on implementation of the new regulatory pricing regime, and the other on preparing a new Energy Act to harmonize Bulgaria's legislation with EU Directives.

13. **Railways.** The Bank has been the government's main external partner in the transformation of the railway sector, particularly through the Railway Rehabilitation Project, which was completed in June 2002. This transformation is at present only half way achieved. Some essential measures have been implemented under the PAL program, especially the divestiture of all railway ancillary activities, securing a major staffing optimization, signing a Public Service Contract, and completing the institutional separation of the national company into two new infrastructure and rail services enterprises together with the opening of rail services to private operators. Key remaining steps include completion of the tariff reform, further staff optimization, and improved corporate governance. They were refined in the context of the recent PEIR and are being supported by the Bank through the PALs. Detailed assistance with the design of these reforms will be further provided through transport sector work in the near future.

14. **Education.** The reform efforts in the education sector aim at improving expenditure management in view of the declining population, especially in school age, and at enhancing quality and access to education. The main priority in the education sector, including universities, is to reallocate expenditures from surplus capacity in teaching staff and underused facilities toward modernization and upgrading of curricula, textbooks, teaching materials, schools, and other quality-enhancing education inputs. The Bank has supported the government program in education through the Education Modernization Project loan (closed on March 31, 2004), the PALs, and the analytical work done for the Poverty Assessment, the PEIR, and the Inter-governmental Finance study[11]. Under PAL-2 the government developed a concept for an education reform strategy and action plan, the implementation of which is being supported through PAL-3.

15. **Health care.** Key reform priorities in the health sector include addressing the concurrent problems of surplus capacity issues in health facilities, the serious deterioration in the quality of facilities and health services, and the inadequate modernization of equipment. At the same time, the government needs to ensure the financial integrity of the NHIF, which is the central point of the reforms in the sector. For a long time the Bank has been supporting the restructuring of the health sector through the Health Sector Restructuring Project which was closed at end-2001. The follow-up Health Sector Reform project approved in late 2000 is under implementation and focuses on the administrative and information systems of the NHIF, and supports the ambulatory care sector and the hospital sector. The reform agenda in

[11] *Issues in Intergovernmental Relations*, the World Bank, January 27, 2004, Report No. 25821-BUL.

the health sector has been supported through the PALs, with PAL-3 focusing on the implementation of the action plan for the hospital restructuring.

16. **Social protection programs.** Social protection programs—pensions, labor market programs, social assistance, and short-term and family benefits—have a wide coverage among the population. On pensions, one reform priority is to improve compliance with, and coverage of, the public pillar. Ensuring successful implementation of the pension reform has been supported through the PALs. During FY04, the preparation of a policy-oriented note has supported the pension policy dialogue. On labor market programs, there is a need to monitor these closely to improve their effectiveness and long-term impact in stimulating labor demand. Subject to progress in key reforms, consideration should be given to reduce the tax burden related to labor market policies in order to curtail labor costs.[12] Some social assistance and benefit programs have become more pro-poor since the mid-1990s and are playing a major role in alleviating poverty. However, given the plethora of these programs, and the complexity of program design in many cases, a constant challenge of the social protection system as a whole is to consolidate the system driven by improving targeting of vulnerable groups, and engage in systematic monitoring of the programs, their costs and effectiveness to ensure fiscal sustainability.

17. The Bank has been the main partner of the government in its efforts to address poverty reduction and meet its social development objectives. The main findings of the Poverty Assessment and the PEIR contribute significantly to the enhanced policy dialogue with the government on its policy options to improve living standards in the country, and increase the effectiveness and adequacy of its social protection programs. The Bank is assisting these important reforms in the social protection system through providing grants amounting to US$2.2 million. The latter focus on poverty monitoring and evaluation, integration of ethnic minorities, child development and building social capital in disadvantaged communities. A Bank-financed Child Welfare Reform project helps address the needs of children in public care, while a Bank-financed Social Investment and Employment Promotion (SIEP), which supports community and employment creation and strengthening of ALMPs, was approved in 2002. The IMF has been also monitoring the sustainability of the pension system and the advancing of the labor market reforms in terms of their relevance for the Fund's program objectives.

B.4. Areas where the World Bank leads and there is no direct IMF involvement.

18. **Private Sector Development.** Bulgaria has completed the divestiture of about 95 percent (based on value of assets) of its non-infrastructure state-owned enterprises (SOEs) since 1995. To encourage the entry of new firms and the expansion of existing ones, the business climate will have to continue to improve focusing on reducing barriers to entry,

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[12] However, such fiscal adjustment requires increasing efficiency in public expenditures, and lowering public expenditures to GDP before implementing tax reductions.

reducing compliance cost of the regulatory regime, developing a competitive environment, and establishing an efficient exit mechanism for non-viable enterprises. Under the PAL program, major changes in the basic legislation have been initiated - notably the Commercial Code, the Civil Procedure Code, and the Labor Code, and the passage of legislation on how the State will regulate economic activity to ensure stability and predictability of regulatory regimes.

19. **In the context of the two Finance and Enterprise Adjustment Loans (FESALs) and the PAL program, the Bank has supported the government in sector restructuring of the non-infrastructure enterprise sector.** Privatization of SOEs has been a major component of the FESALs. Under PAL-1 and PAL-2, the Bank has led the dialogue on reforms covering the regulatory regimes, the insolvency process, and competition.

20. **Public sector governance.** The government is pursuing a broad program to improve public sector governance including strengthening the capacity of the public administration, improving service delivery, reducing corruption, and reforming the judiciary. The support of this program has been the main focus of PAL-2. The policy, legal and institutional framework has been developed and put in place to strengthen merit and depolitization. Performance standards for service delivery have been developed and one-stop shop principles have been introduced in five central administrations and six regional administrations. The system of performance appraisal and professional development within the state administration has been enhanced. Concrete steps have been undertaken to increase accountability and transparency – the conflict of interest and asset declaration regime has been strengthened; a monitoring system to track progress in meeting the anti-corruption objectives has been designed; key ministries and agencies have prepared detailed and practical anticorruption action plans.

C. The World Bank Group Strategy and Lending Operations

21. **The Country Assistance Strategy (CAS) for Bulgaria[13],** discussed by the Bank's Board on May 9, 2002, focuses on three main themes: (i) promotion of competitive private sector led growth, (ii) strengthening public administration reforms and anti-corruption initiatives, and (iii) mitigating the social impact of restructuring and delivering social services more effectively.

22. **Programmatic Adjustment Lending.** Up to three Programmatic Adjustment Loans (PALs), the first two, PAL-1 and PAL-2, were approved by the Board in February 2003 and June 2004, respectively, [14]and the third one is under preparation. The PAL program supports

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[13] [1]*Memorandum of the President of the International Bank for Reconstruction and Development and the International Finance Corporation to the Executive Directors on a Country Assistance Strategy of the World Bank Group for Bulgaria*, May 31, 2002.

[14] *Program Document for a Proposed Programmatic Adjustment Loan to the Republic of Bulgaria*, The World Bank, January 23, 2003, *Program Document for a Proposed Second Programmatic Adjustment Loan to the Republic of Bulgaria*, The World Bank, May 4, 2004.

the government's reforms aiming at: (a) completion of privatization and restructuring in energy and infrastructure; (b) improving the environment for private sector led growth; (c) deepening the financial sector; (d) reducing poverty and improving human capital, and better delivery of social services; and (e) support public administration reform and anti-corruption programs.

23. **The World Bank's assistance program in Bulgaria to date comprises 37 operations for a total original commitment of US$1,987.2 million equivalent.** This includes eleven adjustment loans (US$1,075.8 million), 19 investment projects (US$750.7 million), one debt reduction loan (US$125.0 million), four Bank-managed Global Environmental Fund (GEF) grants, and two Bank-managed Prototype Carbon Fund (PCF) operations. Of these 37 operations, 24 have been completed, of which ten have been partially cancelled during implementation, and thirteen operations are currently under implementation (see Table 20 below). In addition, a grant by the Institutional Development Fund, in the area of regulatory reforms in infrastructure, was approved in February 2005 in the amount of US$381,000.

24. **IFC's Activities in Bulgaria comprise 25 projects (totaling US$293 million) in the support of financial sector development, gas production, tourism and restructuring of post-privatized companies.** Of those, 20 projects were approved from 1999-on. In the financial sector, IFC has supported two specialized SME banks, established Bulgaria's first micro lending bank, and has invested in a leasing company and in a venture capital fund. Also, IFC has invested in a number of key manufacturing projects covering cement production, electronic assembly, pulp and paper mill, and copper processing. In FY04 alone, IFC has committed about US$90 million to support post-privatization restructuring of a steel mill and glass processing plants.

25. **Economic and Sector Work.** The country diagnostic work recently completed includes: Country Financial Accountability Assessment, Survey on Rural Development Needs, Issues in Inter-governmental Relations, Environmental Sequencing Strategies for EU Accession, and the National Energy Efficiency Study. Other country diagnostic work being completed includes an infrastructure and energy study, a roads study, and a Country Economic Memorandum focused on policy reforms for growth.

Table 20. Bulgaria: Active World Bank Operations (net of cancellations) [a/]

	Operation	US $ million	Board Date
1.	Trade and Transport Facilitation in Southeast Europe	7.4	2000
2.	Health Sector Reform	63.3	2000
3.	Child Welfare Reform	8.0	2001
4.	Registration and Cadastre	30.0	2001
5.	Wetlands Restoration and Pollution Reduction (GEF Grant)	7.5	2002
6.	Social Investment and Employment Promotion	50.0	2002
7.	Revenue Administration Reform Project	34.2	2003
8.	District Heating Project	34.2	2003
9.	Wood Residue to Energy (PCF)	1.8	2003
10.	District Heating (PCF)	5.0	2004
11.	Energy Efficiency Fund (GEF)b/	10.0	2005
12.	Pomoriisko Lake (GEF)b/	0.9	2005

Notes: *a/* PAL-1 (US$ 150 million) was approved by the Board on January 23, 2003, PAL-2 (equivalent to US$125 million) was approved by the Board on May 4, 2004. PAL-3 is expected to reach the Board in June 2005. b/ Not effective yet.

Questions may be referred to Ms. R. Quintanilla (202-473-7673), Ms. Myla Taylor Williams (202-473-6997), or Ms. Stella Ilieva (359-2-9697-251)

Bulgaria: Statistical Issues

1. Bulgaria compiles and submits data to the Fund of sufficient quality and in a timely manner to adequately permit program monitoring and surveillance (Table 21). Despite a comprehensive economic database, problems remain in national accounts and price statistics, particularly in the coverage of the emerging private sector, as well as in the balance of payments statistics, where frequent and substantial revisions have hampered economic analysis. In addition, work remains to be done in fully reconciling high frequency data on economic activity with quarterly and annual national accounts data. Annual international investment position statistics are compiled and reported to STA for publication.

2. On December 1, 2003, Bulgaria subscribed to the International Monetary Fund's Special Data Dissemination Standard (SDDS), marking a major step forward in the development of the country's statistical system.

Real sector

3. The National Statistical Institute (NSI), with technical assistance from the OECD, has established a system to compile national accounts according to the recommendations of the *European System of Accounts 1995*. GDP data by activity and expenditure categories are compiled and reconciled within an annual supply and use framework. Government output and final consumption are estimated on a cash rather than an accrual basis. In addition, Bulgaria publishes national accounts including current and capital accounts for the five main domestic sectors (general government, financial corporations, nonfinancial corporations, nonprofit institutions serving households, and households). As for most countries, the financial account and the balance sheets are missing.

4. The NSI has compiled estimates of quarterly GDP by the production and expenditure approaches in current and constant prices since 1994. The preliminary data are disseminated 80 days after the end of the reference quarter with final figures disseminated after approximately 5 quarters. Problems remain in the coverage of private sector activities as well as the constant price estimates of capital formation and external trade. However, significant progress has been made in the development of export and import deflators. The estimates at constant prices use chain-linked indices, which follows international standards (*SNA 1993*).

5. Revision of the producer price index (PPI), for domestic sales, was completed in June 2004. The NSI has expanded the collection of transaction prices throughout the industrial sector of the domestic economy. Publication of the rebased PPI began in March 2003, with the weights and reference period updated to 2000 and linked at December 2002 to form a continuous monthly series for the period January 2000 to January 2003. The index is to be rebased every 5 years. Timeliness of release is now within one month. Progress is being made on the development of a PPI for export sales.

6. The consumer price index (CPI) provides a reasonable measure of inflation and price developments in Bulgaria. The recommendations provided by STA missions have been broadly implemented. The NSI has completed the exercise to link annual Laspeyres price indices together, producing a time series that begins in 1995. This series also follows the new classifications and index methods recommended by Eurostat and STA, and has been published as the official CPI. The coverage of the index was extended, although it still excludes some important sectors, mainly owner-occupied housing and health and life insurance. Since 2004 financial services are included. The geographical coverage of the index is restricted to 27 urban areas which account for an estimated 65 percent of sales. A new method for imputing missing observations of new products is being applied, but quality adjustment procedures are only applied in a few particular cases (e.g., the heating component).

7. The flow of customs data has improved significantly in recent years and a new system for processing customs records is near completion. The development of export and import unit value indices is progressing smoothly and additional support is expected from Eurostat in this area. The current indices can be used effectively as deflators for the import and export components of the national accounts. The Import and Export Division of the NSI meets monthly with the Bulgarian National Bank to review data issues and ensure consistency between the NSI export and import data and the balance of payments data.

8. The lack of comprehensive labor statistics has hampered the assessment of developments in employment and wages, especially in the private sector, though there have been some recent improvements. Annual data are collected by the NSI, using a census of all establishments. The NSI also obtains current monthly estimates from a quarterly survey of establishments using all public enterprises and a sample of private employers (excluding establishments with less than 5 employees and, for 2003, includes 14,000 private employers out of approximately 113,000 qualifying private enterprises). The main shortcomings of these data include: (i) the under-reporting of private sector wages; (ii) the reporting of only average gross earnings, not wages for time worked and wages by occupation; and (iii) the lack of coverage of the self-employed and employment in small firms. However, administrative National Social Security Institute (NSSI) data are used to estimate wages by occupation and age and the number of self-employed and employment in small firms. The household budget survey could provide an alternative source of data for private sector wages. Regarding employment, the NSI household labor force survey is an alternative source of data, but improvements are needed to make it more consistent with the establishment survey, especially regarding agricultural employment. The survey is conducted four times a year at regular intervals.

9. A Population Census was conducted in early 2001 and is a source for redesign of the household surveys conducted by the NSI, particularly the household budget survey and the labor force survey.

Government finance

10. In recent years, following the recommendations of a combined STA/FAD mission and within the framework of fiscal reporting requirements for EU accession, the authorities have made great progress on the implementation of accrual accounting for government, budgetary and statistical systems. Consolidated data on central government operations are routinely reported for publication in the *GFS Yearbook* and in *IFS*. For the *GFS Yearbook 2004*, 2003 data for the general government sector and its subsectors were reported on a cash basis. The Ministry of Finance prepares data on the execution of the consolidated government on a monthly basis. These data do not conform to *GFS* standards and while not published in a bulletin format they are posted on the Ministry of Finance's website. The authorities have made progress in presenting data on a disaggregated basis, including expenditure by functional classification. However, a full economic classification of expenditure is still not available; in particular, as noted in the draft report on the fiscal ROSC conducted in March/April 2005, defense and security expenditure needs to be allocated to the appropriate economic items.

Money and banking statistics

11. Statistical methods conform with the key classification and valuation principles in the IMF's *Monetary and Financial Statistics Manual, 2000*. To address remaining deviations, the authorities reported that starting in January 2003, positions on financial derivatives, which at present are small, would be included in the balance sheets. Further, the consistency in the coverage of the BNB's claim on banks (which included claims on liquidated banks) and the banks' liabilities to the BNB improved in January 2003 after the BNB wrote off most of the claims on the liquidated banks. With respect to its near-term statistical program, the BNB is progressively harmonizing its data collection and compilation methods in line with the European Central Bank's framework for monetary statistics. In particular, a significant number of enhancements in sectoral and instrument detail and classification have progressively been made in the data for 1995 and onward. These were reflected in the revised monetary statistics published in the August 2002, November 2003, and October 2004 issues of *IFS*. The latter revision in *IFS* is a consequence of the BNB's statistical work in early 2004, following which monetary data were recast to further harmonize with ECB requirements. Among the changes in the national presentation was the creation in February 2004 of a new long-term liabilities category outside the money supply that includes deposits and securities with a maturity over 2 years, deposits redeemable at notice over three months, and capital and reserves. For program purposes, deposits of the newly created public investment company, municipalities and social security funds are considered part of the consolidated general government. These deposits are excluded from M3 and included in net lending to the consolidated general government.

Balance of payments

12. Bulgaria reports monthly balance of payments data on a regular and timely basis, but data are subject to frequent and substantial revisions. An IMF technical assistance mission in December 2000 made a number of recommendations to strengthen the balance of payments and external debt compilation systems, which included the development of a closed-type of international transactions reporting system, the development of estimates of "shuttle trade" with countries bordering Bulgaria, strengthening the methodology for travel transactions, and compiling data on trade credit liabilities. The treatment of the license to operate a mobile telephone service has been clarified and agreed with the BNB. The GSM license purchase has been recorded under foreign direct investment, in Bulgaria's equity capital component in the first quarter of 2001. As there is no repayment obligation, the transaction does not change the country's external debt position. Balance of payments transactions related to the mobile phone license are no longer recorded for the subsequent periods. In 2003, the ROSC mission identified the following problems in the balance of payments statistics: i) residents' foreign currency accounts with resident banks are incorrectly included; ii) merchandise trade data are prone to errors and are not timely; and iii) most data are collected on a cash basis. More recently, large revisions to the data on reinvested profits for 2003 have revealed that the sample on the basis of which the preliminary data for this series are compiled is inadequate, in part because it omits many of the largest firms.

Table 21: Common Indicators Required for Surveillance

As of April 15, 2005

	Date of latest observation	Date received	Frequency of data[6]	Frequency of reporting[6]	Frequency of publication[6]	Memo Items:	
						Data Quality – Methodological soundness[7]	Data Quality Accuracy and reliability[8]
Exchange Rates	Mar 2005	3/31/05	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jan 2005	3/28/05	M	W	D		
Reserve/Base Money	Feb 2005	4/04/05	W/M	M	D	O, O, LO, LO	O, O, O, O, O
Broad Money	Feb 2005	4/04/05	W/M	M	W/M		
Central Bank Balance Sheet	Feb 2005	4/04/05	W/M	W/M	W		
Consolidated Balance Sheet of the Banking System	Feb 2005	3/31/05					
Interest Rates[2]	Feb 2005	4/0505	W	M	W		
Consumer Price Index	Mar 2005	4/14/05	M	M	M	O, LO, O, O	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2003	7/01/04	A	A	A	O, LO, O, LO	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	Feb 2005	3/31/05	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2004 Q4	3/31/05	Q	Q	Q		
External Current Account Balance	Jan 2005	3/31/05	M	M	M	LNO, LO, O, LO	LNO, LNO, LNO, LO, LO
Exports and Imports of Goods and Services	Jan 2005	3/31/05	M	M	M		
GDP/GNP	2004 Q4 (Quarterly); 2001-03 (annual	3/31/05	Q/A	Q/A	Q	O, LO, O, LO	O, O, O, O, O
Gross External Debt	Jan 2005	3/25/05	M	M	M		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[7] Reflects the assessment provided in the data ROSC published in December 2003 and based on the findings of the mission that took place during January 15-30, 2003 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

Sofia, Bulgaria, April 26, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Rato:

1. The attached Supplementary Memorandum of Economic and Financial Policies (SMEFP) describes the performance under the economic program that is supported by the Stand-By Arrangement (SBA) approved by the International Monetary Fund on August 6, 2004 and the policies that the government and the Bulgarian National Bank (BNB) intend to pursue in 2005 as part of the 2004-06 economic and financial program outlined in the Memorandum of Economic and Financial Policies (MEFP) attached to our letter of July 21, 2004. Our core objectives, supported by the policies described in the SMEFP, remain the maintenance of macroeconomic stability and sustained high rates of economic growth in the run up to EU membership in 2007.

2. As described in the SMEFP, macroeconomic performance in the second half of 2004 was better than anticipated and the program objectives were largely exceeded. However, two quantitative and two structural performance criteria for December 31, 2004 were missed, and we request waivers for their nonobservance.

- The general government expenditure ceiling was exceeded by BGN 308 million (0.8 percent of GDP). This nonobservance, which also involved the nonobservance of the structural benchmark proscribing the creation of new state-owned enterprises, had no macroeconomic implications since it resulted from the transfer on December 16 of BGN 340 million (0.9 percent of GDP) to a new enterprise for implementing public investment projects, but which did not engage in any spending in 2004. Without this transfer, the expenditure ceiling would have been observed.

- We did not manage to eliminate completely central government arrears by year-end. A very small amount (BGN 2.2 million) remained outstanding. These arrears will be eliminated in early 2005 and we will seek to avoid accumulating new arrears by the central government in 2005. However, as indicated in Annex II of the SMEFP, we are proposing to allow a small margin for arrears that may arise in the autonomous bodies of the central government and which the Treasury can monitor only with a considerable time lag.

- We were able to incorporate all lev-denominated accounts of the autonomous bodies into the unified budgetary payment system (SEBRA) by December 31, 2004 except for the expenditure accounts of the judicial system. We have received assurances from the independent judiciary that all necessary steps will be taken by September 30, 2005 to incorporate the judicial system's expenditure accounts into SEBRA and propose this action as a structural performance criterion for September 30, 2005.
- An exceptionally heavy agenda (including approval of the 2005 budget and EU accession related legislation) prevented parliament from approving before year-end the draft law to use the Bulstat number as the single identification for all tax and social security payments.

Under our 2005 program, we will ensure observance of the conditionality in the last bullet above as well as at least partial completion of two structural benchmarks missed on December 31, 2004 as prior actions before Executive Board consideration of the first review under the SBA. Altogether, we will implement five prior actions (Annex I of the SMEFP).

3. The SMEFP proposes quantitative performance criteria for June 30, 2005 and September 30, 2005 as well as indicative targets for March 31, 2005 and December 31, 2005, as described in its Annexes II – IV. In addition, program implementation is proposed to be monitored by the three structural performance criteria and the 10 structural benchmarks listed in Annex I of the SMEFP. The indicative targets and structural conditionality for December 31, 2005 may be revised during the second program review, which is scheduled to take place on December 15, 2005. The third review is scheduled to take place by June 13, 2006, and the fourth review by September 5, 2006.

4. We believe that the policies set forth in the SMEFP are adequate to attain the objectives of our program, but we will take any further measures that may become appropriate for this purpose. Bulgaria will consult with the Fund on the adoption of these measures, and in advance of any revisions to the policies contained in the SMEFP, in accordance with the Fund's policies on such consultation. We will provide the Fund with such information as it requests on policy implementation and achievement of program objectives. Apart from setting the performance criteria and structural benchmarks for the remainder of 2005, the forthcoming second review will focus on whether the fiscal stance needs to be tightened in the second half of 2005 in light of external current account developments (as mentioned in ¶4 of the SMEFP).

5. We would like to reaffirm our intention not to make the purchases under the SBA that will become available upon observance of its performance criteria and completion of its reviews and to make all outstanding repurchases to the Fund on the expectations schedule.

Indeed, as mentioned in the SMEFP, we are considering making advance repurchases to the Fund as one option under our plan to reduce further the government's external debt in 2005.

Sincerely yours,

/s/	/s/	/s/
Milko Kovachev Minister of Economy Republic of Bulgaria	Milen Veltchev Minister of Finance Republic of Bulgaria	Ivan Iskrov Governor Bulgarian National Bank

Attachment: Supplementary Memorandum of Economic and Financial Policies

SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. Recent Economic Developments and Objectives for 2005

1. **Economic performance in 2004 was stronger than expected during the program discussions in mid-2004.** Real GDP grew by 5.6 percent thanks to a rebound in agricultural output, a record summer tourist season, and the continued expansion of industrial output in response to strong investment. Compared to the mid-year projection, credit growth was faster than projected, but domestic demand remained broadly unchanged, reflecting a much stronger than expected fiscal performance. Concurrently, the foreign component of aggregate demand improved strongly as the current account deficit was more than 1 percentage point lower than projected, at 7.5 percent of GDP. For the trade balance, the oil price shock during the second half of the year was largely offset by higher margins on the exports of petroleum products and price increases for metal exports. Hence, the current account improvement resulted mainly from higher net services and transfer receipts. Notwithstanding the oil price surge, consumer price inflation abated to 4 percent at year end, leaving average inflation in 2004 at 6.1 percent, compared with 6.3 percent under the program. Registered unemployment reached a five-year low of 11.7 percent of the labor force in September, before increasing for seasonal reasons to 12.2 percent in December 2004.

2. **In view of the better-than-expected economic outcome in 2004, we have set ourselves slightly more ambitious economic objectives for 2005 than had been envisaged under the original program.** We now expect real GDP growth to amount to 5½ percent, and exceed the projection in the original program. Compared to 2004, private domestic demand is expected to grow more slowly in response to higher oil prices and a slowdown of credit expansion. Reinforced by slower growth in real public spending, the slowdown of domestic demand growth is projected to exceed the expected improvement in the external contribution to real GDP growth. The external current account deficit is projected to widen modestly to 7.6 percent of GDP (against 8.3 percent of GDP under the original program), mainly due to the full-year effect of higher oil prices. Meanwhile, with smaller administered price increases than in 2004, the annual rate of inflation is expected to decline to 4 percent and 3½ percent on an average and year-end basis (against 3.6 percent for both under the original program), while a continued fall in the unemployment rate would result from some growth of the labor force and further employment gains.

II. The Economic Program for 2005

3. **Our economic program aims at providing a stable policy framework before and after the mid-year parliamentary election and to prepare the economy for EU accession, which we expect to attain at the start of 2007 after signing the accession treaty in April 2005.** The currency board arrangement will remain the cornerstone of our economic policy and will be maintained until targeted euro adoption in 2009-10 under a strategy agreed last year between the government and the Bulgarian National Bank (BNB). Accordingly, our program for 2005 continues to rely on a judicious mix of fiscal and

incomes policies, measures to restrain credit expansion, and structural reforms to bolster the competitiveness of the economy at an unchanged exchange rate peg.

A. Fiscal policy and reform

4. **The recent and prospective reduction of overheating and external vulnerability has allowed a modest easing of the fiscal stance in 2005 in accordance with ¶15 of the MEFP.** Thus, in light of an overall fiscal surplus of 1¾ percent of GDP in 2004, we intend to ease the fiscal stance somewhat to achieve a general government surplus (defined to treat capital transfers and spending by the new public investment projects enterprise as government expenditure, and adjusted for the net variation of arrears) of at least 1 percent of GDP in 2005 (a performance criterion)[15]. Flexibility in attaining this target will be provided by contingency reserves of 1 percent of GDP and the delay of discretionary nonpriority spending equivalent to 0.7 percent of GDP until the fourth quarter of 2005. However, we are prepared to tighten the fiscal stance at the time of the second review if the current account position turns out to be weaker than currently expected. Moreover, we intend to save 69 percent of any cumulative quarterly tax overperformance (excluding the personal income tax) of the general government in 2005, and the performance criterion on the fiscal balance will be adjusted accordingly. We will seek to avoid the accumulation of new central government arrears (a performance criterion) and urge the local governments to eliminate their arrears (which amounted to less than 0.1 percent of GDP at end-2004).

5. **As a result of tax reductions and the privatization of profitable enterprises the revenue ratio will decline from 39.2 percent of GDP in 2004 to 38.8 percent of GDP in 2005.** In line with its long-standing goal the government has further reduced direct taxes and increased indirect taxes. Direct tax collections will be reduced by a higher standard deduction and by lower tax rates for the personal income tax, and by lower tax rates for the corporate income and dividend taxes. The full impact of the latter tax reductions, as well as of tax breaks for families with children, will be felt in 2006. The low-yielding inheritance tax was abolished, and the delay for VAT export refunds was reduced from 45 to 30 days. The tax losses will be mitigated by higher excises on alcohol and tobacco products in line with EU accession requirements, a slight broadening of indirect tax bases, and improved compliance in response to various measures. In this connection, the government has taken steps, in cooperation with our external consultants, to reverse the surge of excise tax refunds to duty-free shops and gas stations, including through the establishment of an interagency National Control and Coordination Center and the creation of additional mobile teams focused on the prevention of excise tax fraud. The loss of nontax collections in the wake of

[15] The environment enterprise, with revenue and expenditure of 0.2 percent of GDP, has also been consolidated with the general government in 2005, raising the revenue and expenditure ratios by the same amount. The enterprise will be closed and its operations will become part of the Ministry of Environment and Waters.

the privatization of profitable enterprises has been partly offset by the extension of the vignette scheme to passenger cars, which replaced the road tax in January 2005.

6. **The expenditure ratio will rise from 37.5 percent of GDP in 2004 to37.8 percent of GDP in 2005.** Compared to 2004, capital expenditure shows the largest increase in relation to GDP, reflecting in part water, road, and environmental projects financed by the public investment projects enterprise. Social expenditure, mainly welfare assistance and health care, is also rising in relation to GDP. By contrast, expenditure on maintenance and operations, subsidies, and interest is declining in relation to GDP: maintenance and operations because of the budgetary treatment of employment programs as social assistance transfers; subsidies because of the elimination of energy subsidies and the reduction of heating subsidies; and interest payments because the effect of debt reduction operations outweighs that of higher market interest rates. The higher contingency reserves contain 0.3 percent of GDP of additional expenditure on education, mainly for computers and to repair and upgrade schools.

7. **Our efforts to strengthen the sustainability of the public pension and health care systems will continue.**

- With the stepwise implementation of the 1999 pension reform the dependency ratio has declined below one for the first time. In December 2004, the pension indexation formula was enshrined in the social security code and the National Social Security Institute (NSSI) was empowered to verify and re-certify all disability certifications. At the same time, the possibility of converting old-age pensions into disability pensions was eliminated. A council of ministers decree limiting retroactive payments of disability pensions to no more than six months will be issued by September 30, 2005. The NSSI budget has been prepared consistent with an expected 7 percent pension increase from June 1, 2005. The transfer to the second pension pillar remains at 3 percent of the contributions of eligible persons in 2005 but will be increased by one percentage point each in 2006 and 2007.

- A national framework agreement for 2005 with the health care providers introduced new fees to reimburse hospitals and physicians. The number of clinical paths was raised from 80 to 120, and work continues to replace the clinical paths with a larger number of more precisely defined diagnosis related groups covering all inpatient diagnoses and procedures. After this work is completed in 2005, we intend to shift all financing of health care provision for curative and rehabilitative services from the Ministry of Health to the National Health Insurance Fund (NHIF) to streamline and consolidate provider payments, and to convert the Ministry of Health into only regulatory and policy making body. In the course of 2005, we will develop plans for restructuring and closing hospitals and rationalizing staffing and bed distribution and use on the basis of the National Health Map. We will also facilitate hospital choice by the development of a new system of accreditation, and contemplate greater use of copayments while encouraging voluntary supplementary health insurance.

- To reduce nonwage labor costs, we have reduced the employer's share in social contribution payments from 75 percent to 70 percent from January 1, 2005 and will continue to reduce it to 50 percent by 2009.

8. **Structural reforms will continue to be implemented to enhance fiscal transparency and performance.** A fiscal ROSC, conducted in March-April 2005, provided valuable input to, and possible widening of the scope of, ongoing fiscal reforms.

- To enhance transparency, we will prepare an economic classification of the consolidated general, central and local government and social security expenditures for 2001-05 by September 30, 2005 (a structural benchmark). In particular, we will ensure that expenditure for defense and security is fully classified under the appropriate economic categories.

- The 2006 budget will be based on revenue projections which are in line with the expected revenue performance of 2005 and the macroeconomic outlook for 2006. At the same time, expenditure estimates will include the provision of the expected amount of year-end bonuses for government workers and pensioners. With EU accession looming in 2007, the 2006 budget will be the last opportunity to lay the groundwork for the absorption of a sharply increased availability of EU financing, which requires room for local counterpart spending and the payment of the membership contribution. The medium-term objective should be approximate budget balance, after a one-time deficit in 2007 that would result from the delayed refunding of EU agricultural subsidies.

- Preparatory work for the start-up of the National Revenue Agency (NRA) on January 1, 2006 is progressing. There has been solid progress towards making the NRA operational, including some key resource areas such as information technology and human resource management. Staffing plans are well advanced and will start being piloted soon in collaboration with the NSSI. The consultant in charge of customization and the implementation of the revenue management software has been selected and the software acquired. Parliamentary approval of the legislation on the Bulstat number is expected soon (a prior action), and parliamentary approval of the NRA procedural code (the Tax and Social Security Procedural Code) is expected by September 30, 2005 (a structural performance criterion), following its first reading in parliament (a prior action). Drafts of new PIT, CIT, VAT and excise tax laws have been submitted to parliament (a prior action) and are expected to be approved by parliament by September 30, 2005 (a structural benchmark).

- We will incorporate all lev-denominated expenditure accounts of the judicial system in the budgetary payments system (SEBRA) by September 30, 2005 (a structural performance criterion). To promote fiscal transparency, we will not create any new extrabudgetary funds or state-owned enterprises during 2005 (a structural benchmark). The Financial Management Information System (FMIS) has started operating on a trial basis in the Ministry of Finance in January 2005 and will be used exclusively in this ministry from September 1, 2005 (a structural benchmark) and piloted in one additional ministry and one agency in January 2006.

- With its extension to four more ministries in 2004, program budgeting now covers seven ministries. Four more ministries are scheduled to adopt program budgeting in 2005, with a view to preparing the central government budget on a program basis by 2007. To improve budget execution, we intend to move from cash to accrual accounting with the 2006 budget report and have requested technical assistance from the Fund to prepare for the change.

- Further progress will be made to ensure the smooth functioning of fiscal decentralization, especially by enhancing transparency and establishing clear and predictable financial relations between the central government and the municipalities. Expenditure standards for central government mandates have been developed and all mandates are now fully funded. The equalization grant, although at an adequate level, will be better targeted to the poorest municipalities. To help avoid arrears on municipal governments' own mandates, we will assist municipalities in finding replacements for the road and inheritance taxes and raise their own revenue level. To this end, we will update the property tax valuations by September 30, 2005 (a structural benchmark), submit a constitutional amendment to parliament by June 30, 2005 that would allow municipalities to set their own tax rates (a structural benchmark), and transfer the patent tax (a presumptive tax on small businesses) to the municipalities in 2006. A new municipal debt law that introduces procedures for, and limits on, the contracting and guaranteeing of debt by municipalities has passed the second reading in the budget and finance committee and is expected to be approved by parliament later this year. Finally, an amendment to the municipal budget law covering local government insolvency procedures is expected to be prepared by end-2005.

- The government is trying to minimize its future financial obligations arising from two large infrastructure projects involving state-owned enterprises. In March 2005 a public-private partnership contract for the construction and operation of the Trakia highway was signed. We estimate the government's potential obligations arising from shadow tolls for trucks and possible traffic shortfalls at altogether €170 million, spread over 5 to 6 years after the expected completion of the highway in 2007. In addition, the government has decided to support the construction of a nuclear power plant at Belene, in part to compensate for capacity lost from the pending decommissioning of two reactors of the Kozlodui nuclear plant. In deciding on the financing plan, we are examining various approaches to minimize the government's financial involvement.

B. Incomes and Labor Market Policies.

9. **Wage restraint remains crucial to maintain competitiveness and stimulate employment.** To provide guidance to private sector wage bargaining, we are pursuing a restrained wage policy in the public sector. The increase in the budgetary wage bill on July 1, 2005 will be 3.6 percent, with individual wage increases of up to 5 percent. The increase in the aggregate wage bill of the 58 largest public enterprises that are monopolies, received government subsidies, made losses, or had arrears in the third quarter of 2004 has been limited to 4 percent in 2005. The observance of the limit on the wage bill will be monitored as a performance criterion. In consultation with the social partners, we intend to amend our labor regulations with a view to making working conditions more flexible. An attempt to incorporate existing seniority bonuses into the pay scales has recently failed due to union resistance. However, the social partners have recently resumed their discussions, and we expect them to find a solution soon. As a minimum, we intend to issue a decree by December 31, 2005 eliminating the portability of the seniority bonus in the case of unemployment (a structural benchmark), in particular to enhance the re-employment chances of older unemployed persons. We also want to increase work time flexibility by raising the legal limits on maximum working hours, lengthening (perhaps annualizing) calculation periods, and expanding the reasons for work outside regular hours. We expect to reach consensus on a draft law satisfying these requirements and submit it to parliament by September 30, 2005 (a structural benchmark). Following its increase by 25 percent to BGN150 per month in January 2005, we intend to raise the minimum wage in 2006 and 2007 to no more than BGN160 and BGN170, respectively.

C. Financial Sector and Public Asset and Liability Management Policies

10. **Under its monetary program for 2005 the BNB intends to reduce the annual rate of credit expansion to the non government sector from 48¾ percent at end-2004 to 30 percent at end-2005.** This represents a reduction of the expansionary impulse of credit growth by 2 percent of GDP with respect to 2004, thus helping to moderate the external current account deficit. We realize that the currency board peg and an open capital account make the pursuit of an independent monetary policy impossible, but we have taken a series of prudential and administrative measures to ensure that credit expansion slows as programmed and that credit portfolios remain sound.

- In addition to the prudential measures taken before the start of the current SBA (MEFP ¶19), we have implemented all the liquidity draining measures listed in ¶20 of the MEFP. In December 2004, the BNB reduced the proportion of cash in vault that banks can use in fulfilling reserve requirements from 50 percent to zero and subjected all bank deposits and liabilities (except subordinated debt, debt-capital hybrid instruments, and repo agreements among banks) to the standard

8 percent minimum reserve requirement rate by eliminating the special 4 percent rate that had been applied to such deposits and liabilities after July 1, 2004.

- In February 2005 the BNB announced that banks whose credit portfolio expands by more than 6 percent per calendar quarter will be subject to an unremunerated deposit requirement of twice the excess credit expansion, unless the ratio of their credits (including risk weighted off-balance sheet items) minus capital to deposits, other than those by other financial institutions, is below 60 percent. This measure took effect in the second quarter of 2005 and was preceded by a December 2004 IMF technical assistance mission that advised on alternative responses to the credit boom and on the need to address likely undesirable side effects if direct controls were introduced.[16]

- For purposes of capital adequacy calculations, the risk weight of mortgages financing more than 70 percent of assessed value will be raised as of July 1, 2005 from the standard 50 percent to 100 percent.

- After hiring an additional team of experts, the BNB has intensified its targeted on-site inspections to, inter alia, enforce the use of strict credit quality criteria by banks to assess debtors' payment capacity.

- The BNB has also met with aggressive banks to explain its concern about the adverse macrofinancial implications of the pace of bank lending and plans to conduct a public awareness campaign about the risks of excessive borrowing. In this connection, the BNB has prepared a draft law enhancing consumer protection in this area, which the government intends to submit to parliament by September 2005.

- In a step toward meeting EU requirements, the government will raise the deposit insurance limit from BGN15,000 to BGN25,000 during 2005.

11. **The recommendations of the generally favorable safeguards assessment by the Fund are being implemented.** The BNB's governing council has made it a formal practice for the external auditors to present the findings of the annual audit to a session of the full governing council. In March 2005 the BNB's internal audit department began to submit biannual reports on the status of implementation of internal and external audit recommendations to the governing council. The latter will adopt a formal rotation policy for the selection of external auditors, or the responsible audit partner, by mid-2005.

[16] The BNB has taken steps to exclude fictitious loans booked by some banks in late March from the base on which the credit limits are applied.

12. **With the parliamentary approval in January 2005 of an amendment that brings the BNB law in line with ECB requirements, the institutional framework of the banking sector is now almost fully developed and financial sector reforms will focus mainly on nonbanks.** The Financial Supervision Commission's (FSC) supervisory capacity will be strengthened further. A new deputy commission chairman in charge of insurance supervision has been appointed (prior action), and the FSC's statutes will be changed to allow the chairman to designate acting deputies when their positions become vacant. A draft insurance law compliant with EU regulations and facilitating supervision was submitted to parliament in January 2005 and is expected to be approved by parliament by end-June 2005. With the rapid growth of leasing, we are reviewing international practice and intend to adopt an appropriate strategy for reporting requirements and/or supervision of leasing companies by September 30, 2005. We intend to adopt all necessary legal provisions by December 31, 2005 (a structural benchmark) to require the leasing companies to report regularly their ownership structure and financial operations. Finally, given the growing importance of nonbank sources of credit and the possibility of transferring credit risk to nonbanks, we intend to intensify the cooperation between the BNB bank supervision and the FSC.

13. **The government will continue its efforts to reduce the public debt and external borrowing.** In this regard, it redeemed US$938 million of Brady interest arrears bonds in January 2005, financed from resources accumulated in the Fiscal Reserve Account, reducing the external and public debt ratios by some 3½ percentage points of GDP. The government is considering buying back or prepaying other external obligations equivalent to some 2½ percent of GDP, subject to maintaining an adequate level of international reserves. To strengthen external sustainability, the government has established ceilings on the contracting and guaranteeing of external public debt (performance criteria). The government's ongoing strategy of shifting from external to domestic borrowing will also help absorb bank liquidity, provide assets to the private pension funds, and develop the domestic capital market. We are considering expanding the range of assets eligible to meet private investment funds' portfolio requirements to include EU government securities. We continue to improve the administrative capacity of the State Treasury to strengthen the control of debt operations.

D. Other Structural Reforms

14. **Reforms to improve the business climate will continue in 2005, although the mid-year election has slowed down the legislative calendar.** In addition to areas listed below, the broader reform of the judicial system, which aims at making judicial procedures faster and less cumbersome, will also help to improve the business climate.

- The council of ministers has decided to move business (and other entity) registration from the courts to a unified registration agency under the Ministry of Justice. The strategy to implement this decision is expected to be approved shortly by the council of ministers (a prior action), after which the drafting of legislation can begin with inputs from the business community. We intend to submit draft legislation to parliament by September 30, 2005 (a structural benchmark), with a view to achieving parliamentary approval by December 31, 2005. EU funding for the development of software for the registration process has already been obtained.

- The draft law on mediation as an out-of-court dispute resolution alternative was approved by parliament in December 2004. With the regulation of the new profession, establishment of the mediation association, and appropriate confidentiality provisions, the court-referred mediation of commercial disputes is expected to commence in 2005.

- Two laws on a private enforcement system and to amend the enforcement provisions of the civil procedures code were sent to parliament in September 2004. The government expects the legislation to be adopted in the first half of 2005.

- A draft collateral law was submitted to parliament in December 2004, and the government expects the legislation to be adopted by end-2005.

- A donor assessment in June 2004 came to the conclusion that it was not necessary to amend the commercial code to improve corporate governance. Instead, the government decided to train the judges in the area of commercial law (mergers and acquisitions, collateral law, etc.). A training program will start in Spring 2005 at the National Institute of Justice.

15. **We recognize that corruption remains a serious problem and are committed to fight against it.** In accordance with its 2001 National Anti-Corruption Strategy, the government focuses on education, prevention, and criminal investigation and prosecution.

- Existing training programs encompass secondary school students, teachers, civil servants, and judicial officials. A new code of ethics for civil servants is being applied following its adoption by the council of ministers in 2004. Intentions for 2005 include the introduction of web-based training of civil servants and the adoption of a master's degree program on anti-corruption by Sofia University.

- Prevention is being promoted by the progressive introduction of one-stop shops and the spread of e-government. Anti-corruption councils have recently been set up in all regions with the participation of civil servants, the judiciary, businessmen, NGOs, and the media. In cooperation with the United Kingdom, anti-corruption audits have been developed and the first such audits will be conducted in the Ministry of Justice and the Ministry of Youth and Sports. The first results are expected by March 2006. Such audits will be extended to all ministries.

- The reform of the judiciary will help in increasing the number of indictments and convictions for corruption from the current annual rates of 800 and 450 cases, respectively. Meanwhile, training at the police academy is strengthening the capacity of staff in the ministerial inspectorates to handle code of ethics violations. Inspectorates will be introduced in all executive agencies, and the work of all inspectorates will be coordinated by the chief inspectorate at the council of ministers.

- We have issued regulations for public procurement below the EU thresholds and parliament approved the asset forfeiture law in February 2005. During 2005 we intend to introduce legislation requiring purchases and sales of goods and services and movable and immovable property, with a unit value above BGN 10,000, to be settled through bank accounts.

16. **The restructuring of the energy, railway and education sectors will be pursued in close collaboration with the World Bank.** The financial position of the electricity and district heating companies has been strengthened by the mid-2004 tariff increases, which completed the government's three-year price reform. The electricity market has been liberalized further in 2005 with the reduction of the threshold for the right to free contracting of electricity from 40 to 20 gigawatt hours per year for large users. The railway sector has undergone significant restructuring leading to growth in revenues and activity indicators, shutting down of inefficient lines, reduction of the number of passenger trains, staff reductions, and improved financial management. The railway sector has also benefited from tariff increases, the conclusion of public service contracts (PSCs) with the government, and some much needed investment in rolling stock. Nonetheless, we will continue to strive to improve the sector's financial position and efficiency. We will ensure that the parties concerned will fully abide by their commitments under the PSCs in the 2006 budget. Structural reforms in education will aim at boosting quality, efficiency, and competitiveness.

17. **The government intends to complete its privatization program in 2005-06.**

- The remaining 35 percent of the telecommunications company BTC was privatized on the stock exchange in January 2005 against compensatory instruments issued to expropriated owners.

- We have sold five tobacco processing plants and are in the process of selling one other, but attempts to sell the larger cigarette companies of Bulgartabac Holding have been unsuccessful. Following the withdrawal of the only bidder for those cigarette companies in February 2005, we will reopen the bidding process with a view to completing this privatization by end-2005. The remaining units of Bulgartabac Holding are expected to be sold, as assets or shares, within 2005 or dissolved under the commercial code procedures.

- Three large thermal electricity generation companies are expected to be privatized in 2005. The winning bids will be selected by September 30, 2005 (a structural performance criterion). We will examine whether the government's share in other nonnuclear power plants and remaining district heating companies can be privatized as well.

- We intend to sell the airline, the remainder of the river shipping company, and the maritime shipping company by end-2005.

- We will examine whether some companies currently exempt from privatization as per Annex I of the privatization law can be removed from that list for privatization in 2006.

- In addition to these privatizations we are offering all ports and airports with the exception of Sofia airport to concessionaires on a long-term basis.

Bulgaria: Conditionality Under the Stand-By Arrangement in 2005

Prior Actions

1. Adoption by parliament of a draft law to use the Bulstat number as the single identification for all tax and social security contribution payments.

2. Completion of first reading in parliament of the NRA procedural code.

3. Submission to parliament of new PIT, CIT, VAT and excise tax laws required to make the NRA operational.

4. Approval by the council of ministers of a strategy to transfer business registration to a nonjudicial administrative body and establish a unified national electronic register with limited judicial oversight and simplified administrative procedures.

5. Appointment by parliament of a deputy chairman of the Financial Supervision Commission in charge of the insurance sector.

Quantitative Performance Criteria

1. Floor on the overall surplus of the general government (Annex II).

2. Ceiling on central government arrears (Annex II).

3. Ceiling on the wage bill of the 58 largest SOEs in financial distress or monopoly situation (Annex III).

4. Ceiling on the contracting or guaranteeing of nonconcessional external public debt (short term, 1-5 years, longer) (Annex IV).

Structural Performance Criteria

1. Selection of winning bids for the sale of three large thermal electricity companies (Varna EAD, Ruse EAD, and Bobov Dol EAD) (September 30, 2005).

2. Adoption by parliament of the NRA procedural code (September 30, 2005).

3. Incorporation of all lev-denominated expenditure accounts of the judicial system in the budgetary payments system (SEBRA) (September 30, 2005).

Bulgaria: Conditionality Under the Stand-By Arrangement in 2005 (Concluded)

Other Performance Criteria

1. No imposition of new or intensification of existing restrictions on the making of payments and transfers for current international transactions, nor introduction or modification of multiple currency practices, nor conclusion of any bilateral payments arrangements that are inconsistent with Article VIII of the IMF Articles of Agreement, nor imposition or intensification of any import restrictions for balance of payments purposes, nor accumulation of any external payments arrears (continuous)

Structural Benchmarks

1. No new extrabudgetary funds or state-owned enterprises to be created during the program period (continuous).
2. Submit a constitutional amendment to parliament to allow municipalities to set their own tax rates (June 30, 2005).
3. Ministry of Finance to use only the Financial Management Information System (September 1, 2005).
4. Submit to parliament draft legislation to transfer business registration to a nonjudicial administrative body and establish a unified national electronic register with limited judicial oversight and simplified administrative procedures (September 30, 2005).
5. Approval by parliament of new PIT, CIT, VAT and excise tax laws required to make the NRA operational (September 30, 2005).
6. Ministry of Finance to prepare an economic classification of consolidated general, central and local government expenditures (September 30, 2005).
7. Submission to parliament of a draft law raising the legal limits on maximum working hours, lengthening calculation periods, and expanding the reasons for work outside regular hours (September 30, 2005).
8. Government to update the property tax valuations (September 30, 2005).
9. Issuance of a government decree eliminating the portability of the seniority premium in the case of unemployment (December 31, 2005).
10. Approval of legal provisions requiring leasing companies to report regularly their ownership structure and financial operations (December 31, 2005).

Performance Criteria on the General Government Deficit and Central Government Arrears and Indicative Tax Revenue Targets for the General Government

	Fiscal Surplus Floor	Arrears Ceiling	Tax Revenue Target 1/
	(In millions of leva)		
Cumulative change from January 1, 2005			
March 31, 2005 1/	198	5	2,802
June 30, 2005	383	5	5,642
September 30, 2005	605	5	8,522
December 31, 2005 1/	417	5	11,568

1/ Indicative limit or target.

All quarterly limits in this Annex are cumulative.

The general government accounts are defined to comprise the consolidated budget (including the republican budget, the budgets of ministries and local governments, and the social security funds NSSI and NHIF) as well as all extrabudgetary funds and accounts at the central and local government levels, the public investment projects (PIP) enterprise, and the environment enterprise. The central government is defined as the general government minus the sum of the local government budgets and the extrabudgetary funds and accounts at the local government level.

For program monitoring purposes, the arrears of the central (general) government are all overdue obligations on the payment for central (general) government expenditure excluding items in dispute. The stock of central government arrears as of December 31, 2004 amounted to BGN 2.2 million.

For program monitoring purposes, the fiscal balance (surplus/deficit) will be defined as the difference between general government revenue (taxes, nontaxes, and grants) and general government expenditure, including net capital transfers (net acquisition of shares and net lending) and adjusted for the net change of the stock of general government arrears. The quarterly fiscal balance targets will be raised by 69 percent of the excess of actual over targeted cumulative general government tax revenue (including social security and health insurance contributions but excluding the personal income tax), whose total amounted to BGN10,615 million in 2004.

Reporting on the fiscal balance will be cross checked from the financing side as the sum of net credit from the domestic banking system to the general government, general government deposits and accounts abroad, net domestic nonbank credit to the general government, privatization receipts of the central and municipal government budgets, receipts from external loans for project implementation and direct budgetary support minus amortization due, net disbursement/repayment of loans whose final payee is an entity outside the general government consolidation (onlending operations), and the net increase/decrease of general government arrears, including those on the amortization of principal. For calculating the performance against this ceiling, all privatization receipts are treated as financing items. External flows will be converted into leva at the BNB daily exchange rate. Valuation changes in deposits and accounts that are denominated in foreign currencies will be recorded daily and reported by the BNB and the Ministry of Finance at the end of each quarter, and such changes will be netted out.

All data in this Annex will be reported quarterly by the Ministry of Finance (and by the BNB for some of the financing items in the preceding paragraph) within 60 days of the end of each calendar quarter.

Performance Criteria on the Wage Bill of 58 State-Owned Enterprises (SOEs)

	Wage Bill of 58 SOEs
	(In millions of leva)
Cumulative from 1 January 2005	
March 31, 2005 1/	95.0
June 30, 2005	189.9
September 30, 2005	284.9
December 31, 2005 1/	379.9

1/ Indicative Limit

The quarterly ceiling on the aggregate wage bill of the 58 state-owned enterprises closely monitored for their large losses or arrears, for receiving subsidies, or for being monopolies, is 4 percent above the level of the aggregate wage bill in the third quarter of 2004 and is accumulated by the same amount for each subsequent quarter. The wage bill is defined to include wages and payroll taxes paid by the employer but does not include additional compensation under Article 12 of the 2005 Incomes Ordinance.

Those enterprises that have been privatized or ceased operations will be excluded from the list for the respective test dates. Those enterprises that register profits in each of the first two quarters of 2005 will also exit the list in the second half of 2005 unless they are monopolies, have arrears, or receive state subsidies. If an enterprise is excluded from the list, the wage bill ceiling for each subsequent quarter will be adjusted down by the amount of that enterprise's wage bill in the third quarter of 2004 plus 4 percent times the number of quarters it has been excluded from the list. The 58 enterprises monitored are in the table below (enterprises numbers 1 to 4 are considered monopolies).

List of 58 Monitored State-Owned Enterprises

1. BDZ EAD
2. Railway Infrastructure Company
3. Bulgargas EAD
4. National Electric Company
5. NPP Kozlodui EAD
6. TPP Maritza Iztok 2 EAD
7. TPP Bobov Dol EAD (Golemo Selo)
8. Bulgarian Rivershipping Company EAD
9. Mini Bobov Dol EAD (Bobov Dol)
10. Pirin Mine EAD
11. Vazov Machinery Works
12. Dinarit AD
13. Port Burgas EAD
14. Port Burgas - Labor Force
15. DHC - Plovdiv EAD
16. DHC - Shumen EAD
17. DHC - Ruse EAD
18. DHC - Sofia EAD
19. DHC - Sliven EAD
20. DHC - Varna EAD
21. DHC - Pernik EAD
22. Capital Autotransport EAD
23. Sity Transport Varna EAD
24. Sity Transport Plovdiv EAD
25. Ruse Municipal Autotransport EOOD
26. Electrik Bus Transport Pernik EOOD
27. V&K - Dobrich EOOD
28. V&K - Dupnitca EOOD
29. V&K - Turgovishte EOOD
30. Autobus Transportation EAD
31. Passenger Transportation EAD
32. Meden Kladenec EOOD
33. Diana - Bus EAD
34. Plovdiv - BT AD
35. Asenovgrad BT AD
36. Dupnitsa BT AD
37. Yambol BT AD
38. Kurdzali - Bulgartabac AD
39. Haskovo BT AD
40. Shumen BT AD
41. Smolian BT AD
42. Balkan Car 6th September EAD
43. Balkankar - Dunav AD
44. Balkancar - Erma AD
45. Constructing and Rebuilding EAD
46. Transport Constructing and Rebuilding EAD
47. Bointech EOOD
48. Intendanse Service EAD
49. Terem EAD
50. Terem - KRZ Marine Arsenal - EOOD
51. Terem - Georgi Benkovski EOOD
52. Bread and Paste Products - EOOD
53. Balkancar - Zarya AD
54. Beltrans EOOD
55. Electrosteel EAD
56. Rozen Express EAD
57. Niti EAD
58. Terem - Han Krum EOOD

Performance Criteria on the Contracting or
Guaranteeing of Public Sector External Debt 1/2/
(In millions of euros)

	One year and under 3/	Over 1 year 4/	1-5 years 4/
Cumulative change from December 31, 2004			
March 31, 2005 5/	0	38.0	0
June 30, 2005	0	229.8	0
September 30, 2005	0	229.8	0
December 31, 2005 5/	0	229.8	0

1/ The public sector comprises the central government, the local governments, the social security and health insurance funds (NSSI and NHIF) and all other extrabudgetary funds and the Bulgarian National Bank.

2/ The term “debt” has the meaning set forth in point No. 9 of the IMF Guidelines on Performance Criteria with Respect to Foreign debt adopted on August 24, 2000 (Executive Board Decision No. 12274-(00/85)). Excluded from this performance criterion are (i) normal import-related financing credits; and (ii) outstanding balances under bilateral payments arrangements. Debt and commitments falling within the ceilings shall be valued in euros at the program exchange rates of 1.30 US$/€ and 135 ¥/€.

3/ The ceilings apply to debt with original maturities of up to and including one year. The actual stock of short-term debt outstanding (according to this definition) as of December 31, 2004 was zero.

4/ The ceilings apply not only to “debt,” but also to commitments contracted or guaranteed for which value has not been received.

5/ Indicative limits.

Statement by the IMF Staff Representative
May 18, 2005

1. The following information, received since the issuance of the staff report, does not change the thrust of the staff appraisal. It does, however, indicate that the macroeconomic risks to the program objectives remain. If these risks materialize, the fiscal surplus target for 2005 will need to be raised at the time of the second review.

2. **All five prior actions have been implemented.** Four were taken well in advance of the Board meeting, and the last one—submission to Parliament of the new tax laws to make the National Revenue Agency operational—was taken on May 11, 2005, just short of the required five working days prior to the Board meeting. The new tax laws were approved by the Council of Ministers on May 5, but on condition of minor changes, which delayed their submission to Parliament. Nevertheless, the staff has had sufficient time to verify the implementation of these prior actions.

3. **High frequency indicators of economic activity are broadly in line with annual projections**. The unemployment rate started its seasonal decline, dropping to 12.7 percent in March (compared with 13.7 percent in March 2004). Year-on-year inflation in April increased to 5.1 percent, bringing inflation during January–April to 4.1 percent year-on-year, compared with 3.9 percent projected under the program. The more rapid inflation was mainly due to higher oil prices and a weather-related increase in food prices.

4. **The balance of payments is also evolving broadly as envisaged.** The external current account deficit widened to 7.9 percent of GDP in the twelve months to February due to higher than programmed oil prices and one-off imports early in the year, including investment imports associated with recent privatizations. However, first-quarter trade data indicate that by end-March export and import growth had reverted to levels in line with program projections. On the financial account, bids received for two thermal power generation companies suggest that FDI receipts for the year could exceed program projections.

5. **As foreshadowed in the staff report, banks sought to circumvent the credit curbs that took effect in the second quarter, prompting the Bulgarian National Bank (BNB) to take offsetting action.** As the measures announced by the BNB in February linked maximum quarterly credit growth rates to the end-March stock, banks increased credit sharply in March—a 22 percent month-on-month expansion, compared to a program projection of 30 percent growth for the year as a whole (which translates to growth equivalent to 10 percentage points of GDP). Some of this increase consisted of genuine credits, but most were artificial transactions of various types, many of which have since been unwound. In response, the BNB revised its lending restrictions by limiting the base from which credit growth is to be measured to 4 percent above each bank's end–February credit stock, switching from end-period to daily-average measurement of credit stocks, introducing cumulative limits of 5, 12.5 and 17.5 percent for average credit growth in the second, third and fourth quarters of 2005, and tightening capital adequacy rules. However, to minimize the

disruption to the banking system, the BNB will allow some flexibility, permitting banks, on a case-by-case basis, to expand credit in the second quarter by up to 10 percent above the adjusted end-March base (as opposed to the original intention to allow a 6 percent expansion per quarter) before the punitive reserve requirements begin to apply. Although the projection for credit growth during 2005 remains unchanged at the equivalent of 10 percent of GDP, staff estimates that the flow of credit during the first half could be as high as 6.6 percent of GDP (1.3 percentage point above program projections) if all banks benefit to the full extent from this additional flexibility. The BNB regrets the higher than projected credit expansion during the first half of the year and has provided assurances that it will strictly examine the justification for granting the additional flexibility in each case.

6. **The effect on demand of the higher than projected credit expansion is likely to be offset by a better than projected fiscal performance**. Reflecting higher revenue and lower expenditure, the general government recorded a cash surplus of almost 1.2 percent of annual GDP in the first quarter. This suggests overperformance of 0.7 percent of GDP relative to the accruals based program target. Although some of the revenue overperformance was one-off in nature, the authorities believe that second-quarter expenditure, including notably for public investment projects, will fall short of projected amounts so that the cumulative fiscal overperformance in the first half of the year may reach 1.2 percent of GDP.

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FOR IMMEDIATE RELEASE
May 18, 2005

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Completes First Review Under Stand-By Arrangement for Bulgaria

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Bulgaria's economic performance under its Stand-By Arrangement, which enables the release of SDR 34 million (about US$50.7 million). The 25-month Stand-By Arrangement was approved on August 6, 2004 (see Press Release No.04/175) for a total amount equivalent to SDR 100 million (about US$149.2 million). The authorities continue to treat the arrangement as precautionary.

In completing the review, the Executive Board approved Bulgaria's request for a waiver of the non-observance of two quantitative performance criteria—the ceilings on general government expenditure and central government arrears—and of two structural performance criteria—on the incorporation into the Treasury Single Account of all autonomous Budgetary entities and the parliamentary approval of a draft law to use the Bulstat number as the single identification for all tax and social security payments.

Following the Executive Board discussion on May 18, 2005, Ms. Anne O. Krueger, First Deputy Managing Director and Acting Chair, said:

"Bulgaria's macroeconomic performance in 2004 exceeded expectations under the Stand-By Arrangement and external vulnerability has decreased. The authorities' economic program for 2005 aims at continued strong economic growth, moderate inflation, and the containment of the external current account deficit in the context of the currency board arrangement. The program relies on a measured easing of fiscal policy, wage restraint in the public sector, a slowdown in credit expansion, and a reinvigoration of structural reforms.

"The authorities' fiscal program aims at a general government surplus of at least 1 percent of GDP. Given the need to reduce remaining external vulnerabilities, this modest easing of the fiscal stance will be coupled with strengthened efforts to curtail private domestic demand through measures to slow down credit expansion. The authorities' intention to save one-half of any revenue overperformance also provides an additional safeguard. To shore up the fiscal surplus objective and bolster competitiveness in the wake of a large minimum wage adjustment, wage increases in the public sector will be strictly limited. If external current account developments are weaker than expected, it will be essential for the authorities to increase their fiscal surplus target at the time of the second review in September 2005.

"The monetary program relies on temporary direct controls to reduce credit expansion. The measures recently adopted by the Bulgarian National Bank to prevent banks from taking advantage of any loopholes to evade the credit limits are welcome.

"The authorities intend to reinvigorate structural reforms after the mid-year parliamentary election to stimulate supply, ensure an adequate flow of privatization receipts, and prepare the economy for EU accession early in 2007. The structural reforms aim at improving the business climate, making the labor market more flexible, and further strengthening the public finances," Ms. Krueger stated.

Statement by Jeroen Kremers, Executive Directors for Bulgaria and Victor Ivanov Yotzov, Advisor to Executive Director May 18, 2005

Over the last eight years, Bulgaria has implemented a comprehensive reform agenda and successfully completed several Fund-supported programs that helped the country to stabilize and make progress in the run-up to the EU accession. Decisive reforms and continued prudent macroeconomic policy eventually paid off. Last year, Bulgaria closed all negotiating chapters of the *acquis communautaire,* thus formally ended the negotiating process for its EU accession. Just weeks ago, Bulgaria signed the accession treaty and it is now expected to become a full-fledged member of the EU in January 2007.

The economy continued to develop positively with some economic and structural problems still to be addressed. Following the conclusions from the last Article IV Consultation and the ex-post assessment report on longer-term program engagement, the authorities opted last August for another SBA, designed as a low-access, precautionary arrangement, that will also serve as an explicit exit from Fund program engagement. The program focuses on fiscal adjustment, measures to moderate rapid credit growth, improving the business climate, and making further progress in structural reform.

No matter the outcome of the parliamentary elections, scheduled for next month, the economic policy will continue to be based on preservation of the currency board arrangement until adoption of the euro. All major political parties have committed to continue implementing the current program with the Fund and to maintain a cautious fiscal policy, oriented toward sustainable economic growth.

Recent economic developments

Performance under the program so far has been quite strong and in many areas program targets were exceeded. Nourished by strong growth in investment and a large reduction in the negative contribution of net exports, real GDP grew in 2004 by 5.6 percent – the highest growth rate since the start of the economic transformation. A rebound in agricultural output and record-high tourist receipts have also contributed to growth, while domestic demand remained broadly unchanged, reflecting a tighter than programmed fiscal performance. Robust output growth resulted in a lower unemployment rate, although at 12.7 percent of the labor force it is still high and many jobless are still to benefit from the expansion of the economy.

Even though economic growth in 2004 has exceeded somewhat the estimated potential, and despite surging oil prices, end-year inflation declined from 5.6 percent in 2003 to 4 percent at the end of 2004, being just slightly above the program target. Although inflation is still a bit higher than in most of the main trade partners, international competitiveness has not been significantly damaged. While the REER appreciated modestly, unit labor costs continued to decrease. Over the medium term, inflation is expected to decline further, but is likely to remain above the EU average due to a faster productivity growth and some administrative price adjustments still to be implemented.

There has been an overall strong performance under the program, and most of the program conditionality for the first review was satisfied. The nonobservance of a few performance criteria was rather minor and technical in nature. All prior actions have been implemented. Four out of five prior actions were met well in advance, one prior action – on several tax laws required to make the National Revenue Agency (NRA) operational – was met one day late. In fact, due to some technical reasons and because of several consecutive holidays in early May, after the Council of Ministers promptly approved the laws, they were submitted to Parliament as required, but four instead of five working days before the Board date. Nevertheless, this provided staff with sufficient time to verify the implementation of these measures. In addition, all program objectives remain in place and the missed criteria have been timely addressed as part of the remainder of the program.

Fiscal policy

Fiscal policy has been appropriately tight over the last couple of years and has simultaneously created more room for priority spending. Strong revenue growth and improved tax compliance in 2004 resulted in a sizeable consolidated budget surplus that amounted to 1.8 percent of GDP – twice as high as programmed. On the back of over-performance of VAT, excise and import duties, revenue was about one percentage point of GDP higher than in the previous year despite the cut of corporate tax rate. In nominal terms, expenditure was contained as programmed, but declined somewhat as percentage of GDP because of the higher GDP growth and lower subsidies owing to continued structural reforms. Social assistance and unemployment payments were also lowered in line with reduced unemployment and higher disposable household income.

The economic program for 2005 continues to rely on prudent fiscal policy providing at the same time more flexibility to accommodate those expenditure overruns that are unavoidable. Notwithstanding the approaching parliamentary elections, the authorities are determined not to exceed the programmed expenditure total and to stick to a consolidated budget surplus of at least one percent of GDP. Although it appears a slight fiscal relaxation compared to the 2004 outcome, it is justified in view of the reduced external vulnerability. The authorities have also committed to tighten fiscal policy further if the external current account deficit proved to be weaker than projected. As a way of preventing revenue overperformance from generating correspondingly higher spending, the authorities agreed to save the bulk of any tax revenue overperformance of the general government.

In their medium-term fiscal framework (MTFF), the authorities envisage in principle balanced budgets for the years to come with the possible exception of 2007, which is the expected year of EU accession and as such will be marked with more accession-related spending. Under a currency board arrangement, this framework is seen as the only proper response to the external current account deficits and as an instrument for offsetting the impact of the credit boom. Expenditure restructuring, centered on lowering of current spending, is a key element of the MTFF. The authorities believe that the ongoing institutional strengthening will strongly support the MTFF. In this regard, continued efforts have been put forth to make the NRA operational as of the beginning of the next year.

Credit growth

The last three years were marked by a rapid credit growth to the private sector, with an average pace of increase over the period of about 47 percent annually. The credit expansion has been financed mainly by a strong increase in deposits, and recently by a sharp decrease in banks' net foreign assets. In view of declining nominal interest rates, rising income expectations, and a stable banking system this development was anticipated. As a share to GDP, however, credit to the non-government sector has still been lagging behind compared to virtually all the EU countries, including the newcomers. In this regard, and given the still low level of capital stocks in the country, a strong credit growth, but at a lower and more healthy pace, is very likely over the next several years. A similar phenomenon has been observed in other European countries before joining the EU and potential risks have been successfully contained.

The authorities are fully cognizant of the macroeconomic and financial stability risks associated with rapid credit growth and are strongly committed to deal with the situation. Early attempts at reducing credit growth by taking measures to lower liquidity in the banking system proved to be insufficient due to the open capital account, combined with the relatively high return on capital in the country, which has been attracting solid capital inflows. In response, the authorities requested and the Fund provided technical assistance on policies and tools to manage rapid credit growth. Following the conclusions of the highly appreciated technical assistance, the authorities adopted measures – on a temporary basis only – to control more directly the credit extension.

In February 2005, the BNB announced some amendments to the regulation on the minimum reserve requirements. The amendments stipulate that banks whose portfolio expands more than 6 percent per quarter will be subject to an unremunerated deposit requirement of twice the excess credit expansion, unless the ratio of their credits to deposits is below 60 percent. However, as the measures became effective as of April 1, a number of banks opted to boost lending prior to that date so as to create a larger base from which to calculate growth rates. This unwelcome development prompted the central bank to undertake an additional set of measures that was announced in late April. These measures include: (i) limiting the base from which credit growth is to be measured to a maximum of 4 percent above banks' credit stocks at end-February; (ii) moving to measurement of credit growth on the basis of daily average levels over the quarter rather than end-quarter levels; (iii) introducing limits of 5, 12.5 and 17.5 percent cumulative growth compared to the base level in the second, third and fourth quarters of 2005 respectively. The ultimate goal is to lower the annual rate of credit growth to about 30 percent by the end of 2005 and the monetary authorities are firmly committed to succeed in their endeavors.

External sector

On the back of strong growth in services, particularly tourist receipts, as well as a significant increase in current transfers, the external current account deficit improved markedly in 2004. Although at 7.5 percent to GDP the deficit is still considered high and needs to be further addressed, it was 9.2 percent of GDP in 2003 and was projected to decline to 8.8 percent of GDP in the following year. The merchandise trade deficit, however, continued to widen as imports kept on growing faster than exports, reflecting rapidly growing economic activity and surging oil prices. Exports also rose impressively despite a moderate real appreciation. As most of the imports relates to growing domestic demand, partly financed by bank credits, the authorities continue to exert efforts to moderate imports by tempering credit growth.

Financing current account deficits does not seem to pose any problems so far. On the back of high FDI inflows, official foreign reserves have grown in each year since the currency board implementation in 1997. In 2004, gross international reserves rose by 28 percent, covering more than five months of prospective GNFS imports and stood twice as high as the short-term external debt. Although FDI in 2004 was surprisingly low (because of a debt financed merger and acquisition transaction of a big domestic company, followed by a transfer of the realized capital gains abroad), expectations for 2005 and beyond are quite favorable, showing FDI inflows exceeding current account deficits.

The debt burden continues to lessen as the authorities continue their policy aimed at reducing public debt and external borrowing. The reduction of foreign public debt over the last three years has been remarkable – from 66 percent to GDP in 2001 to about 35 percent at the end of 2004. By redeeming US$ 938 million of Brady bonds in January 2005, financed exclusively from resources accumulated in the fiscal reserve account, foreign public debt fell below 30 percent of GDP. Debt sustainability analysis provided by staff shows that in virtually all scenarios external debt-to-GDP ratios decline, meaning the medium-term current account appears sustainable. The authorities' strategy of shifting from external to domestic borrowing will also help absorb excessive bank liquidity, provide assets to the private pension funds, and strengthen domestic capital markets. Nonetheless, as the public borrowing requirement has been constantly falling, total public debt is expected to decline from 41 percent to GDP in 2004 to less than 20 percent by 2010, while the foreign public debt is expected to fall to just about 13 percent.

In conclusion, while asking for completion of the first review, the authorities wish to express once again their gratitude to the Fund for providing surveillance and assistance, which have been helping Bulgaria to make progress in implementing the needed economic reforms, as well as during the preparation for the EU accession. The authorities are firmly committed to the policy framework under the current program and they believe its successful implementation will make the exit from Fund financial assistance a smooth one.