

Bulgaria: Request for Stand-By Arrangement—Staff Report; Staff Statement; and Press Release on the Executive Board Discussion

In the context of the Request for Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff report for the Request for Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on **December 13, 2001**, 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 February 12, 2002.** 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 **February 27, 2002** updating information on recent developments.
- a Press Release summarizing the **views of the Executive Board as expressed during its February 27, 2002 discussion** of the staff report that completed the review.

The documents listed below have also been separately released.

Letter of Intent sent to the IMF by the authorities of Bulgaria*

Memorandum of Economic and Financial Policies by the authorities of 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

Request for Stand-By Arrangement

Prepared by the European I and the Policy Development and Review Departments
(In consultation with other departments)

Approved by Carlo Cottarelli and Liam P. Ebrill

February 12, 2002

- In a letter to the Managing Director dated February 12, 2002, and the accompanying Memorandum of Economic Policies (MEP) (attached), the Bulgarian authorities request support in an amount equivalent to SDR 240 million (37 percent of quota) under the Stand-By Arrangement (SBA) for a new comprehensive economic program covering the period 2002–03. The SBA would succeed the three-year extended arrangement that expired in September 2001. Bulgaria's economic program is also supported by the World Bank, the European Union (EU), and other donors. The Bank is considering a series of Programmatic Adjustment Loans for 2002–05.
- In concluding the last Article IV consultation on March 23, 2001, Executive Directors commended the authorities for the turnaround in economic performance achieved under the previous EFF arrangement, but noted the scale of what remained to be done to create a dynamic market economy, reduce unemployment, and accede to the EU. They agreed that it would be vital for the authorities to maintain prudent macroeconomic policies and push firmly ahead with the structural reform agenda.
- This report is based on discussions held in Sofia during September, October and December 2001. The mission teams comprised Messrs. Schiff (head), De Broeck, Feyzioglu, and Fernandez, and Ms. Poirson (all EU1), Mr. Lehmann (PDR), and Ms. Salimi (assistant, EU1). Mr. Radev (OED) attended some of the discussions, and Ms. Sorsa, the resident representative, assisted the mission. The mission met with the Prime Minister, all key economic ministers, the Governor of the Bulgarian National Bank, parliamentarians, and representatives of trade unions and the private sector, and coordinated its work closely with the World Bank staff.
- The quality and timeliness of statistical reporting are generally sufficient for program monitoring and surveillance purposes, and efforts are being made to improve transparency and the observance of international standards and codes. STA technical assistance is addressing remaining deficiencies in price and labor market statistics. Since May 2000, the authorities have participated in the GDDS, and are taking steps toward subscribing to the SDDS. The ROSC binder covering a range of sectors was updated in March 2001.

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EXECUTIVE SUMMARY

- The authorities have requested a two-year stand-by arrangement, in the amount of SDR 240 million, or 37 percent of quota.
- Macroeconomic developments remain broadly favorable, although a rise in the external current account deficit is a concern. Real GDP growth is estimated to have moderated to about 4½ percent in 2001, as export growth decelerated with the slowdown in the European Union (EU) and the crisis in Turkey, and is projected to reach 4 percent this year. Inflation was low during 2001 at 4.8 percent and is expected to remain subdued this year. Competitiveness indicators remain adequate and the current account deficit, which increased to about 6½ percent of GDP in 2001, is projected to improve to below 6 percent in 2002-2003 as a result of a recovery in exports and lower oil prices.
- Bulgaria has established a good track record of macroeconomic stability in the context of a currency-board arrangement (CBA) supported by prudent fiscal policy. However, notwithstanding major structural reforms since 1997, progress in several areas has been slow, including in the energy and transportation sectors, administrative reform, and governance issues.
- The requested stand-by arrangement would be centered on the CBA, a continuation of prudent fiscal and incomes policies, and an acceleration of privatization and other structural reforms. The general government fiscal deficit is targeted at 0.8 percent of GDP in 2002, with a view to achieve a balanced budget in the medium-term. As a result, total public debt is projected to decline to less than 63 percent of GDP in 2003 from about 73 percent in end-2001.
- Key structural reform areas are: (a) accelerating privatization, including in the financial sector; (b) restructuring enterprises in the transportation and energy sectors and adjusting prices towards cost-recovery levels; (c) improving efficiency in the health care and education sectors to limit spending growth; (d) strengthening tax administration and improving budgeting and expenditure management; (e) developing further financial intermediation and strengthening prudential supervision; (f) continuing trade liberalization; and (g) improving the business environment and facilitating the creation of new enterprises.
- External risks to the program, albeit significant, are manageable. Bulgaria's external accounts appear most sensitive to the extent of the slowdown in the EU and the level of oil prices, and significant adverse developments on any of these fronts would require corrective policy actions to keep the external accounts in check. On the political front, the authorities will have to resist pressures to relax fiscal and incomes policies and slow down structural reform.

I. BACKGROUND

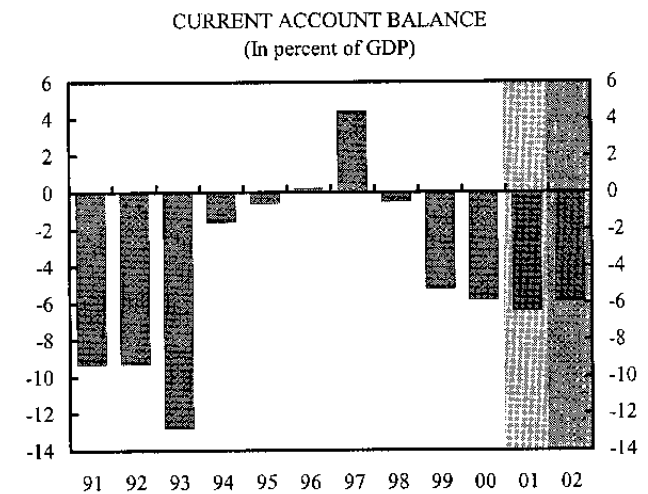
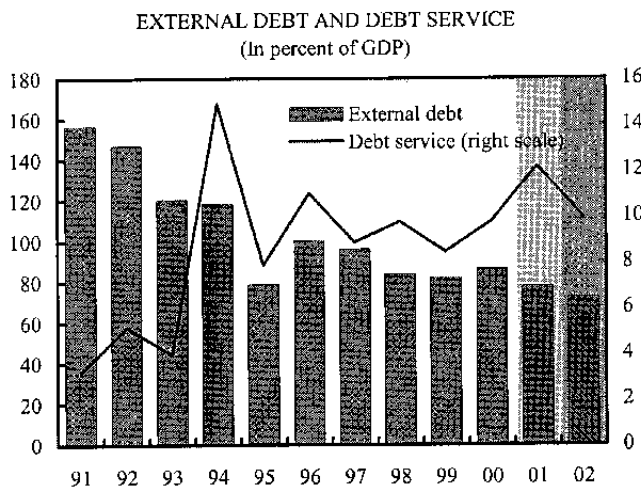
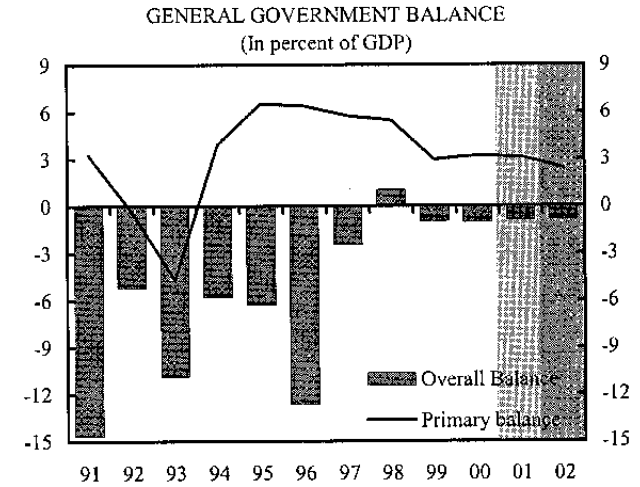
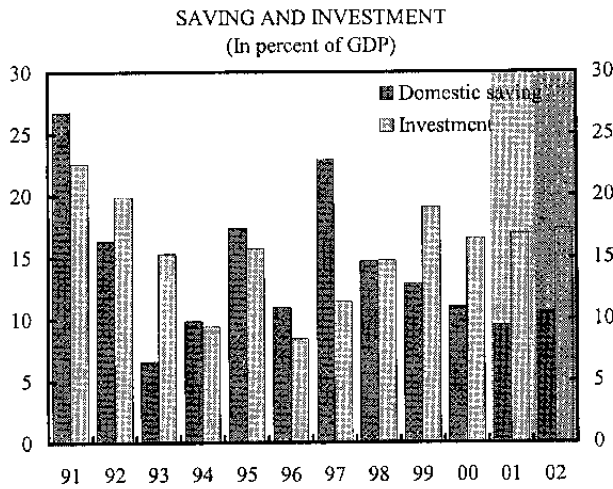
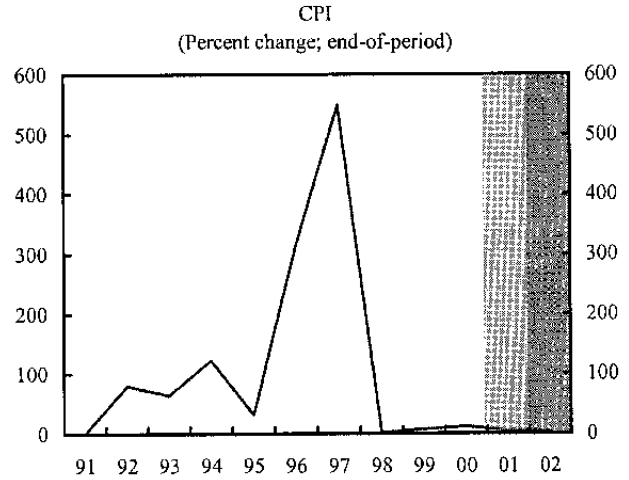
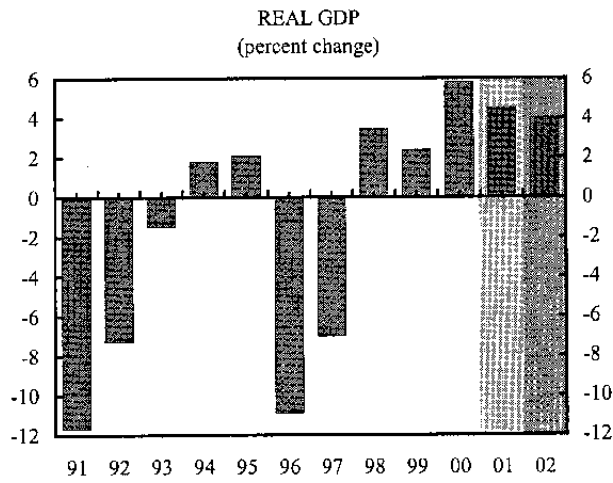
1. **Bulgaria started late its transition to a market economy, but has come a long way in four years thanks to sound macroeconomic policies and deep structural reforms.** During the early years of transition, progress in economic reforms was slow and macroeconomic policies erratic, leading to a severe financial crisis in 1996–97 (Figure 1 and Table 1). Since then, Bulgaria has witnessed significant structural changes in its economy, as most of the non-infrastructure enterprises and banks have been privatized or liquidated, trade and prices liberalized, bank supervision enhanced, and pension and health care reforms initiated. Macroeconomic stability was achieved and maintained through tight fiscal and incomes policies in the context of the Currency Board Arrangement (CBA) established in mid-1997. As a result of these policies, output growth has picked up from negative levels, led by investment and exports, inflation has declined to single digits from hyperinflationary levels, and the external debt-to-GDP ratio, near 100 percent in 1997, has come down rapidly. The EU recognized these achievements in its 2001 Regular Report, noting that Bulgaria has established a satisfactory track record of macroeconomic performance and is close to being a functioning market economy.¹

2. **Despite the overall positive performance, progress in several areas has remained slow.** In two key sectors, energy and transportation, reform efforts have been inadequate; governance issues have not been addressed effectively; and administrative capacity has not been strengthened sufficiently to implement fully the new legislative and regulatory frameworks. Lack of good progress in these areas required cuts in much-needed social spending and public investment to achieve the desired fiscal stance.

3. **GDP growth in 2001 is estimated to have moderated to about 4½ percent, owing to adverse external shocks.** After registering close to 6 percent growth in 2000, GDP growth in the first three quarters of 2001 eased to 4.7 percent, as export growth decelerated with the slowdown in the EU and the crisis in Turkey (Figure 2). Year-on-year volume growth of exports of goods and services stood at 12½ percent, compared with 24 percent in 2000. Imports, on the other hand, continued to grow at a strong pace (16½ percent), fueled by demand for raw materials and consumption goods. Domestic demand remained robust, led by strong investment, which surged 18½ percent. According to national account statistics, household consumption remained flat, although strong growth in imports of consumer goods, rapid credit growth to households, and positive increases in real wages suggest that

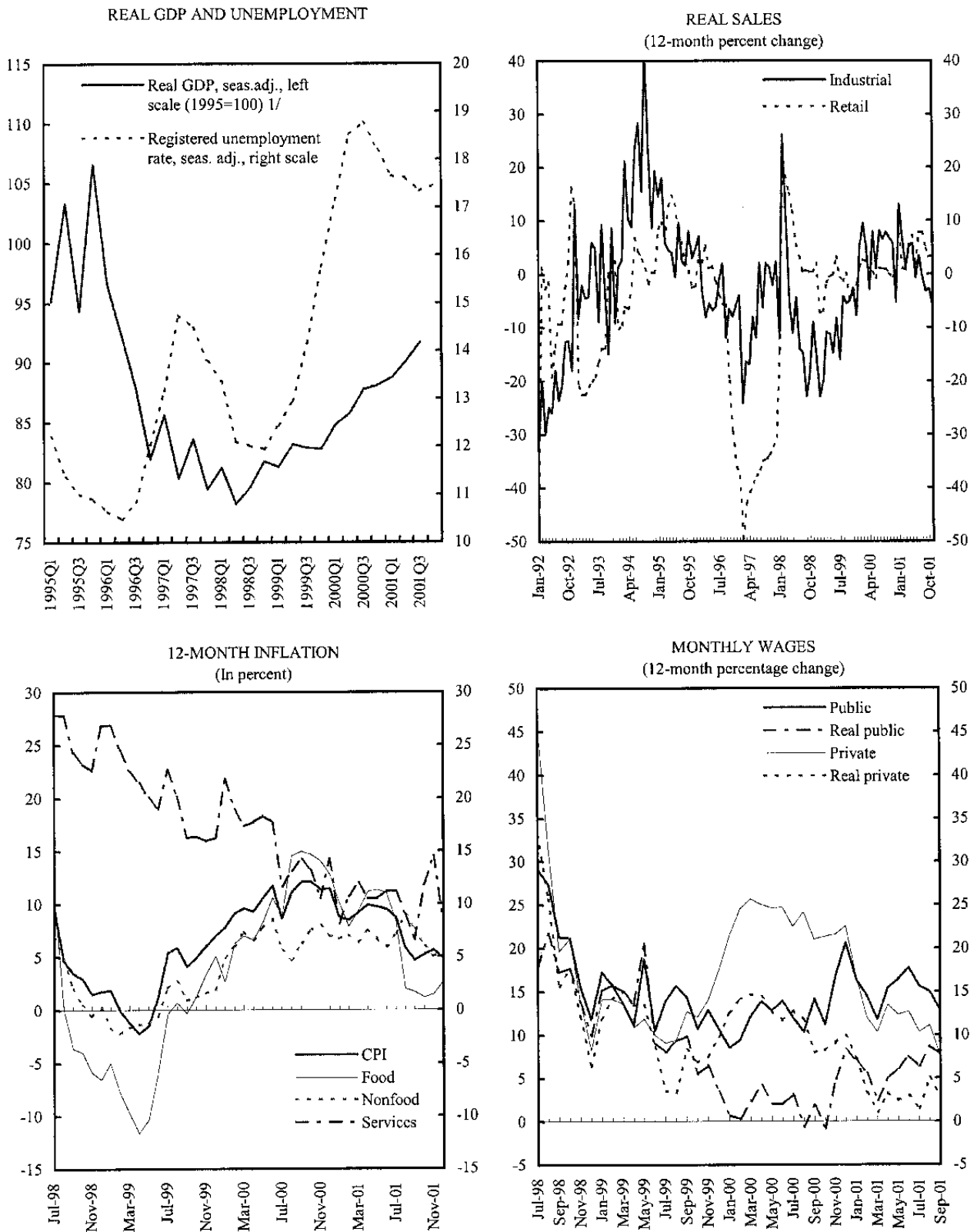
¹ In December 1999 the EU invited Bulgaria to start membership negotiations. So far 14 negotiation chapters have been closed out of a total of 27 opened.

Figure 1. Bulgaria: Selected Economic Indicators, 1991-2002 1/



Sources: Bulgarian authorities; and Fund staff estimates and projections.
1/ Data for 2001 are estimates; and 2002 are projections.

Figure 2. Bulgaria: Real Sector Developments, 1992-2001



Sources: Bulgarian authorities; and Fund staff estimates.

1/ In adjusting for seasonality, the impact of the 1997 crisis has been eliminated.

consumption figures could be revised upward.² On the supply side, growth continued to be driven mainly by industry and services. Available evidence suggests that growth eased further in the last quarter, as indicators of industrial production, export sales, and retail sales all slowed. Unemployment leveled off at around 18 percent in 2001, while real wages increased by 4½ percent in the first three quarters (Box 1 and Figure 3).

4. **Inflation remained subdued throughout the year.** Moderate price increases reflected a reversal of the previous year's surge in food prices, lower oil prices, and delayed adjustment in administered prices, including for energy. As a result, the 12-month inflation rate, after having peaked at 12.4 percent in October 2000, declined to 4.8 percent by end 2001.

5. **The growth in monetary and credit aggregates signals a further recovery in money demand and an improvement in lending to the private sector, in the context of a sound banking system** (Figure 4 and Table 2). The domestic currency component of M3 increased by 19 percent in real terms in the 12-month period to November 2001, evidence that confidence in the lev has been sustained. Lending to the non-government sector (excluding outstanding loans from non-operating banks) increased by 19 percent in real terms, a solid expansion, from a low base, on account of both consumer and enterprise credits. Banks remained profitable and well capitalized, and all major banks met or exceeded prudential regulations. Stress tests performed in the context of the recent FSAP suggest that the banking system is resilient to foreign exchange and interest rate risks, and can also absorb considerable credit risk.³

6. **The current account balance is estimated to have widened to 6½ percent of GDP in 2001** (Figure 5 and Table 3). The estimated deterioration of the trade account deficit from 10 percent of GDP in 2000 to 12 percent of GDP in 2001 is largely explained by the slowdown in exports of raw materials and in exports to Turkey and the EU.⁴ On the other hand, exports of light manufacturing, such as textiles and clothing, and tourism performed very strongly in 2001. The net impact of September 11 events on the current account is

² The authorities and the staff suspect that a part of household consumption could also have been misclassified as inventory buildup because of poor statistical sampling techniques, since the difference between the increase in inventories and what is implied by industry production and sales figures is implausibly high.

³ The findings and the recommendations of the Financial Sector Assessment Program conducted in the fall of 2001 are envisaged to be discussed in detail at the time of the Article IV consultation.

⁴ The EU and Turkey accounted for 51 percent and 10 percent of Bulgarian exports, respectively, in 2000.

Box 1. Recent Labor Market Developments

Overall employment declined by more than 10 percent during 1997-2001, as the large contraction in the public sector was not fully offset by gains in the private sector.

As a result, **the unemployment rate increased** from 14 percent to 18 percent over 1997–2000, before leveling off in 2001. Job creation in the formal private sector remained sluggish in part owing to the Russian crises in late 1998 and the Kosovo conflict in 1999, but also because restructuring lagged behind in many privatized companies sold to management-employee buyouts.

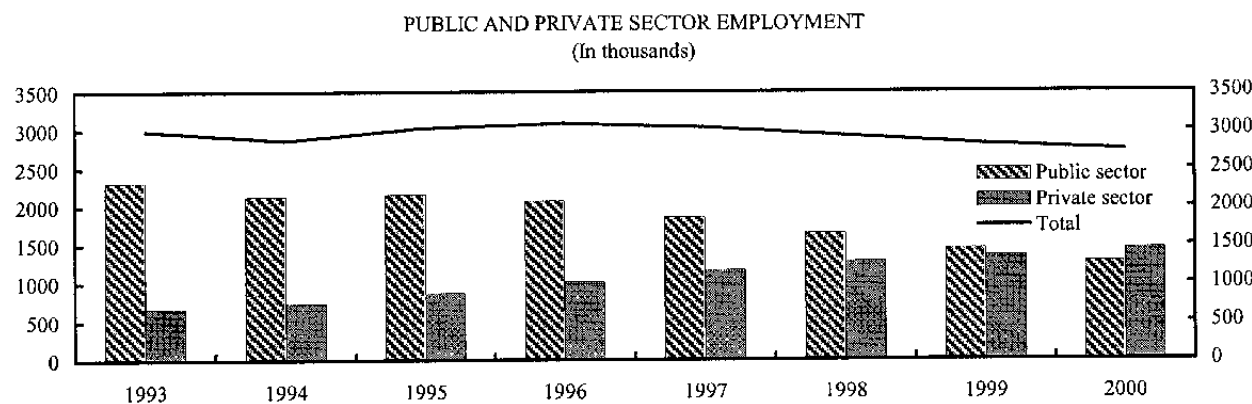
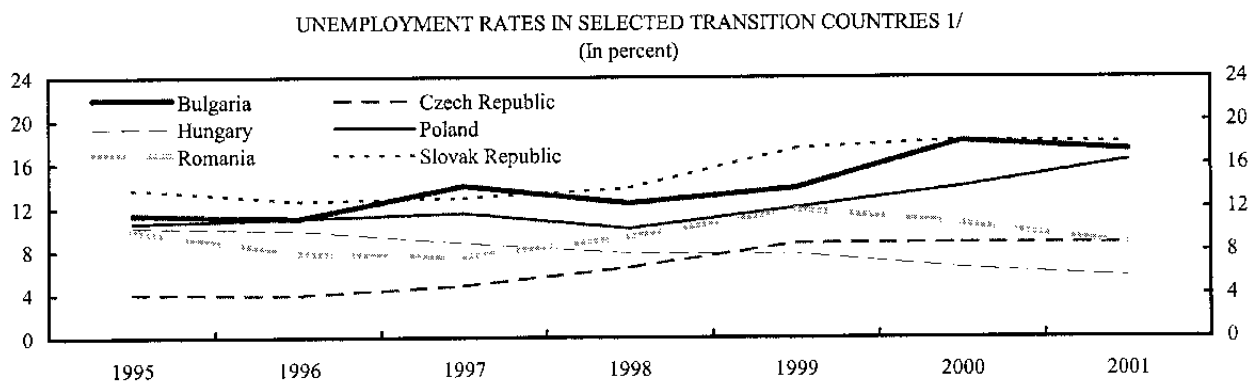
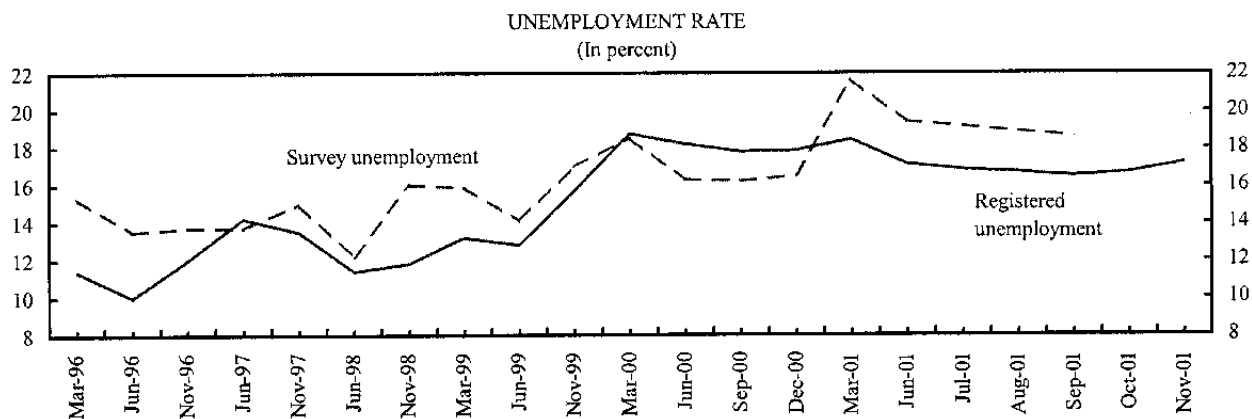
Unemployment affects disproportionately certain regions, the young and the unskilled. Also, **more than half of unemployed have been so for more than a year.** Higher unemployment rates for the unskilled as well as substantial long-term unemployment appear to reflect in part a mismatch between the skills of these groups and the needs of a growing private sector, while large regional disparities point to a lack of geographic mobility, owing in part to rigidities in the housing market.

Real wages have been on an upward trend since mid-1997. The increase appears to have been broad-based with cumulative gains of 57 percent and 42 percent in the private and public sectors respectively. However, real wages have not yet reached the level of the early 1990s.

The recovery in wages has contributed to a decline in poverty: According to the latest figures available from the World Bank, 12 [6] percent of the population lived below a poverty line of 2/3 [1/2] of per capita income in 2001 compared to 36 [20] percent in 1997. Still, poverty rates remained at more than double the level in 1995. Absolute poverty is comparable to that of Romania and Latvia—with about 6 ½ percent of the population living under US\$2.15 per day—but it exceeds the level in countries such as Hungary and Poland.

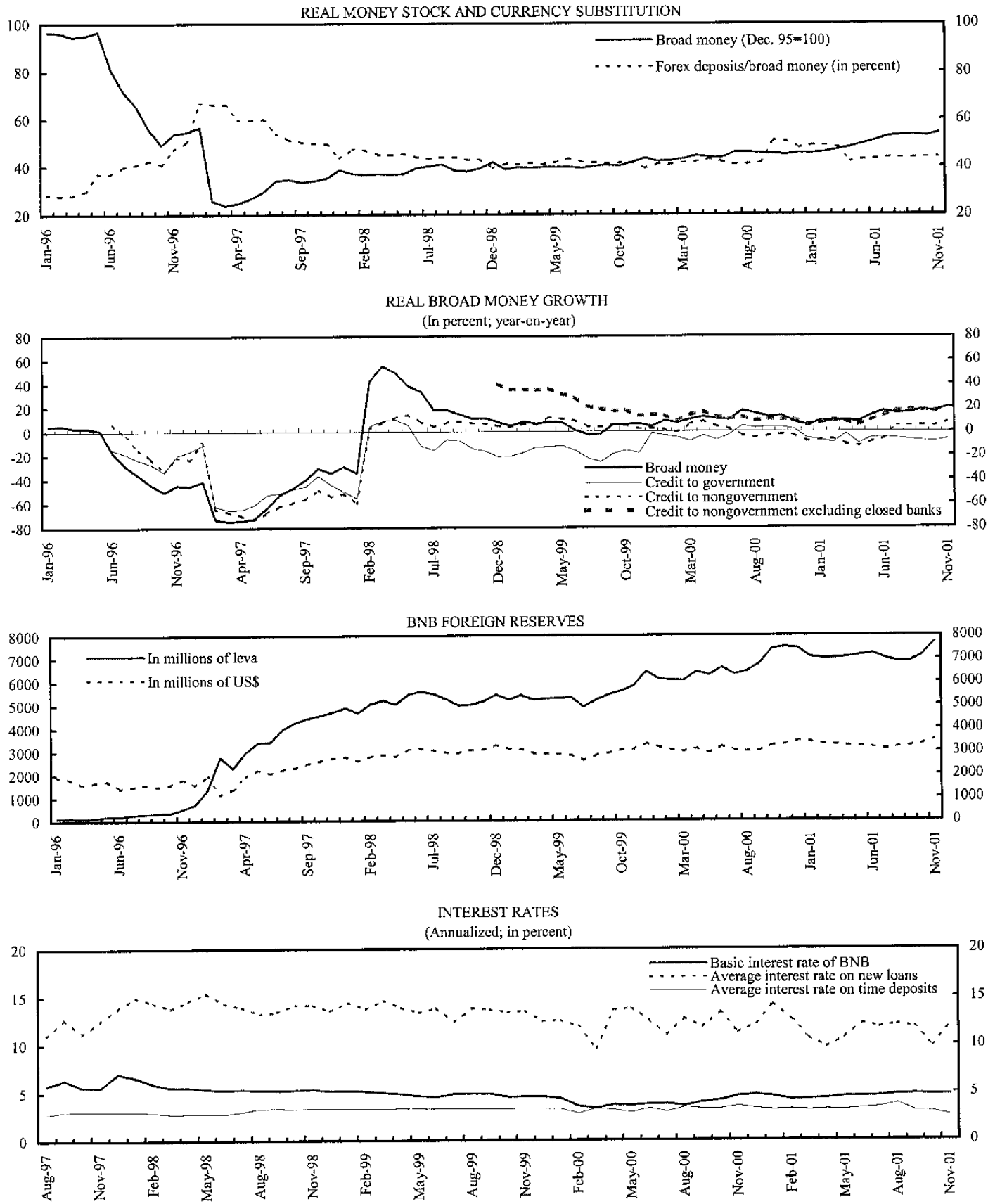
Notwithstanding recent steps to enhance labor market flexibility, some rigidities remain to be addressed. Amendments to the labor code approved in 2001 allowed for the termination of contracts for economic reasons, more flexibility in working hours, and reduced the cost of overtime work. However, procedures for collective redundancies remain rigid and require difficult coordination with the labor unions, representing an obstacle to firm-level restructuring. Also, wage setting remains largely negotiated at the national level, which appears inappropriate in light of the high and persistent regional unemployment differentials; and payroll taxes are still very high, which hinders job creation in the formal sector.

Figure 3. Bulgaria: Unemployment Indicators, 1993-2001



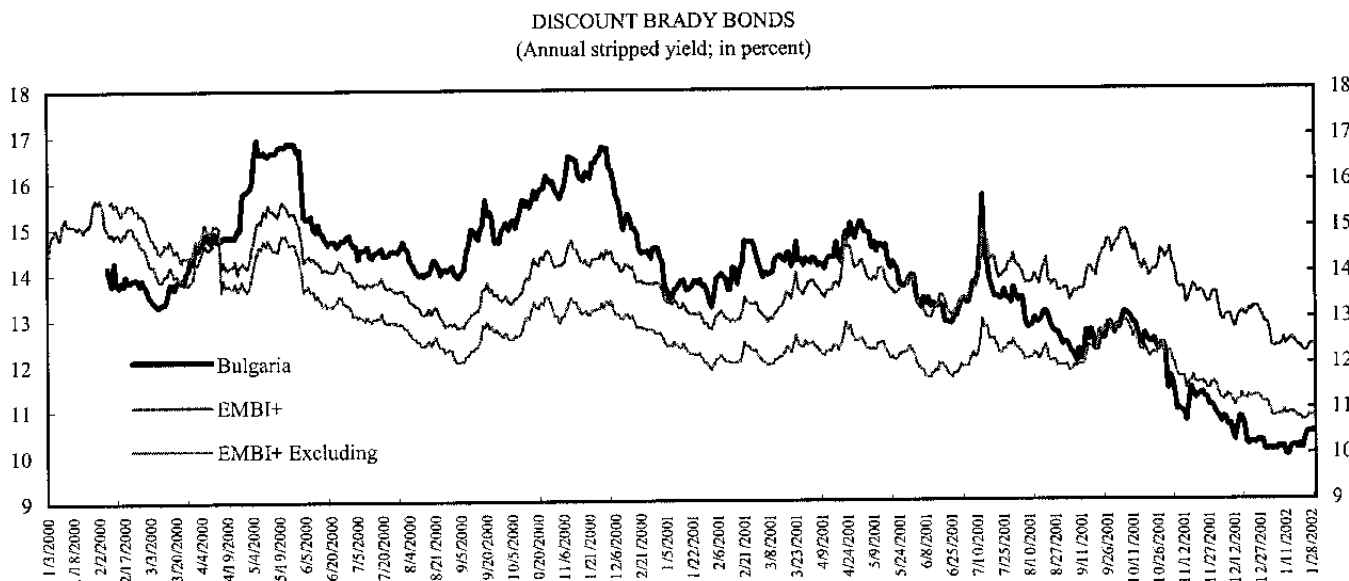
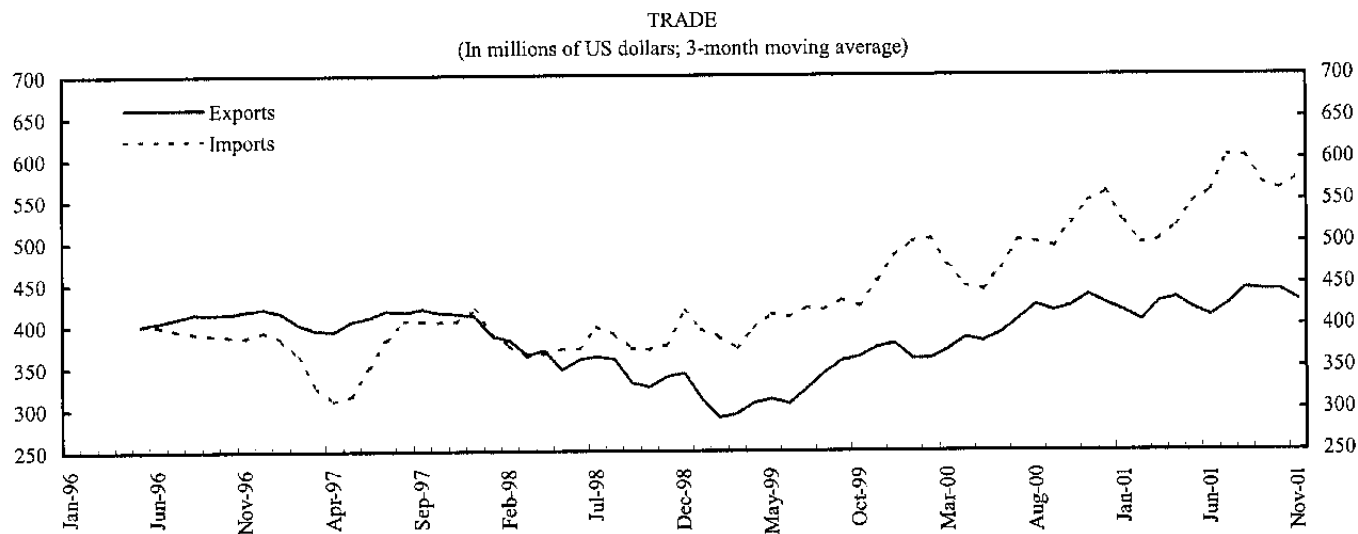
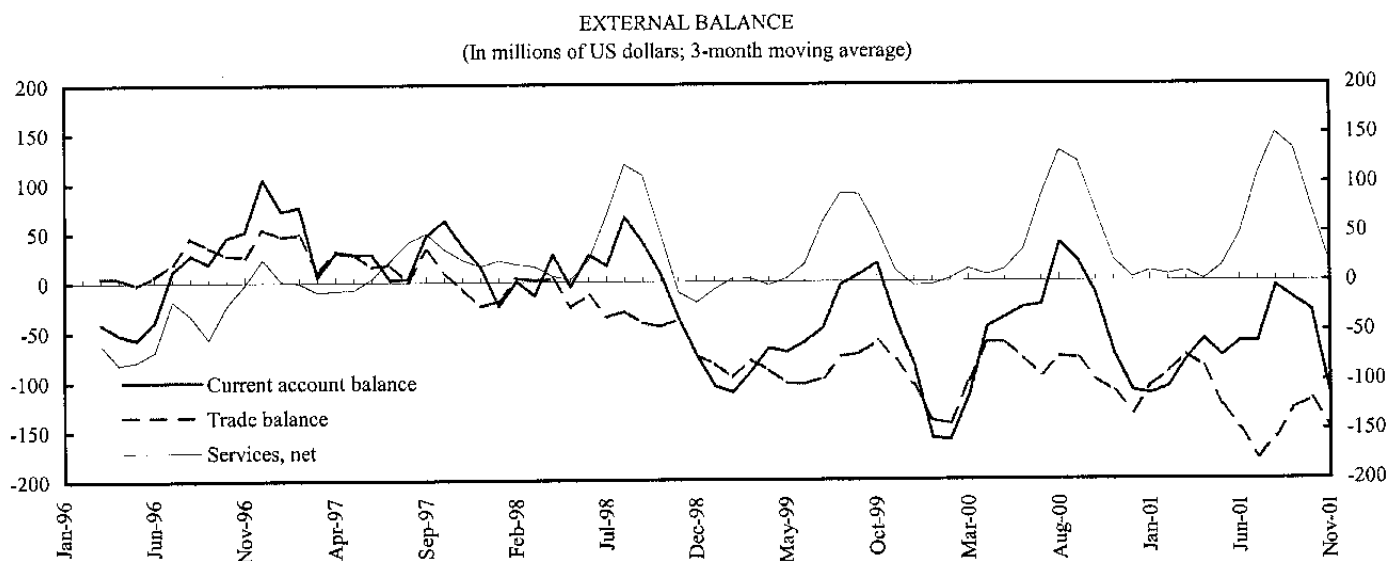
Sources: World Economic Outlook; National Statistical Institutes; OECD-CCET Labor Market Database on EU applicants; and Unicef.
1/ 2001 data are projections.

Figure 4. Bulgaria: Monetary and Financial Indicators, 1996-2001



Sources: The Bulgarian National Bank; and Fund staff calculations.

Figure 5. Bulgaria: External Sector Developments, 1996-2002



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

estimated to be limited, as the additional slowdown in export growth has been likely offset by the reduction in oil prices and lower world interest rates.

7. **In response to the deteriorating current account balance, and given the still high debt-to-GDP ratios, the authorities tightened the fiscal stance in the last quarter of 2001** (Table 4 and 5). Specifically, the government revised the annual deficit target to 0.9 percent of GDP from the budgeted 1½ percent of GDP. Achieving the revised target was difficult, as lower-than-expected interest expenditure was more than offset by overruns in subsidies and the election-related capital spending earlier in the year (with an estimated additional pressure of 0.5 percent of GDP on the deficit). Nevertheless, the authorities met their target by maintaining most discretionary spending at 90 percent of budgeted levels through the fourth quarter, avoiding starting up any new investment projects, postponing wage increases in the budgetary sector scheduled for October, and reducing the number of central administration employees by 10 percent in October. However, bowing to political pressures, the government extended a one-time payment of 20 leva (US\$10) per pensioner and increased transfers to municipalities to cover arrears, financed in part by moving forward to 2001 a part of the 2002 dividend payments of several profitable state-owned monopolies.

8. **The external position has remained under control:**

- **The current account deficit was fully financed, including through Bulgaria's debut Eurobond issue, leaving end-year reserves at an adequate level.** The combined capital and financial account recorded a surplus of US\$1.1 billion in the first 11 months of 2001 in spite of a slowdown in foreign direct investment. Despite delays in privatization, FDI covered about three-fourths of the current account deficit, allowing the external debt-to-GDP ratio to fall quite significantly to below 78 percent. In addition, the authorities issued a 250 million euro Eurobond with a maturity of 5 years and 3 months in November, noting their desire to maintain reserves levels and take advantage of lower interest rates. This issue, at 376 basis points spread over benchmark five-year German bonds, was oversubscribed. As a result, end-year reserves stood at US\$3.6 billion (or 4.8 months of prospective imports of goods and nonfactor services).
- **Contagion from Argentina and Turkey has been limited.** Spreads on Bulgaria's Brady bonds have been narrowing since the June election, reflecting prudent policies and markets' expectation of a more active debt management strategy. The collapse of the CBA in Argentina has not had any significant impact on this trend. There have been no discernable contagion effects on Bulgaria's domestic financial markets either, and financial fundamentals and indicators of external vulnerability remain comfortable (Table 6). Since November, Standard and Poor's, Moody's, and Fitch have upgraded Bulgaria's credit rating.
- **More fundamentally, Bulgaria's competitiveness remains adequate** (Box 2 and Figure 6).

**Box. 2. Indicators of External Competitiveness do not Expose Mis-alignments
Over the Last Few Years**

The real effective exchange rate has continued its upward trend over the last 3 years (Figure 6), showing about 9 percent appreciation since early 1998, or about 2.4 percent per year. Previous work on this issue has shown that the largest part of this real appreciation can be explained by the more rapid productivity growth in the tradables sector (the Balassa-Samuelson effect). Moreover, real appreciation in Bulgaria was shown to be in line with that observed in other countries in the early stages of the transition process.¹

Since 1998, local currency unit labor costs have remained stable (third chart in Figure 6). Over this period the weakness of European currencies vis-à-vis the U.S. dollar has implied a fall in ULC in euro terms by 15 percent in the two years to September 2001. This compares favorably to other eastern European countries, which have predominantly shown increases in euro unit labor costs in the four years since 1998.²

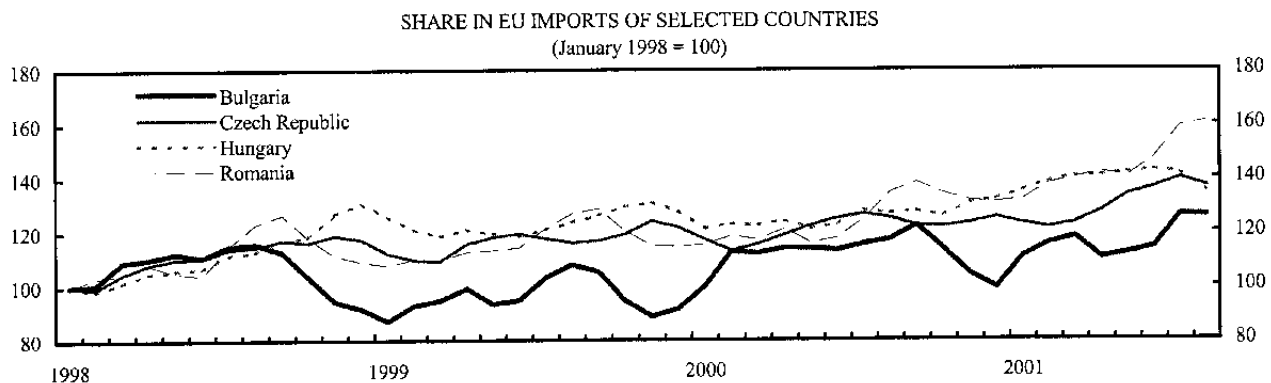
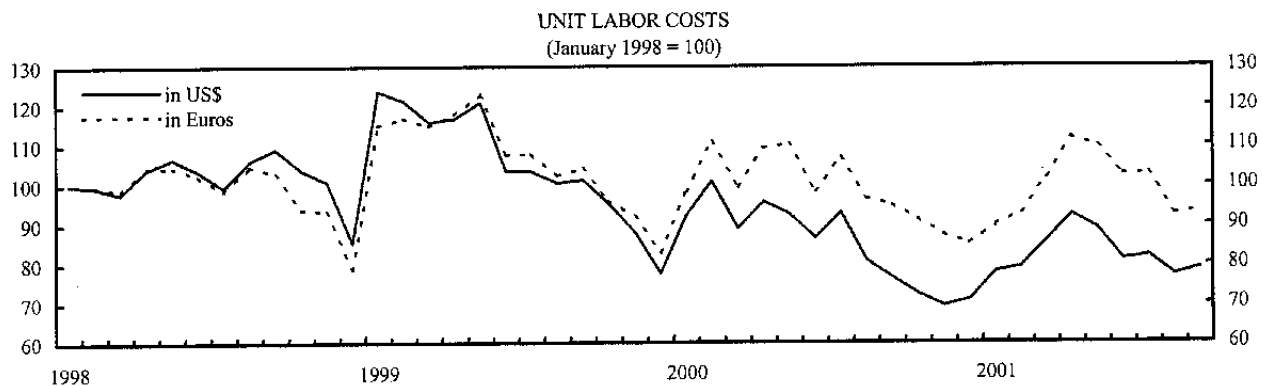
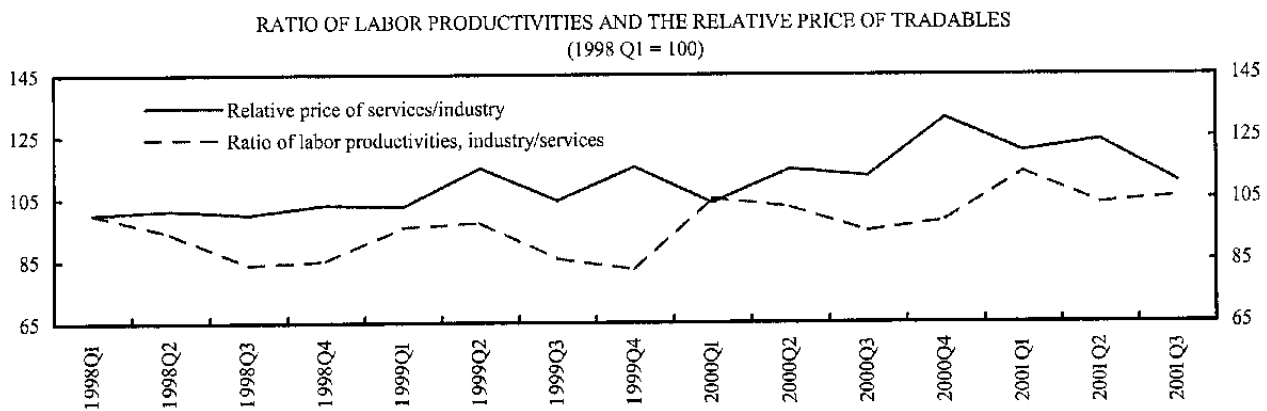
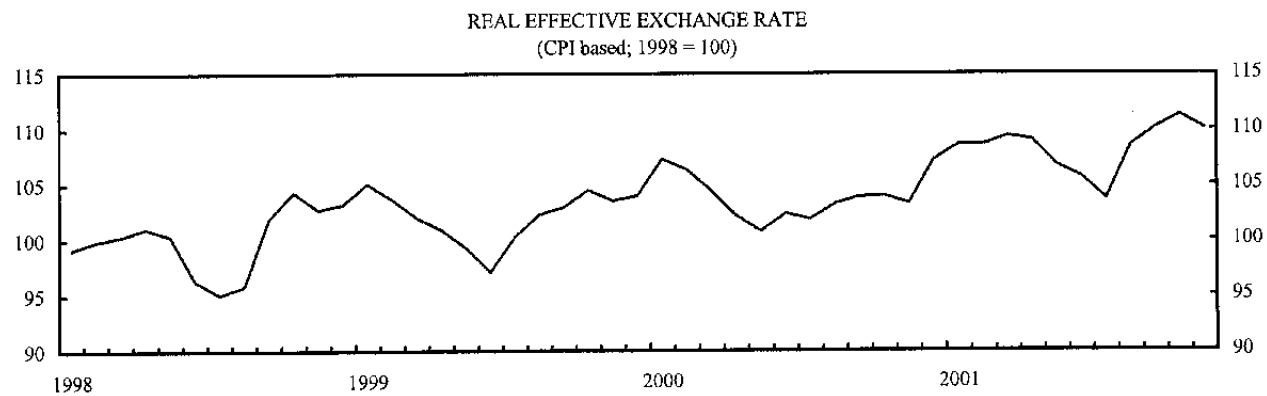
However, gains in export market shares have been modest, underlining the need for further structural reform. Export performance has been held back by the disruption of transport links in the region during the Kosovo crisis of 1999, and the delays in attracting export-oriented foreign direct investment. Over the last two years performance in EU markets has been markedly better, with export values growing by about 1.2 percent for every one percent increase in EU import demand. By comparison, between mid-1997 and mid-1999 almost no market shares were gained. Also, Bulgarian exports are now more diversified, and the share of consumer goods exports has grown at the expense of the traditional exports of raw materials. The dollar value of textiles and clothing exports, for instance, is currently growing at nearly 30 percent year-on-year, most of which facilitated by European enterprises which have sub-contracted to Bulgarian producers or established their own facilities within Bulgaria.

In a recent survey of businesses in Bulgaria respondents viewed the exchange rate as appropriately valued but argued that regulatory obstacles still impede a better performance in export markets. Specifically, respondents highlighted that starting a new business is “extremely difficult, time-consuming, and accompanied by a lot of red tape”. Also, the legal system was regarded as inadequate and making it difficult to contest government decisions, and to resolve and adjudicate disputes between private parties. Further, the difficulties in obtaining credit, and the poor enforcement of customs regulations were pointed out.

1/ See SM 00/61: *Bulgaria: Selected Issues and Statistical Appendix*, March 2000.

2/ EBRD: *Transition Report 2001*, London: EBRD.

Figure 6. Bulgaria: Indicators of Competitiveness, 1998-2001



Sources: National Statistical Institute; and Fund staff calculations.

9. **Despite the overall positive performance, several short-term risks and major reform challenges remain.** In the short-term, slower-than-projected EU growth, a reversal of the oil price decline, or insufficient foreign direct investment would increase external risks, requiring vigilance in policies to maintain macroeconomic stability. Over the medium term, Bulgaria needs to reduce unemployment and poverty, which remain above first-tier EU accession countries. Also, to achieve a fully functioning market economy and enhance competitiveness, Bulgaria needs to remove key structural obstacles—such as inefficiencies in the enterprise sector, a low level of financial intermediation, a burdensome bureaucracy, and corruption.

10. **The new political constellation also poses risks.** The new government—a coalition formed after the June 2001 parliamentary elections, led by a new political movement headed by the former king Simeon the Second Saxe-Coburg Gotha, and with key members inexperienced in politics—has lacked full cohesion. Moreover, public impatience has escalated as a result of the government’s inability to deliver on its campaign pledge to cut taxes and increase social spending while balancing the budget, and the general view that gains of the last four years have not been broadly shared. This impatience was manifested in the November-December presidential elections, when the socialist candidate, who supports higher social spending and a more lax fiscal policy, was elected. Nevertheless, the government seems to have strong ownership of the economic program, and up to now has been able to pass key legislation, including the 2002 budget as agreed with the Fund staff, key amendments to the Energy Law, and a new Privatization law.

II. THE AUTHORITIES’ ECONOMIC PROGRAM

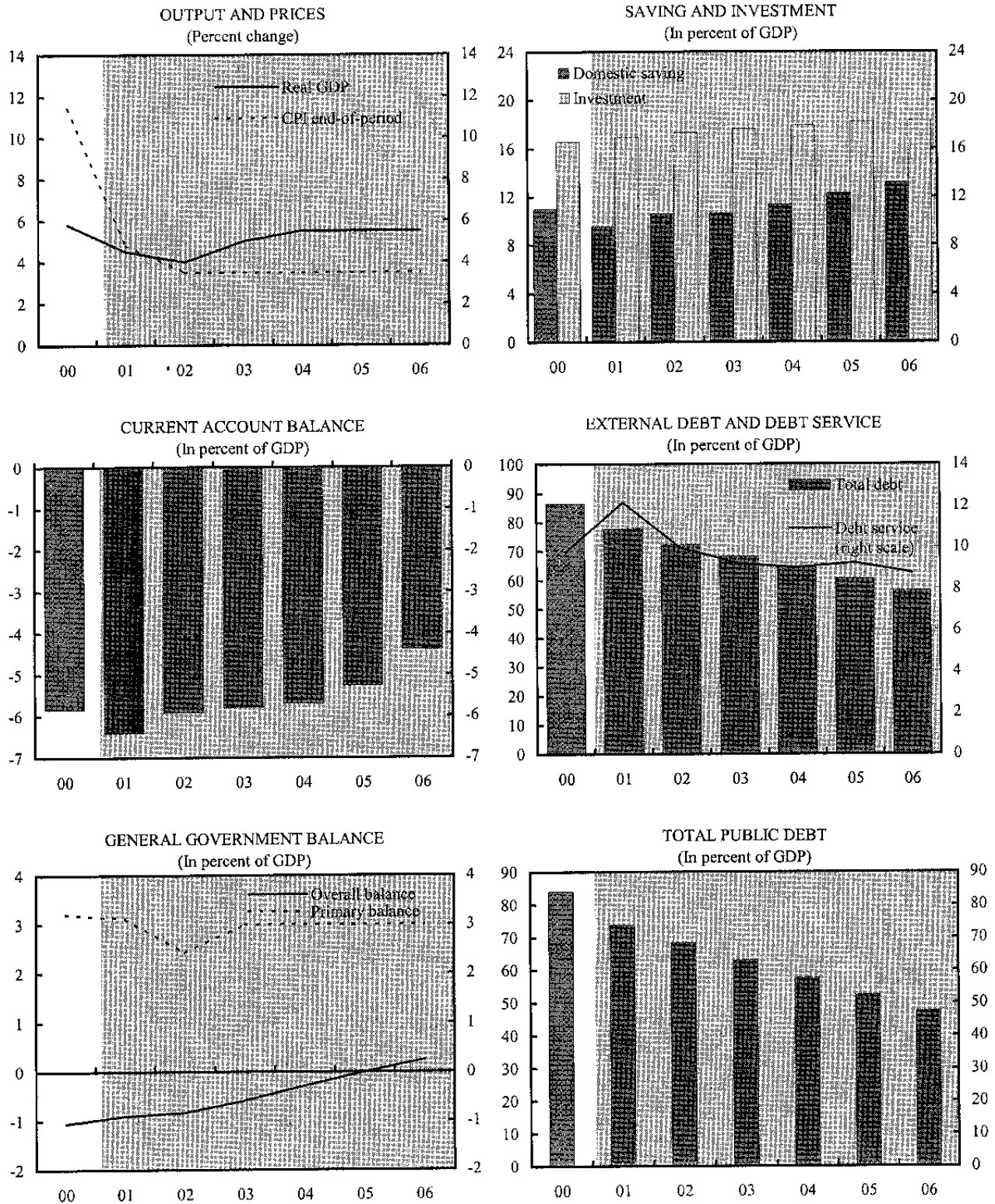
A. Policy Framework and Macroeconomic Objectives

11. **The authorities’ overall strategy to address the challenges is to continue with prudent fiscal and incomes policies in the context of the CBA, and complete the structural reform agenda (§4).**⁵ The authorities consider the CBA, which provides a stable nominal anchor and the discipline to maintain tight fiscal and incomes policies, as the cornerstone of macroeconomic stability. The authorities are complementing these policies with an acceleration of structural reforms—including in the financial sector, labor markets, enterprise sector, and trade. These reforms aim to allow scarce resources to be increasingly channeled to sectors with higher value-added and achieve a fully functioning market economy, with a view to promote job creation, improved productivity, and ultimately high quality growth.

12. **These policies underlie the authorities’ ambitious macroeconomic framework, targeting strong growth, low inflation, and declining current account deficit and public and external debt-to-GDP ratios (§5–6, Figure 7 and Table 7).** While the slowdown in

⁵ ¶ Denotes the paragraph number in the accompanying MEP.

Figure 7. Bulgaria: Medium-Term Projections, 2000-2006



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

external demand in 2001 is expected to spill over to early 2002, lowering the growth rate to 4 percent, in 2003 output growth is expected to accelerate to above 5 percent and remain there in the medium term, led by strong investment and export growth. The required increase in productivity would come not only from factor accumulation but also from more efficient allocation of resources. Higher investment is expected to be financed increasingly by domestic private saving, which should rebound from the low level of 2001 with income growth, more effective financial intermediation, and a continued conservative fiscal stance, and reach levels now observed in more advanced central European transition countries in the medium term. The external current account deficit is targeted to decline to below 6 percent of GDP in 2002-03 as exports recover, and average world oil prices decline.⁶ Over the medium term, the current account deficit is expected to remain below 5 percent of GDP, and would be fully financed by FDI. This would allow the gross external debt-to-GDP ratio to decline from 78 percent in 2001 to 68 percent by 2003, and reach around 56 percent by the middle of the decade. These improvements in the external accounts would create room for the foreign reserve coverage to remain at adequate levels. Inflation is projected to exceed that observed in Bulgaria's trading partners only to the extent implied by Balassa-Samuelson effects and further adjustment of administrative prices toward market-based levels.

B. Fiscal Policy and Fiscal Structural Reforms

13. **The authorities' medium-term fiscal plan supports the CBA and promotes output growth** (§7). The authorities are committed to lower the budget deficit gradually from the targeted 0.8 percent of GDP deficit in 2002 to balance over the medium term, with a view to reduce pressure on the external accounts, allow savings to be channeled to private investment, and decrease the public debt-to-GDP ratio. Within this framework, the authorities are keen to continue to lower taxes on labor and capital while broadening the tax base and enhancing tax administration. Non-interest expenditure is envisaged to remain at around 35 percent of GDP, as an increase in the efficiency of spending would help accommodate a stronger social safety net, a proper level of public investment, and EU and NATO accession related spending.

Fiscal policies in 2002-03

14. **The 2002-03 fiscal stance is fully consistent with macroeconomic stability.** In 2002, while the overall deficit is targeted to decline, the primary surplus would be reduced from 3.0 percent of GDP in 2001 to 2.4 percent of GDP in 2002.⁷ This is consistent with the operation of automatic stabilizers in response to below-potential growth triggered by external

⁶ The rebound in export growth reflects a projected turnaround in EU import growth in the second half of 2002, and firmer prices for key exports, including metals.

⁷ About 0.2 percentage point of GDP is accounted for by social security contributions to the new fully-funded pension pillar, which would increase private saving by an equal amount.

shocks, but will not threaten external sustainability, in particular in light of the sharp decline in foreign interest payments. In 2003, the primary surplus is expected to return to around 3 percent of GDP as growth is expected to recover, and the positive impact of fiscal and structural reforms taken in 2002 have their full effect. However, as external current account deficits projected for 2002–03 remain large and the considerable uncertainty surrounding external economic and financial conditions is likely to continue in the short term, the authorities are prepared to move to a tighter fiscal stance, should the external current account deficit threaten to be wider than projected (§8).

15. **The 2002 budget achieves a good balance between the need to lower tax rates and increase social spending within the budget deficit limit.** The authorities have lowered corporate and personal income tax rates, partly offset by broadening the tax base and adjusting excise tax rates toward EU levels (§8-11).⁸ These measures and lower output growth are expected to reduce total revenue by 1 percentage point of GDP. Concurrently, the authorities have increased spending to strengthen the social safety net, while lowering other expenditure outlays through reforms in the fiscal and real sectors, leading to an expected 0.6 percentage point of GDP decline in non-interest spending.

16. **While the 2002 budget can be successfully implemented, it will require sustained efforts in carrying out structural reforms.** The budget is based on realistic macroeconomic assumptions, and does not assume major improvements in tax administration. However, staff cautioned the authorities that structural reforms—including in health care, education, energy, and railways—have to be implemented strictly to increase efficiency in these areas and limit growth in spending on wages, subsidies, and operations and maintenance. Achievement of the fiscal targets would also be aided by continued improvements in tax administration, notably progress in the establishment of a unified revenue agency and customs.

17. **The authorities will continue to implement flexibly the budget to be able to respond to shocks (§8).** They will limit discretionary spending in the first three quarters of 2002 to 90 percent of their allocated levels, and will refrain from committing the contingency funds until external risks decline. These policies would provide potential flexibility of about 1 percentage point of GDP. In addition, conservative estimation of interest payment expenditure and nontax revenues also provides a buffer, despite the forwarding to 2001 of a part of the dividend payments of several state-owned monopolies.

18. **The 2002 tax measures are designed to reduce the distortionary effect of taxation and support an enhanced business climate (§9–10).** The authorities have reduced corporate and personal income tax rates, lowering the corporate tax rate below the average for the first-tier accession countries and the personal income tax rate below those in most central European transition countries. The authorities decided to forgo their campaign promise to

⁸ The savings are largely “locked in” as interest payments on the Brady bonds, which are due in January and July, depend on LIBOR with a six-month lag.

introduce a zero corporate tax rate on reinvested profits, as the staff argued that the effect on investment would be limited relative to the lost revenue (on the order of 2 percent of GDP), and would favor large, mainly state-owned enterprises over small and medium sized enterprises and market entrants. Regarding indirect taxes, the uniformity of Bulgaria's VAT regime is a key strength, and the authorities put in place a mechanism to eliminate fully within three years the one remaining exception, the zero VAT rating on tourist packages sold abroad. In addition, the authorities increased excise duties toward the EU levels, and raised presumptive taxes and other taxes and fees, in large part to adjust for accumulated inflation.

19. Non-interest expenditure will be maintained at about 35½ percent of GDP in 2002, in line with the medium-term fiscal framework (¶11-12). Subsidies to the district heating companies and the state railway company will be limited to levels below those extended in 2001 reflecting saving from implementing restructuring plans for these two sectors, and operations and maintenance expenditure will be lowered significantly, reflecting the ongoing improvements in the efficiency of government operations. The budget sector wage bill will be reduced by 0.2 percent of GDP, as a 7½ percent average wage increase will be offset by a reduction in overstaffing. These spending cuts make room for some increase in social spending, including for the guaranteed minimum income and the targeted energy benefit. The authorities are also doubling the child allowances, while switching from a universal benefit to a scheme that targets the low-income households. Public investment will remain broadly at last year's levels, but its composition will shift toward projects related to EU accession.

Fiscal structural reforms

20. To secure medium-term fiscal viability, the authorities are—in consultation with the World Bank—advancing the reform of the pension system and the health care and education sectors (¶13). Regarding the pay-as-you-go (first pillar) pensions, with the recent reforms, the system is becoming viable, but the authorities are ready to make necessary changes in the parameters should the long-term viability of the system be jeopardized. The second pillar (mandatory fully-funded pension insurance), launched in the beginning of 2002, currently receives 2 percentage points of social security contributions, which is not sufficient to guarantee adequate retirement income in the face of fixed costs of pension funds. The authorities are thus committed to raising the contributions to the second pillar to 5 percentage points by 2007. In the health care sector, the key fiscal challenge is to arrest subsidies at budgeted levels of 1.4 percent of GDP, while improving the quality of hospital care. With the help of the ongoing accreditation process, the authorities intend to privatize or close approximately 10 percent of the hospitals, shifting resources to health care institutions that provide high quality services and reducing excess capacity inherited from central planning. The education sector is also replete with overcapacity, and maintains one of the lowest student-teacher ratios in the world. The authorities aim to reduce costs, while maintaining enrollment levels and education quality, by merging schools and reducing the number of teachers by about 10 percent. This plan will have a significant impact on maintenance and operations expenditure and the wage bill, as teachers' wages account for about half of the total wage bill in the budget.

21. **The government is imposing hard budget constraints on municipalities to end the accumulation of arrears that has occurred in recent years (¶13).** Changes made in the 2002 budget align better the revenues guaranteed by the state and the expenditure commitments of the municipalities mandated by the state. Also, the government committed itself to reverse the practice of the last three years, and not cover losses stemming from excess spending at the municipality level.

22. **The authorities are keen to continue with administrative reforms that would improve revenue collection and enhance budget preparation and execution (¶14).** Improving revenue collection is indispensable to limit the revenue loss from the ongoing tax cuts and to cope with the additional medium-term spending pressures. To this end, the authorities are establishing a unified revenue agency (URA), which will strengthen collection of taxes and social security contributions, and taking steps to enhance the customs administration with the help of external consultants. To focus more on the composition and efficiency of spending, the authorities are, with assistance from the Fund, strengthening the budget preparation process. The improvements in the process are expected to allow priorities to be identified at an early stage, underlying projections to be based on a solid foundation, and decisions to be made in a transparent manner. Bulgaria's treasury is functioning well, and improvements based on a well-defined agenda are continuing.

C. Labor Market Policies

23. **The incomes policy for the state enterprise sector and the minimum wage policy remain keys to guiding wage formation and improving the financial situation of state-owned enterprises (¶16).** The 2002 incomes policy closely links wage increases with financial performance and is expected to limit wage growth (for the 60 closely-monitored enterprises that have largest losses and arrears, are monopolies, or receive subsidies) to 2 percent in 2002. Regarding the minimum wage, the authorities increased the rate by 17 percent in October 2001 to about 35 percent of the average wage, arguing that it was a one-time adjustment to bring the minimum wage more in line with other wages in the economy, and that it would also help strengthen social security contributions. They envisage no increase in 2002, and are ready to link further increases to the average public wage increase.⁹ The staff noted that such a rise in the minimum wage was not appropriate in light of continuing high unemployment, and that Bulgaria could not afford to repeat such large increases. The staff welcomed the authorities' intention to link future increases to public sector wages, noting that such practice would help de-politicize the process.

24. **The program envisages measures to improve further the functioning of the labor market to bring down unemployment and safeguard the CBA (¶17).** Already in 2001

⁹ While a link to economy-wide wages would normally be more appropriate, the authorities prefer to link the minimum wage to public sector wages, owing to problems with correctly identifying wages in the private sector.

positive steps were taken to improve the flexibility of the labor market, including allowing for dismissals for economic reasons, reducing the cost of overtime work, and increasing the flexibility in working hours. Noting the high unemployment rate, the authorities are ready to amend the Labor Code, in close cooperation with social partners, to lower the cost of hiring and dismissing. Besides these market-based measures, the authorities are enhancing active labor market policies, for which more funds are allocated in the 2002 budget. The programs increase the incentives to hire long-term unemployed and train workers to acquire new skills. The authorities are also supporting a small program—with funds worth 20 million leva—that guarantees loans to small and medium sized businesses in regions of high unemployment.

D. Financial Sector Policies

25. **The authorities are committed to developing further financial intermediation and strengthening prudential supervision to support sustainable credit growth** (§8). Credit to the private sector, long-term investment credit in particular, remains limited in the wake of the 1996–97 financial crisis. Against this, the authorities are moving to accelerate the privatization of remaining banks and other financial institutions (§19). In particular, they are redoubling their efforts to sell Biochim, the finalization of which would increase the share of private banks in Bulgaria to more than 90 percent. However, the authorities have not firmed up their plans regarding the sale of the last large public bank, DSK (State Savings Bank). The staff encouraged the authorities to expedite the sale of this bank, but cautioned that, given the size of the bank and the social role it plays, it is important that it is sold to a high quality strategic investor. Besides privatization, the authorities are taking measures to eliminate structural barriers to credit, including a lack of quality credit information and accounting data, weaknesses in corporate governance, and uncertainties in the enforcement of creditor rights (§20). To stimulate long-term credits, the authorities are excluding long-term deposits, which are a small fraction of total deposits, from reserve requirement. Both the authorities and the staff recognized that, while the banking supervision meets many international standards, the hoped-for pickup in private sector credit requires the authorities to be in a position to strengthen further oversight to ensure the soundness of the financial system. To this end, the authorities agreed to implement recommendations of the FSAP (§21), which include increasing further the supervision powers of the Bulgarian National Bank (BNB) through legislative changes and capacity buildup, strengthening the supervision of insurance companies, pension insurance companies, and pension funds, and adopting legislation to improve the process of handling insolvent banks.

E. Other Areas of Structural Reform

26. **The reform agenda in the enterprise sector is key to the authorities' plan to create a fully market-oriented and competitive economy.** Of about 2,000 SOEs, more than half are loss makers or have arrears to the budget, the National Social Security Institute, workers, or suppliers. The authorities are keen to complete the privatization of the SOEs in a transparent manner within two years, and eliminate preferences for management employee buy outs to attract high-quality strategic investors. They have already taken an important step in this direction by passing a new Privatization Law (§22–23). Regarding the state railways

company, for which there are no privatization plans in the short term, the authorities are continuing with the restructuring—designed with assistance from the World Bank—to have the company function on a commercial basis. These efforts would not only improve efficiency, but also reduce budgetary transfers. In addition, the authorities have stepped up their efforts to improve the functioning of the markets and the business climate, including by amending the commercial code and training judges to reduce the costs of starting and operating a business, improving liquidation and bankruptcy proceedings, and enhancing governance.

27. **The authorities are committed to accelerating long-delayed reforms in the energy sector.** The authorities' sectoral strategy aims to increase the efficiency of the energy sector and reduce the direct and indirect subsidies from the budget (SM/01/89). Within this strategy, selected amendments to the Energy Act, in particular those related to the rehabilitation plan for the district heating sector were approved by parliament in the fall of last year. Other pending amendments would be incorporated in a new Energy Act, which would be prepared by mid-2002 and reflect the government's intention to further liberalize the sector and bring the energy legislation in line with EU directives (§25). In addition, the authorities will make a new regulatory pricing regime fully operational, and announce a concrete timetable to bring household tariffs to cost-recovery levels to send the right market signals to investors and households.¹⁰ However, in view of the social consequences, full cost recovery will be reached only gradually, and in tandem with an increase in targeted social assistance. The authorities are also taking steps to restructure the gas sector, the coal mines, and the district heating companies, including by reinvesting in infrastructure in regions where district heating is viable (§26).

F. External Sector Policies

28. **The authorities are continuing the process of trade liberalization.** Bulgaria scored a 2 in the Fund's trade restrictiveness index, has numerous free trade agreements, and is already committed to granting free trade in industrial products with EU countries this year. However, the number of tariff rates and bands, special provisions for specific products, and seasonal and mixed tariffs are high, and the unweighted average most favored nation (MFN) tariff rate is twice that in the European Union. The authorities are committed to take a number of measures to reduce these distortions, including by adopting a schedule of tariff reductions that would lower the MFN rate to the EU level over four years (§27). However, the authorities were reluctant to reduce the number of tariff bands, arguing that the number of tariffs would need to be increased once Bulgaria joins the EU.

29. **The authorities are pursuing a more active debt management strategy.** Within the overall objective of lowering the public sector debt-to-GDP ratio without unduly drawing

¹⁰ Preliminary information indicated that current household electricity and district heating prices fell short of cost-recovery levels by up to 50 percent.

down the level of the Fiscal Reserve Account (FRA), the authorities are reducing the floating and dollar component of the debt stock—primarily Brady bonds—and establishing benchmarks for international and domestic yield curves (¶28). The staff welcomed these efforts, noting that they are geared toward reducing the portfolio risk, but cautioned the authorities about the tradeoff between meeting these objectives, primarily by issuing new Eurobonds, and reducing the maturity structure of total debt, as Brady bonds have very long maturities. The authorities may issue a Eurobond this year with a view to use the proceeds for the purchase of outstanding bonded debt, provided the Bradys are trading at an acceptable discount. The authorities are committed to maintaining a high level of assets in the Fiscal Reserves Account (FRA), at least 90 percent of next year's gross public debt service requirements.¹¹ This policy will leave sufficient room for flexible liability management, while providing contingency against fiscal risks. The authorities are also committed to increase the transparency of the operations by making broad-based information—including the medium-term debt service payments schedule—publicly available on a timely basis (¶29).

III. MEDIUM-TERM SUSTAINABILITY AND CAPACITY TO REPAY THE FUND

30. **The medium-term balance of payments projections indicate a modest financing gap of US\$300 million over the program period** (Table 8). The medium term balance of payments shows a gradual improvement in the current account deficit, driven by tourism revenues and continued modest gains in export market shares. However, a financing gap of about US\$150 million is projected to emerge in both 2002 and 2003, reflecting the need to keep net international reserves at a minimum unchanged in the face of an uncertain external and financial environment and to meet a peak in net repurchases of Fund credit.

31. **Debt and reserve related indicators do not expose external vulnerability at present.** The ratio of public external debt to GDP is still high at 66 percent. Over seventy percent of this debt is at floating interest rates and two-thirds of it is denominated in U.S. dollars. However, this debt is predominantly of long maturities (nearly 70 percent of debt has residual maturities over 10 years), and, based on the floors on the FRA, the government will maintain ample liquidity over the next year to service this debt. Moreover, the private sector has only limited exposure to short term external liabilities, and the ratio of gross official reserves to short term debt by remaining maturity is high at over 2.5. Several credit upgrades by international rating agencies and the recent narrowing of the spreads on Bulgarian Brady bonds are further evidence of the markets' improving confidence in Bulgarian debt.

32. **Significant but manageable external risks to the program exist.** Risks emerging from further contraction in Turkey are limited, and competition from Turkish exporters—in

¹¹ The FRA includes all budgetary and deposit accounts of the general government in the domestic banking system, and other highly liquid foreign assets of the central government.

particular in the EU markets for textiles and clothing—do not appear to be intensifying at present. Further, as interest payments on Brady Bonds are locked in six months in advance, and about one half of the remaining public debt is at fixed rates, if international interest rates stood at their average 2001 level—at 3.8 percent compared to the projected 2.6 percent for the six months LIBOR—the public sector interest bill would only increase by about US\$30 million.¹² However, a failure to carry out the envisaged privatization program or attract sufficient greenfield FDI would put the projected external financing at risk, requiring additional adjustment to ensure that debt levels continue to decline. Moreover, Bulgaria's external accounts are more sensitive to two key parameters:

- Staff estimates show that should international oil prices remain at the average level of the year 2001, the current account would be about one percentage point higher than currently projected.
- As over fifty percent of exports are destined to EU markets, a slowdown in Europe that is worse than currently projected poses a more substantial risk to the medium term outlook. Unchanged real growth in export demand relative to 2001 would, other things equal, widen the trade deficit by about 1.2 percent of GDP.

However, in either of these two cases, the general equilibrium impact on the current account deficit would likely be significantly less than suggested by the partial analysis here, as imports would be expected to decline as well with lower GDP growth.

33. **The staff believes that Bulgaria has the capacity to make timely repurchases from the Fund.** Over the course of the proposed arrangement, total debt service to the Fund will be lower than in previous years, averaging 15 percent of total external debt service, or 2.6 percent of export of goods and nonfactor services, and will go down in absolute terms. Outstanding Fund credit will also decline over the duration of the arrangement (Table 9). Under the Fund's safeguards assessment policy, the BNB was subject to the transitional procedures with respect to the expired extended arrangement. The BNB cooperated fully in providing Fund staff with the required documentation, and the External Audit assessment was completed on March 21, 2001. Based on the review, the staff has concluded that the BNB's external audit mechanism meets internationally accepted standards and no further action is necessary at this juncture. With respect to Bulgaria's request for an SBA, the BNB is now subject to a full Stage One safeguards assessment, which is underway and should be completed by no later than first review of the new arrangement.

¹² Estimates of the public sector's external interest payment are based on the fall in international benchmark rates as projected in the current WEO forecasts.

IV. FEATURES OF THE PROPOSED ARRANGEMENT

34. **The arrangement is proposed to be for two years covering the period February 27, 2002 – February 26, 2004.** The program will be monitored on the basis of prior actions, quantitative and structural performance criteria, and benchmarks, as specified in Table 1 attached to the MEP and defined in Annexes I to VI attached thereto (Box 3). Reviews will be semi-annual. The first review will focus on those structural reforms necessary for successful implementation of the 2002 budget and on progress made in enhancing the efficiency and health of the financial sector. Quantitative performance criteria for end-September 2002 and end-December 2002 will be specified at the time of the first review, and consecutive quantitative performance criteria will be specified at the time of the following reviews. There will be nine potential drawings during the program, equally phased with the exception of a slightly larger first disbursement (Table 10).

35. **The authorities indicated that they might treat the arrangement as precautionary in the future.** The present conditions point to the Bulgaria's need for purchases from the Fund to maintain adequate reserves. Moreover, the authorities were concerned about the negative signaling effect of drawing under an arrangement initially announced as precautionary. However, if the external accounts improve more than expected, and are fully financed, then the authorities might treat the arrangement as precautionary. These issues will be closely examined in the coming reviews.

V. STAFF APPRAISAL

36. **Although Bulgaria has established a good track record of macroeconomic stability and sound policies, an unfinished reform agenda and recent adverse external shocks have put a drag on the economy.** Since the 1996–97 financial crisis, output growth has averaged 4 percent after years of decline, inflation has shrunk to single digits from near-hyperinflationary levels, and the external debt-to-GDP ratio declined substantially. These achievements stemmed from the strong policy framework supported by the previous arrangement. Despite these efforts, external debt burden is still high, many inefficient state-owned enterprises continue to dominate key sectors, including energy and health care, and corporate governance and the business climate remain inadequate. Moreover, recent adverse external shocks, in particular the slowdown in Europe and the economic crisis in Turkey, have dampened export growth in 2001, and will likely extend their effect to 2002.

37. **To achieve high and sustainable growth, the Bulgarian authorities have committed to a well-designed policy framework, centered on the CBA.** The staff supports this approach, in particular as the CBA provides a good nominal anchor, has broad public support, and has served Bulgaria well. Bulgaria's competitiveness under the CBA remains adequate, and there is substantial scope for further improving productivity with the completion of the reform agenda. In addition, to ensure the continued viability of the CBA, the authorities are committed to maintain tight fiscal and incomes policies. The framework also bodes well for Bulgaria's quest to join the EU in the medium term. However, as all policies are closely linked, slippage in one area can jeopardize the success of the whole

Box 3. Structural Conditionality

Coverage of Structural Conditionality in the Program

A key component of the new program is an ambitious structural reform agenda. This agenda is motivated by the need to cement macroeconomic stability, given the constraints of the currency board arrangement, and to complete the transition process. Compared with the EFF arrangement, however, the scope and detail of the structural conditionality is significantly reduced. There is ample room for streamlining Fund structural conditionality under the new program as much reform has been achieved under the EFF arrangement and already close cooperation with the World Bank has been intensified.

Conditionality focuses on areas that are macro-crucial and fall within the Fund's expertise (Table 1 of MEP). Given the key role played by fiscal policy and the medium-term fiscal challenges, completing the Unified Revenue Agency and Treasury Single Accounts projects, improving the budget process, and adopting a targeted child allowance allocation system are subject to structural benchmarks. To complete the move toward a competitive and fully-functioning market economy, a strict incomes policy for major state enterprises, adopting a bank bankruptcy law, completing financial sector privatization, and further trade liberalization are also covered by such conditionality. The program subjects to conditionality in the form of performance criteria or benchmarks a number of measures that are outside the Fund's core competence but that, in view of their fiscal implications, are critical for the program's objectives. These measures, the design of which are based on World Bank inputs, aim to advance reforms in the education and health care sectors, and announce a schedule to raise household electricity and district heating prices to cost recovery levels.

A number of other measures that are relevant to achieve the program's objectives and are within the Fund's core competence—in such areas as tax policy, public expenditure policy, financial sector development, and external debt management—will be monitored in the context of reviews but are not subject to structural performance criteria or benchmarks. Reforms that are relevant for the program's macroeconomic objectives but are outside the Fund's core responsibility—including advancing labor market and pension system reform, completing privatization in a transparent manner, raising the efficiency of the energy sector, and improving the business climate—will be closely monitored by Fund staff, but covered by World Bank conditionality.

Status of Structural Conditionality from Earlier Programs

Bulgaria has complied with the main structural conditionality measures under the EFF arrangement. However, two structural benchmarks were not met as the outgoing Parliament failed to approve draft amendments to the Energy Law, which also put on hold the enactment of corresponding secondary legislation. Parliament at the end of 2001 approved amendments that allow a full implementation of the rehabilitation program for the district heating sector. The other amendments from the package will be part of a new Energy Act which is expected to be prepared by mid-2002. In view of the important fiscal implications, the new program includes structural conditionality on having this new Act finalized. In addition, two privatization-related structural benchmarks are still outstanding, as the process of divestiture of residual state shares and the sale of assets of a number of liquidated enterprises has not been completed. Finalizing these measures is expected to be subject to World Bank conditionality.

Structural Areas Covered by World Bank Lending and Conditionality

The World Bank is preparing a Programmatic Adjustment Loan (PAL) which will take a comprehensive approach toward identifying Bulgaria's remaining reform needs and include detailed structural conditionality in a number of areas that are relevant to the new program. The PAL is expected to be approved in the late summer of 2002 and will be structured as three one-year operations. The first operation would focus on private sector development and would include measures to (i) complete the privatization of financial institutions and non-infrastructure enterprises and advance the restructuring of the energy and infrastructure sectors; (ii) strengthen the legal and regulatory framework governing business activities; (iii) increase the flexibility of labor markets and alleviate the social costs of labor retrenchment and reallocation; and (iv) stimulate the development of contractual savings institutions and financial markets. The main focus of the second operation would be public administration reform, with an emphasis on strengthening the judicial system. The third operation would aim at completing the reform agenda. The World Bank has also initiated a Public Expenditure Review, the results of which will help support Fund advice on expenditure policies.

Other Relevant Structural Conditions not Included in Current Program

The new program does not any longer cover agricultural policies. While the agricultural sector continues to have important macroeconomic relevance, as it accounts for more than 10 percent of GDP, progress in reforming the sector is covered by a World Bank loan operation and has been steady while accession-related EU involvement is growing.

program. In this context, the authorities should resist political pressure to relax fiscal and incomes policies and slow down structural reform, and tighten the fiscal stance should the external conditions warrant it.

38. **The tight fiscal stance planned for 2002–03 is appropriate, but attaining it will require strict implementation of structural reforms.** The budgeted deficit of 0.8 percent of GDP in 2002 safeguards the external accounts and supports private sector growth by allowing savings to be channeled to private investment. The intention to reduce the budget deficit in 2003 further toward balance is consistent with the medium-term fiscal framework and the authorities' objective to reduce substantially the public debt burden. The authorities' continued effort to meet the deficit target—by refraining from committing to more than 90 percent of the budgeted expenditure outlays until sufficient resources are secured and maintaining realistic but conservative revenue estimates—is commendable. In addition, the staff welcomes their commitment to implement rigorously structural reforms both in the fiscal arena and in the real sector with a view to limit the growth in subsidies, wages, pensions, and spending on operations and maintenance in health care, education, railways, and the energy sector. The authorities' effort to impose hard budget constraints on municipalities is a good step toward reforming fiscal federalism.

39. **The tax rate cuts and the emphasis on strengthening the social safety net in the 2002 budget are welcome.** Now corporate and personal income tax rates are on the low side compared with other countries in the region, but social security contribution rates remain high. The staff supports the authorities' intention to continue to lower gradually the direct tax burden, but underlines the importance of ensuring that this is done in a manner consistent with their medium-term framework and does not narrow the tax base or introduce new distortions. Continued improvement in tax and customs administration, including establishing a unified revenue agency, will help create the necessary room for such tax cuts. The VAT scheme is well designed and uniform, and should be protected from pressures to create exceptions. Regarding expenditure, the authorities are appropriately emphasizing outlays to support those that carry the heaviest burden of transition. The staff commends the authorities' effort to ensure better targeting of this group by changing legislation on child allowances and enhancing active labor market policies. Also, the authorities may find room for much-needed public sector wage increases by continuing to reduce public employment.

40. **The staff welcomes the authorities' resolve to implement strictly the incomes policy and further increase the flexibility of the labor markets.** These policies will signal appropriate wage formation in the economy, improve labor mobility, and help safeguard competitiveness. However, the authorities should avoid enlarging the scope and size of the loan guarantee program for small- and medium-size enterprises, since it can distort lending decisions and impose budgetary costs. In light of continued high unemployment, we welcome the authorities' decision not to increase the minimum wage this year, and to link future increases to public wage increases.

41. **The financial sector appears in good shape, but has not yet been fully tested.** The banking sector as a whole is profitable, and most banks rank high in satisfying prudential

regulations. However, credit to the private sector remains moderate, and to stimulate it, the authorities are taking appropriate steps. A key step is to complete as a matter of priority the privatization of the banking sector by selling the last two large public banks to well-qualified strategic investors. In addition, the authorities are aiming appropriately to provide quality credit information, strengthen corporate governance, and enforce creditor rights. As these measures are expected to contribute to rising volumes of credit to private sector, the staff welcomes the authorities' efforts to strengthen supervision through legislative changes and capacity buildup.

42. **To attain a fully market-oriented and competitive economy, the authorities are aiming appropriately to finalize the privatization program and restructure sectors that are not to be privatized in the short term.** The authorities are making major efforts to complete the privatization of the remaining enterprises within two years in a transparent fashion, and to this end passed a well-designed privatization law. While these efforts are commendable, the authorities should ensure that buyers are of high quality. In those sectors where broad privatization is not immediate, particularly transportation and energy sectors, the authorities are making good efforts to restructure the enterprises to improve efficiency and reduce risks to the budget. In that regard, the staff welcomes the plan to announce a timetable for the adjustment of energy prices to cost-recovery levels, make a new regulatory pricing regime fully operational, and adopt a new Energy Law that liberalizes further the sector.

43. **The authorities are liberalizing further trade and are pursuing a more active debt management strategy.** Although Bulgaria has a relatively open trade regime, further trade liberalization will facilitate the needed restructuring of the economy, attract FDI, and enable companies to cope better with competitive forces particularly in the EU. Therefore, the authorities' intention to cut in half the MFN tariff rate in four years is commendable, and provides sufficient adjustment time for the companies. Regarding debt management, the authorities' recent Eurobond debut to better manage its debt stock as well as to support foreign reserves was successful. Their strategy aims appropriately to lower the debt-to-GDP ratio, and reduce portfolio and roll-over risk by better aligning currency composition of the debt with the composition of trade flows, maintaining the long maturity of the debt stock, and avoiding bunching of repayments.

44. **Overall, in view of the strong commitment made by the authorities in the areas of fiscal, incomes, and structural reform policies, as well as Bulgaria's excellent track record in implementing the Fund programs, the staff supports the authorities' request for the stand-by arrangement.**

Table 1. Bulgaria: Selected Economic Indicators, 1996-2001

	1996	1997	1998	1999	2000	2001			
						Q1	Q2	Q3	Q4
Output, prices, and employment									
	(Percent change, from same period of previous year)								
Real GDP	-10.9	-6.9	3.5	2.4	5.8	4.5	5.1	4.5	...
CPI (end-of-period)	310.8	549.2	1.7	7.0	11.4	9.1	9.5	4.7	4.8
Monthly, averaged during period	12.8	26.4	0.2	0.6	0.9	0.3	-0.1	0.5	0.8
Unemployment rate (percent, period average)									
Registered unemployment	11.0	14.0	12.4	13.8	18.1	18.5	17.8	16.7	17.1
Labor force survey unemployment	14.2	14.4	14.1	15.7	16.9	21.6	19.4	18.6	19.5
Retail sales, real (period average)	-36.2	-30.5	2.0	-2.1	0.2	2.2	2.3	2.5	...
Monthly dollar wages (level) 1/	86.3	80.5	111.0	120.6	118.0	123.1	130.5	133.3	...
Public sector wages, real (period average)	...	-19.5	23.5	10.7	2.4	4.9	6.2	7.6	...
Private sector wages, real (period average)	...	...	22.1	9.4	11.6	3.8	2.9	3.1	...
Consolidated government 2/									
	(In percent of GDP)								
Revenue	31.9	36.8	39.5	40.5	40.7	44.7	48.5	31.6	...
Noninterest expenditure	22.3	29.6	34.0	37.6	37.5	38.3	42.2	30.1	...
Primary balance	9.6	7.3	5.5	2.9	3.2	6.4	6.3	1.5	...
Interest payments	19.7	8.5	4.4	3.9	4.3	8.4	1.8	5.5	...
Overall balance	-10.1	-1.2	1.0	-1.0	-1.1	-2.0	4.5	-4.0	...
External financing	-2.9	0.3	-0.7	0.2	-1.6	-3.6	-1.3	-5.3	...
Domestic financing	15.6	-2.7	-2.0	-1.3	1.3	-0.7	-10.5	8.7	...
Privatization receipts	0.2	3.2	1.7	2.2	1.4	6.3	7.4	0.6	...
Total public debt	117.6	109.4	96.2	88.1	84.0	74.2	73.8	72.2	...
Domestic public debt 3/	60.2	16.3	14.4	13.0	6.9	6.2	6.2	6.2	...
Money and credit									
	(End-of-period; percent change, from same period of previous year)								
Broad money (millions of leva)	1,310	6,019	6,597	7,351	9,291	9,482	9,679	10,303	...
Broad money (M3)	124.5	359.3	9.6	11.4	26.4	25.8	27.7	22.9	...
Lev money	52.7	423.0	18.2	11.5	15.6	17.8	25.0	18.8	...
Leva credit to nongovernment	15.6	297.2	69.7	21.4	21.4	15.6	20.0	27.9	...
FX deposits (U.S. dollar millions)	1,357	1,477	1,543	1,477	1,958	1,941	1,811	2,092	...
FX deposits (percent of M3)	50.5	43.6	39.2	39.1	44.3	45.3	43.1	43.5	...
Broad money to FX reserves ratio	3.4	1.4	1.3	1.2	1.3	1.4	1.4	1.5	...
Interest rates (annualized)									
	(In percent; end-of-period)								
BNB basic rate	435.0	7.0	5.2	4.6	4.7	4.3	4.6	4.8	4.8
Time deposit (leva)	211.8	3.0	3.3	3.2	3.3	3.1	3.3	3.0	3.4
Balance of payments 4/									
	(In millions of U.S. dollars)								
Gross official reserves	793	2,474	3,056	3,222	3,460	3,080	3,040	3,120	3,579
(In months of imports of GNFS)	1.6	5.0	5.6	5.0	4.9	4.3	4.2	4.3	4.8
Current account balance	131	288	-61	-652	-701	-237	-185	-71	...
(In percent of GDP)	0.2	4.4	-0.5	-5.3	-5.8	-8.4	-6.5	-2.0	...
Trade balance	188	321	-381	-1,081	-1,175	-224	-455	-407	...
Exports	4,890	4,809	4,193	4,006	4,812	1,282	1,232	1,298	...
Imports	4,703	4,488	4,574	5,087	5,988	1,506	1,683	1,705	...
External debt	9,602	9,760	10,274	10,204	10,371	10,117	10,052	9,889	...
(In percent of GDP)	97.7	96.2	83.8	82.3	86.5	77.7	77.2	75.9	...
Exchange rates									
Leva per U.S. dollar 5/	0.487	1.777	1.675	1.947	2.102	2.214	2.306	2.142	2,219
(y-o-y percent change, + means depreciation)	589.3	264.5	-5.7	16.2	8.0	8.2	12.7	-4.0	5.6
REER (CPI)									
(y-o-y percent change, + means appreciation)	-38.8	77.5	5.2	0.8	3.2	4.9	3.6	6.0	...

Sources: Bulgarian authorities; and staff estimates.

1/ Average monthly wage in the public (including nonbudgetary) sector.

2/ Includes the republican budget, municipalities, and extrabudgetary funds. The coverage became more comprehensive from 1998 onward, resulting in a structural break.

3/ Domestic debt increased by 2.5 percent of GDP in June 1997 due to a restructuring of central bank claims on government.

4/ Starting 1998, a new methodology was adopted for the calculation of BOP data.

5/ End-of-period, in redenominated leva.

Table 2. Bulgaria: Monetary Survey, 1997-2002

	1997	1998	1999	2000				2001				2002			
	Dec.	Dec.	Dec.	Mar.	June	Sep.	Dec.	Mar.	June	Sep.	Dec. Proj.	Mar. Proj.	June Proj.	Sep. Proj.	Dec. Proj.
(In millions of leva)															
Broad money 1/	6,019	6,597	7,351	7,538	7,578	8,383	8,616	8,824	9,679	10,303	11,073	11,079	11,482	11,932	12,842
Lev money	3,395	4,013	4,475	4,400	4,401	4,899	5,174	5,184	5,502	5,822	6,330	6,428	6,687	6,972	7,718
Currency	1,314	1,742	1,957	1,824	1,875	2,110	2,374	2,225	2,427	2,601	2,871	2,753	2,927	3,043	3,454
Deposits	2,080	2,271	2,518	2,576	2,526	2,788	2,801	2,959	3,075	3,220	3,459	3,675	3,759	3,929	4,264
Foreign currency deposits 1/	2,624	2,584	2,876	3,138	3,177	3,484	3,442	3,640	4,176	4,481	4,743	4,651	4,795	4,960	5,124
Net foreign assets	4,851	5,272	5,994	6,161	6,461	7,266	7,019	7,397	8,167	7,907	8,287	8,150	8,945	9,214	9,367
Net domestic assets	1,167	1,325	1,357	1,377	1,117	1,117	1,597	1,427	1,512	2,395	2,786	2,929	2,537	2,718	3,474
Domestic credit	5,136	4,227	4,237	4,625	4,180	4,325	4,654	4,865	4,514	5,308	5,950	5,955	5,474	5,705	6,448
Government 2/	1,642	510	156	367	-116	137	488	724	96	717	619	740	202	452	366
Non-government	3,495	3,717	4,081	4,258	4,297	4,188	4,167	4,141	4,418	4,590	5,330	5,216	5,273	5,253	6,083
Public enterprise (SOE)	1,254	946	713	691	621	447	422	342	356	334	318	293	271	249	227
Private sector	2,241	2,772	3,368	3,567	3,675	3,741	3,745	3,799	4,062	4,257	5,012	4,922	5,002	5,003	5,855
Other Items Net	-3,969	-2,902	-2,881	-3,248	-3,063	-3,208	-3,058	-3,439	-3,002	-2,913	-3,164	-3,026	-2,937	-2,987	-2,974
Reserve money	2,174	2,387	2,722	2,581	2,611	2,769	3,021	2,928	3,085	3,367	3,673	3,520	3,762	3,944	4,394
(In millions of U.S. dollars)															
Net foreign assets	2,731	3,147	3,079	3,009	3,157	3,256	3,339	3,340	3,541	3,692	3,734	3,745	4,113	4,244	4,323
BNB	1,531	1,941	1,972	1,666	1,831	1,643	1,816	1,567	1,779	1,899	1,906	1,947	2,277	2,369	2,407
DMB	1,200	1,207	1,107	1,344	1,325	1,613	1,523	1,773	1,762	1,793	1,828	1,798	1,836	1,875	1,915
Foreign currency deposits (percent of broad money)	1,477 (43.6)	1,543 (39.2)	1,477 (39.1)	1,533 (41.6)	1,552 (41.9)	1,562 (41.6)	1,637 (39.9)	1,644 (41.3)	1,811 (43.1)	2,092 (43.5)	2,137 (42.8)	2,137 (42.0)	2,205 (41.8)	2,285 (41.6)	2,364 (39.9)
Memorandum items: (12-month growth rate in percent)															
Broad money	359.3	9.6	11.4	20.4	22.5	25.7	17.2	17.1	27.7	22.9	28.5	25.6	18.6	15.8	16.0
Lev money	423.0	18.2	1.0	19.9	25.6	25.2	15.6	17.8	25.0	18.8	22.3	24.0	21.5	19.8	21.9
Currency	939.1	32.6	12.4	16.4	26.7	25.1	21.3	22.0	29.5	23.3	21.0	23.7	20.6	17.0	20.3
Foreign currency deposits	296.8	-1.5	11.3	21.1	18.6	26.4	19.7	16.0	31.5	28.6	37.8	27.8	14.8	10.7	8.0
Reserve money	780.1	9.8	14.0	17.3	20.7	20.9	11.0	13.4	18.2	21.6	21.6	20.2	21.9	17.1	19.6
CPI inflation	578.5	3.3	7.0	9.5	11.7	12.0	11.4	9.2	9.5	4.7	4.8	6.2	5.9	2.7	3.5
Currency/broad money ratio	21.8	26.4	26.6	24.2	24.7	25.2	27.5	25.2	25.1	25.2	25.9	24.8	25.5	25.5	26.9
Currency/deposit ratio	27.9	35.9	36.3	31.9	32.9	33.6	38.0	33.7	33.5	33.8	35.0	33.1	34.2	34.2	36.8
Foreign currency /total deposits	55.8	53.2	53.3	54.9	55.7	55.5	55.1	55.2	57.6	58.2	57.8	55.9	56.1	55.8	54.6
(Real index, Dec. 1995=100)															
Broad money	38.6	41.6	43.4	43.1	43.6	45.4	45.6	46.2	50.8	53.3	55.9	54.7	56.9	60.2	62.6
Lev money	29.9	34.8	36.3	34.6	34.7	36.5	37.6	37.3	39.7	41.4	43.9	43.6	45.5	48.3	51.7
Credit, non-government	36.5	38.1	39.1	39.6	40.1	36.9	35.8	35.3	37.7	36.3	41.5	39.6	40.2	40.8	46.0
of which by operating banks 3/	36.5	50.8	57.7	57.8	60.1	60.4	60.6	62.5	67.6	70.8	78.4	75.9	77.2	79.0	90.2
(In percent of GDP, end of period)															
Ratio to nominal GDP															
Broad money	27.1	28.4	28.3	37.2	32.6	27.9	30.6	37.5	37.9	32.6	33.5	43.1	41.5	35.0	36.0
Lev money	15.3	17.3	17.2	21.7	18.9	16.3	18.4	22.0	21.5	18.4	19.1	25.0	24.2	20.5	21.6
Reserve money	9.8	10.3	10.5	12.7	11.2	9.2	10.7	12.4	12.1	10.6	11.1	13.7	13.6	11.6	12.3

Sources: Bulgarian National Bank; National Statistical Institute; and staff estimates.

1/ In December 2000 and 2001 corrected for a large deposit at the BNB related to the sale of Bulbank.

2/ In December 1998 claims on government have decreased by around BGR 500 million, as commercial banks started to report government securities at their market value, instead of their nominal value.

3/ Real index, December 1997 = 36.5.

Table 3. Bulgaria: Balance of Payments Projections, 1999-2006
(In millions of U.S. dollar)

	1999	2000	2001				2001 Proj.	2002	2003	2004	2005	2006
			Q1 Act.	Q2 Act.	Q3 Act.	Q4 Proj.						
CURRENT ACCOUNT	-652	-701	-237	-185	-71	-342	-835	-838	-897	-969	-981	-896
Trade Balance	-1,081	-1,175	-224	-451	-407	-470	-1,552	-1,569	-1,756	-1,895	-1,991	-2,059
Exports (f.o.b.)	4,006	4,812	1,282	1,232	1,298	1,271	5,083	5,450	5,895	6,429	6,998	7,695
y-o-y growth (percent)	-4.5	20.1	15.4	5.2	3.9	-0.8	5.6	7.2	8.1	9.1	8.9	10.0
Imports (f.o.b.)	-5,087	-5,988	-1,506	-1,683	-1,705	-1,741	-6,634	-7,019	-7,651	-8,324	-8,990	-9,754
y-o-y growth (percent)	11.2	17.7	6.5	19.8	14.8	3.4	10.8	5.8	9.0	8.8	8.0	8.5
Services, net	314	505	30	143	401	13	586	615	672	780	887	1,012
Income, net	-185	-321	-136	-19	-171	0	-326	-358	-346	-386	-388	-394
of which: Interest Payments of the Centr. Gover	-433	-438	-209	-35	-168	-33	-457	-405	-421	-471	-463	-447
of which: Income to Direct Investors	39	-107	-15	-27	-67	-50	-159	-225	-256	-291	-322	-349
Current Transfers	300	290	93	142	106	115	456	474	533	532	511	545
CAPITAL AND FINANCIAL ACCOUNT	747	839	0	264	23	529	816	945	863	1,223	1,589	1,731
Capital Transfers	-2	25	0	0	0	0	0	0	0	0	0	0
Foreign Direct Investment, net	802	1,003	280	94	103	170	647	900	900	1,000	1,000	1,000
of which: privatization receipts	227	366	19	0	0	20	39	300	250	150	50	0
Portfolio Investment, net	-199	-179	-126	45	-130	149	-61	-317	-379	-211	-143	-143
of which: Amortization of Brady Bonds	0	0	0	0	-16	0	-16	-106	-179	-211	-243	-243
Other Investment, net 1/	193	59	-153	110	166	210	333	362	342	434	733	874
General Government, net	-105	-216	-117	-18	-96	185	-46	25	216	184	183	174
Domestic Money Banks, net	67	-383	-115	-117	93	-75	-214	-262	-300	-200	-100	-50
Other Private Sector, net	231	658	79	245	169	100	594	599	426	450	650	750
Errors and Omissions	-45	-70	-1	14	-116	0	-104	0	0	0	0	0
OVERALL BALANCE	96	137	-237	79	-48	187	-19	108	-34	254	608	835
FINANCING	-96	-137	237	-79	48	-187	19	-108	34	-254	-608	-835
Change in Gross International Reserves (increase: -) 1	-527	-409	234	-70	130	-106	188	0	0	-197	-437	-576
Use of Fund Credit (purchase: +)	162	136	3	-9	-82	-81	-168	-108	35	-57	-171	-259
Purchases	286	275	67	65	0	0	132	139	131	33	0	0
Repurchases	-124	-139	-63	-74	-82	-81	-301	-246	-97	-90	-171	-259
Exceptional Financing, net	270	136	0	0	0	0	0	0	0	0	0	0
Financing Gap (gap: +)	0	0	0	0	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS												
Gross International Reserves 2/	3,222	3,460	3,080	3,040	3,120	3,579	3,579	3,579	3,580	3,777	4,214	4,790
in months of prospective gnfs imports	5.0	4.9	4.3	4.2	4.3	4.8	4.8	4.4	4.1	4.0	4.1	4.3
Current account in percent of GDP	-5.3	-5.8	-1.8	-1.4	-0.5	-2.6	-6.4	-5.9	-5.8	-5.7	-5.3	-4.4
Trade account in percent of GDP	-8.7	-9.8	-1.7	-3.5	-3.1	-3.6	-11.9	-11.1	-11.3	-11.2	-10.7	-10.1
FDI (net) in percent of the current account deficit	123	143	...	...	...	...	77	107	100	103	102	112
Gross external debt	10,204	10,371	10,117	10,052	9,889	...	10,121	10,231	10,540	10,933	11,263	11,530
in percent of GDP	82.3	86.5	77.7	77.2	75.9	...	77.7	72.2	68.1	64.4	60.5	56.5
public	9,403	9,230	8,876	8,841	8,579	8,741	8,741	8,551	8,560	8,553	8,483	8,350
private	801	1,141	1,240	1,211	1,310	...	1,380	1,680	1,980	2,380	2,780	3,180
External Debt Service of the Central Government 3/	638	639	393	125	403	181	1,102	909	853	908	1,019	1,038
GDP	12,404	11,993	...	...	...	...	13,024	14,165	15,484	16,986	18,622	20,405

Sources: Bulgarian Authorities, and Fund staff estimates.

1/ Excluding valuation changes.

2/ Historical figures include valuation changes.

3/ Includes most obligations to the IMF.

Table 4. Bulgaria: General Government, 1999-2002
(In millions of leva)

	1999	2000	2001 1/		2002
	Actual	Actual	Budget	Prel. Act.	Budget
Total revenue and grants	9,190	10,352	10,762	11,140	11,719
Tax revenue	6,992	7,994	8,455	8,486	8,996
Profit taxes	748	736	787	1,146	809
Nonfinancial enterprises	618	619	658	806	695
Financial enterprises	129	117	129	340	115
Income taxes	1,056	1,098	1,092	1,067	1,094
VAT	1,927	2,359	2,528	2,452	2,780
Excise duties	691	815	902	775	1,023
Customs duties	259	221	139	195	100
Social insurance contributions	1,883	2,230	2,410	2,286	2,521
Pension fund	1,563	1,629	1,775	1,637	1,767
Unemployment fund	148	151	163	161	189
Health Insurance Fund	173	451	472	488	565
Other taxes 2/	428	535	598	564	670
Nontax revenues	1,995	2,154	2,032	2,311	2,220
BNB transfers	90	137	130	175	150
Other	1,906	2,018	1,902	2,137	2,070
Grants and donations	203	204	275	343	502
Total expenditure and net lending	9,412	10,620	11,184	11,395	11,976
Noninterest expenditure, net lending, contingency	8,514	9,538	9,811	10,291	10,972
Current noninterest expenditure	7,151	8,127	8,634	8,808	9,630
Compensation 3/	1,208	1,283	1,421	1,194	1,233
Wages and salaries 3/	1,182	1,256	1,393	1,164	1,198
Scholarships	26	28	28	29	35
Maintenance and operations 3/	1,749	2,167	1,797	1,885	1,892
Defense and security	998	885	998	932	1,082
Subsidies 3/	391	250	237	710	733
Social expenditures	2,808	3,543	4,181	4,088	4,690
Pension fund	1,954	2,372	2,590	2,586	2,882
Assistance	491	644	669	665	752
Unemployment	187	209	242	209	297
Health Insurance Fund	93	98	399	404	487
Other social expenditures	0	221	281	224	272
Extrabudgetary funds	-4	0	0	0	0
Capital expenditures	1,076	1,037	914	1,186	1,113
State reserve	0	0	0	0	0
Net lending	-28	63	19	54	0
Contingency	315	311	245	244	230
Enterprise restructuring	291	110	60	60	180
Other contingency	0	165	145	145	0
Natural disaster	24	36	40	39	50
Primary balance	676	814	951	849	747
Interest	898	1,083	1,373	1,104	1,004
External	690	818	1,063	852	785
Domestic	208	265	310	253	219
Overall balance	-223	-269	-422	-256	-257
Financing	223	269	422	256	257
External (net)	42	-404	-31	-94	-106
Domestic (net)	-322	328	-7	-523	-255
Privatization	503	345	460	680	619
Memorandum items:					
Fiscal Reserve Account (in US\$ million)	1,336	1,139	950	1,265	...
Nominal GDP in millions of leva	22,776	25,454	28,210	28,461	30,783

Sources: Ministry of Finance; and staff projections.

1/ To make 2001 projections comparable with the 2000 figures, the activities of the air traffic control fund, which exited the general government sphere as it became a commercial enterprise, should be added back. This would increase non-tax revenues by 152 million leva, wages by 30 million leva, maintenance and operations by 52 million leva, and capital expenditure by 123 million leva.

2/ To make it comparable with the 2000 figure, the 1999 figure has been modified to include the revenues of the extrabudgetary funds for the Road Network and for Environmental Protection.

3/ To make the 2001 actuals comparable with the 2001 budget figures, the impact of the health care reform should be taken into account as follows: the 2001 budget figures on wages should be reduced by 169 million leva, maintenance and operations reduced by 136 million leva, and subsidies increased by 365 million leva (which includes 60 million leva social security contributions, which was earlier netted out in the consolidated government accounts).

Table 5. Bulgaria: General Government, 1999-2002
(In percent of GDP)

	1999	2000	2001 1/		2002
	Actual	Actual	Budget	Prel. Act.	Budget
Total revenue and grants	40.3	40.7	38.1	39.1	38.1
Tax revenue	30.7	31.4	30.0	29.8	29.2
Profit taxes	3.3	2.9	2.8	4.0	2.6
Nonfinancial enterprises	2.7	2.4	2.3	2.8	2.3
Financial enterprises	0.6	0.5	0.5	1.2	0.4
Income taxes	4.6	4.3	3.9	3.7	3.6
VAT	8.5	9.3	9.0	8.6	9.0
Excise duties	3.0	3.2	3.2	2.7	3.3
Customs duties	1.1	0.9	0.5	0.7	0.3
Social insurance contributions	8.3	8.8	8.5	8.0	8.2
Pension fund	6.9	6.4	6.3	5.8	5.7
Unemployment fund	0.6	0.6	0.6	0.6	0.6
Health Insurance Fund	0.8	1.8	1.7	1.7	1.8
Other taxes 2/	1.9	2.1	2.1	2.0	2.2
Nontax revenues	8.8	8.5	7.2	8.1	7.2
BNB transfers	0.4	0.5	0.5	0.6	0.5
Other	8.4	7.9	6.7	7.5	6.7
Grants and donations	0.9	0.8	1.0	1.2	1.6
Total expenditure and net lending	41.3	41.7	39.6	40.0	38.9
Noninterest expenditure, net lending, contingency	37.4	37.5	34.8	36.2	35.6
Current noninterest expenditure	31.4	31.9	30.6	30.9	31.3
Compensation 3/	5.3	5.0	5.0	4.2	4.0
Wages and salaries 3/	5.2	4.9	4.9	4.1	3.9
Scholarships	0.1	0.1	0.1	0.1	0.1
Maintenance and operations 3/	7.7	8.5	6.4	6.6	6.1
Defense and security	4.4	3.5	3.5	3.3	3.5
Subsidies 3/	1.7	1.0	0.8	2.5	2.4
Social expenditures	12.3	13.9	14.8	14.4	15.2
Pension fund	8.6	9.3	9.2	9.1	9.4
Assistance	2.2	2.5	2.4	2.3	2.4
Unemployment	0.8	0.8	0.9	0.7	1.0
Health Insurance Fund	0.4	0.4	1.4	1.4	1.6
Other social expenditures	0.0	0.9	1.0	0.8	0.9
Extrabudgetary funds	0.0	0.0	0.0	0.0	0.0
Capital expenditures	4.7	4.1	3.2	4.2	3.6
State reserve	0.0	0.0	0.0	0.0	0.0
Net lending	-0.1	0.2	0.1	0.2	0.0
Contingency	1.4	1.2	0.9	0.9	0.7
Enterprise restructuring	1.3	0.4	0.2	0.2	0.6
Other contingency	0.0	0.6	0.5	0.5	0.0
Natural disaster	0.1	0.1	0.1	0.1	0.2
Primary balance	3.0	3.2	3.4	3.0	2.4
Interest	3.9	4.3	4.9	3.9	3.3
External	3.0	3.2	3.8	3.0	2.6
Domestic	0.9	1.0	1.1	0.9	0.7
Overall balance	-1.0	-1.1	-1.5	-0.9	-0.8
Financing	1.0	1.1	1.5	0.9	0.8
External (net)	0.2	-1.6	-0.1	-0.3	-0.3
Domestic (net)	-1.4	1.3	0.0	-1.8	-0.8
Privatization	2.2	1.4	1.6	2.4	2.0
Memorandum items:					
Fiscal Reserve Account (in US\$ million)	1,336	1,139	950	1,265	...
Nominal GDP in million leva	22,776	25,454	28,210	28,461	30,783

Sources: Ministry of Finance; and staff projections.

1/ To make 2001 projections comparable with the 2000 figures, the activities of the air traffic control fund, which exited the general government sphere as it became a commercial enterprise, should be added back. This would increase non-tax revenues by 152 million leva, wages by 30 million leva, maintenance and operations by 52 million leva, and capital expenditure by 123 million leva.

2/ To make it comparable with the 2000 figure, the 1999 figure has been modified to include the revenues of the extrabudgetary funds for the Road Network and for Environmental Protection.

3/ To make the 2001 actuals comparable with the 2001 budget figures, the impact of the health care reform should be taken into account as follows: the 2001 budget figures on wages should be reduced by 169 million leva, maintenance and operations reduced by 136 million leva, and subsidies increased by 365 million leva (which includes 60 million leva social security contributions, which was earlier netted out in the consolidated government accounts).

Table 6. Bulgaria: Indicators of Financial and External Vulnerability, 1997-2002

	1997	1998	1999	2000	2001-2002	
					Latest Observation 1/	Date
Real indicators						
CPI end-of-period, 12-month change	549.2	1.7	7.0	11.4	4.8	Dec-01
Real GDP growth rate, year-on-year	-6.9	3.5	2.4	5.8	4.5	Q3-01
Financial indicators						
Public sector debt (in percent of GDP, end-of-period)	109.4	96.2	88.1	84.0	72.2	Sep-01
Broad money (percent change, 12-month basis, end-of-period)	359.3	9.6	11.4	26.4	17.4	Nov-01
Non-government sector leva credit (percent change, 12-month basis end-of-period)	297.2	69.7	21.4	21.4	25.6	Nov-01
Non-government sector foreign exchange credit (percent share in domestic credit end-of-period)	49.9	50.5	51.0	39.5	39.3	Nov-01
Average monthly BNB basic interest rate, nominal annualized	176.0	5.5	4.8	3.9	4.6	Nov-01
BNB basic real interest rate, average basis	-87.6	3.5	-2.1	-6.8	-1.0	Nov-01
Banks' NFA position in US\$ million	941	1,107	1,107	1,523	1,604	Nov-01
Banking system capital adequacy ratio (in percent, end-of-period)	28.9	37.0	41.3	35.5	32.2	Sep-01
Standard performing interest earning assets (in percent, end-of-period)	83.3	87.3	88.3	91.7	92.8	Sep-01
External indicators						
Exports (annual percent change, cumul. since Jan., US\$ basis)	2.5	-12.8	-4.5	20.1	7.5	Oct-01
Imports (annual percent change, cumul. since Jan., US\$ basis)	-1.7	1.9	11.2	17.6	12.5	Oct-01
Current account balance (percent of GDP)	4.4	-0.5	-5.3	-5.8	-1.5	Q3-01
Capital and financial account (percent of GDP)	-6.7	2.9	5.6	6.4	5.3	Q3-01
Portfolio investment (debt securities, etc., percent of GDP)	1.3	-2.0	-1.6	-1.5	-3.6	Q3-01
Other investment (loans, trade credits, etc., percent of GDP)	-2.3	-0.9	0.1	-1.0	-1.1	Q3-01
Foreign direct investment (percent of GDP)	5.0	4.4	6.5	8.4	2.9	Q3-01
Gross official reserves (end-of-period)						
In millions of U.S. dollars	2,474	3,056	3,222	3,460	3,579	Dec-01
In millions of euros	...	...	3,207	3,719	4,061	Dec-01
In months of prospective imports GNFS	5.0	5.6	5.0	4.9	4.8	Nov-01
Fiscal reserve account balance (in millions of U.S. dollars, end-of-period)	791	1,117	1,336	1,139	1,194	Dec-01
Broad money/ NFA (end-of-period)	1.4	1.3	1.2	1.3	1.4	Nov-01
Total short term external debt/ reserves (in percent) 2/	48.6	32.7	18.5	19.4	20.0	Sep-01
Foreign exchange deposits/reserves (percent, end-of-period)	59.7	50.5	45.8	56.6	60.7	Nov-01
Total external debt (percent of GDP)	96.2	83.8	82.3	86.5	75.9	Sep-01
Public external debt (percent of GDP)	93.9	81.1	75.8	77.0	65.9	Sep-01
Total short-term external debt (percent of GDP)	11.9	8.1	4.8	5.6	4.8	Sep-01
External debt service/ exports of GNFS (in percent)	12.8	20.0	18.0	16.7	20.4	Oct-01
External debt service/GDP (in percent)	8.8	9.7	8.4	9.8	10.0	Oct-01
Exchange rate (per U.S. dollar, period average) 3/	1.682	1.760	1.836	2.123	2.190	Dec-01
REER depreciation, end-of-period (-) (12-months basis)	77.4	5.3	0.8	3.0	6.8	Oct-01
Financial market indicators						
Foreign currency debt rating (Moody's, long-term)	B2 4/	B2 4/	B2 4/	B2 4/	B1 4/	Jan-02
Foreign currency debt rating (S&P, long-term)		B	B 4/	B+ 4/	BB-	Jan-02
Foreign currency debt rating (Fitch IBCA, long-term)		B+	B+	B+	BB-	Jan-02
Stripped spread of discount A bonds (basis points, end-of-period)	716	1,011	713	932	505	14-Jan-02

Sources: Bulgarian authorities; press reports; and staff calculations.

1/ Change relative to the same period of the previous year unless otherwise stated.

2/ On a residual maturity basis.

3/ In redenominated leva.

4/ Outlook positive.

Table 7. Bulgaria: Macroeconomic Framework, 1998-2006

	1998	1999	2000	2001 Proj.	2002	2003	2004	2005	2006
					Projections				
(Percent change)									
GDP and prices									
Real GDP	3.5	2.4	5.8	4.5	4.0	5.0	5.5	5.5	5.5
GDP deflator	22.3	3.1	5.6	7.0	4.0	3.5	3.5	3.5	3.5
CPI (end of period)	1.7	7.0	11.4	4.8	3.5	3.5	3.5	3.5	3.5
(period average)	18.8	2.6	10.4	7.5	4.5	3.5	3.5	3.5	3.5
Lev/US\$ exchange rate (end of period)	-5.7	16.2	8.0	5.6	-2.4	-0.5	-0.4	-0.4	-0.3
Real basic interest rate (average) 1/	3.7	-2.0	-6.8	0.5	1.5	2.2	2.8	3.4	4.0
Unemployment rate (in percent, period average)	12.4	13.8	18.1	17.3	15.5	14.5	14.0	13.5	13.0
Monetary aggregates									
Broad money (real, percent change) 2/	8.6	4.9	5.3	22.6	12.0	10.0	11.0	11.0	11.0
Credit to non-government (real, percent change) 3/	5.3	13.6	4.8	29.3	15.0	15.0	15.0	13.0	11.0
(In percent of GDP)									
Saving and investment									
Foreign saving 4/	0.1	6.2	5.6	7.4	6.7	7.0	6.6	5.9	5.1
Gross national saving	14.2	13.8	10.7	10.5	11.4	11.8	12.2	12.9	13.9
Gross domestic saving 5/	14.7	12.9	11.0	9.5	10.6	10.6	11.3	12.3	13.2
Government	8.1	6.8	6.2	6.1	5.1	5.9	6.0	6.0	6.0
Non-government	6.6	6.1	4.7	3.4	5.5	4.7	5.4	6.3	7.1
Gross domestic investment	14.7	19.0	16.6	16.9	17.3	17.6	17.9	18.2	18.3
Gross fixed investment	13.2	15.9	16.2	16.6	16.9	17.1	17.4	17.7	17.8
Change in stocks	1.5	3.1	0.4	0.3	0.4	0.5	0.5	0.5	0.5
Government	3.8	4.7	4.1	3.9	3.4	3.5	3.5	3.5	3.5
Non-government	10.9	14.3	12.5	13.0	13.9	14.1	14.4	14.7	14.8
General government									
Revenue	39.5	40.3	40.7	39.1	38.1	38.0	38.0	38.0	38.0
Non-interest expenditure	34.0	37.4	37.5	36.2	35.6	35.0	35.0	35.0	35.0
Primary balance	5.5	3.0	3.2	3.0	2.4	3.0	3.0	3.0	3.0
Interest payments	4.4	3.9	4.3	3.9	3.3	3.6	3.3	3.0	2.8
Overall balance (excluding external interest payments)	4.2	2.1	2.2	2.1	1.7	2.4	2.5	2.5	2.5
Overall balance	1.0	-1.0	-1.1	-0.9	-0.8	-0.6	-0.3	0.0	0.2
Total public debt	96.2	88.1	84.0	73.6	68.1	62.9	57.5	52.4	47.4
(In millions of U.S. dollars)									
Balance of payments									
Current account	-62	-652	-701	-835	-838	-897	-969	-981	-896
Trade balance	-381	-1,081	-1,175	-1,552	-1,569	-1,756	-1,895	-1,991	-2,059
Exports	4,193	4,006	4,812	5,083	5,450	5,895	6,429	6,998	7,695
Imports	4,574	5,087	5,988	6,634	7,019	7,651	8,324	8,990	9,754
Services, net	373	314	505	586	615	672	780	887	1,012
Receipts	1,788	1,788	2,175	2,397	2,531	2,761	3,053	3,341	3,675
Payments	1,415	1,474	1,669	1,811	1,916	2,089	2,272	2,454	2,663
Income, net	-283	-185	-321	-326	-358	-346	-386	-388	-394
Memorandum items									
Gross official reserves	3,056	3,222	3,460	3,579	3,579	3,580	3,777	4,214	4,790
(in months of prospective imports of GNFS)	6.1	5.0	4.9	4.8	4.4	4.1	4.0	4.1	4.3
Current account balance (in percent of GDP)	-0.5	-5.3	-5.8	-6.4	-5.9	-5.8	-5.7	-5.3	-4.4
External debt/GDP (in percent) 6/	83.8	82.3	86.5	77.7	72.2	68.1	64.4	60.5	56.5
External debt/exports of GNFS (in percent) 6/	171.8	176.1	148.4	135.3	128.2	121.8	115.3	108.9	101.4
External debt service/exports of GNFS (in percent) 6/	20.0	16.5	14.8	16.7	17.7	16.4	16.1	16.6	15.7
Export growth (percent change)	-12.8	-4.5	20.1	5.6	7.2	8.1	9.1	8.9	10.0
Import growth (percent change)	1.9	11.2	17.7	10.8	5.8	9.0	8.8	8.0	8.5
Terms of trade (percent change)	1.1	-6.0	-8.8	0.9	2.2	-0.1	0.1	0.1	0.1
Non-government consumption (real change)	8.0	4.8	2.8	4.5	4.0	4.5	5.0	5.0	5.0
Nominal GDP (in millions of leva)	21,577	22,776	25,454	28,461	30,783	33,454	36,529	39,887	43,554
Nominal GDP	12,259	12,404	11,993	13,024	14,165	15,484	16,986	18,622	20,405

Sources: Bulgarian authorities; and staff projections.

1/ Annual real return from monthly reinvestment at basic rate.

2/ In December 2000 and March 2001 corrected for a large deposit at the BNB related to the sale of Bulbank.

3/ From 1999 on, corrected for outstanding credits at non-operating banks.

4/ Net imports of goods and nonfactor services.

5/ 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.

6/ Medium- and long-term external debt.

Table 8. Bulgaria: External Financing Requirements and Sources, 1999-2003
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003
	Act.		Prel.	Proj.	
Financing Requirements	-2,440	-2,797	-2,221	-2,372	-2,421
Current Account excluding Current Transfers	-951	-991	-1291	-1311	-1430
Amortization of Government Loans	-660	-627	-219	-235	-215
Amortization of Brady Bonds	0	0	-16	-106	-179
Other Portfolio Investment, net	-199	-179	-264	-211	-200
Outflows from Domestic Money Banks	67	-383	-214	-262	-300
Change in Gross International Reserves (increase: -)	-527	-409	188	0	0
Repurchases from the IMF	-124	-139	-301	-246	-97
Errors and Omissions	-45	-70	-104	0	0
Financing Sources	2,440	2,797	2,221	2,372	2,421
Capital Transfers	-2	25	0	0	0
Current Transfers	300	290	456	474	533
Foreign Direct Investment, net	802	1003	647	900	900
Eurobond Issue, net 1/	0	0	219	0	0
Other Investment Flows to the Private Sector, net	231	658	594	599	426
Disbursements of Loans to the Government	555	410	173	260	431
Purchases from the IMF	286	275	132	139	131
Exceptional Financing, net	270	136	0	0	0
Balance/ Residual Financing Requirement	0	0	0	0	0

Sources: BNB, and IMF staff estimates.

1/ Excludes buybacks of outstanding liabilities.

Table 9. Bulgaria: Existing and Prospective Obligations to the Fund, 1998-2009
(in million U.S. dollar)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Previous Arrangements												
Purchases	229	209	209	132								
Repurchases	183	124	139	301	246	97	90	144	166	121	99	66
Charges and Interest	11	22	33	63	46	35	32	28	21	16	9	4
Prospective 2002 SBA												
Purchases					139	131	33					
Repurchases							0	27	93	121	60	4
Charges and Interest					2	6	9	9	7	4	1	0
Total												
Purchases	229	209	209	132	139	131	33					
Obligations to the Fund	194	146	172	363	295	138	130	207	287	262	169	74
in percent of quota	22	17	20	45	36	17	16	26	35	32	21	9
Repurchases	183	124	139	301	246	97	90	171	259	242	159	70
Charges and Interest	11	22	33	63	48	41	41	37	29	20	10	4
Total outstanding Purchases and Loans	1,163	1,248	1,318	1,150	1,042	1,077	1,020	849	591	348	189	119
in percent of quota	134	143	156	141	129	133	126	105	73	43	23	15

Source: Treasurer's Department.

Table 10. Bulgaria: Schedule of Purchases Under the Proposed Stand-By Arrangement, 2002-2004

Amount of Purchase	Available on or After	Contingent on
SDR 32 million (5 percent of quota)	Board approval (February 2002)	Board approval
SDR 26 million (4 percent of quota)	May 15, 2002	Observance of end-March 2002 performance criteria and completion of first review under the SBA 1/
SDR 26 million (4 percent of quota)	August 15, 2002	Observance of end-June 2002 performance criteria
SDR 26 million (4 percent of quota)	November 15, 2002	Observance of end-September 2002 performance criteria and completion of second review under the SBA 1/
SDR 26 million (4 percent of quota)	February 15, 2003	Observance of end-December 2002 performance criteria 1/
SDR 26 million (4 percent of quota)	May 15, 2003	Observance of end-March 2002 performance criteria and completion of third review under the SBA 1/
SDR 26 million (4 percent of quota)	August 15, 2003	Observance of end-June 2002 performance criteria
SDR 26 million (4 percent of quota)	November 15, 2003	Observance of end-September 2003 performance criteria and completion of fourth review under the SBA 1/
SDR 26 million (4 percent of quota)	February 15, 2004	Observance of end-December 2003 performance criteria 1/

1/ In addition to standard clauses on an overdue financial obligation to the Fund or failure to meet a repurchase expectation, on the exchange and trade system, and the performance criterion on the non-accumulation of external arrears.

Bulgaria: Tentative Work Program

1. UFR/Article IV missions, discussions, and Board meetings

- a. Board discussion on Use of Fund resources — February 2002
Program Negotiation
- b. Use of Fund Resources — First review and April 2002
Article IV consultations
- c. Board discussion on use of Fund resources — June 2002
First review and Article IV consultations
- d. Use of Fund Resources — Second review October 2002
- e. Board discussion on use of Fund resources — December 2002
Second review

2. Technical assistance

- a. FAD: Tax policy January 2002
- b. FAD: Long-term country resident expert April 2002 – March 2003
- c. STA: Data dissemination standards February 2002
- d. MAE: Review of TA needs resulting from FSAP April 2002
- e. STA: Price statistics mission to assist with PPI April 2002
sample expansion and other improvements

3. World Bank—tentative timing of policy-based lending

- a. PAL I (FESAL III) –Board discussion September 2002
- b. PAL II – Board discussion October 2003

Bulgaria: World Bank Relations

Lending operations

1. The Bank has approved 25 loans to Bulgaria to date, of which 12 are active (Table 11). The most recent loan approved by the Bank's Board was the Second Agriculture Sector Adjustment Loan (US\$50 million equivalent in June 2001).
2. The Bank's Board discussed a Country Assistance Strategy (CAS) for Bulgaria in May 1998. The priorities articulated in the CAS are: (i) accelerating structural reforms and promoting private sector development; (ii) liberalizing agricultural policies and fostering efficiency in agricultural markets; (iii) completing energy sector reforms; (iv) rationalizing and strengthening the role of the state; (v) fighting poverty and developing Bulgaria's human capital; and (vi) complying with EU environmental standards. The strategy envisages an important role for IFC in developing the private sector through support for privatization and restructuring of state-owned enterprises and new investments in private companies. The IMF and World Bank staff maintain a close collaborative relationship in supporting the Government's structural reforms.
3. The Bank has initiated work on the next CAS covering the period FY02 to FY04. A draft was discussed with the previous Government in March 2001. Since then, the Bank has held extensive public consultations on the draft in Bulgaria. Discussions with the new Government took place in October/December 2001 and the tentative timing for the Board discussion is April 2002.

I. TECHNICAL ASSISTANCE

4. The Bank continues to provide technical and advisory assistance to the Government in a number of areas, including bank and enterprise restructuring and divestiture, agricultural, environment and energy sectors reforms, reform of the social protection system, and public administration reforms.

II. ECONOMIC AND SECTOR WORK

5. Since the first Country Economic Memorandum (CEM) on Bulgaria (February 1991), the Bank has undertaken analytical work in a number of key areas. These include sector studies on agriculture, energy, environment, taxation, privatization, social, and telecommunications. Economic Progress Reports were also prepared for the Consultative Group Meetings.
6. The most recent CEM "Bulgaria: The Dual Challenges of Transition and Accession" was completed in March 2001. An update of the Poverty Assessment (1999), based on a 2001 Living Standards Measurements Survey, is underway and expected to be completed in FY02. A Public Expenditure Review is underway and expected to be completed in FY02.

Table 11. Bulgaria: World Bank Lending Operations

	Lending Operation	Amount	Board Date
1.	Technical Assistance Loan (TAL) ¹	US\$ 17 million	1991
2.	Structural Adjustment Loan (SAL)	US\$250 million	1991
3.	Energy Project ²	US\$ 93 million	1993
4.	Telecommunications Project	US\$ 30 million	1993
5.	Private Investment and Export Finance Loan ³	US\$ 55 million	1993
6.	Water Companies Restructuring Loan ⁴	US\$ 98 million	1994
7.	Debt and Debt Service Reduction Loan	US\$125 million	1994
8.	Agricultural Development Project ⁵	US\$ 50 million	1994
9.	Railway Rehabilitation Project	US\$ 95 million	1995
10.	Health Sector Restructuring Loan	US\$ 26 million	1996
11.	Rehabilitation Loan	US\$ 30 million	1996
12.	Social Insurance Administration	US\$ 24 million	1996
13.	Critical Imports Rehabilitation Loan	US\$ 40 million	1997
14.	Financial and Enterprise Sector Adjustment Loan I	US\$100 million	1997
15.	Environmental Remediation Project	US\$ 16 million	1998
16.	Social Protection Adjustment Loan ⁶	US\$ 80 million	1998
17.	Regional Initiatives Fund	US\$ 5 million	1998
18.	Agriculture Sector Adjustment Loan I	US\$ 75 million	1999
19.	Financial and Enterprise Sector Adjustment Loan II	US\$100 million	1999
20.	Environment and Privatization Support Adjustment Loan	US\$ 50 million	2000
21.	Trade and Transport Facilitation in Southeast Europe Project	US\$ 7 million	2000
22.	Health Sector Reform Project	US\$ 63 million	2000
23.	Education Modernization Project	US\$ 14 million	2000
24.	Child Welfare Reform Project	US\$ 8 million	2001
25.	Agriculture Sector Adjustment Loan II	US\$ 50 million	2001

¹ Of which US\$4.8 million was cancelled.

² Of which US\$14.6 million was cancelled.

³ Of which US\$40.9 million was cancelled.

⁴ Of which US\$41 million was cancelled and US\$12 million reallocated to the District Heating component.

⁵ Cancelled.

⁶ Of which US\$35.4 million was cancelled.

BULGARIA: FUND RELATIONS
As of December 31, 2001

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

II. General Resources Account:	<u>SDR million</u>	<u>%Quota</u>
Quota	640.20	100.0
Fund holdings of currency	1490.44	232.81
Reserve position in Fund	32.78	5.12

III. SDR Department:	<u>SDR million</u>	<u>%Allocation</u>
Holdings	1.80	N/A

IV. Outstanding Purchases and Loans:	<u>SDR million</u>	<u>%Quota</u>
Stand-by	190.95	29.83
EFF	627.62	98.03
Contingency and Compensatory	16.00	2.50
STF	48.43	7.56

V. **Financial Arrangements:**

<u>Type</u>	<u>Approval date</u>	<u>Expiration date</u>	<u>Amount approved (SDR million)</u>	<u>Amount drawn (SDR million)</u>
EFF	09/25/1998	09/24/2001	627.62	627.62
Stand-by	04/11/1997	06/10/1998	371.90	371.90
Stand-by	07/19/1996	04/11/1997	400.00	80.00

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

	<u>Forthcoming</u>				
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>
Principal	195.2	76.6	70.7	113.3	130.8
Charges/Interest	22.1	18.0	16.1	14.0	10.7
Total	217.3	94.6	86.8	127.3	141.5

VII. Safeguards Assessments:

Under the Fund's safeguards assessment policy, the BNB is subject to a full Stage One safeguards assessment with respect to the Stand-By arrangement. A Stage One safeguards assessment of the BNB is underway. The transitional assessment of the BNB, with respect to the arrangement that expired on September 24, 2001, was completed on March 21, 2001. The transitional assessment concluded that BNB's external audit mechanism was adequate.

VIII. Exchange Arrangements:

An amendment to the Law on the Bulgarian National Bank (BNB) effectively established a currency board arrangement. The deutsche mark was chosen as the peg currency, which has since been replaced with the euro at the rate of lev 1.95583 per € 1. The BNB is required to sell and purchase on demand and without restriction currencies of EU member countries for leva on the basis of spot exchange rates that may not differ from the official exchange rate by more than 0.5 percent.

IX. Article IV Consultation:

The last Article IV consultation was concluded on March 9, 2001 (see EBS/01/28). Bulgaria is on a 12-month cycle. The Acting Chairman's summing-up of the discussion was circulated as SUR/01/36. Bulgaria has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, and maintains an exchange rate system that is free of restrictions on the making of payments and transfers for current international transactions.

X. FSAP Participation and ROSCs:

Bulgaria participated in an FSAP held from October 29 to November 14, 2001. Table 12 provides information on the production of ROSCs.

XI. Technical Assistance

Table 13 provides information on IMF technical assistance activities in Bulgaria.

Table 12. Bulgaria: ROSCs

Standard/code assessed	Date of issuance	Document number
ROSC update - Data dissemination, fiscal transparency, transparency of monetary and financial policies, banking supervision, deposit insurance, insurance supervision, securities market supervision	03/08/2001	---
ROSC – Data dissemination, fiscal transparency, transparency of monetary policy, banking supervision, system of deposit insurance, insurance supervision, securities market supervision	03/17/2000	EBS/00/46 (revised version of EBS/99/158)
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	EBS/99/158

XII. Resident Representatives:

Mrs. Piritta Sorsa took up the resident representative position on July 16, 2001.

Table 13. Bulgaria: Technical Assistance, 1998-2002

Dept.	Subject/Identified Need	Action	Timing	Counterpart
MAE	Banking supervision/debt management	Mission	Apr. 98	BNB
MAE	Organization and management	Expert	Jun., Sep., Dec. 98	BNB
MAE	Information technology	Expert	Nov. 98	BNB
MAE	Cash processing	Expert	Dec. 98	BNB
MAE	Foreign exchange	Expert	98-99 various visits	BNB
MAE	Payment system	Expert	Jan. 99	BNB
MAE	Banking supervision, organization and management	Mission	Mar.-Apr. 99	BNB
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	Payment system/liquidity management/ bank bankruptcy legislation	Mission	May 00	BNB
MAE	Bank bankruptcy legislation	Expert	Jun. 00	BNB
MAE	Foreign exchange	Mission	Nov. 00	BNB
MAE	Accounting	Mission	Dec. 00	BNB
MAE	Short-term advisor payment system	Expert	Jun. 01	BNB
FAD	Tax administration	Expert	Feb.-Aug. 98	MOF
FAD	Public expenditure management	Mission	Mar. 98	MOF
FAD	Tax administration	Mission	Aug. 98	MOF
FAD	Resident treasury advisor	Expert	Since Oct. 98	MOF
FAD	Collection of tax and social security contributions	Mission	May 99	MOF
FAD	Treasury system	Mission	Sep. 99	MOF
FAD	Unified revenue agency (URA)	Mission	Jan.-Feb. 00	MOF
FAD	Tax administration	Mission	May 00	MOF
FAD	Short-term resident advisor on the URA	Expert	May-Jun. 00	MOF
FAD	Social security administration	Expert	Jun. 00	MOF
FAD	Long-term resident advisor	Expert	Sep. 00-Sep. 01	MOF
FAD	Mission for workshop	Mission	Jun. 01	MOF
FAD	Tax administration - follow-up	Mission	Sep. 01	MOF
FAD	Customs administration	Mission	Oct.-Nov. 01	MOF
FAD	Tax administration	Mission	Sep. 01	MOF
FAD	Long-term resident advisor	Expert	Apr. 02- Mar. 03	MOF
STA	Producer prices	Mission	Apr. -May 98	NSI
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

Bulgaria: Statistical Issues

1. Bulgaria compiles and submits data to the Fund of sufficient quality and in a regular timely manner to adequately permit program monitoring and surveillance (Table 14). 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. Bulgaria is a participant in the GDDS and has posted metadata on the Data Standards Bulletin Board since May 2000. Also, the authorities have made good progress toward provision of data to the Fund in the areas of reserves, external debt, and foreign-currency liquidity in line with SDDS-based benchmarks. A task force, which was created to implement these benchmarks, is finishing its work on official reserves and other foreign currency assets. The task force expects to finalize its work soon, and monthly information on the reserves according to the benchmarks will be published.

Real sector

3. The National Statistical Institute (NSI), with technical assistance from OECD, has established a system to compile national accounts according to the recommendations of the European System of Accounts, 1995. GDP by activity and expenditure categories are compiled and reconciled within the annual supply and use framework. 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 household, and households). As for most countries, the financial account and the balance sheets are missing.

4. A monthly industrial production index is compiled. An IMF STA national accounts statistics mission found problems with the quality of inventories data and the deflation method used to construct the industrial production index, and the mission made recommendations for their resolution.

5. The NSI has also compiled estimates of quarterly GDP by expenditure categories for the period beginning first quarter of 1994 through the second quarter of 2000, based on new significantly improved quarterly surveys. Problems remain in the methods for the deflation of some components of the national accounts, such as household consumption, capital formation, and external trade, and in the coverage of private sector activities. However, significant progress has been made in the development of export and import deflators.

6. A new PPI that uses a Laspeyres index formula with 1995 as the base year was introduced in January 1998. The PPI is undergoing a revision in which detailed product specifications and transaction prices are being introduced gradually during the rotation of

samples by branch classes, with approximately 25 branch classes completed to date. However, the remainder of PPI still uses unit value prices. The NSI is in the process of expanding the collection of transaction prices throughout the industrial sector. The implementation of an action plan which foresaw the completion stage improvements by December 2001 has been delayed, and a June 2000 STA technical assistance mission proposed a new work program that would complete the PPI revision process by January 2004.

7. 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, a new method for imputing missing observations of new products is being applied, and quality adjustment procedures are applied in a few particular cases (e.g., the heating component).

8. The flow of customs data has improved dramatically since the April-May 1998 mission 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 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.

9. The lack of comprehensive labor statistics hampers the assessment of developments in employment and wages, especially in the private sector. Annual data are collected by the NSI, using a census of all establishments. The NSI also obtains current estimates from a monthly survey of establishments using all public employers and a sample of private employers (excluding establishments with less than 5 employees, and including about 10,000 private employers out of approximately 69,000 qualifying establishments). 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 self-employed and employment in small firms. Plans for improvement include using National Social Security Institute (NSSI) data 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 also needs to be conducted on a consistent schedule, semi-annually or quarterly. It has been conducted twice a year since 1993 (three times a year since 1999), but at irregular intervals. From 2001 onward, the NSI intends to conduct the survey on a quarterly basis. Also, Eurostat has been

providing support since mid-2000 in the context of a pilot project ending in mid-2001 to improve the labor force survey's compliance with Eurostat recommendations.

10. The Population Census was conducted in early 2001 and will be a source for redesign of the household surveys conducted by the NSI, particularly the household budget survey and the labor force survey.

Government finance

11. A combined STA/FAD mission in September 1999 reviewed progress under the budget execution reform program, assisted the MoF with the development of a new chart of accounts for the government sector, and provided advice on the implementation of accrual accounting for government, budgetary, and the statistical system. The mission also examined possible actions to improve fiscal transparency in line with the Experimental Report on the Implementation of Standards and Codes prepared in August 1999. Consolidated data on central government operations are routinely reported for publication in the *GFS Yearbook* and in *IFS*. The *GFS Yearbook* also has annual data on local governments.

Money and banking statistics

12. In late 1997 and early 1998, the BNB reported revised money and banking data starting in January 1991 which incorporated recommendations on methodology that were made by STA during missions and in correspondence with the BNB. This allowed the introduction of a page for Bulgaria in the June 1998 issue of *IFS*.

Balance of payments

13. 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 equity capital component in the first quarter of 2001, with no changes in the country's external debt position. Balance of payments transactions related to the mobile phone license are no longer recorded for the subsequent periods.

Table 14. Bulgaria: Core Statistical Indicators as of January 14, 2002

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govt. Balance	GDP	External Public Debt/ Debt Service
Date of Latest Observation	Jan. 14, 2002	Jan. 11, 2002	Jan. 11, 2002	Jan. 11, 2001	Dec. 27, 2001	Dec. 27, 2001	December 2001	November 2001	December 2001	Nov. 31, 2001	Q3 2001 (qtrly) 2000 (annual)	October 2001
Date Received	Jan. 14, 2002	Jan. 14, 2002	Jan. 14, 2002	Jan. 14, 2002	Jan. 14, 2002	Jan. 14, 2002	Jan. 10, 2002	January 4, 2002	January 4, 2002	Jan. 4, 2002	December 20, 2001	Jan. 4, 2002
Frequency of Data	Daily	Daily	Daily	Daily	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly Annually	Monthly
Frequency of Reporting	Daily	Weekly	Weekly	Weekly	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly Annually	Monthly
Source of Update	BNB	BNB	BNB	BNB	BNB	BNB	NSI	BNB	BNB	MoF	NSI	MoF and BNB
Mode of Reporting	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from NSI	Email from BNB	Email from BNB	Email/fax from RR	Email from NSI	Posted on the BNB website
Confidentiality	No	Yes	Yes	Yes	No	No	No	No	No	No	No	No
Frequency of Publication	Daily	Daily	Daily	Daily	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly

Sofia, Bulgaria, February 12, 2002

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

The attached Memorandum of Economic Policies (MEP) describes the policies that the Government and the Bulgarian National Bank (BNB) intend to implement during this year and next. These policies are aimed at ensuring continued macroeconomic stability and supporting sustainable economic growth. In this context, we view as central to our economic program the maintenance of a prudent fiscal policy as well as a completion of the structural reform agenda required to create a fully-functioning market economy. In support of these policies, we are requesting a 24-month stand-by arrangement in the amount of SDR 240 million.

We believe that the policies described in the attached MEP are appropriate to meet the objectives of our economic program, but we stand ready to take additional measures to meet these goals should the need arise. During the period of the arrangement, we will consult with the Fund on the adoption of any such measures that may be necessary in accordance with the Fund's rules on such consultations. Following the expiration of the arrangement, we will consult with the Fund on our balance of payments policies, in line with the Fund's policies on such consultations, if we have outstanding purchases in the upper-credit tranches. Further, during the period of the arrangement, we will consult with Fund staff in case of (i) a decrease in the deposits of the banking department of the BNB with the issue department of the BNB by more than 50 million leva in any given week except if this decrease is accounted for by a profit transfer to the Ministry of Finance; (ii) any increase in outstanding lending by the banking department to banks greater than the equivalent of 2 million leva at the end of any day; or (iii) any decrease in the gross foreign reserves of the issue department by more than 500 million leva in any given month.

The program will be evaluated on the basis of quarterly quantitative performance criteria and structural performance criteria and benchmarks (enumerated in the attached Table and Annexes of the MEP). We will also conduct with the Fund four reviews of economic developments under the program, the first two by mid-June 2002 and mid-December 2002, respectively. In addition to a comprehensive evaluation of economic performance under the program, the first review will focus on those structural reforms necessary for successful implementation of the 2002 budget and on progress made in enhancing the efficiency of the financial sector. Quantitative performance criteria for end-September 2002 and end-December 2002 will also be specified at the time of the first review. The second review will focus on the 2003 budget and continued implementation of those structural reforms of critical importance for macroeconomic performance, including public sector and energy reforms. At the time of this second review, quantitative performance

criteria for end-March and end-June 2003 and indicative targets for the remaining quarters of the year will be specified, as will structural conditionality for 2003 consistent with the ongoing structural reform program.

Sincerely yours,

/s/

Milen Velchev
Minister of Finance
Ministry of Finance

/s/

Svetoslav Gavriiski
Governor
Bulgarian National Bank

Attachments: Memorandum of Economic Policies
of the Government of Bulgaria

MEMORANDUM ON ECONOMIC POLICIES OF THE GOVERNMENT AND THE BULGARIAN NATIONAL BANK

A. Introduction

1. **Bulgaria has come a long way in the last four years.** Since the disappointing early transition years that culminated in a severe financial crisis in 1996–97, macroeconomic stability has been achieved, output growth turned robust after years of decline, and inflation has decelerated to single digits. External debt has been kept under control, declining from nearly 100 percent of GDP in 1997 to 75 percent last year. The structure of the economy also witnessed major changes as most of the non-infrastructure enterprises and banks were privatized, trade and prices were liberalized, and the overhaul of the pension and health care systems was initiated.

2. **Building on this success, we aim to take Bulgaria to the next stage of development.** Our objective is to raise substantially incomes from the current low levels, which are 26 percent of the European Union (EU) average in per capita terms (based on purchasing power parity), and to ensure that the benefits of our economic reform are broadly shared across Bulgarian society. We also aim to continue to reduce poverty and bring down unemployment, which surged as major restructuring of the economy took hold, and has remained stubbornly high. In our view, the most effective means of doing so is to encourage economic growth while cementing macroeconomic stability, and to develop a fully competitive market economy that can withstand the global market forces. Successfully meeting these challenges will also help Bulgaria gain accession to the EU.

3. **We believe the policies described below, to which we are fully committed, will help us meet these challenges.** The memorandum contains a comprehensive statement of our objectives and policy intentions in the fiscal and financial sectors, labor markets, and structural reform. The measures covered by Fund conditionality are listed in Table 1 and Annexes I–VI.

B. Policy Framework

4. **Our policy framework is three-pronged:**

- **We will maintain the currency board arrangement (CBA) at least until accession to the EU.** The CBA has served Bulgaria well, providing a stable monetary environment, contributing to low inflation, and boosting confidence. We are fully committed to take all necessary steps to support it.
- **We will implement a cautious and flexible fiscal policy, which is key to safeguarding external viability under the CBA.** We aim to reach and maintain a balanced budget over the medium term by gradually reducing the budget deficit. This will help to bring down the public debt-to-GDP ratio at a rapid pace. Reforms in the public sector, including enhancing tax administration and improving budgeting and expenditure management and our

efforts to lower costs of maintenance and operations, will help ensure that the tax burden on businesses and individuals will continue to decline while spending is increasingly focused on high priority areas, including social assistance and public investment. Further, we will take those steps necessary to ensure that fiscal policy responds swiftly and decisively to shocks. We recognize that such policies are particularly important at this time of unsettled world markets, and given Bulgaria's vulnerability to fluctuations in its trading partners' demands, exchange rates, or short-term capital flows.

- **We will, in close cooperation with the World Bank, accelerate structural reform** to create a fully functioning and competitive market economy that has the flexibility to adjust to external shocks. Our priorities for 2002 include restructuring the education and health care systems, strengthening revenue collection and public expenditure management, finalizing the privatization programs for the banking and insurance sectors, implementing a new energy pricing regime and preparing a new Energy Act, and advancing trade liberalization. We intend to maintain the reform momentum in 2003 and, among others, complete the privatization of enterprises outside the utility and infrastructure sectors, accelerate the opening of the electricity and gas markets, and initiate the privatization of electricity distribution and generation.

C. Macroeconomic Objectives

5. **Our main medium-term objective is to attain rapid sustained growth of at least 5–6 percent, while keeping inflation low.** To attain such growth, we aim to maintain high productivity growth by continued restructuring of the economy and by raising further private savings and investment, including foreign direct investment, relative to GDP. Such sustained growth would help us make important progress in improving the well being of our citizens, reducing unemployment, and raising the living standards. The current account deficit, which reached about 6½ percent of GDP in 2001, is projected to decline to moderate levels, as the impact of the temporary adverse external shocks subside, the economy becomes more competitive, and investment is increasingly financed by private savings. We expect the external deficit to continue to be mostly financed by FDI, and thus reserves levels to remain comfortable, and the debt-to-GDP ratio to decline rapidly in the medium term. At the same time, inflation is expected to remain low, with price increases relative to our trade partners limited to productivity catch-up and further adjustments in administered prices.

6. **In the short run, we will intensify our efforts to limit the impact of the adverse external shocks on output growth and the external balances.** Output growth in 2002, while still robust, will likely be more moderate than previously expected, at around 4 percent, owing mainly to the temporary slowdown in EU demand and the financial crisis in Turkey. Given these external shocks, we will continue to ensure through tight fiscal and incomes policies that the current account deficit remains manageable, at below 6 percent of GDP in 2002–03.

	2001 Est.	2002 Proj.	2003 Proj.
GDP growth (real; in percent)	4.5	4.0	5.0
CPI inflation (end of period; in percent)	4.8	3.5	3.5
Gross official reserves (end of period; in billions of US\$)	3.6	3.6	3.6
(end of period; in months of imports)	4.8	4.4	4.1
External current account deficit (in percent of GDP)	6.4	5.9	5.8

D. Fiscal Policy and Fiscal Structural Reforms

7. **Our medium-term fiscal strategy supports the CBA, provides increased aid for the poor and appropriate incentives for private sector investment and job creation.** We envisage attaining a broadly balanced budget in 2003, and maintaining it in the medium term. We will continue to lower gradually the corporate tax burden, and will reduce payroll taxes as feasible, with a view to reduce the costs of enterprises and stimulate employment. We will partially compensate for these tax cuts by improving collection and broadening the tax base. On the expenditure side, we will limit non-interest expenditure to below 35 percent of GDP by rationalizing our expenditure and eliminating waste, while strengthening the social safety net for the poor and maintaining a strong public investment program. We will also accommodate within this limit the sizable fiscal costs related to transition, and EU accession and NATO membership requirements. We will pay special attention to sequencing, and will systematically put in place deficit-reducing measures prior to tax reductions or spending increases.

8. **In light of recent adverse external shocks, we tightened the fiscal stance by 0.6 percentage point of GDP relative to the budget in 2001, limiting the general government deficit to 0.9 percent of GDP, and are committed to contain the deficit to 0.8 percent of GDP in 2002.** To deliver the fiscal tightening in 2001, and to compensate for overruns in subsidies and public investment, we took several steps in the fourth quarter of 2001. We maintained most categories of discretionary spending at approximately 90 percent of budgeted levels, refrained from starting any new investment projects, cancelled the public sector wage increase planned for October 1, reduced central administrative staff by 10 percent, and continued to improve tax collection. The budget approved by Parliament in December, 2001 envisages a fiscal deficit of 0.8 percent of GDP in 2002 on a consolidated basis. However, we are prepared to deliver a tighter stance in 2002, should external developments or inflation warrant it. To this effect, we will continue with the practice of releasing only 90 percent of the budgeted discretionary allocations during the first three quarters of the year, with a view to extend it to the full year, if needed. In addition, we have

reserved a contingency fund worth 0.3 percent of GDP, which is only to be distributed in case macroeconomic developments do not substantially worsen relative to our projections. The total flexibility implied by these two measures in 2002 is about 1 percentage point of GDP.

9. **We have reduced the tax burden in 2002 to stimulate investment and improve living standards.** We have lowered the personal income tax by raising the threshold for the non-taxable income bracket by more than expected inflation (from 100 leva to 110 leva), reducing the rates for the middle brackets, and lowering the top marginal tax rate from 38 to 29 percent. We have also effectively lowered social security contributions of self-employed workers by keeping the minimum and maximum incomes subject to contributions at last year's levels. We have unified central corporate income tax rates at the lower rate of 15 percent, while maintaining the municipal corporate income tax rate at 10 percent, implying an effective corporate tax rate of 23½ percent. Further, we have introduced tax incentives for enterprises to hire workers from the pool of long-term unemployed or those in high-unemployment regions. In addition, we have shortened the VAT refund period from four to three months for non-exports, reduced by three-quarters to 500,000 leva the threshold of the required equity capital for optional VAT registration, lowered customs duties in line with international agreements, imposed zero VAT rate on export of software, and eliminated the capital gains tax on sale of shares and tradable rights on the Bulgarian Stock Exchange with a view to stimulate the development of the market. The total impact of these measures is projected at about 1 percent of GDP.

10. **At the same time we are broadening the tax base to move toward a more efficient system that also satisfies EU requirements and continuing our efforts to improve revenue collection.** We have removed the zero VAT rate from tourist packages sold abroad. However, to lessen the immediate impact of this change on the tourism industry, we have agreed to implement this measure in a phased manner by refunding 65 percent of the collected VAT this year, and to gradually eliminate the refunds over three years. We have also imposed VAT on all medicine, and limited the list of imported goods exempt from VAT for grant recipients. We have increased excise taxes on beer and tobacco goods with a view to gradual harmonization with EU levels, increased the excise tax on coffee, and introduced excise taxes on certain types of oils and banderoles for other excise goods declared for export. In addition, we have introduced a road tax, revised municipality fees, updated the property tax base to better reflect the true property values, and raised the patent tax rates to compensate for the accumulated inflation in the last three years. We will continue our efforts to bring down the stock of tax and social insurance arrears (indicative ceiling under the program).

11. **We are increasing non-interest expenditure in key areas, including social spending.** We are raising substantially the share of social expenditure in GDP to continue to support the needy: we are increasing heating assistance, raising child allowances in tandem with measures to target them to the most needy families (the adoption of a targeting plan that ensures consistency with the 2002 budget outlay is a benchmark for end-March 2002), and increasing pensions by 6 percent (with average increase in 2002 of 9 percent), well above the expected inflation levels. We are also maintaining a strong public investment program, in

particular in those areas related to the EU accession. With the support of EU accession funds, we are improving transport infrastructure, undertaking environmental projects to meet the requirements of EU directives, and investing in agriculture and rural development.

12. **To achieve the deficit target while creating room for the tax cuts and higher social spending and adequate investment, we will accelerate needed structural reforms.** These reforms will allow us to limit spending in unproductive areas such as subsidies. We will maintain the share of the general government wage bill in GDP at approximately the 2001 level, which leaves room to increase public sector average wages by 5 percent twice—in January and in July—provided that public employment is rationalized through accelerated structural reforms. Through civil service reform designed to link wage increases to performance, we also expect wage dispersion to increase and services rendered to improve. We are taking steps to focus subsidies on socially important activities, make them more transparent, and target particularly needy consumers. In parallel, we are reducing overall subsidy needs, as we continue to implement reforms in energy, health, and transportation, and state-owned enterprises in other sectors (see below).

13. **We will follow an ambitious public sector reform agenda,** which is key to maintaining fiscal viability in 2002 and the medium-term.

- The **pension reform**, based on a three-pillar pension scheme, is designed to ensure adequate retirement income and restore the long-term viability of the pension system. Regarding the first pillar—the pay-as-you-go insurance—we expect the deficit to decline in the medium term as the retirement age is gradually increased and the rate of increase of pensions is limited to inflation or revenue growth, and we are prepared to adjust the parameters to ensure that the system remains viable. As of January 1, 2002, 2 percentage points of the social contributions are being transferred to the second pillar—the mandatory fully funded insurance—for those who are born on or after January 1, 1960. We intend to increase this rate according to a preannounced schedule to 5 percentage points by 2007. We will ensure that these funds, as well as those in the third pillar—the voluntary private pension system—are invested and administered efficiently by further improving the regulatory framework, and strengthening the supervisory capacity of the State Insurance Supervision Agency and the governance of pension insurance companies and pension funds. We will amend the investment guidelines and regulations for pension funds by September 2002 to improve risk diversification, including through gradually raising the ceiling on investment in foreign securities to 25 percent. To close a loophole that allows for unwarranted early withdrawal, we will draft legislative changes by March 2002, and expect Parliament to adopt them by June.
- As a result of changing demographics, we will restructure the **education sector**, while continuing to maintain enrollment rates, provide equal opportunities to all students, and improve the quality of education. Reductions in teacher employment will to the extent possible be carried out through

attrition and rationalization in urban areas, taking into account social and demographic factors. In addition, we will merge several schools to reduce the administrative and operational costs. With these measures, we expect to raise the student-teacher ratio towards the average level in OECD countries. These measures will be reflected in a redeployment plan for teachers that will be finalized and submitted to the Council of Ministers by end-March 2002 (structural benchmark). The plan will be discussed with the interested parties during the second quarter of the year and implemented before the start of the 2002–03 school year.

- We will continue the **health care reform**, aimed at providing better health care services, while rationalizing and improving the efficiency of the providers. The first stage, which transferred the financing of out-patient services to the newly-established Health Insurance Fund (HIF), has already started to yield better quality of services. In the ongoing second stage, hospital care will be increasingly financed by the HIF. In line with the reform strategy, we will increase the contribution of the HIF to 25 percent of total hospital costs in 2002, and more if the administrative capacity is sufficiently developed. We plan to raise the HIF's share above 50 percent in the medium-term, and to facilitate this, we will make the use of clinical pathways fully operational by March 2002, and finalize accreditation of all the hospitals by end-June 2002 to identify providers of high quality health services (structural benchmark). In addition, we will redirect around 10 percent of medical activities from hospitals to out-patient service providers, reduce expensive and non-effective activities in the hospitals, and privatize or close around 10 percent of hospitals in 2002. These measures will be detailed in a multi-year plan for hospital financing, which we will prepare by mid-2002.
- We are working with the **municipalities** to strengthen further their financial performance. Starting this year, we aim to ensure that funds transferred or revenues guaranteed by the state match the expenditure commitments of the municipalities mandated by the state. At the same time, we are giving greater autonomy to the municipalities to administer local fees and other non-tax revenues to finance the services they choose to provide. Under this new system the municipalities should regain their financial health and move towards balanced budgets in subsequent years. Should a municipality accumulate arrears, including those related to wages, despite these new measures, we will not extend the funds to cover the deficit and will apply the sanctions provided by law.

14. **We will emphasize administrative reforms**, which will help us better manage both revenues and expenditures:

- We are redoubling our efforts to establish the **Unified Revenue Agency (URA)**, and to strengthen **customs administration**, with a view to broaden

the revenue base and create room to lower further the tax and contribution rates. An inter-institutional commission that was established to carry out the URA project adopted a strategic plan in June 2001, which identified in detail the steps needed to establish the URA. In line with the plan, we have already started to modernize the information system, with assistance from the World Bank, and we expect to complete it by end-2003. We also have started to implement changes at the territorial and subdivisional levels to separate the collection of republican taxes from local taxes and charges. We have started to do joint audits, and drafted the legislative changes that allow for better exchange of information among revenue collection units. We expect parliament to adopt these changes by March 2002. We will submit to Parliament all other legislation to unify revenue collection, including, by end-June 2002, a law to establish the unified revenue agency (structural benchmark). We completed the consolidation of the large taxpayer offices into one office located in Sofia, controlling about 60 percent of the budget tax revenue, and we are improving accommodation of tax offices at the territorial level to allow for efficient tax collection. Regarding customs, we are taking several administrative and legislative measures to boost collection, facilitate legitimate trade, reduce internal and external fraud and corruption, and achieve sustainable reform in line with the requirements for accession to the EU. These measures include: increasing mobile anti-smuggling teams; strengthening information exchange with the customs administration of the EU member countries; establishing a central post-clearance control unit; optimizing the facilities at the border crossing points; holding joint inspections with the General Tax Directory; consolidating the number of offices; and establishing an internal audit unit. To implement these measures, we are receiving significant foreign assistance and have signed a three-year contract with the Crown Agents company.

- While the existing budgeting system worked well from the point of view of achieving fiscal targets, we have begun to **reform the budget preparation process** to focus more on spending composition and quality, and economic growth. Specifically, we will identify priorities and include them in the initial strategic phase as indicative allocations to budget units, based on a transparent decision framework. We will bolster expenditure estimates by creating baseline projections for each first level budget unit for the budget year plus three years, using clear and transparent rules. At the same time, we will increase discretion of budget units in managing their administrative costs, while continuing to maintain firm control from the center over the cost limits being provided to line ministries, and putting in place additional reporting requirements on use of funds in areas of particular concern. We will also improve further budget documentation to facilitate more informed discussion by including the impact of major initiatives for the budget year plus three years. We will improve the credibility and transparency of the macroeconomic framework by circulating it more widely, comparing it with other available

forecasts, clearly showing the sensitivity of the budget's major aggregates to variations in macroeconomic parameters, and discussing developments between the time the framework was issued and the presentation of the budget. We plan to advance the start of the 2003 budget preparation to the first quarter of 2002, and plan to make this new framework fully operational by the next budget cycle, for which we have started to receive technical assistance from the IMF.

- We will further **improve the treasury system** to better control and execute government expenditure. The ongoing treasury reform is well advanced, and by now, the treasury single account (TSA) includes all leva accounts of the budget organizations held in the BNB (around 80 percent of the cash resources). The payments of 24 of the 26 ministries and agencies and their sub-ministerial spending units (over 2500) are carried out through the system for Electronic Budgetary Settlement, while their revenues are centralized in the BNB. By December 2002 the funds of the autonomous budgets (BTV, BN Radio, judiciary system, and the HIF) as well as the suspense accounts in leva will also be included in the TSA (structural benchmark from December 2002 onward). In addition, the new chart of accounts is applied by all government agencies from the beginning of 2002, and all first level spending units now report through the new information system.

E. Labor Market Policies

15. Appropriate labor market policies are key to safeguarding the CBA, and bringing down unemployment. Our policies are geared toward ensuring strong productivity growth necessary for sustained increase in real wages, and maintaining financial discipline of the SOEs. Furthermore, we are making every effort to increase the flexibility of the labor market, and moving toward market-oriented solutions to generate jobs. Combined, these policies will help maintain competitiveness, increase employment and wages, and facilitate rapid adjustment of the economy to shocks.

16. To help achieve these goals, we will strictly implement our incomes policy for the SOEs and minimum wage policy . We have issued an incomes policy ordinance, which allows for higher wages only if staff count is reduced or productivity increased. We will monitor particularly closely the wage bill of 60 enterprises, including those with the largest losses and arrears, monopolies, and those receiving subsidies. We expect our incomes policy to limit the increase in the aggregate wage bill of these enterprises to no more than 2 percent (a ceiling on their aggregate wage bill is a quarterly performance criterion for 2002). We plan to freeze the wage bill at the level of the third quarter of 2001 for all those enterprises on the list that are incurring losses or having arrears, and for those receiving subsidies. Monopolies that increase profits, do not have arrears and do not receive subsidies will be allowed to increase their wage bill by up to 5 percent during 2002. In enterprises that exceed their wage bill ceilings, we will take measures to reverse the increase, and penalize its management. Regarding the minimum wage, after the 17 percent increase in October 2001, we will

maintain it at that level throughout 2002. After that, we will increase it annually in line with the average public wage increase.

17. **We will make every effort to continue to improve the functioning of the labor market.** We are pursuing active labor market programs with a view to create new jobs via promoting small and medium size businesses, and allowing unemployed workers to acquire new skills needed for available jobs. These programs, for which we have envisaged larger funds in the 2002 budget, include temporary employment opportunities, and tax incentives for companies that hire long-term unemployed. We have also initiated a loan guarantee program to allow banks to extend loans at market-based interest rates to small-enterprises in regions with high unemployment, but will ensure that the guarantees stay within the 20 million leva budget allocated to the Guarantee Fund for Micro-Crediting, and do not interfere with banks' lending decisions or impose a financial burden on banks. Furthermore, we are starting negotiations with the social partners to prepare amendments to the Labor Code aimed at modernizing and enhancing the flexibility of the labor market, including through the reduction of dismissal costs. We aim to submit these amendments to Parliament by June 2002.

F. Financial Sector Policies

18. **We are committed to strengthen bank intermediation, which shrunk markedly in the wake of the 1996–97 financial crisis, and develop further non-bank financial institutions, under appropriate supervision.** Credit to the private sector is at low levels, although it has begun to grow quite strongly. We are committed to generate the necessary environment that would yield higher levels of credit to the private sector to support the investment that is needed for strong and sustained growth. More broadly, well functioning financial markets would support the CBA, and help our efforts to join the EU. The measures we are taking to strengthen bank intermediation are market-based and aim to eliminate structural barriers to credit growth in the financial sector, including by strengthening corporate governance in the enterprise sector, improving accounting standards, and ensuring that the regulatory framework and its implementation remain sound. In this regard, we will draw on the conclusions and recommendations of the Financial Sector Assessment Program that was conducted in October-November 2001.

19. **We will expedite the full privatization of the financial sector.** We sold the government's stake in the Central Cooperative Bank to a strategic investor in November, 2001, and around 82 percent of the banking sector is now in private hands. Of the remaining state-owned banks, we plan to privatize Biochim Bank by mid-2002, and launch a new tender in the first half of 2002 to that effect. Further, we will adopt by end-March 2002 a privatization plan for DSK Bank—which preferably will involve a strategic investor—with a view to move to the implementation stage before the end of the year (structural benchmark). We will reopen the privatization procedure for the State Insurance Institute, and organize a re-appraisal of its value by March 2002, with a view to sell it by June 2002. For this purpose, we will by end-March 2002 issue a tender to privatize the Institute or, as an interim step toward such privatization, to transfer its management to a strategic investor (structural benchmark).

20. **We are taking measures to stimulate financial markets.** We are improving the provision and exchange of financial and credit record information, including through full implementation of the new accounting and auditing law. We will reinforce creditor rights and insolvency procedures by submitting to Parliament amendments to the civil procedure code, improving corporate governance, and strengthening the business environment more generally. We are committed to abstain from any measures that would interfere with bank lending to the private sector. To stimulate long-term lending, we intend to exclude long-term deposits in the banking system from minimum reserve requirements, while maintaining the level of the requirement at 8 percent for the deposits that continue to be covered. To stimulate the development of the securities markets, we are planning to float up to 30 percent of the shares in major companies that are still partially or fully state owned. Other measures we envisage include enacting amendments to the Law on Public Offering of Securities, introducing international accounting standards in 2003 for financial and publicly listed companies and in 2005 for all enterprises, harmonizing the taxation of financial instruments and services, and address deficiencies in minority shareholder protection. We will give priority to the implementation of the Real Time Gross Settlement System project and aim to finalize it by end-2002.

21. **We will continue to strengthen the oversight of the financial system.** We will undertake further steps to strengthen banking supervision, with a focus on improving institutional capacity and implementation. For this purpose, the BNB will be given broader powers to investigate the identity and suitability of direct and indirect shareholders of banks, both domestic and foreign. We will submit to Parliament the necessary amendments to the Banking Law by March 2002, and the BNB will change the relevant regulations shortly after the amendments are adopted. The supervisory mechanisms will be strengthened to prepare for a projected increase in lending activities and short-term capital flows associated with continued robust growth and EU accession. The BNB will continue to expand its expertise in modern risk management systems and ensure that commercial banks implant such systems tailored to their portfolios. At the same time, to improve the process of handling insolvent banks, including already closed banks, we will take all the steps necessary to have Parliament approve the Bank Bankruptcy Law as drafted in consultation with IMF staff by end-March 2002 (structural benchmark), and to adopt the associated secondary legislation. We will upgrade the supervision of insurance companies by strengthening the legislative and regulatory framework in the areas of corporate governance and internal controls, accounting and actuarial rules, standards of market conduct, and international supervisory coordination and cooperation and improving the quality of on-site inspections including by making them more frequent and more focused on risk assessment. To develop a system-wide perspective on assessing financial sector risks, by March 2002, a forum will be set up for periodic information sharing, coordination and cooperation among the heads of the financial supervision agencies and relevant government officials. We will intensify our efforts to combat money laundering. To this effect, we will by June 2002 submit to Parliament amendments to expand the scope of the Anti-Money Laundering Law to lawyers and exchange bureaus, introduce corporate liability for anti-money laundering offenses, and improve the options for freezing assets during the pre-trial phase. We also will by

March 2002 introduce measures to strengthen the independence and resources of the Financial Investigations Bureau and other anti-money laundering services.

G. Structural Reform

Enterprise restructuring and privatization

22. **While the enterprise sector has witnessed major changes in recent years, important structural impediments to growth remain.** Achievements so far in this area include privatizing more than half of state-owned assets, liquidating a number of non-viable enterprises, and selling more than half of minority share packages in non-strategic enterprises. However, there have been delays in the privatization of several large enterprises, including Bulgartabac and the Bulgarian Telecom Company (BTC). Moreover, the privatization process has at times been less than fully transparent, and a number of privatization deals, including many management-employee buyouts (MEBOs), did not produce the desired improvements in the privatized companies. Furthermore, resolution of unviable entities has been slow, as liquidation and bankruptcy procedures remain cumbersome. Restructuring and rehabilitation efforts of the state railway company (BDZ) and the energy sector remain to be completed.

23. **We are determined to complete the reform of the enterprise sector within two years, with a view to create a fully market-oriented and competitive economy.** First, we are already improving the transparency and quality of privatization overall. Second, we plan to finalize privatization of all viable non-infrastructure SOEs by end-2002, and make major progress in privatizing the infrastructure companies. Third, we will complete the liquidation of those SOEs that are not viable, and further improve the liquidation and bankruptcy procedures. Finally, we will implement rigorous rehabilitation plans for those companies that provide specific public services, particularly BDZ. More specifically:

- **We aim to guarantee transparency and a level playing field for all privatization participants.** We have submitted to parliament a new Privatization Law that removes all preferential terms for MEBOs (such as allowing the use of deferred payments), and restricts privatization methods to auctions, tenders, and public offering of shares, ending the practice of direct negotiations with buyers. On the administrative side, we will make the Privatization Agency (PA) the only body in charge of privatization deals. Also, we intend to publish on a monthly basis details regarding completed sales, including the identity of the buyer, price, deadlines and conditions of payment, and investment and employment commitments.
- **Our ambitious privatization agenda aims to conclude the remaining privatization of large enterprises by end-2002.** In the cases of Bulgartabac and BTC we have signed contracts with sales advisors, prepared the sales strategy, and expect to complete the sale of both companies before mid-2002. The privatization plan for 2002 also aims at selling, among others, the State Insurance Institute, 7 electricity distribution companies, 36 water power plants, the Bulgarian Rivershipping Company, and the Navigation Maritime Bulgare. Also, we will

complete the sale of all residual stakes in privatized companies, excluding packages held due to restitution or legal problems, by end-June 2002. We drafted legislative changes to open ports and airport operations to concession, and expect the concessions to start operating in 2002.

- **We are continuing to work on initiatives to improve the business climate.** We are taking steps to simplify the licensing, permit, and registration systems. This should encourage the establishment of more domestic and foreign businesses. We will refrain from targeting investment incentives—whether through the tax system or otherwise—based on the nationality of investors. In addition, we are improving the delivery of government services to businesses, as well as their accountability, with a “one stop shop” program, which limits the interface between the administration and business to a single office. Moreover, to help the judicial system better serve the business community, we are proceeding with reforms in this area, including training judges on financial procedures and computerization of the courts. Finally, we are amending the commercial code with a view to strengthen corporate governance and accelerate the liquidation and bankruptcy proceedings. These amendments should facilitate liquidating the assets of the enterprises that entered into liquidation in 1999.
- **We are committed to restructuring the state railways company.** Our overall strategy is for the railway operator to ultimately function on a commercial basis, with compensations limited to targeted groups, and adequate subsidies defined for public sector obligations; and the state to be responsible for development of the infrastructure. In line with this strategy, last year under the Special Action Plan for 2001, we raised freight and passenger fares by 20 and 15 percent, respectively, reduced overstaffing and operating costs, and sold surplus assets. However we incurred larger-than-projected losses largely because of lower-than-expected traffic and lack of sufficient progress in implementing the Special Action Plan. This year we are redoubling our efforts to continue restructuring and to keep subsidy needs within the budgeted 70 million leva. Specifically, in January we split infrastructure and operating services, and competition will be gradually introduced as envisaged in the new Railways Law. Moreover, we are rationalizing the staff structure closer to European standards, limiting wage increases, removing from operation surplus assets, and eliminating unprofitable lines. Within the course of the year, and with the help of external consultants and the World Bank, we will determine which activities should be operating at cost recovery levels, and which ones require government subsidies. We will ensure that the state has clear contracts with BDZ on the targeting and level of subsidies. Finally, we will complete within 2002 a long-term business plan that defines the next stage of restructuring.

Energy sector reform

24. **Establishing a more competitive and efficient energy sector is of key importance for accelerating economic growth and reducing fiscal risk.** With this objective in mind, we are revising our medium-term national energy strategy with a view to speeding up liberalization, increasing private sector participation, privatizing the production and

distribution companies, and increasing transparency and competition in the electricity and gas markets. We will ensure that these changes also meet EU accession requirements.

25. Parliament in November 2001 approved urgently needed amendments to the Energy Act. These amendments were designed to enable a further liberalization of the energy sector, as well as to clarify company-customer relations in the district heating sector to improve payments and collections. In line with these legislative changes, about 10 percent of the gas and electricity markets will be prepared to be opened by end-2002, allowing large users to contract supply directly. The November amendments also introduced important institutional changes, including by establishing a Ministry of Energy and strengthening the Regulatory Commission. The Council of Ministers will adopt all regulations envisaged in the current Energy Act by end-June 2002 with the exception of the regulations related to the opening of the gas and electricity markets, which will be adopted by end-March 2002. We will, in consultation with the World Bank, also clarify the implications of the new regulatory pricing regime provided for in the Act. In addition, the regulator will set and announce a timetable by end-April 2002 for the adjustment of household tariffs for gas and electricity to cost-recovery price levels, including an interim target date by which average household tariffs will equal average commercial tariffs (structural performance criterion). The regulator will by end-June 2002 make the new regulatory pricing regime fully operational, including by making available the proper accounting information to determine cost-recovery levels and adopting a transparent pricing mechanism (structural benchmark). In parallel, we have begun to prepare a new Energy Act and intend to have the Council of Ministers approve the final draft by end-June 2002 (structural benchmark). The new Energy Act will harmonize Bulgaria's energy legislation with EU Electricity and Gas Directives, including through introducing an authorization process for adding power generation capacity and allowing investors to take market risks by opening further the electricity and gas markets.

26. In addition to these legislative and regulatory initiatives we are undertaking major restructuring efforts in a number of areas of the energy sector. We will implement the restructuring plan for the district heating sector as adopted and in accordance with its timetable during the current and forthcoming heating seasons to stem the heavy financial losses and prevent further decay of the infrastructure. We will by end-June 2002 prepare a plan which envisages selling all the electricity distribution and—in a next step, following preparation for privatization—the generation companies to strategic investors. We will revise the restructuring program for the gas sector with a view to stimulating the development of the gas market and investment, award licenses for developing the low pressure segment of the market, continue the restructuring of the Bulgargaz transmission company, and finalize the preparations to enable third-party access to the transmission network. We will allow large users to contract gas supply directly, including from abroad to the extent external contractual obligations leave room for it. We will, by end-2002, complete the financial liquidation of unviable coal mines and finalize the privatization of viable mines. From 2003, budgetary support to the coal sector will be strictly limited to financing of the technical liquidation of closed pits and environmental rehabilitation.

External sector policies

27. **Building on the major progress made in recent years, we will pursue further trade liberalization in order to prepare for EU accession, and to create a more attractive environment for foreign investors.** To date we have eliminated non-tariff barriers and substantially reduced tariffs. We aim to further liberalize and simplify our trade regime, and eventually harmonize it with that of the EU. To this end, we will prepare a multiyear schedule, which we will adopt by end-June 2002 (structural benchmark). Guided by this schedule, we will reduce the unweighted average most favored nation (MFN) import tariff rate (currently at 12.7 percent) to 6 percent by 2006, with significant annual reductions, to eliminate the gap with the current EU average and further reduce distortions to international trade. The 2002 Customs Tariff we adopted already goes in this direction. We aim to privatize all remaining state-trading companies during 2002.

28. **We have begun to manage government debt with the objectives to lower the public sector debt-to-GDP ratio, reduce the portfolio risk, minimize roll-over risk, establish benchmarks in international and domestic capital markets, and keep sufficient liquidity in the Fiscal Reserve Account (FRA).** We have submitted to parliament a new Sovereign Debt Law, which provides a firm legal foundation and procedures for issuance of state debt and guarantees. We expect parliament to adopt the law by March 2002, and we plan to also review our debt management strategy by that point. In line with our intended debt strategy, we have already made significant progress in reducing Bulgaria's debt burden, with the end-year public external debt standing at around US\$ 8.7 billion, or 67 percent of GDP. We intend to achieve in 2002 a further significant reduction in the public external debt as a share of GDP, and debt ceilings consistent with this objective are performance criteria under the program. The issue of our first Eurobond in November 2001 has been successful, and if we access the market again, we will ensure that the choice of maturity, size, and currency denomination will continue to be based on the objectives of our debt management strategy. Our policies will also encourage the further development of the domestic market for sovereign debt issues and the definition of the yield curve. A sufficiently high stock of the FRA will be the key to maintaining market confidence and to our meeting external obligations when international capital markets are difficult or too costly to access. We will therefore maintain the FRA at a level in excess of 90 percent of anticipated annual debt service (performance criterion under the program). At the same time, we will seek to maximize its rate of return consistent with maintaining adequate liquidity and prudent risk.

29. **We believe that transparency and predictability are essential for our debt management strategy to be effective.** We will therefore continue to make all relevant data and information available in a timely and broad-based manner to domestic and foreign investors, also through making further efforts in adopting the IMF's Special Data Dissemination Standard. We will make public our medium-term debt service payments schedule. We will also appoint a contact person within the Ministry of Finance to communicate with foreign and domestic investors. The strengthening of our statistical standards with regard to external debt and reserves should further help in this regard.

Table 1. Bulgaria: Prior Actions and Structural Performance Criteria and Benchmarks, 2002¹

Measures	Program Timing	Level of Conditions
1. Parliament to adopt a 2002 State budget consistent with paragraphs 8–12.	Before IMF Board meeting	Prior action
2. Council of Ministers (CoM) to adopt an ordinance on income policies consistent with paragraph 16.	Before IMF Board meeting	Prior action
3. Announce a schedule to bring household electricity prices to full cost-recovery levels (paragraph 25).	End-April 2002	Performance criterion
4. Finalize the school redeployment plan, and submit it to CoM (paragraph 13).	End-March 2002	Benchmark
5. Adopt a child allowance allocation system, limiting allowances to most needy families (paragraph 11).	End-March 2002	Benchmark
6. Bank Consolidation Company (BCC) to adopt a privatization strategy for DSK Bank (paragraph 19).	End-March 2002	Benchmark
7. Issue a tender either to privatize the State Insurance Institute, or to transfer the management of the company to a strategic investor as an interim step toward privatization (paragraph 19).	End-March 2002	Benchmark
8. Parliament to adopt the Bank Bankruptcy law (paragraph 21).	End-March 2002	Benchmark
9. Submit to parliament a law to establish the unified revenue agency (paragraph 14).	End-June 2002	Benchmark
10. Complete accreditation process for all hospitals (paragraph 13).	End-June 2002	Benchmark
11. Have the Council of Ministers approve the final draft of a new Energy Act as described in paragraph 25.	End-June 2002	Benchmark
12. Make the new energy pricing regime fully operational (paragraph 25).	End-June 2002	Benchmark
13. Announce a reform of the import tariff schedule, to be phased over the period to January 2006, reducing the unweighted average MFN tariff to no more than 6 percent with significant annual reductions (paragraph 27).	End-June 2002	Benchmark
14. Further improve the Treasury Single Account (TSA) by ensuring that the funds of the autonomous budgets (BTV, BN Radio, judiciary system, and the HIF) as well as the suspense accounts in leva are also included in the TSA (paragraph 14).	December 2002 onward	Benchmark

^{1/} Paragraph numbers refer to the Memorandum of Economic Policies dated February 12, 2002.

Performance Criterion on the Overall Deficit of the General Government

	Overall deficit ceilings
	(In millions of leva)
January 1, 2002–March 31, 2002	138
January 1, 2002–June 30, 2002	-103
January 1, 2002–September 30, 2002 (indicative)	173
January 1, 2002–December 31, 2002 (indicative)	260

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 fund) as well as all extrabudgetary funds and accounts both at the central and local government levels.

The quarterly limits will be cumulative and will be monitored from the financing side as the sum of net credit from the banking system to the general government, including deposits and accounts abroad, net nonbank credit to the general government, privatization receipts of the budget, and receipts from external loans for direct budgetary support minus amortization paid. For calculating the performance against this ceiling, privatization receipts include the dividends the Bank Consolidation Company (BCC) distributed to the general government and taxes collected from BCC related to the sale of assets, and all the proceeds from the sale of GSM licenses. External drawings and repayments 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.

Performance Criterion on the Floor on the Balance of the Fiscal Reserve Account

	FRA
	(In millions of leva)
March 31, 2002	1,900
June 30, 2002	1,900
September 30, 2002 (indicative)	1,900
December 31, 2002 (indicative)	1,900

The Fiscal Reserve Account (FRA) consists of (1) the balances in leva and in foreign exchange of the following accounts: all budgetary and deposit accounts in the banking system, including the central budget, ministries and agencies, central government extrabudgetary funds as defined in Annex No. 4 of the 2001 Budget Law, the National Social Security Institute, and the Health Insurance Fund, and (2) other highly liquid foreign assets of the central government.

The limits will be monitored from the accounts of the banking system and marked-to-market data of other highly liquid foreign assets of the central government, to be provided monthly by the BNB and the Ministry of Finance. For the purposes of the program, deposit accounts and assets that are denominated in foreign currencies will be converted into leva at the December 31, 2001 exchange rates (2.21926 leva, and 1.25673 SDR per US dollar).

Performance Criterion on the Wage Bill of 60 State-Owned Enterprises (SOEs)

Wage Bill of 60 SOEs

(In millions of leva)

July 1, 2001—September 30, 2001 (actual)	140.3
January 1, 2002—March 31, 2002	143.1
April 1, 2002—June 30, 2002	143.1
July 1, 2002—September 30, 2002 (indicative)	143.1
October 1, 2002—December 31, 2002 (indicative)	143.1

The ceiling on the aggregate wage bill of the 60 state-owned enterprises closely monitored for their large losses or arrears, for receiving subsidies, or for being monopolies, is two percent above the level of their aggregate wage bill in the third quarter of 2001. The wage bill is defined to include wages and payroll taxes paid by the employer.

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 2002 will also exit the list in the second half of 2002, unless they are monopolies, have arrears, or receive state subsidies. If an enterprise is excluded from the list, the wage bill ceiling will be adjusted down by the amount of that enterprise's wage bill in the third quarter of 2001 plus 2 percent. The 60 enterprises monitored (enterprises number 1 to 17 are considered monopolies):

1. Railway Infrastructure Company	21. Passenger Transport EOOD	41. Brikel EAD
2. BDZ EAD	22. Electricity Transport-Sofia EAD	42. Eliseina EAD
3. Bulgargas EAD	23. Autotransport-Sofia EAD	43. Bobov Dol Mines
4. BTC EAD	24. Burgasbus EOOD	44. Energoremont-Gulubovo
5. National Electric Company	25. Bus Transport EOOD	45. Vazov Machinery Works
6. TPP Varna EAD	26. DHC-Burgas EAD	46. Bulgartabac-Plovdiv AD
7. EDC -Varna EAD	27. DHC Vratsa EAD	47. Bulgartabac-Asenovgrad
8. EDC -G. Oriahovitsa EAD	28. DHC-Gabrovo EAD	48. Motori Technika Agrocultur
9. NPP Kozlodui EAD	29. DHC-Pernik EAD	49. Dunarit AD
10. TPP Bobov D	30. DHC-Pleven EAD	50. Bulgarian Rivershopping EAD
11. EDC -Pleven EAD	31. DHC-Plovdiv EAD	51. Balkancar Holding
12. EDC -Plovdiv EAD	32. DHC-Ruse EAD	52. Agrobiochim AD
13. EDC-Sofia City EAD	33. DHC-Sliven EAD	53. Bulgartabac Haskovo AD
14. EDC -Sofia District EAD	34. DHC-Sofia EAD	54. Bulgartabac Shumen AD
15. EDC -Stara Zagora	35. DHC-Kazanluk EAD	55. Hristo Botev Mines EOOD
16. TPP Maritza Iztok 2 EAD	36. DHC-Shumen EAD	56. Bulgartabac Dupnitsa AD
17. TPP Maritza 3-Dimitrovgrad EAD	37. Pirin Mines EAD	57. Sluntse EAD-Smolian
18. City Transport -Varna EOOD	38. Bulgartabac-Gotse Delchev AD	58. NIIFI AD
19. City Transport Plovdiv EOOD	39. Port Burgas EAD	59. Incoms Telecom Holding AD
20. Ruse Municipal Autotransport EOOD	40. Varna Shipyard AD	60. Agrocomplex EAD

Indicative Ceiling on Tax and Social Insurance Arrears

	Total	GTD	NSSI
	(In millions of leva)		
Outstanding as of:			
December 31, 2001 (actual)	683.1	471.7	211.4
Cumulative change from level on December 31, 2001:			
March 31, 2002	-30	-25	-5
June 30, 2002	-60	-50	-10
September 30, 2002	-90	-75	-15
December 31, 2002	-120	-100	-20

These indicative targets are on the sum of change in monitored arrears to the GTD and arrears to the NSSI. For the purpose of these indicative targets, arrears are defined to include interest and penalties. The enterprises monitored for arrears to the GTD:

1. Lukoil - Neftochim	11. Arsenal EAD	21. Trema AD
2. Energokabel AD	12. Vini EAD	22. Madara AD
3. Plama AD	13. Bourgas Seaport	23. Dunarit AD
4. VMZ AD - Sopot	14. PDNG EAD	24. Maritsa KK AD
5. Haskovo BT AD	15. Bourgas Sugar Factory AD	25. Ledenika AD
6. NEK EAD	16. Dupnitsa BT	26. Dobrich Mel AD
7. Solntse BT AD	17. Maritsa - Iztok Mines	27. Plovdiv BT AD
8. Arkus AD	18. Great Bulgarian Mills EAD	28. Ministroi Rodopi AD
9. Sugar Factory AD	19. Kambana 1899 AD	29. Pleven BT AD
10. Pernik Mines	20. Bulgargaz EAD	30. Quartz EAD
31. Bobov Dol Mines	38. NITI EAD Kazanlyk	45. Varnensko Pivo
32. Nefteks Petroleum	39. Stara reka	46. Kitka
33. Zahar Bio AD	40. Shumensko pivo	47. Svetlina
34. Stomaneni trabi	41. Agroteknika	48. Burgasbas
35. Orfei	42. Vineks Preslav	49. Blagoustroisveni Stroeji Burgas
36. Chernomorsko Zlato	43. Chernomore	50. LVK Gamza
37. Korabno mashinostroene	44. Liteks Dzus	

The enterprises monitored for arrears to the NSSI:

1. Agroteknika AD - Karlovo	15. Kitka AD	29. Elprom EMT AD
2. Stomana AD	16. Stara Reka AD	30. Balkanbas Mines
3. Pernik Mines	17. Tezhko Mashinostroene AD	31. Crystal EAD
4. Marbas Mines	18. Arkus AD - Lyaskovets	32. Microprocessor Systems
5. Port of Burgas	19. Promet EOOD	33. Ustrem EOOD
6. Varna Shipyard	20. KK Maritsa Chernomore EOOD	34. Etavia AD
7. Entire Gorubso Madan EAD	21. Chernomore EOOD	35. Montana AD
8. Vidachim AD	22. Dynamo AD,	36. Mras AD
9. Quartz AD	23. Veslets -91 EAD	37. Trema
10. Pirin Mine	24. Podem AD	38. VMZ AD
11. Plama AD	25. ZMM	39. Stomaneni Trabi
12. Burgas Copper Mines	26. Pima AD	40. Andela EAD
13. Higher Medical Institute	27. Rubin AD	41. NITI EAD
14. Polymeri OOD	28. Belopal	42. Obshtinski
		Avtotransport EOOD

43. Sanya	58. Mak AD - Gabrovo	75. Rodopa 95 AD
44. Agropromstroy EAD	59. Orfey OOD,	76. Semena Dobrich AD – Dobrich
45. Bulgarska Roza Sevtopolis AD – Kazanluk	60. Radomir Le Co Co EOOD	77. Elastic EAD
46. Chavdar AD	61. Darvodobiv i Stroitelstvo	78. ZMD Nikopol AD
47. Filtex AD	62. Dobrichka Mesna Kompania	79. Beta AD – Cherven Briag
48. Vitamina AD	63. Prikom EAD	80. Sukmo EOOD
49. Strumatex	64. Kyustendilski Stroitel AD	81. Purvi Mai K – Kazanluk
50. Dobritch Mel AD	65. Dunarit AD	82. Struma OOD
51. Nistra EAD	66. Burya AD	83. Balkan Bank – Headquarters
52. Elprom ZET	67. Mediket EAD	84. Arsenal EAD
53. V i K	68. Harmonia	85. Alukom – Pleven
54. KZU Promishleno Stroitelstvo	69. Pektin EOOD	86. ZMM Technotronica
55. Minstroy AD	70. Uvion OOD	87. Incoms EIM
56. Elena Georgieva AD	71. S-M 33	88. Chepino EAD
57. Ilindentsi Mramor	72. Svetlina AD – Sliven	89. Ruen Elite AD – Sofia
	73. Rilski Len AD – Samokov	90. Proinveks EOOD, Sofia
	74. Filteks AD - Kazanluk	91. Elko OOD
92. Niva AD – Kostinbrod		
93. Kachestvena Metalurgia AD		
94. Dobrich Mel		
95. Kartal EAD		
96. Balkankar Zarya AD – Pavlikeni		
97. ZSK Kremikovtzi - Sofia		
98. YAH & CO Ahrida AD – Kurdjali		
99. Simpto AD – Aytos		
100. Kremikovtski		

For the purpose of assessing compliance with these indicative targets:

- the measured changes in arrears will exclude the amount of principal and interest added by any new tax and social contribution assessment acts issued for arrears incurred before December 31, 2001;
- VAT refund positions (negative outstanding liabilities) will not be netted against liabilities of other enterprises, i.e., if an enterprise has a net refund position, it will count as zero in the total tax arrears for the monitored enterprises;
- agreements entered into after December 31, 2001 on writing off or rescheduling outstanding liabilities to tax authorities or the NSSI will not reduce amounts counted as outstanding liabilities;
- enterprises in the list which are entered into liquidation or bankruptcy proceedings will not drop out of the monitored total until they are struck from the register of active enterprises in Bulgaria; however, the total will no longer include new interest and penalty charges accruing after their entry into bankruptcy or liquidation.
- NEK will include all generation, transmission and distribution companies that were a part of the electricity monopoly prior to its unbundling.

Other Performance Criteria¹

1. The BNB will ensure that gross foreign reserves of the issue department are at least equal to the issue department's liabilities at all times. Issue department liabilities will comprise leva notes and coins in circulation, and deposits from the banking department, banks, government, and the nonfinancial sector with the BNB, excluding liabilities to the IMF. For the purpose of this performance criterion, issue department liabilities will be converted into foreign exchange using the official exchange rate. The BNB will exclude placements from other agencies under fund management contracts from the balance sheet of the issue department.
2. The BNB shall not increase credit to the government at any time during the period of the CBA, except as allowed under the Law of the BNB, nor shall it purchase Bulgarian government securities.
3. During the period of the arrangement, the government does not intend to impose new or intensify existing exchange restrictions on payments and transfers for current international transactions, or introduce or modify multiple currency practices, nor conclude any bilateral payments arrangements that are inconsistent with Article VIII of the IMF's Articles, nor impose or intensify any import restrictions for balance of payments purposes, nor accumulate any external payments arrears except for amounts subject to rescheduling agreements.

¹ All performance criteria listed in this annex are applicable on a continuous basis.

Performance Criteria on the Ceilings on Contracting and Guaranteeing
Public Sector External Debt 1/2/
(In millions of U.S. dollars)

	One year and Under 3/	Over 1 year 4/		1-5 years 4/
		Excluding Eurobonds	Eurobond issuance 5/	
Cumulative change from level on December 31, 2001				
March 31, 2002	0	230	300	0
June 30, 2002	0	560	300	0
September 30, 2002 (indicative)	0	680	300	0
December 31, 2002 (indicative)	0	680	0	0

1/ The public sector comprises the central government, the local government, the social security fund 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 U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective

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, 2001 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/ Gross value of Eurobond issuance, net of the cumulative value of own tradable external debt acquired by the general government in 2002 up to the test date, whether through separate transactions, or in a debt exchange operation. Operations will be valued at the market value on the day of the transaction. Following the end of each quarter, the Minister of Finance will report to the IMF: (i) the contracting and guaranteeing of external debt falling both inside and outside the ceilings, and (ii) the amount of own tradable external debt acquired by the general government. Following the end of each month, information on the contracting and guaranteeing of external debt falling both inside and outside the ceilings will be reported to the IMF by the Ministry of Finance.



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International Monetary Fund
Washington, D.C. 20431 USA

IMF Approves two-year, US\$299 Million Stand-By Credit for Bulgaria

The Executive Board of the International Monetary Fund (IMF) today approved a two-year stand-by credit for SDR 240 million (about US\$299 million) in support of Bulgaria's comprehensive economic program. The decision will enable Bulgaria to draw SDR 32 million (about US\$40 million) from the IMF immediately.

This arrangement will succeed a three-year, SDR 627.6 million (about US\$781 million) credit under the Extended Fund Facility (see Press Release 98/44), which expired in September 2001.

Following the Executive Board discussion, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, said:

“The Fund supports the Bulgarian authorities' economic program centered on the currency board arrangement, prudent and flexible fiscal policy, a strict incomes policy, and privatization and other structural reforms. This program offers good prospects for rapid sustained growth, sound external balances, and lower unemployment and poverty.

“Prospects for 2002 are generally favorable, with output growth expected to reach 4 percent. The external current account deficit is projected to remain at around 6 percent of GDP, mostly financed by foreign direct investment. Nevertheless, it should be monitored closely, in light of the uncertainty surrounding the recovery in Western Europe. Inflation increased in January owing to administrative price hikes and other one-time effects, but should remain subdued in the remainder of the year. The banking sector is well supervised, highly capitalized, profitable, and resilient to foreign exchange and interest rate risks.

“The fiscal deficit target of below 1 percent of GDP in 2002 is appropriate, and the authorities' intent to reduce the fiscal deficit further over the medium term is welcome. To this end, expenditure pressures should be curbed through a continuation of fiscal and structural reforms, and revenue collection should be enhanced by improvements in tax and customs administration. These measures would create room to strengthen further the social safety net, and gradually lower direct tax rates.

“The incomes policy should be implemented strictly, and labor market flexibility should be improved to maintain competitiveness and enhance growth. In addition, the last two large public

banks should be sold to well-qualified strategic investors, structural impediments to private sector credit growth eliminated, and the privatization of non-infrastructure enterprises finalized. Other priorities are to continue with the reforms in health care and education, restructure the transportation and energy sectors with a view to improving efficiency and reducing risks to the budget, liberalize trade further, and develop a public debt management strategy aimed at lowering the debt-to-GDP ratio and reducing portfolio and roll-over risk," Mr. Sugisaki said.

Recent Developments

Macroeconomic developments have been broadly favorable. Real GDP growth is estimated to have moderated to about 4.5 percent in 2001, as export growth decelerated with the slowdown in the European Union and the crisis in Turkey, and is projected to reach 4 percent this year. Inflation was low during 2001 at 4.8 percent and is expected to remain subdued this year. Unemployment leveled off at around 18 percent in 2001, while real wages increased by 4.5 percent in the first three quarters.

Competitiveness indicators remain adequate and the current account deficit, which increased to about 6.5 percent of GDP in 2001, is projected to narrow to below 6 percent in 2002-03 as a result of a recovery in exports and lower oil prices. The estimated widening of the trade account deficit from 10 percent of GDP in 2000 to 12 percent of GDP in 2001 is largely explained by the slowdown in exports of raw materials and in exports to Turkey and the EU. Bulgaria has established a good track record of macroeconomic stability in the context of a currency-board arrangement (CBA) supported by prudent fiscal policy. In response to the deteriorating current account balance, and given the still high debt-to-GDP ratios, the authorities tightened the fiscal stance in the last quarter of 2001. The growth in monetary and credit aggregates signals a further recovery in money demand and an improvement in lending to the private sector, in the context of a sound banking system. Despite the overall positive performance, several short-term risks and major reform challenges remain. In the short-term, slower-than projected EU growth, a reversal of the oil price decline, or insufficient foreign direct investment would increase external risks, requiring vigilance in policies to maintain macroeconomic stability. Over the medium term, Bulgaria needs to reduce unemployment and poverty, which remain above the first-tier EU accession country. It further needs to remove inefficiencies in the enterprise sector, a low level of financial intermediation, a burdensome bureaucracy, and improve governance.

Program Summary

The authorities' overall strategy to address the challenges is to continue with prudent fiscal and incomes policies in the context of the CBA, and advance the structural reform agenda. The authorities consider the CBA, which provides a stable nominal anchor and the discipline to maintain tight fiscal and incomes policies, the cornerstone of macroeconomic stability. The authorities are complementing these policies with an acceleration of structural reforms, including in the financial sector, labor markets, enterprise sector, and trade. These policies underlie the authorities' ambitious macroeconomic framework, targeting strong growth, low inflation, and declining current account deficits and public and external debt-to-GDP ratios.

The authorities' medium-term fiscal plan supports the CBA and promotes output growth. The authorities are committed to lower the budget deficit gradually from the targeted 0.8 percent of GDP in 2002 to balance in the medium term. This plan will allow to reduce pressure on the external accounts, channel savings to private investment, and decrease the public debt-to-GDP ratio. Within this framework, they are keen to continue to lower taxes on labor and capital while broadening the tax base and enhancing tax administration. The 2002 budget achieves a good

balance between the need to lower tax rates and increase social spending within the budget deficit limit. The 2002-03 fiscal stance is fully consistent with macroeconomic stability. In 2002, while the overall deficit is targeted to decline, the primary surplus would be reduced from 3.0 percent of GDP in 2001 to 2.4 percent in 2002. To secure medium-term fiscal viability, the authorities are—in consultation with the World Bank—advancing the reform of the pension system and the health care and education sectors. The government is imposing hard budget constraints on municipalities to end the accumulation of arrears. It is keen to continue with administrative reforms that would improve revenue collection and enhance budget preparation and execution.

Among the structural reforms, the reform agenda in the enterprise sector is key to the authorities' plan to create a fully market-oriented and competitive economy. The incomes policy for the state enterprise sector and the minimum wage policy are crucial to guiding wage formation and improving the financial situation of state-owned enterprises. The program envisages measures to improve further the functioning of the labor market to bring down unemployment and safeguard the CBA. In regard to the financial sector, the authorities are committed to finalizing bank privatization, developing further financial intermediation and strengthening prudential supervision to support sustainable credit growth. They are also pursuing a more active debt management strategy. They are committed to accelerating long-delayed reforms in the energy sector, and are continuing the process of trade liberalization.

Bulgaria joined the IMF on September 25, 1990. Its quota¹ is SDR 640.2 million (about US\$797 million), and its outstanding use of IMF resources currently totals SDR 844.1 million (about US\$1.05 billion).

¹ A member's quota in the IMF determines, in particular, the amount of its subscription, its voting weight, its access to IMF financing, and its allocation of SDRs.

Table 1. Bulgaria: Selected Economic Indicators, 1996-2001

	1996	1997	1998	1999	2000	2001		
						Q1	Q2	Q3
Output, prices, and employment	(Percent change, from same period of previous year)							
Real GDP	-10.9	-6.9	3.5	2.4	5.8	4.5	5.1	4.5
CPI (end-of-period)	310.8	549.2	1.7	7.0	11.4	9.1	9.5	4.7
Monthly, averaged during period	12.8	26.4	0.2	0.6	0.9	0.3	-0.1	0.5
Unemployment rate (percent, period average)								
Registered unemployment	11.0	14.0	12.4	13.8	18.1	18.5	17.8	16.7
Labor force survey unemployment	14.2	14.4	14.1	15.7	16.9	21.6	19.4	18.6
Retail sales, real (period average)	-36.2	-30.5	2.0	-2.1	0.2	2.2	2.3	2.5
Monthly dollar wages (level) 1/	86.3	80.5	111.0	120.6	118.0	123.1	130.5	133.3
Public sector wages, real (period average)	...	-19.5	23.5	10.7	2.4	4.9	6.2	7.6
Private sector wages, real (period average)	...	...	22.1	9.4	11.6	3.8	2.9	3.1
Consolidated government 2/	(In percent of GDP)							
Revenue	31.9	36.8	39.5	40.5	40.7	44.7	48.5	31.6
Noninterest expenditure	22.3	29.6	34.0	37.6	37.5	38.3	42.2	30.1
Primary balance	9.6	7.3	5.5	2.9	3.2	6.4	6.3	1.5
Interest payments	19.7	8.5	4.4	3.9	4.3	8.4	1.8	5.5
Overall balance	-10.1	-1.2	1.0	-1.0	-1.1	-2.0	4.5	-4.0
External financing	-2.9	0.3	-0.7	0.2	-1.6	-3.6	-1.3	-5.3
Domestic financing	15.6	-2.7	-2.0	-1.3	1.3	-0.7	-10.5	8.7
Privatization receipts	0.2	3.2	1.7	2.2	1.4	6.3	7.4	0.6
Total public debt	117.6	109.4	96.2	88.1	84.0	74.2	73.8	72.2
Domestic public debt 3/	60.2	16.3	14.4	13.0	6.9	6.2	6.2	6.2
Money and credit	(End-of-period; percent change, from same period of previous year)							
Broad money (millions of leva)	1,310	6,019	6,597	7,351	9,291	9,482	9,679	10,303
Broad money (M3)	124.5	359.3	9.6	11.4	26.4	25.8	27.7	22.9
Lev money	52.7	423.0	18.2	11.5	15.6	17.8	25.0	18.8
Leva credit to nongovernment	15.6	297.2	69.7	21.4	21.4	15.6	20.0	27.9
FX deposits (U.S. dollar millions)	1,357	1,477	1,543	1,477	1,958	1,941	1,811	2,092

FX deposits (percent of M3)	50.5	43.6	39.2	39.1	44.3	45.3	43.1	43.5	
Broad money to FX reserves ratio	3.4	1.4	1.3	1.2	1.3	1.4	1.4	1.5	
Interest rates (annualized)	(In percent; end-of-period)								
BNB basic rate	435.0	7.0	5.2	4.6	4.7	4.3	4.6	4.8	
Time deposit (leva)	211.8	3.0	3.3	3.2	3.3	3.1	3.3	3.0	
Balance of payments 4/	(In millions of U.S. dollars)								
Gross official reserves	793	2,474	3,056	3,222	3,460	3,080	3,040	3,120	3
(In months of imports of GNFS)	1.6	5.0	5.6	5.0	4.9	4.3	4.2	4.3	
Current account balance	131	288	-61	-652	-701	-237	-185	-71	
(In percent of GDP)	0.2	4.4	-0.5	-5.3	-5.8	-8.4	-6.5	-2.0	
Trade balance	188	321	-381	-1,081	-1,175	-224	-455	-407	
Exports	4,890	4,809	4,193	4,006	4,812	1,282	1,232	1,298	
Imports	4,703	4,488	4,574	5,087	5,988	1,506	1,683	1,705	
External debt	9,602	9,760	10,274	10,204	10,371	10,117	10,052	9,889	
(In percent of GDP)	97.7	96.2	83.8	82.3	86.5	77.7	77.2	75.9	
Exchange rates									
Leva per U.S. dollar 5/	0.487	1.777	1.675	1.947	2.102	2.214	2.306	2.142	2
(y-o-y percent change, + means depreciation)	589.3	264.5	-5.7	16.2	8.0	8.2	12.7	-4.0	
REER (CPI)									
(y-o-y percent change, + means appreciation)	-38.8	77.5	5.2	0.8	3.2	4.9	3.6	6.0	

Sources: Bulgarian authorities; and staff estimates.

1/ Average monthly wage in the public (including nonbudgetary) sector.

2/ Includes the republican budget, municipalities, and extrabudgetary funds. The coverage became more comprehensive from 1998 onward, resulting in a structural break.

3/ Domestic debt increased by 2.5 percent of GDP in June 1997 due to a restructuring of central bank claims on government.

4/ Starting 1998, a new methodology was adopted for the calculation of BOP data.

5/ End-of-period, in redenominated leva.

**Statement by the IMF Staff Representative
February 27, 2002**

This statement provides information that has become available since the issuance of the staff report for the Request for Stand-By Arrangement for Bulgaria (EBS/02/24).

- Indicators, including on industrial exports and retail sales, suggest a slowdown in growth in the fourth quarter of 2001, perhaps in excess of staff's expectations. Thus, while the estimate of 4½ percent growth for the year as a whole may still have been achieved, growth on the order of 4 percent now appears more likely.
- The consumer price index rose by 2.8 percent in January 2002, increasing the 12-month rate to 7.1 percent. This increase largely reflected the one-time impact of increases in administrative prices, including for energy, and the imposition of new indirect taxes. We do not foresee the need for a major revision in our inflation projections at present.
- Monetary data for end-2001 confirm that, as in a number of other southeastern European countries, the changeover to the euro stimulated substantial deposits of DM and other euro-area currencies into euro-denominated deposits in the banking system. This raised the measured money supply significantly in December, but without an actual impact on total liquidity.
- A no confidence vote in parliament on February 13 failed by a wide margin, suggesting that broad support remains for the government's economic program.