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**Bulgaria:** Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding

July 17, 2006

The following item is a Letter of Intent of the government of Bulgaria, which describes the policies that Bulgaria intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Bulgaria, is being made available on the IMF website by agreement with the member as a service to users of the [IMF](#) website.

Sofia, Bulgaria, July 17, 2006

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

Dear Mr. de Rato:

1. The attached Third Supplementary Memorandum of Economic and Financial Policies (TSMEFP) describes the performance under the economic program that is supported by the Stand-By Arrangement (SBA) approved by the International Monetary Fund on August 6, 2004 and the policies that the government and the Bulgarian National Bank (BNB) intend to pursue in the remainder of 2006 as part of the 2004-06 economic and financial program outlined in the Memorandum of Economic and Financial Policies attached to the letter of July 21, 2004 and amended by the supplementary memoranda attached to the letters of April 26, 2005 and March 14, 2006. Our core objectives, supported by the policies described in the TSMEFP, remain the maintenance of macroeconomic stability and sustained high rates of economic growth in the run-up to EU membership in 2007.

2. As described in the TSMEFP, economic developments in the early months of 2006 show a continuation of excess demand trends, with a further deterioration in the current account projected for 2006. All quantitative performance criteria for March 31, 2006 were met. However, the three structural performance criteria for April 30 and June 30, 2006 were missed, and we request waivers for their nonobservance.

- Owing to extended consultations with the business community, it was not possible to complete the parliamentary passage of the new VAT law by April 30, 2006. It has been passed in second reading by the budget commission and its approval by parliament is a prior action for the completion of the third review (TSMEFP, Annex I).
- Delays in parliamentary passage of the law transforming business registration from a judicial to an administrative procedure, and the need to identify and prepare software, meant that it was not feasible for the new business register to start operations by June 30, 2006. We now expect the register to start operations on the date specified in the legislation, of October 1, 2006 (performance criterion).
- The Varna thermal power plant was sold by June 30, 2006. However, it has not yet been possible to complete the sale of the Rousse district heating company, due to

delays in the tender process. We now intend to select winning bids for the Rousse plants by October 31, 2006 (performance criterion).

3. In addition, six of the eight structural benchmarks applying through end-June, 2006 were missed. Of these, one was missed by a small margin, one implemented with delay, and one is on track to be completed shortly. Remedial actions and rephrasing of conditionality have been proposed for the remaining three.

4. We request an extension of the arrangement through to end-March 2007 and a rephrasing of our remaining access of SDR 11 million. We understand that our compliance with the program will be monitored through a fourth review, quantitative and structural performance criteria and structural benchmarks through December 31, 2006, as well as a continuous performance criterion and benchmark through the end of the arrangement. Reaching an understanding on the 2007 budget will be a key element for completion of the fourth review.

5. The TSMEFP proposes quantitative performance criteria for September 30 and December 31, 2006, as described in its Annexes II – IV. In addition, program implementation is proposed to be monitored by the three structural performance criteria, the three continuous performance criteria and the nine structural benchmarks listed in Annex I of the TSMEFP.

6. We believe that the policies set forth in the TSMEFP are adequate to attain the objectives of our program, but we will take any further measures that may become appropriate for this purpose. Bulgaria will consult with the Fund on the adoption of these measures, and in advance of any revisions to the policies contained in the TSMEFP, in accordance with the Fund's policies on such consultations. We will provide the Fund with such information as it requests on policy implementation and achievement of program objectives.

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

Sincerely yours,

/s/

/s/

/s/

Plamen Oresharski  
Minister of Finance  
Republic of Bulgaria

Rumen Ovcharov  
Minister of Economy and Energy  
Republic of Bulgaria

Emilia Milanova  
Deputy Governor  
Bulgarian National Bank

Attachment: Third Supplementary Memorandum of Economic and Financial Policies

## Third Supplementary Memorandum of Economic and Financial Policies

### I. Recent Economic Developments

1. **Recent economic developments point to upward revisions to forecasts of growth, inflation and the current account deficit.** Economic growth is now projected at 5.6 percent for the year, a little higher than the 5.5 percent projected under the program, because of stronger domestic demand. Demand continues to be fueled by strong corporate and household borrowing. At 8.1 percent in April, inflation was somewhat higher than projected, mainly because of higher fuel prices and a larger-than-anticipated impact of the increase in tobacco and alcohol excise duties at the start of the year. Inflation is now expected to moderate to 6.2 percent by the end of the year, compared to 5.7 percent under the program. The current account deficit was considerably larger than projected in the first three months of 2006. This was partly due to temporary factors that should unwind later in the year. Nevertheless the stronger than expected demand suggests that the current account will now show a slight deterioration in 2006 compared to 2005, at about 12.4 percent of GDP, compared to 10.2 percent of GDP previously projected. We do not see competitiveness as being a significant factor in this deterioration. Foreign direct investment is on track to come in close to the program level in 2006, at 9.2 percent of GDP. Gross external debt reached 69.5 percent of GDP at end-March, and is expected to end the year at nearly 70 percent of GDP, close to the programmed level.

### II. Economic Policies and Objectives for the Remainder of 2006

2. **Our economic program aims at maintaining a stable policy framework within which to prepare for EU accession on January 1, 2007 and subsequent entry into the eurozone.** Maintenance of the currency board at an unchanged exchange rate until euro adoption in 2009-10 remains the cornerstone of our economic policy. Strong private sector demand in anticipation of EU accession and convergence is likely to lead to continued high current account deficits and external debt levels through the medium term. The priorities of reducing these external vulnerabilities and lowering inflation in order to meet the conditions for euro adoption will require a continued commitment to very prudent economic policies in coming years. Our program for the remainder of 2006 therefore remains focused on fiscal restraint, incomes policies, tight financial sector supervision, and structural reforms to strengthen competitiveness. The limited capacity and availability of fiscal and monetary policy to manage the very rapid private sector demand growth highlights the importance of the structural agenda in particular, in order for Bulgaria to grow strongly and function effectively under the currency board arrangement and, eventually, within EMU.

## A. Fiscal Policy

3. **Given the further deterioration of the external current account now projected for 2006, we do not see any scope to relax our ambitious fiscal surplus target for this year.** As described in the Second Supplementary Memorandum of Economic and Financial Policies (SSMEFP) attached to our letter of March 14, 2006, and set out in Annex II of this Memorandum, we will achieve a significant increase in the budget surplus from 2.3 percent of GDP in 2005 to at least 3 percent of GDP in 2006 (performance criterion). Should revenues exceed the quarterly targets set out in Annex II, we will save 50 percent of any such cumulative quarterly overperformance, and the performance criterion on the fiscal surplus will accordingly be raised above 3 percent of GDP. In pursuing these objectives we will seek to avoid the accumulation of new central government arrears (performance criterion) and urge municipalities to eliminate their arrears (which amounted to 0.1 percent of GDP at end-March, 2006). We do not envisage making any adjustments to tax rates applying in the remainder of 2006, and we remain committed to permanently withholding 7 percent of discretionary expenditure if necessary to meet our fiscal targets, as set out in the SSMEFP and regardless of the level of the current account deficit.

4. **Fiscal policy implementation in the first three months of 2006 has been consistent with our commitments under the program.** The fiscal surplus in the first quarter is estimated at BGN 398 million, comfortably exceeding the program target of BGN 256 million. Revenues came in slightly below target, partly because of a number of temporary factors which we expect to be made good in the remainder of the year. The revenue shortfall in the first quarter was more than made up by a slow pace of expenditures, especially on wages and salaries, social assistance, and capital spending. For the year as a whole we expect a small overperformance of revenues, which, if realized, would imply an increase in the fiscal surplus target from 3 to 3.2 percent of GDP.

5. **Given the stubbornly high current account deficit, our preliminary plans envisage passage of a budget for 2007 targeting a fiscal surplus of about 2 percent of GDP.** At present considerable uncertainties remain regarding the fiscal impact of EU-related flows and revenue losses arising from accession, as well as about prospective underlying revenue performance. We will therefore refrain from committing to tax cuts for next year until the full parameters of the 2007 budget are clarified in the fall of 2006. Reaching an understanding on the 2007 budget will be a key element for completion of the fourth review under the SBA.

6. **We have strengthened our program for public sector reforms, including reductions in staff numbers.** Fiscal costs associated with EU accession reinforce the need to restructure existing budgetary spending programs, in order to achieve fiscal savings and more efficient delivery of public services.

- We have cut 3,909 existing positions in the state administration, with a further 1,381 positions identified for closure by the end of 2006.
- We have submitted an education reform strategy to parliament which sets out our broad objectives in terms of improving the quality of teaching, and rationalizing school and staff numbers against the backdrop of sharply falling pupil numbers. In pursuit of these objectives we have identified 5,500 staff cuts that will be implemented by September 30, 2006 (structural benchmark). The 2006 budget incorporates a contingency of BGN 9m to help meet transitional costs associated with school closures and redundancies. We have further decided to move to a decentralized system of school financing based on unified per student standards for financing municipalities, which will provide appropriate incentives to municipalities to implement school consolidation and staff cuts, compared to the present input-based system of school financing. We will develop the new unified standards with the assistance of the World Bank, with Council of Ministers approval expected by October 31, 2006 (structural benchmark). We are developing a strategy for reform of tertiary education, including review of financing mechanisms, which we will submit to parliament by December 31, 2006.
- The move to financing of nearly all hospital care through the National Health Insurance Fund (NHIF) from January 1, 2006 has improved incentives for better financial management in the hospital sector, and there has been no net accumulation of hospital arrears in the first quarter of the year. We are committed not to undermine these incentives by bailing out hospitals that run arrears. However, reimbursements by the NHIF have been running ahead of plan, which could lead to a budget shortfall for the year of around BGN 50 million, requiring offsetting savings elsewhere in the budget sector. In order to improve financial discipline from 2007 on we have drafted amendments to the health insurance law that will: (i) include in the law control procedures and sanctions for misreporting in reimbursement claims by hospitals and other health care providers to the NHIF, at a sufficiently high level to discourage such abuses; (ii) regulate that price and volume ceilings for the clinical paths are part of the annual budget law of the NHIF; and (iii) require hospitals to provide the NHIF with full financial reporting, subject to audit, and give the NHIF powers to withhold finance in case of inadequate reporting or unsatisfactory financial results. We will submit these amendments to parliament by July 31, 2006, with a view to passage by August 31, 2006 (structural benchmark). Nevertheless it remains the case that an improved financial situation in the health sector and more effective delivery of health services will depend on an extensive restructuring and consolidation of the hospital sector. To this end we will engage consultants by September 30, 2006, with the assistance of the World Bank, to develop a National Hospital Masterplan.

7. **Any changes to pension levels in the remainder of 2006 will be limited to the lower pension brackets, and fit within the overall NSSI budget plan.** Our plans for 2007 are based on pension indexation according to a 50 percent/50 percent ratio between CPI and insured income growth from June 1, 2007, increasing the employees' share of social security contributions from 35 percent to 40 percent, and raising the contribution to the second pillar of the pension system from 4 to 5 percent.

8. **We are pursuing our program of revenue administration reform.** The start-up of the National Revenue Agency (NRA) in January 2006 did not lead to any discernible initial loss in revenues, and we are confident that over time the NRA will contribute to revenue gains. Unfortunately there has been further delay in the delivery of the new software to integrate tax and social security collections. We now expect the new integrated collection software system to be fully operational by December 31, 2006 (structural benchmark). The new law on duty free trade, specifying limits on individual purchases of goods and fuels and strengthened controls, is expected to be passed by the parliament by August 31, 2006. The new VAT law is intended to be passed by the parliament by July 25, 2006 (prior action). We intend the PIT and CIT laws to be passed by July 31, 2006 (structural benchmark).

9. **We are planning a number of other reforms in the fiscal area:**

- **Fiscal transparency.** We intend to present parliament with realistic fiscal projections in the 2007 budget, and plan to achieve our fiscal target without resort to within-year caps on discretionary expenditures. Along with the budget submission we plan to provide more information, including full medium-term fiscal forecasts, an expanded analysis of fiscal risks, details of concessions, central government contingent liabilities, and government financial asset holdings. We recognize the importance of improved public procurement procedures, especially in view of increased project funding from the EU. A new public procurement law has been adopted. It remains our intention to avoid the creation of new extrabudgetary funds or state-owned enterprises (continuous structural benchmark). However, the CoM has approved the transformation of the existing Road Agency into an extrabudgetary fund structure from January 2007, in order to meet EU requirements. The Road Agency will continue to be fully consolidated in general government accounts, and subject to the same accounting and auditing standards as the rest of the budget sector. The legal process for closure of the Public Investment Projects company (PIP) will be initiated by December 31, 2006 (structural benchmark).
- **Expenditure management.** While our budget management system meets EU requirements, we nevertheless intend to further strengthen public expenditure management. With the reporting for the second half of 2006 we will have implemented the Financial Management Information System as the sole expenditure

accounting system in the Ministry of Finance. We intend to identify improved expenditure control mechanisms for other ministries by the end of 2006.

- **Program budgeting.** We are continuing to introduce program and performance-oriented budgeting. We intend to expand pilot program budgeting by six further ministries in the 2007 budget, bringing the total to 16 ministries and one agency, and five ministries will also report their 2006 budgets on a program basis.

## **B. Incomes and Labor Market Policies**

10. **The persistent excess demand situation underscores the importance of public sector wage restraint and labor market reforms to help maintain competitiveness and flexibility of the economy.** Budget sector wages will be increased by 6 percent on average in July 2006. Larger wage increases needed to attract and retain staff working on EU project administration will be met within the overall budgeted wage bill. In 2007, we intend public sector wages to rise only modestly in real terms. In the first quarter of 2006 we observed the quarterly limit on the increase of the aggregate wage bill of the 58 largest public enterprises that are monopolies, received government subsidies, made losses, or had arrears in the third quarter of 2005. Observance of these limits will continue to be monitored on a cumulative quarterly basis (performance criterion). We continue to plan for an increase in the minimum wage in 2007 to BGN 170, from BGN 160 in 2006.

11. **Labor market reforms are aimed at improving flexibility and labor force participation.** Our key policy initiatives in this area are:

- The parliament has passed legal amendments to increase working time flexibility by extending the maximum working week from 40 to 48 hours and by lengthening calculation periods for overtime work from four to six months.
- We have been unable to agree with our social partners on the removal of the obligatory character of the portability of seniority bonuses in case of unemployment, change of employer or job position. We are continuing the discussions with our social partners on this issue, and hope to reach agreement by the end of 2006 (structural benchmark). Any reduction in seniority pay for existing workers resulting from our discussions would be expected to be added back in to the basic wage, so that no existing employee would suffer a pay cut from the change.

## **C. Financial Sector and Public Asset and Liability Management**

12. **The bank credit ceilings adopted by the BNB in 2005 will be phased out gradually.** Total credit growth in the first quarter of 2006 was in line with the ceilings set by the BNB, and the individual banks that exceeded the limits were subjected to significant



penalty deposits at the BNB. However, as expected, banks are increasingly able to circumvent the limits. Methods have included passing loans to foreign banks' head offices, and packaging loans in off-balance sheet special purpose vehicles, in order to remove loans from bank balance sheets to free up space for new lending within the ceilings. At the same time, credit from the nonbank financial sector continues to grow strongly. Thus the effectiveness of the bank credit ceilings in reducing financial flows to the private sector is much diminished at this stage. The lifting of the credit ceilings will be phased so as to minimize disruption to the financial sector. Our plans in this regard will be discussed with IMF staff.

13. **The existing tight bank prudential and supervisory framework will be maintained.** To allow the implementation of Basel II as of January 2007, we have submitted to parliament a new law on Credit Institutions for approval by September 30, 2006 (structural benchmark), and the BNB will issue the relevant regulations by the end of 2006 at the latest. The BNB will apply the EU Capital Requirement Directive in a conservative way.

14. **Transparency in lending has been improved.** The new law on consumer credit requires disclosure in advertising of effective annual percentage rates on consumer and household mortgage loans between BGN 400 and BGN 40,000.

15. **Supervision of the rapidly growing non-bank financial sector is being modernized.** The pension law was amended to remove the minimum share that voluntary pension funds were required to hold in government securities, with only a modest impact on these funds' asset allocation. The law on supplementary supervision of financial conglomerates has been submitted to parliament and is expected to be approved by September 5, 2006 (structural benchmark). The Financial Supervision Commission (FSC) has received technical assistance from the IMF to support the implementation of the insurance law adopted in December 2005.

16. **We will continue to strengthen prudential and market conduct regulation, and supervision, of the insurance sector.** By end July, the FSC will develop (a) an internal procedure for enforcement and (b) a strategy to tighten supervision of underwriting practices of non-life insurance companies. During the second half of 2006, the FSC will re-license compulsory motor third party liability (MTPL) insurance companies. The FSC will also conduct an in-depth review of the adequacy of premiums and of the other guarantees for the solvency of the insurance companies offering MTPL insurance. By the end of 2006, we will submit to the Council of Ministers a draft amendment to the Insurance Code that will a) tighten corporate governance practices of insurance companies by requiring separation of powers between the board and the management and by requiring independent directors, and b) require audit of the statutory annual returns of insurance companies. By year end, the FSC will issue a regulation to exclude investments in related and affiliated companies from calculations of own funds for meeting statutory solvency requirements.

17. **We will improve the follow-up to money laundering-related disclosures of the Financial Intelligence Agency.** Referrals to the police made by the Agency are rising rapidly but have not led to any convictions by the courts. To improve the follow-up to these disclosures a special unit within the police has been established. This unit is organized in a similar manner to the unit that was created in the prosecutor's office in March 2006.

18. **Public asset and liability management will continue to aim at reducing gross debt while maintaining adequate reserve cover.** The ceilings on the contracting and guaranteeing of external public debt in 2006 remain as in the original program (performance criteria). We have no immediate plans for additional external debt prepayments, but such prepayments could be considered, subject to the maintenance of freely available international reserves. In order to better monitor municipal borrowing we are developing a register for such loans, to be made operational by December 31, 2006 (structural performance criterion).

#### **D. Other Structural Reforms**

19. **We are proceeding with the reform of business registration.** The law transforming business registration from a judicial to an administrative procedure under the Registration Agency was passed on March 24 and enacted on April 25, 2006. We intend to make the new registry operational by October 1 (structural performance criterion).

20. **We are committed to further privatization of state assets.** The privatization of Varna electricity generation company has recently been completed. We will issue tenders for the eastern and western plants of the Rousse district heating company by August 15, 2006, with a view to selecting the winning bids for both by October 31, 2006 (structural performance criterion). We will proceed expeditiously to privatize the Bobov Dol power plant once the court case concerning its sale is resolved. All but one of the remaining district heating companies are expected to be privatized by December 31, 2006. We intend to privatize units of Bulgartabac Holding during the second half of 2006. We have selected the winning bid for the river shipping company in Rousse. The transaction has been approved by the Privatization Agency and the Council of Ministers. The privatization strategy for the maritime shipping company will be submitted to parliament by July 31, 2006, with approval expected by August 31. The privatization strategy for the airline company has been approved, and the tender has been issued. The concession agreement for the Varna and Bourgas airports has been awarded, and provided there are no further court appeals we hope that construction work will commence later in 2006. Concessions for four major ports are being prepared.

21. **Based on an assessment by business organizations, we plan to establish a body to evaluate the regulatory environment.** This will monitor the implementation of existing regimes, and scrutinize new regulatory proposals. We have prepared draft amendments to the

law on investment promotion intended to speed up administrative processes, and plan to submit them to parliament by August 31, 2006, following further consultation within government.

22. **We are continuing to implement our anti-corruption program.** We have prepared the anti-corruption strategy for 2006-08 and implementation program for 2006. In the first three months of 2006, we set our priority towards prevention and counteraction of high-level corruption, corruption in the education and healthcare systems, as well as in the administration of the tax revenues. We plan to develop an amendment to the Law on the Political Parties to introduce transparency in party financing (including publicity of the source of financing) by end 2006. The National Audit Office is due to publish an audit report on the political parties by September 30, 2006. We have prepared a program for transparency in the activity of the state administration and high-level officials.

## **Annex I. Bulgaria: Conditionality Under the Stand-By Arrangement in 2006**

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### ***Prior Action***

1. Approval by parliament of the new VAT law.

### ***Quantitative Performance Criteria***

1. Floor on the overall surplus of the general government (Annex II).
2. Ceiling on central government arrears (Annex II).
3. Ceiling on the wage bill of the 58 largest SOEs in financial distress or monopoly situation (Annex III).
4. Ceiling on the contracting or guaranteeing of nonconcessional external public debt (short term, 1-5 years, longer) (Annex IV).

### ***Structural Performance Criteria***

1. Selection of winning bids for the western and eastern plants of Rousse district heating company (October 31, 2006).
2. Acceptance of new company registrations by the new business register established by legislation enacted on April 25, 2006 (October 1, 2006).
3. Establishment of a register which covers all municipal borrowing and is ready to receive data (December 31, 2006).

### ***Continuous Performance Criteria***

1. No imposition of new or intensification of existing restrictions on the making of payments and transfers for current international transactions, nor introduction or modification of multiple currency practices, nor conclusion of any bilateral payments arrangements that are inconsistent with Article VIII of the IMF Articles of Agreement, nor imposition or intensification of any import restrictions for balance of payments purposes, nor accumulation of any external payments arrears.
  2. No reduction of tax rates and bases applying in 2006.
  3. The monthly minimum wage not to exceed BGN160 during 2006.
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## Bulgaria: Conditionality Under the Stand-By Arrangement in 2006 (concluded)

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### *Structural Benchmarks*

1. No new extrabudgetary funds or state-owned enterprises to be created except for the state executive agency to disburse EU funds for building roads.
2. Approval by parliament of new CIT and PIT laws (July 31, 2006).
3. Approval by parliament of an amendment to the Health Insurance Law as detailed in paragraph 6, bullet 3 of TSMEFP (August 31, 2006).
4. Approval by parliament of a law on supplementary supervision of financial conglomerates (September 5, 2006).
5. Implementation of employment cuts of at least 5,500 positions in the education sector (September 30, 2006).
6. Approval by parliament of a new law on credit institutions, to allow implementation of Basel II (September 30, 2006).
7. Approval by the Council of Ministers of the system of school financing based on the unified per student standards (October 31, 2006).
8. Agreement with social partners on a solution repealing the obligatory character of the portability of seniority bonuses in the case of unemployment, change of employer, or job position. (December 31, 2006).
9. Initiate the legal procedure for the closure of the Public Investment Projects company (PIP) (December 31, 2006).
10. New integrated tax and social security software system for the NRA to be fully operational (December 31, 2006)

**Annex II. Performance Criteria on the General Government Balance and Central Government Arrears and Indicative Revenue Targets for the General Government**

	Fiscal Surplus Floor	Arrears Ceiling 1/	Overall Revenue Target 2/
	(In millions of leva)		
Cumulative change from January 1, 2006			
March 31, 2006	256	5	4,251
June 30, 2006	786	5	9,051
September 30, 2006	1,099	5	13,554
December 31, 2006	1,387	5	18,454

1/ Arrears ceiling is on the stock of central government arrears.

2/ Indicative target on general government revenue (including grants).

Quarterly limits in this Annex are cumulative with the exception of central government arrears.

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

For program monitoring purposes, the arrears of the central (general) government are all overdue obligations on the payment for central (general) government expenditure excluding items in dispute. The stock of central government arrears as of December 31, 2005 amounted to BGN 4.8 million.

For program monitoring purposes, the fiscal balance (surplus/deficit) will be defined as the difference between general government revenue (taxes, nontaxes, and grants) and general government expenditure, including net capital transfers (net acquisition of shares and net lending) and adjusted for the net change of the stock of general government arrears. In contrast with the national practice, in the program definition the government's social security contributions for its own workers (except those to the second pension pillar) are excluded from both revenue and expenditure. In 2006, the quarterly fiscal balance targets will be raised by 50 percent of the excess of actual over targeted cumulative general government revenue (including grants). If general government revenue (including grants) exceeds the program's

target of BGN 18,454 million, 50 percent of any such cumulative quarterly revenue overperformance will be saved and the fiscal surplus floor raised accordingly.

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

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

**Annex III. Performance Criteria on the Wage Bill of 58 State-Owned Enterprises (SOEs)**

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	Wage Bill of 58 SOEs
	(In millions of leva)
Cumulative from January, 1 2006	
March 31, 2006	89.2
June 30, 2006	178.4
September 30, 2006	267.7
December 31, 2006	356.9

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The quarterly ceiling on the aggregate wage bill of the 58 state-owned enterprises closely monitored for their large losses or arrears, for receiving subsidies, or for being monopolies, is 5 percent above the level of the aggregate wage bill in the third quarter of 2005 and is accumulated by the same amount for each subsequent quarter. The wage bill is defined to include wages and payroll taxes paid by the employer but does not include additional compensation under Article 12 of the 2006 Incomes Ordinance

Those enterprises that have been privatized or ceased operations will be excluded from the list for the respective test dates. Those enterprises that register profits in each of the first two quarters of 2006 will also exit the list in the second half of 2006 unless they are monopolies, have arrears, or receive state subsidies. If an enterprise is excluded from the list, the wage bill ceiling for each subsequent quarter will be adjusted down by the amount of that enterprise's wage bill in the third quarter of 2005 plus 5 percent times the number of quarters it has been excluded from the list. The 58 enterprises monitored are in the table below (enterprises numbers 1 to 4 are considered monopolies).



## List of 58 Monitored State-Owned Enterprises

- |   |   |
|---|---|
| 1 State Railways                              | 30 Burgas Sea Port  |
| 2 Railway Infrastructure                      | 31 Terem Khan Krum  |
| 3 BulgarGas                                   | 32 Terem Georgi Benkovsky   |
| 4 The National Electricity Company            | 33 Terem Ovech  |
| 5 Kozloduy Nuclear Powerstation               | 34 Terem Letetz   |
| 6 Varna Power Station                         | 35 Terem Ivaylo   |
| 7 Bobov Dol Power Station                     | 36 Khaskovo BT  |
| 8 Bobov Dol Coal Mine                         | 37 Gotze Delchev BT   |
| 9 Pirin Coal Mine                             | 38 Shumen BT  |
| 10 Russe Urban Heating Company                | 39 Kardjali Bulgartabak   |
| 11 Shumen Urban Heating Company               | 40 Yambol BT  |
| 12 Plovdiv Urban Heating Company              | 41 Sandansky BT   |
| 13 Sofia Urban Heating Company                | 42 Assenovgrad BT   |
| 14 Varna Urban Heating Company                | 43 Stroitelstvo and Vazstanovjavane<br>(Construction and Refurbishing) Public Company |
| 15 Sliven Urban Heating Company               | 44 Transport Construction and Repair Public Company                                   |
| 16 Pernik Urban Heating Company               | 45 Public Works   |
| 17 Sofia Urban Transport Company              | 46 Military Supplies Company  |
| 18 Plovdiv Urban Transport Company            | 47 Spatial and Urban Public Works   |
| 19 Varna Urban Transport Company              | 48 Copper Well  |
| 20 Sofia Electric Urban Transport Company     | 49 BalkanCar Sredetz  |
| 21 Pernik Trolley Bus Urban Transport Company | 50 BalkanCar Dunav  |
| 22 Pleven Urban Bus Transport                 | 51 BalkanCar Erma   |
| 23 Diana Bus Company                          | 52 Dupnitsa Supply Water and Wastewater Services                                      |
| 24 Passanger Transport                        | 53 Supply Water and Wastewater Services   |
| 25 Aytos Bus Transport                        | 54 Supply Water Engineering   |
| 26 Bus Transport                              | 55 Vazov Mechanical Engineering Plants  |
| 27 Beltrans                                   | 56 Rudozem GORUBSO  |
| 28 Russe Urban Bus Transport                  | 57 Land Geodetic Metrology  |
| 29 Roshen Express                             | 58 Rope Ways  |

**Annex IV. Performance Criteria and Indicative Targets on the Ceilings on Contracting  
or Guaranteeing of Public Sector External Debt 1/2/  
(In millions of euros)**

	One year and under 3/	Over 1 year 4/	1-5 years 4/
Cumulative change from December 31, 2005			
June 30, 2006	0	0	0
September 30, 2006	0	74.6	0
December 31, 2006	0	203.3	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 euros at the program exchange rates of 1.21 US\$/€.

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

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