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

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

- the staff report for the third review under the Stand-By Arrangement and request for waiver of applicability of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **May 20, 2003,** 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 June 19, 2003.** 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 **July 7, 2003** updating information on recent developments.

- a Press Release summarizing the **views of the Executive Board as expressed during its July 7, 2003 discussion** of the staff report that completed the review.

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

Letter of Intent sent to the IMF by the authorities of Bulgaria*
Supplementary Memorandum of Economic 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.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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BULGARIA

Third Review Under the Stand-By Arrangement and Request for Waiver of Applicability of Performance Criteria

Prepared by the European I Department
(In consultation with other departments)

Approved by Carlo Cottarelli and Liam P. Ebrill

June 19, 2003

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Executive Summary

Background: Despite a continued weak external environment, macroeconomic performance has been excellent and the program is on track; but support for the government has dwindled, weakening its ability to carry out necessary structural reforms. In the first quarter of 2003, growth continued to be robust, supported in part by the still-rapid credit growth, unemployment continued to decline, and inflation remained subdued, reflecting mainly the appreciation of the Euro. The government posted a fiscal surplus of 0.3 percent of GDP, an overperformance of around 1 percent of GDP with respect to program. The external current account deteriorated slightly, while international reserves remained comfortable. However, amid disenchantment over the perceived slow improvement in living standards and persistent governance shortcomings, the government's approval ratings have declined to single digits, eroding support for the remaining structural reforms. In this context, two large privatizations have failed, reforms to improve the business climate have continued to lag, while those for the health sector and the judiciary have barely gotten off the ground. The government did manage to privatize the last large state-owned bank, however.

Discussions: Discussions focused on policies to address the risks associated with an unsettled external environment and rapid credit growth and to rekindle the momentum of reforms. As a continued slowdown in the EU or a possible credit-fueled import boom could strain the external position, the authorities committed to (i) save the fiscal overperformance associated with one-off factors and (ii) limit discretionary spending through the fourth quarter in the event of a significant deterioration in the external current account. While strong revenue collection would likely allow the government to meet spending overruns and arrears accumulation in hospitals and municipalities this year, the authorities recognized the need to take more fundamental steps to address these issues in the context of the 2004 budget. Understandings were reached on the next steps in setting up the National Revenue Agency, which the World Bank is supporting through a project loan, and enhancing expenditure management and the budget process. Also, the authorities are designing, with IMF assistance, a more systematic approach to monitoring risks associated with banks' foreign currency lending. The staff called on the authorities to resist the temptation to resort to industrial policies to attract foreign direct investment, pointing instead to the need to advance the lagging reforms. In that regard, the authorities are cooperating with the World Bank under the PAL.

Staff appraisal: Bulgaria has the right mix of macroeconomic policies to continue to enjoy robust growth and macroeconomic stability, but to maintain such performance in the medium term would require more decisive action towards completion of the remaining structural reforms. The government's commitment to exercise caution and maintain flexibility in the conduct of fiscal policy, combined with strong bank supervision, provide assurances that under adverse scenarios macroeconomic stability would be safeguarded. Going forward, the authorities should maintain their own strategy to balance the budget by 2005. However, further postponing crucial structural reforms may constrain growth in the medium term.

I. Introduction

1. **A staff team[1] visited Sofia during May 7–20 to conduct discussions on the third review under the Stand-By Arrangement**. The two-year arrangement for SDR 240 million (37 percent of quota) was approved on February 27, 2002. Five purchases totaling SDR 136 million have been made to date, and an additional SDR 26 million (4 percent of quota) would become available upon completion of this review. Performance under the program continues to be strong, with all performance criteria through end-March observed (Tables 1–2 of Attachment I),[¶ 2].[2] One structural benchmark—the transfer of the remaining leva-denominated accounts to the Treasury Single Account—has been postponed until September because of technical problems.[3]

2. **Setbacks in the privatization of two major enterprises and a further erosion of the coalition's cohesion have weakened the reform momentum.** The popularity of the cabinet has dropped to record low levels due to the failure to deliver on electoral promises of a sharp improvement in living standards and reduction in corruption and complete the high-profile privatizations of the telecommunication company BTC and the tobacco holding Bulgartabac. A number of defections have narrowed the coalition's majority in parliament, and the campaign for the October 2003 municipal elections is likely to add to the pressures. As a result, the coalition is facing difficulties in fully implementing its legislative and economic agenda.

II. Background and Recent Developments

3. **In spite of an unsettled external environment, macroeconomic developments have been favorable.**

- Exports and industrial activity data suggest that the momentum achieved in 2002—when real GDP increased by 4.8 percent—has been maintained in spite of the downturn in the EU (Table 1, Figures 1–2). A reduction in the unemployment rate by almost 2 percentage points in the first four months of 2003 largely reflects the provision of community jobs to long-term unemployed.

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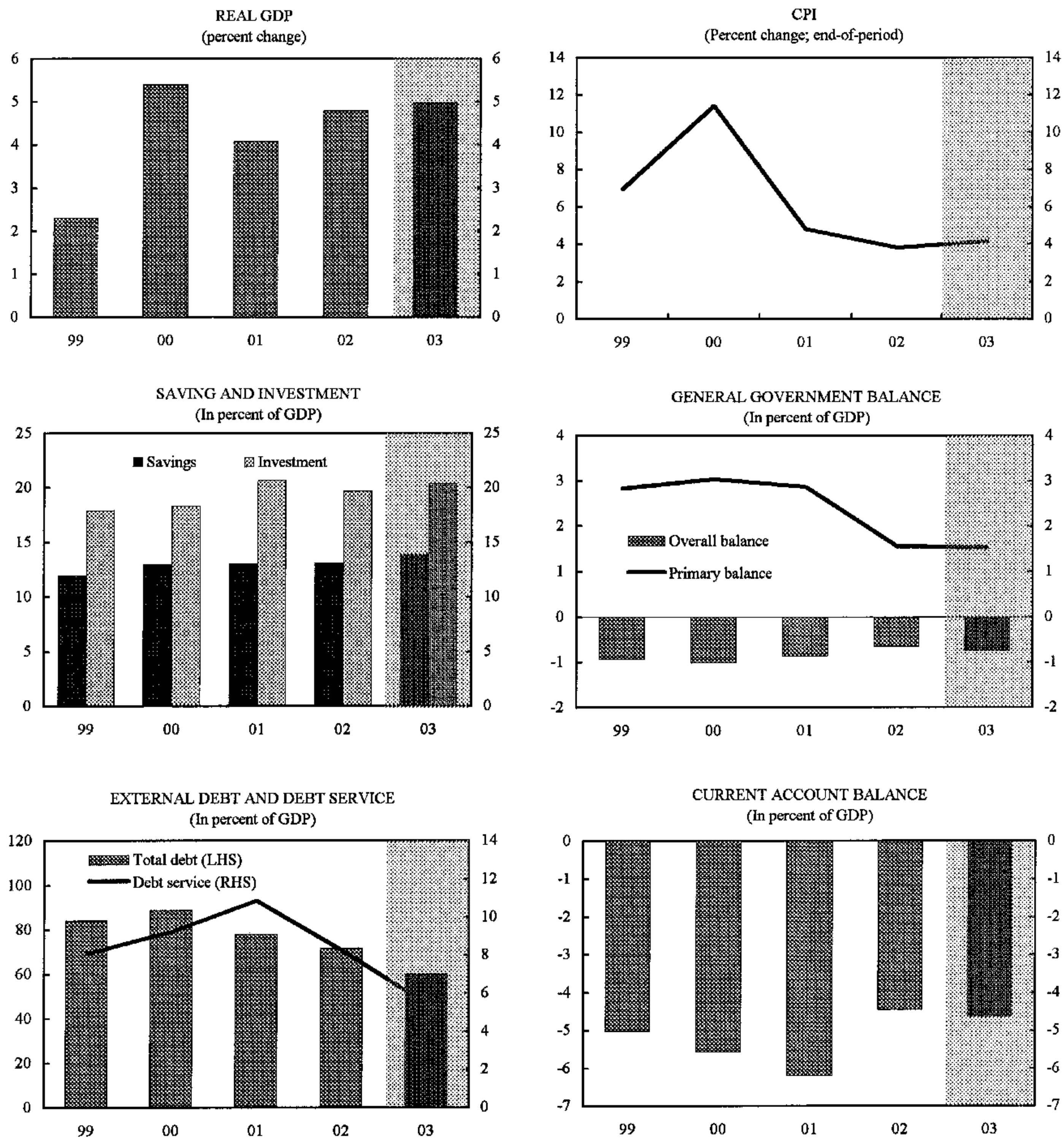
[1] Messrs. Schiff (head), De Broeck, and Egoumé-Bossogo, and Ms. Corbacho (all EU1), Mr. Pitt (PDR), and Mrs. Sorsa (resident representative). The mission met with the President, Prime Minister, key economic ministers, the Governor of the Bulgarian National Bank, parliamentarians, and representatives of trade unions and the private sector, and coordinated its work with World Bank staff.

[2] Numbers in square brackets refer to SMEP paragraphs.

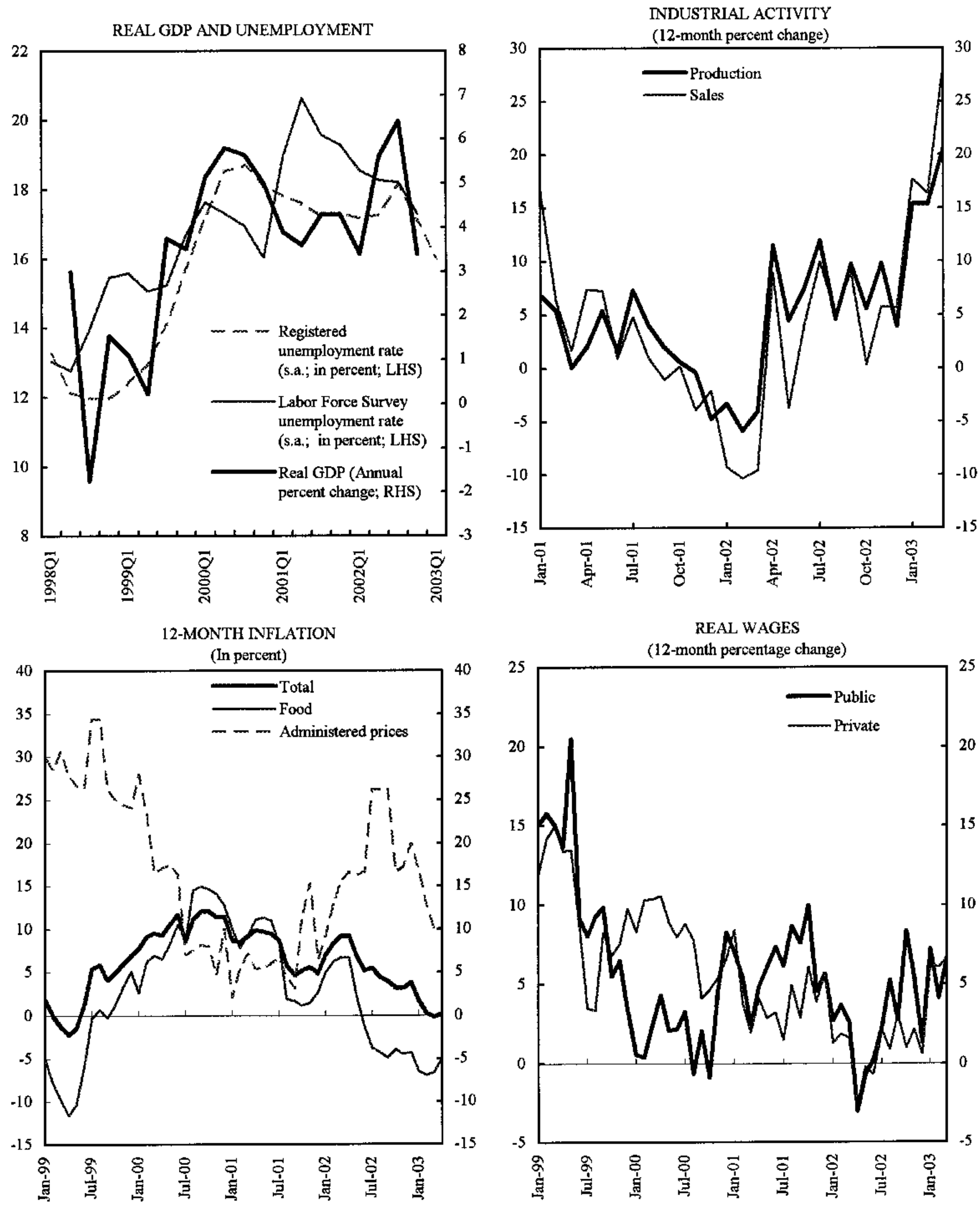
[3] The end-June 2002 structural benchmark on reform of the import tariff schedule was not met as the EU deemed it contrary to its trade policy agenda for accession countries; the benchmark accordingly has been dropped.

Figure 1. Bulgaria: Selected Economic Indicators, 1999-2003 1/



Sources: Bulgarian authorities; and Fund staff estimates and projections.
1/ 2003: Projection.

Figure 2. Bulgaria: Real Sector Developments, 1998-2003



Sources: Bulgarian authorities; and Fund staff estimates.

- Twelve-month inflation fell to virtually zero in April, reflecting the appreciation of the Euro and lower food prices.

- The external position remains sound. While the twelve-month external current account deficit increased to around 5½ percent GDP in the first quarter of 2003, the trade deficit was broadly unchanged at 10½ percent of GDP. In part driven by imports of raw materials and consumer goods and higher oil prices, year-on-year growth in imports in volume terms increased to 25 percent in the first quarter, extending a pattern from the last quarter of 2002. Export growth also accelerated, to 28 percent in volume terms. With delays in two large privatizations, net FDI inflows were subdued, and covered only about 60 percent of the twelve-month current account deficit. The remainder of the deficit was financed in part by a drawdown in international reserves, which, however, continued to exceed 5 months of prospective imports (Tables 2–3, Figures 3–4).

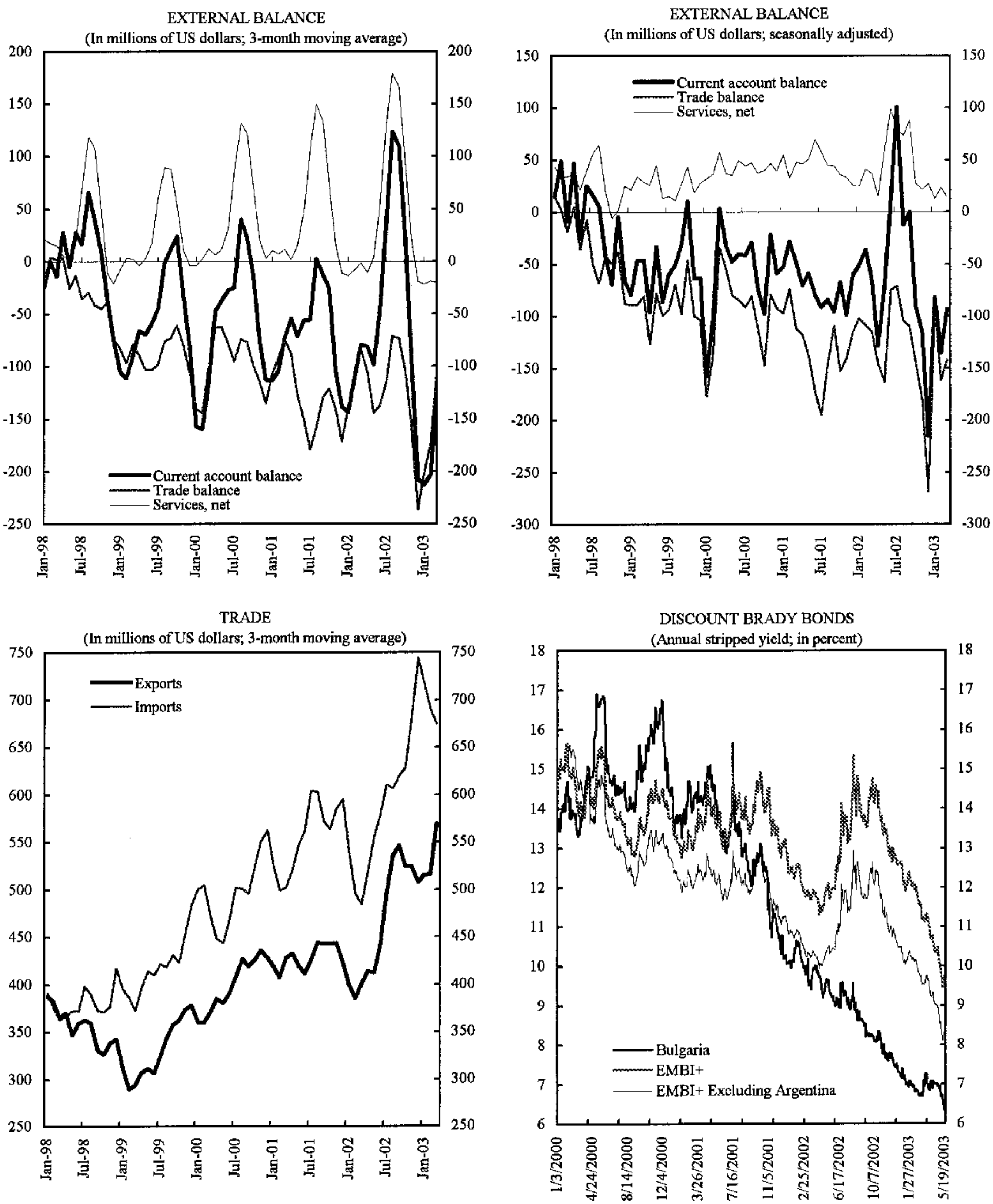
- Financial and external vulnerability indicators suggest that the risk of a crisis in the near term remains low (Table 4). The gross external debt-to-GDP ratio has continued to decline, reaching 58 percent of projected 2003 GDP at end-March. Standard&Poor's upgraded Bulgaria's long-term foreign currency rating by one notch to BB+ in late May, while Moody's raised the country's foreign and domestic currency credit rating by two notches to Ba2 in early June. Spreads on the Bulgaria component of the EMBI+ index have stabilized in the record low 200–250 basis points range.

4. **Fiscal performance has been significantly better than programmed due to an overperformance of revenue collection and cautious discretionary spending.** In the first quarter, the budget recorded a surplus of 0.3 percent of projected 2003 GDP, significantly better than the programmed 0.9 percent deficit (Tables 5–6). Almost half of the overperformance was accounted for by non-tax revenues and grants, in part reflecting one-off factors. Tax revenues and social security contributions were also higher than programmed, boosted by the economic expansion and measures to strengthen revenue collection. Strict control of discretionary spending and lower interest rates resulted in underspending relative to program.[4] This was offset in part by a significant overrun in the reimbursement of medicines by the National Health Insurance Fund, while arrears pressures built in the municipal and hospital sectors. April data indicate that the fiscal performance, revenue collection in particular, continues to be strong.

5. **Bank credit to the private sector has continued to grow rapidly, with no negative repercussions yet for banking system soundness.** Claims on the non-government sector

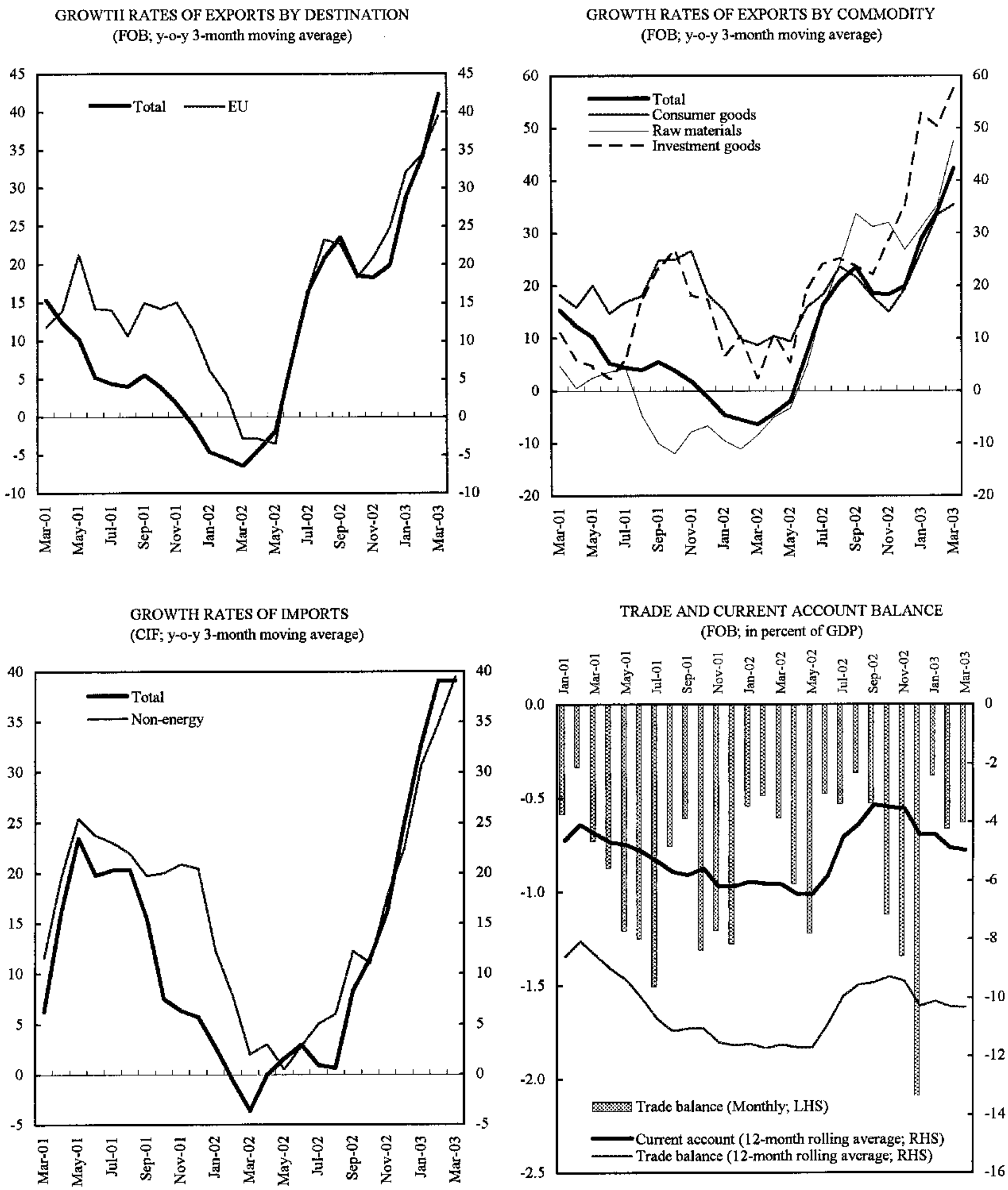
[4] The government also used leva 35 million (0.1 percent of GDP) from the Fiscal Reserve Account (FRA) for policy purposes, within the limits under the program.

Figure 3. Bulgaria: External Sector Developments, 1998-2003



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

Figure 4. Bulgaria: External Sector Developments, 2001-2003



Sources: Bulgarian authorities; and Fund staff estimates.

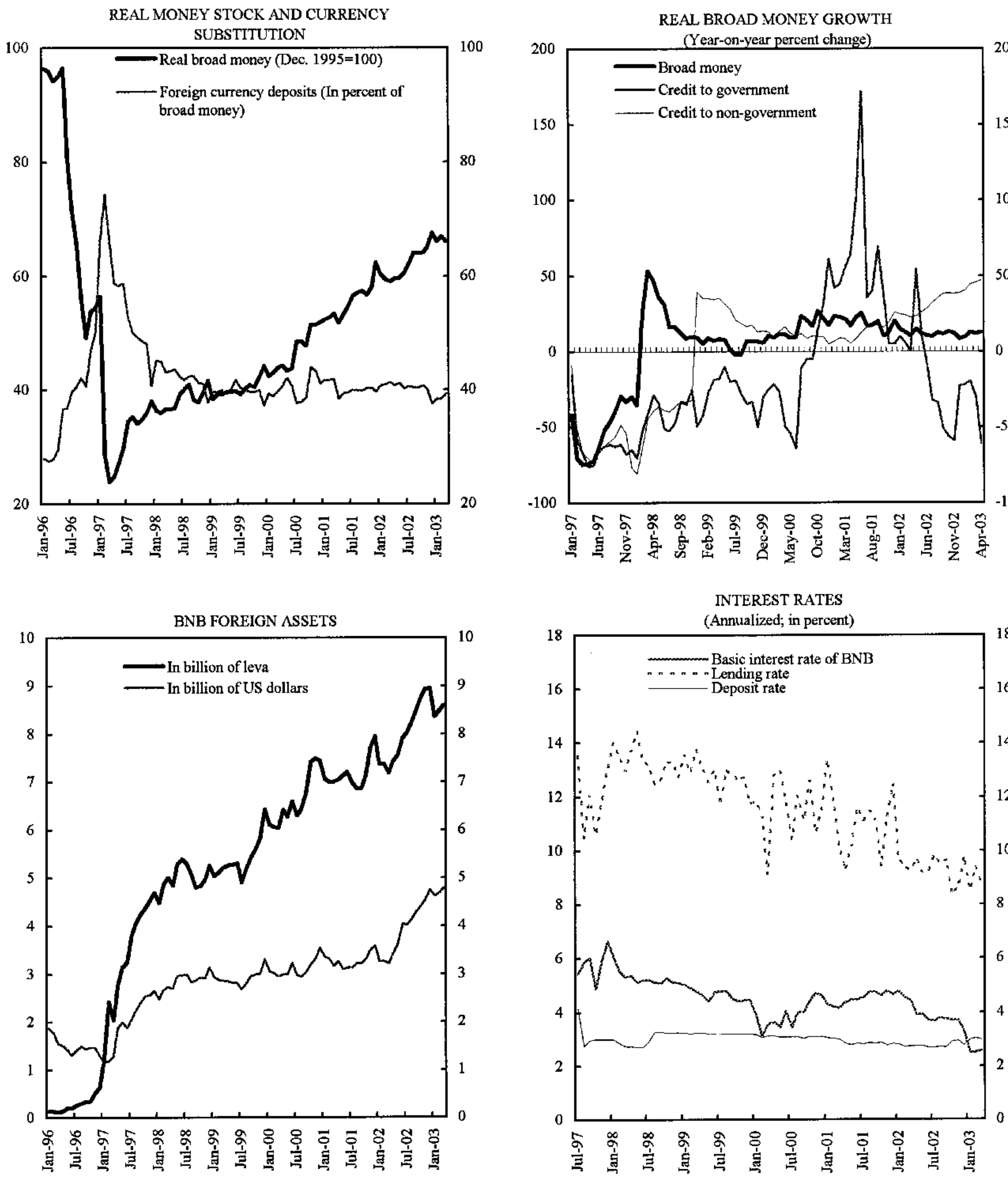
recorded a twelve-month real growth rate of 47.5 percent in April as banks attracted additional deposits and continued to substitute foreign currency-denominated loans to enterprises for low-yielding deposits abroad and expand mortgage and consumer lending (Table 7, Figure 5). Real broad money increased by 12.5 percent over the same period, extending the robust re-monetization trend from recent years. A gradual increase in the money multiplier and narrowing of lending spreads suggest an improvement in the efficiency of intermediation. The rapid credit expansion has not yet affected aggregate bank asset quality and capital adequacy, but some banks with weak prudential indicators are subject to more intense supervision, and increased competition is putting pressure on profit margins, especially those of small banks (Box 1).

6. **The reform agenda advanced on several fronts, but stalled in other key areas**. The authorities successfully sold the last major state-owned financial institution, DSK Bank, meeting an end-June benchmark. They are strengthening revenue administration through the implementation of the National Revenue Agency (NRA) project and the expansion of the operations of the Large Taxpayer Office (LTO), while completing the legislative work to put the reform of municipal finances on a sound legal footing, including through amendments to the municipal budget act aimed at introducing more transparent standards for state-mandated spending. Reforms in the railways and energy sectors—including the approval of a draft new energy law by the Council of Ministers—are also advancing. But efforts to finalize the privatization of two remaining large state enterprises were unsuccessful, and an entirely new strategy for the sale of Bulgartabac needs to be developed. In the fiscal area, efforts to advance and strengthen 2004 budget preparation have fallen short of targets. Finally, few tangible results have been achieved in restructuring the hospital sector or improving the business climate.

III. REPORT ON THE DISCUSSIONS

7. **Discussions focused on policies to address the risks associated with an unsettled external environment and waning support for difficult structural reforms.** Given the favorable macroeconomic conditions and fiscal overperformance, the main challenges are to limit vulnerability to a deterioration in the external position and revitalize the reform agenda. A cautious fiscal policy needs to be maintained in the face of the risk that the external current account deficit could be wider than programmed owing to a more protracted slowdown in the EU or a credit-fueled import boom. A second key risk stems from the lack of incentives and capacity of the government to implement difficult reforms due to its low popular support and weak cohesion, combined with a comfortable macroeconomic position. In this regard, the authorities need to advance privatization, expedite reforms in the health, energy and railways sectors, embark on a strong program of judicial reform and reduce administrative impediments to business activity. The World Bank's programmatic adjustment loans (PALs) provide an appropriate framework for such reforms.

Figure 5. Bulgaria: Monetary and Financial Indicators, 1996-2003



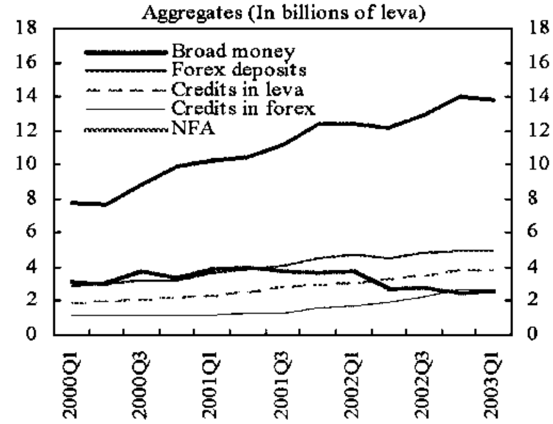
Sources: The Bulgarian National Bank; and Fund staff calculations.

Box 1. Bank Intermediation and Prudential Indicators

Bank intermediation has been growing sharply, but aggregate prudential indicators continue to point to a sound banking system, while profitability has been declining.

Since 2000, the growth in bank intermediation has accelerated (see graph). Reflecting the strong economic growth, broad money increased by three quarters. At the same time, owing to low international interest rates and better domestic lending opportunities, credit to the nongovernment sector both in leva and in foreign currency almost doubled, financed in part by a drawdown in bank foreign assets.

Bulgaria: Broad Money and Commercial Bank Aggregates (In billions of leva)



Aggregate prudential indicators suggest that the banking system is sound, although profitability has suffered (see table). The capital adequacy ratio and bank liquidity remain comfortable, while nonperforming loans have actually declined reflecting the tight supervision and the increase in the share of new loans corresponding to the rapid credit growth. Provisions continue to cover ¾ of substandard loans for the banking system as a whole, a little less for the smaller banks in group IV. As for profitability, the deterioration has been sharper for the smaller banks, as they are the most affected by the intense competition.

Bulgaria: Commercial Banks - Selected Indicators

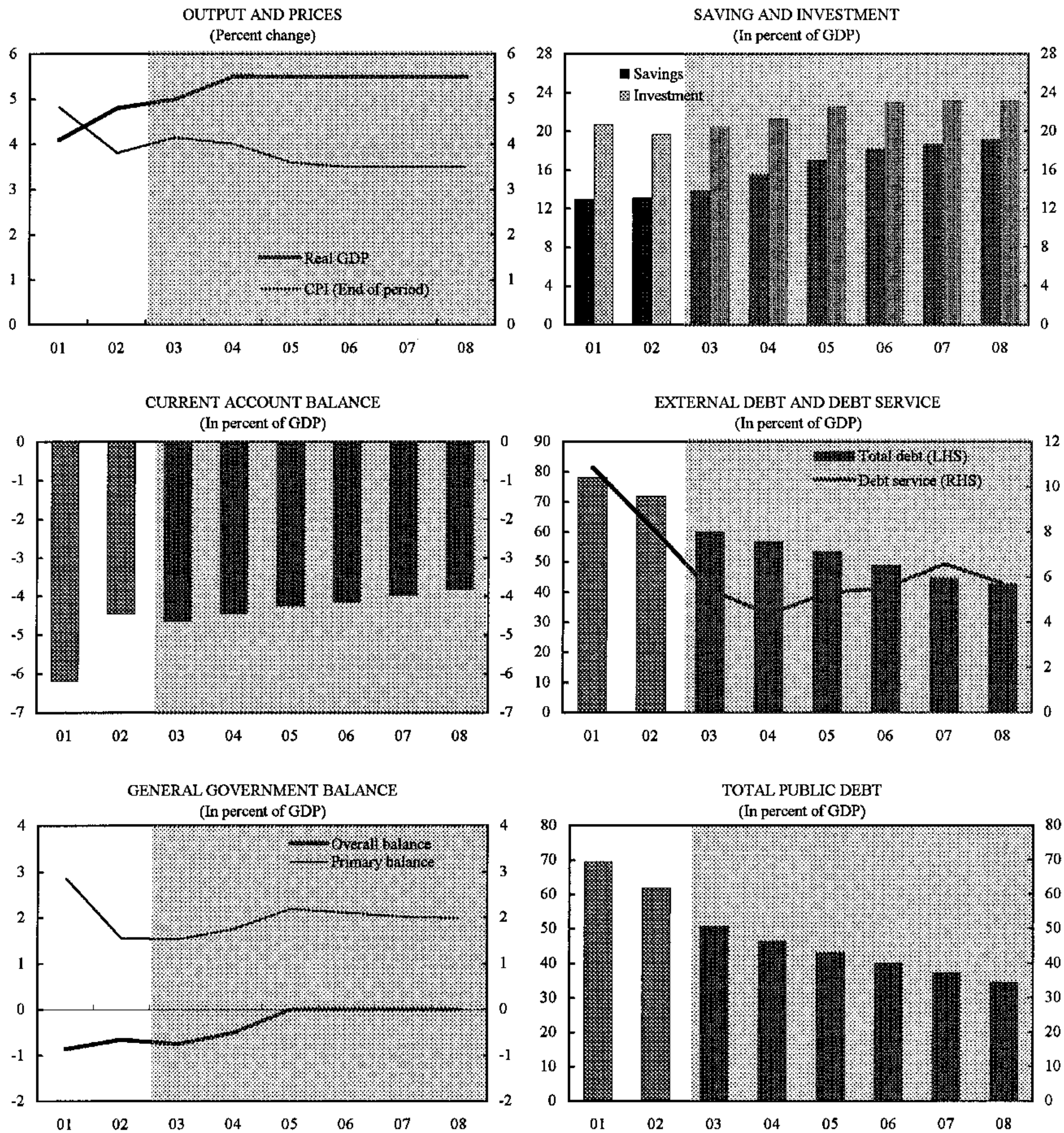
	2000	2001	2002
ROA (After taxes)			
Total	2.7	2.5	1.7
Group IV	1.4	1.0	0.0
NPL (In percent of total loans)			
Total	8.2	7.0	5.5
Loss	3.4	2.7	1.8
Group IV	19.7	15.9	9.9
Loss	3.9	4.5	3.1
Provisions (In percent of substandard loans)			
Total	79.3	73.5	74.3
Group IV	44.7	47.5	58.1
Capital adequacy (Total)			
Total	35.6	31.3	25.2
Group IV	52.0	47.5	35.6

Sources: Bulgarian National Bank; and Fund staff calculations.

A. The Macroeconomic Outlook

8. **The macroeconomic outlook for the rest of 2003 remains positive, in line with the projections in EBS/03/7, but is subject to considerable uncertainty** (Table 8, Figure 6).

Figure 6. Bulgaria: Medium-Term Projections, 2001-2008 1/



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

1/ 2003 onward: projections.

- The projected 5 percent rise in real GDP this year remains achievable, as the growth momentum from the first quarter is expected to be maintained. Robust consumption and investment growth—supported by continued rapid credit expansion—and further gains in export markets will all contribute to this projected outcome.

- Twelve-month inflation is forecast to gradually rise to around 4 percent at end 2003, as a result of adjustments in administered prices and higher food prices.

- The external current account deficit is expected to reach about 4½ percent of GDP for the year (Tables 9–10). Continued solid growth in exports and tourism are forecast to absorb most of the projected acceleration in import growth. Competitiveness remains adequate and the Euro appreciation is expected to have little net impact on the current account position (Box 2 and Figure 7). Despite privatization delays, FDI is projected to more than cover the current account deficit. A small surplus on net private sector flows and official borrowing is expected to permit a further increase in international reserves, maintaining the coverage of prospective imports at more than 5 months.

There are significant downside risks to this external outlook, however, in particular should the recovery in the EU prove slower or credit-driven import demand grow faster than expected. In the absence of a fiscal policy response, if either of these two main risks were to materialize, the current account deficit could widen by almost 2 percentage points of GDP.[5] In addition, greenfield FDI could fall short of projected levels, if investor confidence were eroded in reaction to further setbacks in the high-profile privatizations. The international reserves position would be strong enough, however, to absorb the additional external financing needs associated with the two scenarios, even in case of smaller-than-projected FDI, but coverage of prospective imports would fall to below five months. Under these scenarios, a fiscal policy response would be needed.

9. **The updated medium-term sustainability analysis shows that debt indicators will continue to improve under most scenarios.** Except under some extreme scenarios, Bulgaria's total external debt-to-GDP and public debt-to-GDP ratios will decline over the medium term (Tables 11–12). With around half of both the external and public debt stocks denominated in U.S. dollar, its sharp depreciation versus the leva since 2001 has resulted in a pronounced downward shift in their ratios to GDP.

[5] The alternative scenarios are based on the assumption that relative to the baseline, demand growth from advanced economy trade partners is reduced by two-thirds or that the elasticity of Bulgaria's imports rises by one-fourth, respectively.

Box 2. External Competitiveness

Indicators of external competitiveness show that Bulgaria's competitiveness is being preserved.

Wages and productivity. Real wage increases appear to have remained below productivity increases. While economy-wide real wages rose by about one percent in 2002, productivity increased by 3½ percent. In the tradables sector, real wages even declined as productivity continued to grow robustly by almost five percent.

Trade share in EU. Bulgaria's market share in the EU, its main trading partner, continues to increase (by about 30 percent since Q1 1998). Until mid-2001, the share of imports from the EU rose faster than the market share of Bulgarian exports to the EU, but exports have since caught up (Box Figure 1). Also, the growth in Bulgaria's market share in the EU has kept pace with other CEE countries, (Figure 7, panel 3).

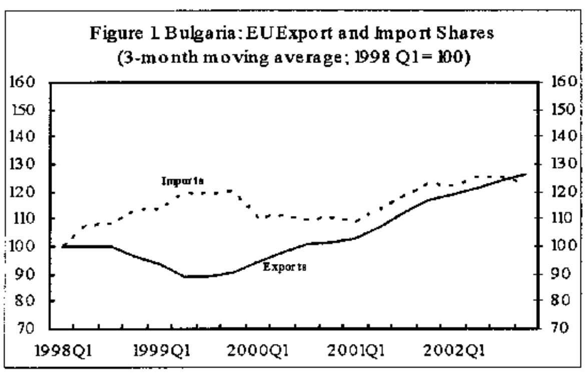


Figure 1. Bulgaria: EU Export and Import Shares (3-month moving average; 1998 Q1 = 100)

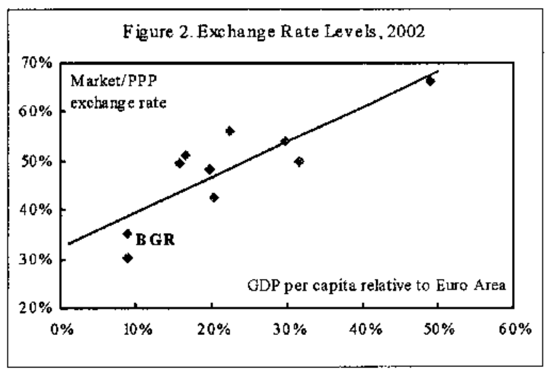
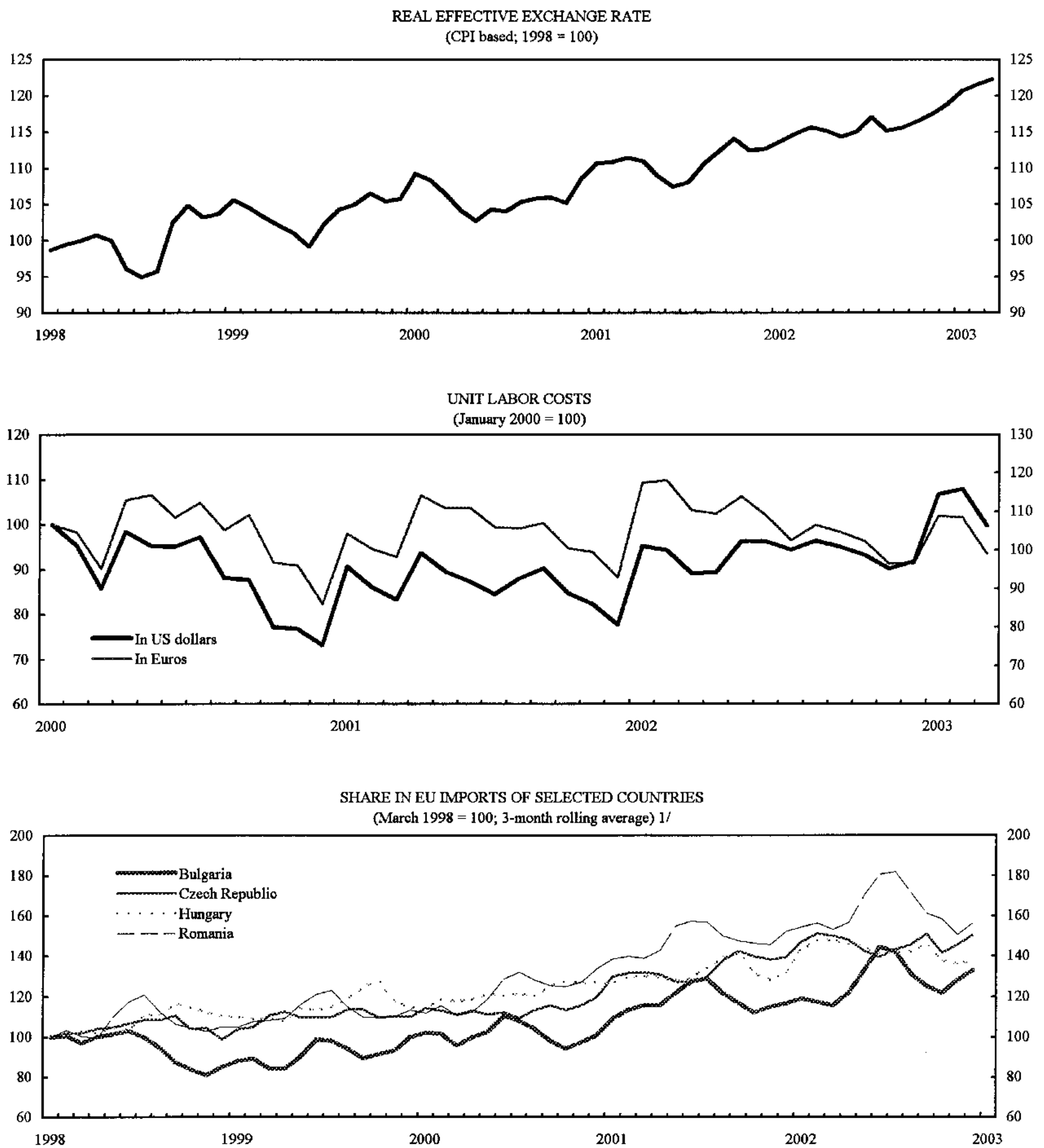


Figure 2. Exchange Rate Levels, 2002

Exchange rate levels. Compared to other CEE countries, Bulgaria's exchange rate appears undervalued. For any given level of GDP per capita, the lower the ratio of market to PPP exchange rates, the lower is the price level—or equivalently, the more the currency may be undervalued. Box Figure 2 shows the market/PPP exchange rate ratio against per capita GDP relative to the Euro area, as measured by market exchange rates, for several CEE countries. Also shown are the fitted values of a simple OLS regression. Bulgaria is below the regression line, indicating that, relative to most other CEE countries, the leva remains undervalued.

Euro appreciation. The recent appreciation of the Euro is likely to have only a small direct impact on Bulgaria's external position. In 2002, more than 50 percent of exports were denominated in Euro, and were therefore unaffected by the exchange rate, while the currencies of most other CEE countries, even if not pegged to the Euro, have also appreciated against the US dollar. Furthermore, export growth—in volume terms—has increased as the Euro has appreciated. Further, a stronger Euro also lowers debt service costs (about 50 percent of external debt is still denominated in US dollar) and the fuel import bill.

Figure 7. Bulgaria: Indicators of Competitiveness, 1998-2003



Sources: National Statistical Institute; Direction of Trade Statistics; and Fund staff calculations.

1/ Bulgaria; Czech republic; and Hungary: Authorities data; and Romania: Direction of Trade Statistics.

B. Fiscal Policy

10. **The strong performance through April augurs well for meeting the 2003 budget targets**. The deficit target of 0.8 percent of GDP for 2003 remains appropriate and consistent with the program's macroeconomic objectives [¶ 9]. In view of the strong fiscal outcome through April and the scope for some additional revenue overperformance and interest savings in the remainder of 2003, the authorities are confident that they can achieve the target while fully covering underfunded mandated spending for municipalities and deal with the expenditure overruns for 2003 as a whole in other municipal spending and the health care sector—non-budgeted spending of 0.6 percent of GDP. The revenue projections for the remainder of 2003 are based on conservative assumptions, and might be exceeded by a significant margin. In such event, the authorities would refrain from spending the non-projected overperformance at least to the extent it reflects non-recurrent or temporary factors—including dividend payments due to postponed privatizations.

11. **Measures were agreed to ensure fiscal flexibility in the face of external shocks and to address budget overruns and arrears in the health sector and municipalities.** The authorities remain committed to the "88 percent rule" (whereby discretionary spending is limited to 88 percent of budgeted levels) through the third quarter. If the current account deficit were to widen significantly relative to program, the authorities would have the flexibility to contain spending by up to 1½ percentage points of GDP by postponing the planned clearance of municipal and hospital arrears and, if necessary, applying the 88 percent rule through end-year [¶ 9]. In view of the strong fiscal performance to-date, the authorities did not see a need to identify more specific contingency measures. However, they recognized that addressing the recurrent problems of budget overruns and arrears in these two sectors required deeper reforms [¶ 10]. They intend to have a new system of intergovernmental fiscal relations—increasing local government autonomy and clarifying the scope of central government transfers—fully in place and ensure adequate funding of mandated spending for the 2004 budget. For hospitals, the plan is to steadily increase the share of financing from the National Health Insurance Fund (NHIF) by expanding the number of qualifying treatments. Staff cautioned that while this reform could instill additional financial discipline, coordinated measures to rationalize the hospital sector would also be needed.

12. **Broad reforms to strengthen revenue collection are advancing, but efforts to enhance expenditure management and the budget process have had mixed results.** The NRA project is the cornerstone of the program to boost revenue collection, with the joint collection of taxes and social security contributions intended to be rolled out in early 2005. To keep to the tight schedule for making the project fully operational, the authorities have set as immediate objectives to start up a regional pilot project and decide on an information technology system by end-September (structural benchmark) [¶ 11]. The NRA project is complemented by further steps to strengthen revenue collection [¶ 11]. As the benefits from the NRA will not materialize for some time, however, the authorities also intend to continue to rely on administrative measures, including the system of VAT accounts—under which all VAT registered enterprises are required to use a special bank account for VAT payments and refunds—and the newly introduced scheme of minimum insurable income thresholds for

social security contributions (EBS/03/7). The recent creation of a full-fledged Treasury function will strengthen control over cash spending, but further steps, including the implementation of the Financial Management Information System (FMIS), are needed to enhance control over expenditure commitments and limit arrears. An ambitious effort to advance the budget preparation cycle has proved only partially successful, but the authorities agreed to catch up with the original calendar and decide on the 2004 expenditure ceilings before the summer recess [¶ 12].

13. **The authorities remain committed to balancing the budget in the medium term, but are considering some backtracking.** Their fiscal strategy envisages lowering the deficit to ½ percent of GDP next year and achieving a balanced budget in 2005. However, arguing that the EU's lackluster growth performance could extend into next year, and pointing to the need to increase co-financing for expected larger EU grants, the authorities indicated that these objectives might be difficult to meet [¶ 13]. In particular, the target dates for reducing the deficit and balancing the budget might be pushed back one year to 2005 and 2006, respectively. Staff argued that Bulgaria was projected to record strong growth in line with its medium term potential next year, creating a favorable window for deficit reduction, and that the government's credibility would be enhanced by adhering to its announced medium-term strategy. The medium-term tax policy plan adopted in mid-2002—including sizable cuts in the corporate tax rate—remains in place. Staff underscored that achieving the objectives of the medium-term fiscal program would also require a sustained effort to cut subsidies—notably in the district heating and railways sectors—and streamline employment in the education and health care sectors. It was also imperative to better target social assistance, advance pension reform and create room for additional capital spending in conjunction with the increase in EU grants.

C. Incomes and Labor Market Policies and the Business Climate

14. **The authorities have expanded active labor market policies (ALMPs) to reduce unemployment, complementing efforts to increase labor market flexibility and maintain wage moderation in public enterprises.** The ALMPs are centered on a program to provide community jobs to 100,000 long-term unemployed. The authorities noted that this program has a limited budgetary impact—participants are paid the minimum wage and stop receiving social assistance—and is having its desired effect on unemployment in the short-term, but staff emphasized that the program would need continued monitoring and, in any case, could not address underlying causes of long-term unemployment. The authorities remain committed (in the context of the World Bank PALs) to amending the labor law to promote flexible forms of employment and reduce hiring and dismissal costs, but prefer to support ongoing discussions between trade unions and employers rather than impose a solution from above [¶ 14]. They observed that the obligatory registration of labor contracts and introduction of minimum insurable income thresholds had not affected labor market flexibility but instead pulled a significant number of workers into the official economy. These policies are complemented by a strict incomes policy for state-owned enterprises; wage developments in the 60 enterprises that are strictly monitored under this policy remain in line with program requirements.

15. **The authorities recognize the need to reinvigorate the privatization process and advance reforms in the energy and railways sectors.** The difficulties surrounding two major privatizations have revealed weaknesses in the legal framework governing large-scale privatizations, notably with regard to the respective roles of the executive and the judiciary, and flaws in the two specific procedures, including those related to employment and investment clauses. Underscoring the need to restore investor confidence, staff pressed for the completion of the sales of BTC and Bulgartabac in a fully transparent and legally sound manner as soon as feasible [¶ 15]. According to the authorities, the draft new energy law marked an important step forward in the reform of the sector and would allow the important privatization of the electricity distribution companies to move ahead. Staff emphasized that the new law should ensure the independence of the energy sector regulator in issuing licensing and regulatory ordinances. The authorities indicated that the restructuring of the district heating companies had advanced, and would allow the virtual elimination of subsidies next year. The restructuring of the railways is also progressing more or less as planned, but staff emphasized the need for a political decision to limit loss-making activities [¶ 15].

16. **Legal reform and improvements in the business climate are key to attract FDI and promote further restructuring.** Staff emphasized that sustaining robust growth over the medium term would require a pickup in FDI and an acceleration in structural reforms. Noting that the subdued level of FDI in the last two years in part reflected persistent concerns about the business environment, the mission urged the authorities to complete the privatization process, embark (with EU and World Bank assistance) on a strong program of judicial reform, and complete steps to reduce administrative barriers to entry and exit. The authorities concurred, and pointed to several legislative initiatives to achieve this objective, including a licensing law and streamlined bankruptcy procedures [¶ 16]. But some in government want such initiatives to be complemented by more activist policies, including a draft investment law providing discretionary incentives in the form of corporate tax breaks or in-kind support. Staff repeated its strong reservations against such measures. Noting the adoption this year of a zero corporate tax rate for enterprises locating in high unemployment regions and proposals to introduce accelerated depreciation allowances for large domestic investment projects, staff also expressed concerns that a proliferation of special tax regimes would erode the transparency and uniformity of the corporate tax and induce distortionary tax arbitrage.

D. Financial and External Sector Policies

17. **The supervisory authorities remain vigilant in the face of a continued rapid increase in bank lending to the private sector.** Staff and the authorities agreed that this rapid increase was a welcome development overall—in part still reflecting a rebound from the sharp drop in bank credit following the 1996–97 crisis—but also presented new challenges. The supervisory authorities emphasized that overall banking soundness was not at stake, and noted that they were already engaged in intensive surveillance of some, mainly small, banks with potential problems, maintained strict limits on open positions and scrutinized individual foreign-currency denominated loans for potential credit risk. But they

were open to the argument that a more systematic approach to monitoring risks from foreign currency lending was desirable, and intend to seek Fund technical assistance in this area [¶ 17]. Referring to the re-occurrence of imbalances in the interbank market in mid-April, the BNB observed that they had been minor and had mainly reflected speculative liquidity management by some smaller banks. The BNB was confident that the scope for such imbalances would be significantly reduced with the introduction of the real time gross settlements system in June. Staff observed that the reverse repo facility organized by the Ministry of Finance, while very limited in scope, could create a precedent for further operations with a monetary policy character and should not be repeated [¶ 7].

18. **Noting the authorities' maintained intention to participate in equity financing of private sector initiatives, staff insisted on strong safeguards and strict limits on the use of FRA resources.** The authorities remain convinced that a government-sponsored fund will have an important catalyctic role in making private equity capital available. They have shortlisted several candidates to manage such a fund, and are leaving open the option that more than one manager be selected and competing funds created. Staff again voiced strong reservations with the arrangement, but took some comfort in the authorities' commitment to remain a minority shareholder, limit their participation to no more than 100 million leva (0.3 percent of GDP), and maintain safeguards agreed to during the second program review [¶ 18].

19. **The broad objectives of external asset and liability management remain to reduce vulnerability and ensure ample liquidity.** In line with its recently published debt management strategy, the Ministry of Finance has continued to expand domestic debt issuance and to monitor international market developments for opportunities to carry out operations to achieve a more balanced interest and currency composition of the public debt (but no major operations have been carried out since the beginning of 2003) [¶ 19]. In a further step to promote the development of local debt markets, the Ministry successfully began to issue Euro-denominated domestic bonds. The FRA will be more actively managed, with a fraction of the liquid deposits in the account transferred to higher-yielding investments and managed according to pre-agreed guidelines. Regarding claims on other sovereigns, the process to settle claims on HIPC-eligible countries is progressing, while options are being explored to deal with around US$1½ billion obligations owed by Iraq, including participation in a general rescheduling of Iraqi debt through the Paris Club.

E. Monitoring and Review Issues

20. **The program incorporates additional structural conditionality aimed at advancing tax administration reform.** As the macroeconomic framework from EBS/03/07 remains valid except for minor changes, the authorities propose to convert the existing end-September and end-December indicative targets into quantitative performance criteria, while the other indicative targets and continuous performance criteria have been retained. Structural conditionality for the remainder of the program aims at advancing the fiscal reform agenda, raising energy prices toward cost-recovery levels, and completing bank privatization (Table 2 in Attachment I). In light of the importance of improving tax administration, an end-

September benchmark to ensure progress in the implementation of the NRA project has been added. As further reforms in the hospital, energy and railway sectors will be covered in conditionality for the second PAL under negotiation with the World Bank and are non macro-critical in nature, no new measures in these areas have been added. Staff supports granting of a waiver of applicability for the June 2003 performance criteria, which are fully expected to be observed.

21. **The authorities do not intend to treat the arrangement as precautionary until the privatization of at least one of the remaining two large state enterprises is completed.** This decision reflects the risk that international reserves would need to be used to cover a widening in the current account deficit or a shortfall in FDI relative to projections.

F. Data Issues

22. **The authorities have made further efforts to improve data quality**. They plan to subscribe to the SDDS by the end of the year. The authorities are also making progress in implementing the outstanding safeguard assessment recommendations [¶ 20].

IV. Staff Appraisal

23. **Bulgaria's macroeconomic performance, in the face of the prolonged slowdown in the EU, has been impressive, but further efforts are required.** The solid growth posted in recent quarters and, in particular, the turnaround in exports since mid-2002, suggest that Bulgaria is now benefiting from six years of strong macroeconomic policies and structural reform. Building on this success, the authorities must continue to pursue sound fiscal and financial sector policies to limit vulnerability, and complete the structural reform agenda to carry growth forward to the medium term. Such efforts will not be easy, however, given the government's weakened political position.

24. **The government's fiscal policy has underpinned recent economic successes, and pressures to loosen such policies should be resisted.** Given Bulgaria's currency board arrangement, fiscal policy bears the brunt of responding to exogenous shocks, and the maintenance of sufficient flexibility in this area remains key. In this regard, the authorities' intentions to continue their cautious approach to discretionary spending for the remainder of 2003 is welcome, but reliance on contingencies based on postponing arrears clearance is clearly second best. Staff urges the authorities to implement firmly their medium-term fiscal strategy, including a modest reduction in the deficit to ½ percent of GDP next year and the achievement of a balanced budget in 2005. Doing so would help cement macroeconomic stability and further enhance the government's credibility. While expenditure pressures exist, in particular for accession-related investment, there is also considerable scope for limiting unproductive spending and increasing taxpayer compliance which, along with expected solid growth next year, would make the deficit target feasible.

25. **The revenue overperformance to date suggests that arrears accumulation and spending overruns in the municipalities and health care sector can be covered this year, but more fundamental solutions are required**. Legislative initiatives to provide additional

autonomy to local government and clarify the scope of transfers from the central government are a step in the right direction. However, this reform will succeed only if the central government carries through with its intentions to fully finance mandated activities in 2004. On health care, staff urges the government to accelerate its reform program, increasing the role of the NHIF in financing hospital care, and pursuing top-down restructuring of the hospital sector.

26. **Fiscal reforms have progressed, but momentum needs to be maintained for some time to come.** The acceleration of the NRA project, expansion of the LTO and other steps to enhance tax administration are welcome. Continued focus on improved information technology and enhanced audit present the best approach for a durable improvement in tax collections. Steps toward program and medium-term budgeting hold promise for improving the allocation of public resources, while the implementation of the FMIS would aid in improving control over spending commitments. However, these projects are in preliminary stages, and consistent attention over the long haul will be required for tangible benefits to be perceived.

27. **Robust growth can be sustained over the medium term only with a revitalization of structural reforms.** While the slump in FDI the last few years partly reflects a downturn in EU economies, the difficult business environment in Bulgaria has contributed as well. The failure of two large privatizations is regrettable, and the government should complete these sales and other remaining privatizations, embark on a strong program of judicial reform and implement long-standing plans to reduce red tape. The new Energy Law should provide a sound basis for independent regulation and further privatization and liberalization of the energy market, which the government should pursue aggressively. Continued reform of the railways—including an explicit political decision on the loss-making activities deserving of government support—would also help improve efficiency and limit government subsidies.

28. **The authorities should resist the temptation to spend their way out of structural problems.** Some in the government place a priority on industrial policies, including new tax and other financial incentives, and government participation in an equity fund. Such policies can be costly to the budget, distort business decisions, introduce an unwanted element of discretion to economic policy, and do not address underlying problems in the business climate.

29. **The rapid growth in credit to the private sector is generally welcome, but presents challenges.** The banking system remains sound and, with the successful privatization of DSK Bank, it is now virtually completely private and largely foreign-owned, contributing to its overall stability. Staff fully supports the ongoing efforts of the BNB to engage in intensive surveillance of the few banks with potential problems, to maintain strict limits on bank open positions, and scrutinize individual foreign-denominated loans for potential credit risk. In addition, the planned effort—with Fund assistance—to develop a more systematic approach to addressing risks from foreign currency lending should further limit bank vulnerabilities to external shocks. To maintain confidence in the CBA, the

Ministry of Finance should refrain from any operations, including reverse repo auctions, that could be interpreted as having a monetary policy dimension.

30. **Staff supports the authorities' request to complete the third review under the Stand-By Arrangement and the request for a waiver of applicability for the end-June performance criteria.** Program implementation and macroeconomic performance have been impressive during the course of the Stand-By Arrangement and the policies outlined in the SMEP provide a solid basis for addressing the challenges ahead. While data for the end-June performance criteria are not yet available, the program is expected to remain fully on track.

Table 1. Bulgaria: Selected Economic Indicators, 1998-2003

	1998	1999	2000	2001	2002	2003 Q1
Output, prices, and employment	(Period average; percent change, from same period of previous year)					
Real GDP	4.0	2.3	5.4	4.1	4.8	...
Real industrial sales	...	...	...	2.9	1.3	21.0
Consumer price index (average)	18.8	2.6	10.4	7.5	5.8	0.6
(End-of-period)	1.7	7.0	11.4	4.8	3.8	-0.2
Unemployment rate (in percent)						
Registered unemployment	12.4	13.8	18.1	17.5	17.4	16.6
Labor force survey	14.1	15.7	16.9	19.8	17.8	...
Real public sector wages	26.3	10.7	2.4	6.3	2.5	6.0
Real private sector wages	22.1	9.4	7.8	4.1	0.9	6.3
Consolidated government 1/	(In percent of annual GDP)					
Revenue	35.4	38.6	38.7	37.6	36.5	8.7
Noninterest expenditure	30.2	35.8	35.7	34.7	34.9	7.3
Primary balance	5.2	2.8	3.0	2.9	1.6	1.4
Interest payments	4.2	3.8	4.0	3.7	2.2	1.1
Overall balance	0.9	-0.9	-1.0	-0.9	-0.6	0.3
External financing	-0.9	0.2	-1.5	-0.3	1.5	-0.4
Domestic financing	-1.4	-1.4	1.2	-1.7	-1.7	-0.1
Privatization receipts	1.5	2.1	1.3	2.9	0.9	0.1
Total public debt 2/	93.0	84.7	80.5	69.6	62.1	50.6
Domestic public debt 3/	13.8	12.5	6.6	6.3	6.5	6.6
Money and credit 4/	(End-of-period; percent change, from same period of previous year)					
Broad money (millions of leva)	6,660	7,548	9,881	12,447	13,996	13,848
Broad money (M3)	11.3	13.3	30.9	26.0	12.4	11.7
Lev money	17.0	14.3	22.9	28.9	16.4	15.5
Leva credit to nongovernment	78.8	20.1	25.0	32.0	31.0	33.6
FX deposits (U.S. dollar millions)	1,502	1,443	1,931	2,227	2,792	3,034
FX deposits (percent of M3)	37.8	37.2	41.1	39.7	37.6	39.3
Broad money to FX reserves ratio	1.3	1.2	1.3	1.6	1.6	1.6
Interest rates (annualized)	(In percent; end-of-period)					
BNB basic rate	5.2	4.6	4.7	4.8	3.4	2.6
Time deposit (leva)	3.3	3.2	3.3	3.4	3.2	3.3
Balance of payments	(In millions of US dollars)					
Gross official reserves	3,056	3,222	3,460	3,580	4,747	4,792
(In months of prospective imports of GNFS)	5.6	5.0	4.8	4.6	5.2	5.2
Current account balance	-61	-652	-702	-842	-677	-391
(In percent of GDP)	-0.5	-5.0	-5.6	-6.2	-4.4	-10.2
Trade balance	-381	-1,081	-1,176	-1,580	-1,593	-315
Exports	4,193	4,006	4,825	5,113	5,688	1,709
Imports	-4,574	-5,087	-6,000	-6,693	-7,281	-2,024
External debt 5/	10,892	10,914	11,202	10,619	10,946	11,048
(In percent of GDP)	85.5	84.2	88.9	78.1	71.9	58.4
Exchange rates						
Leva per U.S. dollar 6/	1.675	1.947	2.102	2.219	1.885	1.795
(yoy percent change, + means depreciation)	-5.7	16.2	8.0	5.6	-15.1	-19.9
REER (end-of period; CPI based)						
(yoy percent change, + means appreciation)	6.2	2.0	2.7	3.6	5.5	5.7

Sources: Bulgarian authorities; and staff estimates.

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

2/ Domestic debt as reported by Ministry of Finance and external debt as reported by BNB, in US$.

3/ In leva.

4/ Starting in 2002, a new format was adopted for monetary data resulting in revisions to historical series.

5/ Trade credits have been added to private debt starting in 2000.

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

Table 2. Bulgaria: Balance of Payments, 1999-2004
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003 Q1 Act.	2003 Q2 Proj.	2003 Q3 Proj.	2003 Q4 Proj.	2003 Projections	2004 Projections
CURRENT ACCOUNT	-652	-702	-842	-677	-391	-239	262	-509	-877	-927
Trade balance	-1,081	-1,176	-1,580	-1,593	-315	-525	-334	-665	-1,839	-1,793
Exports (f.o.b.)	4,006	4,825	5,113	5,688	1,709	1,560	1,832	1,670	6,771	7,501
y-o-y change (in percent)	-4.5	20.4	6.0	11.2	42.4	17.8	11.7	9.6	19.0	10.8
Imports (f.o.b.)	-5,087	-6,000	-6,693	-7,281	-2,024	-2,085	-2,167	-2,335	-8,610	-9,294
y-o-y change (in percent)	11.2	17.9	11.6	8.8	39.4	20.1	16.5	4.6	18.3	7.9
Services, net	314	506	544	594	-60	153	525	-11	607	603
Income, net	-185	-321	-304	-228	-154	-27	-99	-29	-308	-442
Of which: Interest payments of the central gov't	-425	-438	-457	-279	-189	-16	-101	-15	-317	-332
Income to direct investors	22	-107	-149	-195	-29	-57	-57	-57	-228	-333
Current transfers, net	300	290	498	549	137	160	170	196	663	706
CAPITAL AND FINANCIAL ACCOUNT	747	839	1,215	1,393	219	438	328	234	1,219	1,586
Capital transfers, net	-2	25	0	0	0	0	0	0	0	0
Foreign direct investment, net	802	1,003	685	450	179	129	462	158	928	970
Of which: Privatization receipts	227	366	19	136	0	29	362	59	450	500
Portfolio investment, net	-199	-179	82	-77	-60	8	-43	24	-72	-102
Other investment, net	193	59	244	879	-109	302	-91	52	154	718
General government	-105	-216	-308	-137	-51	267	-55	71	231	310
Domestic banks	67	-383	-75	392	-45	19	-41	-42	-109	53
Other private sector	231	658	627	624	-13	16	5	24	32	355
Errors and omissions	-45	-69	205	140	208	0	0	0	208	0
OVERALL BALANCE	96	137	373	715	-172	199	590	-275	342	659
FINANCING	-96	-137	-373	-715	172	-199	-590	275	-342	-659
Gross international reserves (increase: -) 1/	-527	-409	-275	-586	164	-243	-614	252	-441	-574
Use of Fund credit, net	162	136	-169	-142	8	44	24	24	99	-86
Purchases	286	275	132	111	36	71	36	35	178	35
Repurchases 2/	-124	-139	-301	-253	-27	-27	-12	-12	-78	-121
Exceptional financing	270	136	71	13	0	0	0	0	0	0
Financing gap (gap: +)	0	0	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS										
Gross international reserves (stock, e.o.p.) 3/	3,222	3,460	3,580	4,747	4,792	5,035	5,649	5,397	5,188	5,761
In months of prospective GNFS imports	5.0	4.8	4.6	5.2	5.2	5.3	5.9	5.4	5.2	5.3
Current account (in percent of GDP)	-5.0	-5.6	-6.2	-4.4	-10.2	-5.4	4.8	-9.9	-4.6	-4.4
Trade account (in percent of GDP)	-8.3	-9.3	-11.6	-10.5	-8.2	-11.8	-6.1	-12.9	-9.7	-8.6
Exports (in percent of GDP)	30.9	38.3	37.6	37.4	44.6	35.1	33.5	32.4	35.8	36.0
Imports (in percent of GDP)	-39.3	-47.6	-49.2	-47.8	-52.8	-46.9	-39.6	-45.3	-45.5	-44.6
Export volume (year-on-year change)	-2.4	20.2	10.9	8.7	27.9	7.9	5.9	4.5	10.6	8.7
Import volume (year-on-year change)	7.2	9.6	17.9	5.7	24.8	9.4	10.1	0.4	9.8	8.6
FDI (net) in percent of current account	123.0	143.0	81.3	66.5	...	...	...	...	105.8	104.7
Gross external debt (stock, e.o.p.)	10,914	11,202	10,619	10,946	11,048	11,375	11,298	11,383	11,383	11,841
(In percent of GDP)	84.2	88.9	78.1	71.9	...	...	...	...	60.2	56.8
Public	9,454	9,311	8,629	8,333	8,334	8,691	8,644	8,735	8,735	9,019
Private	1,459	1,891	1,989	2,613	2,714	2,684	2,654	2,649	2,649	2,821
External debt service of the central government 4/	168	835	1,095	792	342	66	263	48	719	758
GDP 5/	12,956	12,605	13,600	15,228	3,832	4,447	5,473	5,156	18,909	20,839

Sources: Bulgarian authorities, and Fund staff estimates.

1/ Excluding valuation changes.
2/ According to expectations schedule.
3/ Historical figures include valuation changes.
4/ Includes obligations to the Fund.
5/ Based on quarterly average exchange rates.

Table 3. Bulgaria: Balance of Payments, 1999-2004
(In millions of euros)

	1999	2000	2001	2002	2003				2003	2004
					Q1 Act.	Q2 Proj.	Q3 Proj.	Q4 Proj.	Projections	
CURRENT ACCOUNT	-587	-762	-928	-776	-370	-222	244	-476	-824	-859
Trade balance	-1,008	-1,280	-1,779	-1,690	-296	-488	-311	-622	-1,716	-1,689
Exports (f.o.b.)	3,734	5,253	5,714	6,058	1,618	1,450	1,706	1,560	6,333	7,059
y-o-y change (in percent)	-0.3	40.7	8.8	6.0	19.2	-1.4	1.3	0.8	4.5	11.5
Imports (f.o.b.)	-4,742	-6,533	-7,493	-7,749	-1,913	-1,937	-2,017	-2,181	-8,049	-8,748
y-o-y change (in percent)	16.3	37.8	14.7	3.4	16.6	0.3	5.6	-3.7	3.9	8.7
Services, net	305	547	628	598	-57	142	489	-10	564	568
Income, net	-167	-345	-340	-250	-144	-25	-92	-27	-288	-402
Of which: Interest payments of the central gov't	-399	-477	-513	-302	-176	-14	-94	-14	-299	-312
Income to direct investors	21	-115	-167	-203	-27	-53	-53	-53	-187	-313
Current transfers, net	282	316	562	567	127	148	158	183	617	664
CAPITAL AND FINANCIAL ACCOUNT	712	923	755	1,302	-1	407	305	218	931	1,491
Capital transfers, net	-2	25	0	0	0	0	0	0	0	0
Foreign direct investment, net	758	1,100	893	482	166	120	430	148	864	911
Of which: Privatization receipts	220	394	22	141	0	27	337	55	419	469
Portfolio investment, net	-186	-192	94	-99	-55	7	-40	22	-66	-96
Other investment, net	142	-10	-232	918	-112	280	-84	49	133	676
General government	-97	-235	-341	-150	-48	248	-51	66	216	292
Domestic banks	58	-389	-92	437	-42	18	-38	-39	-102	50
Other private sector	180	614	201	633	-23	15	4	22	19	334
Errors and omissions	-19	27	599	191	206	0	0	0	206	0
OVERALL BALANCE	105	188	426	717	-164	185	550	-257	313	632
FINANCING	-105	-188	-426	-717	164	-185	-550	257	-313	-632
Gross international reserves (increase: -) 1/	-521	-492	-318	-578	157	-226	-572	235	-406	-551
Use of Fund credit, net	156	151	-185	-155	8	41	22	22	93	-81
Purchases	275	295	144	115	33	66	33	33	165	33
Repurchases 2/	-119	-144	-329	-269	-25	-25	-11	-11	-73	-114
Exceptional financing	260	153	78	15	0	0	0	0	0	0
Financing gap (gap: +)	0	0	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS										
Gross international reserves (stock, e.o.p.) 3/	3,207	3,719	4,063	4,575	4,418	4,644	5,216	4,980	4,980	5,531
In months of prospective GNFS imports	4.6	4.7	4.9	5.3	5.1	5.3	5.8	5.3	5.3	5.4
Current account (in percent of GDP)	-4.8	-5.6	-6.1	-4.8	-10.4	-5.4	4.8	-9.9	-4.7	-4.4
Trade account (in percent of GDP)	-8.3	-9.4	-11.7	-10.5	-8.3	-11.8	-6.1	-12.9	-9.7	-8.6
Exports (in percent of GDP)	30.7	38.5	37.6	37.7	45.3	35.1	33.5	32.4	35.9	36.0
Imports (in percent of GDP)	-39.0	-47.9	-49.3	-48.2	-53.6	-46.9	-39.6	-45.3	-45.7	-44.6
Export volume (year-on-year change)	-2.4	20.2	10.9	8.7	27.9	7.9	5.9	4.5	10.6	8.7
Import volume (year-on-year change)	7.2	9.6	17.9	5.7	24.8	9.4	10.1	0.4	9.8	8.6
FDI (net) in percent of current account	129.1	144.4	96.2	62.2	...	...	...	...	104.9	106.1
Gross external debt (stock, e.o.p.)	10,864	12,038	12,049	10,550	10,141	10,708	10,661	10,780	10,780	11,336
(In percent of GDP)	89.5	88.2	79.4	65.7	...	...	...	...	61.2	57.8
Public	9,411	10,006	9,792	8,031	7,650	8,182	8,157	8,271	8,271	8,635
Private	1,453	2,032	2,257	2,518	2,491	2,526	2,504	2,508	2,508	2,701
External debt service of the central government 4/	161	905	1,232	849	318	61	245	45	669	712
GDP 5/	12,144	13,646	15,184	16,060	3,571	4,132	5,096	4,816	17,615	19,609

Sources: Bulgarian authorities, and Fund staff estimates.

1/ Excluding valuation changes.
2/ According to expectations schedule.
3/ Historical figures include valuation changes.
4/ Includes obligations to the Fund.
5/ Based on quarterly average exchange rates.

Table 4. Bulgaria: Selected Vulnerability Indicators, 2000-2003

	2000	2001	2002	2003	
Key Economic and Market Indicators					
Real GDP growth (in percent)	5.4	4.1	4.8	-	-
CPI inflation (period average, in percent) 1/	10.4	7.5	5.8	0.2	Apr-03
Short-term (ST) interest rate (in percent)	4.7	4.8	3.4	2.6	Apr-03
EMBI + secondary market spread (bps; end of period) 2/	772	433	291	237	May-03
Exchange rate NC/US$ (end of period)	2.1	2.2	1.9	1.7	May-03
External Sector					
Exchange rate regime	Currency board, peg to Euro				
Current account balance (percent of GDP) 3/	-5.6	-6.2	-4.4	-0.4	Mar-03
Net FDI inflows (percent of GDP) 3/	8.0	5.0	3.0	0.6	Mar-03
Export growth (US$ value, GNFS)	20.8	7.7	9.9	46.0	Mar-03
Real effective exchange rate (1995 = 100; end of period))	127.7	132.3	139.6	143.6	Mar-03
Gross international reserves (GIR) in US$billion	3.5	3.6	4.7	5.6	May-03
GIR in percent of ST debt at remaining maturity	238.6	293.8	304.7	300.9	Mar-03
Total gross external debt in percent of GDP 3/	88.9	78.1	71.9	58.4	Mar-03
o/w ST debt (original maturity in percent of GDP) 3/	11.5	9.0	10.2	8.4	Mar-03
Private sector debt (in percent of GDP) 3/	15.0	14.6	17.2	14.4	Mar-03
Total gross external debt in percent of exports of GNFS	160.0	140.9	132.2	112.6	Mar-03
Gross external financing requirement (in US$ billion) 4/	-	-	2.1	0.4	Q1-03
Public Sector 5/					
Overall balance (percent of GDP)	-1.0	-0.9	-0.6	0.3	Q1-03
Primary balance (percent of GDP)	3.0	2.9	1.6	1.4	Q1-03
Public sector gross debt (in percent of GDP) 3/	80.5	69.6	62.1	50.6	Mar-03
o/w External debt from official creditors (in percent of total)	38.8	36.1	36.2	35.8	Mar-03
External debt from private creditors (in percent of total)	50.2	52.8	48.5	47.5	Mar-03
Domestic debt linked to foreign currency (in percent of total)	3.5	3.5	3.5	3.3	Mar-03
Domestic debt linked to ST interest rate or inflation (in percent of total)	0.0	0.0	0.0	-	-
Public sector net debt (in percent of GDP)	76.3	65.4	50.9	40.5	Mar-03
Financial Sector 6/					
Capital adequacy ratio (in percent)	35.6	31.3	25.2	-	-
NPLs in percent of total loans	8.2	7.0	5.5	-	-
Provisions in percent of NPLs	79.3	73.5	74.3	-	-
Return on average assets (in percent)	2.9	2.6	2.1	-	-
FX deposits (in percent of total deposits)	54.1	52.8	49.4	50.6	Mar-03
FX deposits (in percent of gross international reserves)	55.8	62.2	58.8	63.3	Mar-03
FX loans (in percent of total loans)	35.4	35.5	41.3	41.5	Mar-03
Net open forex position (sum of on- and off- balance sheet exposure) (in percent of capital)	-5.2	-5.2	-4.2	-	-

Sources: Bulgarian authorities; and Fund staff estimates.

1/ The latest figure is the 12-month rate of inflation as of the indicated period.
2/ Stripped spread of discount A bonds.
3/ 2003: In percent of projected annual GDP.
4/ Sum of the current account deficit, the stock of short-term external debt at the end of the preceding period, amortization of medium- and long-term debt, and other net capital outflows.
5/ General government.
6/ Commercial banks.

Table 5. Bulgaria: General Government Operations, 1999-2003
(In millions of leva)

	1999	2000	2001	2002		2003					
	Actual	Actual	Actual	Budget	Actual	Program 1/	IMF Projection	Difference	Q1 Program	Q1 Prel. Act.	Q1 Difference
Total revenue and grants	9,190	10,352	11,163	11,719	11,799	12,532	12,719	186	2,729	3,042	313
Tax revenue	6,992	7,994	8,516	8,996	8,873	9,656	9,692	36	2,274	2,381	107
Profit taxes	748	736	1,150	809	976	947	969	22	307	332	25
Nonfinancial enterprises	618	619	812	695	871	839	853	15	269	286	17
Financial enterprises	129	117	339	115	105	109	116	7	39	47	8
Income taxes	1,056	1,098	1,063	1,094	1,052	1,073	1,068	-5	242	238	-4
VAT	1,927	2,359	2,454	2,780	2,688	2,943	2,961	18	716	741	25
Excise and fuel duties	691	1,038	1,107	1,380	1,314	1,501	1,486	-15	311	304	-7
Customs duties	259	221	195	100	188	180	196	16	32	48	16
Social insurance contributions	1,886	2,230	2,310	2,521	2,352	2,698	2,670	-28	584	609	25
Pension and unemployment contributions 2/	1,714	1,780	1,822	1,955	1,839	2,118	2,110	-8	460	475	15
Health Insurance Fund	173	451	489	565	513	580	560	-20	124	135	10
Other taxes	428	312	236	313	303	314	342	28	80	108	27
Nontax revenues	1,995	2,154	2,284	2,220	2,625	2,376	2,520	145	418	580	162
BNB transfers	90	137	175	150	173	150	133	-17	0	0	0
Other	1,906	2,018	2,109	2,070	2,453	2,226	2,388	162	418	580	162
Grants and donations	203	204	363	502	301	501	506	6	36	80	44
Total expenditure and net lending	9,412	10,620	11,418	11,976	12,009	12,795	12,982	186	3,034	2,932	-101
Noninterest expenditure, net lending, contingency	8,514	9,538	10,312	10,972	11,296	11,957	12,186	229	2,622	2,545	-77
Current noninterest expenditure	7,151	8,127	8,873	9,629	10,061	10,559	10,788	229	2,451	2,378	-74
Compensation	1,208	1,283	1,196	1,233	1,379	1,427	1,427	0	344	319	-25
Wages and salaries	1,182	1,256	1,159	1,198	1,338	1,389	1,389	0	333	309	-23
Scholarships	26	28	37	35	41	38	38	0	11	10	-1
Maintenance and operations	1,749	2,167	1,925	1,891	2,200	1,992	2,187	195	471	449	-22
Defense and security	998	885	957	1,082	1,066	1,150	1,150	0	234	227	-7
Subsidies	391	250	722	733	772	717	757	40	179	142	-38
Social expenditures	2,808	3,543	4,074	4,690	4,644	5,274	5,267	-6	1,223	1,240	18
Pension fund	1,954	2,372	2,586	2,882	2,944	3,063	3,045	-18	739	732	-7
Assistance and unemployment	678	853	858	1,049	1,007	1,299	1,274	-26	284	260	-24
Health Insurance Fund	93	98	404	487	498	666	711	45	140	196	56
Other social expenditures 3/	83	221	225	272	195	246	238	-8	60	53	-7
Capital expenditures	1,076	1,037	1,145	1,113	1,046	1,230	1,230	0	168	166	-3
Net lending 4/	-28	63	50	0	0	0	0	0	0	0	0
Contingency	315	311	245	230	189	168	168	0	2	2	0
Enterprise restructuring	291	110	60	180	143	20	20	0	0	0	0
Other contingency	0	165	145	0	0	96	96	0	0	0	0
Natural disaster	24	36	40	50	46	52	52	0	2	2	0
Primary balance	676	814	850	747	503	576	533	-42	107	496	390
Interest	898	1,083	1,106	1,004	713	839	796	-43	412	387	-25
External	690	818	853	785	544	640	611	-29	357	336	-22
Domestic	208	265	253	219	169	199	185	-14	54	51	-3
Overall balance	-222	-269	-255	-257	-209	-263	-263	0	-305	110	414
Financing	222	269	255	257	210	263	263	0	305	-110	-414
External (net)	42	-404	-100	-106	481	-57	-57	0	-231	-135	97
Domestic (net)	-322	328	-506	-255	-558	-231	-231	0	386	-18	-404
Privatization	503	345	861	619	286	550	550	0	150	43	-107
Memorandum items:											
Nominal GDP in millions of leva	23,790	26,753	29,709	30,783	32,324	35,214	34,958	-256	7,509	7,518	9

Sources: Ministry of Finance; and staff projections.

1/ Differs from the budget approved by Parliament in certain revenue items.
2/ Pension and unemployment contributions were combined in January 2002.
3/ Includes additional compulsory social security contributions for public sector employees.
4/ From 2002, the net lending item is included in the financing part of the budget.

Table 6. Bulgaria: General Government Operations, 1999-2003
(In percent of GDP)

	1999	2000	2001	2002		2003		
	Actual	Actual	Actual	Budget	Actual	Program 1/	IMF Projection	Difference
Total revenue and grants	38.6	38.7	37.6	38.1	36.5	35.6	36.4	0.8
Tax revenue	29.4	29.9	28.7	29.2	27.4	27.4	27.7	0.3
Profit taxes	3.1	2.8	3.9	2.6	3.0	2.7	2.8	0.1
Nonfinancial enterprises	2.6	2.3	2.7	2.3	2.7	2.4	2.4	0.1
Financial enterprises	0.5	0.4	1.1	0.4	0.3	0.3	0.3	0.0
Income taxes	4.4	4.1	3.6	3.6	3.3	3.0	3.1	0.0
VAT	8.1	8.8	8.3	9.0	8.3	8.4	8.5	0.1
Excise and fuel duties	2.9	3.9	3.7	4.5	4.1	4.3	4.3	0.0
Customs duties	1.1	0.8	0.7	0.3	0.6	0.5	0.6	0.0
Social insurance contributions	7.9	8.3	7.8	8.2	7.3	7.7	7.6	0.0
Pension and unemployment contributions 2/	7.2	6.7	6.1	6.4	5.7	6.0	6.0	0.0
Health Insurance Fund	0.7	1.7	1.6	1.8	1.6	1.6	1.6	0.0
Other taxes	1.8	1.2	0.8	1.0	0.9	0.9	1.0	0.1
Nontax revenues	8.4	8.1	7.7	7.2	8.1	6.7	7.2	0.5
BNB transfers	0.4	0.5	0.6	0.5	0.5	0.4	0.4	0.0
Other	8.0	7.5	7.1	6.7	7.6	6.3	6.8	0.5
Grants and donations	0.9	0.8	1.2	1.6	0.9	1.4	1.4	0.0
Total expenditure and net lending	39.6	39.7	38.4	38.9	37.2	36.3	37.1	0.8
Noninterest expenditure, net lending, contingency	35.8	35.7	34.7	35.6	34.9	34.0	34.9	0.9
Current noninterest expenditure	30.1	30.4	29.9	31.3	31.1	30.0	30.9	0.9
Compensation	5.1	4.8	4.0	4.0	4.3	4.1	4.1	0.0
Wages and salaries	5.0	4.7	3.9	3.9	4.1	3.9	4.0	0.0
Scholarships	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Maintenance and operations	7.4	8.1	6.5	6.1	6.8	5.7	6.3	0.6
Defense and security	4.2	3.3	3.2	3.5	3.3	3.3	3.3	0.0
Subsidies	1.6	0.9	2.4	2.4	2.4	2.0	2.2	0.1
Social expenditures	11.8	13.2	13.7	15.2	14.4	15.0	15.1	0.1
Pension fund	8.2	8.9	8.7	9.4	9.1	8.7	8.7	0.0
Assistance and unemployment	2.9	3.2	2.9	3.4	3.1	3.7	3.6	0.0
Health Insurance Fund	0.4	0.4	1.4	1.6	1.5	1.9	2.0	0.1
Other social expenditures 3/	0.4	0.8	0.8	0.9	0.6	0.7	0.7	0.0
Capital expenditures	4.5	3.9	3.9	3.6	3.2	3.5	3.5	0.0
Net lending 4/	-0.1	0.2	0.2	0.0	0.0	0.0	0.0	0.0
Contingency	1.3	1.2	0.8	0.7	0.6	0.5	0.5	0.0
Enterprise restructuring	1.2	0.4	0.2	0.6	0.4	0.1	0.1	0.0
Other contingency	0.0	0.6	0.5	0.0	0.0	0.3	0.3	0.0
Natural disaster	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.0
Primary balance	2.8	3.0	2.9	2.4	1.6	1.6	1.5	-0.1
Interest	3.8	4.0	3.7	3.3	2.2	2.4	2.3	-0.1
External	2.9	3.1	2.9	2.6	1.7	1.8	1.7	-0.1
Domestic	0.9	1.0	0.9	0.7	0.5	0.6	0.5	0.0
Overall balance	-0.9	-1.0	-0.9	-0.8	-0.6	-0.7	-0.8	0.0
Financing	0.9	1.0	0.9	0.8	0.6	0.7	0.8	0.0
External (net)	0.2	-1.5	-0.3	-0.3	1.5	-0.2	-0.2	0.0
Domestic (net)	-1.4	1.2	-1.7	-0.8	-1.7	-0.7	-0.7	0.0
Privatization	2.1	1.3	2.9	2.0	0.9	1.6	1.6	0.0
Memorandum items:								
Nominal GDP in million leva	23,790	26,753	29,709	30,783	32,324	35,214	34,958	

Sources: Ministry of Finance; and staff projections.

1/ Differs from the budget approved by Parliament in certain revenue items.
2/ Pension and unemployment contributions were combined in January 2002.
3/ Includes additional compulsory social security contributions for public sector employees.
4/ From 2002, the net lending item is included in the financing part of the budget.

Table 7. Bulgaria: Monetary Survey, 1998-2004

	1998	1999	2000	2001	2002	2003				2004
						Q1	Q2	Q3	Q4	Proj.
						Actual	Proj.	Proj.	Proj.	
					(In millions of leva)					
Broad money	**6,660**	**7,548**	**9,881**	**12,447**	**13,996**	**13,848**	**13,801**	**14,408**	**15,818**	**18,170**
Lev money	4,145	4,737	5,822	7,505	8,734	8,402	8,280	8,717	9,570	10,902
Currency in circulation	1,743	1,958	2,374	3,081	3,335	3,088	3,211	3,320	3,608	3,948
Deposits	2,402	2,779	3,448	4,424	5,399	5,314	5,069	5,397	5,961	6,954
Foreign currency deposits	2,515	2,810	4,059	4,942	5,262	5,446	5,520	5,691	6,248	7,268
Net foreign assets	**5,626**	**6,488**	**8,007**	**9,202**	**9,462**	**8,993**	**8,966**	**9,275**	**9,304**	**9,757**
BNB NFA	3,390	3,996	4,661	5,485	6,988	6,685	6,660	6,936	6,882	7,057
DMB NFA	2,235	2,492	3,346	3,716	2,474	2,308	2,306	2,339	2,421	2,700
Net domestic assets	**1,034**	**1,060**	**1,874**	**3,245**	**4,533**	**4,855**	**4,834**	**5,133**	**6,514**	**8,413**
Domestic credit	3,443	3,692	4,820	6,051	7,704	8,219	8,429	8,890	9,897	12,428
General government 2/	1,066	802	1,439	1,584	1,273	1,361	1,342	1,352	1,407	1,815
Central Government	1,049	770	1,407	1,543	1,260	1,349	1,327	1,337	1,392	1,800
Local government	17	32	32	41	13	12	15	15	15	15
Non-government	2,378	2,890	3,381	4,467	6,432	6,858	7,087	7,538	8,490	10,613
Public enterprise (SOE)	565	401	187	203	334	347	350	350	350	350
Private sector	1,812	2,489	3,195	4,264	6,098	6,511	6,737	7,188	8,140	10,263
Capital and reserves	-2,051	-2,301	-2,684	-2,867	-3,291	-3,590	-3,670	-3,791	-3,941	-4,084
Other items net	-358	-330	-263	61	120	226	75	35	558	70
Memorandum items:										
Reserve money	2,387	2,722	3,021	4,033	4,482	4,089	4,144	4,284	4,656	5,094
Currency in circulation	1,743	1,958	2,374	3,081	3,335	3,088	3,211	3,320	3,608	3,948
Banks' reserves	644	763	647	952	1,147	1,001	932	964	1,048	1,146
Foreign currency credit to non-government	922	1,142	1,196	1,584	2,654	2,847	2,806	2,951	3,450	4,244
					(In millions of US dollars)					
Net foreign assets	3,358	3,332	3,810	4,146	5,020	5,010	5,009	5,177	5,190	5,435
BNB NFA	2,024	2,052	2,218	2,472	3,707	3,724	3,721	3,871	3,839	3,931
DMB NFA	1,334	1,280	1,592	1,675	1,313	1,286	1,288	1,305	1,351	1,504
Foreign currency deposits	1,502	1,443	1,931	2,227	2,792	3,034	3,084	3,177	3,486	4,049
(percent of broad money)	37.8	37.2	41.1	39.7	37.6	39.3	40.0	39.5	39.5	40.0
					(12-month growth rate in percent)					
Broad money	11.3	13.3	30.9	26.0	12.4	11.7	13.1	11.3	13.0	14.9
Lev money	17.0	14.3	22.9	28.9	16.4	15.5	13.7	13.0	9.6	13.9
Currency in circulation	32.4	12.4	21.2	29.8	8.2	8.2	13.5	9.9	8.2	9.4
Foreign currency deposits	3.0	11.7	44.4	21.8	6.5	6.4	13.8	15.0	10.4	16.7
Reserve money	10.2	14.0	11.0	33.5	11.2	7.8	12.2	11.5	3.9	9.4
					(12-month change relative to broad money at the beginning of the period)					
Currency in circulation	7.1	3.2	5.5	7.2	2.0	1.9	3.1	2.3	2.0	2.1
Deposits	2.9	5.7	8.9	9.9	7.8	7.2	5.0	5.4	4.0	6.3
Foreign currency deposits	1.2	4.4	16.5	8.9	2.6	2.6	5.0	3.6	7.0	6.4
NFA	9.7	12.9	20.1	12.1	2.1	3.1	3.3	0.3	-1.1	2.9
NDA	1.6	0.4	10.8	13.9	10.4	8.6	9.9	11.0	14.2	12.0
Of which,										
Credit to General government	-16.9	-4.0	8.4	1.5	-2.5	-4.9	1.4	3.1	1.0	2.6
Credit to SOE	-2.2	-2.5	-2.8	0.2	1.1	0.6	0.3	0.4	0.1	0.0
Credit to private sector	14.0	10.2	9.3	10.8	14.7	16.7	15.7	13.0	14.6	13.4
					(Real index, Dec. 1995=100)					
Broad money	41.7	44.2	51.9	62.4	67.6	66.1	66.2	68.6	73.9	81.4
12-month change	9.4	6.0	17.5	20.2	8.3	11.9	9.5	7.2	9.4	10.1
Credit to non-government	24.9	28.3	29.7	37.5	52.0	54.8	56.9	60.1	66.5	79.6
12-month change	39.4	13.6	5.0	26.0	38.7	45.7	33.6	25.2	27.8	19.8
Leva credit to non-gov	26.4	29.7	33.3	41.9	52.9	55.5	59.5	63.3	68.3	82.7
12-month change	75.7	12.3	12.2	25.9	26.2	33.8	29.5	26.5	29.2	21.2
Forex credit to non-gov	22.9	26.5	24.9	31.5	50.8	53.9	53.4	55.7	64.0	75.4
12-month change	5.1	15.8	-6.0	26.3	61.4	66.6	40.4	23.3	25.9	17.9
					(Useful indicators; end of period)					
Money multiplier	2.8	2.8	3.3	3.1	3.1	3.4	3.3	3.4	3.4	3.6
Foreign currency deposits/total deposits	51.2	50.3	54.1	52.8	49.4	50.6	52.1	51.3	51.2	51.1
Credit to non gov / deposits	48.4	51.7	45.0	47.7	60.3	63.7	66.9	68.0	69.5	74.6
					(In percent of GDP; end of period)					
Broad money	29.7	31.7	36.9	41.9	43.3	39.6	39.5	41.2	45.2	47.5
Lev money	18.5	19.9	21.8	25.3	27.0	24.0	23.7	24.9	27.4	28.5
Reserve money	10.6	11.4	11.3	13.6	13.9	11.7	11.9	12.3	13.3	13.3
Credit to non-government sector	10.6	12.1	12.6	15.0	19.9	19.6	20.3	21.6	24.3	27.7
Of which forex credit	4.1	4.8	4.5	5.3	8.2	8.1	8.0	8.4	9.9	11.1
Foreign currency deposits	11.2	11.8	15.2	16.6	16.3	15.6	15.8	16.3	17.9	19.0

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

1/ In May 2002, monetary data were recast to exclude non-operating banks from the consolidated banking system. Changes included also the reclassification of deposits by social security funds and local governments into broad money, which increase broad money and lowered NDA by an equal amount.

Table 8. Bulgaria: Macroeconomic Framework, 1999-2008

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
					Projections					
GDP and prices (annual percent change)										
Real GDP	2.3	5.4	4.1	4.8	5.0	5.5	5.5	5.5	5.5	5.5
GDP deflator	3.7	6.7	6.7	3.8	3.0	3.7	3.2	3.1	3.1	3.1
CPI (end of period)	7.0	11.4	4.8	3.8	4.1	4.0	3.6	3.5	3.5	3.5
(period average)	2.6	10.4	7.5	5.8	2.6	4.2	3.6	3.5	3.5	3.5
Monetary aggregates										
Broad money (real, percent change)	6.0	17.5	20.2	8.3	9.4	10.1	4.8	4.8	5.3	5.3
Credit to non-government (real, percent change)	13.6	5.0	26.0	38.7	27.8	19.8	13.4	11.2	10.0	10.0
Saving and investment (in percent of GDP)										
Foreign saving 1/	5.9	5.3	7.6	6.6	6.5	5.7	5.4	4.8	4.5	4.0
Gross national saving	12.9	12.7	14.5	15.2	15.8	16.8	18.2	18.8	19.2	19.4
Gross domestic saving 2/	12.0	13.0	13.0	13.1	13.9	15.6	17.1	18.2	18.7	19.2
Government	6.5	5.9	5.9	4.3	4.5	4.8	5.8	5.8	5.6	5.4
Non-government	5.5	7.1	7.2	8.9	9.4	10.7	11.3	12.4	13.0	13.8
Gross domestic investment	17.9	18.3	20.7	19.7	20.4	21.3	22.5	23.0	23.2	23.2
Government	4.5	3.9	3.9	3.2	3.5	3.6	4.0	4.0	4.0	4.0
Non-government	13.4	14.4	16.8	16.5	16.9	17.7	18.5	19.0	19.2	19.2
General government (in percent of GDP)										
Revenue	38.6	38.7	37.6	36.5	36.4	35.3	35.2	34.8	34.5	34.5
Non-interest expenditure	35.8	35.7	34.7	34.9	34.9	33.5	33.0	32.7	32.5	32.5
Primary balance	2.8	3.0	2.9	1.6	1.5	1.8	2.2	2.1	2.0	2.0
Interest payments	3.8	4.0	3.7	2.2	2.3	2.3	2.2	2.1	2.0	2.0
Overall balance (excluding external interest payments)	2.0	2.1	2.0	1.0	1.0	1.2	1.8	1.8	1.6	1.4
Overall balance	-0.9	-1.0	-0.9	-0.6	-0.8	-0.5	0.0	0.0	0.0	0.0
Total public debt	84.7	80.5	69.6	62.1	50.7	46.5	43.2	40.1	37.2	34.5
Of which : External	73.0	73.9	63.5	54.7	46.2	43.3	40.6	36.6	32.3	30.3
Balance of payments (in millions of US dollars)										
Current account	-652	-702	-842	-677	-877	-927	-955	-1,004	-1,035	-1,073
Trade balance	-1,081	-1,176	-1,580	-1,593	-1,839	-1,793	-1,841	-1,778	-1,829	-1,819
Exports	4,006	4,825	5,113	5,688	6,771	7,501	8,271	9,190	10,200	11,358
Imports	5,087	6,000	6,693	7,281	8,610	9,294	10,112	10,968	12,029	13,178
Services, net	314	506	544	594	607	603	617	621	645	689
Receipts	1,788	2,175	2,426	2,594	3,039	3,253	3,524	3,855	4,241	4,660
Payments	1,474	1,670	1,882	2,000	2,432	2,650	2,906	3,235	3,597	3,971
Income, net	-185	-321	-304	-228	-308	-442	-422	-587	-653	-757
Memorandum items										
Gross official reserves (in millions of US dollars)	3,222	3,460	3,580	4,747	5,188	5,761	6,008	5,951	5,967	6,153
(in months of prospective imports of GNFS)	5.0	4.8	4.6	5.2	5.2	5.3	5.1	4.6	4.2	3.9
Current account balance (in percent of GDP)	-5.0	-5.6	-6.2	-4.4	-4.6	-4.4	-4.3	-4.2	-4.0	-3.8
External debt/GDP (in percent) 3/	84.2	88.9	78.1	71.9	60.2	56.8	53.5	49.1	44.8	42.8
External debt/exports of GNFS (in percent) 3/	188.3	160.0	140.9	132.2	116.0	110.1	101.9	91.1	80.9	75.1
External debt service/exports of GNFS (in percent)	18.0	16.6	19.6	15.2	10.5	8.5	10.1	10.3	11.9	10.1
Export growth (percent change)	-4.5	20.4	6.0	11.2	19.0	10.8	10.3	11.1	11.0	11.4
Import growth (percent change)	11.2	17.9	11.6	8.8	18.3	7.9	8.8	8.5	9.7	9.5
Terms of trade (percent change)	-5.7	-6.9	1.0	-0.5	-0.1	2.6	1.4	0.9	0.2	0.2
Nominal GDP (in millions of leva)	23,790	26,753	29,709	32,324	34,958	38,245	41,640	45,292	49,264	53,585
Nominal GDP (in millions of US dollars) 4/	12,956	12,605	13,600	15,228	18,909	20,839	22,452	24,189	26,067	28,090

Sources: Bulgarian authorities; and staff projections.

1/ Net imports of goods and nonfactor services.

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

3/ Medium- and long-term external debt.

4/ Based on quarterly average exchange rates.

Table 9. Bulgaria: Balance of Payments, 2001-2008
(In millions of U.S. dollars)

	2001	2002	2003	2004	2005	2006	2007	2008
			Projections					
CURRENT ACCOUNT	-842	-677	-877	-927	-955	-1,004	-1,035	-1,073
Trade balance	-1,580	-1,593	-1,839	-1,793	-1,841	-1,778	-1,829	-1,819
Exports (f.o.b.)	5,113	5,688	6,771	7,501	8,271	9,190	10,200	11,358
y-o-y change (in percent)	6.0	11.2	19.0	10.8	10.3	11.1	11.0	11.4
Imports (f.o.b.)	-6,693	-7,281	-8,610	-9,294	-10,112	-10,968	-12,029	-13,178
y-o-y change (in percent)	11.6	8.8	18.3	7.9	8.8	8.5	9.7	9.5
Services, net	544	594	607	603	617	621	645	689
Income, net	-304	-228	-308	-442	-422	-587	-653	-757
Of which: Interest payments of the central gov't	-457	-279	-317	-332	-374	-414	-411	-430
Income to direct investors	-149	-195	-228	-333	-346	-436	-540	-660
Current transfers, net	498	549	663	706	691	740	803	814
CAPITAL AND FINANCIAL ACCOUNT	1,215	1,393	1,219	1,586	1,434	1,256	1,297	1,392
Capital transfers, net	0	0	0	0	0	0	0	0
Foreign direct investment, net	685	450	928	970	900	940	1,020	1,120
Of which: Privatization receipts	19	136	450	500	150	100	0	0
Portfolio investment, net	82	-77	-72	-102	-93	-93	-316	-505
Other investment, net	244	879	154	718	627	409	594	776
General government	-308	-137	231	310	293	42	141	323
Domestic banks	-75	392	-109	53	77	91	96	96
Other private sector	627	624	32	355	257	276	356	358
Errors and omissions	205	140	208	0	0	0	0	0
OVERALL BALANCE	373	715	342	659	479	252	263	319
FINANCING	-373	-715	-342	-659	-479	-252	-263	-319
Gross international reserves (increase: -) 1/	-275	-586	-441	-574	-247	57	-16	-186
Use of Fund credit, net	-169	-142	99	-86	-232	-309	-246	-133
Purchases	132	111	178	35	0	0	0	0
Repurchases 2/	-301	-253	-78	-121	-232	-309	-246	-133
Exceptional financing	71	13	0	0	0	0	0	0
Financing gap (gap: +)	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS								
Gross international reserves (stock, e.o.p.) 3/	3,580	4,747	5,188	5,761	6,008	5,951	5,967	6,153
In months of prospective GNFS imports	4.6	5.2	5.2	5.3	5.1	4.6	4.2	3.9
Current account (in percent of GDP)	-6.2	-4.4	-4.6	-4.4	-4.3	-4.2	-4.0	-3.8
Trade account (in percent of GDP)	-11.6	-10.5	-9.7	-8.6	-8.2	-7.4	-7.0	-6.5
Exports (in percent of GDP)	37.6	37.4	35.8	36.0	36.8	38.0	39.1	40.4
Imports (in percent of GDP)	-49.2	-47.8	-45.5	-44.6	-45.0	-45.3	-46.1	-46.9
Export volume (year-on-year change)	10.9	8.7	10.6	8.7	8.9	10.2	9.9	10.2
Import volume (year-on-year change)	17.9	5.7	9.8	8.6	9.0	8.5	8.7	8.6
FDI (net) in percent of current account	81.3	66.5	105.8	104.7	94.3	93.6	98.6	104.4
Gross external debt (stock, e.o.p.)	10,619	10,946	11,383	11,841	12,015	11,881	11,686	12,028
(In percent of GDP)	78.1	71.9	60.2	56.8	53.5	49.1	44.8	42.8
Public	8,629	8,333	8,735	9,019	9,123	8,857	8,425	8,504
Private	1,989	2,613	2,649	2,821	2,892	3,023	3,261	3,525
External debt service of the central government 4/	1,095	792	719	758	984	1,134	1,378	993
GDP 5/	13,600	15,228	18,909	20,839	22,452	24,189	26,067	28,090

Sources: Bulgarian authorities, and Fund staff estimates.

1/ Excluding valuation changes.
2/ According to expectations schedule.
3/ Historical figures include valuation changes.
4/ Includes obligations to the Fund.
5/ Based on quarterly average exchange rates.

Table 10. Bulgaria: Balance of Payments, 2001-2008
(In millions of euros)

	2001	2002	2003	2004	2005	2006	2007	2008
			Projections					
CURRENT ACCOUNT	-928	-776	-824	-859	-890	-963	-1,002	-1,049
Trade balance	-1,779	-1,690	-1,716	-1,689	-1,751	-1,706	-1,772	-1,778
Exports (f.o.b.)	5,714	6,058	6,333	7,059	7,863	8,818	9,879	11,104
y-o-y change (in percent)	8.8	6.0	4.5	11.5	11.4	12.1	12.0	12.4
Imports (f.o.b.)	-7,493	-7,749	-8,049	-8,748	-9,614	-10,525	-11,650	-12,882
y-o-y change (in percent)	14.7	3.4	3.9	8.7	9.9	9.5	10.7	10.6
Services, net	628	598	564	568	587	596	624	674
Income, net	-340	-250	-288	-402	-384	-563	-632	-741
Of which: Interest payments of the central gov't	-513	-302	-299	-312	-356	-397	-398	-420
Income to direct investors	-167	-203	-187	-313	-329	-418	-523	-645
Current transfers, net	562	567	617	664	657	711	778	796
CAPITAL AND FINANCIAL ACCOUNT	755	1,302	931	1,491	1,363	1,205	1,256	1,360
Capital transfers, net	0	0	0	0	0	0	0	0
Foreign direct investment, net	893	482	864	911	856	902	988	1,095
Of which: Privatization receipts	22	141	419	469	143	96	0	0
Portfolio investment, net	94	-99	-66	-96	-88	-89	-306	-493
Other investment, net	-232	918	133	676	596	393	575	759
General government	-341	-150	216	292	278	40	137	315
Domestic banks	-92	437	-102	50	73	87	93	94
Other private sector	201	633	19	334	245	265	345	350
Errors and omissions	599	191	206	0	0	0	0	0
OVERALL BALANCE	426	717	313	632	473	242	254	312
FINANCING	-426	-717	-313	-632	-473	-242	-254	-312
Gross international reserves (increase: -) 1/	-318	-578	-406	-551	-252	55	-16	-182
Use of Fund credit, net	-185	-155	93	-81	-221	-297	-238	-130
Purchases	144	115	165	33	0	0	0	0
Repurchases 2/	-329	-269	-73	-114	-221	-297	-238	-130
Exceptional financing	78	15	0	0	0	0	0	0
Financing gap (gap: +)	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS								
Gross international reserves (stock, e.o.p.) 3/	4,063	4,575	4,980	5,531	5,784	5,729	5,745	5,926
In months of prospective GNFS imports	4.9	5.3	5.3	5.4	5.1	4.5	4.1	3.9
Current account (in percent of GDP)	-6.1	-4.8	-4.7	-4.4	-4.2	-4.2	-4.0	-3.8
Trade account (in percent of GDP)	-11.7	-10.5	-9.7	-8.6	-8.2	-7.4	-7.0	-6.5
Exports (in percent of GDP)	37.6	37.7	35.9	36.0	36.8	38.0	39.1	40.4
Imports (in percent of GDP)	-49.3	-48.2	-45.7	-44.6	-45.0	-45.3	-46.1	-46.9
Export volume (year-on-year change)	10.9	8.7	10.6	8.7	8.9	10.2	9.9	10.2
Import volume (year-on-year change)	17.9	5.7	9.8	8.6	9.0	8.5	8.7	8.6
FDI (net) in percent of current account	96.2	62.2	104.9	106.1	96.2	93.6	98.6	104.4
Gross external debt (stock, e.o.p.)	12,049	10,550	10,780	11,336	11,616	11,594	11,510	11,957
(In percent of GDP)	79.4	65.7	61.2	57.8	54.4	49.9	45.6	43.5
Public	9,792	8,031	8,271	8,635	8,820	8,644	8,299	8,454
Private	2,257	2,518	2,508	2,701	2,796	2,950	3,212	3,504
External debt service of the central government 4/	1,232	849	669	712	935	1,089	1,335	970
GDP 5/	15,184	16,060	17,615	19,609	21,342	23,211	25,247	27,461

Sources: Bulgarian authorities, and Fund staff estimates.

1/ Excluding valuation changes.
2/ According to expectations schedule.
3/ Historical figures include valuation changes.
4/ Includes obligations to the Fund.
5/ Based on quarterly average exchange rates.

Table 11. Bulgaria: External Sustainability Framework, 1998-2008
(In percent of GDP, unless otherwise indicated)

	1998	1999	2000	2001	2002	Projections 2003	2004	2005	2006	2007	2008
1 **External debt**	85.5	84.2	88.9	78.1	71.9	**60.2**	**56.8**	**53.5**	**49.1**	**44.8**	**42.8**
2 Change in external debt	-14.9	-1.3	4.6	-10.8	-6.2	-11.7	-3.4	-3.3	-4.4	-4.3	-2.0
3 Identified external debt-creating flows (4+8+11)	-22.7	-0.1	1.1	-3.0	-4.6	-14.1	-6.2	-4.1	-3.8	-3.8	-3.7
4 Current account deficit, excluding interest payments	-3.7	1.3	1.5	2.3	2.2	2.5	2.4	2.0	1.9	1.9	1.9
5 Deficit in balance of goods and services	-0.6	5.9	5.3	7.6	6.6	6.5	5.7	5.4	4.8	4.5	4.0
6 Exports	47.0	44.7	55.5	55.4	54.4	51.9	51.6	52.5	53.9	55.4	57.0
7 Imports	46.4	50.6	60.8	63.1	60.9	58.4	57.3	58.0	58.7	59.9	61.0
8 Net non-debt creating capital inflows (negative)	-4.5	-3.8	-6.8	-2.7	-1.0	-4.7	-4.8	-4.2	-4.1	-4.2	-4.3
9 Net foreign direct investment, equity	4.4	3.6	6.4	3.3	2.5	4.7	4.8	4.2	4.1	4.2	4.3
10 Net portfolio investment,equity	0.2	0.1	0.4	-0.6	-1.5	0.0	0.0	0.0	0.0	0.0	0.0
11 Automatic debt dynamics 1/	-14.5	2.3	6.4	-2.6	-5.7	-11.9	-3.7	-1.9	-1.6	-1.4	-1.3
12 Contribution from nominal interest rate	4.2	3.7	4.1	3.9	2.3	2.1	2.1	2.2	2.3	2.1	1.9
13 Contribution from real GDP growth	-3.3	-1.9	-4.7	-3.4	-3.4	-2.9	-3.0	-2.9	-2.7	-2.5	-2.3
14 Contribution from price and exchange rate changes 2/	-15.4	0.5	7.0	-3.1	-4.6	-11.2	-2.8	-1.2	-1.1	-1.0	-0.9
14 Residual, incl. change in gross foreign assets (2-3)	7.8	-1.1	3.6	-7.8	-1.6	2.4	2.8	0.8	-0.6	-0.5	1.7
External debt-to-exports ratio (in percent)	181.9	188.3	160.0	140.9	132.2	116.0	110.1	101.9	91.1	80.9	75.1
Gross external financing need (in billions of US dollars) 3/	1.9	2.2	2.6	3.2	2.8	3.1	2.9	3.4	3.6	4.1	4.3
in percent of GDP	15.1	17.1	20.8	23.9	18.4	16.2	14.1	14.9	14.8	15.8	15.3
Key Macroeconomic and External Assumptions											
Real GDP growth (in percent)	4.0	2.3	5.4	4.1	4.8	5.0	5.5	5.5	5.5	5.5	5.5
Exchange rate appreciation (Average US dollar value of local currency, change in percent)	-4.5	-4.1	-13.5	-2.8	2.4	14.9	1.1	-1.0	-0.9	-0.9	-0.9
GDP deflator in US dollars (change in percent)	18.2	-0.6	-7.7	3.6	6.3	18.4	4.8	2.1	2.1	2.1	2.1
Nominal external interest rate (in percent)	5.1	4.4	4.7	4.7	3.3	3.7	3.8	4.2	4.6	4.6	4.6
Growth of exports (US dollar terms, GNFS, in percent)	-14.6	-3.2	20.8	7.7	9.9	18.5	9.6	9.7	10.6	10.7	10.9
Growth of imports (US dollar terms, GNFS, in percent)	1.2	10.9	16.9	11.8	8.2	19.0	8.2	9.0	9.1	10.0	9.7
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2003-2008						**65.5**	**59.8**	**52.0**	**43.2**	**34.5**	**28.3**
2. Nominal interest rate is at historical average plus two standard deviations in 2003 and 2004						**62.4**	**61.0**	**57.5**	**53.0**	**48.6**	**46.5**
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004						**67.8**	**72.3**	**68.5**	**63.6**	**58.9**	**56.5**
4. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2003 and 2004						**83.9**	**97.7**	**93.0**	**87.4**	**82.0**	**78.9**
5. Non-interest current account is at historical average minus two standard deviations in 2003 and 2004						**69.1**	**74.2**	**70.3**	**65.4**	**60.6**	**58.1**
6. Combination of 2-5 using one standard deviation shocks						**84.5**	**99.1**	**94.4**	**88.8**	**83.4**	**80.2**
7. One time 30 percent nominal depreciation in 2003						**98.7**	**93.0**	**88.5**	**83.0**	**77.7**	**74.8**

Historical Statistics for Key Variables (past 5 years)	Historical Average	Standard Deviation
Current account deficit, excluding interest payments	0.7	2.5
Net non-debt creating capital inflows	3.8	2.2
Nominal interest rate (in percent)	4.4	0.7
Real GDP growth (in percent)	4.1	1.2
GDP deflator in US dollars (change in percent)	4.0	9.5

Sources: Bulgarian authorities; and Fund staff estimates.

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ Defined as non-interest current account deficit, plus interest and amortization on medium- and long-term debt, plus short-term debt at end of previous period.

Table 12. Bulgaria: Public Sector Debt Sustainability Framework, 1998-2008
(In percent of GDP, unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
						Projections					
1 Public sector debt 1/	88.5	89.8	79.8	70.7	55.1	**50.8**	**47.5**	**44.0**	**40.9**	**37.9**	**35.2**
o/w foreign-currency denominated	80.9	82.0	76.0	66.9	50.5	47.4	44.8	42.0	38.0	33.7	31.5
2 Change in public sector debt	-25.0	1.3	-10.1	-9.0	-15.6	-4.3	-3.3	-3.4	-3.2	-2.9	-2.7
3 Identified debt-creating flows (4+7+12)	-25.9	14.7	0.7	-1.2	-12.0	-3.5	-3.6	-2.0	-1.7	-1.3	-1.2
4 Primary deficit	-5.2	-2.8	-3.0	-2.9	-1.6	-1.5	-1.8	-2.2	-2.1	-2.0	-2.0
5 Revenue and grants	35.4	38.6	38.7	37.6	36.5	36.4	35.3	35.2	34.8	34.5	34.5
6 Primary (noninterest) expenditure	30.2	35.8	35.7	34.7	34.9	34.9	33.5	33.0	32.7	32.5	32.5
7 Automatic debt dynamics 2/	-25.8	11.6	0.5	-0.2	-12.8	-2.7	-1.6	-1.2	-1.1	-0.9	-0.8
8 Contribution from interest rate/growth differential 3/	-21.0	-1.3	-5.9	-4.2	-3.5	-1.9	-2.1	-1.7	-1.4	-1.3	-1.1
9 Of which contribution from real interest rate	-17.5	0.6	-1.6	-1.3	-0.4	0.7	0.4	0.7	0.8	0.8	0.8
10 Of which contribution from real GDP growth	-3.5	-1.9	-4.3	-2.9	-3.1	-2.5	-2.6	-2.4	-2.2	-2.1	-1.9
11 Contribution from exchange rate depreciation 4/	-4.8	12.9	6.4	4.0	-9.3	-0.9	0.5	0.4	0.4	0.3	0.3
12 Other identified debt-creating flows	5.1	5.9	3.3	1.8	2.3	0.7	-0.2	1.4	1.5	1.7	1.5
13 Privatization receipts (negative)	-1.5	-2.1	-1.3	-2.9	-0.9	-1.6	-2.4	-0.7	-0.4	0.0	0.0
14 Recognition of implicit or contingent liabilities	6.6	8.0	4.6	4.7	3.2	2.3	2.2	2.1	1.9	1.7	1.5
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
16 Residual, including asset changes (2-3)	0.8	-13.3	-10.8	-7.8	-3.6	-0.8	0.2	-1.4	-1.4	-1.6	-1.5
Public sector debt in percent of revenues 1/	250.0	232.5	206.1	188.2	151.0	139.7	134.5	125.1	117.5	109.9	102.0
Gross financing 5/	8.1	8.8	8.0	8.2	5.7	4.3	2.5	2.6	2.8	3.7	2.7
in billions of U.S. dollars	1.0	1.1	1.0	1.1	0.9	0.8	0.5	0.6	0.7	1.0	0.8
Key Macroeconomic and Fiscal Assumptions											
Real GDP growth (in percent)	4.0	2.3	5.4	4.1	4.8	5.0	5.5	5.5	5.5	5.5	5.5
Average nominal interest rate on public debt (in percent) 6/	4.8	4.5	5.1	5.2	3.4	4.5	4.8	5.0	5.2	5.4	5.7
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-18.9	0.8	-1.6	-1.5	-0.4	1.5	1.1	1.8	2.1	2.3	2.6
Nominal appreciation (End-period US dollar value of local currency, in percent)	6.1	-14.0	-7.4	-5.3	17.7	1.8	-1.1	-1.0	-0.9	-0.9	-0.9
Inflation rate (GDP deflator, in percent)	23.7	3.7	6.7	6.7	3.8	3.0	3.7	3.2	3.1	3.1	3.1
Growth of real primary spending (deflated by GDP deflator, in percent)	25.9	21.1	5.0	1.4	5.5	4.7	1.5	3.8	4.5	4.8	5.6

	2003	2004	2005	2006	2007	2008
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2003-2008	**46.8**	**40.4**	**34.5**	**29.0**	**24.0**	**19.3**
2. Real interest rate is at historical average plus two standard deviations in 2003 and 2004	**56.2**	**58.3**	**54.6**	**51.1**	**48.0**	**45.0**
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004	**52.5**	**50.8**	**47.2**	**43.9**	**40.9**	**38.0**
4. Primary balance is at historical average minus two standard deviations in 2003 and 2004	**51.9**	**49.7**	**46.2**	**43.0**	**40.0**	**37.2**
5. Combination of 2-4 using one standard deviation shocks	**52.9**	**52.0**	**46.9**	**42.2**	**37.7**	**33.5**
6. One time 30 percent real depreciation in 2003 7/	**76.2**	**72.0**	**67.9**	**64.2**	**60.7**	**57.5**
7. 10 percent of GDP increase in other debt-creating flows in 2003	**60.8**	**57.2**	**53.5**	**50.1**	**46.9**	**44.0**
8. Impact on **debt-to-GDP ratio** if revenue-to-GDP ratio is at historical average minus two standard deviations in 2003-04	**52.7**	**50.1**	**46.6**	**43.3**	**40.3**	**37.5**
8a. Impact on **debt-to-revenue ratio** if revenue-to-GDP ratio is at historical average minus two standard deviations in 2003-04	**152.7**	**145.1**	**132.3**	**124.5**	**116.9**	**108.8**

Historical Statistics for Key Variables (past 5 years)	Historical Average	Standard Deviation
Primary deficit	-3.1	1.3
Real GDP growth (in percent)	4.1	1.2
Nominal interest rate (in percent) 6/	4.6	0.7
Real interest rate (in percent)	-4.3	8.2
Inflation rate (GDP deflator, in percent)	8.9	8.4
Revenue to GDP ratio	37.4	1.4

Sources: Bulgarian authorities; and Fund staff estimates.

1/ Total public sector gross debt expressed in local currency.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the denominator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

7/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 13. Bulgaria: Schedule of Purchases Under the 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
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
SDR 26 million (4 percent of quota)	February 15, 2003	Observance of end-December 2002 performance criteria
SDR 26 million (4 percent of quota)	May 15, 2003	Observance of end-March 2003 performance criteria and completion of third review under the SBA
SDR 26 million (4 percent of quota)	August 15, 2003	Observance of end-June 2003 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
SDR 26 million (4 percent of quota)	February 15, 2004	Observance of end-December 2003 performance criteria

Bulgaria: IMF-World Bank Relations

A. Partnership in Bulgaria's Development Strategy

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

2. The IMF has been leading in supporting Bulgaria's medium-term program in maintaining macroeconomic stability. Building on the achievements of the three-year Extended Fund Facility (EFF) arrangement with Bulgaria, in February 2002 the IMF Board approved a two-year Stand-By Arrangement (SBA) with Bulgaria. The SBA, with a reduced scope and detail of structural conditionality compared to the EFF, focuses on medium-term fiscal challenges and structural reforms with significant macroeconomic, typically fiscal, implications.

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

B. IMF-World Bank Collaboration in Specific Areas

4. In general, the Bank has the lead on the dialogue on the core structural aspects of the reforms while the Fund has the lead on the dialogue on the macroeconomic, typically fiscal, aspects of the reforms. There are a number of areas where the IMF leads and its analyses serve as inputs into the World Bank policy formulation and advice, including policies to maintain macroeconomic stability, fiscal policies, income policies and external sector policies. There are other areas in which the Bank and the Fund share responsibility and are

coordinating closely their policy advice to the Bulgarian authorities such as in the financial sector, public expenditure management and budgeting, and tax administration. In some areas, the Bank has taken the lead but its analysis, country diagnostic work, and policy recommendations served as inputs into the Fund's policy advice on the fiscal front such as education, health care, pensions, social protection, energy, and railways. In areas such as private sector development, strengthening market institutions (including entry and exit policies, regulatory reform to enhance the business climate, judicial reform, labor market reform), and improving governance the Bank has the lead and there is no conditionality under the Fund program. In addition to consultations early in the process of formulating and adjusting each institutions' program with Bulgaria, the Bank and Fund staff teams interact extensively during the review of the progress achieved in the country and coordinate closely their policy advice to the Bulgarian authorities.

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

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

6. In the context of a 24-month Stand-By Arrangement approved on February 27, 2002, the IMF is taking the lead in assisting Bulgaria in safeguarding macroeconomic stability and promoting structural reforms in areas that are macro-critical and fall within the Fund's core expertise. To safeguard the CBA and ensure that it can continue to serve as the macroeconomic policy anchor, the IMF sets ceilings on the size of the overall deficit of the general government and quantitative floors on the balance of the fiscal reserve account. To prevent threats to the currency board and macroeconomic stability that could arise from a loss in competitiveness or excessive external financing requirements, Fund conditionality also includes ceilings on the wage bill of those state enterprises that have the largest losses and arrears, are monopolies, and receive subsidies, and on the contracting and guaranteeing of public sector external debt.

B.2. Areas of shared responsibility.

7. **Financial Sector.** Recently staff of the two institutions carried out a joint IMF-World Bank *Financial Sector Assessment Program* (FSAP) for Bulgaria, providing a shared perspective on the development agenda of the country and on the prioritization and sequencing of reforms in the financial sector. Key findings of the FSAP are conditionalities on financial sector policies under both the SBA and the PAL program. The IMF has

emphasized aspects related to the banking sector—mainly on policies under the mandate of BNB and supervisory agencies—while the World Bank is focusing on policies that affect market performance and development of the financial sector such as improving the legal and institutional framework for lending, restructuring of the banking sector, strengthening creditor rights, corporate insolvency and governance, and non-banking financial sector issues.

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

9. **Revenue Administration.** The IMF and the World Bank have been carrying out a joint effort since 1996 to assist Bulgaria in reforms aimed at the establishment of an efficient revenue collection agency. Diagnostics consistently pointed to revenue collection deficiencies including weak management, and problematic audit and enforcement of collection which in turn facilitates low compliance. Supporting reform efforts, the World Bank implemented a project to modernize the Social Security Institute, including its revenue collection activities. The IMF has provided a long-term advisor to the Ministry of Finance, and focused advisory services through consulting assignments. Joint World Bank-IMF efforts resulted in a proposal for "Implementing a Modern Revenue Collection Agency" in March 2000 which is now moving forward. The World Bank, with technical assistance of the IMF, has submitted for the Bank's Board approval an institutional development project, the Revenue Administration Reform Project (RARP, US$34.5 million), to support the establishment of the national revenue agency (NRA), which seeks to maximize the level of taxpayer voluntary compliance, promote effectiveness and efficiency, establish a professional workforce and approach to collection, and help reduce the scope for corruption.

10. **Public Expenditure Management.** The Bank has taken the lead in the dialogue on the efficiency and effectiveness of public expenditures and has outlined policy directions in the context of the recently completed Public Expenditure and Institutional Review (PEIR)[1] which are going to be further supported by the PAL program. The PEIR notes that notwithstanding progress to date, important challenges remain in: (i) improving management and accountability in the use of public resources; (ii) restructuring and rationalizing intersectoral public expenditure—particularly energy and railways, economic services, defense and security, and general services; (iii) reallocation of intrasectoral priorities—especially in health, education, social protection; and (iv) higher investment requirements in many sectors—infrastructure, environment, education and health—some of which are priorities for EU accession, and some of which should involve the private sector. The PEIR notes that Bulgaria's main fiscal challenges include working towards an improved allocation of expenditures, while gradually reducing the overall level of expenditures over the medium

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

term in tandem with Bulgaria's fiscal targets of easing the overall tax burden, especially payroll taxes.

11. The IMF has provided long-term technical assistance on budgeting and expenditure management. To ensure the fiscal discipline necessary to support the Currency Board Arrangement, the Government has already initiated a number of public expenditure management reforms. New budget procedures were introduced in early 2002 and are being implemented for the 2003 budget. The Government is moving towards preparation of sectoral medium-term budget frameworks (MTBFs) with a view to strengthen budget-policy links. Despite this important progress, the PEIR notes that there is a need to continue and broaden the reform effort, especially in accounting and auditing—internal audit needs to be made operational across all first-level budget units; capital expenditure proposals should be prepared under hard budget constraints and as integral part of the MTBFs; and the financial management at the local level should be strengthened.

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

12. **Energy sector.** While the Government has made important progress in energy sector reforms, the sector still remains largely government owned or controlled and energy consumption is still highly inefficient and heavily subsidized. In mid-2002, the Government approved an energy strategy that envisaged bringing household electricity prices to full cost recovery by 2004. Implementation of the price adjustment schedule has started and is central to the modernization of the sector together with the need to modernize the regulatory framework and initiate privatization of the downstream electricity distribution system. Costly investment in capacity should not be undertaken unless regulatory reforms are more advanced and private investors can assume a larger share of the market risk.

13. The Bank has played the lead role in assisting the Government in the design of the reform program in the sector, and more importantly on its implementation. Although an Energy Project was completed in end-2000, the Bank is continuing its dialogue on the developmental objectives of the sector meant to increase the energy efficiency. In early 2002 the Bank completed the Energy and Environment Review aimed at evaluation of alternative strategies, balancing the need for economic development and environmental protection, and provision of policy recommendations. The Fund and the Bank's teams have worked collaboratively in close consultations with the Government, and the SBA includes a performance criterion focusing on announcement of a schedule for bringing electricity prices to full cost recovery level, and two benchmarks—one on implementation of the new regulatory pricing regime, and the other on preparing a new Energy Act to harmonize Bulgaria's legislation with EU Directives. These performance criterion and benchmarks of the SBA were met. The Government is still working towards achieving the latter benchmark—on harmonization of legislation.

14. **Railways.** The Bank has been the Government's main external partner in the transformation of the railway sector, particularly through the Railway Rehabilitation Project, which was completed in June 2002. This transformation is only half way achieved by now, however. Some essential measures have been implemented, especially the divestiture of all

railway ancillary activities, a major reduction in staffing, and the institutional separation of the national company into two new infrastructure and rail services enterprises together with the opening of rail services to private operators. Yet, other key steps still need to be taken for the railway sector to become financially sustainable and reduce its support requirements from the State, which have been around 0.8 percent of GDP in recent years and could increase if the present situation does not change. These steps include tariff reform, reduction of loss making services to only those that can be socially justified and supported by State contracts, further reduction of staff, and improved corporate governance. They were refined in the context of the recent Public Expenditure and Institutional Review and are being supported by the Bank through the PALs. Detailed assistance with the design of these reforms will be further provided through transport sector work in the near future.

15. **Education and health care.** The reform efforts in the **education sector** aim at improving expenditure management in view of the declining population, especially in school age, and at enhancing quality and access to education. The main priority in the education sector, including universities, is to reallocate expenditures from surplus capacity in teaching staff and underused facilities toward modernization and upgrading of curricula, textbooks, teaching materials, schools, and other quality-enhancing education inputs. The Bank is supporting the Government program in education through the Education Modernization Project loan, the PALs, and through the analytical work done for the Poverty Assessment and the Public Expenditure and Institutional Review.

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

17. **Social protection programs.** Social protection programs—pensions, labor market programs, social assistance, and short-term and family benefits—have a wide coverage among the population. Over 80 percent of Bulgarians receive at least one type of social protection benefit—however, only one-third of the population is of retirement age or poor. On pensions, one reform priority is to improve compliance with, and coverage of, the public pillar, and define a clear rule for indexing pensions. On labor market programs, there is a need to monitor closely to improve their effectiveness and long-term impact in stimulating labor demand. Similarly, the new unemployment insurance fund needs to be monitored closely in terms of its expected increases in registry and contributions, its costs and effectiveness. Subject to progress in key reforms, consideration should be given to reduce the tax burden related to labor market policies in order to curtail labor costs.[2] Some social assistance and benefit programs have become more pro-poor since the mid-1990s and are playing a major

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[2] However, such fiscal adjustment requires lowering public expenditures to GDP before implementing tax reductions.

role in alleviating poverty. However, given the plethora of these programs, the complexity of program design in many cases, a constant challenge of the social protection system as a whole is to examine opportunities for consolidation and engage in systematic monitoring of the programs, their costs and effectiveness.

18. The Bank has been the main partner of the Government in its efforts to address poverty reduction and meet its social development objectives. The main findings of the Poverty Assessment and the PEIR contribute significantly to the enhanced policy dialogue with the Government on its policy options to improve living standards in the country, and effectiveness and adequacy of social protection programs. The Bank is assisting these important reforms in the social protection system through providing grants amounting to US$2.2 million. The latter focus on poverty monitoring and evaluation, integration of ethnic minorities, child development and building social capital in disadvantaged communities. A Bank-financed Child Welfare Reform project helps address the needs of children in public care, while a Bank-financed Social Investment and Employment Promotion (SIEP) which supports community and employment creation and strengthening of ALMPs has recently been approved and will start implementation. Although not subject to structural performance criteria or benchmarks, the IMF has been also monitoring the sustainability of the pension system and the advancing of the labor market reforms in terms of their relevance for the Fund's program objectives.

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

19. **Private Sector Development.** Bulgaria has completed the divestiture of about 95 percent (based on value of assets) of its non-infrastructure SOEs since 1995. However, job creation has not kept pace with labor shedding due to the liquidation of non-viable enterprises and the restructuring of viable ones, contributing to the persistence of the unemployment level. To encourage the entry of new firms and the expansion of existing ones, the business climate will have to be improved focusing on reducing barriers to entry, reducing compliance cost of the regulatory regime, developing a competitive environment, eliminating the constraints to bank lending, and establishing an efficient exit mechanism for non-viable enterprises. These initiatives require major changes in the basic legislation that govern commercial activity - notably the Commercial Code, the Civil Procedure Code, and the Labor Code—and the passage of legislation on how the State will regulate economic activity to ensure stability and predictability of regulatory regimes. The quality of public institutions dealing with the private sector – including regulators and service providers—will have to improve. Finally, judicial reform will have to be implemented, including the establishment of specialized commercial courts and the restructuring of the system of administrative courts.

20. In the context of two Finance and Enterprise Adjustment Loans (FESALs), the Bank has supported the Government in sector restructuring of the non-infrastructure enterprise sector. Privatization of SOEs has been major components of the FESALs. With the first PAL, the Bank has led the dialogue on reforms covering the regulatory regimes, the insolvency process, labor markets, and competition.

C. The World Bank Group Strategy and Lending Operations

The Country Assistance Strategy (CAS) for Bulgaria[1] discussed by the Bank's Board on May 9, 2002, focuses on three main themes: (i) promotion of competitive private sector led growth, (ii) strengthening public administration reforms and anti-corruption initiatives, and (iii) mitigating the social impact of restructuring and delivering social services more effectively.

Programmatic Adjustment Lending. Up to three Programmatic Adjustment Loans (PALs), the first one being approved by the Board in February 2003, [2] would support the Government's reforms aiming at: (a) completion of privatization and restructuring in energy and infrastructure; (b) improving the environment for private sector led growth; (c) deepening the financial sector; (d) reducing poverty and improving human capital, and better delivery of social services; and (e) support public administration reform and anti-corruption programs.

Bank Assistance Program in Bulgaria to date comprises 29 operations for a total original commitment of US$1,600.6 million equivalent. This includes ten adjustment loans (US$900.8 million), 17 investment projects (US$682.4 million), and two Bank-managed Global Environmental Fund (GEF) grants. Of these 29 operations, 21 have been completed, of which two have been restructured and partially cancelled during implementation, and eight operations are currently under implementation. The Revenue Administration Reform Project and the District Heating project have been submitted for Board approval in June.

IFC's Activities in Bulgaria comprise 16 projects (totaling US$178 million) in the support of financial sector development, and restructuring of post-privatized companies. Of those, 13 projects were approved from 1998-on, including bank privatizations and restructurings, as well as credit lines and technical assistance to SMEs.

Economic and Sector Work. The most recently completed country diagnostic work includes: a Public Expenditure and Institutional Review (2002), a Joint World Bank-IMF Financial Sector Assessment Program (2002), and a Poverty Assessment Update (2002). Going forward, the Bank plans additional country diagnostic work on municipal finances, on pension funds, on the energy sector, on gender and ethnicity issues, private sector development, a country financial accountability assessment (currently under preparation) and a CEM focused on policy reforms for growth.

Table 14. Bulgaria: World Bank Operations (net of cancellations)

	Operation	US$ million	Board Date
1.	Environment and Privatization Support Adjustment Loan	50.0	2000
2.	Trade and Transport Facilitation in Southeast Europe	7.4	2000
3.	Health Sector Reform	63.3	2000
4.	Education Modernization	14.4	2000
5.	Child Welfare Reform	8.0	2001
6.	Registration and Cadastre	30.0	2001
7.	Wetlands Restoration and Pollution Reduction (GEF Grant)	7.5	2002
8.	Social Investment and Employment Promotion	50.0	2002
9.	Programmatic Adjustment Loan (PAL)	150.0	2003
10.	Revenue Administration Reform Project 3/	34.5	2003
11	District Heating Project 3/	34.2	2003

[1] *Memorandum of the President of the International Bank for Reconstruction and Development and the International Finance Corporation to the Executive Directors on a Country Assistance Strategy of the World Bank Group for Bulgaria*, May 31, 2002.
[2] *Program Document for a Proposed Programmatic Adjustment Loan to the Republic of Bulgaria*, The World Bank, January 23, 2003.
[3] Scheduled for Board discussion in June 2003.

Questions may be referred to Ms. R. Quintanilla (473-7673), Ms. Myla Taylor Williams (437-6997), or Ms. Stella Ilieva (359-2-9697-251).

Bulgaria: Statistical Issues

1. Bulgaria compiles and submits data to the Fund of sufficient quality and in a regular timely manner to adequately permit program monitoring and surveillance (Table 15). 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 General Data Dissemination System (GDDS) and has posted metadata on the Dissemination 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. Government output and final consumption are estimated on a cash rather than an accrual basis. In addition, Bulgaria publishes national accounts including current and capital accounts for the five main domestic sectors (general government, financial corporations, nonfinancial corporations, nonprofit institutions serving 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 third quarter of 2002, 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. The PPI is being revised. Detailed product specifications and transaction prices are being introduced gradually during the rotation of samples by branch classes. The NSI is in the process of expanding the collection of transaction prices throughout the industrial sector with 83 percent of domestic industry sales now covered. The new work program calls for completing the PPI revision process by June 2004. Publication of the rebased PPI began in March 2003, with the weights and reference period updated to 2000 and linked at December 2002 to form a continuous monthly series for the period January 2000 to January 2003.

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, although it still does not include owner-occupied housing. A new method for imputing missing observations of new products is being applied, but quality adjustment procedures are only applied in a few particular cases (e.g., the heating component).

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 intended 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 is a source for redesign of the household surveys conducted by the NSI, particularly the household budget survey and the labor force survey.

Government finance

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. In January 2003 the ROSC data module was undertaken and the key recommendations are to improve the fiscal data to meet fiscal reporting requirements for EU accession, in particular, implementing the new chart of accounts and the Financial Information Management System; disseminate information on arrears of central and local governments, local government debt, and details of financing; compile and disseminate discrete monthly and quarterly data; and update the MOF website monthly. 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. The Ministry of Finance prepares data on the execution of the consolidated government on a monthly basis. These data do not conform to *GFS* standards and are not published.

Money and banking statistics

12. Statistical methods conform with the principles in the IMF's *Monetary and Financial Statistics Manual, 2000,* notwithstanding several deviations concerning coverage of financial derivatives, valuation of monetary gold, and consistency in the interbank positions between the central bank and the commercial banks. However, the authorities reported that starting in January 2003, positions on financial derivatives, which at present are small, would be included in the balance sheets. Further, the consistency in the coverage of the BNB's claim on banks (which included claims on liquidated banks) and the banks' liabilities to the BNB had improved in January 2003 after the BNB had written off most of the claims on the liquidated banks. With respect to its near-term statistical program, the BNB has began to progressively harmonize its data collection and compilation methods in line with the European Central Bank's framework for monetary statistics. In particular, a significant number of enhancements in sectoral and instrument detail and classification were made in the data for 1995 and onward. These were reflected in the revised monetary statistics published in the August 2002 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's equity capital component in the first quarter of 2001. As there is no repayment obligation, the transaction does not change the country's external debt position. Balance of payments transactions related to the mobile phone license are no longer recorded for the subsequent periods. In 2003, the ROSC mission identified the following problems in the balance of payments statistics: i) residents' foreign currency accounts with resident banks are incorrectly included; ii) merchandise trade data are prone to errors and are not timely; and iii) most data are collected on a cash basis.

Table 15. Bulgaria: Core Statistical Indicators as of May 30, 2003

	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	May 30 2003	May 30 2003	May 30 2003	May 30 2003	May 30 2003	May 30 2003	April 2003	March 2003	March 2003	March 2002	Q4 2002 (qtrly) 2001-02 (annual)	March 2003
Date Received	May 30 2003	May 30 2003	May 30 2003	May 30 2003	May 30 2003	May 30 2003	May 16, 2003	May 30, 2003	May 30, 2003	May 8, 2003	April 26, 2002	May 17, 2003
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	Email from BNB
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

Bulgaria: Fund Relations

As of April 30, 2003

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

II. **General Resources Account**:	SDR million	%Quota
Quota	640.20	100.0
Fund holdings of currency	1401.61	218.93
Reserve position in Fund	32.78	5.12

III. **SDR Department**:	SDR million	%Allocation
Holdings	52.50	N/A

IV. **Outstanding Purchases and Loans**:	SDR million	%Quota
Stand-by	151.54	23.67
EFF	623.26	97.35
STF	19.37	3.03

V. **Financial Arrangements**:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
Stand-by	02/27/2002	02/26/2004	240.00	136.00
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):

	Forthcoming				
	2003	2004	2005	2006	2007
Principal	47.01	89.20	171.57	180.26	140.51
Charges/Interest	13.61	16.88	14.30	10.04	6.19
Total	60.62	106.08	185.87	190.29	146.70

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, Bulgarian National Bank (BNB) is subject to an assessment with respect to the SBA arrangement, which was approved on February 27, 2002 and is scheduled to expire on February 26, 2004. A safeguards assessment of the BNB was completed on June 12, 2002. The assessment identified certain weaknesses and made appropriate recommendations, as reported in EBS/02/121. As of January 2003, the BNB has implemented most of the safeguards recommendations and committed to implementing the remaining ones.

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 ε 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 July 22, 2002 (see EBS/02/121). Bulgaria is on a 24-month cycle. The Acting Chairman's summing-up of the discussion was circulated as SUR/02/80. 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 16 provides information on the production of ROSCs.

XI. **Technical Assistance**

Table 17 provides information on IMF technical assistance activities in Bulgaria.

Table 16. Bulgaria: ROSCs

Standard/code assessed	Date of issuance	Document number
ROSC update – Data dissemination and fiscal transparency.	08/07/2002	SM/02/203
ROSC – Monetary and financial policy transparency, banking supervision, securities regulation, insurance regulation, and payment systems	07/15/2002	SM/02/221
ROSC update – Data dissemination, fiscal transparency, transparency of monetary and financial policies, banking supervision, deposit insurance, insurance supervision, securities market supervision	03/08/2001	EBS/01/28
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 17. Bulgaria: Technical Assistance, 1998-2003

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
MAE	Review of TA needs resulting from FSAP	Mission	May 02	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/WB	Implementation strategy	Mission	Jan. 00	MOF
FAD	Unified revenue agency (URA)	Mission	Jan.-Feb. 00	MOF
FAD	National revenue agency	Expert	Apr-Jun. 00	MOF
FAD	Tax administration	Mission	May 00	MOF
FAD	Short-term resident advisor on the URA	Expert	May-Jun. 00	MOF
FAD	National revenue agency	Mission	Jun. 00	MOF
FAD	Social security administration	Expert	Jun. 00	MOF
FAD	Long-term resident advisor	Expert	Sep. 00-Sep. 01	MOF
FAD	National revenue agency	Mission	Jan. 01	MOF
FAD	Budget reform	Mission	Jan.-Feb. 01	MOF
FAD	Budget and treasury reform	Mission	Jun. 01	MOF
FAD	Tax administration - follow-up	Mission	Sep. 01	MOF
FAD	National revenue agency	Expert	Oct.-Sep. 01	MOF
FAD	Customs administration	Mission	Oct.-Nov. 01	MOF
FAD	Tax administration	Mission	Sep. 01	MOF
FAD	Revenue administration	Mission	Apr. 02	MOF
FAD	Long-term resident advisor	Expert	Apr. 02- Mar. 03	MOF
FAD	Tax policy	Mission	Apr. 02	MOF
FAD		Advisor Visit	Sep.-Oct. 02	MOF
FAD		Advisor Visit	Mar.-Apr. 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
STA	Price statistics	Mission	May 02	NSI
STA	Producer prices	Mission	Jan 03	NSI

Sofia, Bulgaria, June 18, 2003

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

Dear Mr. Köhler,

The attached Supplementary Memorandum of Economic Policies (SMEP) discusses our performance under the program supported by the Stand-By Arrangement (SBA) with the Fund and the policies that the government and the Bulgarian National Bank plan to implement during the remainder of 2003 and 2004. We remain committed to our policy objectives laid out in the Memorandum of Economic Policies (MEP) dated February 12, 2002 and updated in the SMEPs dated July 5, 2002 and January 22, 2003. In the context of our currency board arrangement, we will maintain macroeconomic stability, while working toward continued robust and sustainable growth to improve our people's living standards.

During the last six months, macroeconomic performance has been strong and, as indicated in the SMEP, program implementation was on track. As the third review was delayed for a few days into July, end-June performance criteria (PCs) are legally controlling for the purchase associated with this review. In this context, we request a waiver of applicability for all end-June performance criteria for which data are not yet available. We expect to observe all PCs. We propose to convert the indicative targets previously set for end-September and end-December 2003 into performance criteria.

In view of the above we request the completion of the third review under the SBA. In addition to analyzing economic policies and conditions in general, the fourth review will focus on measures to strengthen tax administration, expenditure management, and the budget process. We will continue to consult with the Fund on a regular basis regarding any additional measures that may become appropriate to ensure that program implementation remains on track.

Sincerely yours,

\s\	\s\
Milen Velchev	Svetoslav Gavriiski
Minister of Finance	Governor
Ministry of Finance	Bulgarian National Bank

Attachment: Supplementary Memorandum of Economic Policies of the Government of Bulgaria and the Bulgarian National Bank

Supplementary Memorandum of Economic Policies of the Government of Bulgaria and the Bulgarian National Bank

A. Introduction

1. **Bulgaria has made further progress toward sustained robust economic growth and higher living standards, which are key objectives of our economic program.** To this end, we have continued to adhere to cautious fiscal and incomes policies in support of the currency board arrangement (CBA). We are carrying out our structural reform agenda to foster growth, while strengthening the social safety net, and taking steps to reduce long-term unemployment.

2. **The implementation of our economic program—supported by a Stand-By Arrangement with the Fund—remains on track.** All end-December 2002 and end-March 2003 performance criteria (PCs) and indicative targets were observed, with the exception of the indicative target on arrears to the electricity company (NEK), for which remedial measures have been taken (Tables 1a and 1b). On structural benchmarks, only the transfer of the remaining accounts into the Treasury Single Account has not been done owing to technical difficulties, but the government intends to complete this process by end-September 2003 (Table 2a and 2b).

B. Recent Economic Developments

3. **After a strong performance in 2002, macroeconomic developments in the first quarter of 2003 have remained favorable, despite an unsettled external environment, including continued slow growth among Bulgaria's trade partners.**

- In 2002, real GDP growth reached 4.8 percent, while unemployment declined significantly. These trends have continued in early 2003, with strong economic activity and a further reduction in unemployment to 14.9 percent at end-April 2003.

- Inflation has fallen steadily, with an increase in the CPI of only 0.2 percent in the twelve months to April 2003.

- The twelve-month external current account deficit increased to 5¼ percent of estimated GDP in the first quarter of 2003 (from 4½ percent of GDP in 2002), as strong imports, notably of raw materials, consumer goods, and oil products, more than offset robust exports. In volume terms, twelve-month import growth reached 25 percent, while export surged by 28 percent. Net FDI inflows, computed on a twelve-month basis, covered 60 percent of the current account deficit and the remainder of the deficit was financed in part by a drawdown in international reserves.

- In 2002, the external financing position strengthened, reflecting the improved current account, the repatriation of banks' deposits abroad, and collateral released in debt management operations. Despite lower-than-expected foreign direct investment, gross international reserves increased to slightly more than 5 months of prospective imports and have remained at that level in the first quarter of 2003. The external debt-to-GDP ratio has decreased sharply to 58.4 percent of projected 2003 GDP by end-March. Reflecting these gains, in late May and early June Standard&Poor's and Moody's upgraded Bulgaria's long-term foreign currency rating by one notch to BB+ and by two notches to Ba2, respectively, while spreads on the Bulgaria component of the EMBI+ index have dropped to an all-time low range of 190 to 230 basis points.

- Financial intermediation has continued to rise rapidly, albeit from a still-low base, contributing to strong economic activity. Real broad money and credit to the private sector rose by 12½ and 47½ percent, respectively, in the twelve months ending April 2003, while interest rate spreads continued to narrow. Prudential indicators suggest that the banking system has remained sound, although profitability has suffered somewhat.

4. **We met our 2002 fiscal deficit target and the execution of the 2003 budget has been significantly better than programmed.** Last year, the deficit was limited to 0.6 percent of GDP and, in the first quarter of 2003, a surplus of 0.3 percent of annual GDP was recorded, compared to a projected deficit of 0.8 percent of GDP. Most of the overperformance in the first quarter was accounted for by better-than-projected revenue collection, in particular with regard to non-tax revenues. The registration of labor contracts and introduction of minimum insurable income thresholds has contributed to a significant rise in social security contributions, which were in line with program expectations. Spending was lower than budgeted as we proceeded cautiously with discretionary spending and some savings on external interest payments materialized. However, a sharp increase in the reimbursement of medicines by the National Health Insurance Fund (NHIF), delays in implementing reforms in the hospital sector, and the underfunding of mandated spending in the municipalities have resulted in spending overruns and arrears accumulation in these sectors, which we intend to address during the rest of the year.

5. **We have continued to implement reforms that would keep our fiscal policy on a sound footing over the medium term**. We have made progress in staffing and building the capacity of the National Revenue Agency (NRA) and strengthened the operations of the Large Taxpayer Office (LTO), meeting ahead of schedule the structural benchmark of raising the share of corporate tax revenue collected by the office to above 60 percent. We also tabled in parliament amendments to the municipal budget act to provide a measure of revenue autonomy to local government and clarify the scope of transfers from the central government.

6. **Structural reforms have advanced, including with bank privatization and improvements in energy sector efficiency, but progress in some areas has proved more challenging.** We have completed the sale of the last large government-owned commercial bank (DSK). We have continued to reform the railways sector, including by reducing loss-making activities, raising passenger tariffs toward cost-recovery levels, and lowering labor costs; and made significant progress in improving the efficiency of district heating. However, the privatization of the tobacco holding (Bulgartabac) ran into difficulties and would need to

be relaunched, while the sale of the telecommunication company (BTC) is taking more time than initially envisaged. Reforms to improve the business climate and restructure the health sector have proved more difficult.

7. **We have further strengthened banking supervision in light of the rapid growth in lending and taken measures to address the occasional large fluctuations in inter-bank overnight rates.** In January, we introduced the new international accounting standards and more detailed bank reporting requirements, including for the currency composition of banks' balance sheets and income and expenses statements. We have maintained a proactive stance regarding supervision, with unscheduled bank inspections in response to signs of serious breaches of prudential norms, followed by mandatory remedial actions and an implementation timetable. In June, we implemented the real time gross settlements (RTGS) system, which will significantly improve the timeliness and security of bank transactions, while reducing occasional sharp fluctuations in interbank overnight interest rates. In this context, a small facility of 10 million leva financed by banks' contributions has been set up at the Bulgarian National Bank (BNB) for the purpose of smoothing temporary daily shortages in leva liquidity. In order to reduce volatility in overnight interest rates, a limited reverse repo facility (of up to 25 million leva) has been successfully introduced by the Ministry of Finance and the BNB has introduced same-day-value exchange of euros into levas by commercial banks.

C. Economic Policies for the Remainder of 2003 and 2004

8. **With global uncertainty subsiding, we see our macroeconomic objectives for 2003 intact and medium-term prospects favorable**. Having weathered the global tension at the beginning of the year with minimum fallout, our economy is expected to continue to grow as envisaged in our program, led by further gains in export markets and strong growth in investment. We expect inflation to remain subdued, reaching 4 percent at end-2003. The external current account deficit is projected to remain at about 4½ percent of GDP in 2003 and decline gradually over the medium-term. However, we are mindful that our external position could deteriorate if EU recovery in 2003 is slower than expected or if the rapid credit growth leads to an unexpectedly large import boom. We would adjust our policies to such circumstances.

Fiscal Policy and Public Sector Reforms

9. **We believe our fiscal targets for 2003 and the medium term are fully achievable but stand ready to implement additional measures, as needed**. The strong first quarter outcome and some additional revenue overperformance and interest savings projected for the remainder of the year provide sufficient cushion to meet the spending pressures that have emerged in the health and municipal sectors. In tandem with measures to stem these pressures, we intend to spend part of this overperformance of approximately 0.8 percent of GDP to cover the reimbursement of medicines and fully fund mandated spending by municipalities. In case the revenue overperformance were to exceed current projections for the remainder of the year, it would in part be saved—at least to the extent the

overperformance is due to one-off factors—and the rest spent in the fourth quarter according to budget priorities. However, if the external current account deficit were to widen significantly relative to program expectations, spending would be kept in line with the original budget targets and, if necessary, the 88 percent rule continued through the fourth quarter.

10. **We are taking steps to limit budget overruns and arrears accumulation in the health care sector and in municipalities**. To deal with the immediate financial pressure arising from overruns in the repayment of medicines, the NHIF is taking administrative steps to increase the co-payment rate and better control the volume of prescriptions. Activities in a number of hospitals under the Ministry of Health are being rationalized. Looking at the longer haul, we are designing, in coordination with the World Bank, a broader hospital reform plan that would put the financial situation of the sector on a sound footing by gradually increasing the role of output indicators and the NHIF in hospital financing. As for municipalities, we intend to complete the broad reform agenda that was initiated last year. In this regard, we expect parliament to approve amendments to the municipal budget law by end-July. Clearance of municipal arrears will be limited to those related to the underfunding of mandated spending and the prompt payment of municipal obligations to public utilities will be strictly enforced.

11. **We will continue to implement measures to improve tax administration**. To make the NRA fully operational as soon as feasible, we will, by end-September, select an information technology system and initiate a pilot project in Bourgas (structural benchmark) and, by end-year, separate the collection function within the national social security institute (NSSI). We are taking steps to ensure that current efforts to strengthen revenue collection—notably the implementation of VAT accounts, the LTO, and the registration of labor contracts and minimum insurable income thresholds for social security contributions—are generating the results expected. To combat customs fraud, new counterfeit-proof banderoles for cigarettes and alcohol will be introduced, border point duty free shops will be closed except at airports, and the recommendations from the Crown Agents consultants implemented.

12. **We are taking steps to enhance budgeting and expenditure management in the context of the preparation of the 2004 budget.** We intend to bring the preparation process back in line with the new, accelerated schedule, and decide on the 2004 expenditure ceilings before the summer recess. Pilot program budgets for 2004 are under preparation in three ministries. The creation of a full-fledged Treasury Department and implementation by end-2003 of the Financial Management Information System at all second level spending units of the Ministry of Finance will strengthen budget execution significantly.

13. **In line with our medium-term fiscal strategy, our goal remains to move to a balanced budget by 2005.** In this context, we will continue to implement the tax policy plan adopted last year with a view to reducing the overall tax burden, shifting from direct to indirect taxation, and maintaining a broad tax base. More specifically, we aim to reduce the corporate tax rate to 20 percent in 2004 and 15 percent in 2005. Assuming continued good

collection performance by the NSSI, we will consider reducing the social security tax rate. On the expenditure side, we intend to raise social spending and to expand the public investment budget in 2004—to absorb an increase in EU-financed projects while limiting crowding out of other projects. In order to create room for tax cuts and additional social and EU accession-related spending, we will step up our efforts to improve tax administration, curtail government subsidies—including for railways, district heating and hospitals—and improve the efficiency of government spending overall.

Labor Market and Other Structural Reforms

14. **To maintain competitiveness and further lower unemployment, we will continue efforts to reform the labor code and strengthen active labor market policies (ALMPs)**. We will foster dialogue among social partners on the proposed labor code amendments to reduce hiring and firing costs. We will continue to help long-term unemployed regain their footing in the labor market through our program "From Social Assistance to Employment" and ensure that labor contracts are formally registered. We are committed to monitor and evaluate closely the efficiency and effectiveness of ALMPs and adjust these as appropriate.

15. **We will advance privatization and expedite reforms in the energy and railways sectors**. We will seek to complete the privatization of Bulgartabac and BTC in a fully transparent manner as quickly as possible. In addition, we will carry on with the preparations for the sale of electricity distribution companies. To facilitate this process and provide a modern institutional and legal framework to the energy sector in Bulgaria, we intend to have the draft energy law passed in parliament by end-June. Technical and administrative changes that are improving the efficiency of the district heating system are continuing and we expect to virtually eliminate the need for government subsidies next year. As for the railways, we will aim to create separate units for freight and passenger transport by end-July 2003 and reach our objectives of 10 percent reduction in personnel compared to 2001 and raising intercity passenger tariffs to 70 percent of cost-recovery levels by end-2003. Further, we are in the process of costing individual services, which will serve as a basis for signing public sector obligation contracts with the government in the context of the 2005 budget.

16. **We will push for further legal and institutional reforms to enhance the business climate.** With the assistance of the EU, World Bank, and others, we will step up the reform of the judiciary and take further steps to improve governance. To help attract more investment, we will continue to reform licensing, permit, and registration regimes and reduce their number. In this context, the draft licensing law, expected to be adopted by parliament by end-July, is intended to limit the government's discretion in introducing new license and permit requirements. The draft amendments to the commercial code expected to be passed by end-July will simplify bankruptcy procedures.

Financial and External Sectors' Policies

17. **In the face of still-strong private sector credit growth, we will continue to strengthen the supervision of the banking system**. We will continue our policy of

conducting unscheduled inspections of any troubled bank followed by mandatory remedial actions. To minimize risks associated with rapidly increasing foreign currency lending, we will monitor closely the foreign currency exposure of banks and urge them to properly hedge against such risks. At the same time, with IMF technical assistance, we will determine the appropriate approach to monitoring the foreign currency-related credit risk arising from banks' fast growing lending in foreign currency to the corporate sector. In this context, the expected passage of amendments to the foreign currency law that would require companies to provide information on their foreign assets to the BNB would—along with the already compiled data on companies' foreign liabilities—help assess their foreign currency exposure.

18. **The proposed government-sponsored private equity fund will be established with a government contribution not exceeding 100 million leva throughout the fund's life and with appropriate safeguards.** We continue to view the establishment of this fund as important to increase equity financing in the private sector, and are moving to select among the short-listed bidders fund managers. We will, at launch, limit government participation to no more than 49 percent of committed funds, with the intention to reduce this participation over time. We will closely monitor the fund's performance. Further, we will establish other firewalls to help ensure that investment decisions are made without government involvement, including the requirement for the government to be a minority shareholder.

19. **We will carry on with our active public debt management, with a view to continuing to reduce external vulnerability**. Our objectives in this regard remain to achieve a more balanced interest and currency composition of the debt and increase the share of domestic debt, while continuing to lower the public debt-to-GDP ratio over the medium term. In addition, as opportunities present themselves, we will conduct specific debt operations, consistent with our strategy. We are also undertaking a more active management of the deposits in the fiscal reserve account (FRA). In this connection, the BNB has signed an agreement with the World Bank on behalf of the government to manage euro 75 million, according to pre-agreed investment guidelines.

Data Quality Issues

20. **We plan to subscribe to the special data dissemination standards (SDDS) by year end, as we are making progress in observing standards and codes, while implementing the remaining safeguard recommendations**. The assessment of the review of standards and codes (ROCS) mission in January concluded that we complied with the majority of standards and codes and we are taking steps to move to standards in those areas that were identified to require additional work. In this regard, we plan to disseminate the international reserves and foreign currency liquidity templates by end-2003. We are also making progress in implementing the remaining safeguard assessment recommendations, in particular preparing the audit procedure manual of the BNB.

Table 1a. Bulgaria: Quantitative Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2002 1/
(In millions of leva, unless otherwise indicated)

Variable and Periods		Target		Outcome	
I.	Ceiling on the overall deficit of the general government				
	Jan. 1, 2002-Mar. 31, 2002		138		39
	Jan. 1, 2002-Jun. 30, 2002		-103		-271
	Jan. 1, 2002-Sep. 30, 2002		173		-492
	Jan. 1, 2002-Dec. 31, 2002		260		209
II.	Floor on the balance of the fiscal reserve account				
	Mar. 31, 2002		1,900		2,477
	Jun. 30, 2002		1,900		3,275
	Sep. 30, 2002		1,900		3,542
	Dec. 31, 2002		1,900		3,336
III.	Ceiling on the wage bill of the 60 monitored SOEs 2/				
	Jan. 1, 2002-Mar. 31, 2002		141.8		139.1
	Apr. 1, 2002-Jun. 30, 2002		141.6		140.1
	Jul. 1, 2002-Sep. 30, 2002		141.1		140.0
	Oct. 1, 2002-Dec. 31, 2002		140.6		139.1
		GTD	NSSI	GTD	NSSI
IV.	Indicative ceiling on tax on social insurance arrears				
	Cumulative change from level on: Dec. 31, 2001:				
	Mar. 31, 2002	-25	-5	-117	-7
	Jun. 30, 2002	-50	-10	-201	-5
	Sep. 30, 2002	-75	-15	-256	-5
	Dec. 31, 2002	-100	-20	-252	-5
		Up to one year	Over 1 year (excluding Eurobonds)	Up to one year	Over 1 year (excluding Eurobonds)
V.	Ceiling on contracting and guaranteeing public sector external debt (millions of U.S. dollars)				
	Cumulative change from level on Dec. 31, 2001:				
	Mar. 31, 2002	0	230	0	46
	Jun. 30, 2002	0	560	0	238
	Sep. 30, 2002	0	690	0	238
	Dec. 31, 2002	0	690	0	238

Table 1a. Bulgaria: Quantitative Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2002 1/
(In millions of leva, unless otherwise indicated) (concluded)

Variable and Periods	Target		Outcome	
	Over one year (Eurobond issuance)	1-5 years	Over one year (Eurobond issuance)	1-5 years
V. Ceiling on contracting and guaranteeing public sector external debt (millions of U.S. dollars)				
Cumulative change from level on Dec. 31, 2001:				
Mar. 31, 2002	300	0	0	0
Jun. 30, 2002	300	0	-79	0
Sep. 30, 2002	300	0	-79	0
Dec. 31, 2002	0	0	-209	0
	NEK	Bulgargaz	NEK	Bulgargaz
VI. Ceiling on changes to arrears owed to Bulgargaz and NEK (millions of Leva).				
Cumulative change in the stock of arrears from level on May 31, 2002:				
Jun. 30, 2002	0	0	0	0
Sep. 30, 2002	0	0	0	0
Dec. 31, 2002	0	0	0	0

1/ Definitions of the performance criteria and indicative targets are included in the Annexes to the Supplementary Memorandum of Economic Policies (EBS/02/121).
2/ Adjusted downwards after the privatization of one of the monitored enterprises.
3/ Adjusted downwards after the privatization of three of the monitored enterprises.
4/ Adjusted downwards after the privatization of one of the monitored enterprises.
5/ Adjusted downwards after the privatization of one of the monitored enterprises.

Table 1b. Bulgaria: Quantitative Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2003 1/
(In millions of leva, unless otherwise indicated)

	Variable and Periods	Target		Outcome	
I.	Ceiling on the overall deficit of the general government				
	Jan. 1, 2003-Mar. 31, 2003		304.9		-109.5
	Jan. 1, 2003-Jun. 30, 2003		100.5		
	Jan. 1, 2003-Sep. 30, 2003		75.7		
	Jan. 1, 2003-Dec. 31, 2003		262.8		
II.	Floor on the balance of the fiscal reserve account				
	Mar. 31, 2003		2,400		3,442
	Jun. 30, 2003		2,400		
	Sep. 30, 2003		2,400		
	Dec. 31, 2003		2,400		
III.	Ceiling on withdrawals from the fiscal reserve account for the acquisition of policy related financial assets				
	Cumulative change from level on: Dec. 31, 2002				
	Mar. 31, 2003		85		34.5
	Jun. 30, 2003		130		
	Sep. 30, 2003		180		
	Dec. 31, 2003		150		
IV.	Ceiling on the wage bill of the 60 monitored SOEs				
	Jan. 1, 2003-Mar. 31, 2003		150.1		145.2
	Apr. 1, 2003-Jun. 30, 2003		150.1		
	Jul. 1, 2003-Sep. 30, 2003		150.1		
	Oct. 1, 2003-Dec. 31, 2003		150.1		
		GTD	NSSI	GTD	NSSI
V.	Ceiling on tax on social insurance arrears				
	Cumulative change from level on: Dec. 31, 2002				
	Mar. 31, 2003	-10	-3	-12.2	-3.6
	Jun. 30, 2003	-20	-6		
	Sep. 30, 2003	-30	-9		
	Dec. 31, 2003	-70	-12		

Table 1b. Bulgaria: Quantitative Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2003 1/
(In millions of leva, unless otherwise indicated) (concluded)

	Variable and Periods	Target		Outcome	
		Up to one year	Over 1 year (excluding Eurobonds)	Up to one year	Over 1 year (excluding Eurobonds)
VII.	Ceiling on contracting and guaranteeing public sector external debt (millions of U.S. dollars) Cumulative change from level on Dec. 31, 2002:				
	Mar. 31, 2003	0	400	0	318.5
	Jun. 30, 2003	0	450		
	Sep. 30, 2003	0	450		
	Dec. 31, 2003	0	500		
		Over one year (Eurobond issuance)	1-5 years	Over one year (Eurobond issuance)	1-5 years
VII.	Ceiling on contracting and guaranteeing public sector external debt (millions of U.S. dollars) Cumulative change from level on Dec. 31, 2002:				
	Mar. 31, 2003	0	0	0	0
	Jun. 30, 2003	250	0		
	Sep. 30, 2003	250	0		
	Dec. 31, 2003	150	0		
		NEK	Bulgargaz	NEK	Bulgargaz
VIII.	Indicative ceiling on changes to arrears owed to Bulgargaz and NEK (millions of Leva). Maximum accumulation of new arrears from level on October 31, 2002:	0	0	2.5	0
	Mar. 31, 2003	0	0		
	Jun. 30, 2003	0	0		
	Sep. 30, 2003	0	0		
	Dec. 31, 2003				

1/ Definitions of the performance criteria and indicative targets are included in the Annexes to the Supplementary Memorandum of Economic Policies.

Table 2a. Bulgaria: Prior Actions, Structural Performance Criteria, and Benchmarks, 2002[1]

	Measures	Program Timing	Form of Conditionality	Status	Review
		MEP, February 2002			
1.	Parliament to adopt a 2002 State budget consistent with paragraphs 8–12.	Before IMF Board meeting	Prior action	Met	First
2.	Council of Ministers (CoM) to adopt an ordinance on income policies consistent with paragraph 16.	Before IMF Board meeting	Prior action	Met	First
3.	Finalize the school redeployment plan, and submit it to CoM (paragraph 13).	End-March 2002	Benchmark	Met	First
4.	Adopt a child allowance allocation system, limiting allowances to most needy families (paragraph 11).	End-March 2002	Benchmark	Met	First
5.	Bank Consolidation Company (BCC) to adopt a privatization strategy for DSK Bank (paragraph 19).	End-March 2002	Benchmark	Met	First
6.	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	Met	First
7.	Parliament to adopt the Bank Bankruptcy law (paragraph 21).	End-March 2002	Benchmark	Met, with a delay	First
8.	Announce a schedule to bring household electricity prices to full cost-recovery levels (paragraph 25).	End-April 2002	Performance Criterion	Met, with a delay	First
9.	Submit to parliament a law to establish the unified revenue agency (paragraph 14).	End-June 2002	Benchmark	Met	Second
10.	Complete accreditation process for all hospitals (paragraph 13).	End-June 2002	Benchmark	Met, with a delay	Second
11.	Have the Council of Ministers approve the final draft of a new Energy Act as described in paragraph 25.	End-June 2002	Benchmark	Met, with a delay	Second

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

Table 2a. Bulgaria: Prior Actions, Structural Performance Criteria, and Benchmarks, 2002[1]
(Concluded)

Measures	Program Timing	Form of Conditionality	Status	Review
12. Make the new energy pricing regime fully operational (paragraph 25).	End-June 2002	Benchmark	Met	Second
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	Not met	Second
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	Benchmark	Not met	Second
	Supplementary MEP, July 2002 2/			
15. Announce a schedule to bring household electricity prices to full cost-recovery levels (paragraph 3).	IMF Board presentation of the review	Prior Action	Met	First
16. Parliament to adopt the Bank Bankruptcy law (paragraph 19).	End-July 2002	Benchmark	Met, with a delay	Second
17. Settlement of the sale of Biochim Bank (paragraph 20)	End-September 2002	Benchmark	Met	Second

1/ Paragraph numbers refer to the Memorandum of Economic Policies dated February 12, 2002.
2/ Paragraph numbers refer to the Supplementary Memorandum of Economic Policies dated July 5, 2002.

Table 2b. Bulgaria: Structural Performance Criteria and Benchmarks, 2003

	Measures	Program Timing	Level of Conditions	Status	Review
		SMEP, February 2003 1/			
	Fiscal				
1.	Initiate the publication on the Ministry of Finance website of data on monthly consolidated government budget implementation and on the Fiscal Reserve Account (paragraph 16).	End-March 2003	Benchmark	Met	Third
2.	Extend the operations of the large taxpayer office so as to include the group of companies that contribute at least 60 percent of tax revenue (paragraph 14).	End-June 2003	Benchmark	Met	Fourth
3.	Implement the Bullstat number as the single key identification for all tax operations (paragraph 16).	End-June 2003	Benchmark		Fourth
4.	Include all non-participating leva-denominated extrabudgetary funds and autonomous budget units in the Treasury Single Account (paragraph 16).	End-September 2003	Benchmark		Fourth
5.	Make the Financial Management Information System fully operational in the Ministry of Finance (paragraph 16).	End-December 2003	Benchmark		
6.	No new extrabudgetary funds or state-owned enterprises will be created during the program period (paragraph 16).	Continuous	Benchmark		
	Financial sector				
7.	Completion of the sale of DSK Bank (paragraph 23).	End-June 2003	Benchmark	Met	Fourth
	Energy sector				
8.	State Energy Regulatory Commission to announce increase in average household electricity prices by 15 percent (paragraph 20).	June 30, 2003	Benchmark		Fourth
9.	Announce increase in average district heating prices by 10 percent (paragraph 20).	June 30, 2003	Benchmark		Fourth
		SMEP, June 2003 2/			
10.	Select an information technology system and initiate a pilot in the town of Bourgas for the National Revenue Agency (paragraph 11).	End-September	Benchmark		Fourth

1/ Paragraph numbers refer to the Memorandum of Economic Policies dated February 12, 2002.
2/ Paragraph numbers refer to this Supplementary Memorandum of Economic Policies

Performance Criterion on the Overall Deficit of the General Government

	Overall deficit ceilings
	(In millions of leva)
January 1, 2003–March 31, 2003	304.9
January 1, 2003–June 30, 2003	100.5
January 1, 2003–September 30, 2003	75.7
January 1, 2003–December 31, 2003	262.8

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)

	FRA
	(In millions of leva)
March 31, 2003	2,400
June 30, 2003	2,400
September 30, 2003	2,400
December 31, 2003	2,400

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. 7 of the 2003 Budget Law, the National Social Security Institute, and the Health Insurance Fund, and (2) other highly liquid foreign assets of the central government.

The following assets qualify as highly liquid foreign assets:
(i) Foreign currency deposits with foreign financial institutions (or their branches) assigned a rating of AA- or higher;
(ii) Fixed income instruments issued by supranationals and foreign sovereigns (including financial institutions) that have a rating of AA- or higher, taken at market value;
(iii) Bulgarian Brady bonds and Eurobonds (acquired as treasury stock through market transactions) taken at 95 percent of market value.
In addition, the fixed income instruments (other than the Bulgarian Brady and Eurobonds) liquidity-wise have to satisfy the following conditions:

- The original size of any issue should be higher than euro 1 billion;
- Holdings in the FRA should not exceed 10 percent of any issue;
- The issue should be traded actively (on a daily basis) OTC in London, New York, or Frankfurt;
- There should be at least 3 market-makers for the issue.

Finally, the modified duration of the entire portfolio of highly liquid assets should not be more than 4.5 years.

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, 2002 exchange rates (1.88496 leva, and 0.73555 SDR per US dollar).

The Ministry of Finance will publish information on the level and composition of the FRA on the Ministry's website on a monthly basis. The information will include the overall balance of the FRA, the balance of the government deposit at the Bulgarian National Bank, and the total amount of foreign exchange denominated assets, including the highly liquid foreign assets.

Performance Criterion on the Ceiling on Withdrawals from the Fiscal Reserve Account for the Acquisition of Policy-Related Financial Assets 1/

	FRA
Cumulative change from December 31, 2002 2/	(In millions of leva)
March 31, 2003	85
June 30, 2003	130
September 30, 2003	180
December 31, 2003	150

1/ Policy-related assets are financial assets, including loans, equity securities, and debt securities, that are acquired for the purpose of public policy as set forth in paragraphs 7.88 to 7.90 of the Government Finance Statistics Manual, 2001.

2/ Net of the cumulative value of disposed policy-related assets up to the test date, including through privatization transactions.

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

	Wage Bill of 60 SOEs
	(In millions of leva)
July 1, 2002–September 30, 2002 (actual)	147.2
January 1, 2003–March 31, 2003	150.1
April 1, 2003–June 30, 2003	150.1
July 1, 2003–September 30, 2003	150.1
October 1, 2003–December 31, 2003	150.1

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 2002. 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 2003 will also exit the list in the second half of 2003 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 2002 plus 2 percent. The 60 enterprises monitored (enterprises number 1 to 17 are considered monopolies):

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

Performance Criteria on Ceiling on Tax and Social Insurance Arrears

	Total	GTD	NSSI
		(In millions of leva)	
Outstanding as of:			
December 31, 2002 (actual)	430.7	226.6	204.2
Cumulative change from level on December 31, 2002:			
March 31, 2003	-13	-10	-3
June 30, 2003	-26	-20	-6
September 30, 2003	-39	-30	-9
December 31, 2003	-82	-70	-12

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

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

The enterprises monitored for arrears to the NSSI:

1. Kremikovci AD, Sofia
2. Stomana AD, Pernik
3. Port of Burgas, Burgas
4. Varna Shipyard
5. Quartz AD
6. Gorubso Madan AD
7. Gorubso Zlatograd AD
8. Gorubso Rudozem EAD
9. Gorubso-ROF Rudozem AD
10. Promet EOOD, Burgas
11. New Plama AD
12. Stara Reka AD
13. Tezhko Mashinostroene AD
14. Kitka AD
15. Beltrans EOOD
16. CR Baza-Pernik EOOD
17. Burgas Copper Mines
18. Cherno More EOOD
19. Arkus AD
20. Prima AD
21. KK Maritsa
22. Dynamo AD,
23. Podem AD
24. Elprom ETM AD
25 Rubin AD
26. Etavia AD
27. Stomaneni Trabi AD
28. Obshtinski Avtotransport EOOD
29. ZMM
30. Trema
31. Belopal
32. Ustrem-Topolovgrad
33 Marz AD
34. NITI EAD
35. Montana AD
36. Sanya
37. Agropromstroy EAD
38. Dobritch Mel AD
39. Radomir Le Co Co EOOD
40. Filtex AD
41. Pirin Mines
42. Nistra EAD

43. Dobruzhan Meat Company
44. Dunarit AD
45. Agrotehnika AD
46. Dobrich Mel
47. Harmonia
48. Ilindentsi Mramor
49. Orfey OOD
50. Ptikom EAD
51. S-M 33
52. Mediket AD
53. Sukmo EOOD
54. Elena Georgieva AD
55. Mak AD
56. Rodopa-95
57. Uvion OOD
58. ZMM Technotronika
59. Struma OOD
60. Pektin EOOD
61. Incoms EIM
62. Elko EOOD
63. V i K
64. Balgarska Roza-Sevtopolis
65. Alukom
66. Niva AD
67. Kartal EAD
68. Balkankar-Zaria AD
69. ZSK Kremikovci
70. Simpto AD
71. Semena Dobrich AD
72. Ruen-Elit AD
73. I. H. I KO Ahrida AD
74. Rilski Len AD
75. Filtex AD
76. Mak Tours AD
77. Biliana Triko AD
78. Zavodski Stroezhi AD
79. Boni Commerce AD
80. Pons Holding AD
81. Kosko EOOD
82. Varnensko Pivo
83. DP Construction & Transpt. Acitv
84. Sadrujie Stoichevi 57-65
85. Sokola AD
86. Zavodski Stroezhi PC-Pernik AD
87. Asenovgrad BT
88. Kocho Chestimenski AD
89. Pulpodeva AD
90. Vagonno-remonten Zavod-Karlov
91. Dunarit EAD
92. LVZ AD
93. Vini EAD
94. Minstroi Rodopi AD
95. Rozhen Express EOOD
96. DP Construction and Reconstruction
97. Industrial Corporation Zelin
98. UI St. Kliment Ohridski
99. Mostsroi AD
100. Alkomet AD

For the purpose of assessing compliance with these performance criteria:

- 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, 2002;
- 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, 2002 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 Criteria[1]

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 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.

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[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, 2002				
March 31, 2003	0	400	0	0
June 30, 2003	0	450	250	0
September 30, 2003	0	450	250	0
December 31, 2003	0	500	150	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, 2002 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 2003 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.

Indicative Ceilings on Changes to Rescheduled and New Arrears
Owed to Bulgargaz and NEK

	Bulgargaz	NEK
	(In millions of leva)	
Outstanding as of October 31, 2002	0	1.87
Maximum accumulation of new arrears from level on October 31, 2002		
March 31, 2003	0	0
June 30, 2003	0	0
September 30, 2003	0	0
December 31, 2003	0	0

1/ For the purpose of assessing compliance with these indicative targets:

- Arrears are defined to include overdue payments of more than three months after the normal settlement period. Arrears are defined to include interest and penalties.
- Arrears will not include new interest and penalties accruing for enterprises that enter into bankruptcy or liquidation nor arrears of companies that have been disconnected.
- The indicative targets apply separately for Bulgargaz and NEK.
- A number of public or state-owned companies or entities will be excluded from the indicative targets because they are being restructured: arrears owed by the district heating companies and public hospitals will be excluded from the indicative target for Bulgargaz, and arrears owed by the railways infrastructure company (BDZ infrastructure) will be excluded from the indicative target for NEK. All other public sector entities will be included.
- The Ministry of Finance shall provide to the IMF detailed entity-by-entity data on the stock of arrears owed to Bulgargaz and NEK separately on a monthly basis. The submission shall comprise of all delinquent customers including those that are excluded for the purpose of assessing compliance with these indicative targets. In addition, the submission shall include brief explanations of actions taken by Bulgargaz and NEK against customers who have defaulted on the payment of rescheduled arrears.

INTERNATIONAL MONETARY FUND EXTERNAL RELATIONS DEPARTMENT

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Third Review and Approves US$37 Million Disbursement Under Stand-By Arrangement for Bulgaria

The Executive Board of the International Monetary Fund (IMF) has completed the third review of Bulgaria's economic performance under its Stand-By Arrangement. The decision will enable Bulgaria to draw SDR 26 million (about US$37 million) from the IMF immediately.

The two-year Stand-By Arrangement was approved on February 27, 2002 (see Press Release No. 02/12) in a total amount of SDR 240 million (about US$337 million). So far, Bulgaria has drawn SDR 136 million (about US$191 million) under the Stand-By Arrangement from the IMF.

Following the Executive Board discussion, Anne Krueger, First Deputy Managing Director and Acting Chair, said:

"Macroeconomic performance continues to be strong in Bulgaria, despite a weak external environment. The authorities' economic program, centered on the currency board and supported by a prudent fiscal policy and a strict wage policy for state-owned enterprises, has contributed to robust growth, subdued inflation, a strong external position, and, recently, a decline in unemployment. Structural reform has advanced in a number of areas, including the energy and railway sectors, tax administration and the sale of the last major state-owned bank. More decisive progress in other key areas will, however, be needed to improve the business and investment environment and ensure broad-based, sustainable growth over the medium term.

"The authorities' strong fiscal performance is commendable, and their continued commitment to a prudent fiscal policy, and its flexible implementation should the external position worsen, will help ensure that the 2003 budget deficit ceiling of 0.8 percent of GDP is observed. Anticipated spending overruns in municipalities and health care can be covered this year by an expected revenue overperformance, but more fundamental reforms will be required to address these issues in the context of the 2004 budget. Over the medium term, the strategy to balance the budget by 2005 while lowering the tax burden and allowing for higher social and EU-related spending remains appropriate. To achieve these goals, efforts to strengthen tax administration and rationalize subsidies and unproductive spending should continue.

"The sharp rise in credit to the private sector from a low base has contributed to the current strong economic performance. To ensure that the banking system remains sound, the Bulgarian

National Bank has appropriately intensified its already-strong supervision and enhanced monitoring of foreign currency lending.

"A reinvigoration of the structural reform effort will enable Bulgaria to achieve sustained robust growth and improved living standards. Reforms to improve corporate governance, strengthen the judiciary, simplify business regulations, and increase labor market flexibility will be key to attracting more investment and reducing unemployment further. Completion of the privatization program, including the privatization of the tobacco holding and telecommunications company, in an expeditious and transparent manner will also be important to strengthen investor confidence," Ms. Krueger said.

Statement by the IMF Staff Representative on Bulgaria
July 7, 2003

This statement provides information on developments since the issuance of the staff report for the second review under the stand-by arrangement for Bulgaria. This information does not change the staff's appraisal in that report.

Macroeconomic developments continue to be broadly favorable, despite a widening of the current account deficit in April.

- Preliminary data indicate real GDP growth in the first quarter of 3.8 percent. Given private sector growth of nearly 7 percent—offset by a very tight fiscal stance—and a rise in industrial output by nearly 10 percent in April over the same period last year, staff continues to view the projected 2003 growth rate of 5 percent as achievable.

- Registered unemployment continued to improve in May, with the unemployment rate declining by 0.6 percentage points over the previous month, to 14.3 percent.

- Twelve-month growth in nominal credit to the private sector and broad money accelerated slightly in May to 49 percent and 15 percent, respectively.

- Consumer prices fell by 0.6 percent in May with respect to April, somewhat less than expected, implying an acceleration in annual inflation to 1.7 percent.

- Balance of payments data for April indicate a widening in the external current account deficit from 5.5 percent of GDP to about 6.3 percent on a 12-month basis, in part due to higher interest payments. Also, a strong rise in imports—in particular of raw materials and investment goods—was partly offset by continued robust export growth, implying a modest rise in the 12-month trade deficit, from 10.4 to 10.8 percent of GDP. However, the overall balance and level of reserves were significantly better than expected.

Program implementation remains very good. Staff has confirmed that end-June performance criteria on contracting and guaranteeing public sector debt have been observed, and preliminary data indicate that the floor on the balance of the Fiscal Reserve Account has been exceeded by a large margin. The general government generated a substantial surplus through May of more than 600 million leva (1.7 percent of annual GDP), compared with an allowable deficit under the program of 103 million leva. All end-June structural benchmarks have been observed, with the exception of that on the implementation of a single taxpayer identification number. This has been largely met in practice, although required legislation has not yet been passed.

The authorities have indicated their intention to publish the staff report without deletions.