

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

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

- the staff report for the fourth review under the Stand-By Arrangement, requests for waiver of applicability of performance criteria and waiver of nonobservance of performance criterion, and request for extension of the Arrangement, prepared by a staff team of the IMF, following discussions that ended on **November 25, 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 January 15, 2004.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **February 4, 2004** updating information on recent developments.
- a Press Release summarizing the **views of the Executive Board as expressed during its February 4, 2004 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*
Memorandum of Economic and Financial Policies by the authorities of Bulgaria*

*May also be included in Staff Report

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

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

Fourth Review Under the Stand-By Arrangement, Requests for Waiver of Applicability of Performance Criteria and Waiver of Nonobservance of Performance Criterion, and Request for Extension of the Arrangement

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

Approved by Susan Schadler and John Hicklin

January 15, 2004

	Page
Contents	
Executive Summary	3
I. Introduction.....	4
II. Background and Recent Developments	4
III. Report on the Discussions.....	12
A. The Macroeconomic Outlook and Risks.....	12
B. Fiscal Policy.....	15
C. Financial Sector Policies.....	19
D. Other Structural Reforms.....	19
E. Monitoring and Review Issues.....	20
F. Data and Transparency Issues.....	21
IV. Staff Appraisal	21
Text Boxes	
1. Why is Private Sector Credit Growth Likely to Slow?.....	14
2. Alternative Measures of the Fiscal Stance.....	17
Figures	
1. Real Sector Indicators, 2000–2003	5
2. Real Sector Developments, 1999–2003	6
3. Real Broad Money and Credit Growth, 1997–2003	5
4. Money and Financial Indicators, 1996–2003.....	7
5. Composition of Current Account, 2001–2003	8

6.	External Sector Developments, 1998–2003.....	9
7.	Current Account and Credit Growth in Selected Countries, 2003 Q3	8
8.	FDI Coverage of Current Account, 2001–2003.....	10
9.	Indicators of Competitiveness, 1998–2003.....	11
10.	Baseline Medium-Term Projections, 1999–2008	13

Tables

1.	Selected Economic Indicators, 1999–2003.....	23
2.	Monetary Survey, 1999–2004.....	24
3.	Balance of Payments, 1999–2004 (in euros)	25
4.	Balance of Payments, 1999–2004 (in U.S. dollars).....	26
5.	Selected Vulnerability Indicators, 2000–2003.....	27
6.	General Government, 1999–2004 (in leva)	28
7.	General Government, 1999–2004 (in percent of GDP).....	29
8.	Macroeconomic Framework, 1999–2008	30
9.	Balance of Payments, 2001–2008 (in euros)	31
10.	Balance of Payments, 2001–2008 (in U.S. dollars).....	32
11.	External Debt Sustainability Framework, 1998–2008.....	33
12.	External Sustainability Framework—Gross External Financing Need, 1998–2008	34
13.	Public Sector Debt Sustainability Framework, 1998–2008	35
14.	Public Sector Debt Sustainability Framework—Gross Public Sector Financing Need, 1998–2008	36
15.	Schedule of Purchases Under the Stand-By Arrangement, 2002–04	37

Appendices

I.	Tentative Work Program.....	38
II.	World Bank Relations.....	39
III.	Fund Relations	46
IV.	Statistical Issues	50

Appendix Tables

16.	World Bank Operations	45
17.	ROSCs.....	48
18.	Technical Assistance, 1998–2003.....	49
19.	Core Statistical Indicators as of January 8, 2004.....	54

Attachment

I.	Letter of Intent and Supplementary Memorandum on Economic Policies of the Government of Bulgaria	55
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EXECUTIVE SUMMARY

Background: Despite increased external risks, macroeconomic developments have been generally favorable, and the program remains largely on track. In the first nine months of 2003, the economy grew at over 4 percent, supported by strong domestic demand, with average inflation at 2 percent and a declining unemployment rate. The external current account deficit has widened to over 8 percent of GDP, reflecting partly the effect on imports of very high growth in credit to the nongovernment sector. However, FDI inflows have been strong, reserves are rising, and competitiveness appears adequate. Despite the increase in credit, prudential indicators do not yet show signs of deterioration. A tight fiscal policy has helped contain this external imbalance; in the first three quarters of the year, the budget recorded a surplus of 2½ percent of projected 2003 GDP, compared to the programmed deficit for the period of 0.2 percent of GDP. While two large privatizations and some fiscal structural measures have been delayed, reforms in other areas have gained traction. The extremely low popularity level of the government, however, may affect the momentum of further reforms.

Discussions: Discussions focused on policies to contain the risks associated with the widening current account deficit and rapid credit growth, and on advancing structural reforms. The authorities indicated they would achieve a balanced budget for 2003 compared with a program deficit target of 0.7 percent of GDP. With respect to 2004, while political considerations precluded changes from the deficit target of 0.7 percent of GDP, the authorities will maintain sufficient flexibility to achieve a balanced budget should external conditions warrant. The authorities also expressed their intention to fully fund municipal mandates, a key step toward adequate fiscal decentralization that would reduce chances for spending overruns, and to take measure to restructure the railways and energy sectors to help limit subsidies. Staff registered their strong opposition to proposals to allocate resources from the Fiscal Reserve Account (FRA) to capitalize various state enterprises. In response, the authorities decided to forego capitalization of the road fund until later in 2004, and then proceed only if macroeconomic conditions permit and in consultation with staff. While noting that the increase in banking sector intermediation was a welcome development, the authorities are strengthening supervisory oversight and standards to encourage prudent lending, thus slowing down credit growth. Moreover, the government is also shifting its deposits currently in commercial banks back to the BNB. Staff urged further progress in the implementation of structural reforms, highlighting their importance in terms of reducing the strain on the budget and improving the business climate.

Staff appraisal: The response of fiscal policy to growing risks has been adequate, though not ideal. More could have been done during 2003 to constrain spending, and a neutral fiscal stance for 2004 would have been desirable. The authorities should refrain from relying on state enterprises using extrabudgetary funds to carry out public sector activities, and reinvigorate their fiscal reform program. Further impetus to complete the remaining fiscal and structural reforms should spur growth and enhance readiness to join the EU. Measures introduced by the authorities to maintain the health of the banking system are commendable.

I. INTRODUCTION

1. **A staff team¹ visited Sofia during November 12–25, 2003 to conduct discussions on the fourth and final review under the Stand-By Arrangement (SBA).** The two-year arrangement for SDR 240 million (37 percent of quota) was approved on February 27, 2002. Seven of nine planned purchases totaling SDR 188 million have been made to date, and an additional SDR 26 million would become available upon completion of this review. The authorities have indicated their interest in a successor precautionary SBA, and discussions could begin in March 2004, following the preparation of an ex post assessment of Bulgaria's experience as a prolonged user of Fund resources.
2. **The program remains largely on track, but there have been slippages in certain areas.** All performance criteria under the program have been met with the exception of the end-September and likely end-December performance criterion on tax arrears collection by the General Tax Directorate (GTD) (Tables 1–2 of Attachment I). Several indicative targets on arrears to the electricity company (NEK) were missed as well [¶ 2].² Most structural benchmarks have been met, but end-September and end-December benchmarks related to tax administration and expenditure management reforms were not fully observed.
3. **Weak popularity and an erosion of the coalition's cohesion has complicated implementation of the government's economic program, but the political situation remains stable.** Following the poor performance of the senior coalition member in recent local elections, the junior party—mainly representing the Turkish minority—has stepped up demands, including for additional budget expenditures. Nevertheless, the government has succeeded in maintaining a tight fiscal stance and in advancing several difficult reforms. Further, there appears to be little appetite across the political spectrum for early elections, and a consensus to maintain the currency board arrangement (CBA) and advance the EU accession process should help ensure that policies remain broadly on track.

II. BACKGROUND AND RECENT DEVELOPMENTS

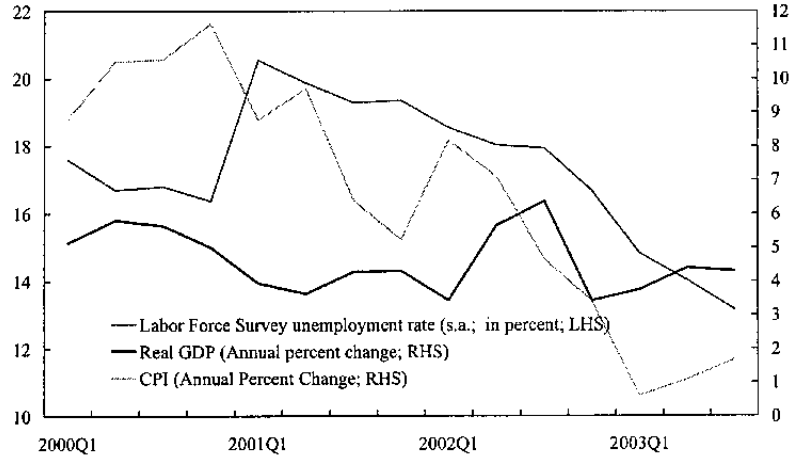
4. **Macroeconomic developments have been generally favorable, but external risks have increased.**

¹ Messrs. Schiff (head), Duenwald, Egoumé-Bossogo, and Joshi (all EUR), Mr. Pitt (PDR), and Mr. Roaf (Resident Representative). The mission met with the Prime Minister, key economic ministers, the Governor of the Bulgarian National Bank (BNB), parliamentarians, and representatives of trade unions and the private sector, and coordinated its work with World Bank staff. Mr. Yotzov (OED) also participated in some of the meetings.

² Numbers in brackets refer to SMEP paragraphs.

- Economic activity remains robust and inflation low (Table 1, Figures 1–2).** Real GDP growth reached 4¼ percent in the

Figure 1. Real Sector Indicators, 2000-2003

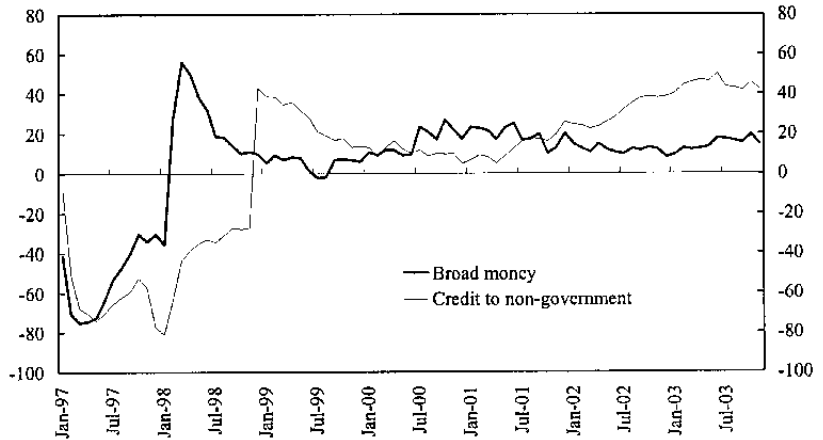


first three quarters of 2003, led by a sharp increase in private consumption and investment. Monthly data on industrial production and sales suggest that growth may have accelerated in the last quarter of 2003. The unemployment rate has continued its decline, reaching

13.2 percent in November 2003. Meanwhile, while year-on-year growth in the CPI rose to 5 percent in November, reflecting a jump in food prices, inflation averaged 2 percent in 2003 (year-to-date), helped by the appreciation of the euro against the U.S. dollar.

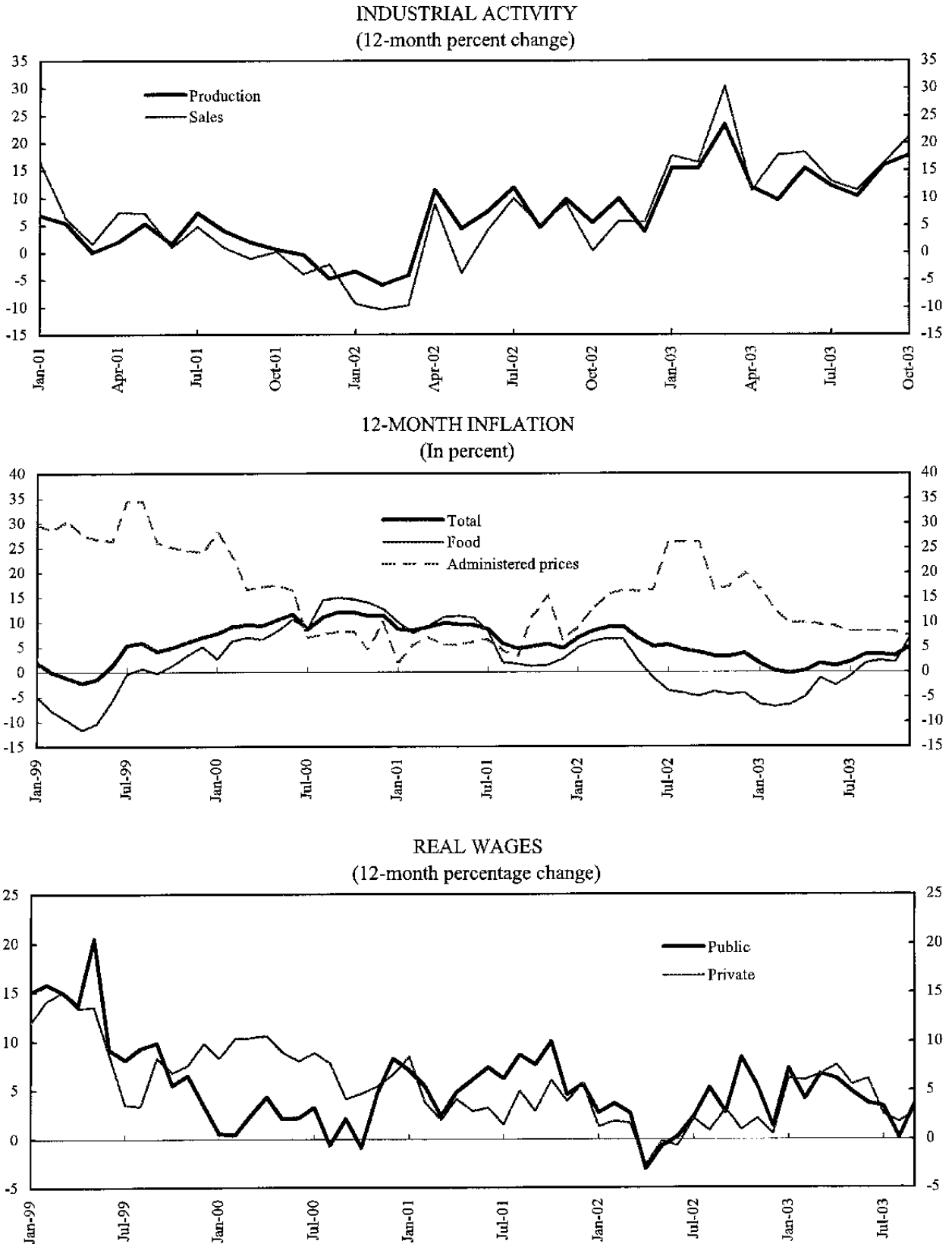
- Private sector credit growth remains very strong (Table 2, Figures 3–4).** Growth in bank claims on the nongovernment sector eased slightly in November, but remained very high at 42½ percent year-on-year in real terms. In the 12 months to November, claims have jumped by over 7 percentage

Figure 3. Real Broad Money And Credit Growth, 1997-2003 (Year-on-year percent change)



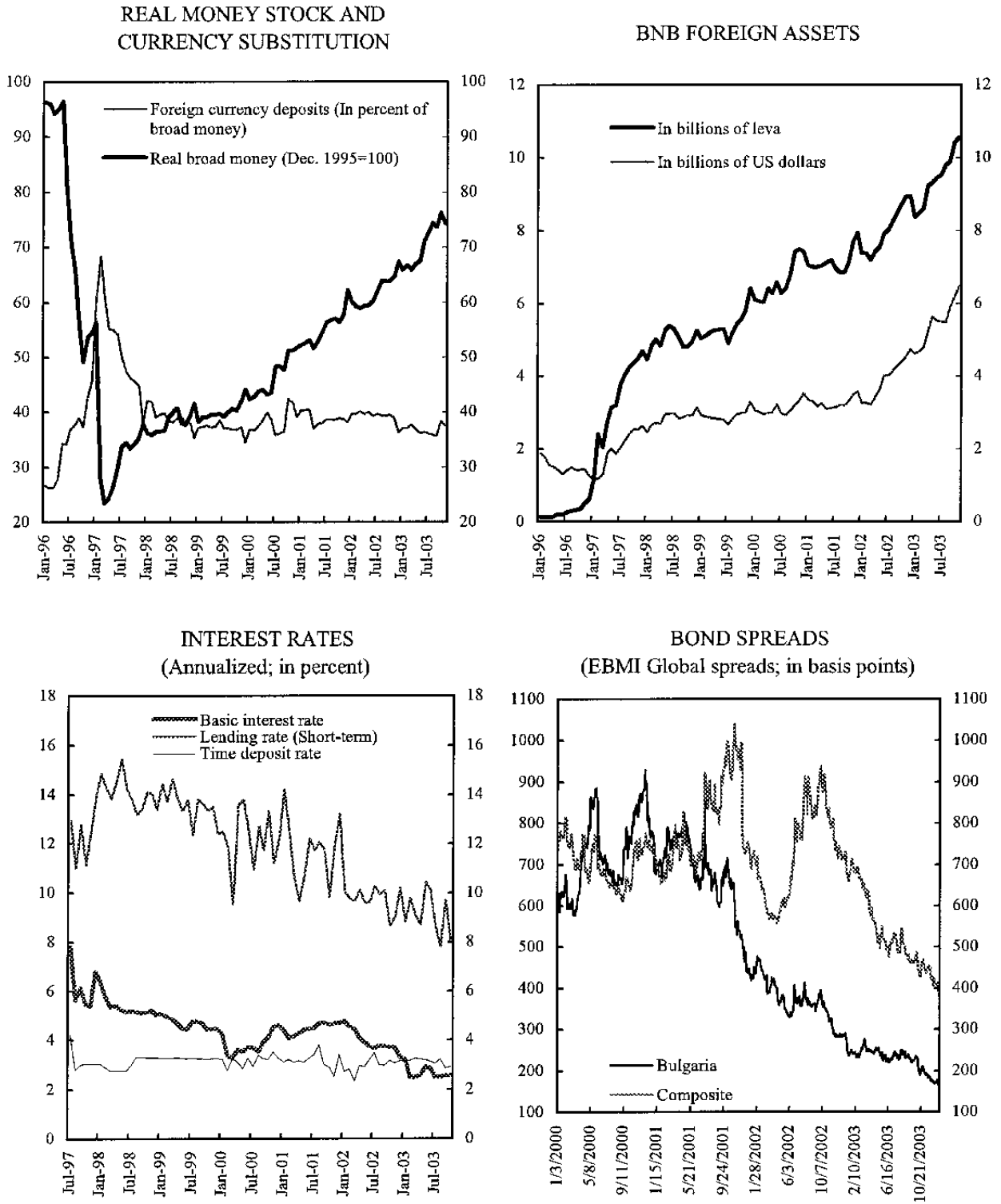
points of estimated 2003 GDP to 26.4 percent, with household credit—both mortgage and consumer loans—being the most dynamic component. Prudential indicators—though admittedly providing lagging signals of asset quality—do not yet show signs of deterioration, and banks are reporting strong profits.

Figure 2. Bulgaria: Real Sector Developments, 1999-2003



Source: Bulgarian Authorities; and Fund staff estimates and projections.

Figure 4. Bulgaria: Money and Financial Indicators, 1996-2003



Source: The Bulgarian National Bank; Bloomberg; and Fund Staff calculations.

• **The external current account deficit has widened**

(Tables 3–4, Figures 5–6). The

twelve-month external current account deficit (in euro terms) increased to nearly 8½ percent of GDP in October, due mainly to a credit-induced import boom. Broadly similar trends have

been observed in a number of other transition countries (Figure 7). Driven by both consumer and investment goods, as well as high oil prices, merchandise imports rose 17 percent in the year to October, outpacing export growth of 11 percent. In addition, the income balance deteriorated, reflecting higher profit remittances.

The current account deficit is likely overestimated, but the extent of overestimation is not clear and, in any case,

the trend in the external balance is clearly a source of concern.³

Figure 5: Composition of Current Account, 2001-03

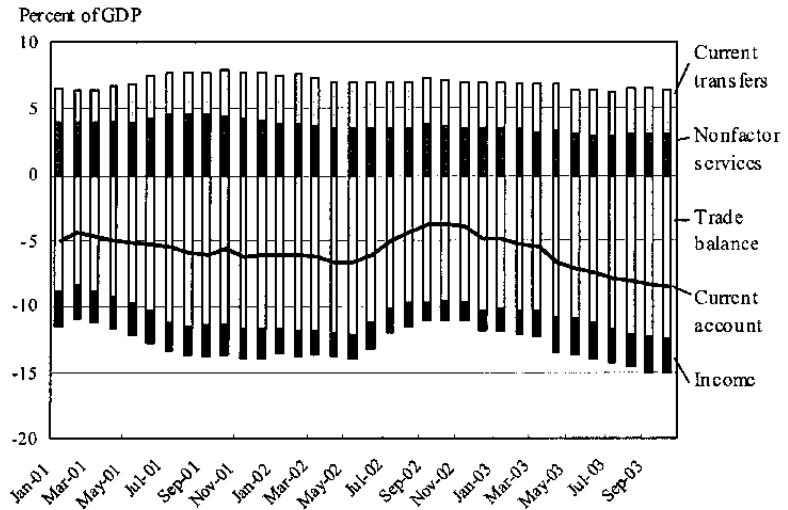
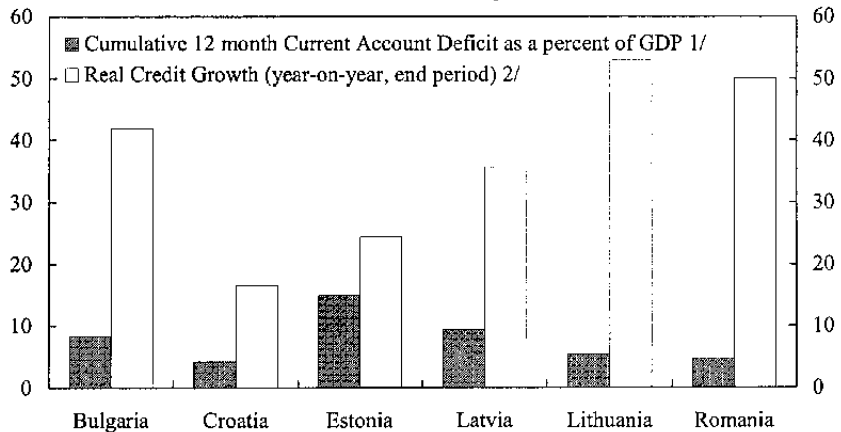


Figure 7: Current Account and Credit Growth in Selected Countries, 2003 Q3

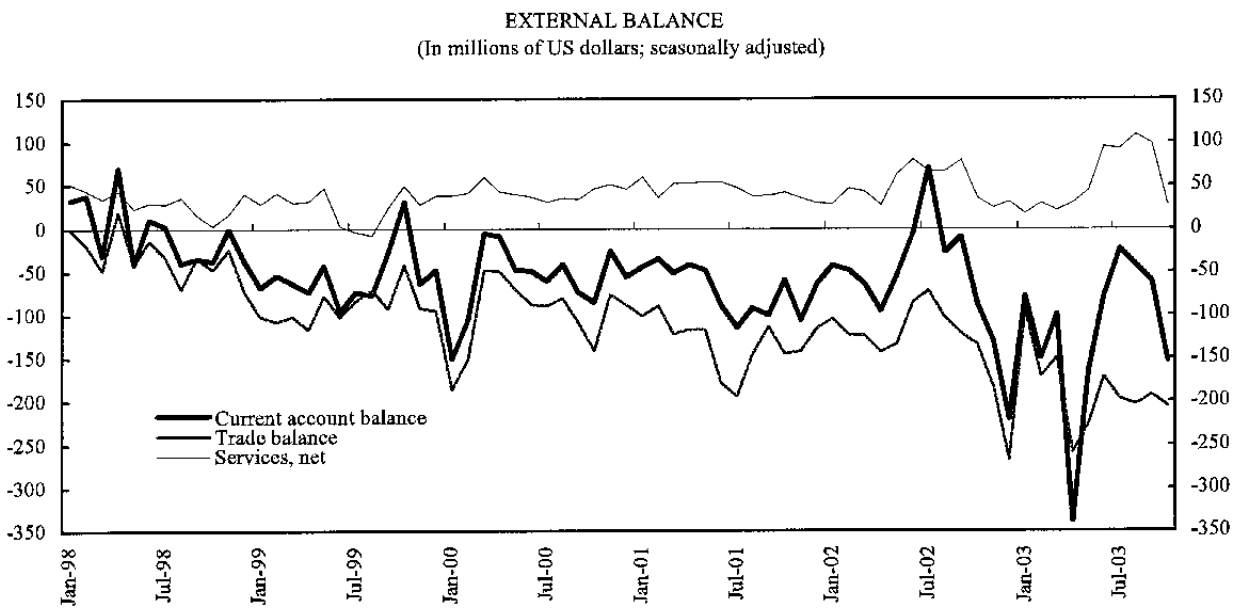
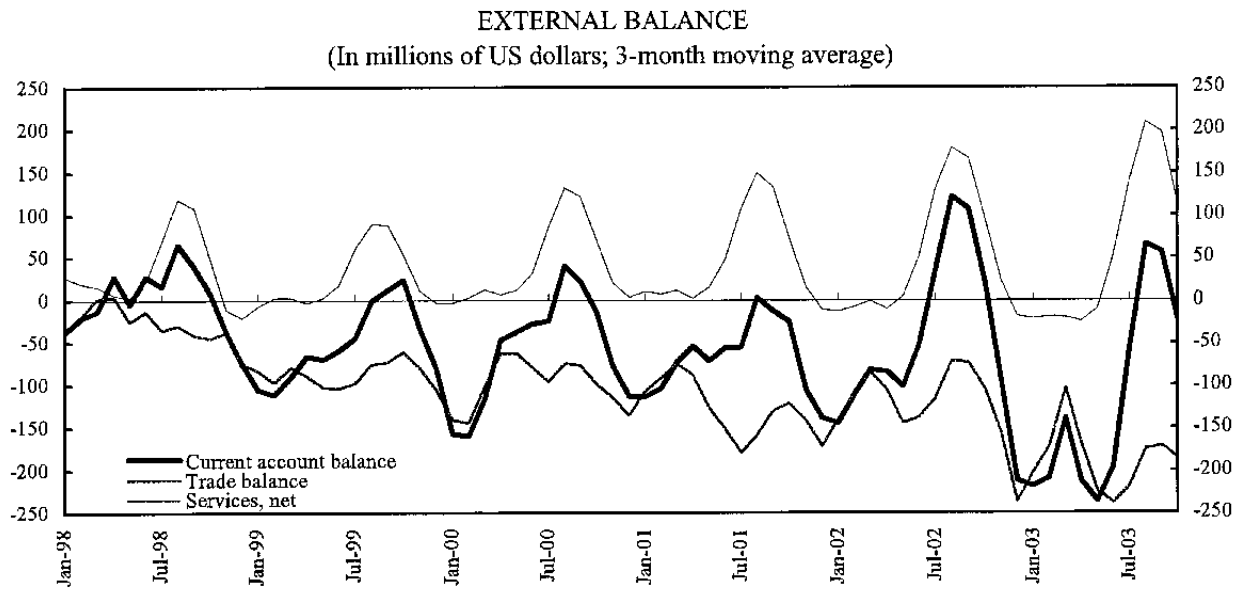


1/ Lithuania data is Q2.

2/ Credit to nongovernment.

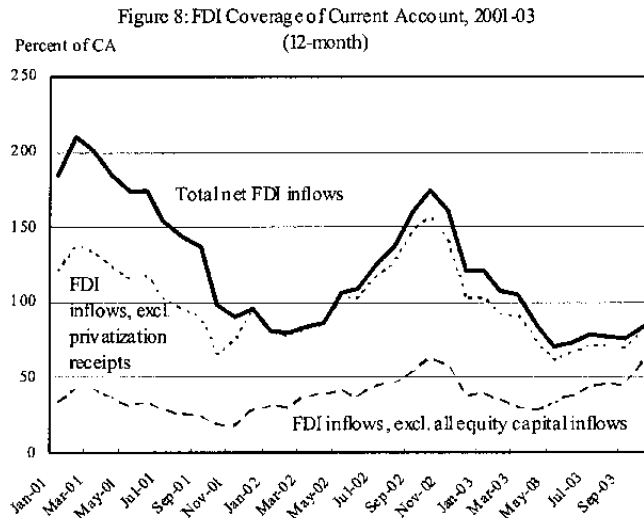
³ The method used by the authorities to compile tourist revenues—based on estimated U.S. dollar receipts per traveler (broadly unchanged since 1999)—risks underreporting in times of a weak dollar. Overall, staff believes that tourism revenue in the 12 months through September may be underestimated by about 1½ percent of annual GDP, although this is about double the positive errors and omissions to date.

Figure 6. Bulgaria: External Sector Developments, 1998-2003



Source: Bulgarian Authorities; and Fund staff estimates.

- **However, FDI inflows have been strong, reserves are rising, and competitiveness appears adequate.** FDI has covered 84 percent of the current account deficit in the twelve months to October (Figure 8). For the year as a whole, coverage of 87 percent is expected, with non-privatization related inflows covering about two-thirds. The stronger-than-

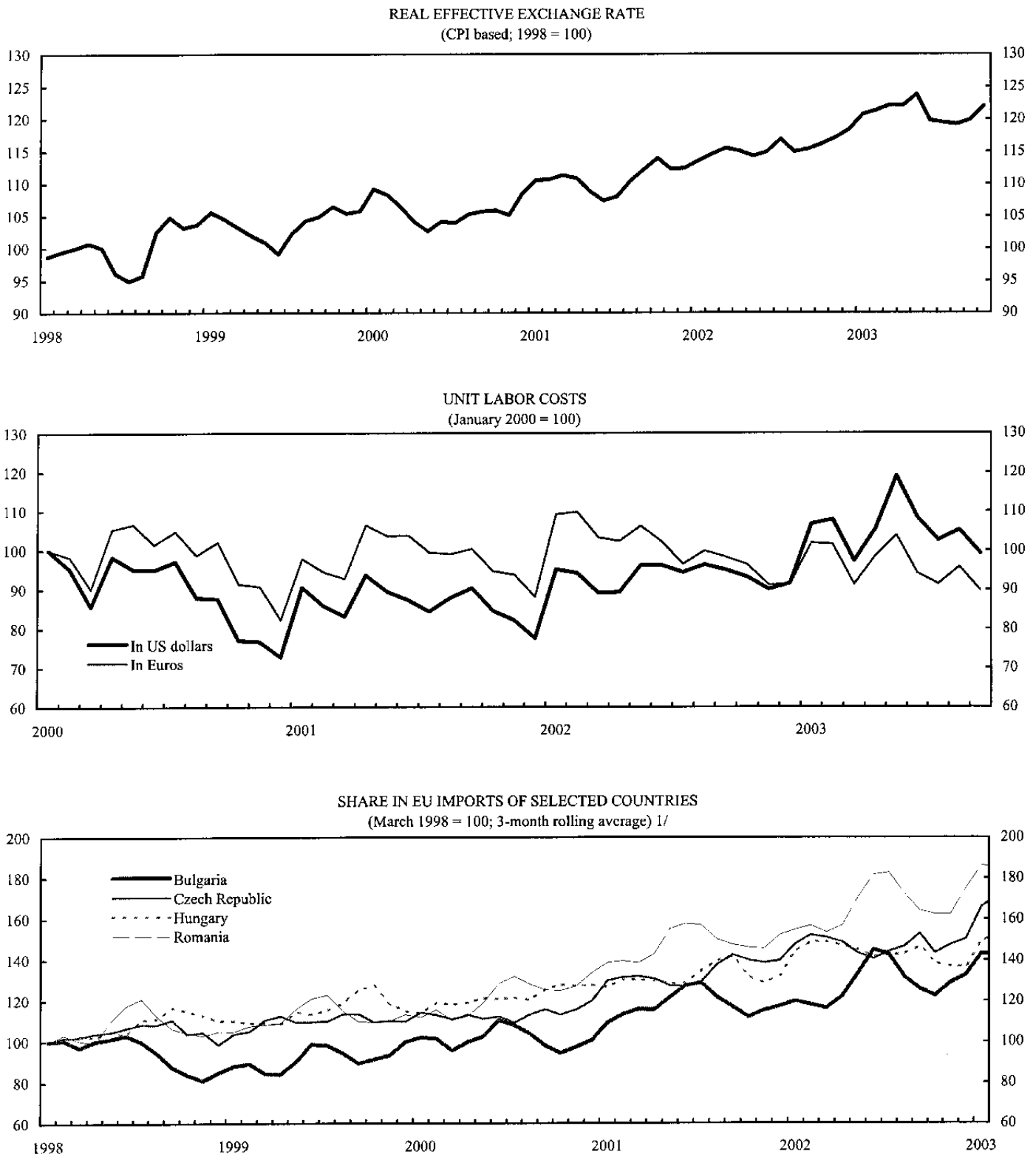


expected FDI, combined with commercial banks' repatriation of foreign assets and other private sector inflows allowed gross international reserves to rise to € 5.3 billion at end-October, well above programmed levels and more than twice the stock of short-term external debt. Gains in EU market share and modest wage increases suggest that Bulgaria has maintained its competitiveness but, in light of the growing current account deficit and the euro's sharp appreciation, this warrants continued scrutiny (Figure 9). Financial market confidence remains strong, as evidenced by the continued decline in spreads on the Bulgaria component of the EMBI+ index to about 160 basis points (Table 5).

5. **Fiscal policy has been tight, helping to contain the external imbalance.** In the first three quarters of the year, the budget recorded a surplus of 2½ percent of projected 2003 GDP, significantly better than the programmed 0.2 percent deficit for this period (Tables 6–7). Two-thirds of the overperformance was due to higher-than-expected tax revenues, as the surge in imports boosted collections of VAT, customs duties, and excise taxes. The remainder of the overperformance is attributable to higher nontax revenues, as well as savings on discretionary and interest expenditures, which offset spending overruns on health care. Preliminary data indicate that the surplus remained at about 2½ percent of GDP through November .

6. **Progress on structural reforms has been good.** The authorities completed the sale of the last major state-owned financial institution, DSK Bank. However the privatization of two key large state enterprises—BTC and Bulgartabac—has not been finalized. In the fiscal area, the authorities are strengthening tax administration and improving budgeting and expenditure management, but there have been implementation delays. Energy sector reforms

Figure 9. Bulgaria: Indicators of Competitiveness, 1998-2003



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

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

have continued, and some progress has been made in railways restructuring. Efforts to improve the business climate have gained traction, with key steps to strengthen the judiciary and rationalize licensing and regulatory regimes. Finally, the role of the National Health Insurance Fund (NHIF) in financing hospital care has been raised as planned, which should increase efficiency.

III. REPORT ON THE DISCUSSIONS

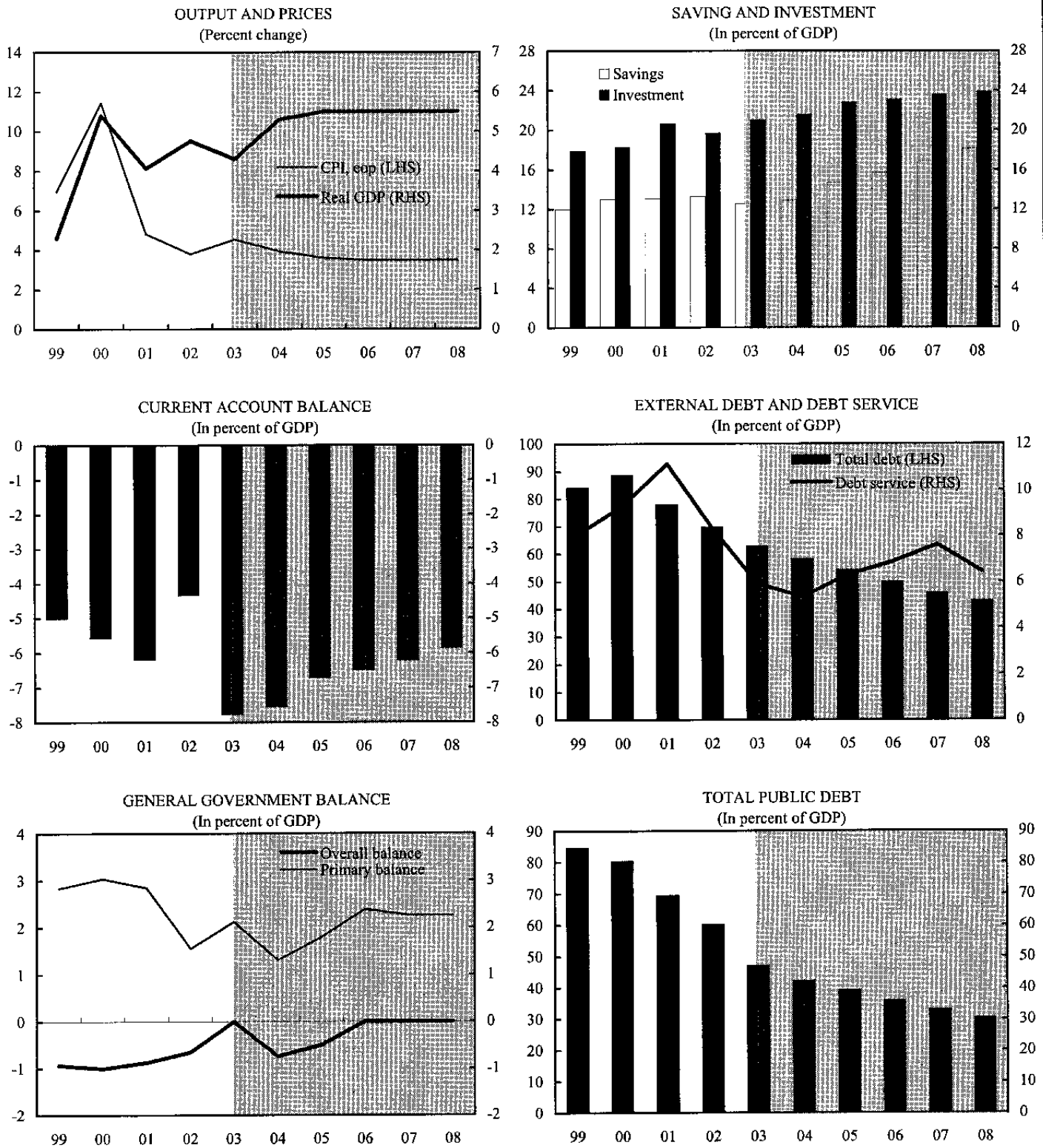
7. **Discussions focused on policies to contain the risks associated with the widening external current account deficit and rapid credit growth, and on advancing structural reforms.** While macroeconomic conditions are expected to remain favorable, a further widening of the current account deficit—perhaps fueled by continued rapid credit growth—or a slowing of non-debt creating inflows, could reverse the positive external debt dynamics of recent years and weaken confidence in the CBA. Further, while prudential indicators remain sound, continued rapid credit growth would threaten banking sector health. Discussions focused on policies to limit vulnerability to these risks: (i) fiscal policy in 2003–04; (ii) measures to reduce credit growth and ensure the continued good health of the banking system; and, (iii) structural reforms needed to ensure strong FDI and medium-term fiscal sustainability.

A. The Macroeconomic Outlook and Risks

8. **Assuming continued sound economic policies, macroeconomic performance is expected to remain favorable and the external position sustainable.** Staff and the authorities had a common view of the macroeconomic framework and key risks (Table 8, Figure 10).

- Real GDP growth likely reached about 4¼ percent in 2003, and is projected to pick up to 5¼ percent in 2004 as the global economy strengthens. Growth should reach its potential of 5½ percent in the medium term, helped by the completion of economic restructuring, increased employment, and a gradual rise in the credit-to-GDP ratio.
- Average consumer price inflation is forecast to increase to around 5 percent in 2004, reflecting adjustments in administered prices and excise taxes. Over the medium term, Balassa-Samuelson effects are likely to keep inflation above EU levels.
- Growth in bank claims on the nongovernment sector is projected to decline to around 20 percent in real terms by end-2004 (see Box 1).

Figure 10. Bulgaria: Baseline Medium-Term Projections, 1999-2008 1/



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

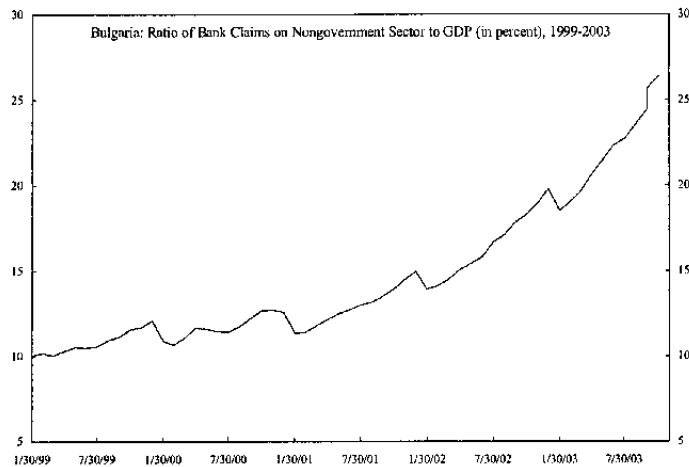
1/ 2003 onward: projections.

Box 1. Why is Private Sector Credit Growth Likely to Slow?

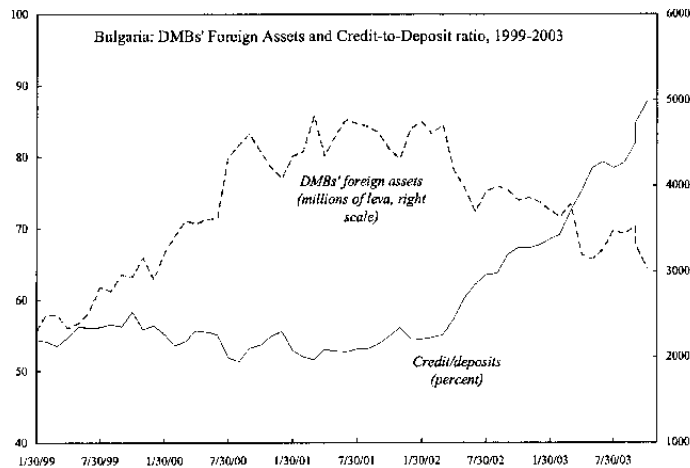
The rapid expansion of credit by the commercial banks in the last two years largely represents a “catching up” following the 1996/97 crisis.

While credit has more room to grow, the pace of growth is likely to slow in the period ahead. Bulgaria’s credit-to-GDP ratio is still low, and some large banks could continue to expand their credit portfolios rapidly. However, a number of factors should contribute to slowing credit growth:

- Since mid-2003, the BNB has been implementing measures to strengthen bank supervision (see paragraphs 18–19).
- Staff discussions with banks revealed that most aim to reduce loan portfolio growth in 2004. Some banks are beginning to run out of funding sources, as deposit growth has not kept pace with credit growth and the repatriation of foreign assets will slow as international interest rates rebound.



- The planned transfer of government deposits and deposits of the Bank Consolidation Company from commercial banks to the BNB would reduce banking sector deposits by about 2¼ percent. In addition, consistent with their overall strategy to increase the share of domestic debt in total debt, the government plans a net domestic bond issuance of 450 million leva. These bonds would be mostly absorbed by banks, and represent about 5 percent of commercial bank claims.



- The external current account deficit is expected to narrow modestly in 2004 to 7½ percent of GDP (Tables 9–10) as import growth moderates owing to lower credit growth and export growth responds to a recovery in the EU and the lagged effect of the improved FDI performance in 2003. FDI inflows in 2004 are conservatively projected to cover 76 percent of the current account deficit, contributing to a further

small increase in international reserves. Over the medium term, the current account deficit is expected to decline gradually, reflecting, in part, a rise in private savings towards levels in other Central and East European countries as incomes rise and financial intermediation deepens. FDI inflows are conservatively projected to decline gradually as a percent of GDP, but prospective accession is likely to keep them strong in absolute terms, similar to the experience of other EU accession candidates. Combined with the expected increased EU transfers, this would allow gross international reserves to remain at a comfortable level and the external debt-to-GDP ratio to decline to below 50 percent by 2007.

9. **This favorable scenario is subject to downside risks.** The key risks are that (i) credit growth will not slow as expected, leading to higher current account deficits, and threatening banking sector health, and (ii) FDI will not develop as expected, for example if investors react to further setbacks in the high-profile privatizations. While in the near term the international reserves position would be strong enough to absorb the additional external financing needs associated with a moderate adverse scenario, confidence in the CBA could be shaken and a fiscal policy response would be needed. Over the medium term, the positive debt dynamics of recent years could slow or reverse, raising questions of sustainability.

10. **Despite the recent deterioration in the external position, the medium-term current account appears sustainable.** First, as noted, the current account deficit may well be significantly overestimated. Second, under the baseline scenario, total gross external debt declines from the current 63 percent of GDP (in U.S. dollar terms) to 43 percent of GDP by 2008, with public debt showing a similar trend (Tables 11–14). Net external debt is projected to decline to below 20 percent in the medium term. Further, the projected 2008 current account deficit would be well below the level required to stabilize gross external debt. Moreover, the debt sustainability analysis shows that in virtually all scenarios, Bulgaria's total external debt-to-GDP and public debt-to-GDP ratios would decline over the medium term. These positive projections could be threatened by a combination of faster-than-expected credit and import growth and lower FDI inflows, which would dampen export growth and require higher debt financing. Under such a scenario (see country specific scenario in Table 11), the external debt-to GDP ratio would decline only marginally .

B. Fiscal Policy

11. **In light of the external risks, staff urged the authorities to target a balanced budget or small surplus in 2003 and 2004.** In 2003, the external current account deficit had been significantly larger than projected, despite a very tight fiscal stance. The program deficit target of $\frac{3}{4}$ percent of GDP would have allowed a major fiscal expansion in the fourth quarter of the year adding pressures on the external position. A significant overperformance was therefore appropriate and—given better-than-expected revenue performance—achievable. For 2004, staff argued that a broadly neutral fiscal stance—another balanced budget—would be desirable, given that significant external pressures are expected to remain.

12. **The authorities vowed to save a significant share of the fiscal overperformance to date, generating a balanced budget in 2003** [¶ 4]. This implied dedicating almost all of the projected annual revenue overperformance to deficit reduction, as any additional unbudgeted spending would be offset by expenditure savings elsewhere. Staff supported plans to fully fund municipal mandates and clear overruns on medicine reimbursements and some hospital arrears but questioned the appropriateness of one-off increases in pensions and wages (costing ½ percent of GDP). Staff also pressed the authorities to put in place measures to prevent a recurrence of hospital arrears, as a prerequisite for clearing them (see paragraph 15). Revenue projections for 2003 appeared conservative and staff pressed the authorities to accumulate a small surplus in the remainder of 2003 should revenue overperformance exceed expectations. However, the authorities were noncommittal on this point.

13. **For 2004, the authorities insisted that a revision to the budget deficit of ¾ percent of GDP was not feasible politically but stated they would maintain sufficient flexibility to achieve a balanced budget if external conditions warrant.** In particular, the authorities will maintain spending at 93 percent of budgeted levels for the first three quarters of the year, providing flexibility of about 1 percent of GDP should the external position fail to improve [¶ 10].⁵ In addition, the budget incorporates contingencies equal to 0.6 percent of GDP. Finally, revenue projections appear conservative and the government is committed to saving most of any overperformance, unless external conditions improve significantly.

14. **The fiscal stance proposed for 2004 is less ambitious than optimal but sufficiently prudent given the built-in flexibility.** The budgeted fiscal stance is modestly expansionary compared with the expected 2003 outcome, in particular in light of the somewhat faster growth anticipated in 2004 (Box 2). However, the various contingencies imply that the fiscal stance will—as in the past several years—be significantly tighter than budgeted for at least the first nine months of the year. The authorities' strong track record of responding flexibly to shocks provides assurance that such a fiscal stance would be maintained if necessary.

15. **The 2004 budget includes a number of significant structural improvements, but could have gone farther in curtailing less productive spending.**

- **On spending,** the budget provides for full funding of municipal mandates (additional spending of ½ percent of GDP relative to the 2003 budget) [¶ 12]. This is a key step toward adequate fiscal decentralization and reduces the chances for spending overruns. In addition, restructuring in the railways and energy sectors is generating savings in subsidies.

⁵ In contrast to past practice, this rule is applied to all budgeted spending, including from spending units' own revenues, via the Treasury Single Account.

Box 2. Alternative Measures of the Fiscal Stance

The fiscal stance in Bulgaria can be examined in a number ways. In particular, several operations classified as below-the-line likely have a similar macroeconomic effect as expenditure. At the same time, transfers to the second pillar of the pension fund imply lower public savings but an equivalent rise in private savings, and therefore should have no impact on aggregate demand. Taking into account these effects, it appears that the budgeted 2004 fiscal stance is slightly expansionary relative to the projected outcome for 2003, but neutral relative to the 2003 budget.

	2003 Budget	2003 Projection	2004 Budget
	(In percent of GDP)		
Total revenue	36.1	36.8	35.2
Total Expenditure	36.8	36.8	36.0
<i>Of which,</i>			
Transfer to the second pillar of the pension system	0.2	0.2	0.3
Below-the-line (B-T-L) operations 1/	0.4	0.4	0.5
Fiscal deficit	-0.7	0.0	-0.8
Fiscal deficit including B-T-L operations and excluding transfer to second pillar	-0.9	-0.2	-1.0

1/ Below-the-line operations in 2004 exclude the planned transfer to the road enterprise, which is unlikely to take place in 2004.

- However, the **wage bill** is projected to rise by 14½ percent relative to the 2003 budget, reflecting an 11 percent increase in the average wage and a rise in average government employment by 3 percent. Staff stressed that, while wages were low, the envisaged rise appeared excessive in the current macroeconomic environment. Moreover, the rise in employment—albeit modest—runs counter to the authorities' vision of a small and well-trained civil service.
- With regard to **tax policy**, a reduction in the corporate tax rate from 23½ percent to 19½ percent and a cut in the personal income tax rate for the lowest income bracket will improve incentives to work and invest.
- On **pensions**, contributions to the second pillar increase from 2 to 3 percentage points (costing an additional 0.1 percent of GDP), an important step toward making the second pillar sustainable. However, average pensions will rise by 12½ percent

compared with the 2003 budget—the combined impact of a 5.8 percent increase in mid-year and a rise in the pension ceiling from low levels.

- On **health care**, the share of hospital spending covered by the NHIF will increase to 45 percent in 2004 [¶ 13]. In addition, the authorities' plan to finance all hospitals on a fee-for-service basis, which, combined with allowing patients to choose their preferred hospital, should lead to a rationalization of the hospital system and reduced opportunities to incur arrears. However, the system remains in transition and implementation of the new financing plan may be problematic.

16. **The 2004 budget also would allow increased reliance on state enterprises, which represents a step in the wrong direction.** In particular, the budget sets aside up to 500 million leva (1¼ percent of GDP) of Fiscal Reserve Account (FRA) resources for the capitalization of a state highway enterprise, which would engage in joint ventures with commercial enterprises for road construction. While agreeing that infrastructure investment is needed, staff objected to the proposed capitalization, pointing both to its potential macroeconomic impact as well as its lack of transparency. Staff also questioned whether joint ventures were the best approach to road construction, citing the possibility of sizable contingent liabilities to the government. In response, the authorities indicated they would forgo any capitalization of this enterprise until at least the second half of the year and then proceed only if macroeconomic conditions allow and in consultation with staff [¶ 9]. The release of these resources is also dependent on the findings of a World Bank review paper of expenditure needs and priorities in the road sector. The budget also envisages the creation of a forestry enterprise and several smaller enterprises which would also be capitalized by FRA resources (totaling ½ percent of GDP). Staff expressed its concern that a proliferation of such public entities would undermine expenditure control and reverse gains over the last several years in fiscal transparency. In addition, the staff continues to be of the view that FRA resources should be used primarily for debt reduction.

17. **Structural reforms in the fiscal area—critical to the ability of the government to carry out its medium-term strategy—have had mixed results.** Regarding the National Revenue Agency (NRA)—the cornerstone of efforts to improve tax administration—a regional pilot project has been successfully implemented but there have been delays in choosing an information technology system (both measures are part of an end-September structural benchmark). This delay could lead to lags in implementation, but the authorities continue to aim at having the NRA fully operational by January 2005 [¶ 11]. In addition, the introduction of the Bulstat number as the single identifier for all tax purposes (a June 2003 benchmark) has still not been implemented, and necessary legislation is expected to be passed only in April. The authorities are extending program budgeting to more ministries. However, progress on improving expenditure management has been limited, as two structural benchmarks were missed or very likely missed: the end-September 2003 benchmark expanding coverage of the Treasury Single Account, and the end-December 2003 benchmark on the implementation of Financial Management Information System (FMIS) fully operational within the Ministry of Finance. These slippages reflect mostly technical difficulties, and the authorities are making efforts to address delays.

C. Financial Sector Policies

18. **Discussions focused on strengthening ongoing efforts to tighten banking supervision and slow credit growth** [¶ 15]. Staff and the authorities agreed that the increased banking sector intermediation was largely welcome. However, staff emphasized the need to limit credit growth and the associated macroeconomic risks and continue to enhance banking supervision. The BNB broadly concurred, but stressed that overall banking soundness was strong and unlikely to deteriorate significantly, and took comfort in the fact that the banking system was virtually fully private and largely foreign-owned, and that risk management practices—including for consumer credit—were generally consistent with good international practices. They also noted that with recent changes in banking legislation, they were now better able to monitor bank ownership and therefore to limit risks from insider lending. Nevertheless, they consented to take expeditiously several additional measures, including removing the reporting floor for the credit registry—which had exempted most consumer lending—and reducing the test period for classifying loans as “loss” from 120 days to 90 days (the announcement of which is a prior action for Board consideration of the review). While the latter measure is relatively stringent, it is aimed at addressing the particularly rapid expansion in short-term consumer credit. They have also postponed plans to reduce banks’ reserve requirements to levels more in line with EU countries. Both staff and the authorities project that these measures would contribute to a slowing of credit growth. However, should credit growth fail to slow, the BNB will continue to apply the measures envisaged in its strategy, including as a last resort to increase liquidity requirements on a bank-by-bank basis.

19. **The government is also addressing the need to contain credit growth in its asset management.** The government has begun returning the deposits it shifted to commercial banks in mid-2003 to the BNB, which should contribute to containing bank lending. It has committed to returning the remaining deposits as they mature, or more rapidly if necessary, and will not repeat similar operations in 2004 [¶ 16]. More generally, the BNB and the Ministry of Finance have formalized their agreement to improve coordination and transparency of the management of FRA resources [¶ 16].

20. **The broad objectives of external asset and liability management remain to reduce vulnerability and deepen the domestic securities market.** In line with its debt management strategy adopted in March 2003, the government has continued to expand domestic debt issuance and to monitor international market developments for opportunities to achieve a more balanced interest and currency composition of the public debt [¶ 17]. The authorities will also likely use a portion of the ample FRA resources to reduce external debt via early debt retirement or buybacks, which could also address the lump in debt service projected in 2007.

D. Other Structural Reforms

21. **The authorities recognize the need to complete privatization and continue reforms in the energy and railways sectors.** While Bulgaria has largely completed the

privatization of non-infrastructure SOEs, as well as banks and insurance companies, the privatization of BTC and Bulgartabac have not been concluded. Staff pressed for the quick and transparent completion of these sales, noting that these delays have negatively affected investor confidence. The government reaffirmed its intention to finalize the sale of BTC to the winning bidder in the near term. In addition, a new strategy to sell individual units of Bulgartabac seems more likely than previous approaches to succeed. [¶ 21]. Energy sector reforms have continued, including by restructuring district heating companies, beginning the process of privatizing electricity distribution companies, and passing the new Energy Law. With World Bank assistance, the restructuring of the railways is also progressing, with cuts in loss-making lines and reduced staffing. However, staff emphasized the need for an explicit political decision on the scope for social activities to be carried out by the railways and subsidized by the government, allowing the railway to operate on a commercial basis [¶ 20].

22. **Progress has been made in establishing a market-friendly business environment, a key to achieving sustainable inflows of FDI [¶ 19].** The government has streamlined regulatory regimes and introduced guidelines on the creation of new regimes. Notable progress has also been made in reforming the judiciary, although sustained efforts over a number of years will be required. The authorities appear to have abandoned plans for more active government involvement in the productive economy, including through publicly-financed equity funds and targeted tax exemptions.

23. **The authorities recognize the need for prudent incomes policies and flexible labor markets in the context of the CBA.** The imposition of hard constraints on the wage bill of key state enterprises has encouraged restructuring and helped moderate economy-wide wage increases. The ceiling on the wage bill of 60 closely monitored state enterprises (a performance criterion) has been consistently observed, and the 2004 incomes ordinance envisages continued tight limits [¶ 21]. The authorities view active labor market programs as a key to reducing unemployment. While they remain committed—in the context of the World Bank PALs—to amending the Labor Code to promote flexible forms of employment and reduce hiring and dismissal costs, ongoing discussions with social partners have not achieved significant progress.

E. Monitoring and Review Issues

24. **Staff supports the authorities' requests for a waiver of applicability for two end-December 2003 PCs and a waiver of the likely non-observance of the end-December 2003 PC on the reduction of tax arrears.** The waiver of applicability for the end-December 2003 performance criteria on the overall fiscal deficit of the general government and the limit on the growth of the wage bill for 60 monitored state-owned enterprises can be supported on the basis that we are fully confident that they have been observed. The waiver for the likely non-observance of the PC on collection of tax arrears by the GTD can also be supported since the expected deviation is largely due to the delay in privatizing Bulgartabac (from which arrears payments were anticipated), and because revenue performance overall has been better than expected. Finally, staff supports the

extension of the SBA to March 15, 2004, so that all necessary data to confirm observance of end-December 2003 PCs can be collected and the final tranche under the program drawn.

F. Data and Transparency Issues

25. **The authorities have further improved data quality.** In December 2003, Bulgaria became a subscriber to the SDDS, and a data quality ROSC was completed and posted on the Fund's website. The authorities are also making progress in implementing the outstanding safeguard assessment recommendations [¶ 18].

IV. STAFF APPRAISAL

26. **Bulgaria's macroeconomic performance in the face of the prolonged slowdown in the EU has been impressive, but risks have intensified.** The solid growth posted in recent years, along with a sharp decline in unemployment and a dramatic rise in financial intermediation, reflect the strong macroeconomic policies and broad structural reforms implemented since 1997. In this context, however, the economy faces a new set of challenges which urgently need to be addressed. Strengthened domestic demand, fueled by rapid credit growth, has put increased pressure on Bulgaria's external position, requiring a continued tight and flexible fiscal policy and the strengthening of already sound banking supervision. At the same time the need to attract solid FDI inflows and ensure the viability of the government's medium-term fiscal strategy underline the importance of completing key structural reforms.

27. **The response of fiscal policy to these risks has been adequate, though not ideal.** While fiscal adjustment during much of 2003 helped contain the widening of external imbalances, and a balanced budget was likely achieved for the year, it would have been preferable to err on the side of caution by doing more to constrain spending. The fiscal stance envisaged in the 2004 budget is mildly expansionary, which is regrettable. However, the authorities have committed to maintaining a significantly tighter fiscal stance should external conditions fail to improve, and the tools at their disposal as well as their strong track record provide comfort that such commitments can be met. Further, by fully funding local government mandates and increasing the role of the NHIF in financing hospital care, the government has limited the scope for spending overruns. However, the significant rise in the wage bill and the increase in public employment planned for 2004—although both from moderate levels—are not fully appropriate in light of macroeconomic pressures and represent a move away from the government's vision of a small and efficient public sector.

28. **Plans to increase reliance on state enterprises to carry out public sector activities are worrying.** The scheme to capitalize a state highway enterprise with FRA resources to the tune of 1¼ percent of GDP is not appropriate in the current macroeconomic environment. Further, international experience suggests that the sort of joint ventures envisaged have a number of potential pitfalls, so that the proper mode for road construction would need to be considered carefully. Staff welcomes the decision to put this plan on hold until macroeconomic risks are under firmer control and more analysis of investment needs is carried out. More generally, however, staff strongly urges the authorities to carry out all such

activities transparently within the budget framework, and to avoid a proliferation of such state entities.

29. **The authorities need to attach greater priority to fiscal reform.** The government's medium-term fiscal strategy relies to a significant degree on the ability to improve tax administration and enhance the efficiency of public spending. In this context, staff urges the authorities to make a major push during 2004 to ensure that the NRA is operational by 2005 as planned. Similarly, while the expansion of program budgeting holds promise for improving the allocation of public resources, it is also important that the government overcome technical obstacles to the implementation of the FMIS and the expansion of the Treasury Single Account to the entire general government.

30. **The authorities have taken the right approach to addressing the rapid growth in private sector credit.** The initial focus by the BNB on more intensive surveillance of aggressive banks has been appropriate. Staff also welcomes more recent steps, including tightening the definition of bad loans and expanding the coverage of the credit register, which should help to contain lending and support the continued health of the banking system. Moreover, commitments to take additional specific measures should credit fail to slow provide further comfort. Finally, the government is now fully cognizant of the risks of too-rapid credit growth and is taking account of this in their debt and asset management.

31. **The authorities have made good progress on their structural reform agenda, but an intensified effort is required to help deal with greater macroeconomic risks.** While further work remains to be done, staff welcomes efforts to enhance the business climate and legal system and fully supports the increased focus on these issues as opposed to the previous emphasis on more active government involvement in the productive economy. However, these efforts are being obscured by the failure to complete the privatizations of BTC and Bulgartabac. While recent steps in this regard are encouraging, they need to be carried through forcefully in the coming months. Efforts to restructure the railways and energy sector are bearing fruit as subsidies have begun to decline. But for railways in particular, further steps—including an explicit political decision on the loss-making activities deserving of government support—are needed. On health care, the expanded role of NHIF in financing hospitals and increased reliance on fee-for-service financing in 2004 are welcome, but the authorities will be hard-pressed to avoid implementation problems.

32. **Staff supports the authorities' request to complete the fourth review under the SBA.** Staff also supports the requests for a waiver of applicability for the end-December performance criteria, the request for a waiver for the likely failure to observe the end-December PC on tax arrears collection, and the request for a program extension. Program implementation and macroeconomic performance have been excellent during the course of the SBA and the policies outlined in the SMEP provide an appropriate response to the key risks looking forward.

Table 1. Bulgaria: Selected Economic Indicators, 1999-2003

	1999	2000	2001	2002	2003		
					Q1	Q2	Q3
Output, prices, and employment							
	(Annual percent change, unless otherwise stated)						
Real GDP ¹	2.3	5.4	4.1	4.8	3.8	4.4	4.3
Real industrial sales	...	...	2.9	1.3	21.7	15.8	13.6
Consumer price index (average)	2.6	10.4	7.5	5.8	0.6	1.1	3.1
(End-of-period)	7.0	11.4	4.8	3.8	-0.2	1.2	3.6
Unemployment rate (in percent)							
Registered unemployment	13.8	18.1	17.5	17.4	16.6	14.3	13.7
Labor force survey	15.7	16.9	19.8	17.8	15.6	13.7	12.8
Real public sector wages	10.7	2.4	6.3	2.5	6.0	4.9	4.0
Real private sector wages	9.4	7.8	4.1	0.9	6.3	6.5	4.8
Consolidated government							
	(In percent of GDP)						
Revenue	38.5	38.7	37.6	36.5	8.8	9.8	10.1
Noninterest expenditure	35.7	35.7	34.7	34.9	7.3	8.1	8.8
Primary balance	2.8	3.0	2.8	1.6	1.4	1.7	1.3
Interest payments	3.8	4.0	3.7	2.2	1.1	0.2	0.6
Overall balance	-0.9	-1.0	-0.9	-0.6	0.3	1.5	0.7
External financing	1.2	-1.5	-0.3	1.5	-0.4	0.9	-0.6
Domestic financing	-2.5	1.2	-1.7	-1.7	-0.1	-2.5	-0.3
Privatization receipts	2.2	1.3	2.9	0.9	0.2	0.1	0.2
Total public debt 1/	84.7	80.5	69.6	60.3	47.7	49.7	50.1
Domestic public debt 1/	12.5	6.6	6.3	6.5	6.6	6.4	6.4
Money and credit 2/							
	(Annual percent change, unless otherwise stated)						
Broad money (millions of leva)	7,536	9,857	12,422	13,967	13,812	14,515	15,450
Broad money (M3)	13.4	30.8	26.0	12.4	11.7	19.3	19.8
Lev money	14.4	22.8	28.9	16.4	15.5	24.2	25.5
Leva credit to nongovernment	19.9	25.0	31.9	31.1	33.8	37.2	41.1
FX deposits (U.S. dollar millions)	1,334	1,834	2,138	2,699	2,898	3,086	3,129
FX deposits (percent of M3)	34.5	39.1	38.2	36.4	37.7	36.4	35.8
Broad money to FX reserves ratio	1.2	1.3	1.6	1.6	1.6	1.5	1.6
Interest rates (annualized)							
BNB basic rate	4.5	4.6	4.7	3.4	2.5	2.9	2.6
Time deposit (leva)	3.3	3.3	3.4	3.2	3.3	3.2	3.2
Balance of payments							
	(In millions of US dollars, unless otherwise stated)						
Gross official reserves	3,222	3,460	3,580	4,747	4,792	5,522	5,887
(In months of prospective imports of GNFS)	5.0	4.8	4.6	4.6	4.5	5.1	5.3
Current account balance	-651	-704	-843	-682	-414	-589	173
(In percent of GDP)	-5.0	-5.6	-6.2	-4.3	-10.4	-12.7	3.1
Trade balance	-1,081	-1,176	-1,581	-1,595	-310	-714	-513
Exports	4,006	4,825	5,113	5,692	1,726	1,795	1,987
Imports	-5,087	-6,000	-6,693	-7,287	-2,036	-2,509	-2,500
External debt 3/	10,914	11,202	10,619	10,946	11,417	12,112	12,324
(In percent of GDP)	84.2	88.9	78.1	69.8	57.0	60.5	61.6
Exchange rates							
Leva per U.S. dollar 4/	1.947	2.102	2.219	1.885	1.795	1.712	1.765
(yoy percent change, + means depreciation)	16.2	8.0	5.6	-15.1	-20.6	-17.5	-12.6
REER (end-of period; CPI based)							
(yoy percent change, + means appreciation)	2.0	2.7	3.5	5.3	5.8	4.3	1.2

Sources: Bulgarian authorities; and staff estimates.

1/ Domestic debt as reported by Ministry of Finance and external debt as reported by BNB, in percent of GDP.

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

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

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

Table 2. Bulgaria: Monetary Survey, 1999-2004

	1999	2000	2001	2002	2003				2004
					Q1	Q2	Q3	Q4	
					Actual	Actual	Actual	Proj.	
(In millions of leva)									
Broad money	7,536	9,857	12,422	13,967	13,812	14,515	15,450	17,178	19,522
Lev money	4,733	5,813	7,494	8,719	8,382	9,021	9,652	10,582	12,026
Currency in circulation	1,962	2,374	3,081	3,335	3,088	3,356	3,624	3,787	4,230
Deposits	2,649	3,296	4,250	5,131	4,866	5,230	5,567	6,184	7,028
Other	123	143	162	253	427	435	462	610	768
Foreign currency	2,802	4,044	4,928	5,248	5,430	5,494	5,797	6,596	7,497
Deposits	2,598	3,855	4,745	5,088	5,202	5,282	5,524	6,356	7,223
Other	204	189	183	160	228	212	273	240	273
Net foreign assets	6,566	8,196	9,454	9,892	9,602	9,886	10,268	10,190	9,839
BNB NFA	3,996	4,661	5,485	6,982	6,685	7,596	7,921	7,922	7,173
DMB NFA	2,570	3,535	3,969	2,910	2,917	2,291	2,347	2,268	2,666
Net domestic assets	970	1,661	2,968	4,075	4,209	4,628	5,182	6,988	9,683
Domestic credit	3,640	4,770	6,009	7,656	8,157	8,130	8,681	9,370	11,818
General government 2/	766	1,408	1,566	1,259	1,335	368	200	222	447
Central Government	736	1,377	1,526	1,247	1,323	355	177	207	432
Local government	30	31	40	12	12	13	23	15	15
Non-government	2,874	3,362	4,443	6,397	6,822	7,762	8,481	9,148	11,371
Public enterprise (SOE)	398	186	202	334	346	336	332	300	300
Private sector	2,476	3,176	4,241	6,063	6,475	7,426	8,149	8,848	11,071
Capital and reserves	-2,303	-2,684	-2,867	-3,293	-3,592	-3,581	-3,628	-3,793	-3,943
Other items net	-368	-426	-174	-288	-356	80	129	1,411	1,808
Memorandum items:									
Reserve money	2,725	3,021	4,033	4,482	4,089	4,304	4,605	4,924	5,499
Currency in circulation	1,962	2,374	3,081	3,335	3,088	3,356	3,624	3,787	4,230
Banks' reserves	763	647	952	1,147	1,001	948	981	1,136	1,269
Foreign currency credit to non-government	1,137	1,191	1,579	2,642	2,834	3,402	3,582	3,963	5,152
% total non-government credit	40	35	36	41	42	44	42	43	45
(In millions of US dollars)									
Net foreign assets	3,373	3,899	4,260	5,248	5,349	5,776	5,816	5,971	5,756
BNB NFA	2,052	2,218	2,472	3,704	3,724	4,438	4,486	4,642	4,196
DMB NFA	1,320	1,682	1,788	1,544	1,625	1,338	1,330	1,329	1,560
Foreign currency deposits	1,334	1,834	2,138	2,699	2,898	3,086	3,129	3,724	4,226
(percent of broad money)	34.5	39.1	38.2	36.4	37.7	36.4	35.8	37.0	37.0
Broad money	13.4	30.8	26.0	12.4	11.7	19.3	19.8	23.0	13.6
Lev money	14.4	22.8	28.9	16.4	15.5	24.2	25.5	21.4	13.6
Currency in circulation	12.5	21.0	29.8	8.2	8.2	18.6	19.9	13.6	11.7
Foreign currency deposits	10.4	48.4	23.1	7.2	4.8	10.7	9.0	24.9	13.6
Reserve money	14.1	10.9	33.5	11.2	7.8	16.6	19.9	9.8	11.7
CPI inflation	7.0	11.4	4.8	3.8	-0.2	1.2	3.6	4.5	3.9
(Contribution to 12-month change in broad money)									
Currency in circulation	3.3	5.5	7.2	2.0	1.9	4.3	4.7	3.2	2.6
Leva Deposits	5.6	8.6	9.7	7.1	5.1	8.1	8.6	7.5	4.9
Foreign currency deposits	3.7	16.7	9.0	2.8	1.9	4.2	3.5	9.1	5.0
Other	0.8	0.1	0.1	0.6	2.8	2.7	3.0	3.1	1.1
NFA	14.0	21.6	12.8	3.5	5.7	8.2	5.1	2.1	-2.0
NDA	-0.6	9.2	13.3	8.9	6.0	11.1	14.7	20.9	15.7
(12-month change in Real Money and Credit)									
Broad money	6.0	17.4	20.2	8.3	11.9	17.8	15.5	17.6	9.3
Claims on non-government	13.5	5.0	26.1	38.7	45.9	50.2	41.9	36.8	19.6
Leva claims	12.1	12.2	25.8	26.3	34.1	35.5	36.1	32.1	15.4
Forex claims	15.9	-6.0	26.5	61.2	66.6	74.4	50.5	43.5	25.1
Credit to Nonfinancial Private Corporations	37.8	18.4	23.9	36.9	44.9	49.3	35.8	...	...
Credit to Households	2.5	1.7	39.1	38.8	50.6	63.6	65.6	...	...
(Selected Indicators)									
Money multiplier	2.77	3.26	3.08	3.12	3.38	3.37	3.35	3.5	3.6
CIC / broad money ratio	26.0	24.1	24.8	23.9	22.4	23.1	23.5	22.0	21.7
CIC / deposit ratio	37.4	33.2	34.3	32.6	30.7	31.9	32.7	30.2	29.7
Foreign currency deposits/total deposits	49.5	53.9	52.7	49.8	51.7	50.2	49.8	50.7	50.7
Credit to non gov / deposits	54.8	47.0	49.4	62.6	67.8	73.8	76.5	72.9	79.8
(In percent of GDP, end of period)									
Broad money	31.7	36.8	41.8	43.2	39.8	41.8	44.5	49.5	50.9
Lev money	19.9	21.7	25.2	27.0	24.1	26.0	27.8	30.5	31.4
Reserve money	11.5	11.3	13.6	13.9	11.8	12.4	13.3	14.2	15.8
Credit to non-government sector	12.1	12.6	15.0	19.8	19.6	22.4	24.4	26.3	32.7
Of which forex credit	4.8	4.5	5.3	8.2	8.2	9.8	10.3	11.4	14.8
Foreign currency deposits	10.9	14.4	16.0	15.7	15.0	15.2	15.9	18.3	19.6

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

	1999	2000	2001	2002	2003				2003	2004
					Q1 Act.	Q2 Act.	Q3 Act.	Q4 Est.			Projections
CURRENT ACCOUNT	-587	-761	-928	-780	-392	-545	160	-612	-1,388	-1,359
Trade balance	-1,008	-1,280	-1,779	-1,692	-292	-649	-452	-698	-2,090	-2,105
Exports (f.o.b.)	3,734	5,253	5,714	6,063	1,633	1,614	1,751	1,632	6,630	6,631
y-o-y change (in percent)	-0.3	40.7	8.8	6.1	20.3	9.7	4.0	5.2	9.3	0.0
Imports (f.o.b.)	-4,742	-6,533	-7,493	-7,755	-1,925	-2,262	-2,203	-2,329	-8,719	-8,736
y-o-y change (in percent)	16.3	37.8	14.7	3.5	17.2	17.0	15.3	2.6	12.4	0.2
Services, net	305	547	628	598	-57	127	513	-7	577	546
<i>Of which:</i> Exports of travel services	881	1,168	1,353	1,394	160	348	722	199	1,430	1,417
Income, net	-167	-345	-340	-253	-171	-155	-77	-26	-428	-403
<i>Of which:</i> Interest payments of the central gov't	-402	-480	-515	-297	-176	-20	-94	-17	-307	-334
Income to direct investors	20	-116	-166	-209	-52	-173	-48	-49	-323	-265
Current transfers, net	282	316	562	567	127	131	175	119	553	603
CAPITAL AND FINANCIAL ACCOUNT	693	950	1,354	1,497	227	855	10	796	1,888	1,433
Capital transfers, net	-2	25	0	0	0	0	0	0	0	0
Foreign direct investment, net 1/	758	1,100	893	918	245	342	175	448	1,210	1,034
<i>Of which:</i> Privatization receipts	212	396	21	144	0	0	0	320	320	277
Portfolio investment, net	-186	-192	94	-99	-58	79	-185	42	-122	-82
Other investment, net	142	-10	-232	963	-30	363	-30	306	610	481
General government	-97	-235	-341	-159	-49	8	-75	139	23	286
Domestic banks	58	-389	-92	437	-54	269	15	27	256	-191
Other private sector	180	614	201	686	74	87	30	141	331	387
Errors and omissions	-19	26	599	-285	69	71	50	0	190	0
OVERALL BALANCE	105	188	426	717	-164	310	170	184	500	74
FINANCING	-105	-188	-426	-717	164	-310	-170	-184	-500	-74
Gross international reserves (increase: -) 2/	-521	-492	-318	-578	157	-457	-224	-162	-687	-32
Use of Fund credit, net	156	151	-185	-155	8	-4	54	-22	36	-42
Purchases	268	293	141	117	33	36	58	0	128	59
Repurchases 3/	-112	-142	-326	-271	-25	-40	-5	-22	-92	-101
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.) 4/	3,207	3,719	4,063	4,575	4,398	4,832	5,053	5,215	5,262	5,293
In months of prospective GNFS imports	4.6	4.7	4.9	5.0	4.9	5.4	5.7	5.7	5.8	5.4
In percent of short-term debt	...	...	...	258.1	240.1	255.8	297.4	208.6	210.4	200.3
Current account (in percent of GDP)	-4.8	-5.6	-6.1	-4.7	-10.5	-13.4	3.3	-12.4	-7.9	-7.6
Trade account (in percent of GDP)	-8.3	-9.4	-11.7	-10.2	-7.8	-15.9	-9.2	-14.1	-11.8	-11.7
Exports (in percent of GDP)	30.7	38.5	37.6	36.7	43.8	39.6	35.7	33.1	37.6	36.9
Imports (in percent of GDP)	39.0	47.9	49.3	46.9	51.6	55.5	44.9	47.2	49.4	48.6
Export volume (year-on-year change)	-2.8	19.4	10.6	9.4	27.9	19.5	9.7	16.2	17.5	9.7
Import volume (year-on-year change)	6.8	9.0	17.6	6.5	23.4	25.4	20.1	12.9	19.7	11.1
FDI (net) in percent of current account	129.1	144.4	96.2	117.8	...	...	...	...	87.1	76.1
Gross external debt (stock, e.o.p.)	10,864	12,038	12,049	10,750	10,479	10,502	10,581	10,400	10,400	10,611
(In percent of annual GDP)	89.5	88.2	79.4	65.0	59.4	59.5	60.0	58.9	58.9	59.0
Public	9,411	10,006	9,792	7,961	7,595	7,553	7,437	7,300	7,300	7,425
Private	1,453	2,032	2,257	2,789	2,884	2,949	3,144	3,100	3,100	3,187
Short-term debt (in percent of total debt, e.o.p.)	...	...	...	16.5	17.5	18.0	23.0	24.0	24.0	24.9
Net external debt (in percent of annual GDP) 4/ 5/	51	46	37	26	23	23	21	20	20	20
External debt service of the central government 6/	782	903	1,286	920	315	75	239	54	683	731
GDP 7/	12,145	13,646	15,184	16,527	3,729	4,076	4,910	4,934	17,649	17,993

Sources: Bulgarian authorities, and Fund staff estimates.

1/ All FDI is assumed non-debt creating.

2/ Excluding valuation changes.

3/ According to expectations schedule.

4/ Historical figures include valuation changes. Differences between annual and fourth-quarter end-of-period figures are due to valuation changes carried forward.

5/ External debt minus gross foreign assets of the banking system.

6/ Includes obligations to the Fund.

7/ Based on quarterly average exchange rates.

Table 4. Bulgaria: Balance of Payments, 1999-2004
(In millions of U.S. dollars)

	1999	2000	2001	2002	2003				2003	2004
					Q1 Act.	Q2 Act.	Q3 Act.	Q4 Est.			Projections
CURRENT ACCOUNT	-651	-704	-843	-682	-414	-589	173	-727	-1,558	-1,714
Trade balance	-1,081	-1,176	-1,581	-1,595	-310	-714	-513	-829	-2,366	-2,655
Exports (f.o.b.)	4,006	4,825	5,113	5,692	1,726	1,795	1,987	1,939	7,447	8,362
y-o-y change (in percent)	-4.5	20.4	6.0	11.3	43.7	35.5	21.2	27.0	30.8	12.3
Imports (f.o.b.)	-5,087	-6,000	-6,693	-7,287	-2,036	-2,509	-2,500	-2,768	-9,813	-11,017
y-o-y change (in percent)	11.2	17.9	11.6	8.9	40.1	44.4	34.4	23.8	34.7	12.3
Services, net	314	506	544	594	-60	154	576	-9	662	689
Of which: Exports of travel services	932	1,074	1,201	1,334	172	402	812	236	1,622	1,786
Income, net	-184	-324	-304	-230	-182	-171	-88	-31	-472	-508
Of which: Interest payments of the central gov't	-429	-444	-462	-281	-189	-22	-106	-21	-338	-421
Income to direct investors	22	-107	-149	-197	-56	-197	-54	-59	-366	-334
Current transfers, net	300	290	498	549	137	142	197	142	619	760
CAPITAL AND FINANCIAL ACCOUNT	747	841	1,216	1,410	242	1,101	20	946	2,309	1,808
Capital transfers, net	-2	25	0	0	0	0	0	0	0	0
Foreign direct investment, net 1/	802	998	803	845	264	388	198	532	1,381	1,304
Of which: Privatization receipts	227	366	19	136	0	0	0	380	380	350
Portfolio investment, net	-200	-179	82	-77	-62	90	-209	50	-132	-104
Other investment, net	131	-38	-223	937	-20	581	-33	364	892	607
General government	-105	-216	-308	-131	-53	172	-84	165	201	361
Domestic banks	67	-384	-75	392	-58	292	15	32	281	-241
Other private sector	169	561	161	677	91	117	35	167	410	488
Errors and omissions	16	35	553	-295	61	42	65	0	168	0
OVERALL BALANCE	96	137	373	729	-172	512	193	219	751	93
FINANCING	-96	-137	-373	-729	172	-512	-193	-219	-751	-93
Gross international reserves (increase: -) 2/	-527	-409	-275	-586	164	-506	-253	-193	-788	-40
Use of Fund credit, net	162	136	-169	-142	8	-6	60	-26	36	-53
Purchases	286	267	126	110	35	41	65	0	142	74
Repurchases 3/	-124	-131	-295	-252	-27	-47	-5	-26	-106	-128
Exceptional financing	270	136	71	0	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.) 4/	3,222	3,460	3,580	4,747	4,792	5,522	5,887	6,080	5,534	5,574
In months of prospective GNRS imports	5.0	4.8	4.6	4.6	4.5	5.1	5.3	5.3	4.8	4.5
In percent of short-term debt	254.2	238.6	293.8	304.7	240.1	244.5	241.6	243.2	221.4	210.9
Current account (in percent of GDP)	-5.0	-5.6	-6.2	-4.3	-10.4	-12.7	3.1	-12.4	-7.8	-7.6
Trade account (in percent of GDP)	-8.3	-9.3	-11.6	-10.2	-7.7	-15.4	-9.3	-14.1	-11.8	-11.7
Exports (in percent of GDP)	30.9	38.3	37.6	36.3	43.1	38.8	36.0	33.1	37.2	36.9
Imports (in percent of GDP)	39.3	47.6	49.2	46.5	50.9	54.2	45.3	47.2	49.0	48.6
Export volume (year-on-year change)	-2.8	19.4	10.6	9.4	27.9	19.5	9.7	16.2	17.5	9.7
Import volume (year-on-year change)	6.8	9.0	17.6	6.5	23.4	25.4	20.1	12.9	19.7	11.1
FDI (net) in percent of current account	123.1	141.7	95.3	124.0	...	...	...	...	88.7	76.1
Gross external debt (stock, e.o.p.)	10,914	11,202	10,619	10,946	11,417	12,112	12,324	12,595	12,595	13,219
(In percent of annual GDP)	84.2	88.9	78.1	69.8	57.0	60.5	61.6	62.9	62.9	58.3
Public	9,454	9,311	8,629	8,333	8,275	8,642	8,665	8,840	8,840	9,249
Private	1,459	1,891	1,989	2,613	3,142	3,469	3,659	3,755	3,755	3,970
Short-term debt (in percent of total debt, e.o.p.)	11.6	12.9	11.5	14.2	17.5	18.6	19.8	19.9	19.9	20.0
Net external debt (in percent of annual GDP) 4/ 5/	48	46	36	27	23	23	22	23	25	24
External debt service of the central government 6/	843	841	1,159	858	338	85	268	65	756	922
GDP 7/	12,956	12,605	13,600	15,685	4,003	4,629	5,520	5,863	20,015	22,690

Sources: Bulgarian authorities, and Fund staff estimates.

1/ All FDI is assumed non-debt creating.

2/ Excluding valuation changes.

3/ According to expectations schedule.

4/ Historical figures include valuation changes. Differences between annual and fourth-quarter end-of-period figures are due to valuation changes carried forward.

5/ External debt minus gross foreign assets of the banking system.

6/ Includes obligations to the Fund.

7/ Based on quarterly average exchange rates.

Table 5. Bulgaria: Selected Vulnerability Indicators, 2000-2003

	2000	2001	2002	2003 1/	
Key Economic and Market Indicators					
Real GDP growth (in percent)	5.4	4.1	4.8	4.3	
CPI inflation (period average, in percent) 2/	10.4	7.5	5.8	2.3	
Short-term (ST) interest rate (in percent)	4.6	4.7	3.4	2.6	Oct-03
EMBI + secondary market spread (bps; end of period)	772	433	291	166	Dec-03
Exchange rate NC/US\$ (end of period)	2.1	2.2	1.9	1.6	Nov-03
External Sector					
Exchange rate regime	Currency board, peg to Euro				
Current account balance (percent of GDP) 3/	-5.6	-6.2	-4.3	-7.8	
Net FDI inflows (percent of GDP) 4/	7.9	5.9	5.4	6.9	
Export growth (US\$ value, GNFS) 5/	20.8	7.7	9.9	27.3	
Real effective exchange rate (1995 = 100; end of period)	127.4	131.9	138.8	143.2	Oct-03
Gross international reserves (GIR) in US\$ billion	3.5	3.6	4.7	6.5	Nov-03
GIR in percent of ST debt at remaining maturity	238.6	293.8	304.7	241.6	Sep-03
Net international reserves (NIR) in US\$ billion	...	...	...	...
Total gross external debt in percent of GDP 6/	88.9	78.1	69.8	61.6	Sep-03
o/w ST debt (original maturity in percent of GDP) 6/	11.5	9.0	9.9	12.2	Sep-03
Private sector debt (in percent of GDP) 6/	15.0	14.6	16.7	18.3	Sep-03
Total gross external debt in percent of exports of GNFS	160.0	140.9	132.1	122.7	Sep-03
Gross external financing requirement (in US\$ billion)	...	...	1.9	3.5	
Public Sector 7/					
Overall balance (percent of GDP) 8/	-1.0	-0.9	-0.6	0.0	
Primary balance (percent of GDP) 8/	3.0	2.8	1.6	2.1	
Debt-stabilizing primary balance (percent of GDP)	...	...	...	-2.6	
Gross public sector financing requirement (in percent of GDP)	...	...	...	3.5	
Public sector gross debt (in percent of GDP) 6/	80.5	69.6	60.3	49.6	Sep-03
o/w External debt from official creditors (in percent of total)	38.8	36.1	36.2	37.8	Sep-03
External debt from private creditors (in percent of total)	50.2	52.6	48.6	45.5	Sep-03
Domestic debt linked to foreign currency (in percent of total)	3.5	3.5	3.5	4.5	Sep-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) 9/	76.3	65.4	49.4	37.1	Sep-03
Financial Sector 10/					
Capital adequacy ratio (in percent)	35.6	31.3	25.2	23.9	Q2-03
NPLs in percent of total loans 11/	17.3	13.1	8.6	8.3	Q2-03
Provisions in percent of NPLs 11/	65.8	61.6	65.0	53.0	Q2-03
Return on average assets (in percent)	3.1	2.9	2.1	3.0	Q2-03
FX deposits (in percent of total deposits)	53.9	52.7	49.8	52.3	Oct-03
FX deposits (in percent of gross international reserves)	53.0	59.7	56.9	59.3	Oct-03
FX loans (in percent of total loans)	35.4	35.5	41.3	43.1	Oct-03
Net open forex position (sum of on- and off- balance sheet exposure) (in percent of capital) 12/	-5.2	-5.2	-4.2	-4.4	Q2-03
Ratio of gross national off-balance sheet exposure to capital	...	...	...	...	...

Sources: Bulgarian authorities; and Fund staff estimates.

- 1/ Staff projections or actual data for period indicated in the next column.
2/ The latest figure is the 12-month rate of inflation as of the indicated period.
3/ 12-month current account in percent of 12-month GDP.
4/ 12-month net FDI inflows in percent of 12-month GDP.
5/ Year-on-year growth rate.
6/ 2003: In percent of projected annual GDP.
7/ General government.
8/ 2003: Cumulative balance up to Q3 in percent of projected annual GDP.
9/ Public sector gross debt minus balance of the fiscal reserve account.
10/ Commercial banks.
11/ Total loans exclude interbank loans. Non-performing loans including watch, substandard, doubtful, and loss.
12/ Does not include off-balance sheet items.

Table 6. Bulgaria: General Government, 1999-2004
(In millions of leva)

	1999 Actual	2000 Actual	2001 Actual	2002 Actual	2003			2004 Budget	
					Program 1/ Prog.	Q1-Q3 Actual	Q1-Q3 Proj.		
Total revenue and grants	9,164	10,361	11,164	11,799	12,532	9,124	9,923	12,789	13,505
Tax revenue	6,955	8,005	8,517	8,873	9,656	7,016	7,677	10,051	10,690
Profit taxes	748	736	1,150	976	947	770	857	1,021	937
Nonfinancial enterprises	636	619	812	871	839	684	769	909	815
Financial enterprises	112	117	339	105	109	86	88	112	122
Income taxes	1,056	1,098	1,063	1,052	1,073	775	793	1,087	1,168
VAT	1,927	2,359	2,454	2,688	2,943	2,113	2,248	3,106	3,336
Excise and fuel duties	910	1,131	1,107	1,314	1,501	1,062	1,118	1,542	1,747
Customs duties	259	221	195	188	180	124	166	218	204
Social insurance contributions	1,846	2,241	2,311	2,352	2,698	1,940	2,229	2,733	2,954
Pension and unemployment contributions 2/	1,682	1,795	1,822	1,839	2,118	1,532	1,757	2,114	2,319
Health Insurance Fund	165	446	489	513	580	408	472	618	636
Other taxes	210	218	236	303	314	232	267	345	344
Nontax revenues	2,006	2,153	2,284	2,625	2,376	1,797	2,021	2,450	2,350
BNB transfers	90	137	175	173	150	150	133	133	156
Other	1,916	2,016	2,109	2,452	2,226	1,647	1,888	2,317	2,194
Grants and donations	203	204	363	301	501	311	225	288	465
Total expenditure and net lending	9,387	10,631	11,423	12,009	12,795	9,200	9,064	12,789	13,789
Noninterest expenditure, net lending, contingency	8,488	9,547	10,317	11,296	11,957	8,442	8,391	12,051	13,001
Current noninterest expenditure	7,020	8,050	8,812	10,061	10,559	7,639	7,710	10,662	11,448
Compensation	1,208	1,283	1,196	1,379	1,427	1,064	1,054	1,520	1,631
Wages and salaries	1,182	1,256	1,159	1,338	1,389	1,038	1,023	1,476	1,588
Scholarships	26	28	37	41	38	26	31	44	43
Maintenance and operations	1,697	2,073	1,876	2,200	1,992	1,455	1,570	2,183	2,337
Defense and security	962	896	957	1,066	1,150	774	939	1,089	1,216
Subsidies	344	250	709	772	717	535	552	902	618
Social expenditures	2,808	3,548	4,074	4,634	5,274	3,811	3,595	4,968	5,645
Pension fund	1,953	2,372	2,586	2,944	3,063	2,278	2,262	3,107	3,376
Assistance and unemployment	703	901	858	1,007	1,299	860	616	914	1,155
Health Insurance Fund	93	103	404	498	666	490	548	717	860
Other social expenditures 3/	59	172	225	185	246	183	169	231	254
Capital expenditures	1,135	1,125	1,198	1,046	1,230	771	650	1,225	1,330
Contingency	315	311	245	189	168	32	31	165	224
Enterprise restructuring	291	110	18	0	20	0	0	4	168
Budget	0	165	188	143	96	0	0	108	
Natural disaster	24	36	39	46	52	32	31	52	56
Primary balance	675	814	847	503	576	682	1,532	738	504
Interest	898	1,083	1,106	713	839	758	673	738	788
External	690	818	853	544	640	599	537	573	593
Domestic	208	265	253	169	199	159	136	165	195
Overall balance	-223	-269	-259	-210	-263	-76	859	0	-284
Financing	223	269	259	210	263	76	-859	0	284
External (net)	283	-404	-96	481	-57	-407	-39	52	369
Domestic (net)	-583	328	-506	-558	-231	483	-820	-51	-85
Net banking system							-886	-296	261
Net nonbank							-113	-145	-895
Privatization	523	345	861	286	550	450	180	390	550
Memorandum items:									
Nominal GDP in millions of leva	23,790	26,753	29,709	32,324	34,725	...	...	34,725	38,321

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.

Table 7. Bulgaria: General Government, 1999-2004
(In percent of GDP)

	1999	2000	2001	2002	2003			2004	
	Actual	Actual	Actual	Actual	Program 1/ Prog.	Q1-Q3 Actual	Q1-Q3 Proj.	Budget	
Total revenue and grants	38.5	38.7	37.6	36.5	36.1	26.3	28.6	36.8	35.2
Tax revenue	29.2	29.9	28.7	27.4	27.8	20.2	22.1	28.9	27.9
Profit taxes	3.1	2.8	3.9	3.0	2.7	2.2	2.5	2.9	2.4
Nonfinancial enterprises	2.7	2.3	2.7	2.7	2.4	2.0	2.2	2.6	2.1
Financial enterprises	0.5	0.4	1.1	0.3	0.3	0.2	0.3	0.3	0.3
Income taxes	4.4	4.1	3.6	3.3	3.1	2.2	2.3	3.1	3.0
VAT	8.1	8.8	8.3	8.3	8.5	6.1	6.5	8.9	8.7
Excise and fuel duties	3.8	4.2	3.7	4.1	4.3	3.1	3.2	4.4	4.6
Customs duties	1.1	0.8	0.7	0.6	0.5	0.4	0.5	0.6	0.5
Social insurance contributions	7.8	8.4	7.8	7.3	7.8	5.6	6.4	7.9	7.7
Pension and unemployment contributions 2/	7.1	6.7	6.1	5.7	6.1	4.4	5.1	6.1	6.1
Health Insurance Fund	0.7	1.7	1.6	1.6	1.7	1.2	1.4	1.8	1.7
Other taxes	0.9	0.8	0.8	0.9	0.9	0.7	0.8	1.0	0.9
Nontax revenues	8.4	8.0	7.7	8.1	6.8	5.2	5.8	7.1	6.1
BNB transfers	0.4	0.5	0.6	0.5	0.4	0.4	0.4	0.4	0.4
Other	8.1	7.5	7.1	7.6	6.4	4.7	5.4	6.7	5.7
Grants and donations	0.9	0.8	1.2	0.9	1.4	0.9	0.6	0.8	1.2
Total expenditure and net lending	39.5	39.7	38.4	37.2	36.8	26.5	26.1	36.8	36.0
Noninterest expenditure, net lending, contingency	35.7	35.7	34.7	34.9	34.4	24.3	24.2	34.7	33.9
Current noninterest expenditure	29.5	30.1	29.7	31.1	30.4	22.0	22.2	30.7	29.9
Compensation	5.1	4.8	4.0	4.3	4.1	3.1	3.0	4.4	4.3
Wages and salaries	5.0	4.7	3.9	4.1	4.0	3.0	2.9	4.3	4.1
Scholarships	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Maintenance and operations	7.1	7.7	6.3	6.8	5.7	4.2	4.5	6.3	6.1
Defense and security	4.0	3.3	3.2	3.3	3.3	2.2	2.7	3.1	3.2
Subsidies	1.4	0.9	2.4	2.4	2.1	1.5	1.6	2.6	1.6
Social expenditures	11.8	13.3	13.7	14.3	15.2	11.0	10.4	14.3	14.7
Pension fund	8.2	8.9	8.7	9.1	8.8	6.6	6.5	8.9	8.8
Assistance and unemployment	3.0	3.4	2.9	3.1	3.7	2.5	1.8	2.6	3.0
Health Insurance Fund	0.4	0.4	1.4	1.5	1.9	1.4	1.6	2.1	2.2
Other social expenditures 3/	0.2	0.6	0.8	0.6	0.7	0.5	0.5	0.7	0.7
Capital expenditures	4.8	4.2	4.0	3.2	3.5	2.2	1.9	3.5	3.5
Contingency	1.3	1.2	0.8	0.6	0.5	0.1	0.1	0.5	0.6
Enterprise restructuring	1.2	0.4	0.1	0.0	0.1	0.0	0.0	0.0	0.4
Budget	0.0	0.6	0.6	0.4	0.3	0.0	0.0	0.3	0.0
Natural disaster	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Primary balance	2.8	3.0	2.8	1.6	1.7	2.0	4.4	2.1	1.3
Interest	3.8	4.0	3.7	2.2	2.4	2.2	1.9	2.1	2.1
External	2.9	3.1	2.9	1.7	1.8	1.7	1.5	1.7	1.5
Domestic	0.9	1.0	0.9	0.5	0.6	0.5	0.4	0.5	0.5
Overall balance	-0.9	-1.0	-0.9	-0.6	-0.8	-0.2	2.5	0.0	-0.7
Financing	0.9	1.0	0.9	0.6	0.8	0.2	-2.5	0.0	0.7
External (net)	1.2	-1.5	-0.3	1.5	-0.2	-1.2	-0.1	0.1	1.0
Domestic (net)	-2.5	1.2	-1.7	-1.7	-0.7	1.4	-2.4	-0.1	-0.2
Net banking system							-2.6	-0.9	0.7
Net nonbank							-0.3	-0.4	-2.3
Privatization	2.2	1.3	2.9	0.9	1.6	1.3	0.5	1.1	1.4
Memorandum items:									
Nominal GDP in millions of leva	23,790	26,753	29,709	32,324	34,725	34,725	34,725	34,725	38,321

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.

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	4.3	5.3	5.5	5.5	5.5	5.5
GDP deflator	3.7	6.7	6.7	3.9	3.0	4.8	3.2	3.2	3.1	3.1
CPI (end of period)	7.0	11.4	4.8	3.8	4.5	3.9	3.6	3.5	3.5	3.5
(period average)	2.6	10.4	7.5	5.8	2.3	5.1	3.6	3.5	3.5	3.5
Monetary aggregates (annual percent change)										
Broad money (real, end of period)	6.0	17.4	20.2	8.3	14.7	9.3	8.1	8.2	8.2	8.2
Credit to non-government (real, end of period)	13.5	5.0	26.1	38.7	36.8	19.6	15.8	11.1	11.1	11.1
Saving and investment (in percent of GDP)										
Foreign saving 1/	5.9	5.3	7.6	6.4	8.5	8.7	8.1	7.4	6.8	5.8
Gross national saving	12.9	12.7	14.5	15.3	13.3	14.0	16.1	16.6	17.4	18.0
Gross domestic saving 2/	12.0	13.0	13.0	13.3	12.5	12.9	14.7	15.7	16.8	18.1
Government	6.7	6.3	6.0	4.3	5.2	4.3	5.1	6.1	5.9	5.7
Non-government	5.3	6.7	7.0	9.0	7.4	8.6	9.6	9.6	11.0	12.4
Gross domestic investment	17.9	18.3	20.7	19.7	21.1	21.6	22.8	23.1	23.6	23.9
Government	4.8	4.2	4.0	3.2	3.5	3.5	3.7	4.0	4.0	4.0
Non-government	13.1	14.1	16.6	16.5	17.5	18.1	19.1	19.1	19.6	19.9
General government (in percent of GDP)										
Revenue	38.5	38.7	37.6	36.5	36.8	35.2	35.2	34.8	34.5	34.5
Non-interest expenditure	35.7	35.7	34.7	34.9	34.7	33.9	33.4	32.4	32.2	32.2
Primary balance	2.8	3.0	2.8	1.6	2.1	1.3	1.8	2.4	2.3	2.3
Interest payments	3.8	4.0	3.7	2.2	2.1	2.1	2.3	2.4	2.3	2.3
Overall balance (excluding external interest payments)	2.0	2.1	2.0	1.0	1.7	0.8	1.4	2.1	1.9	1.7
Overall balance	-0.9	-1.0	-0.9	-0.6	0.0	-0.7	-0.5	0.0	0.0	0.0
Total public debt	84.7	80.5	69.6	60.3	47.2	42.4	39.4	36.2	33.2	30.5
Of which: External	73.0	73.9	63.5	53.1	44.2	40.8	37.9	34.1	29.9	27.1
Balance of payments (in millions of US dollars)										
Current account	-651	-704	-843	-682	-1,558	-1,714	-1,663	-1,753	-1,826	-1,872
Trade balance	-1,081	-1,176	-1,581	-1,595	-2,366	-2,655	-2,742	-2,848	-2,919	-2,922
Exports	4,006	4,825	5,113	5,692	7,447	8,362	9,148	10,057	11,095	12,352
Imports	5,087	6,000	6,693	7,287	9,813	11,017	11,890	12,904	14,014	15,273
Services, net	314	506	544	594	662	689	736	857	936	1,075
Receipts	1,788	2,175	2,426	2,594	3,098	3,433	3,700	4,025	4,397	4,840
Payments	1,474	1,670	1,882	2,000	2,437	2,745	2,965	3,168	3,460	3,765
Income, net	-184	-324	-304	-230	-472	-508	-568	-668	-768	-954
Memorandum items										
Gross official reserves (in millions of US dollars)	3,222	3,460	3,580	4,747	5,534	5,574	5,592	5,339	5,044	5,055
(in months of prospective imports of GNFS)	5.0	4.8	4.6	4.7	4.8	4.5	4.2	3.7	3.2	3.2
Current account balance (in percent of GDP)	-5.0	-5.6	-6.2	-4.3	-7.8	-7.6	-6.7	-6.5	-6.2	-5.9
External debt/GDP (in percent) 3/	84.2	88.9	78.1	69.8	62.9	58.3	54.3	50.0	45.9	43.1
External debt/exports of GNFS (in percent) 3/	188.3	160.0	140.9	132.1	119.4	112.1	104.6	95.8	87.0	80.0
External debt service/exports of GNFS (in percent)	18.0	16.7	20.1	15.8	10.9	7.3	7.5	7.7	6.7	6.1
Export growth (percent change)	-4.5	20.4	6.0	11.3	30.8	12.3	9.4	9.9	10.3	11.3
Import growth (percent change)	11.2	17.9	11.6	8.9	34.7	12.3	7.9	8.5	8.6	9.0
Terms of trade (percent change)	-5.6	-6.8	1.0	-0.4	-1.0	1.3	2.0	0.6	0.4	0.2
Nominal GDP (in millions of leva)	23,790	26,753	29,709	32,324	34,725	38,321	41,722	45,425	49,409	53,743
Nominal GDP (in millions of US dollars) 4/	12,956	12,605	13,600	15,685	20,015	22,690	24,736	26,953	29,328	31,906

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 gross national 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 euros)

	2001	2002	2003	2004	2005	2006	2007	2008
					Projections			
CURRENT ACCOUNT	-928	-780	-1,388	-1,359	-1,318	-1,387	-1,445	-1,481
Trade balance	-1,779	-1,692	-2,090	-2,105	-2,172	-2,254	-2,309	-2,311
Exports (f.o.b.)	5,714	6,063	6,630	6,631	7,248	7,961	8,778	9,770
y-o-y change (in percent)	8.8	6.1	9.3	0.0	9.3	9.8	10.3	11.3
Imports (f.o.b.)	-7,493	-7,755	-8,719	-8,736	-9,420	-10,214	-11,087	-12,081
y-o-y change (in percent)	14.7	3.5	12.4	0.2	7.8	8.4	8.5	9.0
Services, net	628	598	577	546	583	678	741	850
Of which: Exports of travel services	1,353	1,394	1,430	1,417	1,500	1,591	1,686	1,787
Income, net	-340	-253	-428	-403	-450	-529	-608	-754
Of which: Interest payments of the central gov't	-515	-297	-307	-334	-335	-400	-378	-350
Income to direct investors	-166	-209	-323	-265	-352	-389	-488	-601
Current transfers, net	562	567	553	603	722	717	732	734
CAPITAL AND FINANCIAL ACCOUNT	1,354	1,497	1,888	1,433	1,530	1,407	1,382	1,599
Capital transfers, net	0	0	0	0	0	0	0	0
Foreign direct investment, net 1/	893	918	1,210	1,034	1,038	982	1,044	1,123
Of which: Privatization receipts	21	144	320	277	238	119	79	0
Portfolio investment, net	94	-99	-122	-82	-94	-86	-338	-121
Other investment, net	-232	963	610	481	586	511	676	596
General government	-341	-159	23	286	268	56	146	112
Domestic banks	-92	437	256	-191	69	72	76	76
Other private sector	201	686	331	387	250	383	454	409
Errors and omissions	599	-285	190	0	0	0	0	0
OVERALL BALANCE	426	717	500	74	212	19	-62	118
FINANCING	-426	-717	-500	-74	-212	-19	62	-118
Gross international reserves (increase: -) 2/	-318	-578	-687	-32	-14	200	233	-9
Use of Fund credit, net	-185	-155	36	-42	-199	-220	-171	-109
Purchases	141	117	128	59	0	0	0	0
Repurchases 3/	-326	-271	-92	-101	-199	-220	-171	-109
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.) 4/	4,063	4,575	5,262	5,293	5,307	5,107	4,874	4,883
In months of prospective GNFS imports	4.9	5.0	5.8	5.4	5.0	4.4	3.9	...
In percent of short-term debt	...	258.1	210.4	200.3	196.7	178.8	155.4	143.7
Current account (in percent of GDP)	-6.1	-4.7	-7.9	-7.6	-6.7	-6.5	-6.2	-5.9
Trade account (in percent of GDP)	-11.7	-10.2	-11.8	-11.7	-11.1	-10.6	-10.0	-9.2
Exports (in percent of GDP)	37.6	36.7	37.6	36.9	37.0	37.3	37.8	38.7
Imports (in percent of GDP)	49.3	46.9	49.4	48.6	48.1	47.9	47.8	47.9
Export volume (year-on-year change)	10.6	9.4	17.5	9.7	8.3	9.3	9.5	10.2
Import volume (year-on-year change)	17.6	6.5	19.7	11.1	9.0	8.6	8.2	8.0
FDI (net) in percent of current account	96.2	117.8	87.1	76.1	78.8	70.7	72.3	75.8
Gross external debt (stock, e.o.p.)	12,049	10,750	10,400	10,611	10,777	10,807	10,791	11,013
(In percent of annual GDP)	79.4	65.0	58.9	59.0	55.0	50.7	46.5	43.6
Public	9,792	7,961	7,300	7,425	7,527	7,370	7,020	6,926
Private	2,257	2,789	3,100	3,187	3,250	3,437	3,772	4,088
Short-term debt (in percent of total debt, e.o.p.)	...	16.5	24.0	24.9	25.0	26.4	29.1	30.9
Net external debt (in percent of annual GDP) 4/ 5/	37	26	20	20	...	...	...	...
External debt service of the central government 6/	1,286	920	683	731	873	1,045	1,247	916
GDP 7/	15,184	16,527	17,649	17,993	19,597	21,335	23,204	25,237

Sources: Bulgarian authorities, and Fund staff estimates.

1/ All FDI is assumed non-debt creating.

2/ Excluding valuation changes.

3/ According to expectations schedule.

4/ Historical figures include valuation changes.

5/ External debt minus gross foreign assets of the banking system.

6/ Includes obligations to the Fund.

7/ Based on quarterly average exchange rates.

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

	2001	2002	2003	2004	2005	2006	2007	2008
					Projections			
CURRENT ACCOUNT	-843	-682	-1,558	-1,714	-1,663	-1,753	-1,826	-1,872
Trade balance	-1,581	-1,595	-2,366	-2,655	-2,742	-2,848	-2,919	-2,922
Exports (f.o.b.)	5,113	5,692	7,447	8,362	9,148	10,057	11,095	12,352
y-o-y change (in percent)	6.0	11.3	30.8	12.3	9.4	9.9	10.3	11.3
Imports (f.o.b.)	-6,693	-7,287	-9,813	-11,017	-11,890	-12,904	-14,014	-15,273
y-o-y change (in percent)	11.6	8.9	34.7	12.3	7.9	8.5	8.6	9.0
Services, net	544	594	662	689	736	857	936	1,075
<i>Of which:</i> Exports of travel services	1,201	1,334	1,622	1,786	1,894	2,010	2,131	2,259
Income, net	-304	-230	-472	-508	-568	-668	-768	-954
<i>Of which:</i> Interest payments of the central gov't	-462	-281	-338	-421	-423	-506	-478	-442
Income to direct investors	-149	-197	-366	-334	-445	-491	-617	-760
Current transfers, net	498	549	619	760	912	906	925	929
CAPITAL AND FINANCIAL ACCOUNT	1,216	1,410	2,309	1,808	1,931	1,777	1,747	2,022
Capital transfers, net	0	0	0	0	0	0	0	0
Foreign direct investment, net 1/	803	845	1,381	1,304	1,310	1,240	1,320	1,420
<i>Of which:</i> Privatization receipts	19	136	380	350	300	150	100	0
Portfolio investment, net	82	-77	-132	-104	-119	-109	-427	-152
Other investment, net	-223	937	892	607	740	646	854	754
General government	-308	-131	201	361	338	71	184	141
Domestic banks	-75	392	281	-241	87	91	96	96
Other private sector	161	677	410	488	315	484	574	517
Errors and omissions	553	-295	168	0	0	0	0	0
OVERALL BALANCE	373	729	751	93	268	24	-79	149
FINANCING	-373	-729	-751	-93	-268	-24	79	-149
Gross international reserves (increase: -) 2/	-275	-586	-788	-40	-17	253	295	-12
Use of Fund credit, net	-169	-142	36	-53	-251	-277	-216	-138
Purchases	126	110	142	74	0	0	0	0
Repurchases 3/	-295	-252	-106	-128	-251	-277	-216	-138
Exceptional financing	71	0	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.) 4/	3,580	4,747	5,534	5,574	5,592	5,339	5,044	5,055
In months of prospective GNFS imports	4.6	4.6	4.8	4.5	4.2	3.7	3.2	...
In percent of short-term debt	293.8	304.7	221.4	210.9	207.2	186.9	160.9	148.8
Current account (in percent of GDP)	-6.2	-4.3	-7.8	-7.6	-6.7	-6.5	-6.2	-5.9
Trade account (in percent of GDP)	-11.6	-10.2	-11.8	-11.7	-11.1	-10.6	-10.0	-9.2
Exports (in percent of GDP)	37.6	36.3	37.2	36.9	37.0	37.3	37.8	38.7
Imports (in percent of GDP)	49.2	46.5	49.0	48.6	48.1	47.9	47.8	47.9
Export volume (year-on-year change)	10.6	9.4	17.5	9.7	8.3	9.3	9.5	10.2
Import volume (year-on-year change)	17.6	6.5	19.7	11.1	9.0	8.6	8.2	8.0
FDI (net) in percent of current account	95.3	124.0	88.7	76.1	78.8	70.7	72.3	75.8
Gross external debt (stock, e.o.p.)	10,619	10,946	12,595	13,219	13,439	13,487	13,472	13,751
(In percent of annual GDP)	78.1	69.8	62.9	58.3	54.3	50.0	45.9	43.1
Public	8,629	8,333	8,840	9,249	9,387	9,198	8,763	8,647
Private	1,989	2,613	3,755	3,970	4,052	4,290	4,709	5,104
Short-term debt (in percent of total debt, e.o.p.)	11.5	14.2	19.9	20.0	20.1	21.2	23.3	24.7
Net external debt (in percent of annual GDP) 4/ 5/	36	27	25	24	...	...	...	...
External debt service of the central government 6/	1,159	858	756	922	1,102	1,321	1,577	1,157
GDP 7/	13,600	15,685	20,015	22,690	24,736	26,953	29,328	31,906

Sources: Bulgarian authorities, and Fund staff estimates.

1/ All FDI is assumed non-debt creating.

2/ Excluding valuation changes.

3/ According to expectations schedule.

4/ Historical figures include valuation changes.

5/ External debt minus gross foreign assets of the banking system.

6/ Includes obligations to the Fund.

7/ Based on quarterly average exchange rates.

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

	1998	1999	Actual			Projections						Debt-stabilizing non-interest current account 6/ -6.3	
			2000	2001	2002	2003	2004	2005	2006	2007	2008		
1 External debt	85.5	84.2	88.9	78.1	69.8	62.9	58.3	54.3	50.0	45.9	43.1		
2 Change in external debt	-14.9	-1.3	4.6	-10.8	-8.3	-6.9	-4.7	-3.9	-4.3	-4.1	-2.8		
3 Identified external debt-creating flows (4+8+9)	-22.7	0.0	1.4	-4.5	-6.5	-11.0	-6.0	-3.5	-2.8	-2.6	-2.5		
4 Current account deficit, excluding interest payments	-3.7	1.3	1.5	2.3	2.1	5.7	5.3	4.7	4.2	4.1	3.9		
5 Deficit in balance of goods and services	0.1	5.9	5.3	7.6	6.4	8.5	8.7	8.1	7.4	6.8	5.8		
6 Exports	47.0	44.7	55.5	55.4	52.8	52.7	52.0	51.9	52.2	52.8	53.9		
7 Imports	47.0	50.6	60.8	63.1	59.2	61.2	60.6	60.1	59.6	59.6	59.7		
8 Net non-debt creating capital inflows (negative)	-4.5	-3.6	-6.5	-4.1	-1.0	-3.4	-5.9	-5.5	-4.8	-4.8	-4.7		
9 Automatic debt dynamics 1/	-14.5	2.3	6.4	-2.6	-7.6	-13.3	-5.4	-2.7	-2.2	-2.0	-1.7		
10 Contribution from nominal interest rate	4.2	3.7	4.1	3.9	2.2	2.1	2.2	2.1	2.3	2.1	2.0		
11 Contribution from real GDP growth	-3.3	-1.9	-4.7	-3.3	-3.2	-2.3	-2.9	-2.9	-2.7	-2.5	-2.3		
12 Contribution from price and exchange rate changes 2/	-15.4	0.5	7.0	-3.2	-6.6	-13.0	-4.7	-1.9	-1.7	-1.5	-1.4		
13 Residual, incl. change in gross foreign assets (2-3)	7.8	-1.2	3.2	-6.3	-1.8	4.2	1.3	-0.4	-1.5	-1.5	-0.3		
External debt-to-exports ratio (in percent)	182.1	188.3	160.0	140.9	132.1	119.4	112.1	104.6	95.8	87.0	80.0		
Gross external financing need (in billions of US dollars) 3/ in percent of GDP	2.5	2.8	2.6	3.3	2.9	3.9	4.6	4.8	4.9	5.1	5.4		
	20.0	21.6	20.8	24.1	18.2	5-Year Historical Average	5-Year Standard Deviation	19.2	20.2	19.3	18.3	17.4	17.0
Key Macroeconomic Assumptions												Projected Average	
Real GDP growth (in percent)	4.0	2.3	5.4	4.1	4.8	4.1	1.2	4.3	5.3	5.5	5.5	5.5	5.3
Exchange rate appreciation (US dollar value of local currency, change in percent)	-4.5	-4.1	-13.5	-2.8	5.2	-25.5	31.0	19.3	3.1	0.1	0.1	0.0	0.0
GDP deflator in US dollars (change in percent)	18.2	-0.6	-7.7	3.7	9.2	4.6	9.8	22.9	8.1	3.3	3.3	3.1	3.1
Nominal external interest rate (in percent)	5.1	4.4	4.7	4.7	3.3	4.4	0.7	3.8	4.0	3.9	4.5	4.5	4.7
Growth of exports (US dollar terms, in percent)	-14.7	-3.1	20.8	7.7	9.9	4.1	13.5	27.3	11.9	8.9	9.6	10.0	11.0
Growth of imports (US dollar terms, in percent)	2.5	9.6	16.9	11.8	8.3	9.8	5.3	31.9	12.3	7.9	8.2	8.7	9.0
Current account balance, excluding interest payments	3.7	-1.3	-1.5	-2.3	-2.1	-0.7	2.5	-5.7	-5.3	-4.7	-4.2	-4.1	-3.9
Net non-debt creating capital inflows	4.5	3.6	6.5	4.1	1.0	4.0	2.0	3.4	5.9	5.5	4.8	4.8	4.7
													Debt-stabilizing non-interest current account 6/ -6.0
A. Alternative Scenario													
A1. Key variables are at their historical averages in 2004-08 4/						62.9	58.5	52.5	45.5	38.9	33.8	33.8	-6.0
A2. Country-specific Scenario -- Higher trade deficit and lower FDI 2004-2008 5/						62.9	60.0	58.7	57.4	56.9	58.4	58.4	-5.7
B. Bound Tests													Debt-stabilizing non-interest current account 6/ -6.4
B1. Nominal interest rate is at historical average plus two standard deviations in 2004 and 2005						62.9	59.3	56.3	52.0	47.8	44.9	44.9	-6.4
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005						62.9	60.1	57.8	53.0	48.4	45.1	45.1	-6.7
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2004 and 2005						62.9	72.7	79.9	71.2	62.9	56.8	56.8	-9.4
B4. Non-interest current account is at historical average minus two standard deviations in 2004 and 2005						62.9	58.6	55.7	51.4	47.2	44.3	44.3	-6.4
B5. Combination of 2-5 using one standard deviation shocks						62.9	65.7	66.5	61.1	55.9	52.4	52.4	-8.0
B6. One time 30 percent nominal depreciation in 2004						62.9	83.3	75.5	67.5	59.8	54.1	54.1	-8.9

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

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

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

4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

5/ Nominal export growth at 90 percent of baseline scenario, nominal import growth at 105 percent of baseline scenario, net FDI at 75 percent of baseline scenario. Debt accumulation to maintain stocks of reserves at the same level as in baseline scenario.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 12. Bulgaria: External Sustainability Framework--Gross External Financing Need, 1998-2008

	Actual					Projections					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
I. Baseline Projections											
Gross external financing need in billions of U.S. dollars 1/	2.5	2.8	2.6	3.3	2.9	3.9	4.6	4.8	4.9	5.1	5.4
in percent of GDP	20.0	21.6	20.8	24.1	18.2	19.2	20.2	19.3	18.3	17.4	17.0
II. Stress Tests											
Gross external financing need in billions of U.S. dollars 2/											
A. Alternative Scenario											
A1. Key variables are at their historical averages in 2004-08						3.9	3.6	3.7	3.7	3.6	3.6
B. Bound Tests											
B1. Nominal interest rate is at historical average plus two standard deviations in 2004 and 2005						3.9	4.8	5.1	5.1	5.3	5.6
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005						3.9	4.6	4.7	4.9	5.0	5.3
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2004 and 2005						3.9	4.3	4.3	4.4	4.4	4.5
B4. Non-interest current account is at historical average minus two standard deviations in 2004 and 2005						3.9	4.7	5.1	5.1	5.3	5.6
B5. Combination of 2-5 using one standard deviation shocks						3.9	4.1	4.3	4.7	4.9	5.2
B6. One time 30 percent nominal depreciation in 2004						3.9	4.2	4.3	4.4	4.4	4.6
Gross external financing need in percent of GDP 2/											
A. Alternative Scenario											
A1. Key variables are at their historical averages in 2004-08						19.2	16.3	15.6	14.1	12.7	11.6
A2. Country-specific Scenario -- Higher trade deficit and lower FDI 2004-2008 3/						19.2	20.8	21.6	22.8	24.5	27.2
					and end-December 2003 performance						
B. Bound Tests											
B1. Nominal interest rate is at historical average plus two standard deviations in 2004 and 2005						19.2	21.1	20.6	18.8	17.9	17.5
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005						19.2	20.6	20.3	19.1	18.2	17.7
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2004 and 2005						19.2	24.1	26.7	24.8	22.9	21.8
B4. Non-interest current account is at historical average minus two standard deviations in 2004 and 2005						19.2	20.5	20.4	18.6	17.8	17.4
B5. Combination of 2-5 using one standard deviation shocks						19.2	21.1	22.4	22.6	21.5	21.0
B6. One time 30 percent nominal depreciation in 2004						19.2	27.0	25.5	23.7	22.0	20.9

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

2/ Gross external financing under the stress-test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.

3/ Nominal export growth at 90 percent of baseline scenario, nominal import growth at 105 percent of baseline scenario, net FDI at 75 percent of baseline scenario. Debt accumulation to maintain stocks of reserves at the same level as in baseline scenario.

Table 13. Bulgaria: Public Sector Debt Sustainability Framework, 1998-2008
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing primary balance 9/	
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008		
						I. Baseline Projections							
1 Public sector debt 1/	88.5	89.8	79.8	70.7	55.1	46.5	42.9	39.9	36.6	33.6	30.9		
o/w foreign-currency denominated	83.8	82.2	72.8	67.4	52.2	42.6	42.0	40.3	37.4	34.1	30.2	1.1	
2 Change in public sector debt	-25.0	1.3	-10.1	-9.0	-15.6	-8.7	-3.5	-3.0	-3.3	-3.0	-2.7		
3 Identified debt-creating flows (4+7+12)	-26.0	14.7	0.5	-1.2	-12.3	-6.7	-3.0	-2.3	-2.0	-1.7	-1.2		
4 Primary deficit	-5.2	-2.8	-3.0	-2.8	-1.6	-2.1	-1.3	-1.8	-2.4	-2.3	-2.3		
5 Revenue and grants	35.4	38.5	38.7	37.6	36.5	36.8	35.2	35.2	34.8	34.5	34.5		
6 Primary (noninterest) expenditure	30.2	35.7	35.7	34.7	34.9	34.7	33.9	33.4	32.4	32.2	32.2		
7 Automatic debt dynamics 2/	-26.0	11.6	0.2	-0.2	-13.1	-6.3	-2.2	-1.3	-0.9	-0.7	-0.5		
8 Contribution from interest rate/growth differential 3/	-21.0	-1.3	-5.9	-4.2	-3.5	-1.7	-2.3	-1.2	-0.9	-0.7	-0.4		
9 Of which contribution from real interest rate	-17.5	0.6	-1.6	-1.3	-0.4	0.5	-0.1	1.0	1.2	1.2	1.3		
10 Of which contribution from real GDP growth	-3.5	-1.9	-4.3	-2.9	-3.1	-2.2	-2.2	-2.2	-2.0	-1.9	-1.7		
11 Contribution from exchange rate depreciation 4/	-5.0	12.9	6.1	4.0	-9.6	-4.6	0.1	-0.1	0.0	0.0	0.0		
12 Other identified debt-creating flows	5.1	5.9	3.3	1.8	2.3	1.7	0.6	0.8	1.2	1.3	1.5		
13 Privatization receipts (negative)	-1.5	-2.1	-1.3	-2.9	-0.9	-0.5	-1.6	-1.3	-0.6	-0.4	0.0		
14 Recognition of implicit or contingent liabilities	6.6	8.0	4.6	4.7	3.2	2.2	2.2	2.0	1.8	1.6	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)	1.0	-13.3	-10.5	-7.8	-3.3	-1.9	-0.5	-0.7	-1.2	-1.3	-1.5		
Public sector debt-to-revenue ratio 1/	250.0	233.2	205.9	188.2	151.0	126.2	121.8	113.3	105.2	97.5	89.6		
Gross financing need 5/ in billions of U.S. dollars	8.1	7.7	7.0	6.2	4.5	3.5	3.0	3.2	3.0	3.9	2.8		
	1.0	1.0	0.9	0.8	0.7	0.7	0.7	0.8	0.8	1.1	0.9	Projected Average	
Key Macroeconomic and Fiscal Assumptions													
Real GDP growth (in percent)	4.0	2.3	5.4	4.1	4.8	4.1	1.2	4.3	5.3	5.5	5.5	5.5	5.3
Average nominal interest rate on public debt (in percent) 6/	4.8	4.5	5.1	5.2	3.4	4.6	0.7	4.1	4.9	5.8	6.5	6.7	5.9
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-18.9	0.8	-1.6	-1.5	-0.5	-4.3	8.2	1.1	0.1	2.6	3.3	3.6	2.5
Nominal appreciation (increase in US dollar value of local currency, in percent)	6.1	-14.0	-7.4	-5.3	17.7	-0.6	12.5	10.4	-0.2	0.1	0.1	0.0	1.8
Inflation rate (GDP deflator, in percent)	23.7	3.7	6.7	6.7	3.9	8.9	8.4	3.0	4.8	3.2	3.2	3.1	3.4
Growth of real primary spending (deflated by GDP deflator, in percent)	25.9	20.7	5.4	1.3	5.4	11.8	10.9	3.6	2.9	3.9	2.3	4.9	3.9
Primary deficit	-5.2	-2.8	-3.0	-2.8	-1.6	-3.1	1.3	-2.1	-1.3	-1.8	-2.4	-2.3	-2.0
II. Stress Tests for Public Debt Ratio													
A. Alternative Scenario												Debt-stabilizing primary balance 9/	
A1. Key variables are at their historical averages in 2004-08 7/						46.5	39.8	33.5	27.7	22.4	17.5	1.2	
B. Bound Tests													
B1. Real interest rate is at historical average plus two standard deviations in 2004 and 2005						46.5	48.0	48.9	45.4	42.3	39.5	1.0	
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005						46.5	45.6	46.5	45.4	44.6	44.1	0.9	
B3. Primary balance is at historical average minus two standard deviations in 2004 and 2005						46.5	43.7	42.0	38.7	35.7	32.9	1.0	
B4. Combination of 2-4 using one standard deviation shocks						46.5	45.1	43.6	40.2	37.2	34.4	1.0	
B5. One time 30 percent real depreciation in 2004 8/						46.5	65.9	62.2	58.4	55.1	52.1	0.8	
B6. 10 percent of GDP increase in other debt-creating flows in 2004						46.5	52.9	49.6	46.1	43.0	40.1	0.9	

1/ This represents gross public sector debt, and thus is different from general government debt figures shown elsewhere.

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

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/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

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

9/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

Table 14. Bulgaria: Public Sector Debt Sustainability Framework--Gross Public Sector Financing Need, 1998-2008
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
I. Baseline Projections											
Gross financing need 1/ in billions of U.S. dollars	8.1	7.7	7.0	6.2	4.5	3.5	3.0	3.2	3.0	3.9	2.8
	1.0	1.0	0.9	0.8	0.7	0.7	0.7	0.8	0.8	1.1	0.9
II. Stress Tests											
Gross financing need 2/											
A. Alternative Scenario											
A1. Key variables are at their historical averages in 2003-08						3.5	-0.7	-1.2	-1.2	-0.8	-1.7
B. Bound Tests											
B1. Real interest rate is at historical average plus two standard deviations in 2004 and 2005						3.5	8.3	8.2	4.3	5.5	4.2
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005						3.5	4.4	6.3	6.5	8.0	7.1
B3. Primary balance is at historical average minus two standard deviations in 2004 and 2005						3.5	3.9	4.7	3.3	4.3	3.1
B4. Combination of 2-4 using one standard deviation shocks						3.5	4.3	4.2	3.5	4.5	3.4
B5. One time 30 percent real depreciation in 2004						3.5	4.2	6.0	6.2	7.7	6.2
B6. 10 percent of GDP increase in other debt-creating flows in 2004						3.5	3.5	4.4	4.4	5.6	4.3
Gross financing need in billions of U.S. dollars 2/											
A. Alternative Scenario											
A1. Key variables are at their historical averages in 2003-08						0.7	-0.2	-0.3	-0.3	-0.2	-0.5
B. Bound Tests											
B1. Real interest rate is at historical average plus two standard deviations in 2004 and 2005						0.7	1.9	2.0	1.2	1.6	1.3
B2. Real GDP growth is at historical average minus two standard deviations in 2004 and 2005						0.7	1.0	1.5	1.6	2.2	2.1
B3. Primary balance is at historical average minus two standard deviations in 2004 and 2005						0.7	0.9	1.2	0.9	1.3	1.0
B4. Combination of 2-4 using one standard deviation shocks						0.7	1.0	1.0	0.9	1.3	1.0
B5. One time 30 percent real depreciation in 2004						0.7	0.6	0.9	1.0	1.4	1.3
B6. 10 percent of GDP increase in other debt-creating flows in 2004						0.7	0.8	1.1	1.2	1.6	1.4

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

2/ Gross financing under the stress test scenarios is derived by assuming the same ratio of short-term to total debt as in the baseline scenario and the same average maturity on medium- and long term debt. Interest expenditures are derived by applying the respective interest rate to the previous period debt stock under each alternative scenario.

Table 15. 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 1/	Observance of end-December 2003 performance criteria and completion of fourth review under the SBA 2/
SDR 26 million (4 percent of quota)	February 15, 2004	Observance of end-December 2003 performance criteria

1/ This purchase is available only upon completion of the fourth review, scheduled for February 4, 2004.

2/ The purchase was originally contingent on observance of end-September 2003 performance criteria. However, since the fourth review is taking place after December 2003, end-December 2003 performance criteria govern the purchase.

Bulgaria: Tentative Work Program

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

- | | | |
|----|--|-----------------------|
| a. | Use of Fund Resources — Third review | May 2003 |
| b. | Board discussion on use of Fund resources —
Third review | July 2003 |
| c. | Staff visit | September 2003 |
| d. | Use of Fund Resources — Fourth review | November 2003 |
| e. | Preparation of ex-post assessment | January/February 2004 |
| e. | Board discussion on use of Fund resources —
Fourth review | February 2004 |
| f. | Art. IV and possible use of Fund resources | March 2004 |
| g. | Board discussion of Art. IV and use of Fund
resources | May/June 2004 |

2. Technical assistance

- | | | |
|----|-----------------------------|---------------|
| a. | FAD: Revenue Administration | November 2003 |
|----|-----------------------------|---------------|

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

- | | | |
|----|--------------------------|---------------|
| a. | PAL 1 –Board approval | February 2003 |
| b. | PAL 2 – Board discussion | April 2004 |

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 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 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 institution's program with Bulgaria, the Bank and Fund staff teams interact extensively during the review of the progress achieved in the country and coordinate closely their policy advice to the Bulgarian authorities.

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

5. To achieve the objectives of 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.** In 2002, 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 has been a major component of the FESALs, while the Fund provided support for the institution building efforts of the BNB and its Banking Supervision Department in particular. In the financial sector, the Bank has focused on banking, insurance, pension funds, and capital markets while the Fund has continued its focus on 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’s Board approved on June 5, 2003 an institutional development project, the Revenue Administration Reform Project (RARP, €31.9 million), developed with technical assistance of the IMF, to support the establishment of the national revenue agency (NRA), which seeks to maximize the level of taxpayer voluntary compliance, promote effectiveness and efficiency, establish a professional workforce and approach to collection, and help reduce the scope for corruption. The RARP became effective August 7, 2003.

10. **Public Expenditure Management.** The Bank has taken the lead in the dialogue on the efficiency and effectiveness of public expenditures and has outlined policy directions in the context of the Public Expenditure and Institutional Review (PEIR)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 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

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

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. These reforms are also supported by the Bank through the PAL program.

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

12. **Energy sector.** 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 2003 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. In addition, in June 2003 the Board approved two district heating projects to support the rehabilitation of Sofia and Pernik District Heating Companies.

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. During FY04, the preparation of a policy-oriented note will support the pension policy dialogue. 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 role in alleviating poverty. However, given the plethora of these programs, and the complexity of program design in many cases, a constant challenge of the social protection system as a whole is to examine opportunities for consolidation and engage in systematic monitoring of the programs, their costs and effectiveness.

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

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 state owned enterprises (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 governs 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 a major component 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 Bulgaria¹ 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 approved by the Board in February 2003,² 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 33 operations for a total original commitment of US\$1,820.9 million equivalent. This includes eleven adjustment loans (US\$1050.8 million), 19 investment projects (US\$750.7 million), and two Bank-managed Global Environmental Fund (GEF) grants and one Bank-managed Prototype Carbon Fund (PCF) grant. Of these 33 operations, 22 have been completed, of which two have been restructured and partially cancelled during implementation, and eleven operations are currently under implementation.

IFC's Activities in Bulgaria IFC's Activities in Bulgaria comprise 17 projects (totaling US\$213 million) in the support of financial sector development, infrastructure and restructuring of post-privatized companies. Of those, 10 projects were approved from 2000-on, including bank privatizations and restructurings, as well as credit lines and technical assistance to SMEs.

Economic and Sector Work. The country diagnostic work being completed includes: an Infrastructure and Energy Strategy Study (2003), an Inter-governmental finance study (2003), and a National Energy Efficiency Study (2003). Going forward, the Bank plans additional country diagnostic work on environmental sequencing, on pension funds, on gender and ethnicity issues, private sector assessment, rural development assessment, expenditure needs for roads, a country financial accountability assessment (currently under review) and a CEM focused on policy reforms for growth.

Table 16. 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	34.2	2003
11. District Heating Project	34.2	2003
12. Wood Residue to Energy (PCF)	2.0	2003

¹Memorandum 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.

²Program Document for a Proposed Programmatic Adjustment Loan to the Republic of Bulgaria, The World Bank, January 23, 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: FUND RELATIONS

As of November 30, 2003

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

II. General Resources Account:	<u>SDR million</u>	<u>%Quota</u>
Quota	640.20	100.0
Fund holdings of currency	1,410.96	220.39
Reserve position in Fund	32.78	5.12
III. SDR Department:	<u>SDR million</u>	<u>%Allocation</u>
Holdings	49.90	N/A
IV. Outstanding Purchases and Loans:	<u>SDR million</u>	<u>%Quota</u>
Stand-by	188.00	29.37
EFF	605.83	94.63
STF	9.69	1.51

V. **Financial Arrangements:**

<u>Type</u>	<u>Approval date</u>	<u>Expiration date</u>	<u>Amount approved (SDR million)</u>	<u>Amount drawn (SDR million)</u>
Stand-by	02/27/2002	02/26/2004	240.00	188.00
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):

	<u>Forthcoming</u>				
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Principal	4.36	89.20	178.07	206.26	160.01
Charges/Interest		16.80	14.44	10.12	5.98
Total	4.36	106.00	192.51	216.38	165.99

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. The BNB has implemented most of the safeguards recommendations and committed to implementing the remaining ones by end March 2004.

VIII. Exchange Arrangements:

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

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.

X. FSAP Participation and ROSCs:

Bulgaria participated in an FSAP held from October 29 to November 14, 2001. Table 17 provides information on the production of ROSCs.

XI. Technical Assistance

Table 18 provides information on IMF technical assistance activities in Bulgaria.

Table 17. 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:

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

Table 18. 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 P'SAP	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	GDSS	Mission	Jul. 99	BNB
STA	National accounts	Mission	Nov. 99	NSI
STA	Price statistics	Mission	Jun. 00	NSI
STA	BOP statistics	Mission	Dec. 00	BNB
STA	Producer prices	Mission	Nov. 01	NSI
STA	Producer prices	Mission	Apr. 02	NSI
STA	Price statistics	Mission	May 02	NSI
STA	Producer prices	Mission	Jan 03	NSI
STA	SDSS	Mission	Sep. 03	BNB

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 19). Despite a comprehensive economic database, problems remain in national accounts and price statistics, particularly in the coverage of the emerging private sector, as well as in the balance of payments statistics, where frequent and substantial revisions have hampered economic analysis. In addition, work remains to be done in fully reconciling high frequency data on economic activity with quarterly and annual national accounts data. Annual international investment position statistics are compiled and reported to STA for publication.

2. On December 1, 2003, Bulgaria became the 55th country to subscribe to the International Monetary Fund's Special Data Dissemination Standard (SDDS), marking a major step forward in the development of the country's statistical system. The Bulgarian authorities view subscription as the culmination of many initiatives on the statistical front. On December 3–4, 2003, Bulgaria hosted a European Seminar for SDDS coordinators.

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 key classification and valuation principles in the IMF's *Monetary and Financial Statistics Manual, 2000*. To address remaining deviations, the authorities reported that starting in January 2003, positions on financial derivatives, which at present are small, would be included in the balance sheets. Further, the consistency in the coverage of the BNB's claim on banks (which included claims on liquidated banks) and the banks' liabilities to the BNB 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 is progressively harmonizing its data collection and compilation methods in line with the European Central Bank's framework for monetary statistics. In particular, a significant number of enhancements in sectoral and instrument detail and classification were made in the data for 1995 and onward. These were reflected in the revised monetary statistics published in the August 2002 and November 2003 issues 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 19. Bulgaria: Core Statistical Indicators as of January 8, 2004

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govt. Balance	GDP	External Public Debt/ Debt Service
Date of Latest Observation	Jan 8 2004	Dec 31 2003	Dec 31 2003	Dec 19 2003	Dec 19 2003	Dec 19 2003	Nov 2003	October 2003	October 2003	Nov 2003	Q3 2003 (qtrly) 2001-02 (annual)	Oct 2003
Date Received	Jan 8 2004	Jan 5 2004	Jan 5 2004	Dec 31 2003	Dec 31 2003	Dec 31 2003	Dec 10 2003	Dec 15 2003	Dec 23 2003	Jan 5 2004	Dec 19 2003	Dec 16 2003
Frequency of Data	Daily	Daily	Weekly and Monthly	Weekly and Monthly	Weekly and Monthly	Weekly and Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly Annually	Monthly
Frequency of Reporting	Daily	Weekly	Weekly and Monthly	Weekly	Weekly and Monthly	Weekly and Monthly	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	Weekly	Daily	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly

Sofia, Bulgaria, January 15, 2004

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 in 2004. Our core policy objectives—laid out in the Memorandum of Economic Policies dated February 12, 2002 and updated in the SMEPs dated July 5, 2002, January 22, 2003, and June 18, 2003—remain to maintain macroeconomic stability and achieve higher living standards through rapid and sustainable growth.

During the last six months, macroeconomic developments have remained favorable and the program has been largely on track, as discussed in the SMEP. However, we request a waiver for the likely nonobservance of the end-December 2003 performance criterion (PC) on collection of tax arrears. This breach is due to the delay in privatizing a state-owned enterprise from which arrears payments were anticipated. But, revenue performance overall has been better than expected. In addition, as all end-December PCs are legally controlling for the purchase associated with this review, we request a waiver of applicability for the following PCs that we expect to be fully observed, but for which data are not yet available: (i) overall fiscal deficit of the general government; and (ii) ceiling on the growth of the wage bill for 60 monitored state-owned enterprises. We are taking measures to expedite implementation of those indicative targets and structural benchmarks that were missed, largely due to technical difficulties. To allow purchase of the last tranche of this SBA, which can take place after it has been ascertained that end-December 2003 PCs have been met, we request an extension of this program from February 26, 2004 to March 15, 2004.

The Government believes that the policies set forth in the attached SMEP are adequate to achieve the objectives of this program, but will take any further measures that may become appropriate for this purpose. Bulgaria will consult with the Fund on the adoption of these measures, and in advance of revisions to the policies contained in the SMEP, in accordance with Fund's policies on such consultation. We also believe that this program provides a solid basis for a successor precautionary SBA, which we subsequently intend to request. For now, we ask for the completion of the fourth review under this SBA.

Sincerely yours,

\s\
Milen Velchev
Minister of Finance

\s\
Ivan Iskrov
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 continued to make progress toward sustained robust economic growth and higher living standards, which are key objectives of our economic program.** To this end, we have maintained cautious fiscal and incomes policies in support of the currency board arrangement (CBA). Further, we are carrying out our structural reform agenda aimed at eliminating the remaining barriers to growth, while taking steps to reduce poverty and increase employment opportunities.

2. **Our economic program—supported by a Stand-By Arrangement with the Fund—remains broadly on track.** All end-June and end-September 2003 performance criteria (PCs) and indicative targets were observed, with the exception of the end-September PC on tax arrears collection by the General Tax Directorate (GTD) and the end-June and end-September indicative targets on arrears to the electricity company (NEK). Most structural benchmarks for end-June have been met as well, but several benchmarks for end-September and December were either missed or only partially observed. We are seeking to address these delays.

B. Background

3. **Macroeconomic developments in 2003 remained favorable.**

- Real GDP growth reached 4 percent in the first half of the year, led by a sharp increase in private consumption and investment. The unemployment rate continued to decline significantly, reaching 12.9 percent at end-October 2003.
- Inflation remained subdued, at 3.3 percent year-on-year through October.
- Financial intermediation continued to increase, with broad money rising by 15½ percent and claims on the nongovernment sector rising by 41.9 percent year-on-year in real terms in September. Prudential indicators remained sound and banks reported strong profits.
- However, the credit boom contributed to rapid import growth and a deterioration in the external current account balance, with the current account deficit increasing to 7½ percent of estimated GDP in the twelve months through August.
- A rise in net FDI inflows maintained coverage of the current account deficit at about 60 percent in the twelve months through August. Combined with continued repatriation by banks of assets held abroad, this allowed gross international reserves to rise, reaching € 5.1 billion at end-September, more than double the stock of short-term debt. The debt burden continues to lessen, with the external debt-to-GDP ratio

standing at 62 percent, well below the end-2002 level of 70 percent. Reflecting these gains, spreads on the Bulgaria component of the EMBI+ index have dropped below 200 basis points.

4. **Our strong economic performance has been supported by a sound fiscal policy.** A significant overperformance in revenue collection allowed us to respond to the rapid rise in private sector demand and the widening of the external current account deficit while still meeting critical expenditure needs. By saving a significant portion of additional revenue, we expect to have achieved at least a balanced budget for the year. In addition, due to expenditure savings in some areas, we were able to undertake additional unbudgeted expenditures, including to fully fund central government-mandated municipal expenditures and clear overruns on medicine reimbursements and hospital arrears, and on wages and pensions. We are taking steps to limit hospital arrears in the future (see paragraph 13).

5. **We have made further progress with public sector reforms aimed at keeping our fiscal policy on a sound footing over the medium term.** We are pressing ahead with implementation of the National Revenue Agency (NRA). A draft Bulstat law, which regulates the use of the Bulstat number as the single key identification for all tax operations, has been submitted to Parliament. We intend this law to be passed by April, 2004, and to come into effect by mid-2004. We have improved the budget process, including by introducing program budgeting in three ministries. We are proceeding as well with our reform of intergovernmental finances, and to this end have passed the revised municipal budget act, and developed standards necessary for assessing the cost of government mandates.

6. **Other structural reforms have advanced as well—notably with bank privatization and in the energy sector—but progress in some areas has proved more challenging.** We sold the last large government-owned commercial bank (DSK). The sale of the telecommunication company (BTC) is at the final stage of implementation. Only technical problems impede the procedure's finalization, but we expect to conclude the transaction in the very near future, without canceling the current procedure. The sale of the tobacco holding (Bulgartabac), however, is taking considerably longer than initially envisaged. In the energy sector, we have raised electricity and district heating prices toward cost-recovery levels, passed a new Energy Law, and have started to evaluate bids for the majority shares in seven electricity distribution companies. Recent policies to strengthen the legal system and rationalize licensing regimes have improved the business climate. However, reforms to restructure the health sector have proved more difficult.

C. Economic Policies for 2004

7. **We see economic prospects for 2004 and the medium term as favorable, but subject to significant risks.** Our targeted real GDP growth of 4½ percent in 2003 was likely achieved, and with global economic prospects improving, we expect growth to rise to 5¼ percent in 2004. Inflation should remain subdued at about 4 percent. We expect growth in claims on the nongovernment sector to decline to about 20–25 percent in real terms by end-

2004. Private consumption and investment should remain robust, and the extent of narrowing in the current account deficit would be commensurately limited, with the deficit projected to reach 7¼ percent of GDP by end-2004, from about 7¾ percent at end-2003. We anticipate net foreign direct investment (FDI) to cover some three quarters of the current account deficit. We are mindful, however, that our external position could worsen if private sector credit and import growth fail to moderate as expected, if recent gains in FDI are not sustained, or if other capital flows reverse. Further, while the banking system remains sound and financial oversight strong, we recognize that continued rapid credit growth presents new challenges for banking supervision.

8. **Our policies will continue to be focused on limiting the economy's vulnerability to risks and on achieving sustained and rapid economic growth.** Fiscal policy must remain cautious and flexible; the health of the financial sector safeguarded; and structural reforms pursued to remove remaining obstacles to growth and to allow the implementation of the government's medium-term fiscal strategy.

Fiscal Policy and Public Sector Reforms

9. **The 2004 budget is aimed at containing external pressures while meeting key expenditure needs and continuing to reduce the tax burden.** We have targeted a small deficit of 0.7 percent of GDP for 2004—a modestly expansionary fiscal stance compared with the 2003 outcome. In our view, this stance is consistent with macroeconomic stability, and will support a narrowing of the external current account deficit and allow a further modest decline in the external debt-to-GDP ratio. Key features of the budget are noted below. Passage of a budget targeting a deficit of 0.7 percent of GDP is a prior action for Board consideration of the review.

- Social spending—including on health care and education—is increasing as a share of the total budget and as a percentage of GDP.
- Public investment will rise modestly to 3½ percent of GDP, with a focus on infrastructure required for EU accession.
- Public sector wages will rise by 8.5 percent in July.
- Pensions will increase by 5.8 percent in June, and the ceiling on maximum pensions has been raised from 250 leva to 420 leva per month. The share of social security contributions going to second pillar pension funds has increased from 2 to 3 percent.
- The corporate tax rate has been reduced from 23.5 to 19.5 percent, while selected excise taxes were raised further toward EU levels. The personal income tax rate for the lowest income bracket has been lowered from 15 to 12 percent, and minimum income exempted from taxation has been raised from 110 to 120 leva.

- In order to create room for the corporate and personal tax cuts and additional social and EU accession-related spending, we will step up our efforts to improve tax administration, and contain government subsidies, including for railways, district heating and hospitals.
- The 2004 budget also incorporates a maximum of 500 million leva of Fiscal Reserve Account (FRA) resources to finance a road fund. The release of these resources is dependent on the findings and follow-up discussion of a World Bank review paper of expenditure needs and priorities in the road sector, and would only be effected in the second half of the year if macroeconomic conditions permit. Such spending would also only be made in consultation with IMF staff, including in the context of a successor precautionary Stand-By Arrangement, which we intend to request.
- We plan to establish a state-owned forestry enterprise, to be capitalized with 44 million leva, in FRA resources. In this regard, we are seeking to agree with the World Bank on the modalities. We also envisage to transfer a total of 23 million leva in FRA resources to the state-owned environmental enterprise (which was created prior to the benchmark prohibiting the creation of new state-owned enterprises and extrabudgetary funds) and the energy efficiency enterprise, (which will be created later in 2004) .

10. **We are taking steps to ensure that fiscal policy remains sufficiently flexible to adjust to any adverse developments in our external position.** We will continue our practice of proceeding cautiously with discretionary spending. We will limit spending to 93 percent of budgeted amounts in the first three quarters of the year, including from spending units' own revenues, and have built these limits explicitly into our Treasury Single Account (TSA). This provides us with the flexibility to adjust fiscal policy by up to one percent of GDP if the external position fails to improve. Such adjustments would be made in consultation with IMF staff. Additional flexibility is provided by budget contingencies equivalent to 0.6 percent of GDP. Finally, we view our revenue projection as conservative and will save most of the revenue overperformance in 2004, unless external conditions improve significantly, subject to the commitment in the budget that the first BGN 25 million of any revenue performance be directed to tobacco, agriculture, and railway subsidies.

11. **We will strengthen our public sector reform effort, which is crucial to achieving our medium-term fiscal goals.** First, we will implement measures to improve tax administration. We intend to have the NRA operational by January 1, 2005. Toward this end, we have established a pilot NRA project in Burgas, expect to have chosen revenue administration software for the NRA by end-February 2004, and plan to continue conducting joint National Social Security Institute (NSSI) and GTD audits. During 2004, we plan to develop integrated work processes of the tax administration and the NSSI for the purposes of the NRA. We anticipate receiving technical assistance from the Fund in this area in early 2004. We will continue to enhance our budgeting and expenditure management including by extending program budgeting to an additional four ministries in the 2005

budget process. Three out of five modules of the Financial Management Information System (FMIS) have been rolled out in the Ministry of Finance and all its second level spending units. The newly-established steering committee will decide on the next steps to make the system fully operational. The extension of the coverage of the TSA to all leva-denominated extrabudgetary funds has been delayed owing to technical problems, but we intend to complete this process by end-June 2004.

12. **We are making major advances in our system of intergovernmental finances.** First, in the 2004 budget, we have—in contrast to recent years—fully funded all mandated local government spending. In addition, we are preparing legislation pertaining to municipal and state properties and municipal debt. We are developing standards for assessing the costs of municipal mandates. With these measures implemented, we are well-placed to enforce hard budget constraints on municipalities and, in this context, will not clear any municipal arrears accumulated during 2004 and will strictly enforce the prompt payment of municipal obligations to public utilities.

13. **We are determined to enhance efficiency in health spending.** We aim to increase the share of hospital spending covered by the National Health Insurance Fund (NHIF) from 33 percent in 2003 to 45 percent in 2004. Municipal hospitals will receive additional financing from the Ministry of Health, also on a fee-for-service basis. These financing mechanisms will provide financial incentives for enhanced efficiency and quality of hospital care. To limit cost overruns on medicines we have established a positive list of medicines covered by the NHIF and introduced co-payment for selected medicines.

Financial Sector Policies and Debt and Asset Management

14. **While the recent growth of financial intermediation in Bulgaria is a welcome development, we recognize that rapid credit growth presents new challenges for banking supervision.** Bulgaria's banking sector remains sound, but credit growth at the current pace brings with it risks of a future deterioration of bank asset quality. In addition, the rapid rise in lending, including to households, is fueling the ongoing import boom, increasing Bulgaria's external vulnerability.

15. **In response to these risks, the BNB has developed a comprehensive strategy consisting of a set of sequential measures, with its implementation dependent on observed developments in credit growth.** As a first step, we have already conducted discussions with major banks to ensure that lending standards are not being relaxed in an effort to maintain or expand market share. We have also reduced the test period for classifying loans as loss from 180 to 120 days, and have postponed plans to reduce banks' reserve requirements toward EU norms. Although credit growth has already slowed down in the last few months—a trend we expect to persist—we continue to implement our strategy:

- We have reached understandings on business strategies with selected banks containing specific steps to ensure that credit growth returns to more sustainable levels. The implementation of such strategies will be monitored by the BNB.

- We have strengthened our monitoring of loan portfolio quality, including by raising the frequency of on-site inspections of particularly aggressive banks. In this regard, we will require more frequent reporting by such banks. To facilitate this, we hired a number of new inspectors in the latter part of 2003.
- To improve lenders' ability to assess credit risk, we have adopted regulations to remove the 10,000 leva reporting threshold for banks to the credit registry so that all loans will be registered.
- We have announced a further reduction—effective April 1, 2004—in the test period for classifying loans as loss, from 120 to 90 days, matching best international practice. This announcement is a prior action for consideration of the review by the Executive Board.
- If, contrary to expectations and despite these measures, credit growth does not continue to decline, we will increase the frequency and scope of reviews of banks and reexamine their business strategies. We will also continue to apply the measures envisaged in our strategy to influence credit growth, including increasing liquidity requirements on a bank-by-bank basis.

16. **The government, in its asset management, will also remain cognizant of the need to contain credit growth within sustainable levels.** In this context, the government will return the remaining deposits that were auctioned off to commercial banks in mid-2003 to the BNB as they mature, or more rapidly if necessary, and will not repeat similar operations in 2004. Moreover, any funds transferred to the state highway enterprise, as well as funds from the Bank Consolidation Company, will be deposited in the BNB. The Ministry of Finance and the BNB have agreed on draft amendments to the Organic Budget Law with the aim of improving coordination and transparency of the management of FRA resources.

17. **We will carry on with our active public debt management, with a view to continuing to reduce external vulnerability and deepen the domestic securities market.** In line with our debt management strategy adopted in March 2003, our objectives 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. A portion of the assets accumulated in the FRA could be utilized for prepayments and debt reduction operations.

18. **We have also continued to make progress in implementing the measures recommended in the Safeguards Assessment report.** We have established a risk-based methodology for the BNB's Internal Audit Department, ahead of schedule. We are also making good progress in developing an audit procedures manual for the internal audit function, which we intend to complete by the end-March 2004 deadline.

Other Structural Reforms

19. **We are committed to stepping up our efforts to improve Bulgaria's business climate and attract higher FDI on a sustainable basis.** We plan to improve administrative services for foreign and domestic investors through one-stop shops, and by enhancing the infrastructure available to large investors. With the assistance of the EU and World Bank, we have accelerated the reform of the judiciary and improved governance by amending the nation's constitution to limit the immunity of members of the judiciary, to provide for their replaceability in certain defined circumstances, and to limit their terms in office. With regard to Bulgartabac, our new strategy—focused on selling components of the company instead of the entire holding—was approved by parliament in December 2003, and we anticipate completing the sale of several Bulgartabac companies by mid-2004.
20. **Reforms in the energy and railway sectors remain critical to our medium-term fiscal strategy and for removing remaining impediments to growth.** Our new energy law provides a modern framework for the energy sector in Bulgaria. The sale of the electricity distribution companies is expected to be complete by mid-2004. We are continuing, with World Bank assistance, to reform the railways sector; we are committed to reaching our objective of a 10 percent reduction in personnel compared to 2001, and have raised intercity passenger tariffs to 76 percent of cost-recovery levels (compared to the benchmark of 70 percent agreed with World Bank). However, we recognize that a successful reform of the railways will require the government to make explicit decisions about the limited set of activities to be subsidized. Toward this end, we have separated the accounts for freight and passenger transport, and will sign purchase of service contracts for specific railway services in the context of the 2004 budget.
21. **Our labor market policies are aimed at maintaining competitiveness and continuing to lower unemployment by reforming the labor code.** We will seek to accelerate the dialogue among social partners on the proposed labor code amendments to reduce hiring and firing costs by abolishing the seniority premium, promoting flexibility in the duration of employment contracts, and increasing flexibility in employment during periods of production stoppage. We will maintain our incomes policy in regard of those state enterprises incurring the highest losses or overdue liabilities, receiving public subsidies or enjoying monopoly status. In this context, we have issued the 2004 incomes ordinance restricting the growth of the wage bill for the listed enterprises to a maximum of 4 percent for 2004, compared to the third quarter of 2003.
22. **We met our objective to subscribe to the special data dissemination standards (SDDS) by end-2003.**

Table 1. 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		-627.1	
Jan. 1, 2003-Sep. 30, 2003		75.7		-858.2	
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		4,229	
Sep. 30, 2003		2,400		4,399	
Dec. 31, 2003		2,400		3,849	
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		78.5	
Sep. 30, 2003		180		112.8	
Dec. 31, 2003		150		148.6	
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		139.5	
Jul. 1, 2003-Sep. 30, 2003		150.1		140.8	
Oct. 1, 2003-Dec. 31, 2003		150.1		144.4	
		GTD	NSSI	GTD	NSSI
V. Ceiling on tax and 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	-20.0	-7.3
Sep. 30, 2003		-30	-9	-22.5	-11.1
Dec. 31, 2003		-70	-12	-15.9	-16.2

Table 1. 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)
VI. 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	327.9
Jun. 30, 2003	0	450	0	327.9
Sep. 30, 2003	0	450	0	433.4
Dec. 31, 2003	0	500	0	471.0
	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	0	0
Sep. 30, 2003	250	0	0	0
Dec. 31, 2003	150	0	0	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:				
Mar. 31, 2003	0	0	2.5	0
Jun. 30, 2003	0	0	7.1	0
Sep. 30, 2003	0	0	10.5	0
Dec. 31, 2003	0	0	1.1	0

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

Table 2. Bulgaria: Structural Benchmarks, 2003

Measures	Program Timing	Level of Conditions	Status	Review
SMEP, February 2002 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	Not met	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	Partially met	Fourth
5. Make the Financial Management Information System fully operational in the Ministry of Finance (paragraph 16).	End-December 2003	Benchmark	Partially met	Fourth
6. No new extrabudgetary funds or state-owned enterprises will be created during the program period (paragraph 16).	Continuous	Benchmark	Met	Fourth
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	Met	Fourth
9. Announce increase in average district heating prices by 10 percent (paragraph 20).	June 30, 2003	Benchmark	Met	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	Partially met	Fourth

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 June 18, 2003.

Table 3. Bulgaria: Prior Actions for Board Consideration of the Review Under the Stand-By Arrangement

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1. Passage of a budget for 2004 targeting a deficit of 0.7 percent of GDP.
 2. Announcement of a reduction—effective April 1, 2004—in the test period for classifying loans as loss, from 120 to 90 days.
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Performance Criterion on the Overall Deficit of the General Government

	Overall deficit ceilings
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	(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/ leva)	(In millions of
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	21. Passenger Transport EOOD	41. Vazov Machinery Works
2. BDZ EAD	22. Electricity Transport-Sofia EAD	42. Bulgartabac-Plovdiv AD
3. Bulgargas EAD	23. Autotransport-Sofia EAD	43. Bulgartabac-Asenovgrad
4. BTC EAD	24. Burgasbus EOOD	44. Motori Technika Agrocultu
5. National Electric Company	25. Bus Transport EOOD	45. Dunarit AD
6. TPP Varna EAD	26. DHC-Burgas EAD	46. Bulgarian Rivershipping EAD
7. EDC -Varna EAD	27. DHC Vratsa EAD	47. Balkancar Holding
8. EDC -G. Oriahovitsa EAD	28. DHC-Gabrovo EAD	48. Bulgartabac Haskovo AD
9. NPP Kozlodui EAD	29. DHC-Pernik EAD	49. Bulgartabac Shumen AD
10. TPP Bobov D	30. DHC-Pleven EAD	50. Bulgartabac Dupnitsa AD
11. EDC -Pleven EAD	31. DHC-Plovdiv EAD	51. Sluntse EAD-Smolian
12. EDC -Plovdiv EAD	32. DHC-Ruse EAD	52. Incoms Telecom Holding A
13. EDC-Sofia City EAD	33. DHC-Sliven EAD	53. Brikel EAD
14. EDC -Sofia District EAD	34. DHC-Sofia EAD	54. Radio Telecommunication OOD
15. EDC -Stara Zagora	35. DHC-Kazanluk EAD	55. EOOD Hemus EAR
16. TPP Maritza Iztok 2 EAD	36. DHC-Shumen EAD	56. Information Services AD
17. TPP Maritza 3-Dimitrovgrad EAD	37. Pirin Mines EAD	57. Mina Zdravec EAD
18. City Transport -Varna EOOD	38. Port Burgas EAD	58. AD Balkankar - Dunav
19. City Transport Plovdiv EOOD	39. Eliseina EAD	59. Terem EAD
20. Ruse Municipal Autotransport EOOD	40. Bobov Dol Mines	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	11. Arsenal EAD	21. Trema AD
2. Energokabel AD	12. Vini EAD	22. Madara AD
3. Plama AD	13. Bourgas Seaport	23. Dunarit AD
4. VMZ AD - Sopot	14. PDNG EAD	24. Maritza KK AD
5. Haskovo BT AD	15. Bourgas Sugar Factory AD	25. Ledenika AD
6. NEK EAD	16. Dupnitsa BT	26. Dobrich Mel AD
7. Slantze BT AD	17. Mariza - Iztok Mines	27. Plovdiv BT AD
8. Arcus AD	18. Great Bulgarian Mills EAD	28. Ministroi Rodopi AD
9. Sugar Factory AD	19. Kambana 1899 AD	29. Pleven BT AD
10. Pernik Mines	20. Bulgargaz EAD	30. Kvarz EAD
31. Bobovo Coal Mines	38. NITI EAD Kazanlyk	45. Varnensko Pivo
32. Nefteks Petroleum	39. Stara reka	46. Kitka
33. Zachar Bio AD	40. Shumensko pivo	47. Svetlina
34. Stomaneni trabi	41. Agroteknika	48. Burgasbas
35. Orfei	42. Vineks Preslav	49. Blagoustroisveni Strocji Burgas
36. Chernomorsko Zlato	43. Chernomore	50. LVK Gamza
37. Korabno mashinostrocne	44. Liteks Dzus	

The enterprises monitored for arrears to the NSSI:

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

43. Dobruzhan Meat Company	58. ZMM Technotronika	75. Filtex AD
44. Dunarit AD	59. Struma OOD	76. Mak Tours AD
45. Agrotehnika AD	60. Pektin EOOD	77. Biliana Triko AD
46. Dobrich Mel	61. Incoms EIM	78. Zavodski Stroezi AD
47. Harmonia	62. Elko EOOD	79. Boni Commerce AD
48. Ilindentsi Mramor	63. V i K	80. Pons Holding AD
49. Orfey OOD	64. Balgarska Roza-Sevtopolis	81. Kosko EOOD
50. Ptikom EAD	65. Alukom	82. Varnensko Pivo
51. S-M 33	66. Niva AD	83. DP Construction & Transpt. Acity.
52. Mediket AD	67. Kartal EAD	84. Sadrujie Stoichevi 57-65
53. Sukmo EOOD	68. Balkankar-Zaria AD	85. Sokola AD
54. Elena Georgieva AD	69. ZSK Kremikovci	86. Zavodski Stroezi PC-Pernik AD
55. Mak AD	70. Simpto AD	87. Asenovgrad BT
56. Rodopa-95	71. Semena Dobrich AD	88. Kocho Chestimenski AD
57. Uvion OOD	72. Ruen-Elit AD	89. Pulpodeva AD
	73. I. H. I KO Ahrida AD	90. Vagonno-remonten Zavod-Karlovo
	74. Rilski Len AD	91. Dunarit EAD
92. LVZ AD		
93. Vini EAD		
94. Ministroi 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 Criteria¹

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

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

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

	One year and Under 3/	Over 1 year 4/		1-5 years 4/
		Excluding Eurobonds	Eurobond issuance 5/	
Cumulative change from level on December 31, 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.

Statement by the IMF Staff Representative on Bulgaria
February 4, 2004

This statement provides information that has become available since the issuance of the staff report for the fourth review under the stand-by arrangement for Bulgaria. This information does not change the staff's appraisal in that report.

- The second of two prior actions for Board consideration of this review was completed on January 22, when the Bulgarian National Bank announced a reduction, effective April 1, 2004, in the test period for classifying loans as loss from 120 to 90 days. Minimum provisioning for loans 61 to 90 days overdue has also been raised from 30 percent to 50 percent.
- Indications are that all performance criteria for end-December were observed, with the exception of the ceiling on tax arrears to the General Tax Directorate, for which a waiver has been requested. In particular, staff has confirmed that the following performance criteria were observed: ceilings on contracting and guaranteeing public sector debt; the floor on the Fiscal Reserve Account (FRA); the ceiling on use of FRA resources to acquire policy-related assets; and the ceiling on arrears to the National Social Security Institute. Preliminary data on the performance criteria for which waivers of applicability were requested—the general government deficit and wage bill of selected public enterprises—indicate that these have been observed as well.
- Macroeconomic data point to further robust growth but also continued external risks. Industrial production rose by 11 percent year-on-year and industrial sales by 14 percent in November. The twelve-month external current account deficit rose to 8¾ percent of estimated GDP in November, up from 8½ percent in October, with FDI coverage at 80 percent for the same period, and reserves roughly unchanged, at 5.2 billion euros. Year-on-year growth in bank claims on the nongovernment sector decelerated slightly for the second consecutive month in December, reaching 40½ percent in real terms. Owing to higher food and fuel prices, December inflation was significantly higher than expected—1.8 percent month-on-month compared with a projected 0.7 percent—leaving end-year inflation at 5.6 percent.
- Preliminary fiscal data indicate that a very small general government surplus was achieved in 2003, in line with understandings reached during discussions for the review. Both revenues and expenditures were some ¾ percentage point of GDP higher than expected (net of tax arrears clearance operations), with the additional expenditures largely in the social spheres and for arrears clearance.
- The Bulgarian Privatization Agency has formally invited the winning bidder for the state telecommunications company, BTC, to sign the sales contract by February 20. Advent International has agreed to purchase 65 percent of BTC for 230 million euros and to invest a minimum of 400 million euros over the next five years.



Press Release No. 04/20
FOR IMMEDIATE RELEASE
February 4, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Fourth Review Under Stand-By Arrangement with Bulgaria, Approves US\$39 Million Disbursement, Grants Waivers, and Extends Arrangement

The Executive Board of the International Monetary Fund (IMF) today completed the fourth review of Bulgaria's economic performance under its Stand-By Arrangement. In completing the review, the Executive Board approved the disbursement of SDR 26 million (about US\$39 million) to Bulgaria and the extension of the arrangement from February 27 to March 15, 2004. The Board further granted Bulgaria's requests for waiving applicability for the end-December 2003 performance criteria on the overall fiscal deficit of the general government and the limit on the growth of the wage bill for 60 monitored state-owned enterprises, and for the non-observance of the end-December 2003 performance criterion on the reduction of tax arrears.

The two-year Stand-By Arrangement was approved on February 27, 2002 (see [Press Release No. 02/12](#)) for a total amount of SDR 240 million (about US\$358 million). So far, Bulgaria has drawn SDR 188 million (about US\$281 million) under the Stand-By Arrangement.

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

“Macroeconomic performance remains strong in Bulgaria. The authorities' economic program, supported by the Stand-By Arrangement, is centered on the currency board and has been supported by a prudent and flexible fiscal policy and a broad program of structural reforms. These policies have resulted in robust growth, low inflation, and a declining unemployment rate, although the high external current account deficit poses risks.

“The authorities' small surplus in 2003 helped contain the current account deficit. The small budget deficit programmed for 2004 appears sufficiently prudent for now, especially given the built-in flexibility of budget implementation and Bulgaria's strong track record in this regard. It is critical, however, to monitor external developments closely and to take prompt action, if needed. The authorities have correctly decided to proceed cautiously with discretionary spending in the first three quarters of the year, and to postpone potential transfers to a state enterprise for road construction until at least the second half of 2004 and to make any such transfer contingent on macroeconomic developments. Plans to fully fund local government mandates and to implement health care reforms, in order to limit the scope for arrears and spending overruns in 2004, are welcome. Over the medium term, fiscal policy continues to target a balanced budget.

This will require further progress with fiscal reforms—including the full operation of the National Revenue Agency and implementation of the Financial Management Information System.

“While the recent rapid growth of private sector credit reflects a desirable catch-up from depressed levels, this development requires continued vigilance to ensure that the banking system remains healthy and import growth is sustainable. In this regard, the measures taken by the Bulgarian National Bank (BNB) to intensify its already-strong supervision are commendable. Of particular importance is the strategy to tighten the definition of bad loans and to expand the coverage of the loan register. The government’s decision to return deposits from commercial banks to the BNB is appropriate, as this will help moderate the pace of credit growth.

“Progress has been made in many areas of structural reform, including restructuring of the energy and railway sectors, simplification of business regulations, and enactment of judicial reforms. However, additional efforts are needed to complete the reforms, especially in the fiscal area, in order to provide further impetus to economic growth. Completion of the privatization program, including sales of the tobacco holding and telecommunications companies, and measures to increase labor market flexibility should help attract additional investment and further reduce unemployment,” Ms. Krueger said.