April 2000

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Bulgaria: Staff Report for the 1999 Article IV Consultation and Third Review Under the Extended Arrangement

This report was prepared by a staff team of the International Monetary Fund following discussions with the officials of Bulgaria on economic developments and policies. The report was then considered by the IMF's Executive Board in the context of the IMF's periodic consultation with Bulgaria, as required under Article IV of the IMF Articles of Agreement. The views expressed in the staff report itself are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF or of the authorities of Bulgaria; a supplementary statement by IMF staff may also be included. The views of the Executive Board as expressed in the discussion of the Article IV consultation report and as summarized in a Public Information Notice (PIN) are also included. In addition, a statement by the member country authorities may be appended. Further background documentation prepared by IMF staff for the consultation may be published separately at a later date. The policy of publication of Article IV staff reports allows for the deletion of market sensitive information.

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INTERNATIONAL MONETARY FUND

BULGARIA

Staff Report for the 1999 Article IV Consultation and Third Review Under the Extended Arrangement

Prepared by the European I Department

(In consultation with other departments)

Approved by Jacques R. Artus and Christian Brachet

March 14, 2000

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I. Introduction

1. A staff team visited Sofia during January 17–31, 2000 to hold discussions for the Article IV consultation and the third review under the extended arrangement.[1] The discussions included a technical consultation to assess the effectiveness of past Fund-provided technical assistance and future needs (Appendix I). In this connection, the mission also discussed progress made in implementing internationally recognized standards in line with recommendations contained in the Report on the Observance of Standards and Codes (EBS/00/46). The three-year arrangement for SDR 627.62 million (98 percent of quota) was approved in September 1998, and so far six purchases of SDR 52.3 million each have been made (Appendix II). Bulgaria's economic program is supported by the World Bank (Appendix III), the EU, and other donors.

2. In 1999, Executive Board deliberations on Bulgaria focussed on the need for the authorities to persevere with structural reform. In concluding the last Article IV consultation and the first review under the extended arrangement in February 1999, Executive Directors commended the prudent fiscal stance supporting the currency board arrangement, but emphasized the need to strengthen enterprise financial discipline and to increase the role of the private sector through an aggressive pursuit of structural reforms. In completing the second review in September, Directors pointed to the role of sound policies in minimizing economic disruption stemming from adverse external shocks, including the Kosovo crisis, and urged the authorities to keep up the momentum of reform to achieve sustained growth in the medium term.

3. In the attached letter to the Acting Managing Director and the accompanying Memorandum on Economic Policies, the authorities report on progress made, describe their policies for 2000, and request completion of the third review. Bulgaria's seventh purchase of SDR 52.3 million under the arrangement is contingent on completion of the review.

4. Despite weaker than expected performance in the October 1999 local elections and a subsequent cabinet reshuffle, the center-right ruling coalition remains firmly in power. A majority in parliament has enabled the coalition led by Prime Minister Kostov's Union of Democratic Forces to implement an ambitious reform agenda. In December 1999, the EU invited Bulgaria to start membership negotiations. General elections are due by April 2001.

5. The quality and timeliness of statistical reporting by Bulgaria are generally sufficient for program monitoring and surveillance (Appendix IV). Despite good progress, there is still a need to

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[1] The team comprised Mr. Kähkönen (head), Messrs. Horváth, Feyzioğlu, and Gelos (all EU1), Ms. Banerji (PDR), and Ms. Strayer (assistant, EU1). Mr. Gueorguiev (OED) attended most of the discussions. The mission was assisted by Mr. Stella, the resident representative, and it coordinated its work closely with World Bank staff. The mission met with the President, the Prime Minister, all key economic ministers, the Governor of the Bulgarian National Bank, parliamentarians, and representatives of trade unions and the private sector.

improve the source data, compilation methods, timeliness, and public availability, especially in the real sector and the balance of payments. The authorities have undertaken to implement technical assistance recommendations aimed at such improvements under the program. Bulgaria is a pilot country for the General Data Dissemination Standard.

II. Background

Under the currency board arrangement, Bulgaria has achieved stabilization and made encouraging progress in structural reform, thus setting the stage for sustained rapid growth. However, a series of adverse shocks in 1998–99 postponed the emergence of the growth dividend. The long-awaited recovery is now underway and program implementation has continued on track, making the near-term outlook promising. Reducing the presently high unemployment and implementing the extensive reform agenda to achieve the goal of EU accession remain the key challenges.

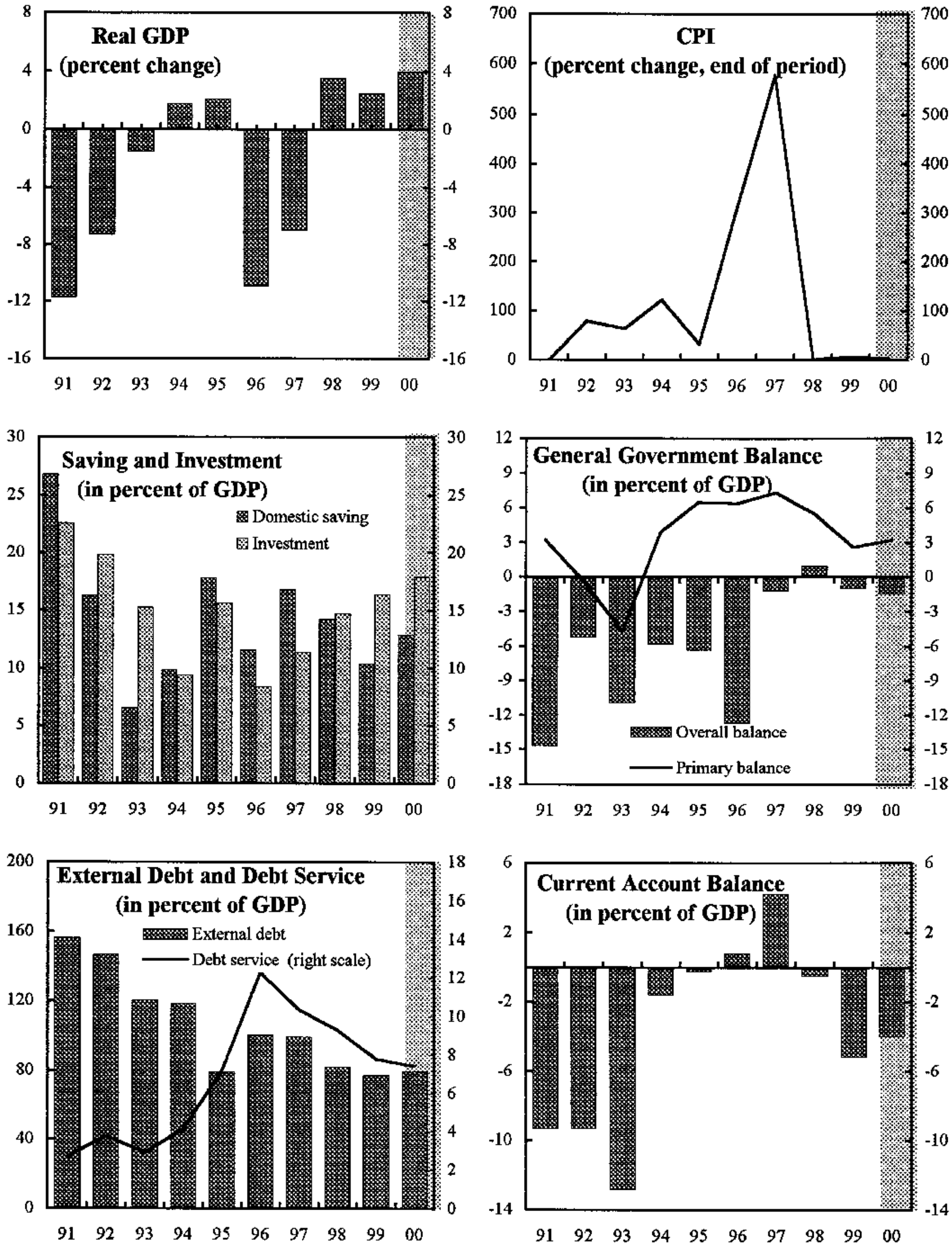
6. **Under the currency board arrangement (CBA) introduced in mid-1997, Bulgaria has achieved macroeconomic stabilization** (Table 1 and Figures 1 and 2). Determined anti-inflation efforts only started with the introduction of the CBA in the aftermath of a severe banking and foreign exchange crisis in 1996–97. The CBA has been underpinned by a conservative fiscal policy: in 1998 the general government even registered a small surplus, and last year's deficit was limited to 0.9 percent of GDP. As a result, inflation has been brought under control, with the CPI increasing by only 1.8 percent (annual average) in 1999. The CBA continues to have a solid foundation: all major political forces support it, interest rates are low and stable, fiscal reserves ample, and commercial banks highly liquid.

7. **The CBA has also provided impetus and discipline for accelerated structural reform.** Since the establishment of the CBA, two thirds of state assets outside infrastructure have been privatized, and the restructuring of large state monopolies in the utilities sector is underway. Loss-making state enterprises have been made subject to a strict incomes policy. Banking supervision has improved markedly. Four (out of seven) state banks have been privatized, and two more are on the market. The share of administered items in the CPI has been reduced sharply to 14 percent, trade has been liberalized significantly, and land restitution has been nearly completed. Many of the most significant advances took place in 1999, the year of the most intensive reform so far (Box 1).

8. **The implementation of the EFF-supported program has continued on track.** The government's three-year program is now halfway through completion, and so far all purchases have been made on schedule. The solid performance continued in late 1999. All quantitative performance criteria for end-December 1999 were observed (Table 2). While the indicative target on reducing outstanding obligations to social security and customs was missed, a larger-than-programmed reduction in tax arrears helped overall arrears to the budget to decline by almost 50 percent in the second half of the year, broadly as scheduled. All end-December structural performance criteria were also observed, and good progress was made in meeting structural benchmarks (Table 3).

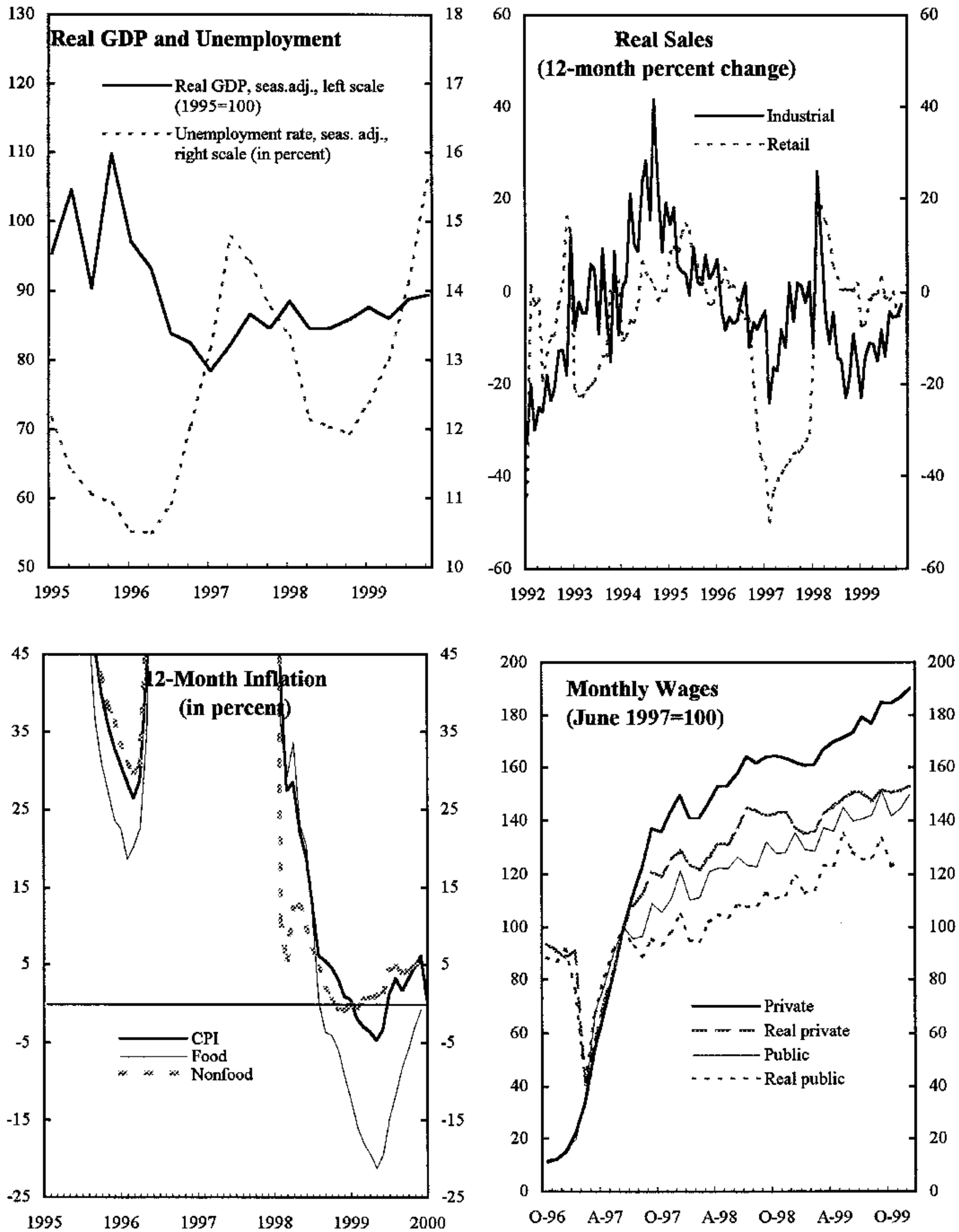
9. **The authorities' strong efforts notwithstanding, the growth dividend from stabilization and reform has been slow in coming.** True, the initial post-crisis experience was encouraging: after years of declining output, activity rebounded in the second half of 1997 as the CBA-based policy

Figure 1. Bulgaria: Selected Economic Indicators, 1991-2000 1/



Sources: Bulgarian authorities; and Fund staff estimates and projections.
1/ Data for 1999 are estimates and for 2000 are projections.

Figure 2. Bulgaria: Real Sector Developments, 1992-2000



Sources: Bulgarian authorities; and Fund staff estimates.

Box 1. Progress in Structural Reform During 1999

Privatization. 1999 saw the biggest wave of privatization in Bulgaria's history.

- A record number of deals (1,225) were completed. The share of privatized long-term fixed assets reached 49 percent by end-1999, up from 30 percent a year earlier, and that of privatized assets excluding infrastructure rose to 78 percent.
- Major sales in the non-financial sector included the oil refinery Neftochim, the steel giant Kremikovtsi, the fertilizer producer Agropolichim, and Balkan Airlines.

Energy sector. A new Energy Law was passed in July, creating a framework for a fundamental reform of this critical sector, and the restructuring of energy companies started in earnest.

- An independent regulatory body began operations in September, and started drafting the secondary energy legislation.
- The accounting separation of the electricity monopoly NEK into its generation, transmission, and distribution components was completed, and preparations started for its legal separation ahead of the eventual privatization of some components.
- A strong action plan to restructure and financially rehabilitate Bulgargaz, the natural gas monopoly, was adopted in June and elaborated in October. Strict implementation of the plan, together with a partial write-off of tax liabilities, helped Bulgargaz (the company that used to have the largest tax arrears) to clear its arrears to the budget by year's end.

Enterprise financial discipline and restructuring. Wage discipline in state enterprises was tightened, and the so-called "isolation program", initiated in 1996 when the worst performers were cut from bank credit and forced to restructure, was implemented successfully.

- All loss-making state enterprises continued to face restrictions on wage increases, and a wage bill freeze was imposed on the 100 SOE's with the largest losses or arrears, as well as on state monopolies.
- The government completed the isolation program for commercial enterprises (Group B) on schedule by mid-1999, through privatizing or entering into liquidation all 41 enterprises in this group. By end-1999, production in all Group B enterprises in liquidation had ceased, and the bulk of their assets had been disposed of.
- In fall 1999, the government approved updated restructuring plans for all Group A enterprises under isolation (utilities and railways). The plans aim at sharply reducing the need for state subsidies by these enterprises.

Fiscal and social reforms. Strong efforts were made to prepare major reforms that will help to ensure fiscal sustainability.

- Most extrabudgetary funds were closed at the beginning of the year, and subsequently other preparations were completed to allow a January 1, 2000 launch of the Single Treasury Account, a key element of a well-functioning treasury.
- A decision was taken in November to unify the collection of taxes and social contributions under a single agency.
- In preparation for a fundamental overhaul of the pension system, legislation for two of the three pillars was adopted.
- The reform of the health system started in mid-1999 with the introduction of a separate health contribution.

Financial sector. Bank privatization continued apace, and measures were taken to make the financial system more efficient.

- Expressbank was sold to Societé Generale. A contract for the sale of Hebros Bank to a foreign investor was signed, and tenders for the sale of Bulbank and Biochim bank were issued.
- Further progress was made in addressing bank insolvencies: tenders were issued for the assets of a majority of the already closed banks, and a new draft law on bank bankruptcy was prepared.
- A new Foreign Exchange Law that combines hitherto fragmented and outdated legislation and substantially liberalizes foreign exchange currency operations was adopted by parliament in September.

Governance. Steps were taken to improve the business environment, public administration, and transparency.

- Important amendments to the Commercial Code to speed up liquidation and bankruptcy procedures were submitted to parliament in September.
- Following an interministerial review of the licensing and registration regime, a program was adopted in October to reduce red tape and increase transparency.
- In December, the functions and organizational structures of ministries were redefined, and two ministries were eliminated through merger.
- In September, the authorities published a report on the observance of standards and codes, prepared with Fund staff.

Price and trade liberalization. Early in the year, the price and trade regimes were substantially liberalized.

- Significant price liberalization in January 1999 reduced the share of administered items in the CPI to 14 percent.
- Effective January 1, 1999, the average tariff rate was reduced by 2.5 points to 15.1 percent. In addition, the import surcharge and all export taxes except one were abolished, and a large number of non-tariff barriers were removed.

Agricultural sector. The authorities made good progress toward the creation of a well-functioning land market.

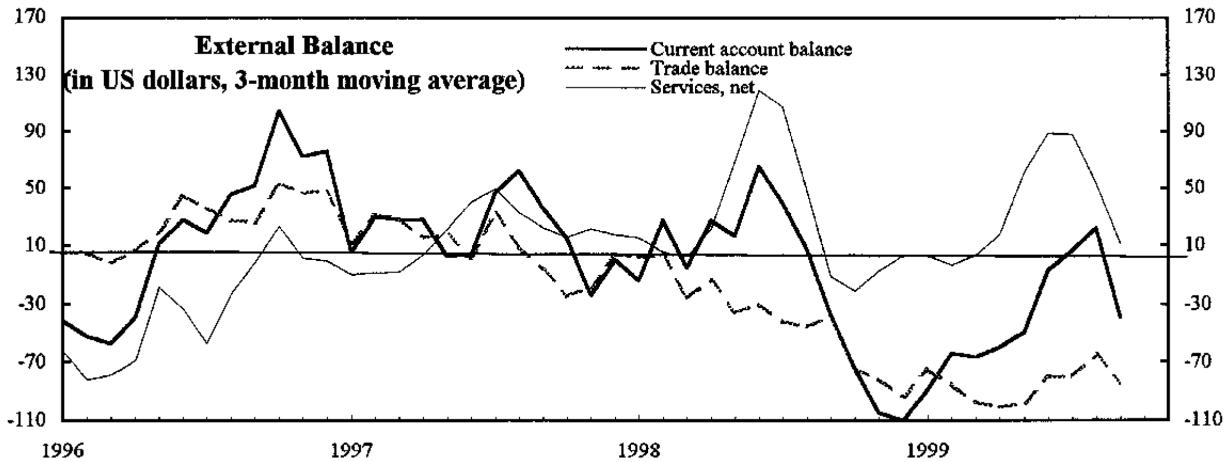
- By end-December, land restitution was 96 percent complete, up from 80 percent at end-1998. An amendment to the law on the usage and ownership of land was passed, reducing bureaucratic impediments to land transactions. A land market information system to facilitate transactions was put in place.

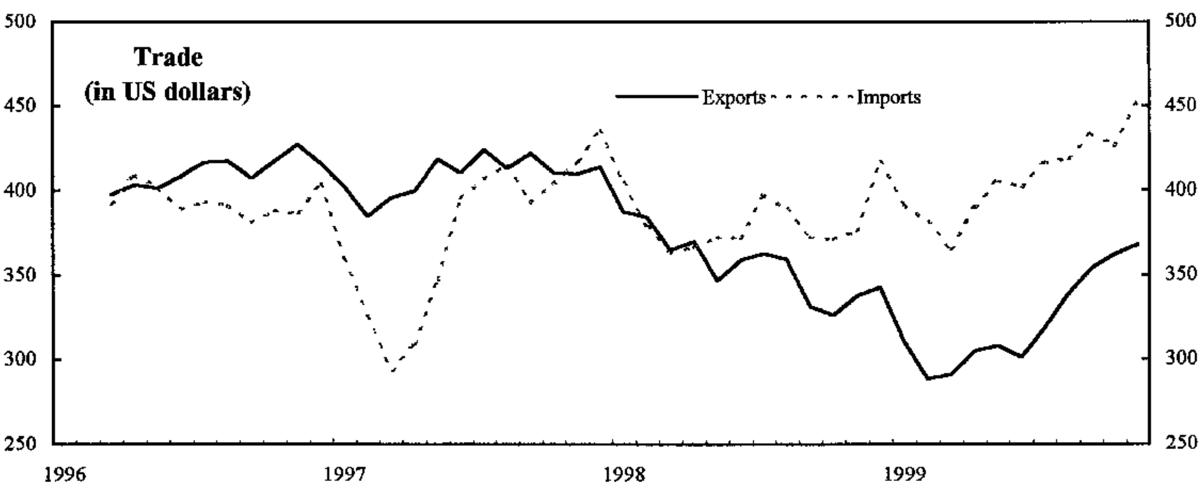
framework restored credibility and sharply reduced inflation. The carry-over from this rebound helped GDP growth to reach 3.5 percent in 1998, the highest rate since the onset of transition. However, since the initial rebound and all the way through mid-1999, a series of adverse shocks kept GDP flat and put the external current account deficit on a rising path (Figure 3). Starting in 1998, exports and activity suffered from a slowdown in partner countries and weak export prices as a result of the global financial crises. In March–June 1999, the Kosovo conflict blocked transit routes to western Europe, raising transport costs and causing further losses in exports. In 1999, Bulgaria also faced the strains related to the most intensive stage of privatization and restructuring: large inefficient enterprises in the traditional sectors were being phased out, and were only gradually being replaced by a dynamic private sector. The combined effect of these shocks was a sharp decline in exports (by one third between fall 1997 and spring 1999) and a marked worsening of the external current account deficit (from ½ percent of GDP in 1998 to over 7 percent of GDP in the first half of 1999). Despite the substantial withdrawal of external stimulus, GDP was broadly constant through mid-1999 owing to buoyant domestic demand, particularly private investment. On the supply side, while output in industry (especially in export sectors) declined, production in agriculture and services increased.

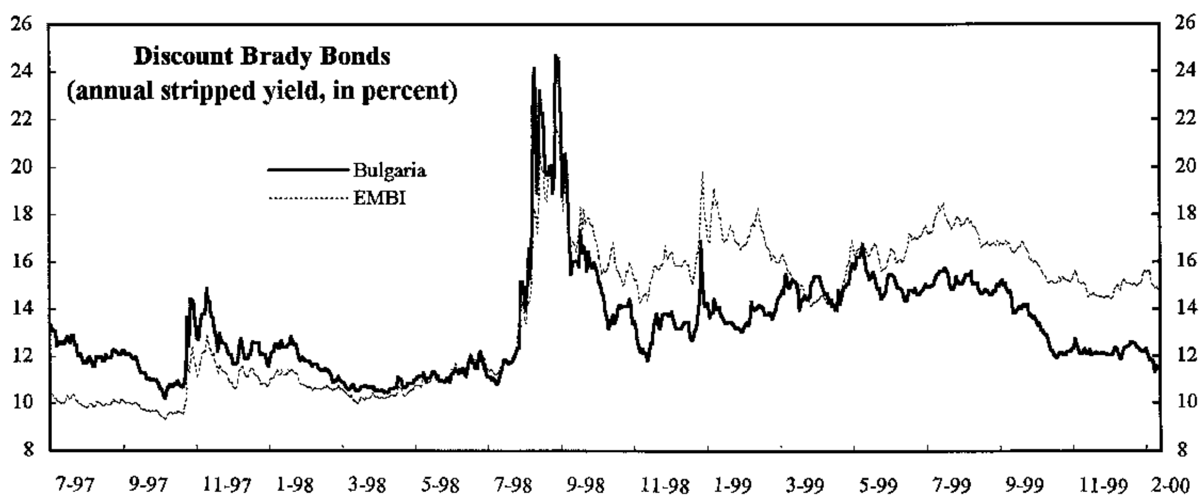
10. **With the shocks tapering off, the long-awaited recovery of exports and output got underway in the second half of 1999.** By all indications, the economy hit the bottom during the Kosovo crisis. In the third quarter GDP grew by 4.5 percent year on year, with a marked pick-up in services, robust agricultural output, and stable industrial production. This suggests that the worst effects of the shocks had been overcome, although the unavoidable disruptions from rapid restructuring were still being felt. For the full year, GDP growth is estimated at 2.5 percent, a full point more than expected at the time of the second program review last September. With a gradual recovery in exports and strong tourism receipts, the current account deficit was limited to an estimated 5.2 percent of GDP in 1999, almost ½ percent of GDP below the program projection. This still implies a withdrawal of external stimulus of over 5 percent of GDP which was more than offset by the growth of domestic demand, with construction and other private investment being the fastest growing components. The increase in investment was financed by foreign saving, as domestic private saving declined to smooth consumption. The current account deficit was fully financed by foreign direct investment and other inflows, including additional official financing to help cover the estimated export loss of US$100 million arising from the Kosovo crisis. Reserve cover remained adequate at 6 months of imports of goods and nonfactor services.

11. **The near-term outlook is quite promising.** The authorities' objectives for 2000 of GDP growth of 4 percent and a current account deficit of no more than 4 percent of GDP appear well within reach. The carry-over from the pick-up in activity in the latter part of last year will alone go a long way toward meeting the growth objective. Moreover, the latest business surveys indicate optimism about investment and industrial and retail sales. The growth of disposable incomes is expected to remain robust owing to the solid output growth and some reduction in the tax burden. This, together with structural reforms to increase private sector initiative, should allow private saving to rise from last year's exceptionally low level, while leaving room for a moderate expansion of private consumption. Regarding the external position, while sluggish growth and weak exports through mid-1999 had raised concerns about competitiveness and vulnerability, these concerns have now been reduced substantially (Box 2). Export growth should reach double digits, boosted by a large

Figure 3. External Sector Developments, 1996-2000







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

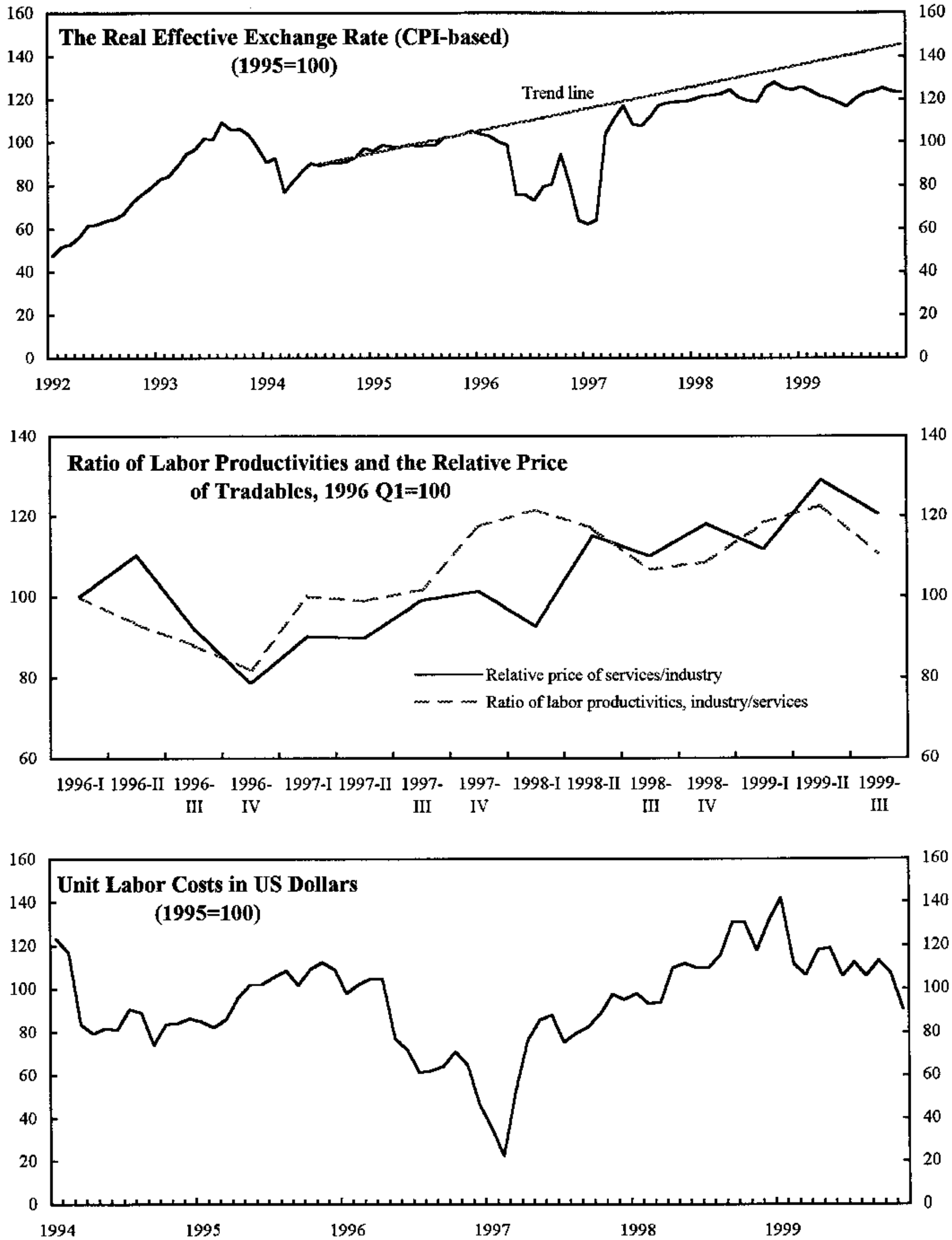
Box 2. Competitiveness and External Vulnerability

According to traditional indicators, competitiveness is broadly adequate and external vulnerability limited (Table 4 and Figures 4–5). The weakness of exports and growth in 1998–99 seems to have been largely attributable to the adverse shocks, and real exchange rate indicators point to adequate competitiveness in the absence of further external disturbances. First, the CPI-based real effective exchange rate of the lev has been broadly unchanged over the past year, and is below its trend level. Second, the movements of the real exchange rate over the past few years track fairly closely the productivity differential between the traded and nontraded sectors, suggesting that the trend real appreciation represents an equilibrium phenomenon (the Balassa-Samuelson effect) rather than a misalignment. Third, average wages (at US$160 per month in industry) remain low even by regional standards, and did not increase during 1999 in U.S. dollar terms. Finally, an upward trend in unit labor costs was reversed during 1999: they remained stable in leva terms, and declined markedly in U.S. dollar terms owing to the strengthening of the U.S. dollar against the euro (to which the lev is pegged). As for vulnerability, Bulgaria's external debt is relatively high (82 percent of GDP at end-1999) but is on a declining path and has a long average maturity, official reserves at 6 months of imports are substantial, and a stable ratio of foreign currency deposits to broad money suggests continued confidence in the lev.

Export developments in 1999 also support the view that competitiveness is not under major threat. Last year, despite the overall export weakness, labor-intensive non-traditional exports like textiles rose, while the share of traditional exports (metals, chemical, fertilizers) declined to around 31 percent, down from 40 percent in 1998. It is noteworthy, however, that toward the end of the year, exports by companies in traditional sectors which had been restructured, such as iron and steel, picked up. The fact that Bulgaria's market share in the EU remained stable during this difficult period also gives reasons for optimism. However, the persisting blockage of the Danube due to the Kosovo crisis is likely to dampen prospects for the recovery of some bulky exports which are more dependent on river transport.

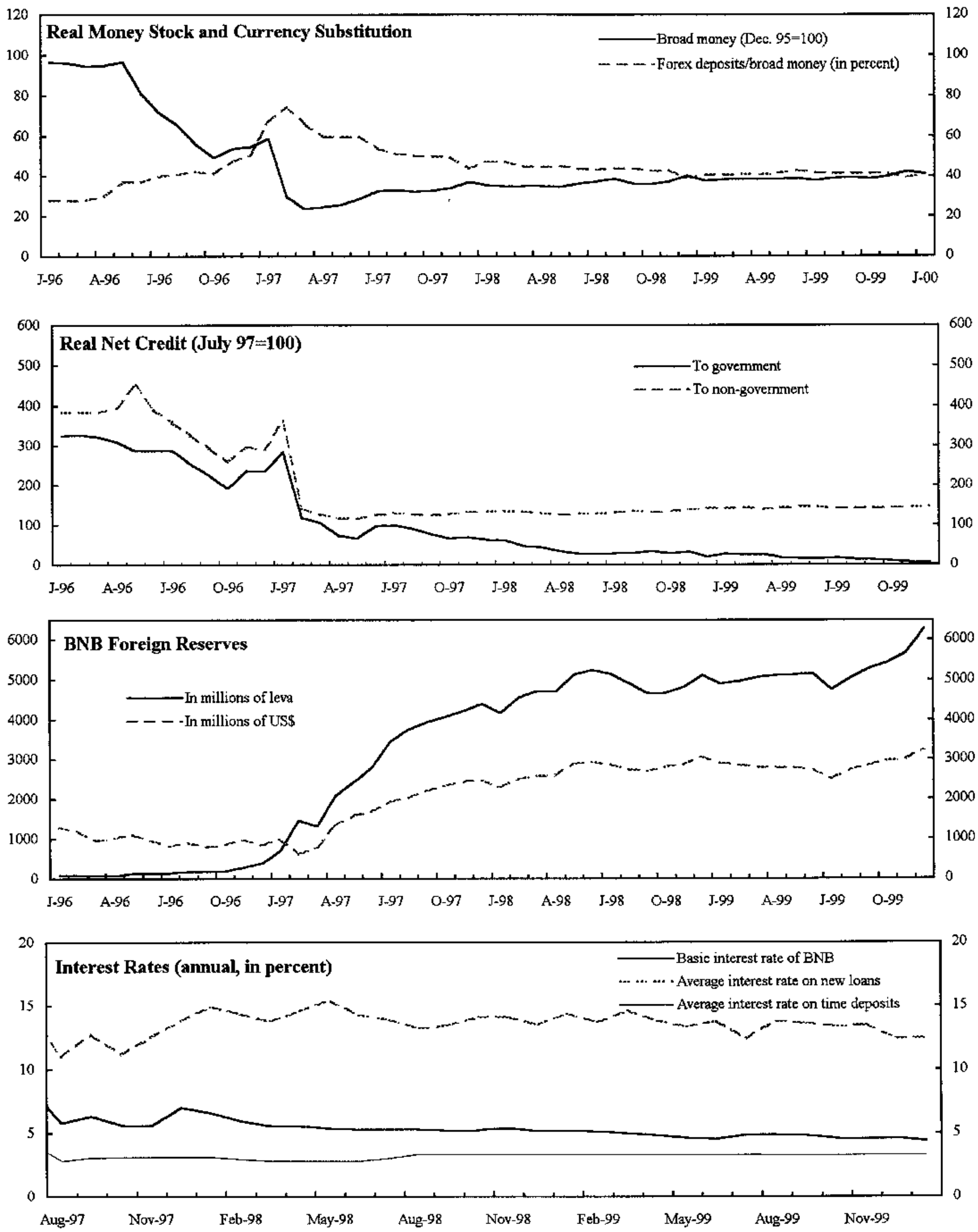
These conclusions are elaborated in Chapter I of the Selected Issues paper. This chapter analyzes Bulgaria's export performance over the past decade, focussing on the slump in 1998–99, and reviews what conventional indicators tell us about Bulgaria's present competitiveness.

Figure 4. Bulgaria: Indicators of Competitiveness, 1992-1999



Sources: National Statistical Institute; and Fund staff calculations.

Figure 5. Bulgaria: Monetary and Financial Indicators, 1996-2000



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

carry-over from last year and a markedly better external environment than a year ago. This should more than offset the impact of a projected more modest increase in imports, turning the current account deficit to a declining path. Hence, the outlook in 2000 is for more balanced growth than in recent years, with both domestic and external demand making positive contributions.

12. **However, challenges remain:**

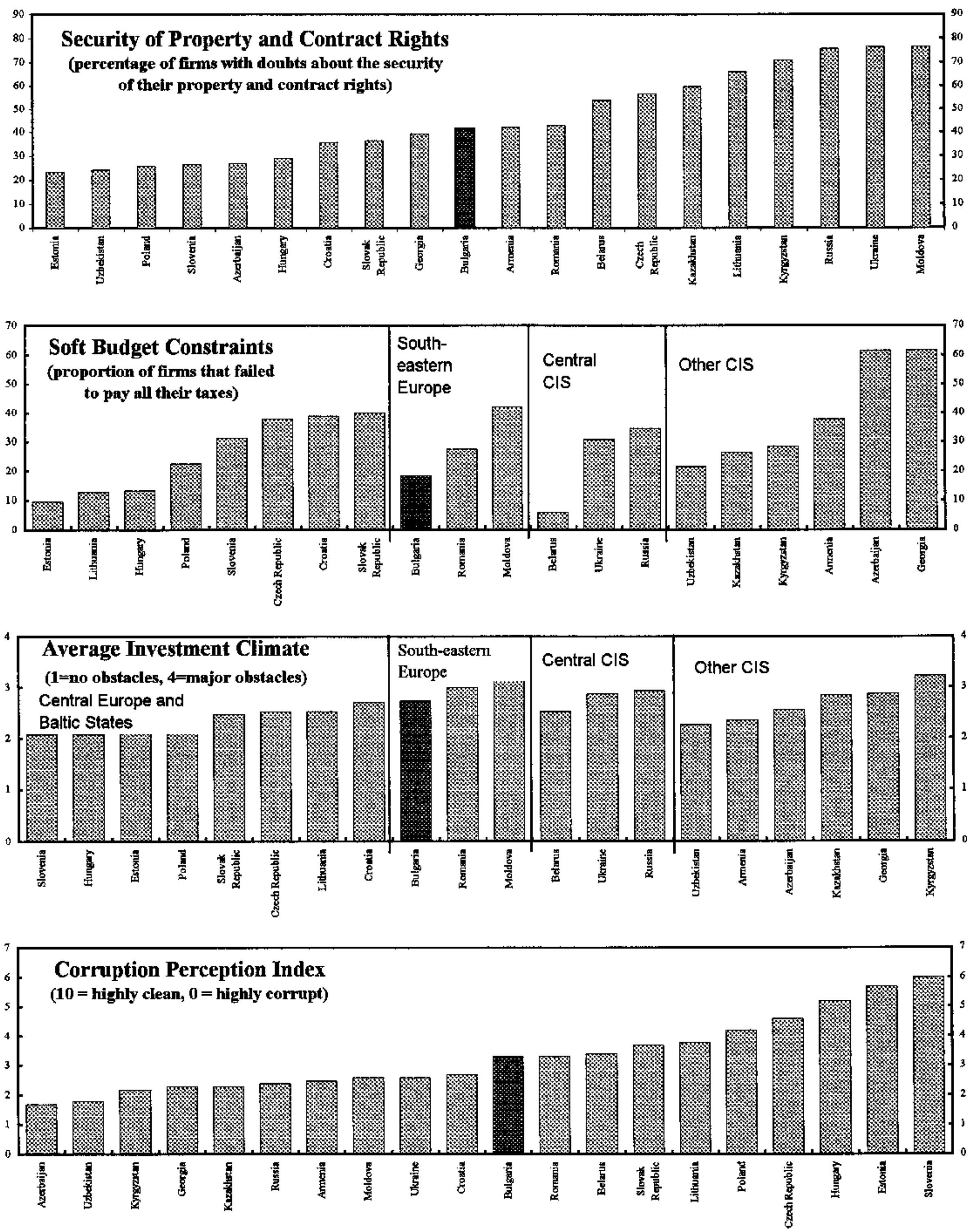
- **Unemployment is high.** Bulgaria's unemployment rate has been persistently high during the transition, reflecting a generally weak growth record (including a number of severe output contractions), low regional mobility, and high non-wage labor cost components. Having declined to 12 percent in 1998, unemployment increased substantially during 1999, reaching 16 percent in December. Poverty is also believed to remain widespread, especially among pensioners and in less developed regions, although the lack of poverty surveys since 1997 makes an assessment of the present extent of the problem difficult. Much of last year's rise in unemployment was attributable to labor shedding in the public sector (especially in state enterprises undergoing restructuring) and a higher participation rate, although increased incentives to register as unemployed also played a role (under the new health system, benefits will only be available to registered persons and their dependents). Despite this net increase in unemployment, the rate of private sector job creation was quite high.

- **There is a long remaining agenda to meet the criteria for EU accession, the government's key goal** (Figures 6 and 7). Bulgaria's per capita income is the lowest among the 12 candidate countries, and many years of very rapid growth are required for the country to catch up with even the middle-income countries in the group. Bulgaria also has some way to go in the development of a fully competitive market economy. The state-owned sector continues to suffer from a lack of financial discipline: fewer than half of all state-owned enterprises make profits, and a culture of nonpayment remains pervasive. Effective liquidation and bankruptcy procedures are yet to be put in place, slowing down the exit of unviable enterprises. The emerging private sector also faces many obstacles, including burdensome bureaucracy and red tape, weak governance, and a banking system hesitant to extend credit. Bulgaria's sovereign credit rating remains well below investment grade, and cumulative foreign direct investment at less than US$200 per capita is low by regional standards.

III. Report on the Discussions

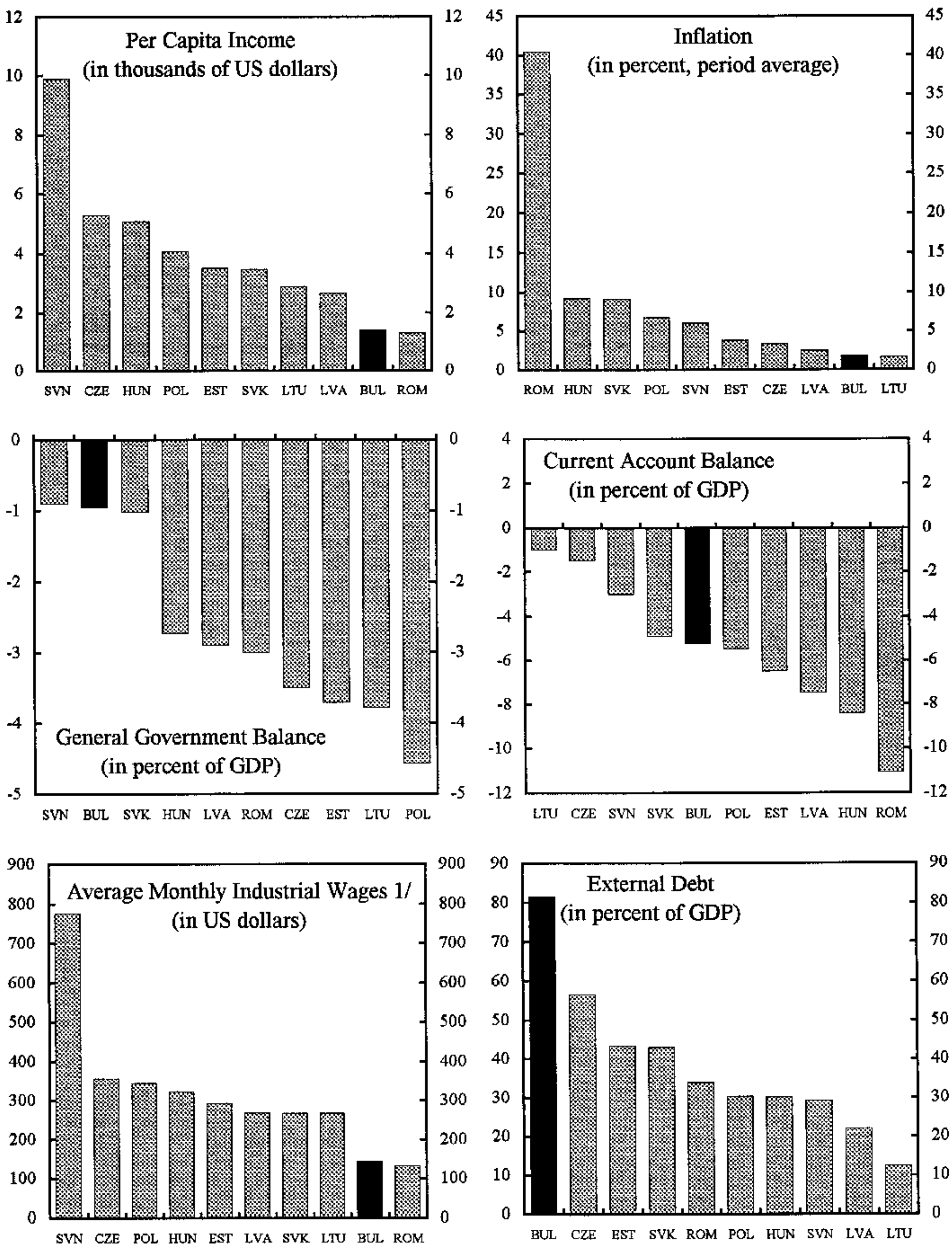
13. **Discussions focussed on policies that would help Bulgaria consolidate the incipient recovery and move to a path of sustained rapid growth, while increasing the economy's market orientation.** Achieving these objectives would help raise living standards, reduce unemployment and poverty, and bring Bulgaria closer to EU membership. There was full agreement that the authorities' overall strategy should continue to be based on the currency board arrangement, underpinned by prudent fiscal and incomes policies and intensive structural reform.

Figure 6. Bulgaria: Business Environment in Transition Economies



Sources: EBRD Transition Report 1999; Business Environment and Enterprise Performance Survey; and Transparency International.

Figure 7. Bulgaria: International Comparisons, 1999



Source: World Economic Outlook.

Note: BUL, Bulgaria; CZE, Czech Republic; EST, Estonia; HUN, Hungary; LVA, Latvia; LTU, Lithuania; POL, Poland; SVK, Slovak Republic; and SVN, Slovenia.

1/ Estonia, Latvia, Lithuania, Romania, economy-wide wages; Hungary, Poland, and Slovenia manufacturing gross wages.

A. Macroeconomic Framework

14. **The authorities reaffirmed their commitment to the CBA-based medium-term policy framework** (Tables 5–7, and ¶5–6).[2] They shared the staff's assessment that the CBA-based strategy had served Bulgaria well, most recently in allowing the economy to survive last year's severe shocks relatively unscathed. The CBA would need to continue to be supported by prudent fiscal and incomes policies to safeguard external viability, as well as by intensive structural reform to remove supply-side bottlenecks and create an enabling environment for the private sector. To facilitate reaching annual GDP growth of at least 4–5 percent over the medium term and maintaining inflation at moderate levels, the authorities were committed to keeping the underlying budget position in broad balance, while allowing actual deficits of up to 2 percent of GDP to cover transitional costs of structural reform. This would ensure a steady reduction in the debt-to-GDP ratio, helping to preserve fiscal and external sustainability (Appendix V provides a more detailed description of the medium-term scenario, including a positive assessment of Bulgaria's capacity to repay the Fund). The staff and the authorities agreed, however, that fiscal policy alone would not generate rapid growth and reduce unemployment. Comprehensive structural reforms would be needed to improve productive capacity and encourage saving and investment, including foreign direct investment. A strict incomes policy for state-owned enterprises would continue to help safeguard competitiveness. On unemployment and poverty, the authorities and the staff shared the view that promoting sustained private sector growth was the main instrument for combating these problems.

15. **Regarding immediate prospects, there was agreement that Bulgaria was well positioned for a solid recovery in 2000.** The better-than-projected macroeconomic outcomes in 1999 gave the authorities confidence that the targeted pick-up in growth to 4 percent and a reduction in the current account deficit to 4 percent of GDP would materialize, with inflation of 3½ percent during the year. The staff concurred, and noted that the large carry-over from last year could make the rebound in activity and exports in 2000 even stronger than now projected. There were, however, also downside risks. Any slowdown in structural reform, in particular enterprise privatization and restructuring, could prolong the "adjustment blues" Bulgaria had been experiencing, and result in weaker growth. Lack of wage discipline or a softening of enterprise budget constraints could undermine competitiveness and the incipient export recovery, leading to a higher current account deficit. To minimize the risks, the policies agreed for 2000 included a broadly unchanged fiscal stance, continued wage discipline, and intensive structural reform.

B. Fiscal Policy

16. **While commending the authorities for maintaining a strong track record of prudent fiscal policy in 1999, the staff noted that last year's outcome benefited from non-recurring factors and masked a lack of firm control over municipal spending** (Table 8). The authorities explained that following marked overperformance in 1998 (a general government surplus of 1 percent

[2] ¶ refers to the relevant paragraph in the Memorandum on Economic Policies.

of GDP), the original budget for 1999 had envisaged a deficit of 2.8 percent of GDP, based on conservative revenue estimates and allowing higher spending on investment and the transitional costs of structural reform. In the event, the Kosovo crisis and other shocks caused the current account deficit to widen substantially more than projected, jeopardizing external viability. In response, the authorities had tightened the fiscal stance, resulting in a general government deficit of 0.9 percent of GDP in 1999. The tighter stance was achieved through a strong revenue performance and strict control of spending in the central government. The staff noted that the favorable outcome in 1999 was in part the result of one-time factors, including substantially higher-than-budgeted nontax revenues and a sharp reduction in tax arrears. Also, the prudent overall fiscal stance had masked significant differences among the branches of government. In particular, while the central government achieved a surplus, municipalities ran sizable deficits and needed additional transfers from the central budget.

17. **Discussions on the 2000 budget focused on tax policy and administration, as well as on selected expenditure items.** The main elements of the draft budget for 2000 were discussed on an October 2000 staff visit before the budget was sent to parliament. At that time, the authorities proposed to continue their medium-term efforts to reduce the tax burden through a two-point reduction in the top profit tax rate to 25 percent, and a moderate upward shift in the personal income tax brackets. The staff concurred, noting that the revenue loss would be small (some ⅓ percent of GDP), but emphasized that substantial reductions in the tax rates over the medium term would only be possible if the tax and social security administrations were improved markedly. To this end, the staff urged the authorities to move rapidly on the initiative to create a unified revenue agency which the authorities were contemplating. The authorities agreed that this agency, which would combine the collection activities of the tax and social security administration, would have major potential for improving the government's revenue collection capacity. They were, however, concerned that an unduly rapid implementation schedule could disrupt revenue collection in the interim. Subsequently, a January 2000 joint IMF–World Bank technical assistance mission clarified the schedule to the authorities' satisfaction, and the agency is now going to be implemented in a phased manner during 2000–1 (¶13). On the expenditure side, agreement had already been reached at the time of the second review on preserving the ratio of social assistance to GDP, while substantially reducing subsidies and reigning in budgetary wage increases to create room for the up-front costs of pension and health reforms. The draft budget reaffirmed these commitments which were consistent with the authorities' aim to keep non-interest spending under 35 percent of GDP over the medium term.

18. **The 2000 budget is designed to keep the fiscal stance broadly unchanged from last year, while retaining sufficient flexibility to respond to unforeseen developments (¶7–11).** The budget approved by parliament is closely in line with the draft budget discussed on the October 1999 staff visit. It allows for a general government deficit of up to 1½ percent of GDP, but some overperformance as in the previous two years is likely. The revenue estimates are conservative as nominal GDP is expected to be higher than projected when the budget was formulated, and expenditure estimates include margins of close to 2 percent of GDP (in particular, generous spending contingencies and, as last year, permission for the Ministry of Finance to limit discretionary spending to 90 percent of the budgetary allocation). To strengthen fiscal discipline in the local government sector, the budget law for 2000 limits the spending of municipalities to the level of revenues collected (rather than projected), and links central government transfers to the municipalities' fiscal performance. Regarding flexible budget implementation, if the external current account deficit does

not improve as expected, the authorities are committed to using the margins to reduce the fiscal deficit further. Conversely, if the current account position improves more than projected and revenues exceed targeted levels, public investment could be accelerated, and civil service reform could be buttressed through decompression in the public wage structure in the second half of the year. Box 3 provides a fuller discussion of the highlights of the approved 2000 budget.

19. **The authorities were determined to carry out sweeping institutional reforms in the fiscal and social areas** (¶12–14, and Box 4). The fiscal reforms—the creation of the above-mentioned unified revenue agency and the treasury project—were designed to improve budget performance and implementation both in the short and longer runs. The unified revenue agency holds the promise of significant future improvements in revenue collection capacity, while the implementation of the treasury has already strengthened expenditure management. The social reforms—overhauling the pension and health systems—were key to ensuring medium-term fiscal viability but would result in some additional transitory burden on the budget.[3] While welcoming the authorities' ambitious plans, the staff emphasized the need for an appropriate phasing of the reforms to conform to available administrative capacity and to avoid disruptions to budget performance. The staff also noted that sufficient provisions were made in the 2000 budget to cover the transitional costs of the health and pension reforms.

C. Competitiveness

20. **The government's program includes a broad range of measures to enhance competitiveness.** The staff emphasized that despite improved prospects the currency board arrangement left little margin for error in this area. Accordingly, the staff saw a need for a continued strict incomes policy for state enterprises and moderation in wage increases in the budgetary sector. Improved labor market flexibility, which would help create employment and maintain competitiveness, would also be important. On the Bulgarian side, neither the authorities nor the business community saw labor costs as a constraint for faster growth of exports and activity. Rather, surveys had identified red tape, corruption, and administrative inefficiency as key hindrances. Nevertheless, to harden budget constraints, the government agreed to continue imposing wage bill freezes on state monopolies, enterprises with the largest losses and arrears, and enterprises receiving state subsidies (¶15). Moreover, the increase in the average budgetary wage of 8 percent would result in only a mild increase in real terms, especially considering that much of the rise in take-home pay would be offset by an increase in the employee share of the social security contribution from 5 to 20 percent. The authorities were also keen to improve the business climate. To this end, they had in late 1999 adopted a program aimed at reducing red tape and increasing transparency. Key measures would include eliminating and simplifying licensing requirements, and creating streamlined systems to facilitate the establishment and

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[3] The transitory costs of the pension and health reforms in 2000 are estimated at some 1 percent of GDP. In the case of pension reform, these costs arise primarily from lower initial revenue from contributions by some occupational groups which will be more than offset in future years by lower spending as a result of tightened parameters, such as a higher retirement age and reduced scope for early retirement. As for health reform, the additional burden reflects set-up costs of the new system.

Box 3. Highlights of the 2000 Budget

The 2000 budget envisages a general government deficit of 1.4 percent of GDP, below the targeted deficit for 1999, but slightly higher than the outcome. The key features of the budget include the following:

- **A revenue-to-GDP ratio at close to 37 percent.** This ratio is conservatively estimated, and broadly comparable to the exceptionally high 1999 ratio of 40 percent once one-off factors that boosted revenue last year are removed. These factors included a reduction in tax arrears, high revenue from penalty interest on arrears, and a profit transfer from the Bulgarian National Bank. The revenue loss of about ⅓ percent of GDP from small cuts in corporate and personal income taxes is expected to be offset by improvements in tax and social security administration, including the phased introduction of a unified revenue agency that will collect taxes and social security and health contributions. Nontax revenues are expected to remain buoyant, boosted by the full-year effect of recent increases in road fees and municipal levies.

- **Total expenditures at 38 percent of GDP**, with non-interest spending comfortably below the government's indicative medium-term limit of 35 percent of GDP.

- Higher **spending on pensions and health** by a total of 0.6 percent of GDP to accommodate the transitional costs of pension reform (starting from the beginning of 2000) and the next phase of health reform (starting in mid-2000). The budget also includes an additional contingency of 0.8 percent of GDP for these reforms, which will only be released should the difficult-to-estimate first-year costs of reforms exceed original estimates. On other spending, an increase in the average **wage in budgetary sector** of 8 percent (including the increase in the employee share of social contributions from 5 to 20 percent) will allow some real increase without having a strong demonstration effect on enterprise wages. Together with reductions in staffing, this should keep the budget's wage bill broadly constant relative to GDP. Moreover, **subsidies** will be cut by over ½ percent of GDP, consistent with restructuring plans for state railways and other state enterprises. Finally, spending on **social assistance** will be broadly constant relative to GDP.

- The budget includes significant **margins to allow a tightening of the fiscal stance if needed**. In addition to explicit spending contingencies amounting to 1.2 percent of GDP (including those related to pension and health reforms), the authorities are committed to continuing the practice of transferring only 90 percent of discretionary spending to agencies until the last quarter of the year. The introduction of a treasury from the beginning of 2000 will also improve control over expenditure. Moreover, nontax revenues have been projected conservatively as they do not include any profit transfers from the Bulgarian National Bank.

- Finally, the budget law includes **measures to strengthen fiscal discipline in the municipal sector.** It prescribes that spending may not exceed actual revenues collected, and links central government transfers to fiscal performance.

Box 4. Fiscal and Social Reforms

The key features of these reforms (of which the pension and health reforms are discussed in more detail in Chapter II of the Selected Issues paper) **are as follows**:

- By enhancing revenue collection capacity, the creation of a **unified revenue agency** to collect both taxes and social insurance contributions should enable the presently high tax and contribution rates to be reduced over the medium term. Until now, the tax and social security administrations have had parallel structures but separate information systems. Combining the collection activities of the two agencies under a single information and enforcement system should result in economies of scale and reduce the presently widespread evasion and underreporting. To minimize disruptions, the agency will be implemented in a phased manner during 2000–1 with IMF and World Bank technical assistance.

- The **treasury** system being implemented will enhance the Ministry of Finance's capacity for effective budget execution. Over the past 1½ years, major progress has been made with the help of an FAD long-term advisor. By now, central government funds have been centralized in a single treasury account at the Bulgarian National Bank, most extrabudgetary funds and accounts have been closed (14 remain, down from over 1,000 in 1998), and the number of spending units has been reduced markedly. These measures have already strengthened expenditure management and fiscal transparency substantially. Further progress will be made over the coming year, including through putting in place modern accounting and information management systems.

- Bulgaria's **pension reform** is among the most ambitious in the transition world. The old pay-as-you-go (PAYG) system was unviable: Bulgaria's population is aging rapidly and has been on a declining trend, the average effective retirement age at 56 years has been very low, and with no link between lifetime contributions and benefits, the system lacked incentives to contribute. The new system being put in place is a modern three-pillar system, consisting of a strengthened version of the existing PAYG system (first pillar) and two fully funded pillars (a mandatory public pillar for new entrants, and a voluntary private one). The legislative basis for strengthening the first pillar (the Social Insurance Code) was adopted by parliament last year, and phased implementation started from the beginning of 2000. Key changes include substantially reducing early retirement categories, raising the retirement age (although parliament decided not to raise the regular and early retirement ages to the extent originally envisaged), and establishing a link between contributions and benefits. The second pillar will be launched in 2002, and preparations have already started. The legislative basis for the third pillar was adopted last year, paving the way for the creation of voluntary defined-contribution funds.

- The **reform of the health system** aims at improving the quality of health care substantially while keeping the costs under control. Under the old system, health care in Bulgaria was universal and nominally free, but its delivery became increasingly inefficient in recent years: the quality deteriorated despite overcapacity and overstaffing, in part owing to lack of investment. Although the country's public expenditure on health at 4 percent of GDP in 1999 was among the lowest in the region, the cost to patients was substantial as side payments were commonly required. The new system being implemented continues to provide all citizens access to basic health benefits, but assigns health care delivery to public and private providers under contracts negotiated competitively with the Health Insurance Fund (HIF) created in mid-1999. These providers will therefore have incentives to improve efficiency, including through downsizing and investment. The HIF started collecting contributions from July 1999. In the next stage of the reform, a for-fee provision of primary and specialized care will begin in mid-2000, followed a year later by the extension of the new system to hospital care. In 2000, increased budgetary resources amounting to 4½ percent of GDP will be transferred to the health sector, in part to cover the set-up costs of the new system. The medium-term financial viability of the new health system requires tight expenditure control by the HIF.

working of businesses (¶29). Moreover, employment and investment clauses in privatization contracts would be made less restrictive, and the Labor Code would be amended to make employment and working hours more flexible (¶16).

21. **The minimum wage was subject to much discussion.** During the near-hyperinflation of 1996–97, the real value of the minimum wage had eroded substantially, reaching a low point at the equivalent of US$5 per month in early 1997. Subsequently, the authorities had raised the minimum wage faster than other wages, and for 2000 they proposed a major further increase of up to 50 percent. In their view, raising the minimum wage sharply would bring about a welcome increase in revenue from social security contributions, since a large share of private sector workers underreported their wages, paying the minimum contribution tied to the minimum wage. They noted that this was the only remaining indexation, and thought that the labor market repercussions would be minor as only 1 percent of budgetary workers and very few in the private sector actually received the minimum wage. By contrast, in the staff's view social security collections could be raised more effectively and in a more lasting way through other measures, in particular by establishing the unified revenue agency. The staff also argued against underestimating the direct and indirect labor market consequences of a sharp minimum wage increase: the measure could have a signaling effect on other wages, and work against the government's objective of reducing unemployment. The staff acknowledged, however, that the existing ratio of minimum to average wage (29 percent) was somewhat below that in other transition countries (where it is typically about one third) and that some upward correction in the ratio should not be a threat to competitiveness. Ultimately, an agreement was reached on a 12 percent increase in the minimum wage from February 2000 (¶11), which makes the ratio of the minimum wage (now US$39 per month) to the average public sector wage (US$120) comparable to that in other transition economies. This ratio would be maintained in the future.

D. Financial Sector Issues

22. **The staff stressed the importance of a well-functioning financial sector for sustained growth.** Bulgaria has made major progress in strengthening its financial system following the banking crisis of 1996–97: the share of bad loans in the banks' portfolios has declined sharply to 9 percent, the capital adequacy ratio averaging 40 percent is well above the required minimum level, and great strides have been made in improving banking supervision, so that Bulgaria is now fully or largely compliant with most of the 24 Basle Core Principles (EBS/00/46). However, the rudimentary state of Bulgaria's capital market and the exceptionally low level of bank credit to the private sector are indications that further improvements could yield significant growth dividends. In this regard, the staff noted that prudent credit expansion to the private sector could be promoted by increasing competition in the banking sector (including through privatizing the remaining three state-owned banks), providing better information about potential borrowers, and strengthening the legal environment and enforcement of contracts (Box 5). The authorities agreed, and were determined to take the necessary steps (¶26, 28). The sale of the two state banks currently on the market (including Bulbank, the country's largest bank) would be completed during 2000, and the only state-owned bank remaining after these sales would be prepared for privatization. Other measures being taken included establishing a central credit registry at the Bulgarian National Bank (BNB), drafting and adopting new legislation (especially on bank bankruptcy and electronic signature), improving the implementation of international accounting standards, and training judges on financial issues.

Box 5. Why is Private Sector Credit So Low in Bulgaria?

Bank lending to the private sector is low in Bulgaria by any standard. It amounts to only 12 percent of GDP, compared with 17 percent for transition economies, 49 percent in the U.S., and 120 percent in the U.K. Financial intermediation is low even when controlling for Bulgaria's stage of development: based on a cross-country regression, a country with Bulgaria's per capita GDP is expected to have a 30 percent ratio of credit to the private sector to GDP. This is not due to low bank liquidity: deposit-to-loan ratios are high, but banks tend to hold bonds instead of extending loans. Neither do demand factors seem to limit credit expansion as private investment is buoyant.

Rather, the low level of credit to the private sector seems to be mainly accounted for by the following factors:

- **The banking crisis in 1996–97.** As in other countries that went through a banking crisis, banks in Bulgaria became more cautious in their lending during and after the crisis. Before the crisis, lending to the private sector had been higher (20 percent of GDP in 1995), but much of it was based on unsound banking practices under weak supervision.
- **Economic restructuring.** Many old customers have ceased or reduced operations, or have become uncreditworthy under the restructuring that has taken place since the crisis. New customers from the emerging private sector typically do not have a credit history or appropriate collateral, and transparent financial information is often lacking.
- **Lack of competition in the banking sector,** despite a relatively large number of banks (35). The banking system is dominated by a small number of large banks, all of which were state owned until 1998. Interest margins are high and banking services inefficient, and banks have not felt pressure to cut costs.
- **An imperfect legal environment.** The resolution of financial disputes is often slow, and contract enforcement is weak. Collateral is hard to seize, and bankruptcy and liquidation procedures remain fraught with ambiguity and uncertainty. A legal provision that criminalizes the extension of loans without "proper security" even in the absence of fraudulent intent acts as a deterrent for bank officials.

Is lack of credit a significant impediment to faster economic growth? Lack of bank credit did not prevent private investment from recovering from 9 percent of GDP in 1997 to an estimated 12 percent of GDP in 1999 as retained earnings and foreign investors provided the bulk of the financing. However, it is likely that increased financial intermediation would improve the allocation of resources in Bulgaria, promoting higher growth. There is mounting international evidence that the level of credit has a causal effect on growth, and estimates from a cross-country study[1] suggest that were Bulgaria to develop its banking system to the average level of countries in its income group, its yearly growth rate could be 1–2 percentage points higher.

The Bulgarian authorities agreed with the analysis, and noted that they were taking several measures under the EFF-supported program to facilitate fast and healthy growth of credit to the private sector. Continued bank privatization would promote competition in the financial sector. A central credit registry would soon be made fully operational, improving the information base for credit decisions. The planned training of judges on financial issues should help accelerate the resolution of disputes. A law on land registration and cadastre, which would facilitate the use of land as collateral, was being discussed in parliament.

Nevertheless, challenges remain. The staff welcomed the ongoing efforts, but stressed that more remained to be done. The existing generally solid legislation should be enforced strictly and complemented by clear implementing regulations. Accounting standards and disclosure rules would need to be implemented stringently and creditor's rights enforced more consistently. To accelerate the handling of enterprise bankruptcy cases, the existing draft amendments to the Commercial Code should be adopted quickly. Moreover, a thorough review of existing practices governing insolvency and liquidation procedures would be desirable. Consideration should also be given to the removal of the provision in the Criminal Code that penalizes the extension of loans without "proper security". At a minimum, the law should be clarified so as not to criminalize reasonable lending practices.

This topic is covered in more detail in Chapter III of the Selected Issues paper.

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[1] Ross Levine, Norman Loayza, and Thorsten Beck (2000), "Financial Intermediary Development and Economic Growth: Causality and Causes," *Journal of Monetary Economics*, forthcoming.

23. **The authorities are making further efforts to improve the regulatory and prudential framework in the financial market** (¶27). BNB officials proposed to lower the minimum reserve requirement from 11 to 8 percent, explaining that this would improve banks' profitability, lower interest spreads, and broadly offset the liquidity impact of the recent introduction of the single treasury account. The staff supported this measure, which will take effect July 1, 2000, noting that it should not jeopardize the soundness of the financial system as prudential liquidity requirements were adequate, the banks maintained high and stable liquidity ratios, and most banks had access to the interbank markets. The staff also welcomed the authorities' intention to amend the law on deposit insurance to allow the fund to collect premiums and invest resources more efficiently.

E. Structural Reform

24. **Discussions on structural issues centered on measures to maintain and strengthen the momentum of reform.** While noting the generally impressive progress made over the past year, the staff stressed that rapid and comprehensive reform remained key to Bulgaria's economic success and that delays in implementing reforms could harm growth prospects. The authorities indicated that they were determined to press ahead with reforms on a wide front, and besides reaffirming existing commitments agreed to further action in a number of areas. World Bank staff participated in all key discussions on structural issues, and their advice was the basis of many of the agreed initiatives.

25. **Energy sector reform was a key focus of the discussions.** The staff emphasized that moving to a competitive market economy would require significant restructuring away from Bulgaria's traditionally energy-intensive industries, and rapid convergence to market clearing energy prices in the context of effective natural monopoly regulation. However, until recently Bulgaria's energy sector had still been largely unreformed, creating serious bottlenecks for the whole economy. The authorities noted that significant progress has been made during the past year. In particular, parliament had adopted an Energy Law laying the foundations for an efficient energy market, and the rehabilitation and restructuring of the natural gas monopoly Bulgargaz had been initiated successfully. Looking forward, the authorities were eager to carry out the legal separation of the electricity monopoly (NEK) into generation, transmission, and distribution components as a precursor to the eventual privatization of some of the components. While commending the authorities' efforts, the staff cautioned that a comprehensive and transparent regulatory framework, a key requirement to attract strategic investors, would need to be in place before the separation. Accordingly, the outstanding secondary legislation should be adopted as a matter of priority, and the newly created Energy Regulatory Commission should be strengthened to allow it to oversee the various natural monopolies in the sector effectively. The staff also urged increased focus on the district heating and coal mining sectors where progress had been slower than in the electricity and gas sectors. In the end, agreements were reached in all the main areas:

- In the **electricity sector,** the authorities accepted that key elements of the secondary legislation needed to be in place prior to the legal separation of NEK into its components (¶22). Agreement was also reached on the principles of a transitory price-setting mechanism aimed at avoiding excessive price volatility prior to the liberalization of prices in 2001, a key concern for the authorities.

- A comprehensive action plan to restructure and rehabilitate **district heating companies** (DHCs) would be adopted with World Bank assistance (¶23). The DHCs are in a dire financial situation as a result of an unexpectedly strong demand effect of end-user tariff increases and the recent surge in world energy prices. Previous plans focused on financial rehabilitation have proved inadequate, and the authorities are now prepared to consider options for a fundamental restructuring of this sector which provides heat to 18 percent of the population.

- Discussions on **Bulgargaz** focused on ensuring that its good performance continues despite the difficult situation of several large customers (including DHCs). A further problem was that newly prepared separate financial statements revealed that the gas distribution activity was in poor financial state. The authorities reiterated their commitment to the full implementation of the Bulgargaz rehabilitation plan, and undertook to develop a program to attract strategic private investors to the gas distribution market.

- As for **coal mines,** agreement was reached on accelerating the pace of divesting auxiliary activities, closing the unviable sections of mines, and preparing the viable sections for privatization (¶25).

26. **Building on major progress last year, privatization and enterprise restructuring will continue in 2000**. Following the largest wave of privatization in Bulgaria's history in 1999, the authorities expect to complete the divestiture of non-infrastructure assets during this year (¶17). Several large attractive enterprises which were offered for sale last year—such as Bulbank, BTC (the telecommunications company), and Bulgartabak—are still on the market. While encouraging the authorities to avoid undue delay, the staff recognized their legitimate concern to locate good strategic investors and ensure competition in the respective sectors. For already privatized enterprises, the authorities agreed to dispose of all residual state shares, with few exceptions. Progress has also been made on the sale of assets in unviable state enterprises, and the authorities are committed to streamlining liquidation and bankruptcy proceedings (¶18–19). In addition, new restructuring plans for state monopolies have been developed and are being implemented (¶20). The staff noted the important progress made under the restructuring plan for the railway company BDZ, but pointed out that given the limited capital transfers and reduced operating subsidies available from the budget, continued cost cutting and revenue raising efforts would be needed to ensure long-run sustainability.

27. **Structural initiatives in other areas are also moving apace.** The reform of **public administration** has become increasingly important: adopting the obligations of EU membership (including the acquis communautaire) while simultaneously implementing an ambitious program of structural reform will severely challenge the government's administrative capacity. The authorities have already started to respond to this challenge by streamlining and redefining the functions and structures of ministries (¶30). Looking forward, the authorities intend to introduce a more flexible public sector pay system, with room for wage decompression to be created by ongoing substantial reductions in overstaffing. Bulgaria has continued to liberalize **trade** in line with the government's medium-term plan (¶33). Over the past two years, tariffs have been reduced steadily (the simple average rate now stands at 13.7 percent, compared with 18.1 percent in 1998), and most non-tariff

barriers have been removed. During 2000, the government is also committed to further steps, including the elimination of the only remaining export ban. If these steps are fully implemented, Bulgaria's trade regime will merit a rating 2 ("open") as measured by the Fund's index of aggregate trade restrictiveness, compared with 6 ("moderately restrictive") just two years ago.[4] In **agriculture**, now that land restitution has been completed, the focus is on making the agricultural land market well functioning, including through a new information system and improved legislation on registering titles (¶31).

F. Other Issues

28. **The authorities continue to place a great deal of emphasis on managing external debt prudently** (¶34). The government is in the final stages of developing a debt management strategy to ensure fiscal and external sustainability and to reduce total public sector debt from the present 88 percent of GDP to below the Maastricht criterion of 60 percent of GDP. Guidelines for contracting and guaranteeing non-concessional debt have already been formalized, and external vulnerability indicators developed for monitoring purposes. In parallel, the authorities intend to establish an effective process for prioritizing and selecting projects consistent with the government's medium-term economic and social objectives. The financing of these projects will be determined on the basis of fiscal and external sustainability considerations in consultation with donors. The authorities continue to pursue debt service swaps for infrastructure or environment with Paris Club creditors, and have over the past year resolved bilateral disputes with two creditors, leaving one more to be settled.

29. **Technical consultation discussions indicated that Fund-provided technical assistance (TA) had generally been well received and successfully implemented, and that the authorities had started implementing the recommendations of the recent Report on the Observance of Standards and Codes.** In reviewing the effectiveness of past Fund technical assistance, FAD, MAE, and STA noted that Bulgaria had in recent years received an extraordinary amount of TA in many critical areas, and it had typically used this assistance well (Appendix I). For their part, the authorities considered Fund TA to have been of generally high quality and tailored to key needs. The Fund's help in implementing the treasury, setting up the currency board, strengthening banking supervision, and improving real sector and balance of payments statistics was particularly appreciated. Looking forward, the authorities saw a need for the Fund to continue to play a significant role in providing TA in selected areas, although in the run up to EU accession the European institutions could be expected to become increasingly involved. In this context, the authorities urged close coordination among TA providers. The authorities also identified a number of priorities for future Fund TA: the establishment of the unified revenue agency, continued assistance in banking supervision and the treasury project, and national account statistics. They also thought that continued Fund support would help in implementing the recommendations made in the Report on the Observance of Standards and Codes

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[4] This index was developed in "Trade Liberalization in Fund-Supported Programs" (EBS/97/163). While it covers the most critical elements of trade restrictiveness, such as tariff levels and nontariff barriers, it does not incorporate other elements, such as tariff dispersion. In Bulgaria, tariff dispersion is still high, with minimum and maximum tariffs of 0 and 74 percent, respectively.

(EBS/00/46). The authorities had found the report useful, and had already taken initial action in the fiscal, monetary, and statistical area toward greater transparency.

30. **The program will continue to be monitored based on quantitative performance criteria and indicative targets, and on structural performance criteria and benchmarks (¶35).** Quarterly disbursements of SDR 52.3 million each are envisaged throughout the remainder of the extended arrangement, subject to the observance of quarterly performance criteria and completion of semi-annual program review. The next review is to be completed by end-September 2000.

IV. Staff Appraisal

31. **The Bulgarian economy survived last year's severe shocks relatively unharmed, and the prospects for 2000 are promising.** In the first half of 1999, the Kosovo conflict and weak partner country demand and prices hurt exports and economic activity. In addition, intensive restructuring of enterprises led to unavoidable disruptions, especially in the traditional export industries. Nevertheless, exports started to recover in the second half of the year, and output growth resumed. For the full year, GDP growth is estimated at 2.5 percent, and the current account deficit, which had increased sharply in the first half of the year, was contained to about 5 percent of GDP. The positive trends are likely to continue in 2000. With improved prospects for exports and investment, the government's target of GDP growth of 4 percent in 2000 is well within reach. The current account deficit is expected to decline significantly, and inflation should remain moderate.

32. **The good economic performance under difficult circumstances was the result of sound policies.** The authorities remain fully committed to the currency board arrangement which has served Bulgaria well and which continues to have a solid foundation. Fiscal policy was prudent as the general government deficit was limited to 0.9 percent of GDP in 1999, almost 2 percentage points below initial projections. This fiscal tightening helped to curb the current account deficit to a level that could be financed. Incomes policy for state-owned enterprises was strictly implemented, serving to contain labor costs and maintain competitiveness. Furthermore, structural reforms continued on a wide front: privatization and enterprise restructuring was accelerated, reforms were initiated in the energy sector, land restitution was completed, two more state banks were sold to strategic investors, and trade and price liberalization continued.

33. **The recent good progress and encouraging near-term prospects notwithstanding, Bulgaria still faces enormous challenges.** The immediate challenge is to make the recovery sustained and reduce unemployment and poverty. For the longer term, Bulgaria's goal of EU accession requires very rapid growth over many years to enable the country to catch up with the rest of Europe, and major further efforts to develop a fully competitive market economy.

34. **In response to these challenges, Bulgaria should aim high, and support its goals with continued sound policies.** For the medium term, the authorities appropriately aim at growth of at least 4–5 percent, while maintaining a stable macroeconomic environment and establishing a fully competitive market economy. This would help raise living standards, reduce unemployment and poverty, and move Bulgaria closer to EU membership. To achieve the desired results, fiscal and incomes policies have to remain prudent, and the momentum of structural reform has to be maintained.

Despite the recent positive developments, there is no room for complacency: weak budgetary and wage discipline or hesitation in implementing structural reforms would only postpone a sustained economic recovery, the government's ultimate objective.

35. **The 2000 budget is prudent, and institutional reforms in the fiscal sphere should help maintain medium-term sustainability.** The budget aims to keep the fiscal stance broadly unchanged from last year. It allows for a deficit of up to 1½ percent of GDP, and has margins to permit adjustments in the fiscal stance if warranted by unforeseen developments. To preserve these margins, every effort should be made to exercise tight expenditure discipline, including in the local government sector. To create a solid foundation for future budgets, the authorities are implementing welcome reforms in several areas. The establishment of a unified revenue agency to collect taxes and social contributions holds the promise of major improvements in revenue collection capacity. While the agency will appropriately be implemented in a phased manner, a strong start over the next few months is critical to the success of this initiative. The full implementation of the treasury project over the coming year should greatly enhance budgetary control. The ambitious pension and health reforms have gotten off to a good start. Both entail additional transitional costs for which adequate provisions have been made in this year's budget. To ensure long-term viability which these reforms aim to restore, the authorities should be prepared to review the underlying parameters in light of the early experience under these reforms.

36. **Continuation of a strict incomes policy and more flexible labor market policies are vital for preserving competitiveness and reducing unemployment.** With an incipient recovery in exports supported by an improved external environment, present competitiveness appears adequate. To preserve it, real wage increases should not exceed productivity gains in the period ahead. In this regard, the authorities' decision to continue wage bill freezes for the worst-performing state enterprises, as well as for state monopolies and enterprises receiving state subsidies, is welcome. The moderation shown by the authorities in budgetary and minimum wage increases should also help to limit wage demands in the private sector. While growth-oriented macroeconomic and structural policies remain key for combating unemployment, reducing labor market rigidities is also important. To this end, the government should as a matter of priority submit to parliament amendments to the Labor Code, with provisions to ease restrictions on employment and working hours. Over the medium term, it will also be important to reduce the presently high social insurance contributions rates. This should be possible provided the unified revenue agency succeeds in improving compliance, especially in the private sector.

37. **The authorities should build on good recent progress to improve the functioning of the financial sector.** While banking supervision has improved greatly, bank lending to the private sector has been slow to pick up. Increased competition through privatizing banks to strategic investors, establishing a fully operational central credit registry, and strengthening the enforcement of contracts and legislation will help to ensure a healthy recovery in private sector credit. The planned reduction in the minimum reserve requirement from 11 to 8 percent does not jeopardize the soundness of the financial system, and should help reduce interest spreads and offset the liquidity impact of the introduction of a single treasury account. New laws on bank bankruptcy and on electronic signature will help modernize Bulgaria's financial system.

38. **The momentum in structural reform should be maintained.** The pace and extent of structural reform are key determinants of Bulgaria's future growth rate, and the authorities should spare no effort in implementing strong initiatives on a wide front. The remaining large-scale commercial state enterprises and well as the two state banks currently on the market should be sold expeditiously, with due consideration to finding strong strategic investors and ensuring competition in the markets. The role of the private sector can be further enhanced through a sale of the remaining shares in privatized companies. In the energy area, the new Energy Law represents a significant achievement, and the next challenge is to adopt the corresponding secondary legislation. Only after a transparent regulatory framework is in place should the legal separation of the electricity monopoly NEK be completed; doing otherwise could deter strategic investors. Strong measures are also needed to address the financial problems of the district heating companies and coalmines. Regarding the former, the authorities' commitment to work with World Bank experts to develop and implement a fundamental restructuring plan is welcome. As for the latter, the authorities should implement expeditiously their plan to close unviable coal mine pits and prepare the remaining mines for privatization. The reform of public administration is of critical importance, not only to improve the delivery of public services, but also to enhance administrative capacity to cope with the challenge of implementing an ambitious domestic reform agenda while simultaneously adopting obligations and directives required for EU membership.

39. **Strong efforts should be made to improve the business climate and governance**. Surveys have identified red tape, corruption, and administrative inefficiencies as major obstacles to doing business in Bulgaria, and the government should implement the recommendations of a high-level working group in these areas as a matter of priority. To foster the growth of the private sector, legal uncertainty needs to be minimized, and existing laws as well as private contracts should be enforced more consistently. To improve corporate governance, bankruptcy and liquidation procedures should be further streamlined, and accounting standards implemented stringently.

40. **Over the past couple of years, Bulgaria has made generally very good use of Fund technical assistance**. In future, the provision of technical assistance by the EU and other institutions is likely to increase, but Bulgaria deserves continued Fund support in key areas, such as banking supervision, tax administration, and national accounts and balance of payments statistics.

41. **Bulgaria has made good progress toward transparency and observance of codes and standards.** The authorities provided excellent cooperation in the preparation of the recent Report on the Observance of Standards and Codes, and their decision to publish the report is commendable. In the period ahead, the authorities should continue their already initiated efforts to implement the recommendations made in this report.

42. **The staff supports the authorities' request for completion of the third review under the extended arrangement**. Over the past year, the authorities have persevered with their ambitious program in the face of adverse circumstances. Their commitment to the strategy based on the currency board arrangement is strong, and they have established a solid track record of implementing prudent macroeconomic and structural policies. All performance criteria for end-December 1999 were observed. Looking forward, the policies set out in the Letter of Intent and the Memorandum on Economic Policies provide a sound basis for the continuation of IMF support.

43. **The Article IV consultation with Bulgaria should remain on the standard 12-month cycle.**

Table 1. Bulgaria: Selected Economic Indicators, 1995-1999

	1995	1996	1997	1998	1999 Est.	1999 Q1	1999 Q2	1999 Q3	1999 Q4
	(Percent change, from same period of previous year)								
Output, prices, and employment									
Real GDP	2.1	-10.9	-6.9	3.5	2.5	-0.7	1.6	4.5	...
CPI, 12-month 1/	32.9	310.8	578.5	1.0	6.2	-2.8	-3.3	1.7	6.2
Monthly, averaged during period	2.4	12.5	17.3	0.1	0.5	-0.1	-0.6	1.9	0.8
Unemployment rate (percent) 1/	11.1	12.5	13.7	12.2	16.0	13.2	12.8	14.2	16.0
Retail sales, real, 12-month change	-2.2	-36.2	-30.5	2.0	-2.1	-4.6	0.8	-0.7	-2.1
Business climate indicator 1/ 2/	...	...	4.8	9.8	-4.3	-3.0	-7.8	-4.1	-4.3
Monthly dollar wages (levels) 3/	127.4	56.0	107.6	127.8	122.1	119.2	119.4	122.2	122.1
Real wages, 12-month	43.1	-29.8	9.0	10.8	4.2	18.8	17.3	12.7	4.2
Consolidated government 4/	(In percent of GDP)								
Revenue	35.7	31.9	31.4	36.8	40.3	41.6	41.3	39.7	39.1
Non-interest expenditure	27.2	22.6	25.5	31.4	37.2	32.7	39.4	35.4	40.9
Primary balance	8.5	9.3	5.9	5.4	3.0	8.9	2.0	4.3	-1.8
Interest payments	14.1	19.7	7.9	4.4	4.0	8.0	1.9	5.4	1.1
Overall balance	-5.6	-10.4	-2.1	0.9	-0.9	0.9	0.0	-1.1	-2.9
External financing	-1.3	-2.9	-0.8	-1.0	0.0	-2.3	-0.3	-1.2	3.7
Domestic financing	7.0	13.3	-0.5	-1.5	-0.9	0.8	-1.3	-0.6	-4.0
Privatization	0.0	0.0	3.3	1.6	2.6	0.6	1.5	3.0	3.2
Public debt	100.9	105.8	110.4	80.2	87.7	81.7	84.4	83.5	87.7
Of which: Domestic 5/	37.3	22.0	24.4	20.3	19.8	18.8	19.0	19.3	19.8
Money and credit	(Percent change, from same period of previous year)								
Broad money (level)	583.7	1,310.3	6,018.6	6,597.2	7,351.1	6,261.1	6,183.6	6,669.3	7,351.1
Broad money (M3)	39.6	124.5	359.3	9.6	11.4	5.1	2.3	10.0	11.4
Lev money	50.9	52.7	423.0	18.2	11.5	12.2	3.5	14.9	11.5
Credit, non-government	32.4	226.1	198.4	6.4	9.8	4.5	10.5	9.7	9.8
FX deposits (U.S. dollar million)	2,245	1,357	1,477	1,543	1,477	1,423	1,415	1,503	1,477
FX deposits (percent of M3)	27.2	50.5	43.6	39.2	39.1	41.4	43.3	41.3	39.1
Broad money ratio to reserves	5.3	3.4	1.4	1.3	1.2	1.2	1.2	1.3	1.2
Interest rates (annualized)	(In percent, end month average)								
BNB basic rate	2.8	435.0	7.0	5.2	4.6	5.1	4.7	4.9	4.6
Time deposit (leva)	51.6	213.8	3.0	3.3	3.2	3.3	3.3	3.3	3.2
Balance of Payments 6/	(In millions of U.S. dollars)								
Gross official reserves	1,546	793	2,468	3,056	3,222	2,780	2,726	2,882	3,222
(In months of GNFS imports)	3.6	2.0	6.4	6.1	6.4	5.6	5.4	5.8	6.4
Current account balance	-76	21	445	-61	-632	-266	-177	20	...
Current account (percent of GDP)	-0.6	0.2	4.4	-0.5	-5.2	-9.9	-6.5	0.6	...
Trade balance	94	133	394	-381	-998	-224	-303	-239	...
Exports	4,913	4,691	4,814	4,193	3,928	873	904	1,062	...
Imports	4,819	4,558	4,420	4,574	4,926	1,097	1,207	1,300	...
External debt	10,147	9,514	9,733	10,021	10,002	9,490	9,515	9,728	10,002
(In percent of GDP)	77.4	96.8	95.9	81.8	81.6	77.5	77.7	79.4	81.6
Exchange rates									
Leva per U.S. dollar 1/ 7/	0.071	0.487	1.777	1.675	1.947	1.821	1.894	1.834	1.947
(percent change, + means depreciation)	7.1	589.3	264.5	-5.7	14.3	8.7	4.0	-3.2	6.2
REER (CPI)									
(percent change, + means appreciation)	8.1	-38.9	85.6	4.2	-0.9	-1.7	-1.7	0.4	0.2

Sources: Bulgarian authorities; and staff estimates.

1/ End of period.
2/ Industry: average of public and private sectors. A number above zero indicates a positive average assessment of current business conditions.
3/ Average monthly wage in state enterprise and budget sector, end of period, excluding end-of-year bonuses.
4/ Includes the republican budget, municipalities, and extrabudgetary funds.
5/ Domestic debt increased by 2.5 percent of GDP in June 1997 due to a restructuring of central bank claims on government.
6/ Starting 1998, a new methodology was adopted for the calculation of BOP data.
7/ In redenominated leva. On June 5, 1999, the lev was redenominated by removing three zeros. As a result, one lev now equals one deutsche mark.

Table 2. Bulgaria: Performance Criteria and Indicative Targets for 1999-2000

	1999		2000			
	Dec. 31		Mar. 31	June 30	Sept. 30	Dec. 31
	Target 1/	Actual 1/	Target 2/	Target 2/	Indicative 2/	Indicative 2/
			(in millions of leva)			
Ceilings on overall deficit of the general government (minus = surplus)	222	212	219	-9	224	95
Indicative floor for revenue of the general government	8,370	9,644	2,061	4,394	6,692	9,136
Floor on the change in the balance of the Fiscal Reserve Account	443	509	-444	-303	-470	-178
Floor on deposits of Banking Department 3/	680	856	680	680	680	680
Ceiling on changes in tax arrears 4/	-358	-417	...	...	...	...
Ceiling on changes in tax and social insurance arrears	...	...	-39	-83	-133	-191
Indicative ceilings on changes in tax arrears	...	...	-30	-60	-90	-120
Indicative ceilings on changes in social insurance arrears	...	...	-9	-23	-43	-71
Indicative ceilings on changes in total outstanding liabilities of monitored enterprises to NSSI and customs 4/	-65	-17	...	...	...	...
Indicative ceilings on changes in total outstanding liabilities of monitored enterprises to customs	...	...	0	0	-2	-2
Indicative ceilings on changes in the stock of net bank credit to the general government	-132	-616	391	125	302	51
Ceilings on outstanding stock of external debt of 1 year or under 5/	80	0	40	80	120	160
Ceilings on contracting or guaranteeing of non-concessional external debt of over 1 year	840	462	700	850	950	1,100
Ceilings on contracting or guaranteeing of 1-5 years non-concessional external debt	250	0	250	250	250	250
Structural and other performance criteria		All met (see Table 3)				

Sources: Program projections; and data provided by the Bulgarian authorities.

1/ Using EFF Second Review definitions and exchange rates, with 1.8 lev/U.S. dollar; cumulative from January 1, 1999.
2/ Using EFF Third Review definitions and exchange rates, with 1.94687 lev/U.S. dollar; cumulative from January 1, 2000.
3/ Actual levels.
4/ Cumulative from July 1, 1999.
5/ Excluding normal import-related credits.

Table 3. Bulgaria: Structural Performance Criteria and Benchmarks for December 31, 1999 Under the EFF-Supported Program

	Strategies and Measures	Implementation
I.	**Structural Performance Criteria**	
1.	Enactment by parliament of the law on the first pillar of pension reform.	Met
2.	Issue tender for Biochim bank.	Met
3.	Form a list of enterprises comprising unprivatized enterprises in the original list of 100 state-owned enterprises with the largest losses and arrears, and state monopolies including district heating companies, NEK, and Neftochim. Ensure that these state-owned enterprises as a group keep their wage bill for the third and fourth quarters of 1999 under the level of their aggregate base wage bill. The aggregate base wage bill equals the sum of the wage bills in the third quarter of 1998 for enterprises in the original list and of the wage bills in the second quarter of 1999 for the newly-added state-owned monopolies. Within this total ceiling, no more than 10 percent of these enterprises may exceed their individual wage bill ceilings. If an enterprise is privatized or ceases operations, it will be dropped from the list and the base wage bill will be adjusted appropriately.	Met
4.	Terminate production activities in all Group B enterprises entered into liquidation by June 30, 1999, and sell the core assets (accounting for at least 50 percent of each enterprise's long-term fixed assets) in no fewer than half of these enterprises.	Met
5.	Complete accounting separation of Bulgargaz into import, transport, storage, distribution, and transmission components.	Met
II.	**Structural Benchmarks**	
1.	Establish a tax policy unit in the Ministry of Finance, outside the tax administration department.	Delayed. Implementation expected in March 2000.
2.	Produce first-round unified tax register based on the BULSTAT number.	Met
3.	Transfer all central government funds with the exception of Type 3 suspense accounts and extra-budgetary accounts for private donations to the single treasury account in the BNB.	Not met. Phased implementation during 2000 in line with latest IMF technical assistance recommendations is on track.
4.	Bring Bulgartabac to the point of sale.	Met
5.	Complete comprehensive audit report for Bulgargaz for 1998 by an international audit firm.	Met
6.	Increase capital adequacy ratio to 12 percent.	Met
7.	Issue a 2000 Trade Decree (to take effect on January 1) that lowers MFN tariffs for non-agricultural goods to 12 percent (average) and 32.5 percent (maximum), and for agricultural goods to 24 percent (average), and 74 percent (maximum).	Met
8.	Abolish registration (automatic licensing) requirements for coal and coke, petroleum, liquid fuels, ready-to-use drugs, textiles, ferrous and non-ferrous metals, computer software (HS 27, 30, 52, 54-55, 61-62, 74-76, 78-80, 85).	Met
9.	Reduce the number of extrabudgetary funds and accounts, starting with the Energy Resource Fund and the SFRD with the 1999 budget. No new EBFs will be established.	On track (continuous)
10.	Enforce compliance with prudential regulations and implement strategy to bring offending banks into compliance, including the right for the BNB to require prompt corrective action (PCA).	On track (continuous)

Table 4. Bulgaria: Indicators of External Vulnerability, 1995-2000

	1995	1996	1997	1998	1999/2000 Latest Observation 1/	Date
Real indicators						
CPI end of period, 12-month change	32.9	310.8	578.5	1.0	6.2	Dec-99
Real GDP growth rate, year on year	2.1	-10.9	-6.9	3.5	4.5	Q3-99
Financial indicators						
Public sector debt (in percent of GDP, end of period)	100.9	105.8	110.4	80.2	87.7	Dec-99
Broad money (percent change, 12-month basis, end of period)	39.6	124.5	359.3	9.6	11.4	Dec-99
Non-government sector leva credit (percent change, 12-month basis end of period)	36.7	15.0	297.2	69.7	21.4	Dec-99
Non-government sector foreign exchange credit (percent share in domestic credit end of period)	24.7	45.2	49.9	50.5	51.0	Dec-99
Average monthly BNB basic interest rate, nominal annualized	65.2	262.7	176.0	5.5	4.6	Dec-99
BNB basic real interest rate, average basis	22.8	-30.0	-87.9	4.2	-3.5	Dec-99
Banks' NFA position in US$ million, end of year	830	806	1,200	1,207	1,107	Dec-99
External indicators						
Exports (annual percent change, US$ basis)	35.8	-4.5	2.6	-12.9	6.9	Q3-99
Imports (annual percent change, US$ basis)	32.2	-5.4	-3.0	3.5	16.3	Q3-99
Current account balance (percent of GDP)	-0.6	0.8	4.4	-0.5	0.6	Q3-99
Capital and financial account (percent of GDP)						
Portfolio investment (debt securities, etc.)	-0.5	-1.3	1.3	-1.8	-1.2	Q3-99
Other investment (loans, trade credits, etc.)	1.5	11.3	-2.3	0.5	-5.5	Q3-99
Foreign direct investment	0.7	1.4	5.0	3.3	5.0	Q3-99
Gross official reserves (in millions of U.S. dollars end of period)	1,546	793	2,468	3,056	3,222	Dec-99
Official reserves in months of imports GNFS	3.6	2.0	6.4	6.1	6.4	Dec-99
Official reserves in percent of currency board liabilities and official debt service (end of period)	...	...	90.5	100.6	116.3	Dec-99
Fiscal reserve account balance (in millions of U.S. dollars, end of period)	...	...	791	1,117	1,336	Dec-99
Broad money/ NFA (in percent, end-of-period)	5.0	2.7	1.2	1.2	1.2	Dec-99
Foreign exchange deposits/reserves (percent, end of period)	145.2	171.1	59.8	50.5	52.6	Dec-99
Total external debt (percent of GDP)	77.4	96.8	95.9	81.6	81.7	Dec-99
Of which: Public external debt (percent of GDP)	63.6	83.8	80.0	65.0	68.0	Dec-99
External debt service/ exports of GNFS (in percent)	16.3	17.3	14.1	19.0	15.9	Dec-99
External debt service/GDP (in percent)	8.0	11.0	8.8	9.7	7.8	Dec-99
Exchange rate (per U.S. dollar, period average)	0.067	0.178	1.681	1.761	1.986	Feb-00
REER depreciation, eop (-) (12-months basis)	8.1	-38.9	85.6	4.2	-0.9	Dec-99
Financial market indicators						
Foreign currency debt rating (Moody's, long term)	...	B3	B2	B2	B2 /3	Jan-00
Foreign currency debt rating (S&P, long term)				B	B /3	Jan-00
Foreign currency debt rating (Fitch IBCA, long term)				B+	B+	Jan-00
Stripped spread of discount bonds (basis points, end of period)	...	1,396	605	792	495	11-Feb-00

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

1/ Change relative to the same period of the previous year unless otherwise stated.
2/ In redenominated leva. On June 5, 1999, the lev was redenominated by removing three zeros. As a result, one lev now equals one deutsche mark.
3/ Outlook positive.

Table 5. Bulgaria: Macroeconomic Framework, 1995-2004

	1995	1996	1997	1998	1999		2000	2001	2002	2003	2004
					2nd Rev. 1/	Est.	Proj.	Proj.	Proj.	Proj.	Proj.
	(Percent change)										
GDP and prices											
Real GDP	2.1	-10.9	-6.9	3.5	1.5	2.5	4.0	4.5	5.0	5.5	5.5
GDP deflator	64.1	122.9	948.7	22.2	0.5	1.8	6.5	3.7	3.6	3.2	3.2
CPI (end of period)	32.9	310.8	578.5	1.0	1.8	6.2	3.5	3.5	3.5	3.1	3.1
(period average)	62.1	123.0	1,082.2	22.3	...	0.3	6.8	3.3	3.4	3.1	3.1
Lev/US$ exchange rate (end of period)	7.1	589.3	264.5	-5.7	7.5	16.2	-1.4	-0.9	-1.7	-1.7	-0.9
Real basic interest rate (average) 2/	23.0	-26.1	-69.7	4.5	3.1	-1.3	2.3	2.5	3.0	3.0	3.0
	(In percent of GDP)										
Saving and investment											
Foreign saving 3/	-1.7	-2.6	-5.6	0.6	4.6	6.0	4.9	3.8	3.2	2.9	2.9
Gross national saving	15.1	8.6	15.8	14.2	9.9	11.2	14.0	14.6	15.7	16.2	16.2
Gross domestic saving 4/	17.4	11.0	17.0	14.2	11.0	10.4	13.0	13.9	14.8	15.3	15.3
Government	-1.9	-8.6	4.5	8.6	5.5	6.5	5.0	5.6	5.5	5.4	5.0
Non-government	19.2	19.5	12.5	5.6	5.4	3.9	8.0	8.3	9.3	9.9	10.3
Gross domestic investment	15.7	8.4	11.4	14.7	15.5	16.4	17.9	17.6	18.0	18.2	18.2
Government	1.1	0.7	2.4	3.8	3.4	4.4	3.1	3.2	3.4	3.4	3.0
Non-government	14.5	7.7	9.0	10.9	12.1	12.0	14.8	14.4	14.6	14.8	15.2
General government											
Revenue	36.1	32.6	36.7	39.5	38.0	40.3	36.6	36.9	37.1	37.2	37.3
Non-interest expenditure	27.8	24.9	29.2	33.5	34.6	37.2	33.4	33.0	33.6	33.9	34.1
Primary balance (excluding BNB transfers)	6.5	6.4	7.3	5.5	3.0	2.6	3.2	3.9	3.5	3.3	3.2
Interest payments	14.6	20.3	8.4	4.4	4.9	4.0	4.6	4.7	4.4	3.9	3.5
Overall balance	-6.3	-12.7	-1.2	1.0	-1.5	-0.9	-1.4	-0.9	-0.9	-0.6	-0.4
	(In US$ million)										
Balance of payments											
Current account	-77	21	446	-61	-687	-632	-512	-427	-370	-340	-373
Trade balance	94	133	394	-381	-641	-998	-901	-834	-804	-782	-815
Exports	4,913	4,691	4,814	4,193	3,715	3,928	4,453	4,919	5,405	5,886	6,371
Imports	4,819	4,558	4,420	4,574	4,356	4,926	5,353	5,753	6,209	6,668	7,185
Services	-303	-282	-185	90	-229	46	57	56	51	51	47
Receipts	1,523	1,533	1,542	2,094	1,423	2,074	2,320	2,463	2,645	2,777	2,962
Payments	1,825	1,815	1,727	2,004	1,652	2,027	2,262	2,408	2,594	2,726	2,915
Of which : Interest	582	543	521	530	512	500	570	621	636	638	635
Memorandum items											
Gross official reserves	1,546	793	2,468	3,056	3,251	3,222	3,476	3,524	3,710	3,968	4,336
(in months of imports of GNFS)	3.1	1.6	5.3	6.1	7.1	6.0	6.0	5.6	5.5	5.5	5.5
Current account balance (in percent of GDP)	-0.6	0.2	4.4	-0.5	-5.6	-5.2	-4.0	-3.0	-2.4	-2.0	-2.0
Non-government consumption (real change)	-1.8	-2.0	-17.2	8.0	3.0	2.7	3.7	4.6	3.1	4.2	4.6
Nominal GDP (in millions of leva)	880	1,749	17,055	21,577	22,010	22,515	24,937	27,010	29,367	31,962	34,785
Nominal GDP	13,106	9,831	10,146	12,255	12,286	12,250	12,924	14,191	15,695	17,239	19,012

Sources: Bulgarian authorities; and staff projections.

1/ Projections at the time of the Second Review of the EFF.

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

3/ Net imports of goods and nonfactor services.

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

Table 6. Bulgaria: Monetary Survey, 1997-2000

	1997	1998				1999				2000			
	Dec.	Mar.	June	Sep.	Dec.	Mar.	June	Sep.	Dec.	Mar. Proj.	June Proj.	Sep. Proj.	Dec. Proj.
	(In millions of leva)												
Broad money	6,019	5,958	6,045	6,064	6,597	6,261	6,184	6,669	7,351	7,176	7,314	7,492	8,238
Lev money	3,395	3,272	3,386	3,405	4,013	3,670	3,504	3,913	4,475	4,277	4,363	4,475	5,135
Currency	1,314	1,285	1,416	1,463	1,742	1,567	1,479	1,687	1,957	1,871	1,908	1,957	2,278
Deposits	2,080	1,986	1,970	1,942	2,271	2,103	2,025	2,226	2,518	2,406	2,455	2,518	2,857
Foreign currency deposits	2,624	2,686	2,659	2,659	2,584	2,591	2,679	2,757	2,876	2,899	2,951	3,017	3,104
Net foreign assets	4,851	5,377	5,636	5,114	5,272	4,907	4,886	5,237	5,994	5,413	5,732	5,464	6,130
Net domestic assets	1,167	581	410	951	1,325	1,354	1,298	1,433	1,357	1,763	1,582	2,028	2,108
Domestic credit	5,136	4,673	4,169	4,480	4,227	4,365	4,175	4,262	4,237	4,610	4,400	4,837	4,867
Government 1/	1,642	1,166	757	940	510	702	404	377	156	521	253	425	171
Non-government	3,495	3,507	3,412	3,540	3,717	3,663	3,771	3,885	4,081	4,089	4,148	4,412	4,696
Public enterprise (SOE)	1,254	1,128	974	930	946	830	792	750	713	710	709	708	706
Private sector	2,241	2,379	2,437	2,610	2,772	2,833	2,979	3,135	3,368	3,379	3,438	3,705	3,990
Other items net	-3,969	-4,092	-3,760	-3,529	-2,902	-3,011	-2,877	-2,829	-2,881	-2,847	-2,819	-2,810	-2,759
Reserve money	2,174	2,095	2,074	2,045	2,387	2,200	2,163	2,290	2,722	2,629	2,673	2,546	2,882
	(In millions of U.S. dollars)												
Net foreign assets	2,731	2,932	3,113	3,056	3,147	2,695	2,580	2,855	3,079	2,795	2,966	2,838	3,194
BNB	1,531	1,669	1,854	1,808	1,941	1,665	1,594	1,662	1,972	1,733	1,894	1,737	2,042
DMB	1,200	1,263	1,260	1,248	1,207	1,030	986	1,193	1,107	1,062	1,072	1,102	1,152
Foreign currency deposits	1,477	1,465	1,469	1,589	1,543	1,423	1,415	1,503	1,477	1,497	1,527	1,567	1,617
(percent of broad money)	(43.6)	(45.1)	(44.0)	(43.9)	(39.2)	(41.4)	(43.3)	(41.3)	(39.1)	(40.4)	(40.4)	(40.3)	(37.7)
Memorandum items:	(12-month growth rate in percent)												
Broad money	359.3	93.3	50.7	17.9	9.6	5.1	2.3	10.0	11.4	14.6	18.3	12.3	12.1
Lev money	423.0	227.4	110.8	32.7	18.2	12.2	3.5	3.5	3.5	16.5	24.5	14.4	14.4
Currency	939.1	384.0	156.0	51.4	32.6	21.9	4.4	15.3	12.4	19.4	29.0	16.0	16.4
Foreign currency deposits	296.8	29.0	10.6	3.3	-1.5	-3.5	0.8	3.7	11.3	11.9	10.1	9.4	7.9
Reserve money	780.1	244.2	86.8	27.0	9.8	5.0	4.3	12.0	14.0	19.5	23.6	11.2	5.9
CPI inflation	578.5	27.4	18.8	5.5	0.9	-2.8	-3.3	1.7	6.2	8.5	10.8	4.8	3.5
Currency/broad money ratio	21.8	21.6	23.4	24.1	26.4	25.0	23.9	25.3	26.6	26.1	26.1	26.1	27.6
Currency/deposit ratio	27.9	27.5	30.6	31.8	35.9	33.4	31.4	33.8	36.3	35.3	35.3	35.4	38.2
Foreign currency deposits/total deposits	55.8	57.5	57.4	57.8	53.2	55.2	57.0	55.3	53.3	54.6	54.6	54.5	52.1
	(Real index, Dec. 1995=100)												
Broad money	37.0	35.3	36.3	36.2	40.2	38.2	38.4	39.2	42.1	40.4	41.0	42.0	45.6
Lev money	28.7	26.6	27.9	27.9	33.6	30.7	29.9	31.6	35.2	33.0	33.6	34.4	39.1
Credit, non-government	34.9	33.8	33.3	34.4	36.8	36.3	38.1	37.1	38.0	37.4	37.8	40.2	42.3
	(In percent of GDP, end of period)												
Ratio to nominal GDP													
Broad money	26.8	34.0	31.8	25.2	28.3	33.5	30.8	25.5	29.3	36.4	32.9	25.6	28.8
Lev money	15.1	18.7	17.8	14.2	17.2	19.6	17.5	14.9	17.8	21.7	19.7	15.3	17.9
Reserve money	9.7	12.0	10.9	8.5	10.2	11.8	10.8	8.7	10.8	13.3	12.0	8.7	10.1

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

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

Table 7. Bulgaria: Summary Balance of Payments, 1998-2004

	1998	1999		2000		2001	2002	2003	2004
	Actual	2nd Rev.	Proj.	2nd Rev.	Proj.	Proj.	Proj.	Proj.	Proj.
Current account balance	-61	-687	-632	-534	-512	-427	-370	-340	-373
Trade balance	-381	-641	-998	-591	-901	-834	-804	-782	-815
Exports 1/	4,193	3,715	3,928	4,161	4,453	4,919	5,405	5,886	6,371
Imports 1/	4,574	4,356	4,926	4,752	5,353	5,753	6,209	6,668	7,185
Services balance	90	-229	46	-162	57	56	51	51	47
Receipts	2,094	1,423	2,074	1,601	2,320	2,463	2,645	2,777	2,962
Of which: Interest	307	201	282	231	365	376	385	402	426
Payments	2,004	1,652	2,027	1,763	2,262	2,408	2,594	2,726	2,915
Of which: Interest	530	512	500	531	570	621	636	638	635
Transfers, net	230	184	320	219	332	352	383	391	394
Capital account balance	179	762	677	516	622	507	684	560	697
Foreign direct investment, net	537	600	600	400	550	550	550	450	450
Portfolio investment, net	-180	-55	-228	-65	-80	-10	60	70	100
Medium- and long-term financial capital, net	100	146	188	161	83	-106	-10	-51	47
Disbursements	582	428	463	493	476	482	483	487	633
Amortization	482	281	275	332	393	587	494	538	586
Short-term trade credits, net	9	20	80	20	60	68	79	86	95
Other short-term capital, net 2/	-44	-113	33	0	9	5	5	5	5
Errors and omissions, net	-243	164	4	0	0	0	0	0	0
Overall balance	118	76	45	-18	110	81	313	220	324
Financing	-117	-75	-46	-97	-110	-230	-458	-366	-468
Change in BNB gross foreign assets (increase:-)	-521	-195	-208	-236	-254	-48	-186	-258	-368
Obligations deferred/rescheduled	278	0	0	0	0	0	0	0	0
Change in arrears	-4	-40	0	0	0	0	0	0	0
Use of Fund credit, net	130	160	162	139	143	-182	-272	-108	-100
Financing gap	0	0	0	115	0	149	145	145	145
Memorandum items:									
Medium- and long-term external debt	9,733	9,491	9,407	9,915	9,616	9,407	9,047	8,798	8,907
Gross official reserves (including gold)	3,056	3,251	3,222	3,488	3,476	3,524	3,710	3,968	4,336
(in months of imports of GNFS)	6.1	7.1	6.0	7.0	6.0	5.6	5.5	5.5	5.5
(excluding gold, in months of imports of GNFS)	5.4	5.9	5.4	5.9	5.4	5.1	5.0	5.0	5.1
Current account balance	-0.5	-5.6	-5.2	-4.1	-4.0	-3.0	-2.4	-2.0	-2.0
Trade balance	-3.1	-5.2	-8.1	-4.5	-7.0	-5.9	-5.1	-4.5	-4.3
Exports	34.2	30.2	32.1	31.9	34.5	34.7	34.4	34.1	33.5
Imports	37.3	35.5	40.2	36.4	41.4	40.5	39.6	38.7	37.8
Medium- and long-term external debt	79.4	77.2	76.8	76.0	74.4	66.3	57.6	51.0	46.9
External debt service	9.8	7.5	7.3	7.7	8.6	10.8	8.9	7.4	6.9
Interest	4.3	4.2	4.1	4.1	4.4	4.4	4.1	3.7	3.3
Amortization	5.4	3.3	3.3	3.6	4.2	6.4	4.9	3.7	3.6
Real GDP	3.5	1.5	2.5	4.0	4.0	4.5	5.0	5.5	5.5
Growth in domestic demand	13.9	...	6.9	...	3.1	4.7	4.3	5.7	4.7
Import volume	20.0	-7.0	3.4	9.0	5.3	5.4	5.4	5.8	6.0
Export volume	-4.0	-13.5	-6.2	9.7	11.8	8.0	7.3	7.0	6.3
Volume of partner imports	3.0	1.3	-0.2	6.0	6.8	6.5	6.3	6.5	6.2
Import unit value	-13.8	1.7	4.2	0.1	3.2	2.0	2.4	1.5	1.7
Export unit value	-9.3	0.0	-0.2	2.1	1.4	2.3	2.4	1.8	1.8
Terms of trade	5.2	-1.6	-4.2	2.0	-1.5	4.2	1.6	0.3	0.2

Sources: Bulgarian authorities and staff projections.

1/ Customs basis.

2/ Includes the discrepancy between settlements and customs data in the trade account, clearing account transactions, changes in net foreign assets of deposit money banks, and other short-term capital flows.

Table 8. Bulgaria: General Government, 1998-2000 1/

	1998	1999			2000	2001	2002
		1st Review 2/	EFF 2nd Review	Prel. Actual	Proj. 2/	Proj.	Proj.
	(In millions of leva)						
Revenues	8,514	8,217	8,370	9,065	9,136	9,962	10,899
Of which : Tax revenues	6,677	7,229	6,929	6,923	7,539	8,269	9,047
Of which: VAT/turnover taxes	1,832	1,880	1,861	1,927	1,974	2,172	2,375
Social insurance contributions	1,644	2,174	1,919	1,793	2,124	2,348	2,581
Nontax revenues	1,697	986	1,419	1,968	1,596	1,693	1,852
Expenditures	8,188	8,907	8,696	9,279	9,491	10,194	11,158
Of which : Non-interest expenditures	7,233	7,725	7,622	8,382	8,338	8,918	9,876
Of which : Compensation	1,075	1,141	1,216	1,216	1,211	1,317	1,498
Subsidies	444	352	271	334	208	144	117
Social expenditures	2,356	2,963	2,803	2,681	3,116	3,510	3,845
Defense and security	941	928	963	981	1,004	1,103	1,217
Primary balance	1,179	492	748	683	799	1,044	1,024
Interest	955	1,181	1,074	896	1,154	1,276	1,282
External	692	871	789	688	827	887	873
Domestic	263	310	285	208	327	389	409
Overall balance	224	-690	-326	-213	-355	-232	-259
(Excluding costs of structural reform) 3/	241	-436	-121	78	-86	-150	-189
Financing	-224	690	326	213	355	232	259
External (net)	-145	437	-49	42	-14	-290	-433
Domestic (net)	-438	-172	-207	-331	54	189	406
Privatization	359	425	582	503	315	333	285
	(In percent of GDP)						
Revenues	39.5	33.1	38.0	40.3	36.6	36.9	37.1
Of which : Tax revenues	30.9	29.1	31.5	30.8	30.2	30.6	30.8
Of which: VAT/turnover taxes	8.5	7.6	8.5	8.6	7.9	8.0	8.1
Social insurance contributions	7.6	8.8	8.7	8.0	8.5	8.7	8.8
Nontax revenues	7.9	4.0	6.4	8.7	6.4	6.3	6.3
Expenditures	37.9	35.9	39.5	41.2	38.1	37.7	38.0
Of which : Non-interest expenditures	33.5	31.1	34.6	37.2	33.4	33.0	33.6
Of which : Compensation	5.0	4.6	5.5	5.4	4.9	4.9	5.1
Subsidies	2.1	1.4	1.2	1.5	0.8	0.5	0.4
Social expenditures	10.9	11.9	12.7	11.9	12.5	13.0	13.1
Defense and security	4.4	3.7	4.4	4.4	4.0	4.1	4.1
Primary balance	5.5	2.0	3.4	3.0	3.2	3.9	3.5
(Excluding costs of structural reform)	5.5	3.0	4.3	4.3	4.3	4.2	3.7
Interest	4.4	4.8	4.9	4.0	4.6	4.7	4.4
External	3.2	3.5	3.6	3.1	3.3	3.3	3.0
Domestic	1.2	1.3	1.3	0.9	1.3	1.4	1.4
Overall balance	1.0	-2.8	-1.5	-0.9	-1.4	-0.9	-0.9
(Excluding costs of struct. reform 3/	1.1	-1.8	-0.5	0.3	-0.3	-0.6	-0.6
Financing	-1.0	2.8	1.4	0.9	1.4	0.9	0.9
External (net)	-0.7	1.8	-0.2	0.2	-0.1	-1.1	-1.5
Domestic (net)	-2.0	-0.7	-0.9	-1.5	0.2	0.7	1.4
Privatization	1.7	1.7	2.6	2.2	1.3	1.2	1.0
Memorandum item:							
Fiscal Reserve Account (in US$ mn) 4/	1,133	1,354	1,362	1,336	1,272	1,274	883
Nominal GDP in millions of leva	21,577	24,810	22,010	22,515	24,937	27,010	29,367

Sources: Ministry of Finance; and staff projections.

1/ Includes the activities of the State Fund for Reconstruction and Development (SFRD) and the Energy Resource Fund (ERF) which were closed with the approval of the 1999 budget.

2/ Official budget.

3/ From 2000, costs of structural reform include projected additional costs of social security reforms.

4/ End of period, excluding the ERF through end-1998. From 1999, the FRA includes all general government accounts except accounts with funds not owned by the government, and those of municipalities.

Table 9. Bulgaria: Projected Payments to the Fund
(as at January 31, 2000 in millions of SDRs)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	Beyond	Total
Obligations from existing drawings												
1. Principal												
a. Repurchases	91.4	236.2	195.2	76.6	62.0	52.3	52.3	52.3	52.3	26.2	0.0	896.9
b. PRGF/SAF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Charges and Interest 1/												
a. on Fund credit	41.2	34.4	23.4	16.4	13.2	10.5	8.0	5.5	3.0	0.8	0.0	156.4
b. on use of SDRs	(0.4)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.4)
Total obligations 2/	132.2	270.6	218.6	93.0	75.2	62.8	60.3	57.8	55.3	27.0	0.0	1,052.9
(percent of quota)	20.7	42.3	34.1	14.5	11.7	9.8	9.4	9.0	8.6	4.2	0.0	164.5
Obligations from prospective drawings												
1. Principal												
a. Repurchases	0.0	0.0	0.0	0.0	8.7	43.6	52.3	52.3	52.3	52.3	52.3	313.8
b. PRGF/SAF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Charges and Interest 1/												
a. on Fund credit	3.7	12.9	14.9	14.9	14.9	14.0	11.8	9.3	6.8	4.3	2.1	109.6
b. on use of SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations 2/	3.7	12.9	14.9	14.9	23.6	57.6	64.1	61.6	59.1	56.6	54.4	423.4
(percent of quota)	0.6	2.0	2.3	2.3	3.7	9.0	10.0	9.6	9.2	8.8	8.5	66.1
Cumulative (existing and prospective)												
1. Principal												
a. Repurchases	91.4	236.2	195.2	76.6	70.7	95.9	104.6	104.6	104.6	78.5	52.3	1,210.7
b. PRGF/SAF Repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Charges and Interest 1/												
a. on Fund credit	44.9	47.3	38.3	31.3	28.1	24.5	19.8	14.8	9.8	5.1	2.1	266.0
b. on use of SDRs	(0.4)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.4)
Total obligations 2/	136.0	283.5	233.5	107.9	98.8	120.4	124.4	119.4	114.4	83.6	54.4	1,476.3
(percent of quota)	21.2	44.3	36.5	16.9	15.4	18.8	19.4	18.7	17.9	13.1	8.5	230.6

1/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA, and on current interest rates for SAF, PRGF, and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.

2/ Overdue obligations (if applicable) will be settled in full at close of business February 1, 2000.

Bulgaria: Review of Fund-Provided Technical Assistance and Progress Toward Implementing the Recommendations of the Report on the Observance of Standards and Codes

1. This appendix presents (i) a summary of technical assistance (TA) provided by the Fund over the past three years, (ii) an assessment of its effectiveness from the perspective of both the authorities and the Fund's TA-providing departments, (iii) a discussion of future TA needs and plans as seen by the authorities and Fund staff, and (iv) a review of progress made to date toward implementing the recommendations made in the Report on the Observance of Standards and Codes (ROSC). The ROSC was originally published in September 1999 (EBS/99/158, Supplement 1) and a slightly modified version has now been issued in binder form (EBS/00/46) to accompany this staff report.[1] The TA-providing Fund departments covered in this appendix are Monetary and Exchange Affairs (MAE), Fiscal Affairs (FAD), and Statistics (STA).

A. Monetary and Exchange Affairs

Summary of TA activities

2. Very considerable technical assistance resources have been devoted to Bulgaria in central banking, not only by MAE, but by USAID and the EU as well (Table 10). The extensive MAE technical assistance program of the last three years has focused on: (i) preparing for the Currency Board Arrangement (CBA) put in place on July 1, 1997, (ii) closing all insolvent banks before the start of the CBA, (iii) implementing the CBA, (iv) strengthening banking supervision, and (v) strengthening the operations of the BNB.

3. A resident banking supervision advisor, whose two-year assignment has just ended, coordinated the on-site assistance provided by USAID (two resident experts) and the off-site and special supervision assistance provided by EU (four resident experts) for the past two years. The considerable progress made in these two years was reflected in the impressive results of the recently completed Basel Core Principles Assessment conducted by MAE. Bulgaria now has a good banking law, good prudential regulations, and steadily improving supervision and enforcement.

4. The BNB has undertaken to strengthen its human resources management, its budget systems, its Information Technology systems, and its accounting systems. Several MAE experts have made a number of short visits over the past two years to assist in these areas. MAE assistance was also provided to improve the BNB's foreign exchange reserve management through a number of short-term visits supplemented by a six-month expert visit. Finally, in the payments system area, an MAE recommendation was implemented to shift the settlement function to the BNB from the Bank Service company, which developed and operates the system. This step was closely coordinated with the Treasury project in the Ministry of Finance and the BNB accounting systems reform.

[1] The binder omits descriptive material covering accounting and auditing, since no assessment of observance of standards was carried out for these areas.

Assessment of effectiveness of Fund-provided TA

5. MAE considers that Bulgaria's central bank has received an extraordinary amount of technical assistance by any measure, and it has used this assistance well. One measure of progress is the positive result of Bulgaria's recent participation in the IMF's ROSC modules on its transparency practices in the monetary policy and banking supervision areas. The BNB's very strong compliance with the Basel Core Principles also testifies to its impressive progress in the difficult area of banking supervision.

6. For their part, BNB officials indicate that they have been very pleased with Fund TA in the central banking area, especially in helping to establish the currency board and improving banking supervision.

Future TA needs and plans

7. MAE expects the need for technical assistance to wind down after the completion of the currently planned work program (which includes a mission in April/May 2000 and several expert visits). Issues that remain to be covered include the following:

- Liquidity management under the currency board. With an increase in economic activity, the system will need to be reviewed with a view to analyzing the adequacy of the safeguards in place to withstand potential pressures.

- Banking supervision. The BNB will need to continue its program of development of banking supervision capabilities and will continue to receive technical assistance from USAID and possibly from the EU. To some extent the focus needs to shift to the development of the BNB's own training programs. Progress will, however, need to be reviewed, and additional MAE technical assistance may become necessary.

- Accounting systems. The BNB will need to continue its program of human resource development, and to further develop its budget and accounting systems. MAE would be available to provide some continued support in this latter area.

- Payments system. Reform in this area is complex but well advanced. The BNB's internal development of the settlement activity must remain well coordinated with the development of the Ministry of Finance's treasury.

- Finalization of draft bank bankruptcy law. A draft has been prepared, but needs to be amended to conform better with policy requirements. MAE aims to ensure that sufficient assistance is available in this area.

8. BNB officials also see a need for continued Fund TA, noting that while the EU and the ECB were likely to get more involved, there were few substitutes for the Fund as a TA provider in central banking. In their view, priority areas would include banking supervision, reserve management, information technology, and accounting.

Transparency in the monetary sector

9. Government and BNB officials helped IMF staff prepare several ROSC modules on the monetary sector (monetary policy, banking supervision, and deposit insurance) as a part of the Report on the Observance of Standards and Codes. These included comparison of existing practices with the IMF *Code of Good Practices on Transparency in Monetary and Financial Policies,* and *Basle Core Principles of Effective Banking Supervision.*

10. The authorities welcomed the report, and since its initial publication in September 1999 have already implemented certain recommendations in the monetary sector. Specifically:

- The quarterly report on compliance with prudential banking regulations has been shortened and made more focused.
- A quarterly report on the condition of the banking sector is now prepared regularly.
- A memorandum of understanding has been signed between the BNB and the Deposit Insurance Fund (DIF) defining the nature of information exchange between the two institutions.
- A public relations department has been set up in the DIF, with a view to explaining the activities of the fund more clearly to public.

B. Fiscal Affairs

Summary of TA activities, with FAD's commentary on effectiveness of the TA provided and future needs

11. ***Tax legislation.*** The Fund's Legal Department drafted a VAT law modeled after the structure of the EU 6th Directive, which was not fully taken into account in the draft prepared by the Ministry of Finance. The subsequent recommendation to introduce those principles of the EU Directive that were judged to be compatible with an effective operation of the Bulgarian Tax Administration had been incorporated into amendments to the VAT law enacted at the end of 1998.

12. Also in 1998, parliament enacted an amendment to the Corporate Income Tax Act. In support of the preparatory work for this amendment, a mission comprising fiscal and legal experts visited Sofia in September 1998, where the mission drafted amendments regarding incentives for business and investment and the repeal of the tax holiday provisions of the Foreign Investment Act. No further technical assistance on tax legislation is envisaged at present.

13. ***Tax administration.*** Since 1997, FAD has sent four missions to Sofia to assist the authorities in developing and implementing a tax administration reform program. The first mission in February 1997 focused on three objectives: (a) establishing a large

taxpayer office (LTO) to maintain tight control over the tax base; (b) strengthening tax administration's management; and (c) improving control of taxpayers in the emerging private sector.

14. In August 1998, a follow-up mission found that the tax department's dual responsibilities—formulating tax policy and collecting taxes—were increasingly out of line with its resources and recommended assigning these activities to two separate units within the Ministry of Finance. The third mission, in May 1999, provided recommendations on the collection of social insurance contributions. That mission found that the authorities were facing challenges in ensuring compliance with high combined rates of social insurance contributions and income tax on payrolls and recommended measures to improve the coordination of the Social Insurance Institute and the General Tax Administration Department.

15. FAD agreed to send a resident expert to Sofia for one year beginning in August 1997 to implement the reforms recommended by the first mission. Although progress in implementing the tax administration reforms was slower than expected, some of the measures were implemented—including the establishment of a LTO and the development of a unique taxpayer identification number (UIN), both of which were included as prior actions in the EFF program.

16. However, the 1998 and 1999 missions found that little progress had been made in addressing two critical issues: (a) the effective implementation of the UIN in the tax department (after a cross-matching of the social security, customs, and tax administrations registers); and (b) the need to strengthen and reorganize the tax department headquarters. Subsequently, the latter recommendation has been implemented.

17. In November 1999, the authorities requested further technical assistance in establishing a unified revenue agency to collect taxes as well as pension, health, and unemployment contributions. To this end, a mission, including World Bank staff, visited Sofia in January 2000. It worked with the authorities to formulate a strategy and a detailed schedule of implementation for the unified revenue agency which was incorporated into the program documents. FAD is prepared to provide further TA, including in the form of a resident advisor, to help implement the new agency.

18. ***Public expenditure management.*** A technical assistance mission in 1997 made recommendations on financial management under Currency Board Arrangements. A further mission in 1998 recommended development of a treasury to provide greater transparency in government operations and sustain fiscal discipline without incurring expenditure arrears. The project had several main components: (i) a treasury single bank account in the Bulgarian National Bank, and arrangements for spending units to process payment orders drawn on that account; (ii) elimination of most extrabudgetary funds, a radical reduction in the number of first level budget units: (iii) a new accounting framework based on a treasury general ledger, where each spending unit will have a single ledger account; (iv) a computerized financial management system that will improve fiscal reporting and management of the budget; and (v) an improved capacity to

undertake cash and debt management. Substantial progress is being made toward achievement of these goals with both the 1999 and 2000 budgets incorporating a number of major reforms.

19. A long-term advisor was appointed in late September 1998 to provide necessary technical support for implementing the project and his assignment has been now extended until October 2000. In his second term, the advisor is expected to assist in the effective implementation of the treasury and increasingly focus on budget preparation and training issues as well as the development of financial information systems. EU-Phare, OECD Sigma and other agencies are expected to gradually play a larger role in providing technical assistance in public expenditure management although the Fund's treasury project remains the largest at this stage.

20. To date, the TA in public expenditure management has been very effective, with the authorities implementing most of the major recommendations from TA missions. Thus in 1997, the authorities put in place the Fiscal Reserve Account as a key fiscal mechanism for the operation of the currency board. FAD recommendations for the consolidation of government financial resources, reduction in the numbers of first level spending units, and two-stage budget execution process were also all implemented as recommended. In some cases, Fund program conditionality played a supporting role in effecting these changes.

21. The treasury advisor appointed in the fall of 1998 has made considerable progress in establishing a functioning treasury. However, there is still a long way to go and FAD will continue to support this project through the resident advisor for the next nine months, by which time the first stages of the computerization should be completed.

22. FAD has no plans for further work in the public expenditure management area beyond the existing nine-month commitment to provide further assistance on the treasury system. Other providers, including EU Phare, OECD Sigma, the World Bank, and bilateral donors are involved in public expenditure management work on budget preparation and budget audit and review.

The authorities' views

23. Ministry of Finance officials were generally pleased with the TA provided by FAD, singling out the Fund's help in implementing the treasury as having been particularly valuable. Looking forward, they expected the overall need for TA to remain significant but, given Bulgaria's aspiration to join the EU, European TA providers would be expected to increase their share. In this context, they stated that the Fund's help in coordinating the TA efforts involving various donors would be appreciated. From the authorities' perspective, key priorities for Fund TA should be to continue the term of the treasury advisor, and to provide a resident advisor on the unified revenue agency.

Fiscal transparency

24. The authorities cooperated with IMF staff in the preparation of the fiscal transparency section of the ROSC which included an assessment of existing fiscal practices based on the IMF *Code of Good Practices in Fiscal Transparency*. The report noted that the authorities had taken significant steps to improve fiscal transparency and that a number of additional measures were under implementation or being planned. Areas where further improvements could be achieved were:

- the inclusion of a more complete description of the macroeconomic framework in the budget presentation, specifying the assumptions and risks underlying budget estimates,
- enhancement of budget information on contingent liabilities, tax expenditures, quasi-fiscal activities, and long-term fiscal sustainability,
- measures aimed at ensuring uniform interpretation and enforcement of tax laws, and
- improved dissemination of budget and within-year fiscal information to the public.

25. The authorities have already made significant progress in implementing the last mentioned recommendation, including by publishing explanatory notes on various aspects of the 2000 budget. Initiatives relating to the implementation of all other fiscal transparency recommendations are also underway by now, and the Fund's resident advisor will continue to provide technical assistance on improving fiscal transparency.

C. Statistics

Summary of TA activities, with STA's commentary

26. ***Data dissemination and transparency.*** Bulgaria has made good progress in improving the quality of its data dissemination system in recent years. The authorities have moved to improve the scope, timeliness, and quality of the data reported system, and the production and dissemination process have been upgraded to improve data integrity and expand public access to data. In large part these advances have been due to the authorities' own initiatives, supported by technical assistance provided by the Fund and other international agencies. The authorities' recent decisions to participate in the GDDS, serving as a pilot country study in this initiative, and to prepare the ROSC represent important steps in this process.

27. In July 1999 a STA mission visited Sofia to prepare the metadata for Bulgaria's participation in the GDDS and to review data transparency for the ROSC. In its review of the Bulgarian data dissemination system, the mission concluded that while present data compilation and dissemination practices meet most GDDS recommendations, and in many cases exceed them, the following areas could benefit from further development:

- Comprehensive national accounts statistics are not yet widely disseminated on a quarterly basis,

- detailed fiscal data are not published domestically, even on an annual basis,

- prolonged and large adjustments occur in trade data,

- national statistical reporting is impaired by gaps in survey reporting responses,

- an adequate treasury data reporting system would need to be developed, and

- gaps remain in external debt reporting.

28. The authorities have since made further progress, and the pilot metadata prepared by Bulgaria, including plans for improvement, are now being circulated to other countries in the region as a concrete example of GDDS metadata.

29. ***Balance of payments statistics.*** A June 1999 technical assistance mission in balance of payments statistics to the Bulgarian National Bank followed up on the implementation of the recommendations of a May 1996 mission. The mission noted that while the number of staff assigned to balance of payments compilation had increased and improvements to data collection had been made, the information collected through the international transactions reporting system was still incomplete and problems with merchandise trade data have persisted, affecting the currentness of the data. The mission recommended:

- the development of a closed international transactions reporting system (ITRS),

- the development of surveys to provide improved data for the transportation and travel components,

- limiting the duplication of work between the BNB and the National Statistics Institute (NSI) in the collection of data on foreign direct investment activity in Bulgaria, and

- specific improvements to the compilation of exceptional financing transactions data.

30. At the 1999 Annual Meetings, the authorities reported that a plan for implementing the recommendations of the mission had been produced, some recommendations had already been implemented and work was underway for the remainder. The authorities undertook to assess the need for further technical assistance for the improvement of the ITRS. They also requested technical assistance for improving the presentation of international reserves and foreign currency liabilities as part of the balance sheet of the BNB. STA was not able to offer assistance in this fiscal year or to make commitments for the future in this area, but has since provided draft operational guidelines on the reserves template.

31. ***Money and banking statistics.*** Recent technical assistance missions to Bulgaria included a multisector statistics mission (with a monetary statistics component) in March 1995 and a follow-up money and banking statistics mission in November 1995. The Bulgarian National Bank has revised money and banking data from January 1991 onward, incorporating recommendations on methodology that were made by STA during missions and through correspondence with the BNB. Provision of these data and further correspondence on methodology with the authorities led to the introduction of the page for Bulgaria in the June 1998 issue of *IFS* and its inclusion in the 1998 *IFS Yearbook.*

32. Monetary statistics for publication in *IFS* are reported on a regular and timely basis, with a lag of 1–2 months. No major outstanding issues remain in the reported data. The BNB staff maintains close contact with STA on issues of compilation methodology.

33. ***Real sector statistics.*** A November 1999 STA mission provided technical assistance to the National Institute of Statistics in national accounts, following an April 1998 mission on price statistics. In general, the national accounts estimates prepared by the NSI conform to the *System of National Accounts 1993* and the *European System of Accounts 1995*. Annual and quarterly GDP estimates by industry and expenditure categories are compiled at both current and constant prices while GDP estimates by income are produced annually at current prices only. There are several outstanding issues that may affect the quality of both the national accounts and price statistics:

- Most of the recommendations of the price statistics mission related to the consumer price index (CPI) are being implemented. However, limited progress has been made in expanding representation of the CPI to rural areas and in adjustments for quality changes as new items are introduced.

- With regard to the producer price index (PPI), progress is being made in expanding the number of industries for which actual transaction prices are collected, but full coverage of all industrial activities will not be completed until 2001.

- The recent national accounts mission examined the compilation of quarterly GDP and found a need for improvements in source indicator series, particularly in the industrial production index, measurement of inventories, and the estimation of value added for unincorporated enterprises including informal activities. One notable problem is the sizable differences between the annual estimates and their quarterly components, which could be due to the use of a quarterly sample biased in favor of largest enterprises. Shortcomings were also found in the deflation of construction and distribution services.

34. STA has worked with the NSI to develop a project for improving price statistics, which are documented in the price statistics mission report, with additional technical assistance missions planned to complete the project.

The authorities' views

35. The authorities appreciated past Fund TA, and were interested in further assistance in a number of areas. The NSI considered that the TA was very significant in improving the quality of its activities and speeding up compliance with the EU standards. The broad knowledge of the Fund's advisors, and their catalytic role in resolving issues across different institutions were particularly appreciated. The BNB also saw the Fund's TA in statistics as having been helpful. Looking forward, NSI and BNB officials suggested balance of payments statistics, national accounts, data dissemination standards, and possibly the financial survey as priority areas for future Fund TA.

Table 10. Bulgaria: Technical Assistance, 1997-2000

Dept.	Subject/Identified Need	Action	Timing	Counterpart
MAE	Currency board	Mission	May 97	BNB
MAE	Resident advisor in banking supervision	Expert	Sept. 97-Sept. 98	BNB
MAE	Central Bank and currency board issues	Mission	1997/98	BNB
MAE	Currency board and banking sector	Advisor to Governor	1997/98 short visits	BNB
MAE	Reserve management	Mission	Oct. 97	BNB
MAE	Banking supervision/debt management	Mission	Apr. 98	BNB
MAE	Organization and management	Expert	June, Sept. 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	June & Aug./Sept.99	BNB
MAE	Transparency Report/Based Core Principles	Mission	Jul. 99	BNB
MAE	Deposit insurance	Mission	Oct. 99	BNB
FAD	Fiscal management under a currency board	Mission	Jan.-Feb. 97	MOF
FAD	Tax and customs administration	Mission	Feb. 97	MOF
FAD	Tax administration	Mission	April 97	MOF
FAD	Fiscal management	Mission	April 97	MOF
FAD	Tax administration	Expert	Aug. 97-Feb. 98	MOF
FAD	Tax policy	Mission	Sept. 97	MOF
FAD	Tax and customs administration	Mission	Sept. 97	MOF
FAD	Tax policy	Mission	Oct. 97	MOF
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	Sept. 99	MOF
FAD	Unified revenue agency	Mission	Jan.-Feb. 00	MOF
STA	Producer prices	Mission	Apr. 98	NSI
STA	BOP statistics	Mission	June-July 99	BNB
STA	GDDS	Mission	July 99	BNB
STA	National accounts	Mission	Nov. 99	NSI
EXR	Macroeconomic policies	Seminar	May 97	BNB/ Parliament

Bulgaria: Fund Relations
As of January 31, 2000

A. Financial Relations

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

II. General Resources Account:	SDR Million	%Quota
Quota	640.20	100.0
Fund holdings of currency	1,504.39	235.0
Reserve position in Fund	32.69	5.1

III. SDR Department:	SDR Million	%Allocation
Holdings	45.65	N/A

IV. Outstanding Purchases and Loans:	SDR Million	%Quota
Stand-by arrangements	431.90	67.5
Extended arrangements	313.80	49.0
Contingency and Compensatory	64.00	10.0
Systemic Transformation	87.17	13.6

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	09/25/1998	09/24/2001	627.62	313.80
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):

	Overdue	Forthcoming				
	01/31/2000	2000	2001	2002	2003	2004
Principal		91.4	236.2	195.2	76.6	62.0
Charges/Interest		41.2	34.4	23.4	16.4	13.2
Total		132.6	270.6	218.6	93.0	75.2

B. Nonfinancial Relations

VII. Exchange Rate Arrangement

On July 1, 1997, a fixed exchange rate regime was introduced pegging the lev to the deutsche mark at leva 1,000 per 1 DM. The Bulgarian National Bank is bound to sell and purchase on demand and without restriction deutsche mark for leva on the basis of spot exchange rates that may not differ from the official exchange rate by more than 0.5 percent. The total amount of monetary liabilities of the Bulgarian National Bank may not exceed the lev equivalent of the gross international foreign exchange reserves determined on the basis of the official exchange rate. As of January 4, 1999, the peg currency was changed to the euro, at a fixed exchange rate of leva 1,955.83 per euro, changed leva 1.95583 per euro following the July 5, 1999 redenomination of the lev.

VIII. Last Article IV Consultation

The last Article IV consultation was concluded at EBS/99/13, 2/3/99. Bulgaria is on a 12–month cycle. The Acting Chairman's summing-up of the discussion was circulated as SUR/99/21. Bulgaria has accepted the obligations of Article VIII, Sections 2, 3 and 4 of the Articles of Agreement.

IX. Resident Representative

Mr. Peter Stella took up the resident representative position on January 18, 1998.

X. Technical Assistance

Table 10 (at the end of Appendix I) provides information on IMF technical assistance activities in Bulgaria.

Bulgaria: World Bank Relations

Lending operations

1. The Bank has approved 20 lending operations to date (Table 9). The most recent loan, the Environment and Privatization Support Adjustment Loan (EPSAL), is a three tranche operation in the amount of US$50.1 million equivalent (EURO 49.5 million), and was presented to the Board on February 24, 2000. The loan aims to support the comprehensive reform of Bulgaria's environmental policies and to support measures to accelerate compliance with EU environmental standards.

2. The Executive Board of the World Bank Group discussed a Country Assistance Strategy for Bulgaria in April 1998. The priorities for Bulgaria's development strategy are as follows: (i) accelerating structural reforms, in particular the divestiture of state-owned enterprises and banks, and promoting private sector development; (ii) liberalizing agricultural policies, and fostering efficiency in agricultural markets; (iii) completing energy sector reforms with emphasis on privatization of power generation and distribution, and improvements in the efficiency of district heating; (iv) rationalizing and strengthening the role of the state; (v) fighting poverty and developing Bulgaria's human capital, with emphasis on reform of the social protection systems; and (vi) complying with EU environmental standards. The program also envisages an important role for IFC in developing the private sector through support for privatization and restructuring of state-owned enterprises and new investments in private companies. IMF and World Bank staff continue to collaborate closely on support for the Government's structural reforms.

3. Total World Bank financing for 1999–2001 could range from about US$300 million to US$700 million depending on continued satisfactory macroeconomic performance underpinned by IMF support, progress in implementing structural reforms, and continuing improvement in the performance of the Bank-financed project portfolio. The upper ceiling includes up to US$300 million in adjustment lending and up to US$400 million in investment lending to support the development of agriculture, health, education, environmental remediation, district heating, and public sector management. If the current reform progress is not sustained, the Bank will limit its lending to a core program not to exceed financing headroom of about US$300 million, which would be focussed on investment projects, the success of which does not depend critically on progress in macroeconomic and structural reforms.

I. Technical Assistance

4. The Bank is actively involved in providing technical and advisory assistance to the Government in several areas, including bank and enterprise restructuring and divestiture, external debt monitoring, agricultural and energy sectors reforms, reform of the social protection system, and legal and administrative reforms.

II. Economic and Sector Work

5. The Bank has undertaken analytical work in a number of key areas. The first Country Economic Memorandum (Bulgaria: Crisis and Transition to a Market Economy), distributed to the Executive Directors in February 1991, was made available to the public. Economic Progress reports have been prepared for the Consultative Group Meeting held in June 1994, and for the joint G-24/CG Meetings held in April 1997, November 1997 and April 1999. Sector studies on energy, environment and telecommunications were completed in 1992; an environmental strategy paper was issued in December 1994.

6. Five other economic reports on Bulgaria have been completed since 1993: (i) an Agricultural Strategy Paper prepared jointly with the EU-Phare program; (ii) an Energy Power Options Study, prepared by the Bank at the request of the G-7, in collaboration with a number of other international organizations; (iii) a study of higher education; (iv) a report titled "Bulgaria: Public Finance Reform in the Transition," focusing on medium-term issues of resource mobilization, fiscal decentralization, public investment, and social insurance and health finance reform (incorporated in a broader study titled "Financing Government in the Transition-Bulgaria: Political Economy of Tax Policies, Tax Bases and Tax Evasion"); and (v) a report titled "Bulgaria's Private Sector Assessment." In December 1997 the Bank issued a series of Agricultural Policy Notes recommending policy and institutional reforms necessary for the development of the agricultural sector. This analysis provided the basis for the formulation of the Government's agricultural sector reform program and Bank assistance for the sector.

7. The Bank has also prepared a "Poverty Assessment" report which analyzes the nature and extent of poverty in Bulgaria and recommends a policy agenda to address poverty issues. In line with this effort, in January 2000, the Government and the Bank held the first ever high-level Government retreat on mainstreaming social development and poverty issues in the Government's overall policy agenda. In addition, a Child Welfare Study is expected to be finalized shortly. A Country Economic Memorandum is scheduled for completion in 2000; it will represent the EU accession framework, analyze the institutional and regulatory issues, the macroeconomic and sectoral challenges during pre-accession and provide an evaluation of the nature and the scope of the changes needed to prepare for membership.

Table 11. Bulgaria: World Bank Lending Operations

	Lending Operation	Amount	Board Date
1	Technical Assistance Loan (TAL)[1]	US$17.0 million	1991
2	Structural Adjustment Loan (SAL)	US$250.0 million	1991
3	Energy Loan	US$93.0 million	1993
4	Telecommunications	US$30.0 million	1993
5	Private Investment and Export Finance Loan [2]	US$55.0 million	1993
6	Water Companies Restructuring Loan[3]	US$98.0 million	1994
7	Debt and Debt Service Reduction Loan	US$125.0 million	1994
8	Agricultural Development Project [4]	US$50.0 million	1994
9	Railway Rehabilitation Project	US$95.0 million	1995
10	Health Sector Restructuring Loan	US$26.0 million	1996
11	Rehabilitation Loan	US$30.0 million	1996
12	Social Insurance Administration	US$24.3 million	1996
13	Critical Imports Rehabilitation Loan	US$40.0 million	1997
14	Financial and Enterprise Sector Adjustment Loan I	US$100.0 million	1997
15	Environmental Remediation Project	US$16.0 million	1998
16	Social Protection Adjustment Loan	US$80.0 million	1998
17	Regional Initiative Fund	US$5.0 million	1998
18	Agricultural Sectoral Adjustment Loan	US$75.8 million[5]	1999
19	Financial and Enterprise Sector Adjustment Loan II	US$100.0 million[5]	1999
20	Environment and Privatization Support Adjustment Loan	US$50.1 million[5]	2000

[1] Of which US$4.8 million was cancelled in 1998.
[2] Of which $40.9 million was cancelled in 1997.
[3] Of which US$41 million was cancelled and US$12 million reallocated to the District Heating component in 1997.
[4] Cancelled in 1997.
[5] Denominated in EURO, and shown in US$ equivalent.

Bulgaria: Statistical Issues

1. Bulgaria collects and transfers data to the Fund of sufficient quality and in a timely manner to permit program monitoring and surveillance. The IFS began to publish a country page for Bulgaria in June 1998, and Bulgaria was also included in the 1998 yearbook. 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. Bulgaria is a GDDS pilot country.

Real sector

2. The National Statistical Institute (NSI), with technical assistance from OECD, has established a sophisticated system of national accounts. GDP by activity and expenditure categories are compiled and reconciled with the use of annual supply and use tables. In addition, Bulgaria publishes advanced national accounts including current and capital accounts according to the *1993 SNA* for the five main domestic sectors (general government, financial corporations, non-financial corporations, nonprofit institutions serving household, and households). As for most countries, the financial account and the balance sheets are missing.

3. A quarterly industrial production index exists and the authorities have also begun publishing a monthly series. 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.

4. The NSI has also compiled estimates of quarterly GDP by expenditure categories for the period beginning first quarter of 1994 through the second quarter of 1999, based on significant progress in developing new quarterly surveys. Problems remain in the methods for the deflation of some components of the national accounts, including household consumption, capital formation, and external trade, and in the coverage of private sector activities.

5. A new PPI that uses a Laspeyres index formula with 1995 as the base period was introduced in January 1998. Test PPI indices are being calculated for four selected branch classes, using detailed product specifications and transaction prices. However, the PPI still uses unit value prices. The NSI will need to expand the collection of transaction prices throughout the industrial sector, and implement an action plan that would result in staged improvements in the PPI through 2001.

6. The consumer price index (CPI) provides a reasonable measure of inflation and price developments in Bulgaria. A May 1998 technical assistance mission recommended new methods and procedures for the estimation of missing prices and the treatment of seasonal

goods. The mission also proposed the implementation of a regional item structure for compiling the CPI, and developed an action plan to implement these recommendations during the next three years.

Government finance

7. Consolidated data on central government operations are routinely reported for the *GFS Yearbook*, and the *IFS*. The *GFS Yearbook* also has annual data on local governments. A combined STA/FAD mission in September 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.

Money, banking, and statistics

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

Balance of payments

9. Bulgaria reports balance of payments data on a regular and timely basis, but data are subject to frequent and substantial revisions. An IMF STA balance of payments statistics mission in June 1999 recommended (1) the development of a more comprehensive, closed international transactions reporting system (ITRS), (2) the development of surveys to provide improved data for the transportation and travel components of the current account, (3) limiting the duplication of work between the BNB and the NSI in the collection of data on direct investment activity in Bulgaria, and (4) improving the compilation of data on exceptional financing transactions. The authorities plan to compile and publish the international investment position statement in near future.

Table 12. Bulgaria: Core Statistical Indicators as of February 22, 2000

	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	Feb. 21 2000	Feb. 18 2000	Feb. 18 2000	Feb. 12 2000	Feb. 12 2000	Feb. 12 2000	December 1999	November 1999	November 1999	Jan. 31 2000	Q3 1999 (qtrly) 1998 (annual)	December 1999
Date Received	Feb. 21 2000	Feb. 21 2000	Feb. 21 2000	Feb 21 2000	Feb. 21 2000	Feb. 21 2000	Jan. 10 2000	Feb. 21 2000	Feb. 21 2000	Jan. 20 2000	Jan. 5 2000	January 2000
Frequency of Data	Daily	Daily and Weekly	Daily and Weekly	Weekly and Monthly	Weekly and Monthly	Daily and Weekly	Monthly	Monthly	Monthly	Bi-weekly	Quarterly Annually	Debt, Monthly Debt service, Bi-weekly
Frequency of Reporting	Daily	Weekly	Weekly	Weekly and Monthly	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Bi-weekly	Annually	Debt, on request Debt service, Bi-weekly
Source of Update	BNB	BNB	BNB	BNB	BNB	BNB	NSI	BNB	BNB	MoF	NSI	Debt, BNB Debt service, MoF
Mode of Reporting	BNB Website	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from NSI	Email from BNB	Email from BNB	Fax from RR	Email from NSI	Reuters Email from MOF
Confidentiality	No	No	No	No	No	No	No	No	No	No	No	No
Frequency of Publication	Daily	Weekly	Weekly	Weekly	Weekly	Weekly	Monthly	Quarterly	Quarterly	Bi-monthly	Quarterly	Debt, Annually Debt service, Bi-monthly

Bulgaria: Medium-Term Macroeconomic Scenario and Fiscal Sustainability Analysis

1. **Bulgaria's medium-term economic outlook is favorable, provided sound economic policies are maintained.** Output growth is expected to be strong, at around 5 percent annually, with inflation at moderate levels (Table 5 and Figure 8). The current account deficit is expected to decline from its peak of over 5 percent of GDP in 1999 to around 2 percent of GDP in the medium term. This scenario is subject to both upside and downside risks. The positive impact of structural reform on exports and growth could be stronger than projected. On the downside, significant policy slippage, or a marked worsening of the external environment could lower Bulgaria's medium-term growth prospects and weaken its external position. The remainder of this Appendix provides a discussion of the key features of the baseline scenario.

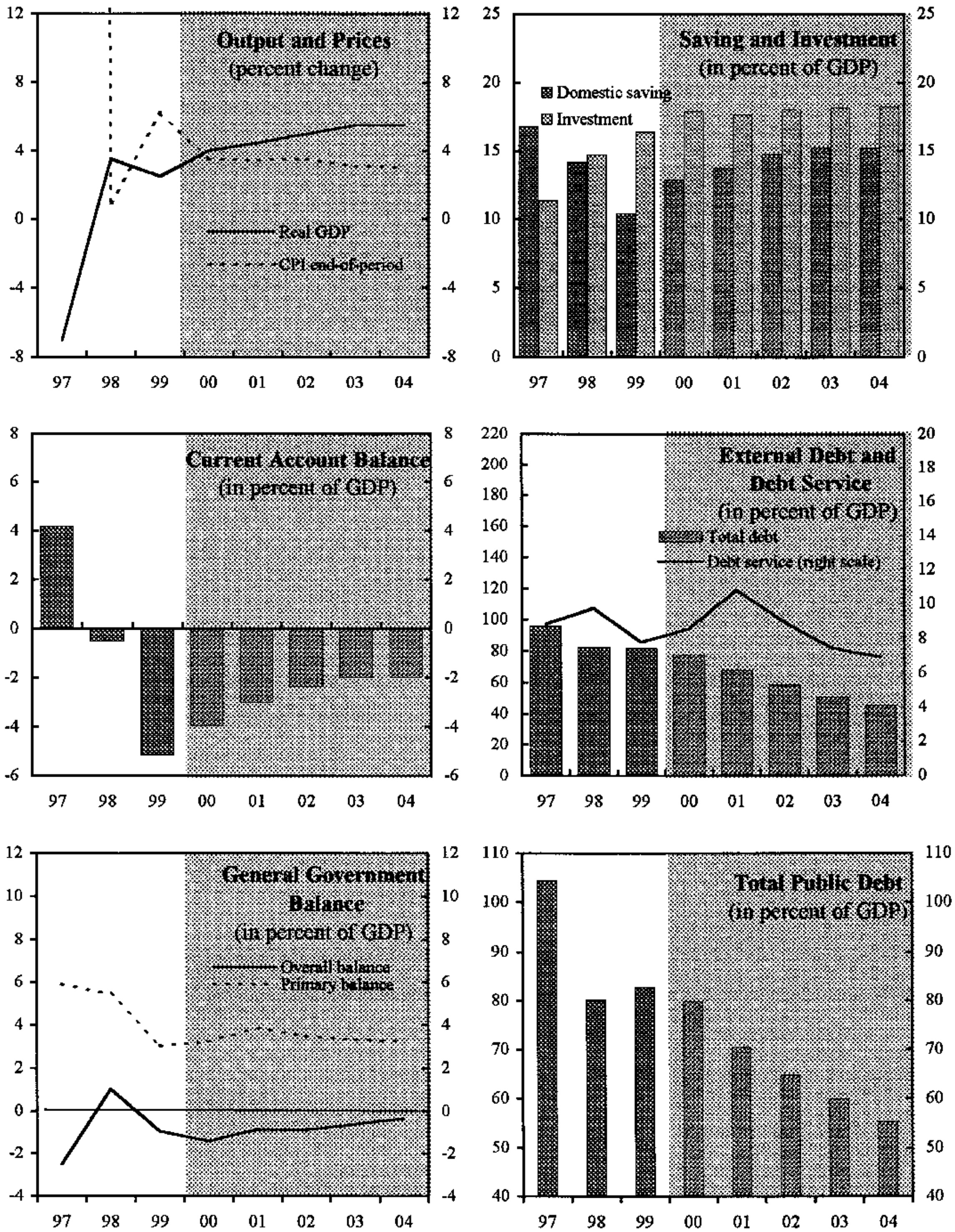
2. **The medium-term scenario is based on a continuation of current policies and an external environment in line with the Fund's winter 2000 World Economic Outlook.** The policies include a conservative fiscal stance, strict control over labor costs in state enterprises, and intensive structural reform that will unleash productivity growth and attract foreign investors. Regarding the external environment, partner country demand for Bulgarian exports is expected to pick up after a small decline in 1999 and to remain robust throughout the projection period, with an average annual partner demand growth rate of 6–7 percent (Table 7). The negative terms-of-trade shock resulting from the sharp increase in the oil price in 1999 is assumed to persist in 2000, but should be reversed in the medium term.

3. **Prudent domestic policies and a favorable external environment will propel export and investment growth.** In 2000, the increase in exports is expected to be especially strong, at around 12 percent, in large part reflecting the large carry-over from the recovery in the second half of 1999. In the medium term, export growth should remain somewhat above partner country demand, at around 7–8 percent, as the structural shift in production toward export-oriented sectors should start to show results. Regarding investment, with continued macroeconomic stability and good growth prospects the share of non-government investment in GDP should reach pre-crisis levels of around 15 percent. Part of the higher investment will be financed by recovering domestic saving, and will be supported by financial deepening. Foreign saving at around 3 percent of GDP will finance the rest.

4. **Strong investment and exports will be the main sources of output growth and improvement in the external position.** The increased investment levels and the ongoing structural reform and privatization will boost productivity and output. Imports will also increase, but at a slower pace than exports, by around 5–6 percent per annum, since domestic demand will grow only moderately. Consequently, the current account deficit is expected to improve steadily from 4 percent of GDP in 2000 to 2 percent of GDP in the medium term. Inflation is expected to remain moderate, although somewhat above that in the euro area, reflecting productivity gains in the traded sector.

5. **Fiscal sustainability is expected to be maintained.** The government is expected to maintain the primary surplus above 3 percent of GDP throughout the period. With interest

Figure 8. Bulgaria: Medium-Term Projections, 1997-2004



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

payments coming down relative to GDP, the overall deficit should decline from the 1½ percent of GDP budgeted for 2000 by some 1 point of GDP over the medium term. These deficits will not increase public debt, as they will be financed primarily by privatization receipts. The stabilization of nominal debt combined with strong growth in output should help to reduce the public debt-to-GDP ratio from 88 percent in 1999 to the Maastricht threshold of 60 percent by around 2003. Throughout the projection period, the balance in the fiscal reserve account is expected to remain at an adequate level.

6. **The external position should continue to improve, allowing Bulgaria to meet its external obligations comfortably.** Rapid GDP growth, declining current account deficits, and an increasing role of foreign direct investment in financing the deficits will all work to reduce the external debt ratio rapidly, from 82 percent of GDP in 1999 to 47 percent in 2004. Existing donor commitments fully cover the financing needs envisaged for 2000, but moderate financing gaps of US$100–200 million remain in the medium term. Reserve cover should stay at comfortable levels of 5–6 months of imports. Debt service obligations are projected to peak at 23 percent of GNFS in 2001, and decline thereafter (Table 9). Debt service to the Fund is projected to account for 18 percent of total debt service the same year, about 8 percent of gross reserves, and below 45 percent of quota. Consequently, Bulgaria should have no difficulty in servicing its debt, including its obligations to the Fund.

Sofia, Bulgaria, March 9, 2000

Mr. Stanley Fischer
Acting Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Fischer:

In 1999, the Government of Bulgaria continued to implement stabilization and reform policies successfully under the three-year economic program supported by the extended arrangement. Reflecting our strong efforts, all end-December 1999 performance criteria were observed, and recent macroeconomic developments have been quite favorable. Despite adverse circumstances, including the Kosovo crisis, GDP grew by 2.5 percent last year, and the external current account deficit was limited to about 5 percent of GDP. Both outcomes were better than expected just a few months ago.

To consolidate the recent gains, we are determined to stay on course. The attached Memorandum on Economic Policies of the Government of Bulgaria describes the progress made and measures that we will implement during 2000 to help achieve our main goals of sustained high growth and a rapid transition to a fully competitive market economy.

The Government of Bulgaria believes that the policies described in the Memorandum are adequate to achieve the objectives of its economic program, but stands ready to take additional measures as necessary to keep the program on track. The government will remain in close consultation with the IMF in accordance with the Fund's policies on such consultations.

Sincerely yours,

/s/
Muravei Radev
Minister of Finance

/s/
Svetoslav Gavriiski
Governor, Bulgarian National Bank

Attachment: Memorandum on Economic Policies
of the Government of Bulgaria

MEMORANDUM ON ECONOMIC POLICIES OF THE GOVERNMENT OF BULGARIA

A. Introduction

1. In 1999, our economy faced major challenges. The effects of the global financial crises in 1998 continued to be felt through weak external demand for Bulgarian goods and low export prices for our key commodities. In addition, the war in Kosovo blocked our main trade routes and reduced investor confidence in the region. These external shocks coincided with the most intensive phase of our enterprise privatization and restructuring program, causing unavoidable disruptions in production as unviable enterprises were being phased out.

2. In response to these challenges, we continued to carry out sound economic policies. These policies were underpinned by the currency board arrangement to which we remain fully committed. Fiscal policy was prudent as we limited the general government budget deficit to 214 million leva (0.9 percent of GDP), and incomes policy for state-owned enterprises was implemented strictly. At the same time, we continued structural reforms on a wide front. We accelerated privatization, recording the highest level of sale of state assets in Bulgaria's history, and brought the isolation program for commercial enterprises to a successful conclusion. We initiated sweeping reforms in the energy and transportation sectors, including the restructuring of large state monopolies. We continued to strengthen the financial sector by selling state banks to strategic investors and by further improving banking supervision.

3. The macroeconomic outcomes in 1999 testify that we met the challenges posed by the severe shocks successfully. While the shocks kept economy activity subdued in the first half of 1999, output rebounded strongly in the third quarter, and GDP growth for the year is now estimated at 2.5 percent. Toward the end of the year, higher food and energy prices raised inflation from earlier exceptionally low levels, but inflation during the year at 6.2 percent remained moderate. The external current account deficit widened markedly in the first half of 1999, but was contained to an estimated 5.2 percent of GDP for the full year as exports started to recover after midyear. Confidence in the lev remained strong, with gross official reserves at US$3.2 billion and the fiscal reserve account at US$1.4 billion at end-1999.

4. Firmly committed to maintaining macroeconomic stability and advancing reforms, we will continue to conduct economic policies in the framework of our three-year adjustment and reform program (July 1998–June 2001) which the IMF supports under the extended arrangement. The remainder of this memorandum sets out in detail our macroeconomic and structural objectives and policies for the period ahead.

B. Macroeconomic Objectives and Policy Framework

5. Our main medium-term goal remains to achieve annual GDP growth of at least 4–5 percent while maintaining a stable macroeconomic environment and making our market

economy fully competitive. Pursuing this goal will help to raise living standards and reduce unemployment and poverty, and it is consistent with our aim to join the EU which in late 1999 invited us to start membership negotiations. For 2000, we believe the specific objectives set at the time of the second program review last summer are achievable, and have updated them only marginally (see tabulation below). Hence, we aim at GDP growth of 4 percent, with moderate inflation, an improvement in the current account position, and comfortable fiscal and foreign exchange reserves.

	1999		2000	
	2nd Review	Est.	2nd Review	Proj.
GDP growth (real; in percent)	1.5	2.5	4.0	4.0
CPI inflation (end of period; in percent)	1.8	6.2	2.8	3.5
Gross official reserves				
(end of period; in billions of US$)	3.3	3.2	3.5	3.5
(end of period; in months of imports)	7.1	6.0	7.0	6.0
External current account deficit (in Percent of GDP)	5.6	5.2	4.1	4.0
Fiscal reserve account (in billions of US$)	1.4	1.4	1.5	1.3

6. To achieve the objectives for 2000, we are determined to continue our prudent fiscal and incomes policies and maintain the momentum of structural reform. We believe that strict implementation of our 2000 budget and tight control over wages in state-owned enterprises will support the currency board arrangement and preserve competitiveness, while structural reform will increase the economy's market orientation and lay the foundation for rapid growth. The focus in the structural area will be on completing the enterprise privatization program, imposing hard budget constraints on state enterprises, implementing major institutional reforms (including the overhaul of the health and pension systems and the establishment of a unified revenue agency and a treasury), strengthening the financial sector (including through further bank privatizations), and improving Bulgaria's business and investment climate (including through cutting red tape and corruption). The subsequent sections of this memorandum provide an outline of the initiatives in the various areas, while Tables 1 and 2 contain the specific measures and their intended timing.

C. Fiscal Policy

7. Prudent fiscal policy remains the linchpin of our strategy to support the currency board arrangement. In 1999, an overall strong revenue performance and cautious expenditure management enabled us to limit the general government deficit to 0.9 percent of GDP, well

below the originally budgeted 2.8 percent of GDP. This tighter-than-envisaged fiscal stance was instrumental in containing the effects of the various shocks on the external current account. In 2000, we aim to maintain a broadly unchanged fiscal stance. We will limit the general government deficit to no higher than 1½ percent of GDP, with the primary surplus at 3¼ percent of GDP, compared with 3 percent last year.

8. While we believe that the envisaged fiscal stance is consistent with the macroeconomic framework for 2000, we are prepared to tighten fiscal policy during the year if the external current account deficit does not improve as expected. Conversely, if the current account position improves more than projected and revenues exceed targeted levels, there could be room for some acceleration of public investment and supporting civil service reform through decompression in the wage structure in the second half of the year. To ensure that the targeted deficit is not exceeded and to facilitate a tightening if needed, the 2000 budget law maintains the provision allowing the Ministry of Finance to limit discretionary expenditures to 90 percent of the budgetary allocation. The budget also includes expenditure contingencies of 1¼ percent of GDP, mainly to cover the transitional costs of structural reform. Owing to the inherent uncertainties in forecasting expenditures in the first year of major reforms, a contingency amounting to 0.8 percent of GDP has been allocated for possible activation in the health and pension sectors. These funds will not be used to finance an increase in entitlements above those already established for 2000, and we will use these funds only after consultation with Fund staff. Another ¼ percent of GDP is reserved for one-time operations that ensure a final resolution for enterprises to be privatized, liquidated, or restructured.

9. In 2000, we aim at a strengthened fiscal performance in the municipalities and the National Social Security Institute (NSSI). In 1999, within the prudent general government stance there were marked differences among the branches of government. While the central government achieved a small surplus, the performance of the NSSI was somewhat weaker than expected, and municipalities ran sizable deficits. This year, we expect improvements in enforcement and the information exchange between tax administration and the NSSI to help enhance the collection capacity of both agencies. As for the municipalities, we have introduced new provisions in the 2000 budget law which should ensure improved expenditure discipline in the local government sector. These provisions include limiting expenditure to the level of revenues collected (rather than projected), and linking transfers from the central government to fiscal performance, with penalties for deviations.

10. We aim to collect general government revenues equivalent to over 36½ percent of GDP despite making moderate cuts in personal and corporate income taxes. The tax changes, which took effect from January 1, 2000, included a reduction in the higher marginal rate of the corporate income tax from 27 to 25 percent, an increase in the minimum threshold for taxable monthly income under the personal income tax from 75 to 80 leva, and a corresponding rise in the floors of all other tax brackets. We estimate the combined revenue loss from the cuts in the corporate and personal income taxes at ⅓ percent of GDP. These losses should in part be offset by improvements in tax and social security administration, in particular the phased establishment of a unified revenue agency to collect taxes as well as

social security and health contributions, a harmonization of the bases for the personal income tax, health, and social security contributions; extending the coverage of the presumptive ("patent") tax; and improving the selectivity of audits. Tax revenue will also be helped by our continued strong efforts to reduce arrears to the budget. In the second half of 1999, we managed to reduce tax arrears (including interest and penalty) by 417 million leva from the end-June level of 759 million leva, reflecting the privatization or restructuring of the state enterprises with the largest overdue obligations. Moreover, during the same period we reduced the overdue obligations to social security and customs by the monitored companies by 17 million from 150 million leva at end-June. In 2000, we propose to widen the performance criterion on arrears to include both taxes and social security contributions, in line with the scope of the unified revenue agency, and are committed to reducing these arrears from the end-1999 level of 512 million leva by 39 million leva in the first quarter of 2000 and by a further 44 million leva in the second quarter, with subceilings for taxes and social security contributions. Overdue obligations to customs will remain subject to indicative targets.

11. Expenditures will be contained to about 38 percent of GDP. To accommodate the transitional costs of the pension reform (from the beginning of 2000) and health reform (effective from mid-2000), spending in these areas has been raised by a total of over ½ percent of GDP. These spending increases have been offset by reductions in staffing and subsidies, the latter consistent with the restructuring plans for state enterprises. The average wage in the budgetary sector will be raised by 7.9 percent during 2000. In the social area, the budget will preserve the real value of social assistance. In addition, effective from February 1, 2000 the minimum wage, which applies to 1 percent of budgetary employees, has been raised from 67 leva (US$35) per month to 75 leva (US$39). From now on, the minimum wage will be raised every six months, starting on October 1, 2000, in line with the increase in the average public sector wage. In expenditure management and control, we will build on the recent steady progress in implementing the treasury, and will by end-2000 concentrate all central government budgetary and extrabudgetary accounts which are not subject to restrictions imposed by foreign donors in a single treasury account. To improve the quality of public investment, in preparing the 2001 budget we will rely on a list of priority projects established in an updated public investment program.

12. We are implementing sweeping institutional reforms to maintain medium-term fiscal viability. Building on the macroeconomic stability achieved, we are now in a position to address long-term fiscal problems. Besides the above-mentioned implementation of the treasury, we are taking steps to establish a unified revenue agency and to ensure the viability of the pension and health systems.

13. We will spare no efforts to put in place a unified revenue agency to administer the collection of taxes and social insurance payments which we expect to enhance revenue collection capacity significantly over time. We recognize the need to reduce tax and social security contribution rates over the medium term, and to adapt revenue administration to an economic environment with a rapidly growing number of private taxpayers. To help achieve these objectives, we will unify the registration, control, collection, audit, and enforcement

activities based on modern information technology using the Unique Identification Number. We will implement this reform in a phased manner, building on progress made in individual agencies and ensuring a stable revenue performance. Throughout the process, we will retain the National Social Security Institute and the Health Insurance Fund as independent agencies, and will ensure that revenues for social insurance will continue to be separately identified and transparently channeled to these agencies. Key measures in the coming months include the setting up of a high-level interministerial committee and of a strong project management team, the adoption of a strategy paper that develops the vision and implementation plan for the unified revenue agency, and the submission to parliament of draft legislation to further rationalize the bases for tax and social insurance payments. The new agency will be established during 2001, starting unified revenue collection from large taxpayers, and will be fully operational by the end of 2001.

14. We are implementing a radical overhaul of the pension and health systems. While the primary emphasis in pension reform is now on putting the first and third pillars in operation, we will continue our efforts to develop the system, including by (i) strengthening the regulation and supervision of voluntary pension funds by end-March 2000, (ii) reviewing the scope for expanding the investment options of voluntary pension funds by end-June 2000, and (iii) assessing by end-June 2000 the need for remedial action to restore the long-term financial viability of the first pillar in light of the changes to the originally envisaged parameters made by parliament. In addition, we will accelerate the preparatory work for the universal second pillar, which as parliament recently decided will be launched in 2002, two years earlier than originally envisaged. Turning to the health sector, we will complete the re-registration of health care establishments as commercial companies, and define the division of responsibilities among state and municipal institutions and the Health Insurance Fund by end-March, 2000. We will sign a framework agreement with representatives of outpatient health care providers on the functioning of the HIF-financed medical care by April, and will conclude a critical mass of individual contracts with outpatient health care providers to be able to launch the new system for primary and specialized healthcare from July 1, 2000. In parallel, we will begin preparations for the second stage, to be launched from mid-2001, comprising hospital care.

D. Labor Market Policies

15. We will continue to implement a strict incomes policy for state-owned enterprises. We are committed to keeping the total labor cost of state-owned enterprises under control by restricting their wage bill, while allowing them to choose the level and quality of employment. The incomes policy ordinance for 1999 served well in achieving this objective. In particular, among the enterprises that we monitor most closely, those with large losses or arrears reduced their combined wage bill by 20 percent between the third quarter of 1998 and the fourth quarter of 1999, and monopolies reduced their total wage bill by 4 percent between the second and fourth quarters of last year. The incomes policy ordinance for 2000, which was approved on February 17, maintains the overall objective but includes some improvements, such as removing seasonal factors from the measurement of productivity and profits. At the same time, we have allowed the district heating companies more flexibility in

setting their wage bills in line with seasonal demand. Finally, we have formulated an updated list, now comprising 121 enterprises, that during 2000 will be subject to the strictest constraint, namely a wage bill freeze. This list now includes not only monopolies and enterprises with the largest losses and arrears but also enterprises that are subsidized by the government.

16. We will take steps to increase labor market flexibility, with a view to reducing unemployment and maintaining competitiveness. By end-March 2000, we will submit to the Council of Ministers amendments to the Labor Code that will substantially liberalize labor regulations while complying with EU and ILO standards. The amendments will include provisions to make hiring, firing, and working hours more flexible. Moreover, we will continue to implement programs aimed at retraining and encouraging employment, and support the start of small businesses to facilitate the absorption of the unemployed by the private sector. We will also make employment and investment clauses in privatization contracts more flexible.

E. Structural Issues

Enterprise restructuring and privatization

17. After the largest wave of divestiture in Bulgaria's history in 1999, we have now entered the last year of privatization of non-infrastructure assets. By end-1999 we had privatized 77.5 percent of state-owned assets excluding infrastructure and 48.7 percent of the total assets. This year will see the completion of large-scale enterprise privatization, the divestiture of residual shares in enterprises that have been privatized, and further mass privatization. Regarding the large enterprises, there remains an attractive pipeline of major assets ready for sale in 2000, notwithstanding our strong progress in 1999. Owing to the complexity of the deal and the conflict between the financial aspiration of potential acquirers and our desire to open the market for competition, we have not yet been able to complete the sale of a majority package of BTC, the telecommunications company. If negotiations with the current bidder fail, we will quickly reopen the tender with every intention to finish the sale this year. We also intend to sell Bulgartabak (which is already on offer) this year and make progress in preparing assets in the power sector for privatization (see the section on energy sector reform below). As for residual shares, we will by end-June sell or otherwise dispose of these for all enterprises that are not involved in litigation related to the determination of ownership or restitution claims, with a small number of exceptions. Our approach will be eclectic: if the majority shareholder does not wish to purchase the residual shares they will be offered in mass privatization auctions or in the stock exchange. On mass privatization, success has been achieved in disposing of less significant enterprises through this method of ownership transformation. The seventh mass privatization auction, offering shares in 90 enterprises, will be completed in March 2000. Seven more auctions are scheduled for the remainder of 2000.

18. Following the successful completion of the isolation program for Group B (commercial enterprises) in mid-1999, we were determined not to allow the assets or the

affected employees to remain in an indefinite state of suspension. We therefore achieved our commitment under the performance criterion to terminate production activities for all Group B enterprises that had been entered into liquidation and disposed of at least half of the assets in more than half of the affected enterprises. In other cases leasing arrangements have been made with private sector concerns which effectively bring the assets under private management. We will continue to press ahead with further asset sales as market conditions allow but aim to finish the process by end-2000.

19. Despite the progress already made, we recognize that liquidation and bankruptcy proceedings need to be accelerated for both private and state enterprises, and are taking steps to streamline these processes. An amendment to the Commercial Code that simplifies and accelerates bankruptcy procedures has passed first reading in parliament, and judges have been receiving training on bankruptcy matters. We will ensure that by end-June 2000, the newly established unit under the Council of Ministers will be fully operational, setting requirements for the selection, removal, and supervision of liquidators for state-owned enterprises and subsequently enforce these requirements. Moreover, by end-June 2000 we will establish a commission including experts from outside the government to review practices in this area, and to evaluate the need for further possible amendments. Also by mid-2000, we will create a body within the Ministry of Justice to supervise receivers.

20. With the exception of national railways, BDZ, the state enterprises remaining in isolation (Group A) are utilities in the energy sector. Our determined strategy is to make all these enterprises commercially viable through the use of cost reductions, selective investments in new infrastructure, and adjustments in tariffs. We will not hesitate to liquidate those enterprises which clearly are not viable in the long run. In the second half of 1999 Group A enterprises were already subjected to wage bill freezes, and they submitted restructuring plans aimed at enabling them to live within the reduced subsidies provided in the 2000 budget. The restructuring of the energy companies is described in the next section. As for BDZ, important progress has been made in rehabilitating the company in accordance with its financial recovery program approved last November. In 2000, the company will take measures sufficient to reduce its losses from 151 million leva (excluding a state subsidy of 60 million leva) in 1999 to 98 million leva (excluding a subsidy of 40 million leva) while fully repaying its arrears to the state which totaled 49 million leva at the end of last year. Losses are concentrated on the passenger side, where a new timetable was introduced with effect from January 15. We anticipate this will result in a decline in terms of train kilometers of almost 25 percent and cost savings in excess of 13 million leva. We also intend to introduce pre-paid cards that will limit the number of subsidized trips that individuals may make and improve the company's cash flow. Moreover, we will work with the Ministry of Labor and Social Policy to analyze ways to improve the targeting of transport subsidies.

Energy sector reform

21. We will strengthen the independent regulatory commission to ensure a well-functioning market in energy. This commission was established in September 1999, but has yet to become fully operational. By end-March 2000, we will clearly define the

commission's functions and the mechanism of financing its operations, provide budgetary resources to enable it to discharge its core functions until a new, permanent financing mechanism is in place, and seek a twinning arrangement with an experienced regulatory agency in western Europe. During 2000, the commission's top priority is to put in place the regulatory prerequisites for implementing the legal separation of NEK, the electricity company. These include ordinances on the pricing system and the general conditions for draft contracts for the purchase and sale of power. These ordinances are expected to be adopted in April 2000. The commission will also develop pricing mechanisms for the district heating and gas sectors, and implement the permit and licensing regime which will be the key source of its funding over the medium term.

22. Building on steady progress made to date, including accounting separation a year ago, we have put in place all the technological prerequisites for the legal separation of NEK into the generation, transmission, and distribution components. However, to ensure a smooth and transparent transition to a regulated competitive market we regard the adoption of key pieces of secondary legislation related to the Energy Law as a necessary condition for the legal separation. Also, the regulatory commission and the State Agency of Energy will by April 15, 2000 agree with the World Bank on an effective mechanism to monitor the price setting policies through which transfer prices between generators, the Single Buyer (the electricity transmission and dispatch company) and distribution companies are to be determined until the price regulation ordinance takes effect (no later than mid-2001). We will only proceed with NEK's legal separation when the core regulatory framework has become effective and the agreed price monitoring mechanism is in place.

23. We are committed to the continued restructuring of Bulgargaz, the natural gas monopoly. The financial recovery and restructuring program introduced in mid-1999 and further specified in September has produced promising initial results. Collection under the rescheduling program concluded with major customers last year has been 99 percent, and we intend to continue to enforce the terms of the contracted agreements. Having been the company with the largest arrears in mid-1999, Bulgargaz has since eliminated all its overdue obligations and fully met its current obligations to the budget. In December 1999, an international accounting firm completed an audit of the company's 1998 accounts, and the accounting separation of its transmission, import, distribution, transit, and storage activities was achieved. Looking forward, Bulgargaz will continue to implement its restructuring plan on schedule. Agreed purchase volumes for 2000 from the single supplier of gas are based on Bulgaria's anticipated consumption, and we expect to significantly increase our role as a transit route for gas to neighboring countries, in line with the long-term agreement with the gas supplier. We will also ensure that Bulgargaz completes a full inventory of its physical assets by end-March 2000 to prepare the company for eventual legal separation.

24. We are determined to take strong measures to address the financial problems of the district heating companies (DHCs) both in the short and long runs. In view of the recent weak financial results of the DHCs resulting from higher fuel prices, increased disconnection rates, and a marked decline in collection rates, we will take a number of actions immediately to prevent a build-up of payments arrears. First, taking into account the seasonal nature of the

DHCs' operations, we will frontload the release of budgetary subsidies to DHCs. Second, through a similar early release of budgetary transfers not exceeding those already planned in the budget, we will enable budgetary organizations and municipalities to settle their arrears with the DHCs. In the case of Sofia DHC, which accounts for well over half of the district heating system and which is the only DHC owned by a municipality, we will request the municipality to cover part of the higher-than-expected losses. We will also subject DHCs to tight cost discipline to bring them in compliance with the existing rehabilitation plans. Here, measures will include the sale of non-core assets and strict observance of existing wage ceilings. Simultaneously, we will develop a comprehensive Action Plan in coordination with the World Bank to address the long-term problems of DHCs, including the Sofia DHC. This Action Plan will be based on an assessment of the government's objectives regarding DHC pricing, subsidies, and investment, and will be coordinated with the government's overall energy policy and public investment program. Specifically, the Plan will draw on an analysis of the financial, environmental, and social impact of alternative options for each individual DHC and the district heating system as a whole; identify which DHCs should continue to operate; and include restructuring and investment plans for the cases where maintaining a DHC is considered to be the most efficient option, with a declining path for operating subsidies. The Action Plan will be submitted to the Council of Ministers by end-May and approved by it by end-June.

25. The coalmining sector has also undergone substantial restructuring, with further progress to come. Nine unviable pits (sections of coalmines) have already been closed down, and all legal obstacles to privatizing viable coalmines has been eliminated from January 1, 2000. Looking forward, by end-March 2000 the Council of Ministers will adopt an action plan aimed at closing production in any remaining unviable pits during 2000 and preparing the viable ones for privatization.

Financial sector

26. We will continue our bank privatization efforts. We had three important achievements in the second half of 1999: we completed the sale of Expressbank to a high-quality strategic investor, signed the sales contract for Hebros, and issued a tender to sell Biochim, with a March 17, 2000 deadline for final bids to allow the unexpectedly large number of potential buyers to complete due diligence. We are confident that we will be able to choose a suitable buyer and sign the sales contract by end-June 2000. We are also advanced in the sale of Bulbank, the largest bank in Bulgaria. We expect to receive bids by end-April, and to sign the sales contract by end-2000. For the last remaining state bank, the State Savings Bank, we will work with the technical assistance consultant to transform it to a full commercial bank during 2000, preparing it for privatization over the medium term. As for the Central Cooperative Bank, where the state's share is just below 50 percent, we will reduce this share to below 33 percent by mid-2000.

27. Building on the major progress already made, we are fully committed to further improving the regulatory and prudential framework for the financial sector. From July 1, 2000, we will reduce the **minimum reserve requirement** from 11 to 8 percent. We believe

this measure will improve the banks' profitability, lower interest spreads, and cushion the liquidity impact of the introduction of the single treasury account. The Bulgarian National Bank has recently taken a number of steps to strengthen **banking supervision**: assigning CAMELS rating to all banks in Bulgaria was completed during 1999; the monthly off-site bank monitoring system has been improved substantially, and its results have been harmonized with those obtained from on-site CAMELS rating; revised regulations have been adopted on large loans, provisions, and licensing, including elements of consolidated supervision; a comprehensive report on the state of the banking sector is now prepared quarterly; and the BNB has adopted internal rules to ensure the timely preparation of a monthly compliance report. Looking forward, we will continue to improve these monitoring systems, and will discuss with a forthcoming IMF technical assistance mission other measures to further strengthen supervision. We are also strengthening the **deposit insurance** fund (DIF). In November 1999, the BNB and the DIF signed a memorandum of understanding which defines the modalities of a regular data exchange that should allow the DIF to anticipate possible future needs for its funds. Also, we will submit to the Council of Ministers by end-March 2000 amendments to the law on deposit insurance to make the DIF more effective in collecting premiums and investing funds.

28. We are also taking other measures to create a well-functioning financial sector. To facilitate a recovery in private sector credit, we will make the central credit registry maintained by the BNB operational by end-March 2000, through introducing a new software system. We will also ensure that the registry covers all banks by end-June 2000. By end-March, we will submit to the Council of Ministers a new law on electronic signature which will help replace paper trail of payments with electronic trail. Moreover, we are improving the implementation of international accounting and auditing standards, and are training our judges on financial issues. As for facilitating the exit of unviable banks, we have issued tenders for the assets of a majority of the already closed banks where the Ministry of Finance was the dominant creditor. We have also designated the DIF as the agency that will administer future bank bankruptcies, and will submit a new law on bank insolvency to parliament by end-March 2000.

Other policies

29. To improve the business climate and attract foreign direct investment, we are committed to taking measures to reduce red tape, corruption, and superfluous state interference in economic activity. Already in 1998–99, legislation was amended to provide for a more efficient resolution of contractual disputes. More recently, following an interministerial review of the licensing and registration regime, in October 1999 the Council of Ministers adopted a program to reduce red tape and increase transparency. A working group has recommended in January 2000 to the Council of Ministers a list of measures to facilitate the business operations of companies in Bulgaria. The recommendations of the working group include proposals for the revocation, amendment, and simplification of licenses; the introduction of common transparent rules for granting permits and licenses; the creation of streamlined systems (beginning already from end-March 2000) to facilitate the establishment and operation of businesses; and provisions for training administrative staff

dealing with licenses and permits. By end-March 2000, the Council of Ministers will submit to parliament detailed proposals based on the working group's recommendations, and will adopt an agenda for implementing the recommendations over the medium term. The Foreign Investment Agency has established an annual monitoring system of administrative barriers, and the results of the first review became available in January 2000.

30. We are committed to a wide-ranging reform of public administration. Our intention is to create for the first time in Bulgaria a public service which is professional and merit-based, cost-effective, and which has a strong client orientation. At the same time we intend to accelerate our program of actions against corruption. We have already completed the first stage of this reform program. In December 1999, the functions and organizational structures of ministries were redefined, and a number of ministries were eliminated through merger (including the former Ministries of Trade and Industry which were combined into a new Ministry of Economy). As for overall budgetary employment, during 2000 staffing will be reduced by 36,500, or 6.7 percent. In addition, on July 1, 20,000–25,000 health care workers will move to the commercial sector. In the second stage of implementing our broad reform agenda we intend to take the following measures. In the first half of 2000, we will introduce a new framework for performance management in the public administration. By March 2000, we will develop a strategy to introduce more flexible pay and employment systems in the public sector. This will strengthen the professionalization of the public administration, address key areas of recruitment and retention difficulty, and provide for increased pay decompression for managerial positions in the public administration. In the next few months, we will also draft various pieces of primary and secondary legislation concerning the public administration. In this context, we will carry out further organizational and functional reviews, evaluating the possibilities for privatization of certain administrative services, and aiming for the introduction of market mechanisms in the financing, operation, and management of executive agencies. We will also seek to strengthen service delivery, and to ensure that resources continue to be allocated only to high-priority purposes. To further improve the quality of public services, we will continuously promote the professional development and training of civil servants.

31. In agriculture, we will take further steps to develop a well-functioning land market and promote the creation of a private sector rural credit market. Regarding the land market, by December 1999, restitution had reached over 96 percent, compared to 80 percent a year before. A land information system has been implemented which includes a comprehensive database to facilitate transactions on the land market. Looking forward, we expect parliament to approve the Law on Land Registration and Cadastre by end-March 2000, and this will further facilitate the tracking and registering of land titles. On rural credit, we have established a warehouse receipts system, and are currently carrying out an information campaign to explain its advantages to producers and banks. We have reduced the amount of short-term lending by the State Fund for Agriculture (SFA) from 34 million in 1999 to 30 million leva this year, while the amount of long-term lending, including loan guarantees, has been kept at last year's level of 50 million leva.

32. Recognizing the significance of high-quality data for the formulation of economic policies, we will continue to improve our statistics. In particular, we will enhance the quality of quarterly GDP through improvements in source statistics, including through improved coverage of informal activities. With respect to PPI, work will continue toward full coverage of all industrial activities by end-2001. In the balance of payments area, a closed international transactions reporting system (ITRS) is being developed. Bulgaria is a pilot country for the implementation of the General Data Dissemination System (GDDS), and is committed to use the GDDS as a framework for the development of its statistics.

33. We have continued to liberalize our trade regime with a view to improving export performance and competitiveness. During 1999, the last remaining export tax (on lumber) was removed. The Decrees for customs tariffs and trade policy measures for 2000 reduced tariff protectionbarriers and import licensing requirements in line with program commitments. As a result, from January 1, 2000, the simple average tariff rate stands at 13.7 percent, compared with 15.2 percent in 1999. We also intend to eliminate by end-June 2000 the export ban on raw tobacco through an amendment of the Tobacco Act. We will explore the scope for a further reduction in the number of tariff bands in 2001 from the present 25. Finally, we will complete the removal of all 33 state trading companies with foreign trade operations from the public sector by end-2000.

34. Prudent management of external debt will continue to be an important priority for the government. In the last six months we have developed guidelines for contracting and guaranteeing non-concessional debt, developed external vulnerability indicators which we now publish quarterly, and successfully resolved bilateral disputes with Italy and the Netherlands, with discussions with Austria being at an advanced stage. By end-March 2000 we will formulate a debt management strategy to strengthen our ability to assess external vulnerability and manage our external debt over the medium term. At the same time, we will also develop a timetable for implementing the strategy by end-2000. In this context, we will improve and expand the list of indicators used to assess vulnerability. We will continue to pursue debt service swaps for infrastructure or environment with Paris Club creditors, and other debt management operations will be undertaken only if overall liquidity is sufficient and there are adequate reserves in the fiscal reserves account. In the area of domestic debt, we will refrain from converting privatizations vouchers into government debt.

F. Program Monitoring

35. During the remainder of the second year of the extended arrangement, the program will be monitored based on the implementation of structural performance criteria and benchmarks (Table 1), and on quarterly and continuous quantitative performance criteria and indicative targets (Annexes I–VII). The government will conduct with the IMF the fourth review under the arrangement no later than September 2000. Other performance criteria—applicable on a continuous basis—remain as defined in the Memorandum of September 9, 1998, except for the one relating to the minimum reserve requirement which will take into account the planned reduction from July 1, 2000 (Annex VIII).

Table 1. Bulgaria: Prior Actions, Structural Performance Criteria, and Structural Benchmarks for the Third Program Review and Beyond

		Program Timing	Implementation Status
A.	**Prior Action**		
1.	Appointment by the Deputy Prime Minister of an Inter-Ministerial Steering Committee to oversee design and implementation of the Unified Revenue Agency. Appoint a full-time project manager reporting to the Chairman of the Steering Committee.	March 15, 2000	
B.	**Structural Performance Criteria**		
(I)	**Existing Measures**		
1.	Form a list of enterprises comprising unprivatized enterprises in the original list of 100 state-owned enterprises with the largest losses and arrears, and state monopolies including district heating companies, NEK and Neftochim. Ensure that these state-owned enterprises as a group keep their wage bill for the third and fourth quarters of 1999 under the level of their aggregate base wage bill. The aggregate base wage bill equals the sum of the wage bills in the third quarter of 1998 for enterprises in the original list and of the wage bills in the second quarter of 1999 for the newly added state-owned monopolies. Within this total ceiling, no more than 10 percent of these enterprises may exceed their individual wage bill ceilings. If an enterprise is privatized or ceases operations, it will be dropped from the list and the base wage bill will be appropriately adjusted.	End-Dec. 1999	**Met. Enterprises with large losses or arrears reduced their combined wage bill by 20 percent between the third quarter of 1998 and the fourth quarter of 1999, and monopolies reduced their total wage bill by 4 percent between the second and fourth quarters of last year. Out of a total of 84 enterprises, only 4 violated the wage freeze.**
2.	Enactment by parliament of the law on the first pillar of pension reform.	End-Dec. 1999	**Met. Code for Mandatory Social Insurance adopted in December 1999, and in force as of January 1, 2000.**
3.	Terminate production activities in all Group B enterprises entered into liquidation by June 30, 1999, and sell the core assets (accounting for at least 50 percent of each enterprise's long-term fixed assets) in no fewer than half of these enterprises.	End-Dec. 1999	**Met. Production activities have been terminated. Of the 15 enterprises in liquidation, LTFA exceeding 50 percent of total sold in 4 enterprises, and a mixture of sales and write-offs in another 4 enterprises raised the share of LTFA removed from state sector above 50 percent.**
4.	Complete accounting separation of Bulgargaz into import, transport, storage, distribution, and transmission components.	End-Dec. 1999	**Met. Experimental separate accounts for end-September 1999 received in January 2000, and accounts for the full year received in March 2000.**

Table 1. Bulgaria: Prior Actions, Structural Performance Criteria, and Structural Benchmarks for the Third Program Review and Beyond

		Program Timing	Implementation Status
5.	Issue tender for Biochim bank.	End-Dec. 1999	**Done.**
(ii)	**New Measures**		
1.	Submit to COM amendments to the Labor Code with provisions making hiring, firing, and working hours more flexible.	End-March 2000	
2.	Submit to COM drafts of the key pieces of secondary legislation related to the Energy Law covering the technological aspects of the energy market; the general conditions of contracts for the sale of electricity, heating energy and natural gas; the permit and licensing regime; and price regulation, including the prices paid to generation companies and by distribution companies in the electricity sector. The price regulation for electricity will be effective from July 1, 2001.	End-March 2000	
3.	Form a list of 121 enterprises comprising state-owned enterprises with the largest losses and arrears, all monopolies including district heating companies, other state institutions, and enterprises that receive subsidy. Ensure that these state-owned enterprises as a group keep their wage bill for the first and second quarters of 2000 under the level of the base wage bill, which is their aggregate wage bill in the third quarter of 1999. Within this total ceiling, no more than 10 percent of these enterprises may exceed their individual wage bill ceilings unless their total wage bill remains below 10 percent of the aggregate wage bill of all the enterprises in the list. If an enterprise is privatized or ceases operations, it will be dropped from the list and the base wage bill will be appropriately adjusted.	End-March and end-June 2000	
4.	COM adoption of comprehensive action plan for restructuring the district heating sector agreed with the World Bank.	End-June 2000	
5.	COM approval of Unified Revenue Agency Strategy.	End-June, 2000	
6.	Sign the sale contract of Biochim that includes a firm deposit.	End-June 2000	

Table 1. Bulgaria: Prior Actions, Structural Performance Criteria, and Structural Benchmarks for the Third Program Review and Beyond

		Program Timing	Implementation Status
C.	**Structural Benchmarks**		
(i)	**Existing Measures**		
1.	Establish a tax policy unit in the Ministry of Finance, outside the tax administration department.	End-Dec. 1999	**Delayed. Implementation expected in March 2000.**
2.	Produce first-round unified tax register based on the BULSTAT number.	End-Dec. 1999	**Done.**
3.	Transfer all central government funds with the exception of Type 3 suspense accounts and extra-budgetary accounts for private donations to the single treasury account in the BNB.	End-Dec. 1999	**Target revised. Phased implementation during 2000 in line with latest IMF technical assistance recommendations is on track.**
4.	Bring Bulgartabac to the point of sale.	End-Dec. 1999	**Done. Privatization procedure was opened and information memorandum was sent out in December 1999.**
5.	Complete comprehensive audit report for Bulgargaz for 1998 by an international audit firm.	End-Dec. 1999	**Done.**
6.	Increase capital adequacy ratio to 12 percent in steps.	End-Dec. 1999	**Done.**
7.	Issue a 2000 Trade Decree (to take effect on January 1) that lowers MFN tariffs for non-agricultural goods to 11 percent (average), and for agricultural goods to 24 percent (average), maximum tariffs in industry are lowered to 30 percent, and the number of tariff bands reduced to 25.	End-Dec. 1999	**Done.**
8.	Abolish registration (automatic licensing) requirements for coal and coke, petroleum, liquid fuels, ready-to-use drugs, textiles, ferrous and non-ferrous metals, computer software (HS 27, 30, 52, 54-55, 61-62, 74-76, 78-80, 85).	Jan. 1, 2000	**Done.**
9.	Enforce compliance with prudential regulations and implement strategy to bring offending banks into compliance, including the right for the BNB to require prompt corrective action (PCA).	Continuous	**On track.**

Table 1. Bulgaria: Prior Actions, Structural Performance Criteria, and Structural Benchmarks for the Third Program Review and Beyond

		Program Timing	Implementation Status
(ii)	**New Measures**		
1.	Enactment by parliament of legislation to expedite the completion of bankruptcy proceedings, including for state-owned enterprises.	End-March 2000	
2.	Ensure that all banks report to the Central Credit Registry necessary information for the Registry to be fully operational.	End-June 2000	
3.	Remove Biochim bank from public sector.	End-March 2000	**Condition revised and changed into an end-June 2000 structural performance criterion.**
4.	Submit to parliament amendments to the Energy Law to establish rules for the future financing of the Regulatory Commission primarily from licensing fees and penalties rather than only from budgetary allocations.	End-April 2000	
5.	Sell through other means or irreversibly put up for sale through the centralized mass privatization auctions residual state-owned shares in nonstrategic companies privatized by end-1999 net of those shares held due to restitution or legal proceedings or reserved for employees. In addition to these exclusions, there will be no more than 20 enterprises with remaining state-owned shares.	End-June 2000	
6.	Complete the sale of assets of Group B enterprises entered into liquidation.	End-Dec. 2000	
7.	Refrain from a conversion of outstanding privatization vouchers into government debt.	Continuous	

Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
1. Fiscal Sector				
1.1 Overall fiscal stance	Ensure fiscal sustainability and support CBA arrangement	Maintain a broadly balanced budget, except for possible transitional costs of structural reforms and adequate provision for infrastructure investment.	EFF period	**On track**
		Maintain adequate balance in the Fiscal Reserve Account (FRA).	EFF period	**On track**
1.2 Fiscal transparency	Redefine the boundaries of the government sector	Incorporate quasi-fiscal costs of restructuring or liquidating state-owned enterprises and any support provided to enterprises explicitly in the budget.	Budget 2000-01	**On track**
		Include in the annual budget law a limit and on the amount of new government guarantees extended.	Budget 2000–01	**Done for 1999. Not included in the budget law for 2000, but will be implemented through a separate Council of Ministers decree in February.**
		Separate commercial activities from the budget; corporatize and privatize these activities, where appropriate.	EFF period	**On track**
	Enhance government sector accountability	Reduce the number of extrabudgetary funds and accounts. Do not establish new EBFs.	Budget 2000-01	**Done. No new funds and accounts have been opened. The 2000 Budget law envisages ten extrabudgetary funds and accounts to be transformed into second level budget spending units under the respective ministries.**
		Consolidate all central government extrabudgetary accounts and extrabudgetary funds with the exception of funds in Type 3 suspense accounts and extrabudgetary accounts for private donations on a gross basis into the general government budget, and include them in the single treasury account from January 1, 2000.	2000 Budget	**Done as part of the 2000 Budget, except when contracts signed with official donors prohibited inclusion into the single treasury account.**
		Put in place phase I of an improved financial management information system for the treasury covering all first -level spending units and selected second- level spending units of the central government.	*End-2000* *End-March 2001*	
		Strengthen the budgetary procurement process, and improve internal audit.	End-1999	**Done**
		Further improve the information content of reports and analyses of the budget and its implementation made available to the public.	2000 and onward	**On track**

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
1.3 Tax policy	Improve the efficiency of the tax system	Eliminate VAT exemption for tourism services abroad.	Budget 2000, with effect from January 1, 2001	**Done**
		Fully implement the rule that tax changes cannot be legislated in laws other than the tax laws and do not introduce new tax exemptions.	EFF period	**On track**
		If and when overall fiscal situation permits, progressively reduce the tax burden.	EFF period	**On track**
		Establish a tax policy unit in the Ministry of Finance, outside the tax administration department.	End-1999 **Structural Benchmark**	**Delayed. Will be implemented by February 2000.**
		Extend the occupational coverage of the presumptive ("patent") system and review the level of presumptive taxation on a continuing basis.	2000 budget	**Done with amendments of the Personal Income Law.**
1.4 Tax, Social Security and Health Insurance administration	Improve collection, enhance enforcement and compliance while reducing compliance costs	*Appointment by the Deputy Prime Minister of an Inter-Ministerial Steering Committee to oversee design and implementation of the Unified Revenue Agency. Appoint a full-time project manager reporting to the Chairman of the Steering Committee.*	*March 15, 2000* ***Prior Action***	
		Create a full-time project team.	*April 15, 2000*	
		Submit to parliament draft legislation to further rationalize bases for tax and social insurance payments to facilitate collections by the Unified Revenue Agency.	*End-June 2000*	
		Computerization of GTAD and Customs.	End-1999	**Delayed. *Timing revised***
		Complete computerization of Customs.	*End-June 2000*	
		Strengthen taxpayers services, including advance rulings.	1999–onward	**On track.**
		Finalize project implementation strategy, including a clear definition of the project structure.	*June 15, 2000*	
		Prepare a strategy paper to develop the Unified Revenue Agency, covering the functions, organization and procedures of the Agency, and the interim steps to improve the coordination of revenue collection efforts of the GTAD and NSSI.	*June 15, 2000*	
		COM approval of Unified Revenue Agency Strategy.	*June 30, 2000* ***Structural Performance Criterion***	
		Complete the review of existing GTAD and NSSI business process.	*End-June 2000*	
		Develop computerization strategy for Unified Revenue Agency.	*End-Sept. 2000*	
		COM will pass draft amendments to laws to harmonize the main elements of revenue bases for the Personal Income Tax (PIT), the Social Insurance Fund Contribution (SIFC), and Health Insurance Fund Contribution (HIFC) especially with respect to the self-employed and small business.	2000 budget	**Done**

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		Harmonize bases for PIT, SIFC, and HIFC to the extent possible.	2001 budget	
		Define work relationships to have an employment character when they satisfy criteria that are prescribed in the laws or regulations.	2000 budget	**Done with the adoption of the Social Insurance Code in December 1999.**
		Prohibit the offsetting of tax liabilities against SOE inter-enterprise arrears.	EFF period	**On track**
		Parliament will adopt the draft Tax Procedure Code, which will limit the collection responsibilities of the GTAD to national and local taxes.	End-Sept. 1999	**Done with delay. Tax Procedure Code adopted in December 1999 has eliminated GTAD's responsibility for collecting miscellaneous nontax revenues.**
		Produce first-round unified tax register based on the BULSTAT number.	End-1999 **Structural Benchmark**	**Met. The NSI has compared the BULSTAT register with the National Tax Register. The identified taxpayers are marked and the list was distributed to regional tax offices for checking.**
		Implement a selective audit program to control VAT fraud instead of relying on a full audit of each VAT client.	End-1999 onward	**On track. A selective audit program has been developed and sent to the tax offices for testing. A software for automatic selection is being developed.**
		Set up a mechanism to monitor the stock of VAT refund claims made and VAT refunds processed on a monthly basis.	End-August 1999	**Done**
1.5 Public expenditure	Rationalize government financial management	Improve the existing treasury functions consistent with recommendations of FAD technical assistance report.	EFF period	**On track**
		Review the regulatory framework to allow for transparent pricing of general government payments.	End-Sept. 1999	**Done**
		Establish framework agreements with commercial banks for handling of government payments through zero-balance accounts.	End-1999	**Done**
		Switch to electronic payments of budgetary payment transactions.	End-June 2000	**On track**
		Transfer all central government funds with the exception of Type 3 suspense accounts and extra-budgetary accounts for private donations to the single treasury account in the BNB.	End-1999 **Structural Benchmark**	**Not met. Phased implementation during 2000 in line with latest IMF technical assistance recommendations is on track.**
		Transfer remaining central government fund with the exception of Type 3 suspense accounts and extra-budgetary accounts for private donations to the single treasury account in the BNB, except where disallowed by donors.	End-2000	

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		Implement 2000 budget and accounting on the basis of revised chart of accounts.	2000 budget	**On track**
		Substantially reduce the number of second level spending units.	2000 budget	**Some reduction achieved from January 1, further reduction expected during 2000.**
	Improve public investment planning	Update and prepare reports on investment program and its execution on annual and three-year rolling basis.	EFF period	**On track, but its coordination with the budget process is inadequate and the prioritization of projects unresolved.**
		Inter-Ministerial Committee to submit to the Council of Ministers recommendations on linking together public investment planning, budget allocations, and government guarantees.	*End-April 2000*	
		In line with Inter-Ministerial Committee recommendations: *(a) coordinate the Public Investment Program with the budget preparation process.* *(b) create mechanism for screening projects in their early planning phases.*	*End-June 2000* *End-June 2000*	
		Strengthen the centralized management of grants in the budget.	*End-June 2000*	
	Civil service reform	Review and amend civil service statute and compensation system to enhance transparency and accountability and insulate civil service from political interference; further reduce overstaffing.	1999–2000	**Civil Service bill promulgated, substantial reductions in budgetary employment planned for 2000.**
		Develop a strategy to introduce more flexible pay and employment systems in the public sector.	*End-March 2000*	
1.6 Social Security		Submit to parliament a draft Social Security Code consistent with the Tax Procedures Code.	End-Oct. 1999	**Done**
1.6.1 Social assistance	Improve equity, targeting, and administration of Social Assistance Program	Consolidate current fragmented social assistance system and improve targeting.	Budget 1999, 2000	**Met, except for child allowances.**
		Prepare strategy paper on targeting child allowances in consultation with the World Bank.	*End-April 2000*	
		Council of Ministers approval of a strategy paper on targeting child allowances.	*End-June 2000*	
		Target child allowances.	Budget 2001 onwards	
1.6.2 Pensions	Reform the pension system to improve long-term financial viability and help lower payroll taxes	Progressively move toward a diversified three-pillar system involving both the public and the private sectors by introducing a second (mandatory) defined-contribution pension scheme for new entrants; and establishing a third pillar with one or more voluntary defined-contribution schemes, including occupational funds.	EFF period	**On track. Law on Voluntary Pension Insurance and Code for Mandatory Social Insurance are in force as of January 1, 2000.**
		Launch a public education campaign on pension reforms.	End-Sept. 1999	**Done**

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		Enactment by parliament of the law on the first pillar of pension reform.	End-1999 **Structural Performance Criterion**	**Done. Code for Mandatory Social Insurance adopted in December 1999, and in force as of January 1, 2000.**
1.6.3 Health	Rationalize and make more cost-effective supply of public health services	Implement health insurance system.	2000–01	**On track. Health Insurance Fund launched in mid-1999, health reform for primary and specialized care in mid-2000, for hospital care a year later.**
		Sign framework agreement with outpatient health providers.	*End-April 2000*	
		Sign individual contracts with outpatient health providers.	*End-June 2000*	
		Ensure that the NSSI has appropriate administrative powers to collect the HIFC.	End-Sept. 1999	**Done with delay.**
2. Labor Market Policies		Form a list of enterprises comprising unprivatized enterprises in the original list of 100 state-owned enterprises with the largest losses and arrears, and state monopolies including district heating companies, NEK and Neftochim. Ensure that these state-owned enterprises as a group keep their wage bill for the third and fourth quarters of 1999 under the level of their aggregate base wage bill. The aggregate base wage bill equals the sum of the wage bills in the third quarter of 1998 for enterprises in the original list and of the wage bills in the second quarter of 1999 for the newly added state-owned monopolies. Within this total ceiling, no more than 10 percent of these enterprises may exceed their individual wage bill ceilings. If an enterprise is privatized or ceases operations, it will be dropped from the list and the base wage bill will be appropriately adjusted.	End-September 1999 End-December 1999 **Structural Performance Criteria**	**Done** **Done**
		Form a list of 121 enterprises comprising state-owned enterprises with the largest losses and arrears, all monopolies including district heating companies, other state institutions, and enterprises that receive subsidy. Ensure that these state-owned enterprises as a group keep their wage bill for the first and second quarters of 2000 under the level of the base wage bill, which is their aggregate wage bill in the third quarter of 1999. Within this total ceiling, no more than 10 percent of these enterprises may exceed their individual wage bill ceilings unless their total wage bill remains below 10 percent of the aggregate wage bill of all the enterprises in the list. If an enterprise is privatized or ceases operations, it will be dropped from the list and the base wage bill will be appropriately adjusted.	End-March and end-June 2000 **Structural Performance Criteria**	

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		Submit to COM amendments to the Labor Code with provisions making hiring, firing, and working hours more flexible.	End-Dec.1999 *End-March 2000* ***Structural Performance Criterion***	**Delayed** **Timing revised**
		Substantially increase the flexibility in enforcing employment and investment clauses in existing privatization contracts and in formulating new ones to enable privatized enterprises to adapt to market conditions.	*February 1, 2000 onward*	
3. Structural Reform				
3.1 Privatization and enterprise restructuring				
3.1.1 Enterprise privatization		*Sell through other means or irreversibly put up for sale through the centralized mass privatization auctions residual state-owned shares in nonstrategic companies privatized by end-1999 net of those shares held due to restitution or legal proceedings or reserved for employees. In addition to these exclusions, there will be no more than 20 enterprises with remaining state-owned shares.*	*End-June 2000* ***Structural Benchmark***	
		Residual shares in enterprises privatized from January 1, 2000 will be sold within six months of their privatization under the above-mentioned conditions.	*Continuous*	
3.1.2 Financial discipline and transparency	*Increase financial transparency*	*Implement enhanced disclosure requirements for nonfinancial enterprises.*	*End-June 2000*	
	Accelerate liquidation of unviable enterprises and streamline insolvency and liquidation procedures	*Establish a Commission consisting of experts from inside and outside the government to review existing practices governing insolvency and liquidation proceedings.*	*End-June 2000*	
		Ensure that the recently created Commission under the Council of Ministers will set requirements for selection, removal, and supervision of liquidators of SOE's.	*End-June 2000*	
		Enforce requirements for selection, removal, supervision of liquidators for SOEs.	*End-June 2000 onward*	
		Introduce a body within the Ministry of Justice that will establish uniform practices, training, general reporting requirements, and selection criteria for trustees appointed in bankruptcy cases.	*End-June 2000*	
		Streamline court procedures for realization of collateral.	1998 *End-June 2000*	**Progress on realization of collateral by budget** **Target revised.**

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		Terminate production activities in all Group B enterprises entered into liquidation by June 30, 1999, and sell the core assets (accounting for at least 50 percent of each enterprise's long-term fixed assets) in no fewer than half of these enterprises.	End-Dec. 1999 **Structural Performance Criterion**	**Done. Production activities have been terminated. Of the 15 enterprises in liquidation, LTFA exceeding 50 percent of total sold in 4 enterprises, and a mixture of sales and write-offs in another 4 enterprises raised the share of LTFA removed from state sector above 50 percent.**
		Complete the sale of assets of Group B enterprises entered into liquidation.	End-Dec. 2000 **Structural Benchmark**	
		Submit to parliament draft legislation to expedite the completion of liquidation and bankruptcy proceedings for state-owned enterprises.	**End-Sept. 1999 Structural Performance Criterion**	**Done.**
		Enactment by parliament of legislation to expedite the completion of bankruptcy proceedings, including for state-owned enterprises.	***End-March 2000 Structural Benchmark***	
		Privatize Neftochim without increasing customs tariffs for refined fuels.	End-March 2000	**Done. Neftochim was privatized Dec. 1, 1999.**
		Bring Bulgartabac to the point of sale.	End-Dec. 1999 **Structural Benchmark**	**Done. Privatization procedure was opened and information memorandum were sent out in December 1999.**
		Complete the transfer of shares of Arsenal to private sector buyer or enter into liquidation or insolvency.	End-Sept. 1999 **Structural Benchmark**	**Done. Arsenal was privatized in September 1999.**
		Pass a clarifying interpretation of the discount factor for MEBO bids offering deferred payment schemes.	End-Sept 1999	**Done with delay in October. Measure revised.**
		Implement the clarifying interpretation of the discount factor for MEBO bids offering deferred payment schemes to require proper calculation of discounted value of deferred payments.	*End-March 2000 onward*	
		Approval by MOF of new restructuring plans for all Group A enterprises.	End-Sept. 1999 **Structural Benchmark**	**Done, two with delay.**

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures
Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		For BDZ: (a) Approval of new rehabilitation plan by COM (b) Close 2 loss-making lines, and sectors from other loss-making lines accounting for 200 km of track (c) Eliminate all fare exemptions and reductions with the exception of the disabled, children, and decorated war veterans effective from January 1, 2000 (d) Privatize or enter into liquidation 8 subsidiaries performing auxiliary activities (e) Privatize or enter into liquidation 5 additional subsidiaries performing auxiliary activities (f) Sell at least 10,000 tons of scrap (g) Keep total wage bill below that in the third quarter of 1998 (h) No new commercial bank lending to BDZ from June 30, 1999.	(a) End-Sept. 1999 **Structural Performance Criterion** (b) End-Dec. 1999 (c) End-Dec. 1999 (d) End-Sept. 1999 (e) End-Dec. 1999 (f) End-Dec. 1999 (g) End-Sept. and end-Dec. 1999 (h) Continuous	**(a) Implemented with delay on November 17, 1999** **(b) Done - Railway lines accounting for 53km and sectors of lines accounting for 313 have been closed.** **(c) Not done, but remaining exemptions are minimal, and remaining reductions are consistent with minimizing losses.** **(d) Done.** **(e) Done with delay by end-January 2000.** **(f) Done.** **(g) Observed in both quarters.** **(h) Observed.**
		Implement BDZ Financial Rehabilitation Plan adopted by the COM in November 1999, keeping subsidies at budgeted levels and without incurring arrears.	*2000-01*	
3.1.3	Improve business climate	Conduct a review of existing domestic licensing, permit, and other regulatory requirements to identify those that might inhibit the growth of the private sector.	End-October 1999	**Done. List of measures submitted to COM in January 2000.**
		Begin putting in place streamlined systems to facilitate the establishment and operation of businesses.	*End-March 2000*	
		Council of Ministers to submit to parliament detailed proposals based on working group's recommendations.	*End-March 2000*	
		Council of Ministers to adopt an agenda for implementing the working group's recommendations.	*End-March 2000*	
3.2 Energy Sector Reform		According to the Energy Action Plan: . Adjust electricity tariffs . Liberalize the prices of: - domestic coal for households - briquettes . Phase out state subsidies for coal mining	 Continuous End-June 2000 End-2001 End-2000	 **Done** **Done by end-1999** **Deadline revised from end-June 2001** **Deadline revised from end-June 2000**

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		According to the electricity sector restructuring program:		
		. Continue to adjust average electricity tariffs to cover a large part of the ongoing investment program out of retained earnings and attract private interest to the sector	EFF period	**On track**
		. Establish separate legal corporate entities for NEK's components: - distribution	End-Dec. 1999	**Delayed since secondary legislation is not yet in place**
		- transmission	End-June 2000	
		. Implement privatization - Distribution activities	End-Dec. 1999	**Delayed pending the clarification of the regulatory framework and legal separation.**
		Bundle the 28 regional distribution companies in the electricity sector into larger units to facilitate their privatization with the assistance of a qualified privatization advisor.	End-Dec. 1999	**Done, 7 units created.**
		Allow concessions for coal mining enterprises as envisaged in the action plan.	1999–2000	**Done, allowed from January 1, 2000.**
		COM approval of an action plan to prepare coal mines for speedy privatization.	*End-March 2000*	
		Liberalize household gas supply sector.	EFF period	**On track**
		Approval by COM of a fully elaborated financial recovery and restructuring plan for Bulgargaz, with a detailed timetable for implementation.	End-Sept, 1999 **Structural Performance Criterion**	**Done, with delay of two weeks.**
		Submit to parliament amendments to the Energy Law to establish rules for the future financing of the Regulatory Commission primarily from licensing fees and penalties rather than only from budgetary allocations.	*End-April 2000* ***Structural Benchmark***	
		Submit to COM drafts of the key pieces of secondary legislation related to the Energy Law covering the technological aspects of the energy market; the general conditions of contracts for the sale of electricity, heating energy and natural gas; the permit and licensing regime; and price regulation, including the prices paid to generation companies and by distribution companies in the electricity sector. The price regulation for electricity will be effective from July 1, 2001.	End-Dec. 1999 *End-March 2000* ***Structural Performance Criterion***	**Delayed** ***New target***
		COM adoption of key pieces of secondary legislation.	*April 15, 2000*	

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		Agree with the Regulatory Commission and the World Bank on close monitoring by the Regulatory Commission of NEK with the assistance of the State Agency of Energy, its sole shareholder. This monitoring mechanism will ensure that the contractual relationships with and price setting by the Single Buyer (NEK transmission) remain in line with the adopted secondary legislation during the transition period ending no later than mid-2001, upon the decision of the COM. The agreement will commit NEK to abide by rulings of the Regulatory Commission.	*April 15, 2000*	
		Proceed with legal separation of NEK only if all preceding three measures have been completed.		
		Adopt all secondary legislation related to the Energy Law as amended.	End-March 2000 *End-Sept. 2000*	**Deadline modified** ***New target***
		Evaluate the energy supplement paid under the social assistance scheme targeted to low income households in order to improve design and implementation for the 1999-2000 heating season within the existing budget allocation.	End-Oct. 1999	**Done**
		Implement Bulgargaz Rehabilitation Plan adopted by COM.	*2000-01*	**On track**
		Complete comprehensive audit report for Bulgargaz for 1998 by an international audit firm.	End-Dec. 1999 **Structural Benchmark**	**Done**
		Complete accounting separation of Bulgargaz into import, transport, storage, distribution, and transmission components.	End-Dec. 1999 **Structural Performance Criterion**	**Done, experimental separate accounts for end-Sept. received, accounts for full year received in [March 2000].**
		Limit the quarterly wage bill of Bulgargaz to the level of the same quarter of the previous year.	End-Sept. 1999 End-Dec. 1999	**Done** **Done**
		Introduction of differentiated prices and tariffs for transport and distribution of natural gas.	End-March 2000 *End-Dec. 2000*	**Deadline moved owing to delay in putting secondary legislation in place** **New target.**
		COM will adopt a program with the objective of attracting strategic private investors to develop the gas distribution market according to Bulgargaz rehabilitation plan.	*End-June 2000*	
		Cut off gas and electricity to state-owned enterprises who do not pay bills on time.	EFF period	
		Install control and metering devices in all substations supplied by district heating companies outside Sofia.	End-Sept. 2000	
		Install control and metering devices in all substations supplied by Sofia district heating companies.	*End-June 2001*	
		Reach agreement with Sofia municipality to cover part of the losses of Sofia district heating company from 2000.	*End-June 2000*	

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		Submit to COM a comprehensive action plan for restructuring the district heating sector.	*End-May 2000*	
		COM adoption of comprehensive action plan for restructuring the district heating sector agreed with the World Bank.	*End-June 2000* ***Structural Performance Criterion***	
		Privatize district heating companies or transfer them to the municipalities that are willing to accept them, under suitable regulatory arrangements for tariff setting and quality of services.	EFF period	
3.3 Financial Sector Reform				
3.3.1 Banking supervision	Ensure soundness of banking system	Increase capital adequacy ratio to 12 percent in steps.	End-1999 (12 percent) Structural benchmark	**Done**
		Reduce minimum reserve requirement ratio from 11 percent to 8 percent.	*July 1, 2000*	
		Review and amend regulations on large loan exposures.	End-1998	**Done in November 1999.**
		Adopt regulations on consolidated supervision.	End-March1999 *End-June 2000*	**Delayed. Partially done. Elements of consolidated supervision were introduced in the newly adopted regulations on large loans and provisions in November 1999.** ***Target revised***
		Enforce compliance with prudential regulations and implement strategy to bring offending banks into compliance, including the right for the BNB to require prompt corrective action (PCA).	Continuous **Structural Benchmark**	**On track**
		Present quarterly compliance and enforcement reports.	Quarterly	**On track**
		Implement a program to further develop banking supervision.	1998–2000	**On track**
		Assign CAMELS rating to the remaining banks.	End-1999	**Done, except for two banks that started operations in 1999.**
		Harmonize the early warning system CAEL with CAMELS.	End-1999	**Done**
		Provide regular information on deposit distribution of the commercial banks to the Deposit Insurance Fund.	End-Sept. 1999 onward	**On track**
		Develop a new management report on the condition of the banking sector, in line with a structure agreed with the IMF, and send to management of the Board for discussion every quarter.	End-Sept. 1999 onward	**On track**
		Reduce and eliminate government intervention in credit markets.	1998–99	**On track, except for CCB.**
		Issue the Compliance Report within 5 weeks after the reporting quarter.	End-Sept. 1999 onward	**On track**

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Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		Adopt amended regulations on large exposure of banks and on the evaluation of risk exposure of banks and allocation of necessary provisions.	End-Sept. 1999	**Done**
		Revise banking regulations to allow replacement of paper trail of payments with electronic trail.	End-1999 *End-June 2000*	**Delayed because it requires the adoption of a law on electronic signature, which is being drafted in line with the EU directives on this subject that were adopted in December 1999.** ***Target revised***
		Submit to Council of Ministers a draft law on electronic signature.	*End-March 2000*	
		Submit to the Council of Ministers draft amendments to the Law on Deposit Insurance to improve its effectiveness.	*End-March 2000*	
		Ensure that the Central Credit Registry is operational, by introducing a new software system and making it accessible to all banks.	*End-March 2000*	
		Ensure that all banks report to the Central Credit Registry necessary information for the Registry to be fully operational.	*End-June 2000* ***Structural Benchmark***	
3.3.2 Banking sector	Establish a competitive banking system	Privatize remaining state banks: . Hebrosbank . Biochim.	 1999 2000	 **Sale contract signed in December 1999** **On track**
		Issue tender for Biochim bank.	End-1999 **Structural Performance Criterion**	**Done**
		Remove Biochim bank from public sector.	End-March 2000 **Structural Benchmark**	**Condition revised.**
		Sign the sale contract of Biochim that includes a firm deposit.	*End-June 2000* ***Structural Performance Criterion***	
		State Savings Bank (SSB): Begin implementing technical assistance program to upgrade SSB capacity *Transform SSB to a full commercial bank.*	 End-Sept. 1998 *End-2000*	 **Delayed start to Sept. 1999; interim program adopted and implemented.**

[1] Text in italics refers to measures agreed or modified during the third review.

Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		Issue tender for Hebros bank.	End-Sept. 1999 **Structural Benchmark**	**Done**
		Receive final binding bids for Bulbank.	*End-June 2000*	
		Design a new administrative system for bank bankruptcies and submit necessary draft legislation to parliament.	End-March 2000	
		Increase the capacity of the DIF to adequately handle bankrupt banks.	End-Sept. 1999 and onward	**On track**
3.3.3 Nonbank financial sector	Upgrade nonbank financial sector to Western European standards	Pass new law on securities market.	1998	**Done in Dec. 1999.**
3.4 Agricultural Policies	Liberalize agricultural markets	Conduct State Reserve or other government purchases and sales of grain at market prices through competitive tender or the commodity exchange.	Continuous	**Being observed.**
		Abolish 2 percent tax imposed in the turnover of agro-processing industries to finance the SFA.	End-Sept. 1999	**Done**
		Set quantitative limits for long-term lending extended by the SFA. *Reduce total new short-term financing provided by SFA in 2000, and continue reducing it thereafter.*	EFF period	**Limit for long-term lending in 2000, including loan guarantees, set at 50 million leva** ***Limit for short-term lending in 2000 set at 30 million leva.***
		Complete restitution and titling of agricultural land.	End-Dec. 1999	**95.6 percent of restitution completed.**
		Terminate Zarneni Hrani as a legal entity.	End-Dec. 1999	**Done. 93.9 percent privatized, remainder entered into liquidation.**
		Complete privatization or enter into liquidation long-term assets under the jurisdiction of the Ministry of Agriculture that have been slated for privatization, except for those transferred from other Ministries.	*End- June 2000*	
		Reduce the stake of state entities in the Central Cooperative Bank to under 33 percent.	*End-June 2000*	
		State entities will be excluded from subscribing to future share issues or capital increases in the Central Cooperative Bank.	Continuous	**On track**
3.5 Statistical Issues	Improve the statistical base for macroeconomic decision making	Improve quality, consistency, and timeliness of: . *PPI* . *Quarterly GDP* . External trade statistics; balance of payments; and external debt, especially the coverage of private sector transactions . *Revise historical (1995-97) balance of payments statistics according to the new methodology in trade and services.*	 *End- 2001* *End-December 2000* End-March 2000 onward *End-September 2000*	
		Fully implement GDDS.	End-2000	**On track**

[1] Text in italics refers to measures agreed or modified during the third review.

Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
		Use the GDDS as the framework for the development of statistics	*Continuous*	
4. External Sector Policies				
4.1 Trade Policy		Abolish remaining export tax for unprocessed lumber and profiled lumber (of HS 44) following the introduction of a stumpage fee system.	Jan. 1, 2000	**Done**
		Amend the Tobacco Act to make removal of export prohibition of unfermented tobacco effective from July 1, 2000.	*End-June, 2000*	
		Abolish registration (automatic licensing) requirements for coal and coke, petroleum, liquid fuels, ready-to-use drugs, textiles, ferrous and non-ferrous metals, computer software (HS 27, 30, 52, 54-55, 61-62, 74-76, 78-80, 85).	Jan. 1, 2000 **Structural Benchmark**	**Done**
		Refrain from introducing new temporary tariff exemptions and temporary tariff quotas.	July 31, 1998 Ongoing **Structural Benchmark**	**Being observed**
		Reduce import tariffs for refined fuel products.	EFF period	**Import tariffs reduced from 25 percent in 1998 to 22.5 percent in 1999. No further reductions are envisaged during 2000, except in the context of free trade agreements.**
		Issue a 2000 Trade Decree (to take effect on January 1) that lowers MFN tariffs for non-agricultural goods to 11 percent (average), and for agricultural goods to 24 percent (average), maximum tariffs in industry are lowered to 30 percent, and the number of tariff bands reduced to 25.	End-1999 **Structural Benchmark**	**Done**
		Issue a 2001 Trade Decree (to take effect on January 1) that lowers MFN tariffs for non-agricultural goods to 10 percent (average) and for agricultural goods to 22 percent (average).	End-2000	
		Execute tenders for the privatization of the remaining 21state trading companies with foreign trading operations.	End-1999	**Privatization tenders announced for 16 companies.**
		Issue tenders for the privatization of the remaining 5 state trading companies with foreign trading operations.	*End-June 2000*	
		Complete privatization of all 33 state trading companies with foreign trading operations.	*End-2000*	
4.2 Capital Account Liberalization	Liberalize capital account to increase integration of Bulgaria in global financial system	Review regulations on capital account transactions and develop a phased plan for further opening of capital account.	End-March 1999	**Foreign Exchange Law approved in [Sept.] 1999. Implementing regulations in place. No further plan has been developed.**

[1] Text in italics refers to measures agreed or modified during the third review.

Table 2. Bulgaria: Summary and Timetable for Macroeconomic and Structural Measures Under the EFF-Supported Program, 1999-2001[1]

Policy Area	Objectives and Targets	Selected Strategies and Measures	Implementation	Implementation Status
4.3 Debt Management	Improve debt management	Establish guidelines for approving projects financed or guaranteed by nonconcessional external credits.	End-Sept. 1999 **Structural Benchmark**	**Done**
		Remove bilateral debt from the list of state secrets.	End-Dec. 1999	**Done**
		Develop and start publishing external vulnerability indicators.	End-Dec. 1999	**Done**
		Devise a debt management strategy for the medium term.	End-March 2000	**On track**
		Develop an implementation plan for the debt management strategy to be in place by end-2000.	*End-March 2000*	
		Refrain from a conversion of outstanding privatization vouchers into government debt.	*Continuous* ***Structural Benchmark***	

[1] Text in italics refers to measures agreed or modified during the third review.

Overall Deficit and Revenues of the General Government

	Overall deficit ceilings 1/	Revenues (Indicative)
	(In millions of leva)	
January 1, 2000–March 31, 2000	219	2,061
January 1, 2000–June 30, 2000	-9	4,394
January 1, 2000–September 30, 2000 (indicative)	224	6,692
January 1, 2000–December 31, 2000 (indicative)	95	9,136

1/ The figures denote the largest allowable level of the deficit; a negative figure denotes a surplus.

The general government accounts are defined to include 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, net nonbank credit to the general government, privatization receipts of the budget, and receipts from external loans for direct budgetary support minus amortization paid.

The overall deficit ceilings have been defined excluding contingency expenditure related to the cost of structural reform (defined as contingency spending not related to natural disasters), and will be adjusted upward for the cumulative actual contingency expenditure related to the cost of structural reform. This adjustment will not exceed BGN 21 million at end-March, BGN 50 million at end-June, BGN 130 million at end-September, and BGN 269 million at end-December 2000.

Floor on the Balance of the Fiscal Reserve Account
(In millions of leva)

	FRA	Assumed cumulative flow of official external financing to the budget (excluding the IMF)
Level on December 31, 1999	2,601	
Cumulative change from level on December 31, 1999		
March 31, 2000	-444	49
June 30, 2000	-303	152
September 30, 2000 (indicative)	-470	398
December 31, 2000 (indicative)	-178	505

The Fiscal Reserve Account (FRA) consists of the balances in leva and in foreign exchange of the following accounts: all budgetary accounts in the banking system, including the central budget, ministries and agencies, central government extrabudgetary funds as defined in Annex No. 6 of the 2000 Budget Law, the National Social Security Institute, and the Health Insurance Fund.

For the purpose of the program, the balance of the FRA is defined net of net onlending of purchases from the IMF by the BNB from January 1, 2000. It is also defined before the use of the contingency (as defined in Annex I) and will be adjusted by the same amount in the opposite direction of the adjustment on the ceiling of the overall deficit for actual use of the contingency.

The floor on the balance of the FRA will also be adjusted downwards by the amount of the shortfall of official external financing to the budget (other than from the IMF) relative to program projections. This adjustment will be capped at US$25 million per quarter calculated at the program exchange rate, i.e., at a cumulative US$100 million by the end of 2000. Any excess official financing relative to program assumptions will raise the FRA floor by the amount of this excess.

The limits will be monitored from the accounts of the banking system, to be provided twice monthly by the BNB and the Ministry of Finance. For the purposes of the program, deposit accounts that are denominated in foreign currencies will be converted into leva at the December 31, 1999 exchange rates.

Floor on Deposits of the Banking Department

The available balances of the Banking department will be deposited in the Issue Department, including a deposit in SDRs according to the reserve position and holdings of SDRs at the IMF. The Banking Department may hold part of its deposits in foreign currencies.

From January 1, 2000 until December 31, 2000, the deposit of the Banking Department with the Issue Department shall, on average in any given week, exceed BGN 680 million. The floor on the Banking Department deposits is indicative from July 1, 2000 to December 31, 2000.

The floor set above will be adjusted for:

(i) cumulative repurchases to the IMF less maturity payments made by the government to the BNB from January 1, 2000.

(ii) any revaluation loss on the monetary gold which might be debited from the deposit of the Banking Department, if the gold price falls below DM 500 per troy ounce.

During the monitoring period, any increase in outstanding lending by the Banking Department to banks greater than the equivalent of BGN 2 million will require consultation with the IMF staff.

Ceiling on Tax and Social Insurance Arrears

	Total	GTAD (indicative)	NSSI (indicative)
		(In millions of leva)	
Outstanding as of:			
December 31, 1999 (actual)	549	383	166
Cumulative change from level on December 31, 1999:			
March 31, 2000	-39	-30	-9
June 30, 2000	-83	-60	-23
September 30, 2000 (indicative)	-133	-90	-43
December 31, 2000 (indicative)	-191	-120	-71

The performance criterion is on the sum of monitored arrears to the GTAD and the NSSI. For the purpose of this performance criterion, arrears are defined to include interest and penalties. The enterprises monitored for arrears to the GTAD:

1. Lukoil - Neftochim
2. BDZ
3. Plama AD
4. VMZ AD - Sopot
5. Haskovo BT AD
6. NEK EAD
7. Solntse BT AD
8. Arkus AD
9. Sugar Factory AD
10. Pernik Mines
11. Arsenal EAD
12. Vini EAD
13. Bourgas Seaport
14. PDNG EAD
15. Bourgas Sugar Facory AD
16. SKGT EAD
17. Maritsa - Iztok Mines
18. Great Bulgarian Mills EAD
19. Kambana 1899 AD
20. Bulgargaz EAD
21. Trema AD
22. Madara AD
23. Dunarit AD
24. Maritsa KK AD
25. Ledenika AD
26. Dobrich Mel AD
27. Plovdiv BT AD
28. Minstroi Rodopi AD
29. Pleven BT AD
30. Quartz EAD
31. Bobov Dol Mines

The enterprises monitored for arrears to the NSSI:

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

43. Sanya
44. Agropromstroy EAD
45. Kombinat za Obrabotka na Tsvetni Metali AD
46. Chavdar AD
47. Filtex AD
48. Vitamina AD
49. Strumatex
50. Dobritch Mel AD
51. Nistra EAD
52. Elprom ZET
53. V i K
54. KZU Promishleno Stroitelstvo
55. Minstroy AD
56. Elena Georgieva AD
57. Ilindentsi Mramor
58. Metalni Konstruktsii
59. Orfey OOD,
60. Radomir Le Co Co EOOD
61. Darvodobiv i Stroitelstvo
62. Dobrichka Mesna Kompania
63. Prikom EAD
64. Ilyo Voyvoda AD
65. Dunarit AD
66. Burya AD
67. Mediket EAD
68. Harmonia
69. Pektin EOOD
70. Uvion OOD
71. S-M 33
72. Technologia na Metalite
73. Sparky AD
74. Polyma AD
75. Rodopa 95 AD
76. Microak OOD
77. Elastic EAD
78. ZMD Nikopol AD
79. Aves-94 AD
80. Sukmo EOOD
81. Gorubso EAD
82. Struma OOD
83. Balkan Bank – Headquarters
84. Arsenal EAD
85. Balkanbas Mines, Paisiy Mine
86. ZMM Technotronica
87. Incoms EIM
88. Chepino EAD
89. Cherno More Mine
90. Panagyurski Mini EOOD
91. Elko OOD
92. Dervent OOD
93. Kachestvena Metalurgia AD
94. Dobrich Mel
95. Kartal EAD
96. Kamet AD
97. Djebel Basma Service-4U
98. Josi EOOD
99. Tezhko Mashinostroene AD
100. Sipak-Bis OOD

These lists are to be updated at the time of the fourth review.

For the purpose of assessing compliance with this performance criterion:

- 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, 1999;
- 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, 1999 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.

Indicative Ceilings on the Monitored Total Outstanding Liabilities to Customs

	(In millions of leva)
Outstanding as of:	
December 31, 1999 (actual)	5.5
Cumulative change from level on December 31, 1999:	
March 31, 2000	0
June 30, 2000	0
September 30, 2000	-2
December 31, 2000	-2

This indicative ceiling relates to the total of the outstanding liabilities (including principal, interest and penalty charges) of the 20 largest debtors to the Customs Department. The list of enterprises covered is provided below.

Outstanding liabilities to the Customs Department exclude VAT and excise obligations collected at customs.

Agreements on writing off or rescheduling outstanding liabilities to the Customs Department entered into after December 31, 1999 will not reduce amounts counted as outstanding liabilities.

Enterprises in the list below which are entered into liquidation or bankruptcy proceedings will continue to be included in 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.

1. Haskovo BT
2. Amal-2000 OOD
3. Tri Alkols EOOD
4. Galax EOOD
5. VMZ Sopot
6. Bourgas Port EAD
7. Samotlor OOD
8. Neftochim AD
9. Bapersugar AD
10. Grainer-Dippa OOD
11. Sanvel Lazio EOOD
12. Buren Foundation
13. Van Kempen Rousse
14. Inter Karlen 1 EOOD
15. Yanex – Yanulcho Petrov
16. Elliss M.
17. Offset Express AD
18. Y. N. Linda and DZU
19. Glenfield Sofia
20. Science and Education

Ceilings on Contracting and Guaranteeing of External Debt 1/
(In millions of U.S. dollars)

	One year and Under 2/	Over 1 year 3/	1–5 years 3/
Cumulative change from level on December 31, 1999:			
March 31, 2000	40	700	250
June 30, 2000	80	850	250
September 30, 2000 (indicative)	120	950	250
December 31, 2000 (indicative)	160	1,100	250

1/ Debt 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. 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.

2/ The ceilings apply to the outstanding stock of short-term debt with original maturities of up to and including one year contracted or guaranteed by the general government or the Bulgarian National Bank. The general government is defined in Annex I. Short-term debt is defined for the purpose of this performance criterion to include all short-term obligations other than (i) normal import-related financing credits; and (ii) outstanding balances under bilateral payments arrangements. The actual stock of short-term debt outstanding (according to this definition) as of December 31, 1999 was zero.

3/ The ceilings apply to the contracting or guaranteeing of external non-concessional debt with original maturities of more than one year by the general government or the Bulgarian National Bank. A subceiling on such debt of more than one year and up to and including 5 years is also defined. The general government is defined in Annex I. Concessional loans are defined as those with a grant element of at least 35 percent of the value of the loan, using currency-specific discount rates based on the commercial interest reference rates reported by the OECD (CIRRS) in effect at the time of contracting or guaranteeing the loan. Excluded from the ceilings are: (i) changes in indebtedness resulting from refinancing credits and rescheduling operations, including the capitalization of interest; (ii) liabilities to the IMF; and (iii) changes in indebtedness resulting from debt exchange operations.

Indicative Ceilings on the Cumulative Change in Net Credit
from the Banking System to the General Government

	(In millions of leva)
Cumulative change from level on December 31, 1999:	
March 31, 2000	391
June 30, 2000	125
September 30, 2000	302
December 31, 2000	51

Net credit from the banking system to the general government for the purposes of the program is defined as the sum of banks' claims on all parts of the general government as defined in Annex I above, less the sum of general government deposits with the banking system (excluding the balance of suspense accounts), as reported in the accounts of the banking system. Claims cover bank loans and advances to the general government, as well as bank holdings of general government debt. General government deposits cover: (i) deposits of the consolidated budget (including those of local governments and the net balance of the Privatization Agency); and (ii) the net balances of all other extrabudgetary funds and accounts, except the type 3 suspense accounts.

For the purposes of the program, those components of net credit to the general government that are denominated in foreign currencies will be converted into leva at the exchange rates and cross exchange rates prevailing on December 30, 1999 (accounting exchange rates).

For assessing observance of the above limits on the cumulative change of net bank credit to the general government, the reported level of net bank credit to the general government as defined above will be adjusted to exclude: (i) the impact of debt operations (including any government instrument issued to guarantee deposits of a bank which is closed, or to recapitalize banks); and (ii) the impact of transactions involving closed banks. The indicative ceilings will be raised by an amount equal to the shortfalls in official financing relative to the program assumptions up to a limit of US$100 million; and lowered by an amount equal to the excess. Both amounts will be converted to leva at the accounting exchange rate defined above.

The limits will be monitored from the accounts of the banking system, including the FRA, supplemented by information provided monthly by the Ministry of Finance on government debt, nonbank financing, gross and net receipts from cash and mass privatization. The limits will be adjusted appropriately if a revision of the monetary survey affects net banking system credit to general government.

Other Performance Criteria[1]

1. The BNB will ensure that gross foreign reserves of the issue department are at least equal to the issue department's liabilities at all times. Issue department liabilities will comprise leva notes and coins in circulation, and deposits from the banking department, banks, government, and the nonfinancial sector with the BNB, excluding liabilities to the IMF. For the purpose of this performance criterion, issue department liabilities will be converted into foreign exchange using the official exchange rate.

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. Required reserves of the banking system will not be reduced to below 11 percent of eligible liabilities until June 30, 2000, after which they can be reduced to 8 percent. The conditions for banks' access to required reserves will not be changed.

4. During the period of the arrangement, the government does not intend to impose new or intensify existing exchange restrictions on payments and transfers for current international transactions, or introduce or modify multiple currency practices, nor conclude any bilateral payments arrangements that are inconsistent with Article VIII of the IMF's Articles, nor impose or intensify any import restrictions for balance of payments purposes, nor accumulate any payments arrears except for amounts subject to rescheduling.

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

Statement by the IMF Staff Representative on Bulgaria
March 31, 2000

1. This statement highlights economic and policy developments in Bulgaria since the circulation of the staff report for the Article IV consultation and third review under the extended arrangement (EBS/00/45). This information does not alter the thrust of the staff appraisal.

2. The latest economic data broadly confirm the picture drawn in the staff report. In January, real industrial sales rose by 5.2 percent from a year ago, with sales for exports growing particularly fast, by 28 percent. However, unemployment has continued to increase, reaching 18.1 percent in February. The CPI increased by 3.7 percent in the first two months of 2000, raising year-on-year inflation to 9.1 percent. Average 12-month inflation remains low at 3.5 percent. The pick-up in inflation reflects higher energy prices and the return of food prices to a normal seasonal pattern following an exceptional decline during the previous winter. Regarding the balance of payments, last year's current account deficit, at US$663 million or 5.4 percent of GDP, turned out to be marginally higher than the staff's estimate, but was more than fully financed by higher-than-estimated foreign direct investment at US$734 million. On March 24, gross official reserves stood at US$3.0 billion, compared with US$3.2 billion at end-1999.

3. Policy implementation remains generally on track. The prior action on the appointment by the Deputy Prime Minister of a steering committee and a project manager to oversee the design and implementation of the unified revenue agency was completed on March 29. On March 30 the Council of Ministers is expected to establish a tax policy unit in the Ministry of Finance, completing the implementation of this end-1999 structural benchmark. The authorities have also indicated that they expect to complete on time the structural performance criteria for end-March on submitting to the Council of Ministers drafts of an amended Labor Code and key pieces of secondary energy legislation. However, while the legislation to expedite the completion of bankruptcy proceedings passed first reading in parliament already in early March, final parliamentary approval (a structural benchmark for end-March 2000) is now envisaged only in April. Budget execution is on schedule. The general government deficit through March 17 was 43 million leva, well below the program ceiling of 219 million for the first quarter. Revenue collection has continued to be strong, and the indicative target for end-March is likely to be met by a comfortable margin.

4. On March 24, parliament approved the government's updated Bulgaria 2001 program which outlines the objectives and policies up until the general elections scheduled for no later than April next year. In the economic area, the program emphasizes fighting unemployment and poverty as a key objective, and many of the announced measures to achieve this goal are among the government's commitments under the extended arrangement with the Fund. However, the program also proposes a freeze on the user price of electricity and district heating until the end of the 2000–01 heating season. In the case of district

heating, foregoing the option of raising prices seems premature, since the feasibility of a price freeze can only be assessed once the government has formulated a comprehensive action plan to restructure the district heating sector (Council of Ministers' approval of such a plan is a structural performance criterion for end-June 2000). Similarly, it is too early to assess the full implications of freezing the price of electricity. Such a freeze would, however, call into question the authorities' commitment to unifying household and non-household user prices by mid-2001, which would require a sizable increase in household tariffs from the present levels soon after the end of the 2000–01 heating season. The staff is concerned that the proposed price freezes could weaken energy sector reform and put pressure on the budget, and will clarify these issues with the authorities by the time of the next program review.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 00/32
FOR IMMEDIATE RELEASE
April 19, 2000

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Bulgaria

On March 31, 2000, the Executive Board concluded the Article IV consultation with Bulgaria.[1]

Background

Under the currency board arrangement (CBA) introduced in mid-1997, Bulgaria has achieved macroeconomic stabilization and made substantial progress in structural reform. The CBA has been underpinned by a prudent fiscal policy: in 1998 the general government registered a small surplus, and in 1999 the deficit was limited to 0.9 percent of GDP. As a result, inflation has been brought under control. The CPI increased by only 1.8 percent (annual average) in 1999, and while higher energy and food prices have raised the year-on-year inflation rate to 9.1 percent in February 2000, average 12-month inflation remains low at 3.5 percent. Since the introduction of the CBA, two thirds of state assets outside infrastructure have been privatized, and the restructuring of large state monopolies in the utilities sector is underway. Loss-making state enterprises have been made subject to a strict incomes policy. Banking supervision has improved markedly. Four (out of seven) state banks have been privatized, and two more are on the market. The share of administered items in the CPI has been reduced sharply, trade has been liberalized significantly, and land restitution has been nearly completed. Many of the most significant advances took place in 1999, the year of the most intensive reform so far.

The authorities' strong efforts notwithstanding, the growth dividend from stabilization and reform has been slow in coming. True, after years of declining output, activity had rebounded in the second half of 1997 as the CBA-based policy framework restored credibility

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. In this PIN, the main features of the Board's discussion are described.

and sharply reduced inflation. The carry-over from this rebound helped GDP growth to reach 3.5 percent in 1998, the highest rate since the onset of transition. However, since the initial rebound and all the way through mid-1999, a series of adverse shocks kept GDP flat and put the external current account deficit on a rising path. Starting in 1998, export and activity suffered from a slowdown in partner countries and weak export prices as a result of the global financial crises. In March–June 1999, the Kosovo conflict blocked transit routes to western Europe, raising transport costs and causing further losses in exports. In 1999, Bulgaria also faced the strains related to the most intensive stage of privatization and restructuring: large inefficient enterprises in the traditional sectors were being phased out, and were only gradually being replaced by a dynamic private sector. The combined effect of these shocks was a sharp decline in exports (by one third between fall 1997 and spring 1999) and a marked worsening of the external current account deficit (from ½ percent of GDP in 1998 to over 7 percent of GDP in the first half of 1999).

With these shocks tapering off, the long-awaited recovery of output and exports got underway in the second half of 1999, suggesting a brightening of short-term prospects. By all indications, the economy hit the bottom during the Kosovo crisis. In the third quarter of 1999, GDP grew by 4.5 percent year on year, with a marked pick-up in services, robust agricultural output, and stable industrial production. For the full year, GDP growth is estimated at 2.5 percent. With a gradual recovery in exports and strong tourism receipts, the current account deficit was held to 5.4 percent of GDP in 1999. Data for the early months of 2000 suggest that the positive trend in exports and activity has continued, and for the year as a whole the authorities' targets of GDP growth of 4 percent and a current account deficit of no more than 4 percent of GDP appear well within reach. Export growth should reach double digits, boosted by a large carry-over from last year and a markedly better external environment than a year ago.

However, challenges remain:

- **Unemployment is high.** Having declined to 12 percent in 1998, unemployment rose substantially during 1999, and reached 18 percent in February 2000. Poverty also remains widespread, especially among pensioners and in less developed regions.

- **There is a long remaining agenda to meet the criteria for EU accession, the government's key goal.** Bulgaria's per capita income is the lowest among the 12 candidate countries, and many years of very rapid growth will be required for the country to catch up with even the middle-income countries in the group. Bulgaria also has some way to go in completing structural reforms to develop a fully competitive market economy. The state-owned sector needs a higher degree of financial discipline. Effective liquidation and bankruptcy procedures are still in the process of being put in place, slowing the exit of unviable enterprises. The emerging private sector also faces many obstacles, including burdensome bureaucracy and red tape, weak governance, and a banking system hesitant to extend credit. Bulgaria's sovereign credit rating remains well below investment grade, and cumulative foreign direct investment at less than US$200 per capita is low by regional standards.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for having implemented sound policies that had brought macroeconomic stability to Bulgaria and had helped the country weather last year's severe shocks. They observed that prudent fiscal and incomes policies as well as the acceleration of structural reforms had helped to curb the current account deficit, maintain competitiveness, and initiate a rebound in economic activity and exports. Looking ahead, Directors considered that the authorities' immediate challenge is to ensure that the recovery becomes self-sustaining and to reduce unemployment and poverty. For the longer term, Bulgaria's goal of EU accession will require rapid growth over many years and substantial further efforts to develop a fully competitive market economy.

Directors endorsed the broadly unchanged stance of fiscal policy in 2000. They noted that the 2000 budget allowed for a general government deficit of up to 1.5 percent of GDP, including transitional costs of structural reform, while providing margins to adjust the fiscal position if warranted by unforeseen developments. Directors underscored that, to preserve those margins, it would be important to exercise tight expenditure discipline, including in the municipalities.

Directors considered that the ongoing institutional reforms would lend important support to the efforts to achieve medium-term fiscal sustainability. They welcomed the recent initial steps to create a unified revenue agency to collect taxes and social contributions. Noting that, once fully operational, the new agency should help to promote good governance and enhance revenue collection capacity markedly, they urged the authorities to make every effort to ensure the success of this initiative. Directors also encouraged the authorities to complete expeditiously the treasury project which had already helped to strengthen budgetary control. Directors regarded the authorities' pension and health reforms as appropriately ambitious. While noting that adequate provisions had been made in this year's budget to cover the transitional costs of these reforms, they urged the authorities to be prepared to adjust the underlying parameters further as needed to preserve the long-term viability of the social security funds.

Directors stressed the importance of wage moderation and flexible labor markets for maintaining competitiveness and reducing unemployment. Noting the incipient export recovery and an improved external environment, they considered that present competitiveness was broadly adequate. Directors, however, emphasized that, to preserve competitiveness, real wage increases should be kept within productivity gains. In this regard, Directors supported the authorities' decision to continue wage bill freezes for the worst-performing state enterprises as well as state monopolies. They also considered that the moderation shown by the authorities in budgetary and minimum wage increases would help to contain wage demands in the private sector. To reduce labor market rigidities, Directors encouraged the authorities to ease restrictions on employment and working hours in the context of an amended Labor Code. They also urged the authorities to consider lowering the presently high social contribution rates in the medium term, noting that this should be possible provided the unified revenue agency succeeds in improving compliance, especially in the private sector.

Directors welcomed the progress made in improving banking supervision, but noted that the provision of bank credit to the private sector remained low. They considered that financial intermediation could be improved through selling the remaining state-owned banks to strategic investors, establishing a fully operational central credit registry, and strengthening the enforcement of contracts and legislation. Directors also endorsed the planned reduction in the minimum reserve requirement, considering that it, too, would help reduce interest rate spreads and maintain liquidity in commercial banks.

Directors observed that rapid progress in structural reform remained critical for Bulgaria's medium-term growth prospects. While noting that 1999 had been the year of the most intensive economic restructuring so far, with generally good progress in most areas, Directors urged the authorities to spare no efforts in continuing to implement strong initiatives on a wide front. They welcomed the authorities' intention to sell the remaining large-scale commercial state enterprises during 2000, emphasizing the importance of finding strong strategic investors and ensuring competition. While considering the adoption of the new Energy Law a major achievement, Directors stressed the need to implement the provisions of the law strictly and in a timely manner. In this context, they expressed concern about the authorities' plan to freeze the prices of electricity and district heating, noting that this could reduce the momentum of energy reform and create extra pressures on the budget. They called for the authorities to formulate and implement a plan for a fundamental restructuring of the district heating companies and the coal sector. Moreover, they urged further efforts to strengthen public administration, with a view to improving the delivery of public services and enhancing the capacity to implement an ambitious reform agenda.

Directors considered that the authorities' efforts to support private sector growth should be strengthened. They urged the authorities to implement as a matter of priority the recommendations of a high-level working group to reduce administrative inefficiencies. They also emphasized the importance of enforcing existing laws as well as private contracts, streamlining bankruptcy and liquidation procedures, and implementing accounting standards stringently to improve the business climate and governance.

Directors commended the authorities on their efforts to enhance transparency, including through publication of a Report on the Observance of Standards and Codes. They welcomed the fact that the authorities were already implementing the recommendations in the report, and encouraged them to continue. Directors also noted that, in recent years, Bulgaria had made good use of the extensive technical assistance provided by the Fund, and considered that Bulgaria deserved continued technical assistance support from the Fund in those areas in which the Fund had a comparative advantage. Regarding statistics, Directors welcomed Bulgaria's interest in participating in the General Data Dissemination System.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board As part of a pilot project, the staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 1999 Article IV consultation with Bulgaria is also available..

Bulgaria: Selected Economic Indicators

	1996	1997	1998	1999	2000 1/
Real economy		(Percent change)			
Real GDP 2/	-10.9	-6.9	3.5	2.5	4.0
CPI, 12-month	310.8	578.5	1.0	6.2	3.5
Unemployment rate (percent)	12.5	13.7	12.2	16.0	...
Public finance		(In percent of GDP)			
General government balance	-12.7	-2.5	0.9	-0.9	-1.4
Public debt	105.8	110.4	80.2	87.7	79.4
Money and credit		(Percent change, end of year)			
Real broad money	-45.4	-32.3	8.6	4.9	8.3
Real credit to the non-government sector	-20.6	-56.0	5.3	3.4	11.3
Interest rates (annualized)		(In percent)			
BNB basic rate (end-month average)	435.0	7.0	5.2	4.6	...
Time deposits (end-month average)	213.8	3.0	3.3	3.2	...
Balance of payments		(In millions of U.S. dollars)			
Gross official reserves	793	2,468	3,056	3,222	3,476
(in months of GNFS imports)	1.6	5.3	6.1	6.0	6.0
Current account (percent of GDP)	0.2	4.4	-0.5	-5.4	-4.0
Trade balance (percent of GDP)	1.4	3.9	-3.1	-8.7	-7.0
Exchange rates					
Exchange rate regime		Currency board since July 1, 1997 3/			
Present exchange rate (March 20, 2000)		2.0132 leva/U.S.$			
Nominal effective exchange rate (1995=100) 4/	56.9	5.6	5.4	5.8	...
Real effective exchange rate (1995=100) 4/ 5/	86.0	105.0	122.7	122.1	...

Sources: Bulgarian authorities; and IMF staff estimates.

1/ Projection.
2/ The 1999 figure is an estimate.
3/ The currency board arrangement fixed the exchange rate at 1,000 leva=1 DM through end-1998 and 1,955.83 leva=1 euro since January 1, 1999. On July 5, 1999, the lev was redenominated by removing three zeroes. As a result, one lev now equals one deutsche mark.
4/ Annual average level.
5/ CPI-based.

Statement by J. de Beaufort Wijnholds,
Executive Director for Bulgaria
March 31, 2000

Despite the negative impact of external shocks and short-term restructuring costs, 1999 was a successful year for Bulgaria. Sound macroeconomic policies have brought about a strong rebound of economic growth in the second half of 1999, which led to a positive and higher than initially projected GDP growth of 2.5 percent, accompanied by low inflation. Macroeconomic stability, combined with decisive structural reforms is fostering rapid economic recovery and creating prospects for strong growth in the medium term.

The currency board arrangement continues to provide a solid foundation for macroeconomic stability, which was maintained despite the negative impact of the Kosovo conflict and weaker external demand in the first half of 1999. Tight fiscal policy combined with restrictive incomes policy for loss-making state-owned enterprises contained labor costs and preserved competitiveness. The overall deficit of the general government was 0.9 percent of GDP, well below the originally budgeted 2.8 percent of GDP. Prudent fiscal policy played a major role in containing the current account deficit to about 5.4 percent of GDP.

In the medium term, the Bulgarian authorities aim to achieve strong economic growth in the range of 4-5 percent, which would allow a decrease in poverty and unemployment and convergence in living standards toward those of the leading EU accession countries in the region. The main pillars of the government's policy are sound fiscal policy, a cautious incomes policy that will ensure competitiveness of the economy, and accelerated structural reforms. The medium term goals are outlined in the updated program of the government, "Bulgaria 2001" which was presented to parliament in March 2000. The completion of structural reforms in the economic and in the social spheres and successful start of the EU accession negotiations are the major objectives within the specified goal.

The mechanisms to achieve higher growth are: (i) creation of a business friendly environment through radical economic restructuring and removal of administrative barriers to businesses (unnecessary licenses, regulations, red tape, etc.); (ii) a radical reform of public administration (fight against corruption); (ii) attracting strategic foreign investors for the remaining big state-owned Bulgarian firms; (iii) within the framework of the Stability Pact for Southeastern Europe and the EU pre-accession funds, attracting sizable official assistance for major infrastructure projects with regional importance, and on that basis creating jobs in depressed regions of the country.

Fiscal Policy

In 2000 the fiscal stance will remain broadly unchanged, with a general government deficit of no more than 1.5 percent of GDP, and a primary surplus in excess of 3 percent of GDP. Fiscal policy sustainability will be maintained through major expenditure and revenue reforms. On the expenditure side, the government is on track with the structural measures and performance criteria regarding implementation of pension and health reforms. The code of Mandatory Social Insurance was adopted in December 1999, which satisfied an important structural performance criterion. On the revenue side, the authorities are taking measures, which will allow for reducing the overall tax and social security contribution burden over the medium term. A major project is under way to create a unified revenue agency to administer the collection of taxes and social insurance payments in order to enhance revenue collection capacity significantly over time. Fiscal transparency is another area where Bulgarian authorities have made a substantial progress. The most important measures are the elimination of most of the extra-budgetary accounts, launching the Single Treasury Account as of January 1, 2000, as well as explicit accounting for quasi-fiscal costs of restructuring or liquidating the SOEs in the budget.

Economic Restructuring

In 1999 the authorities had their most successful year so far in the sphere of structural reforms. By the end of 1999, 77.5 percent of state-owned assets slated for privatization had been privatized and major sales, such as the oil refinery Neftochim, the steel giant Kremikovtsi, the fertilizer producer Agropolichim, and Balkan Airlines have been completed. For 2000 the authorities plan to complete large-scale privatization, the divestiture of residual shares in enterprises that have been privatized, and to further mass privatization. The government intends to complete the sale of BTC, the Telecommunication Company, to sell the tobacco holding Bulgartabak and to make significant progress in preparing assets in the power sector for privatization.

The government is taking important steps to increase labor market flexibility and further enhance competitiveness. The most important measures include the submission of an amended Labor Code that will enhance labor market flexibility to the Council of Ministers on March 30 and a wage bill freeze on state-owned enterprises with large losses or arrears.

Finally, wide-ranging reform of public administration will help to create a more business friendly environment and thus attract a larger amount of direct foreign investment. Important in this area is the government's commitment to combat the corruption both domestically and internationally, through regional cooperation efforts. Seven South European countries, including Bulgaria, recently joined forces to create an anti-corruption body for Southeast Europe as part of the Stability Pact.

Financial Sector

The government is determined to continue financial sector reforms. In 1999 the most important achievements in this area were the completed sale of Expressbank to a strategic investor, a signed sales contract for Hebros, and issued tender for the sale of Biohim. The government expects to sign a sales contract for Bulbank by the end of 2000. The only remaining state bank, the State Savings Bank, will be transformed to a full commercial bank in 2000 and will be prepared for privatization over the medium term.

To increase the efficiency of financial intermediation, the Bulgarian National Bank (BNB) will reduce minimum reserve requirements from 11 to 8 percent from July 1, 2000. BNB took further steps to strengthen bank supervision through assigning CAMELS ratings to all banks in Bulgaria. The BNB will also continue to modernize the payments system.

Energy sector reform

Energy sector reform is high on the government's agenda. In 1999, a new Energy Law was adopted, and the rehabilitation and restructuring of the natural gas monopoly Bulgargaz was successfully initiated. The secondary regulations on price formation mechanisms and the licensing procedures in the electricity generation, transmission and distribution activities were submitted to the Council of Ministers on March 30. The next steps are the legal separation of NEK(National Electricity Company) into generation, transmission, and distribution components, liberalizing prices in 2001, and aiming at privatization of some of these components. A forthcoming action plan will assess the overall prospects of the current system of district heating in Bulgaria and will be submitted to the Council of Ministers by end-May and approved by end-June. The government will emphasize cost-cutting measures and views them to be of crucial importance for enhancing the efficiency of the firms in energy sector, thus increasing their attractiveness for future privatization.

Staff raised concerns regarding the recent government decision not to increase district heating and electricity prices for households until the end of the heating season 2000-2001. Large district heating price hikes in 1998 and 1999, while still insufficient to cover the full cost of providing district heating to end-users, led to an increased rate of disconnections and a substantial decrease in the collection rate (the district heating bills in January 2000 amount to 41-70 percent of the average wage in the country). These adverse effects suggest that any further rise in district heating prices is likely to lead to a decline in overall revenues due to further disconnections and increase in arrears, which will more than offset the effect of increased payments from paying customers. Therefore, the opinion of the government is that this decision, in its envisaged way of implementation, is not inconsistent with the drive to reform the energy sector and will not hurt in any major way the envisaged restructuring efforts. Raising prices is simply not among the available instruments for reducing the losses in the sector anymore. Under these circumstances, government pressure on the district heating companies to reduce their costs and improve their collection rate is expected to be more effective. They will no longer be able to cover their inefficiencies behind higher prices.

As for electricity, the current average tariff at the constant exchange rate from the beginning of the program is USD 0.0378 per kilowatt-hour and that for households is USD 0.0353 per kilowatt-hour. The government will continue to adjust the average tariff so as to achieve an average price of USD 0.04 per kilowatt-hour by mid-2001 which implies about 10% tariff rate increase on average for households and businesses. The government has provided so far ample proof that it can enact such an increase: twice in both 1998 and 1999, and most recently on January 1, 2000,the electricity tariff for households has been adjusted upward by a double-digit figure. In addition, the regulations on price formation mechanisms, already submitted to the Council of Ministers are expected to provide transparency and to reduce uncertainty for the potential strategic investors in the sector. Meanwhile, NEK's profit margin is sufficient to absorb the costs of higher world energy prices and the more expensive US dollar, both expected to be of temporary nature, as, for instance, indicated in the recent World Economic Outlook discussion. NEK's gross profit for 2000 is expected to remain at the 1999 level of BGN 150 million, allowing for some BGN 70 million in taxes to the central and municipal governments.

Progress towards Transparency

Bulgaria has made considerable efforts to improve the formulation of economic policies and to disseminate information on these policies and their outcome to the public. The government has aimed at increased transparency in economic and social statistics, in fiscal, monetary, and financial policy, and banking supervision, and Bulgaria is a pilot country for the GDDS (Global Data Dissemination System) initiative. The GDDS pilot metadata for Bulgaria is now being circulated to other countries in the region as an example. Moreover, the authorities participated in the preparation of a Report on Observance of Codes and Standards, (ROSC) an earlier version of which is already published on the web. To increase transparency even further, the government decided to participate in a pilot project for the voluntary release of Article IV consultation staff reports.

Finally, a word on technical assistance. As the staff notes, Bulgaria has made extensive use of Fund technical assistance and has used this assistance well. The Bulgarian authorities wish to express their gratitude for this support, as well as for the strong support and cooperation they have continued to receive from the Fund staff through their regular missions.