March 2001
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Bulgaria: 2000 Article IV Consultation and Fifth Review Under the Extended Arrangement—Staff Report; Staff Statement; Public Information Notice and News Brief on the Executive Board Discussion; and Statement by the Authorities of Bulgaria

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2000 Article IV consultation with Bulgaria and fifth review under the Extended Arrangement, the following documents have been released and are included in this package:

- the staff report for the combined 2000 Article IV consultation and Fifth Review Under the Extended Arrangement, prepared by a staff team of the IMF, following discussions that ended on **January 29, 2001** with the officials of Bulgaria on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on March 8, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff statement of **March 23, 2001** updating information on recent economic developments.
- a Public Information Notice (PIN) and News Brief summarizing the **views of the Executive Board as expressed during its March, 23, 2001 discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the authorities of Bulgaria.

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

Letter of Intent by the authorities of Bulgaria*
Memorandum of Economic and Financial Policies by the authorities of Bulgaria*
Report on Observance of Standards and Codes—Update
Selected Issues and Statistical Appendix paper

*Included in Staff Report.

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

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INTERNATIONAL MONETARY FUND

BULGARIA

Staff Report for the 2000 Article IV Consultation and Fifth Review Under the Extended Arrangement

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

Approved by Jacques R. Artus and Liam Ebrill

March 8, 2001

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I. Introduction

1. **A staff team visited Sofia during January 15–29, 2001 to hold discussions for the 2000 Article IV consultation and the fifth (final) review under the extended arrangement.**[1] The mission also followed up on the Report on the Observance of Standards and Codes (ROSC) originally issued in September 1999 (an update will be issued to the Executive Board separately). The three-year arrangement for SDR 627.62 million (98 percent of quota) was approved in September 1998, and so far ten purchases of SDR 52.3 million each have been made (Appendix I). Bulgaria's economic program is supported by the World Bank (Appendix II), the EU, and other donors.

2. **In discussing Bulgaria during 2000, Executive Directors commended the authorities for their sound macroeconomic policies, and urged them to persevere with structural reform.** In concluding the third review and the last Article IV consultation (in March) and the fourth review (in September), Directors observed that prudent fiscal and incomes policies and the acceleration of structural reforms had helped Bulgaria to weather adverse shocks and initiate a rebound in economic activity and exports. Looking forward, Directors stressed the need to continue strong and comprehensive policies, including vigorous structural reform in the enterprise and energy sectors, and measures to improve governance and the business climate.

3. **In the attached letter to the Managing Director and the accompanying Memorandum on Economic Policies, the authorities report on progress made, describe their policies for 2001, and request completion of the fifth review.** Bulgaria's eleventh purchase of SDR 52.3 million under the arrangement is contingent on completion of the review. The final purchase, of the same amount, is contingent on observance of the performance criteria for end-March 2001 set in the Memorandum.

4. **General elections will be held in June 2001.** Since mid-1997, the center-right Union of Democratic Forces has ruled as the dominant coalition partner in a government enjoying a parliamentary majority. Opinion polls suggest that neither this coalition, nor the opposition Socialist Party and its allies, is likely to obtain a majority in the new parliament, necessitating the formation of a broader coalition government. Most observers believe that a coalition led by either main party would remain committed to policies leading to EU accession. The EU invited Bulgaria to start membership negotiations in December 1999.

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[1] The team comprised Messrs. Kähkönen (head), De Broeck, and Feyzioğlu, and Ms. Poirson (all EU1), Mr. Auboin (PDR), and Ms. Burton (assistant, EU2). Ms. Budina (OED) attended most of the discussions, and Mr. Stella, the resident representative, assisted the mission. The mission 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.

5. **The quality and timeliness of statistical reporting by Bulgaria are generally sufficient for program monitoring and surveillance** (Appendix III). Nevertheless, important deficiencies remain in real sector and balance of payments statistics. These are being addressed with Fund technical assistance. The lack of comprehensive labor statistics hampers the assessment of developments in private sector wages and employment. Since May 2000, Bulgaria has participated in the General Data Dissemination System. The authorities are making progress toward subscribing to the Special Data Dissemination Standard.

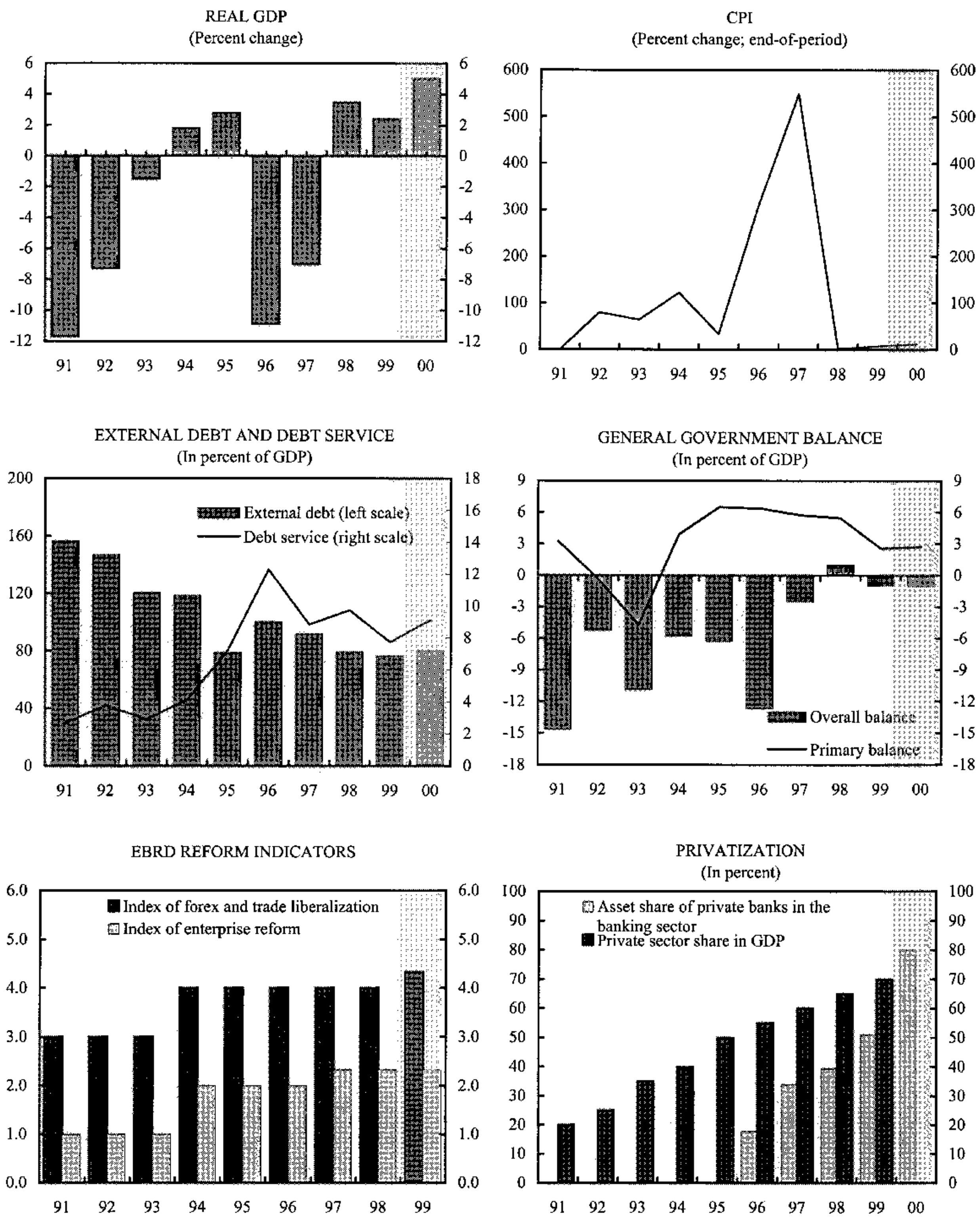
II. Background

6. **After a disappointing performance during the early years of transition, Bulgaria has come a long way in three years** (Table 1 and Figure 1). Having fallen by more than a third between 1989 and 1997, real GDP has since increased by 11 percent, despite severe shocks, including the global financial crises and the war in Kosovo. Inflation, which reached near-hyperinflationary levels during a banking and foreign exchange crisis in 1996–97, has been brought under control. External debt has declined from nearly 100 percent of GDP in 1997 to about 80 percent now. Starting from almost scratch, in three years over one half of enterprise assets and four fifths of bank assets have been privatized.

7. **This turnaround owes much to a sound policy framework centered on a currency board arrangement (CBA).** Bulgaria's early transition was characterized by stop-and-go policies and lack of structural reform. Since the introduction of the CBA in mid-1997, the authorities have followed prudent stabilization policies. The general government fiscal position has been in approximate balance, and under a strict incomes policy for state enterprises, the worst-performing firms have been subject to wage bill freezes. The CBA continues to have broad political and public support, and shows no signs of strain, as interest rates are low and stable, fiscal reserves ample, and banks liquid. An ambitious structural reform agenda has also been implemented quite successfully. Besides the rapid privatization, the authorities have improved banking supervision, started the overhaul of the pension and health care systems, and liberalized trade and prices. Less progress has been made in reducing inefficiencies in the enterprise sector, restructuring the energy sector, and improving the business climate. Indeed, while exports have begun to grow rapidly, they have yet to return to levels reached in the mid-1990s, and productivity outside manufacturing has been stagnant.

8. **Recent policy performance has remained generally good, with some slowdown in structural reform.** All performance criteria for September and December 2000 were observed (Tables 2 and 3). State enterprises have maintained wage discipline, and fiscal policy has remained prudent, with the general government deficit contained to 1 percent of GDP in 2000. Following intensive efforts in 1999, the authorities also generally maintained the momentum of reform in 2000, with major advances in most areas (Box 1). However, toward the end of the year signs emerged of some slowdown in sensitive areas, stemming in large part from the approach of the elections. A key structural benchmark for September 2000, the submission to parliament of amendments to the Energy Law, was still

Figure 1. Bulgaria: Indicators of Progress, 1991-2000



Sources: Bulgarian authorities; and Fund staff estimates.

Box 1. Progress in Structural Reform During 2000

Fiscal reforms. Four major reforms were implemented to help ensure long-term fiscal sustainability.

- In June, the Council of Ministers approved a plan to create a Unified Revenue Agency aimed at enhancing the capacity to collect taxes and social contributions. Good progress has been made in implementing the plan.
- The implementation of the Single Treasury Account (STA) in the central bank, a key step in further improving treasury operations, started in January. All leva accounts in the BNB were consolidated in the STA by July. Good progress was made toward consolidating the government's accounts in commercial banks into the STA.
- A strengthened pay-as-you-go pension scheme was introduced from the beginning of 2000, voluntary private pension funds were licensed, and preparations were made to launch a fully funded mandatory private pension scheme in 2002.
- The first stage of the health care reform involving outpatient care was launched from the beginning of July.

Financial sector. Further progress was made in enabling sound private sector credit growth, promoting competition, and modernizing the financial sector.

- In October, parliament approved amendments to the Commercial Code designed to simplify and accelerate bankruptcy procedures, and judges were trained on bankruptcy issues.
- A central credit registry accessible to all banks was made fully operational in March.
- Bulbank, the largest bank in Bulgaria, was sold to a strategic foreign investor in July, and a new tender for the sale of another large bank, Biochim, was issued in September.
- Important measures to modernize the payments system, including steps to legalize electronic signatures, were taken.
- A modern bank bankruptcy law was submitted to parliament in September, and passed first reading in November.

Incomes policy. Wages in state enterprises were kept under control through the continued application of a strict incomes policy (defined in the incomes policy ordinance for 2000, adopted in February).

- In 2000 Q3, the total wage bill in the 97 most closely monitored enterprises (including the worst-performing ones) was 8½ percent below that in 1999 Q3.

Labor markets. Besides promoting private sector growth, the government tackled the unemployment problem through a combination of measures to increase labor market flexibility and active labor market policies.

- In June, draft amendments to the Labor Code easing restrictions on hiring and firing were submitted to parliament.
- A comprehensive assessment of active labor market policies was carried out with World Bank assistance.

Privatization. Progress was made in selling residual shares and leveling the playing field for bidders.

- The share of privatized long-term fixed assets rose from 47 percent at end-1999 to 51 percent at end-2000, and that of assets excluding infrastructure increased from 71 to 78 percent during the same period.
- Residual government shares in most nonstrategic enterprises were sold or otherwise disposed of.
- Amendments to the Privatization Act aimed at increasing the efficiency and transparency of the privatization process were approved by parliament in November.

Energy sector. A number of programs to overhaul this critical sector were adopted, but implementation was uneven.

- The break-up of the electricity monopoly NEK into its generation, transmission, and distribution components was completed in June. Business plans aimed at improving financial performance were implemented in the separated companies.
- A comprehensive action plan to restructure district heating companies (DHCs) was adopted by the Council of Ministers in June. In line with the plan, the Council of Ministers decided in September to withdraw subsidies from selected DHCs. However, owing to delays in amending the Energy Act, other components of the plan could not be implemented.
- An action plan adopted in June identified additional coal mine pits where production would cease or unviable activities would be liquidated. The liquidation of 5 nonviable coal mine companies has been initiated.
- The rehabilitation program for the gas monopoly, Bulgargaz, continued to be implemented, although the opening of the domestic gas market was postponed pending the approval of amendments to the Energy Act.

Governance. Several steps have been taken to enhance the business climate and improve the provision of public services.

- Red tape was reduced through the removal or simplification of 121 licensing and regulatory requirements.
- A "one-stop shop" program was introduced in the ministries, districts, and 14 municipalities.
- As part of a comprehensive reform of public administration, the organization structure of ministries and government bodies was redesigned, and progress was made in setting the parameters of a new merit-based compensation system.

Trade liberalization. Further progress has been made in liberalizing Bulgaria's already relatively open trade regime.

- The last remaining export tax (on lumber) was removed in January, and the last non-tariff barrier (export ban on raw tobacco) was eliminated in April.
- In January 2000, the average MFN tariff was cut to 13.7 percent from 15.2 percent, and the number of tariff bands was reduced. In January 2001, the average tariff was cut to 12.4 percent, and the number of tariff bands was reduced further.

outstanding in February 2001, holding back the creation of an efficient and competitive energy sector and the restructuring of the ailing district heating sector. Also, parliamentary approval of amendments to the Labor Code (aimed at making wages and employment more flexible) was delayed by nine months, to March 2001, as social partners continued to debate the details. Moreover, while an amended Privatization Law aimed at increasing transparency was approved expeditiously in November 2000, new strategies to sell the telecommunications and tobacco monopolies are yet to be put in place. The first attempts to sell these companies, initiated in 1998, were suspended last summer.

9. **Despite a pickup in inflation, the macroeconomic situation at end-2000 was quite comfortable:**

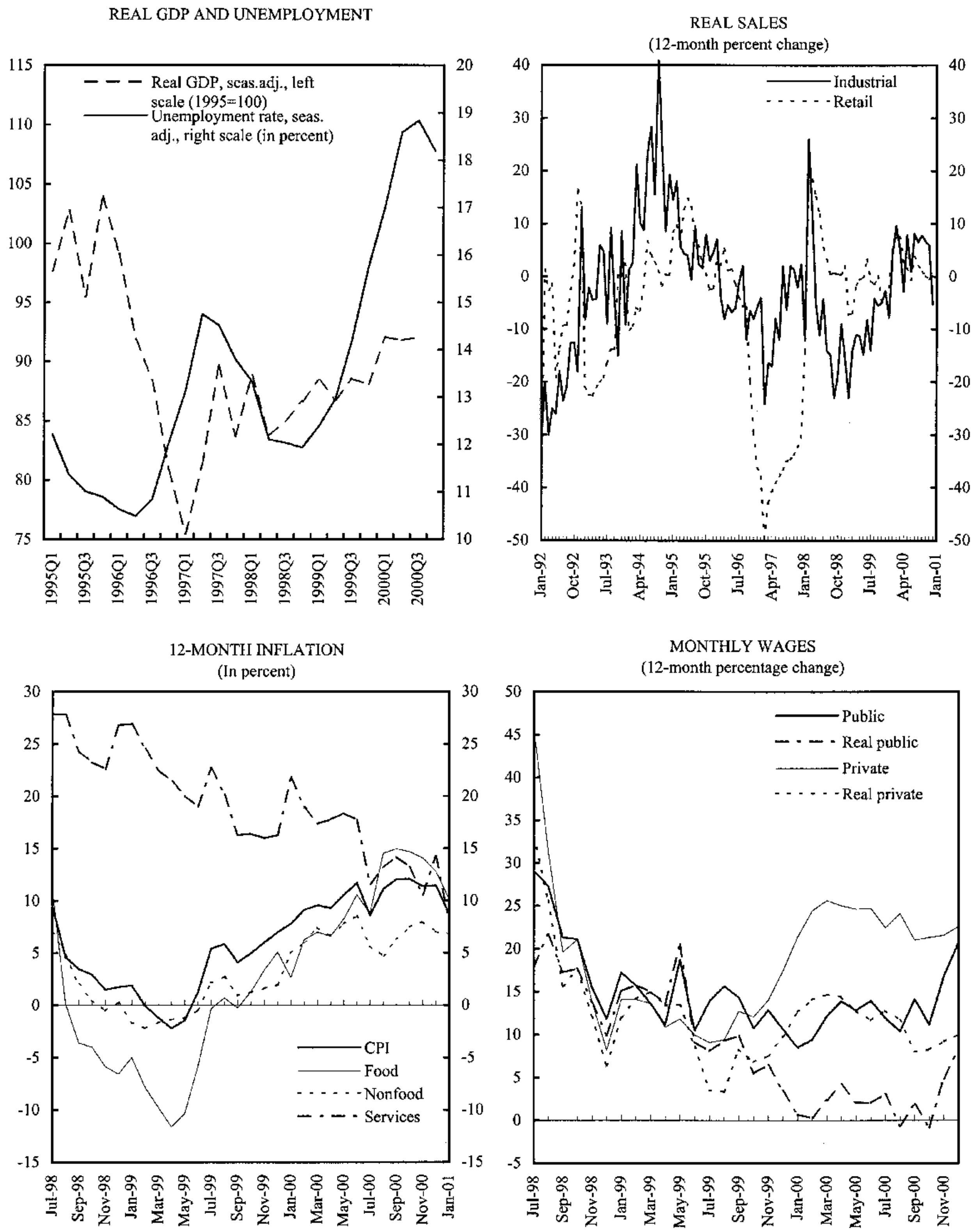
- **GDP growth in 2000 is estimated at 5 percent, compared with the targeted 4.5 percent** (Figure 2). In the first three quarters, GDP increased by 5.3 percent year on year, albeit from a low base, as activity in the first half of 1999 was affected by the Kosovo crisis. Net exports and domestic demand contributed roughly equally to the brisk growth. Export volume rose by 23 percent, reflecting mainly a favorable external environment and, to a lesser extent, the supply response from enterprise restructuring. The growth of domestic demand was driven by fixed investment (up by 10 percent), whereas private consumption rose by a moderate 3 percent. Available indicators suggest that the recovery that started in mid-1999 continued in the last quarter of 2000. In that quarter, industrial production increased by 4 percent year on year and sales for exports by 20 percent, while retail sales were flat.

- **Inflation rose to double digits, mainly reflecting temporary shocks.** In December, year-on-year inflation stood at 11.4 percent—well above the projection of 6 percent made at the time of the fourth program review last summer. The higher-than-projected inflation resulted mainly from two factors that were beyond the authorities' control and are likely to be temporary: imported inflation (reflecting the weakening of the euro and a rise in world energy prices) and a drought. It did not reflect a loosening of credit conditions. Lending rates remain clearly positive in real terms, and commercial banks' net foreign assets have continued to increase more rapidly than credit to the private sector. Also, velocity has been broadly unchanged, once the revaluation of U.S.-dollar-denominated deposits is corrected for.

- **The pickup in inflation notwithstanding, competitiveness seems to remain adequate** (Figure 3). This is evidenced by the rapid growth of exports (especially by companies in labor-intensive sectors and by companies sold to foreign investors), a stable real effective exchange rate, and sharply lower unit labor costs, stemming from productivity gains as a result of restructuring and investment.

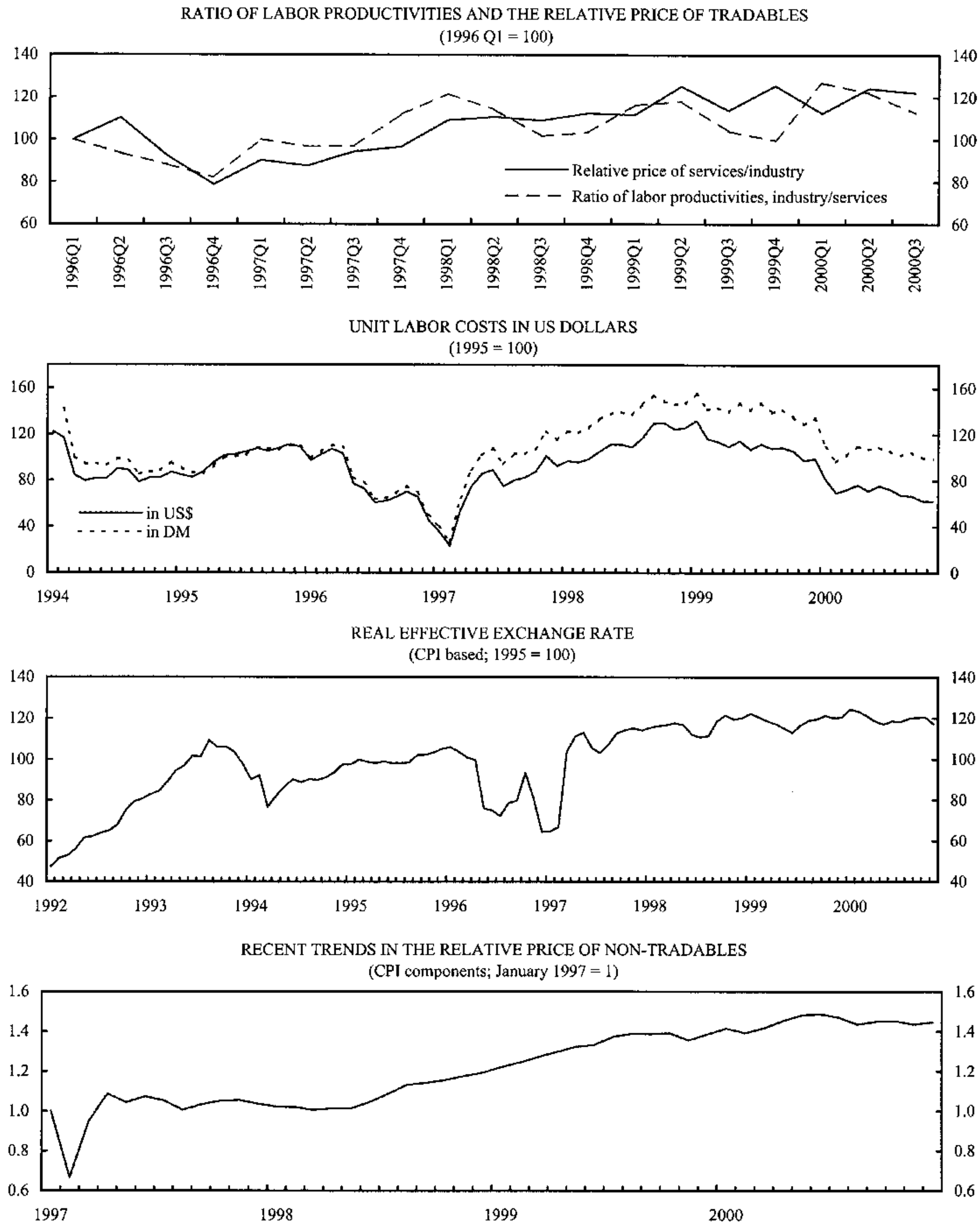
- **Also, the external position is under control** (Figure 4). The current account deficit amounted to US$696 million (5.8 percent of GDP) in 2000, roughly the same as in the previous year, as increased receipts from exports and tourism offset the impact of a sharp rise in energy imports. The current account gap was fully covered by foreign

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



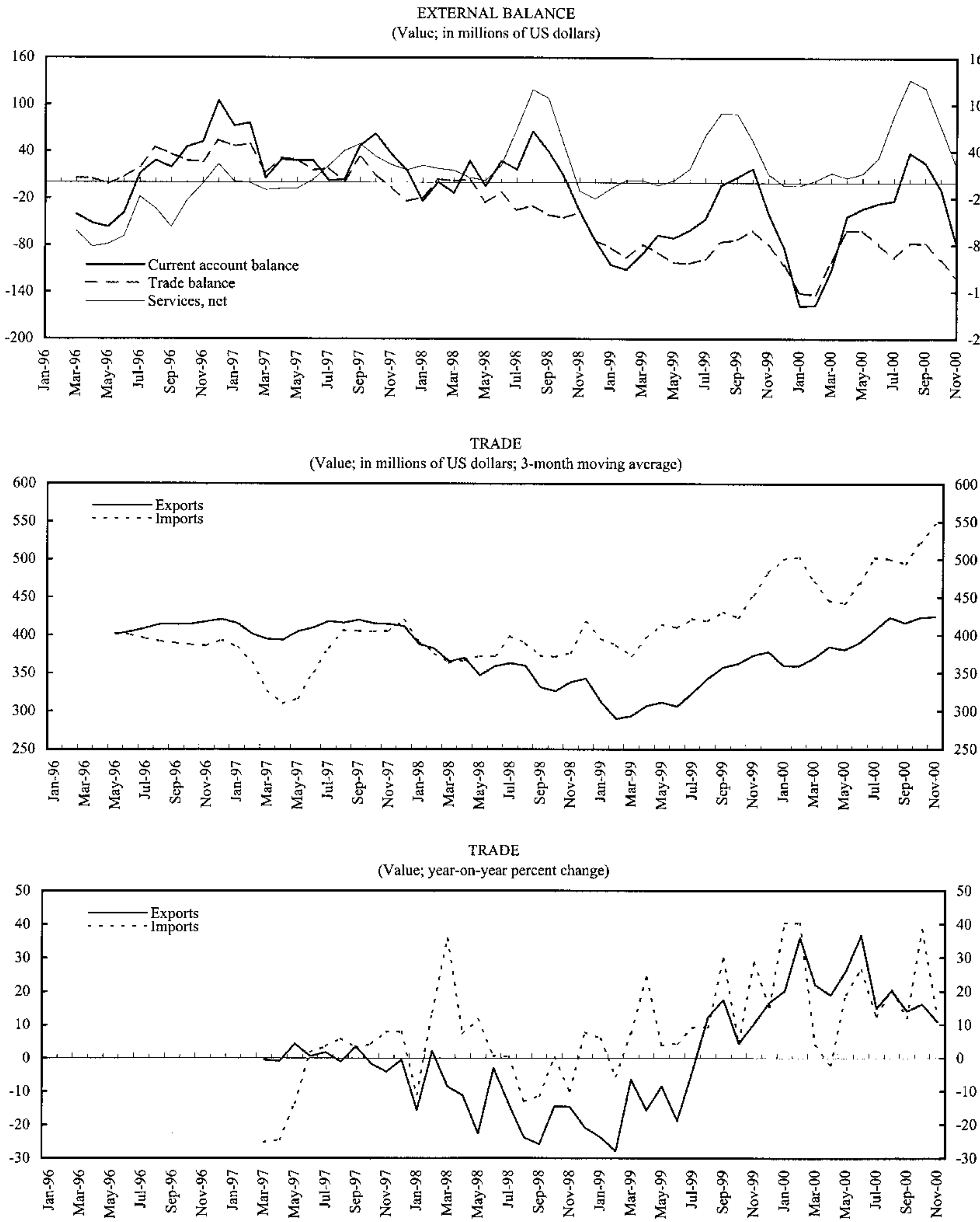
Sources: Bulgarian authorities; and Fund staff calculations.

Figure 3. Bulgaria: Indicators of Competitiveness, 1992-2000



Sources: National Statistical Institute; and Fund staff calculations.

Figure 4. Bulgaria: External Sector Developments, 1996-2000



Source: Bulgarian authorities.

direct investment (which has shifted toward greenfield investment) and other inflows: at end-December gross official reserves were at US$3.5 billion, somewhat above the program projection and providing reserve cover of five months of imports of goods and nonfactor services.

- **The contagion from financial turmoil in Turkey and Argentina has been limited** (Table 4 and Figure 5). The spreads on Bulgaria's Brady bonds widened temporarily between September and early December 2000, and again in the second half of February 2001. The widening exceeded that on the EMBI+ index, reflecting geographical proximity with Turkey and perceived similarity in the exchange rate regime with both countries. However, Bulgaria's financial markets have remained calm and the banking system has been little affected. The further impact of the financial crisis in Turkey on Bulgaria's economy is also likely to be limited. Bulgaria's fundamentals (reserves, budget, current account, structural progress) are sound, the external financing needs for 2001 are expected to be fully covered by foreign direct investment and official financing, and Turkey accounts for only some 5 percent of Bulgaria's trade.

10. **Despite the encouraging developments, Bulgaria can hardly rest on its laurels.** First, unemployment reached record levels in early 2000, largely owing to labor shedding related to restructuring. While joblessness has since started to decline, it remains high, at 17.9 percent in December 2000. Second, Bulgaria is still far from its goal of EU accession, which it ambitiously targets for 2006 (Figures 6–8).[2] To join the EU, the authorities need to remove major structural obstacles to catch up with per capita incomes in other accession countries and to make the economy fully competitive. The bottlenecks include: inefficiencies in the enterprise sector, owing to the large share of insider deals in privatization and slow exit procedures; a low level of financial intermediation; the high energy intensity of production, stemming from an exceptionally high reliance on energy under central planning and a slow start in restructuring the energy sector; and burdensome bureaucracy, red tape, and corruption.

11. **While the good policy record of the past few years bodes well for the future, Bulgaria's economy faces risks.** In the near term, the main downside risk is a relaxation of policy efforts ahead of the elections. Bulgaria would also suffer from any significant slowdown in the EU, the destination of over one half of its exports, although the effect of this would be partly offset by an expected pickup in regional trade and investor confidence resulting from recent developments in the FR Yugoslavia. In the medium term, the risks include low growth owing to the slow pace of reform, fiscal pressures on the expenditure side (including those related to EU and NATO accession and social sector reforms), and

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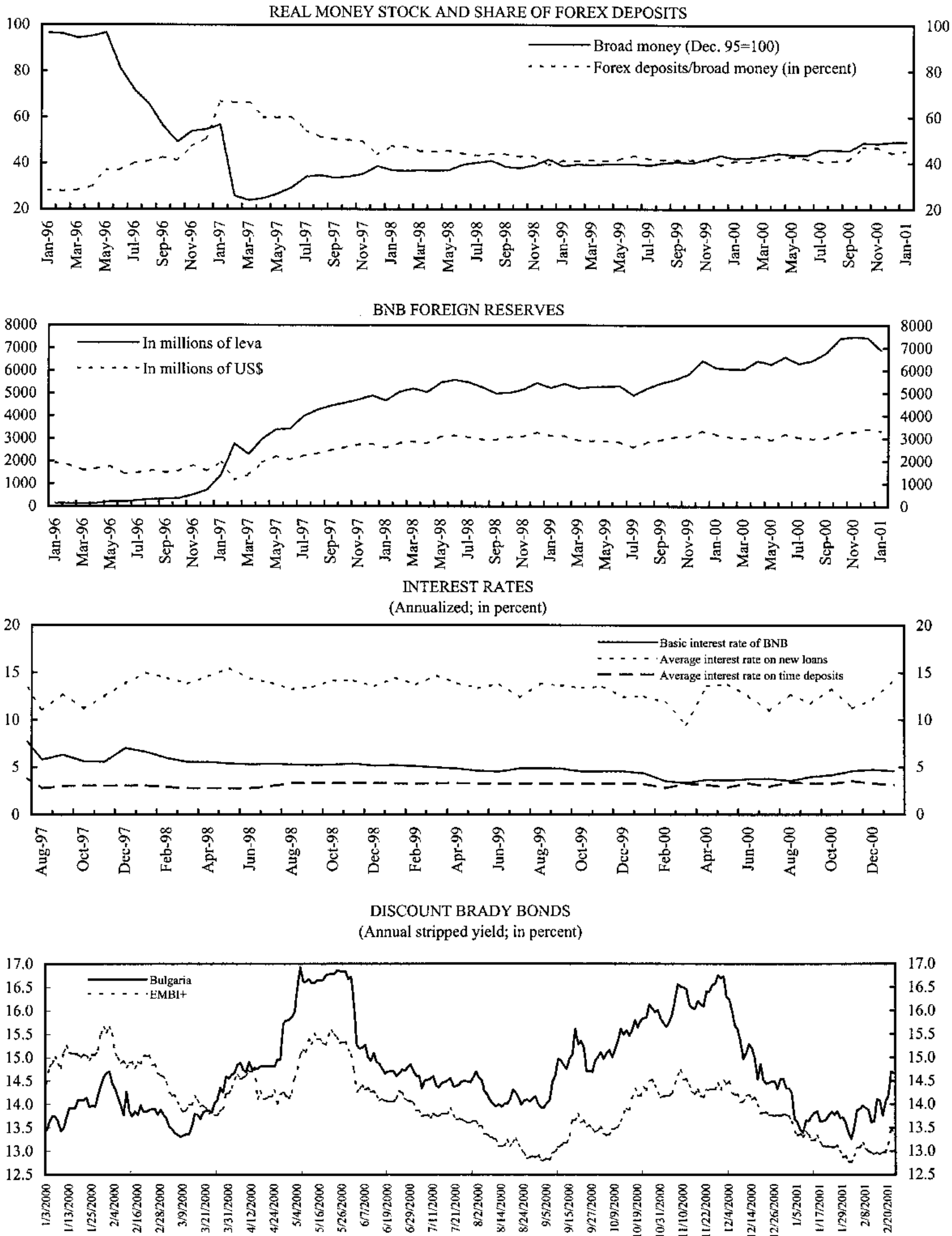
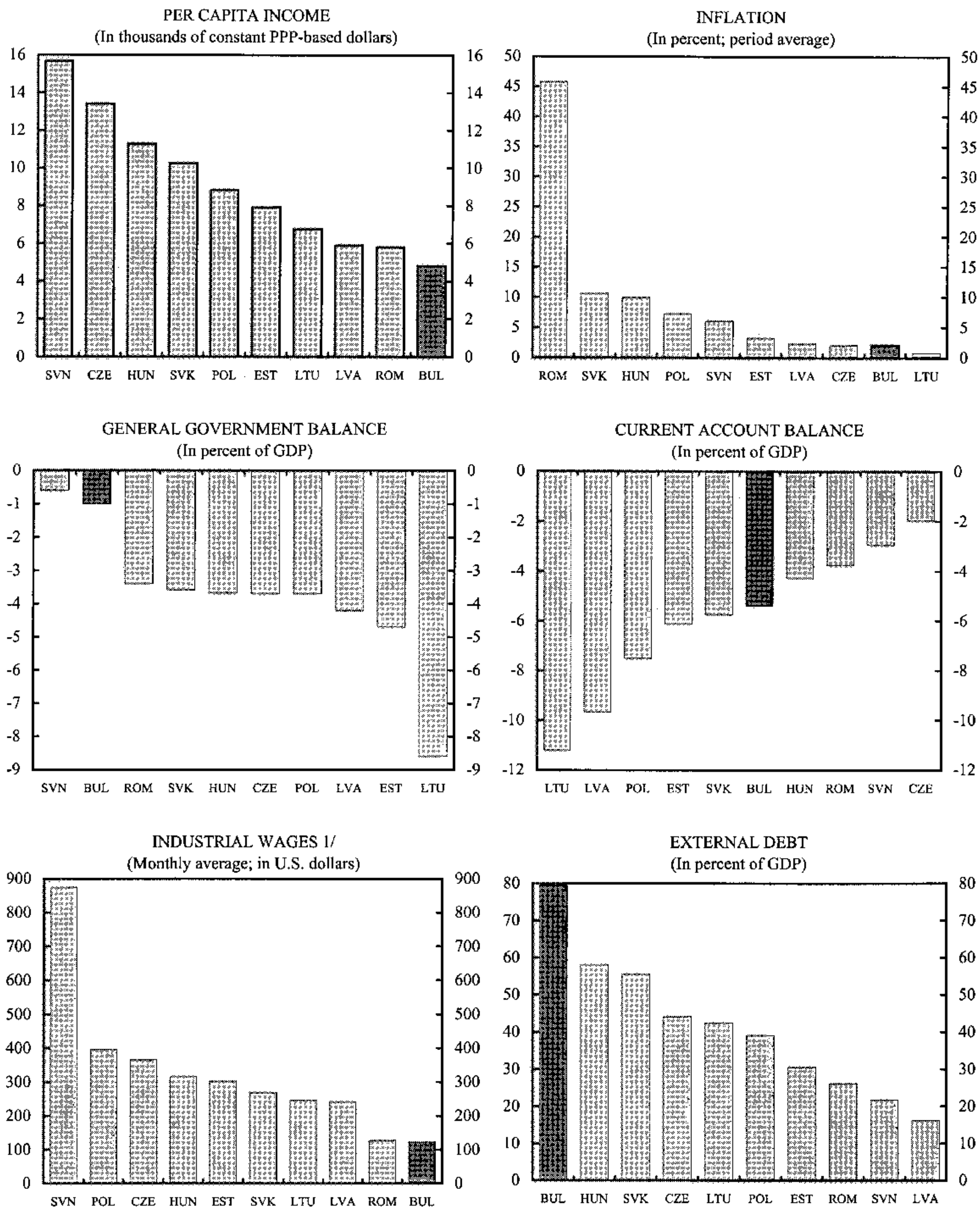
[2] In its latest Regular Report, the EC concluded that Bulgaria had "clearly made further progress towards becoming a functioning market economy," but was "not yet able to cope with competitive pressure and market forces within the Union in the medium term."

Figure 5. Bulgaria: Monetary and Financial Indicators, 1996-2001



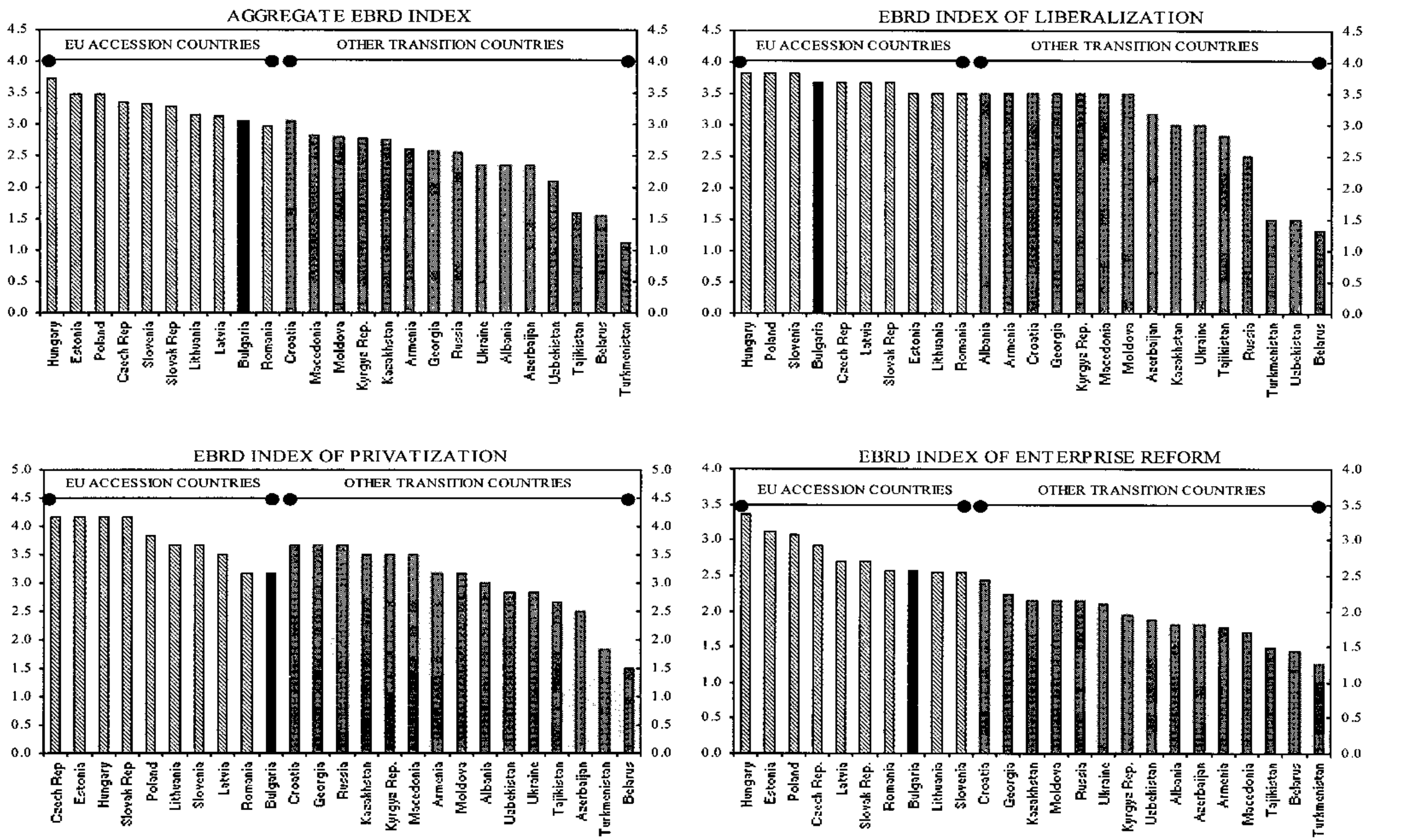
Source: The Bulgarian National Bank; Bloomberg; and Fund staff calculations.

Figure 6. Bulgaria: Macroeconomic Indicators in Selected EU Accession Countries, 1999



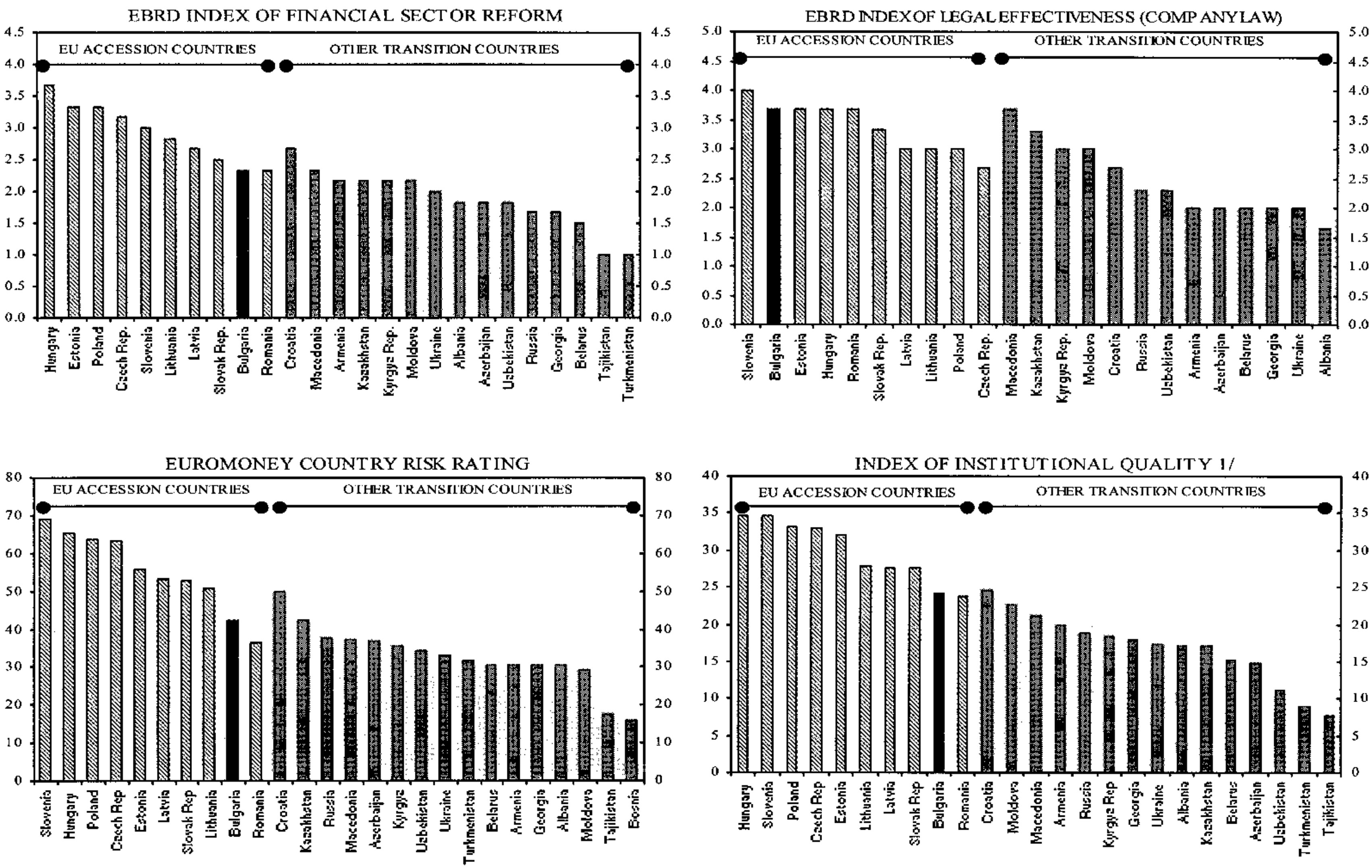
Source: World Economic Outlook.
Note: BUL, Bulgaria; CZE, Czech Republic; EST, Estonia; HUN, Hungary; LVA, Latvia; LTU, Lithuania; POL, Poland; SVK, Slovak Republic; and SVN, Slovenia.
1/ Estonia, Latvia, Lithuania, Romania, economy-wide wages; Hungary, Poland, and Slovenia, manufacturing gross wages.

Figure 7. Bulgaria: Relative Progress in Structural Reform, 1999
(Higher ratings indicate more progress)



Source: EBRD.

Figure 8. Bulgaria: Relative Progress in Institutional Reform, 1999
(Higher ratings indicate more progress)



Source: EBRD, EUROMONEY, BEATRICE WEDER, "Institutional Reform in Transition Economies" (IMF, 2000).
1/ Data for 1997-98.

contagion from other currency board countries or emerging markets (particularly as Bulgaria moves toward reliance on market borrowing over the next few years).

III. Report on the Discussions

12. **The discussions focused on how to ensure that policies remain supportive of the authorities' goals of rapid sustained growth and a fully competitive market economy both before and after the mid-2001 elections.** The staff underscored the need to stay the course before the elections: the 2001 budget had to be implemented conservatively, unwarranted wage increases in state enterprises avoided, and the momentum of structural reform maintained. The staff also noted that the post-election government would be well advised to continue the CBA-based strategy of prudent fiscal policy, wage discipline, and ambitious structural reform. This strategy had served Bulgaria well in recent years, and would offer the best prospects for removing the obstacles to income convergence with the other EU candidates and a fully functioning market economy. For their part, the authorities were determined to bring the current Fund-supported program to a successful conclusion. They also indicated willingness to continue with the current strategy, while noting that discussions on a possible new Fund arrangement would be left to the new government. Staff discussions with the opposition also suggested broad agreement with the goals and thrust of the CBA-based strategy.

A. Macroeconomic Framework

13. **The authorities concurred with the staff's assessment that the prospects for 2001 were good, provided economic policies remained sound** (Tables 5–7 and ¶5–6).[3] Based on the strong momentum from last year and projected productivity gains from structural reform, the staff considered that the GDP growth target of 5 percent was well within reach. On the demand side, private consumption and investment would be the main sources of growth, as the external environment would be more neutral than in 2000. The authorities were confident that inflation would come down significantly in 2001, noting that key factors underlying the hike in inflation last year (higher energy prices and a weaker euro) appeared to be temporary and that prices in Bulgaria were quite flexible. Indeed, in January 2001 inflation already fell markedly, to 8.7 percent year on year. The staff concurred, and estimated jointly with the authorities that inflation would come down to 4½ percent by the end of the year, assuming some continued pressure on food prices stemming from the persistent drought and planned adjustments in administered prices. Both the staff and the authorities expected the current account deficit to narrow by 1 point to 4½ percent of GDP, owing to an easing of international energy prices. Although Bulgaria's debt service would rise sharply this year (to US$1.6 billion from last year's US$1.1 billion, reflecting increased amortization of official debt and Fund repurchases), the financing needs were expected to be broadly covered by foreign direct investment and official loans and grants. Should these prove insufficient, the

[3] ¶ refers to the relevant paragraphs in the attached Memorandum on Economic Policies.

authorities would make use of the annual budget law's authorization to issue Eurobonds up to US$200 million. The staff and the authorities shared the view that the projected favorable outcomes were predicated on a broadly neutral fiscal stance, continued wage discipline in state enterprises, and structural reforms to promote private sector activity.

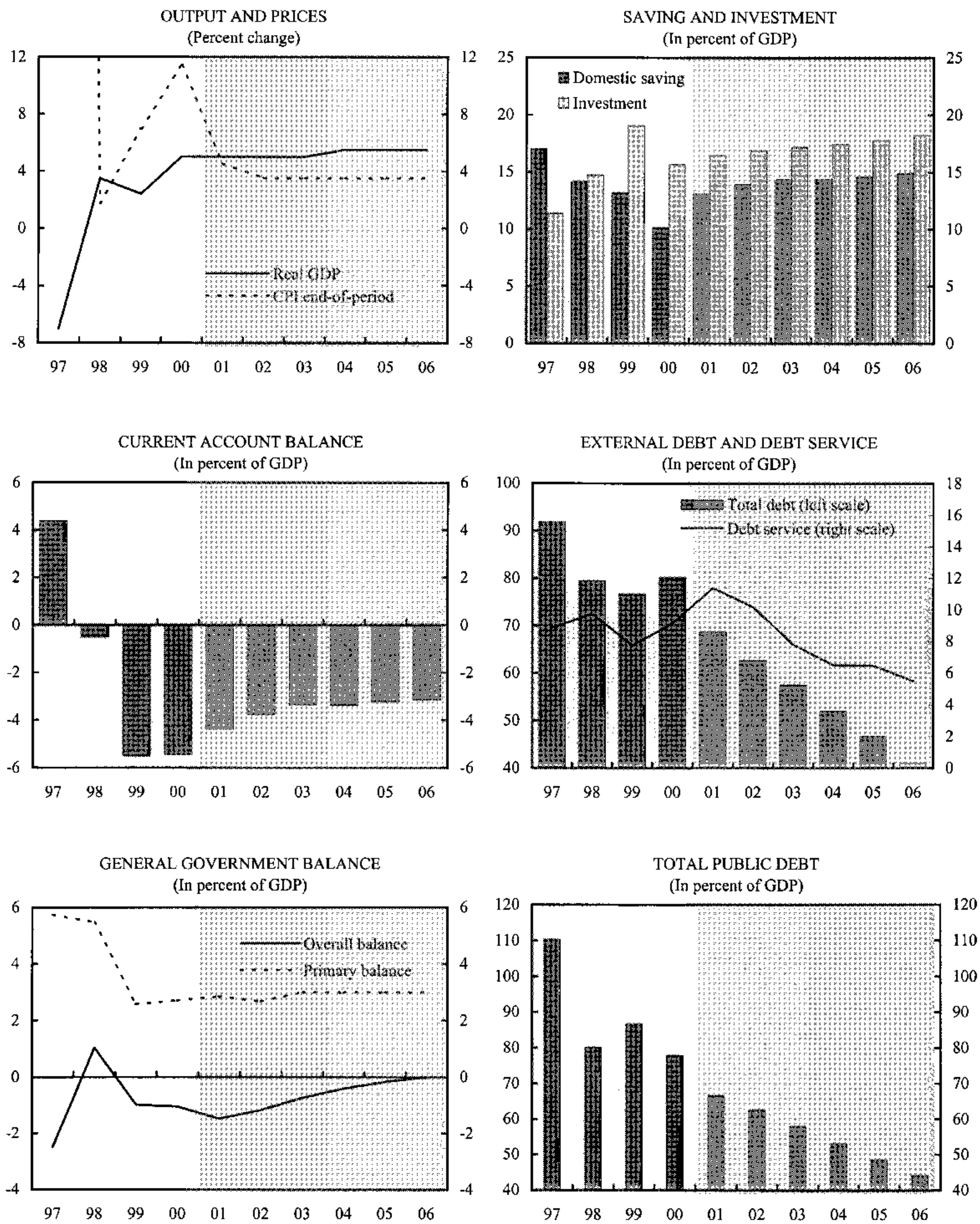
14. **There was an overall agreement on the authorities' medium-term targets and the policies to achieve them** (Figure 9). The authorities explained that their medium-term framework targeted GDP growth of at least 5 percent annually, with inflation a few points above partner country levels, reflecting rapid productivity growth. To support the growth objective, the framework foresaw a moderate pickup in investment that is increasingly financed by domestic private saving, while recourse to foreign saving would be reduced to bring down the external debt to below 50 percent of GDP by the middle of the decade from the present 80 percent of GDP. This would also ensure sufficient capacity to repay the Fund (Table 8). Both sides agreed that the pick-up in private saving would require improved enterprise financial discipline, to raise corporate profitability, and further reform of the financial sector, to promote household saving. The staff noted that even with a projected rise to close to 20 percent, the investment-to-GDP ratio would remain low by the standard of episodes of rapid growth in other countries. Factor accumulation therefore needed to be complemented by strong productivity gains brought about by structural and institutional reform.[4] Also, to prevent investment from being crowded out by the government's financing needs, fiscal policy should remain cautious. To this end, the authorities were committed to a medium-term fiscal framework aimed at a broadly balanced underlying fiscal position, with actual deficits of up to 2 percent of GDP to cover one-time costs of structural reform (¶15). The staff agreed that this strategy, which the authorities would outline to the EU in May 2001 as part of Bulgaria's Pre-Accession Economic Program, would ensure fiscal sustainability, allowing the public debt burden to fall in line with external debt.

B. Fiscal Policy

15. **The staff commended the authorities for their continued prudent conduct of fiscal policy, which helped to contain the general government deficit to 1 percent of GDP in 2000** (Tables 9 and 10). The staff noted that while the 2000 budget had originally targeted a deficit of 1½ percent of GDP, the moderate tightening relative to this target had been appropriate in light of the higher-than-projected inflation and the external current account deficit. The tightening had not been difficult to achieve, as revenues exceeded budget estimates by almost 10 percent, owing to conservative initial estimates and a higher-than-projected revenue base. Indeed, it had been agreed at the time of the fourth program review that some additional, mostly temporary, spending above budgeted levels would be possible, to promote growth and ease the pain of adjustment. In the event, the authorities increased capital expenditure and social assistance by a total of ¾ percent of GDP, made

[4] Bulgaria's growth potential and the challenges to achieving it are discussed in Chapter I of the Selected Issues paper.

Figure 9. Bulgaria: Medium-Term Projections, 1997-2006 1/



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

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

additional one-time pension and wage payments also amounting to ¾ percent of GDP, and raised transfers to municipalities to enable them to clear arrears estimated at 1 percent of GDP.

16. **The prudent overall fiscal position in 2000 masked weaker-than-envisaged performances by the municipalities and the National Social Security Institute (NSSI), which the authorities intended to rectify in 2001** (¶10). Last year, as in 1999, municipalities had required more central government support than budgeted. The NSSI's financial position was also significantly weaker than expected, reflecting both a revenue shortfall (owing to a large drop in employment) and an expenditure overrun (an unexpectedly large number of workers took early retirement before the start of the new pension system in January 2000). To strengthen financial discipline in municipalities, the authorities had for 2001 increased penalties for fraud and enhanced incentives for keeping spending within realized revenues. To improve the NSSI's finances, the authorities aimed to raise revenue collection through continuing efforts to create a unified revenue agency (URA) to enhance the capacity to collect taxes and social contributions (¶11). The staff noted that the URA project was already beginning to show results, and urged the authorities to implement the project on schedule, with continued Fund and World Bank technical assistance.

17. **Regarding fiscal policy in 2001 more generally, the authorities agreed to maintain a neutral stance, with flexibility to respond to unforeseen developments** (¶7 and Box 2). They noted that the 2001 budget adopted by parliament would maintain the primary surplus at 3¼ percent of GDP, with an increase in external interest payments accounting for a widening of the budgeted general government deficit by ½ percent of GDP, to 1½ percent of GDP. The staff stressed the importance of implementing the budget conservatively, to achieve the intended fiscal stance, avoid the frontloading of expenditure to the pre-election period, and preserve room for maneuver in case risks materialize. The authorities indicated that, as in recent years, they would save 10 percent of discretionary allocations through the first three quarters of the year. This saving (amounting to over 1 percent of GDP) would help to avoid frontloading, and, together with contingencies of almost 1 percent of GDP, would provide ample margins to respond to unforeseen developments. If inflation or the current account deficit threatened to be higher than projected, the authorities would be prepared to tighten the fiscal stance, including through continuing the saving of part of the discretionary allocations through the last quarter if necessary. If the external position was not under threat and revenues exceeded budgeted levels—an eventuality which was not assured this year, as the budget's revenue estimates were less conservative than in the past—the authorities would save the overperformance, to create room for further tax cuts in 2002. The authorities also accepted the staff's argument that the proceeds from the sale of Bulgaria's largest bank (which would be channeled to the government as dividends from the Bank Consolidation Company) and the second GSM license (net of transactions costs) represented one-time asset transactions and should therefore be used to reduce the public debt.

18. **Within this framework, the 2001 budget reduced the tax burden substantially, to support private sector activity and job creation** (¶ 8). The tax cuts included reducing the

Box 2. Highlights of the 2001 Budget

The 2001 budget features sizable tax cuts, while maintaining a neutral fiscal stance and including margins to tighten the fiscal position if warranted by inflationary or external risks. The broad outlines of the draft budget were agreed at the time of the fourth review last summer, and the details elaborated during a September staff visit. The budget approved by parliament in mid-December 2000 closely followed the agreed draft budget, with one exception: parliament decided to postpone a VAT measure by one year, necessitating offsetting revenue measures. The salient features of the approved budget are as follows:

- **A neutral fiscal stance.** The budget allows for a general government deficit of up to 1½ percent of GDP, ½ percent of GDP above the 2000 outcome. However, the primary surplus will remain at 3¼ percent of GDP, and the fiscal impulse is zero, as the widening of the deficit is solely on account of higher external interest payments.

- **Sizable tax cuts that bring the revenue-to-GDP ratio down to 37½ percent of GDP.** The tax cuts, which are estimated to result in a revenue loss of 1½ percentage points of GDP, include reducing the personal income tax burden by 2 percentage points, the central corporate profit tax rates by 5 points, and the social contribution rates by 3 points. In addition, to remove obstacles to businesses (especially small and medium-size enterprises), presumptive taxation has been simplified, the VAT refund period for nonexporters reduced from 6 to 4 months, and accelerated depreciation allowed for software products. To offset part of the revenue loss, the authorities had agreed in September to remove the zero rating of VAT on tour packages sold abroad from January 2001, with a revenue impact of 0.3 percent of GDP. As parliament later decided to postpone this removal by one year, the authorities took legislative and administrative measures designed to increase collection to compensate for this loss. Nontax revenue is also expected to fall by 1 percent of GDP, bringing the total revenue decline to 2½ percent of GDP.

- **A reduction in the ratio of noninterest spending to GDP by 2½ points, to bring noninterest spending within the authorities' medium-term target of 35 percent.** Part of the reduction is achieved through the reversal of the temporary spending increases in 2000 afforded by the revenue overperformance. Beyond this, the authorities are implementing the ongoing pension and health reforms with a view to achieving cost savings, reducing subsidies to state enterprises through restructuring (especially in state railways and the district heating companies), and taking measures to improve financial discipline in the municipalities. Spending on operations and maintenance has also been budgeted to decline as a ratio to GDP, although as in previous years autonomous units will be able to spend any excess revenue above the budgeted levels. (This would show up as higher-than-budgeted nontax revenue, offset by higher-than-budgeted spending on operations and maintenance.) The government's wage bill on a comparable basis remains constant as a ratio to GDP. Defense spending is also kept constant relative to GDP, in line with a medium-term reform plan for the military that foresees savings from further rationalization of operations broadly offset by additional spending related to Bulgaria's aspirations to join the NATO. Within the overall expenditure containment, priority spending (such as growth-enhancing public investment and social assistance) has been protected.

- **Substantial margins to allow for flexibility in implementing fiscal policy.** The budget includes explicit expenditure contingencies totaling 0.9 percent of GDP. Moreover, the authorities are committed to continuing the practice of transferring only 90 percent of discretionary expenditure to spending units until the last quarter of the year, creating a margin of over 1 percent of GDP.

personal income tax burden by 2 percentage points, the corporate profit tax rates by 5 points, and social contribution rates by 3 points. Moreover, presumptive taxation was streamlined, the VAT refund period for nonexporters reduced, accelerated depreciation of software products allowed, and customs duties reduced. With these measures, tax revenues for 2001 were estimated to decline by 1½ percent of GDP. While welcoming the tax cuts, which were in line with the understandings reached during the fourth program review, the staff noted that even after the cuts the tax wedge for labor income remained high (71 percent at the average pay level) and urged the authorities to create opportunities in future years for additional cuts, especially in the social contribution rates. The staff also noted that, following strong lobbying by the tourism industry, parliament had decided to postpone the removal of zero rating of VAT on tour packages sold abroad by one more year. This maintained the only remaining significant distortion in Bulgaria's otherwise exemplary VAT system, and created a revenue gap of 0.3 percent of GDP. To close this gap, the authorities agreed to take legislative and administrative measures to improve collection.

19. **To create room for the tax cuts, the 2001 budget envisaged maintaining overall expenditure broadly unchanged in real terms** (¶9). The authorities explained that a significant part of the expenditure containment would be achieved by reverting to baseline spending levels in areas, such as wages, pensions, and municipal transfers, where revenue overperformance had afforded one-time increases last year. Beyond this, the authorities would implement the ongoing pension and health reforms with a view to achieving cost savings (¶13–14). They would also reduce subsidies to state enterprises through restructuring, especially in state railways and the district heating companies. Within the overall expenditure containment, the authorities would, however, protect priority spending, such as growth-enhancing public investment and social assistance. Also, the government's wage bill on a comparable basis would remain constant as a ratio to GDP. The staff regarded the budget's expenditure estimates as realistic, provided the underlying structural measures were implemented strictly. Any delay in implementing these measures would reduce the cost savings and force expenditure cuts in other areas to meet the overall expenditure limit. To further improve expenditure management and budget monitoring, the staff encouraged the authorities to complete the remaining steps in creating a fully-functioning treasury (¶12). On budgetary wages, the staff concurred with the authorities that average pay remained low even by regional standards, contributing to weaknesses in administrative capacity. Accordingly, the staff did not object to the authorities' plan to raise budget sector wages by 10 percent in April, and recommended World-Bank-supported efforts to link pay to performance and decompress the pay structure to further improve incentives. With average budgetary sector employment nearly 5 percent below last year's level, reflecting sizable staffing reductions in 2000, the April increase would be well within budgeted limits, and would leave room for a more moderate further increase in October.

C. Competitiveness

20. **To enhance competitiveness, the authorities agreed to maintain a strict incomes policy for state enterprises, increase labor market flexibility, and improve the business climate.** The staff noted that while the strong growth in exports and other indicators gave

comfort that competitiveness was not currently a major issue, cautious fiscal policy would need to be complemented by continued wage discipline in state enterprises to prevent the uptick in inflation from eroding competitiveness in the period ahead. The authorities agreed that the incomes policy for 2001 would need to maintain a strong link between financial performance and wages in the 1,500 state enterprises covered by the policy (¶16). In particular, the wage bills of the most closely monitored enterprises (those accounting for the bulk of the losses and arrears in the state sector, monopolies, and those receiving subsidies) would remain under strict limits, with a rise of up to 5 percent allowed in 2001, and subject to close monitoring. Regarding labor market flexibility, the extended discussion in parliament on amendments to the Labor Code had on balance resulted in a strengthening of the provisions to make employment and working hours more flexible, and the staff found the business community to be generally satisfied with the outcome (¶17).[5] To reduce red tape and corruption, which domestic businesses and foreign investors perceive as the main obstacle to better competitiveness, the authorities would continue to simplify the licensing and registration regime, after having eliminated or streamlined 120 requirements last year (¶29). Moreover, a "one-stop shop" program to reduce bureaucracy was underway and would be expanded, an international arbitration law to improve the environment for FDI was being drafted, the commercial court system would be improved, and public administration streamlined.

D. Financial Sector Policies

21. **The staff and the authorities considered that the banking system was generally sound, and the legal and regulatory framework for banking supervision broadly adequate** (Box 3). Once the new bank bankruptcy law that was in parliament was approved, improvements in this area would mainly be found in enhancing the quality of implementation (¶19).

22. **While commending the authorities for their success in bank privatization so far—80 percent of bank assets have been sold to private, mostly foreign, investors—the staff inquired about the authorities' plans to complete the bank privatization program** (¶18). The authorities explained that they were in the final stages of completing the once-postponed sale of Biochim bank, making good-faith efforts to agree on terms with the sole bidder. They were also looking for a strategic investor for the government's minority share in

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[5] Bulgaria's labor market policies and institutions are put into perspective in a forthcoming background paper covering the hard-peg EU accession countries (Bulgaria and the Baltics). The paper will be issued ahead of the next Article IV consultation discussions for Estonia, Latvia, and Lithuania. It paper concludes that continuing restructuring in agriculture and the newly privatized sectors will put further pressure on the Bulgarian labor market, underscoring the importance of making employment and wages more flexible. Looking ahead, the four countries will need to address the structural problems of long-term and youth unemployment and the implications and requirements of EU accession.

Box 3. Banking Sector Soundness

Bulgaria's banking sector is small and concentrated. Bulgaria has 35 banks, 8 of which are foreign bank branches. Following the privatization of Bulbank in 2000, the proportion of bank assets that are still state-owned has declined to below 20 percent. The sector remains small by the standards of other EU accession countries: at end-2000, total assets amounted to less than 40 percent of GDP. Concentration in the sector is high, with 3 banks—including the state-owned DSK (the former State Savings Bank)—accounting for more than half of all assets, capital and reserves, and deposits of nonfinancial institutions and other clients. The bottom 27 banks are mostly very small institutions, or foreign bank branches.

The banking sector continues to focus its activity on intermediating short-term deposits into low-risk liquid assets. At end-2000, loans to non-financial institutions accounted for some 30 percent of total banking sector assets, while deposits in other financial institutions—almost exclusively deposits denominated in foreign currency—and securities comprised over one half of total assets. This conservative asset management strategy is in part a response to the 1996–97 banking crisis and the relative dearth of good domestic lending opportunities, but it also reflects the sector's dependency on foreign currency and short-term deposits as its main source of funding: 55 percent of all deposits are denominated in foreign currency, and over 90 percent of deposits have a maturity of less than 1 year. There are no indications that this composition of assets and liabilities, which has been broadly stable since the end of the banking crisis, is about to change, but the trend toward an increase in credit to private enterprises as share of total assets is likely to continue.

The sector's earnings and cost base are stable, but the preference for allocating assets in short-term deposits and securities dampens profitability. In 2000, core banking earnings (net interest income and commissions and fees) accounted for 70 percent of total banking sector operating income. Following the introduction of the CBA, the sector has come to rely less on earnings from trading and foreign-exchange-related activities, the share of which in total operating income has stabilized in the 25–30 percent range. Also in 2000, interest expenses absorbed only around 20 percent of operating income, reflecting banks' access to cheap lev deposits. The low deposit rates in part reflect depositors' preference for short-term, liquid deposits, as well as the still limited competition in the market for household deposits. In contrast, operating expenses accounted for almost 55 percent of operating income, indicating an imbalance between these expenses and the income-generating capacity from an asset portfolio overweight in relatively low-return deposits and securities. As a result, the profitability of Bulgaria's banking sector is relatively low. In view of the high operating costs, profitability is unlikely to improve unless banks reduce operating costs, increase lending activities, and diversify the sources of noninterest income.

The overall compliance of the banking sector with regulatory and supervisory requirements has improved considerably a result of the substantial strengthening of the regulatory and supervisory functions and the large-scale provisioning for bad loans in the wake of the 1996–97 banking crisis. At end-2000, risk-weighted capital adequacy was 35.6 percent for the sector as whole, far above the required 10 percent. However, some smaller banks still had a capital base that the supervisory authorities deemed insufficient to adequately cover the risks associated with their activities. The average share of loans that were standard had increased to 91.8 percent by end-2000, with only few banks reporting significantly lower ratios. Banks met limits on single large exposures by a large margin overall, but a number of individual banks were found to have violated these regulations. In a number of cases, the supervisory authorities also established continued non-compliance with restrictions on insider lending. The reduction in the minimum reserve requirement from 11 to 8 percent in July 2000 did not affect overall liquidity in the system, and no individual banks faced liquidity problems at year-end. Finally, the net open foreign exchange position at the end of 2000, at 4.3 percent of the capital base, was well within the regulatory limits.

While Bulgaria's banking sector now appears overall sound, it may face significant challenges in the years ahead. Currently, the sector enjoys high capital adequacy and liquidity, and does not face major risks associated with nonperforming loans or foreign currency exposure. However, the soundness of the sector as a whole could mask significant problems in a number of smaller banks, which may require further action. Moreover, the sector's limited exposure to major credit and currency risks in part reflects its conservative asset management strategy. Increased competition from privatization and foreign participation will likely lead banks to reassess their earning strategies, and opt for an increase in lending and lending-related activities. Together with the projected increase in short-term capital flows associated with prospective EU membership, this will pose new challenges for banks' internal risk management systems and the supervisory authorities alike. The high liquidity requirements of a currency board environment, which restricts active liquidity management by the central bank, adds to these challenges.

the Central Cooperative Bank. The remaining state-held bank, DSK (formerly the State Savings Bank), had been brought fully under the regulatory and prudential requirements facing commercial banks, but would need further restructuring to strengthen and diversify its commercial basis. While exploring the long-term options for the bank, including the involvement of a strategic investor, the authorities were in the process of transferring 25 percent of the state's shares to the Bank Consolidation Company which has handled previous bank privatizations. This was expected to improve governance and, in view of a plan to float these shares, to stimulate the development of the stock market.

23. **There was extensive discussion on how to ensure a healthy expansion of bank credit to the private sector.** The staff noted that the substantial progress in reforming and strengthening the banking system since the crisis of 1996–97 had not yet led to a significant pickup in bank credit to the private sector. In 2000, commercial banks' net foreign assets continued to expand far more rapidly than their lending to the private sector, reflecting the perceived high risk of such lending. The authorities considered that on the banking side the conditions for a steady credit expansion were now in place, and suggested that the main remaining impediments to credit growth related to weaknesses in corporate governance and uncertainties in the enforcement of creditor rights. Concurring with this view, the staff welcomed the authorities' plans to remove these obstacles, in particular the legal amendments being prepared to strengthen creditors' rights, including through making the collection of collateral easier (¶20). However, the staff advised against further reductions in the minimum reserve requirement (following a cut from 11 to 8 percent in mid-2000) at this stage, as it was important to retain ample capacity to respond to abrupt systemic demands for liquidity and avoid the risk that banks would withdraw the added liquidity in foreign exchange rather than increase their lending.

24. **The staff supported the authorities' efforts to develop the nonbank financial sector.** As major progress in establishing a sound and well-functioning banking sector had been achieved, the authorities' focus was moving to the development of nonbank financial institutions, including insurance companies and pension funds, and the securities markets. The authorities acknowledged that intermediation outside the banking sector was rather limited, and were taking initial steps to identify the obstacles. The staff indicated that an in-depth analysis of these and other financial sector issues could be made in the context of a Financial Sector Assessment Program tentatively planned for late 2001.

E. Structural Issues

25. **While the approach of the June elections was making major new initiatives difficult, the authorities were committed to making additional efforts in areas where structural reform was lagging.** Noting that reform had slowed in the energy sector and large-scale privatization, the staff stressed that aggressive structural reform remained critical to the success of Bulgaria's economic program. Serious delays would be costly: they would cause fiscal and quasi-fiscal pressures, and prevent the economic recovery from becoming self sustaining. The authorities reiterated their overall commitment to vigorous structural reform, but noted that parliament's agenda in the remaining few pre-election months was

crowded and that sensitive new measures were unlikely to be passed before the elections. In the end, agreement was reached on structural initiatives which, if fully implemented, would bring reform in the lagging areas back on track. Many of the agreed measures were based on the advice of World Bank staff who participated in all key discussions on structural issues.[6]

26. **Discussions on energy sector reform centered on improving the legislative framework for establishing a competitive and efficient energy sector** (¶24–28). The staff argued that, having the most energy-intensive economy among the EU candidates, Bulgaria needed substantial further restructuring and liberalization in the energy sector to become a rapidly growing market economy able to compete in the European markets. While welcoming recent progress and the authorities' plans in some subsectors (notably electricity, gas, and coal), the staff noted that delays in amending the Energy Act were creating uncertainty about the direction of reform and stalling progress in other subsectors, particularly the loss-making district heating companies. The authorities stated their intention to make Bulgaria a regional energy center—electricity exports had already doubled in 2000, and Bulgaria had strong expertise in this area—and were planning to pursue an investment strategy aimed at adding capacity for export purposes. The staff emphasized that for such a strategy to be successful, it should be carried out by the private sector. Moreover, the legal framework for the energy sector would need to be strengthened, to prevent the misallocation of resources and quasi-fiscal liabilities that could result from a government-promoted investment strategy in new capacity or lack of price adjustments.

27. **Against this background, the staff and the authorities agreed on the need to amend the Energy Law as a matter of priority.** The staff urged that the amendments be guided by a number of key principles: reducing quasi-fiscal liabilities by having private companies carry the risk for investing in new projects; increasing efficiency by allowing competitive transactions at all market levels; and improving transparency by reinforcing the operational independence of the regulatory commission and clearly separating its regulatory and licensing functions from the policymaking and ownership functions exercised by other agencies. The authorities agreed to work with World Bank staff to have these principles reflected in the draft amendments that would be sent to parliament by mid-March; this would be a prior action for completing the review. The authorities were, however, not fully confident that parliament would be able to approve the amendments before the elections. The staff noted that if the approval of the amendments was delayed, key measures agreed in mid-2000 to rehabilitate the ailing district heating sector would remain unimplemented for the second heating season. The authorities indicated that in any case they remained committed to

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[6] The structural measures subject to Fund conditionality during the remainder of the extended arrangement are listed in Table 1 of the attached Memorandum on Economic Policies. These measures comprise one prior action, one structural performance criterion, and several structural benchmarks. The authorities' intentions in a full range of structural areas, including measures not subject to Fund conditionality, are outlined in Appendix I of the Memorandum.

adopting a new energy pricing regime based on full cost recovery from January 2002. To ensure a smooth transition to the new regime, price adjustments would be made as needed in the second half of 2001.

28. **The authorities were determined to improve the quality of privatization and strengthen financial discipline in state enterprises.** The staff welcomed the recent amendments to the Privatization Law, which would increase the transparency of the remaining privatizations (Box 4). The staff expressed concern, however, that the requirement of parliamentary oversight and approval could further delay the long-outstanding privatization of the telecommunications and tobacco monopolies. This would increase the risks for investor confidence and budget financing. The authorities assured the staff that they were committed to completing large-scale privatization in a timely manner, with a focus on attracting high-quality strategic investors (¶21). In particular, they planned to submit to parliament in March revised strategies for the privatization of the two monopolies, although parliamentary approval on these sensitive was not expected before the elections. They were also preparing a comprehensive strategy for privatizing energy assets. For already privatized enterprises, substantial progress had been made in disposing of residual state shares, and the authorities expected the process to be completed by end-2001. Regarding financial discipline, the staff welcomed the recent amendments to the Commercial Code streamlining liquidation and bankruptcy proceedings, while stressing the need to strengthen implementation capacity. The authorities noted that they were taking several steps, including training judges and trustees, in this regard (¶22). The staff also emphasized the importance of strong measures to put the financial rehabilitation plan of the national railway company back on track, and were reassured by the authorities' commitment to reduce the losses of the company substantially in 2001 (¶23).

F. External Sector Policies

29. **The staff noted that trade reforms under the program were well on track.** After eliminating the last nontariff barrier in April 2000 (the export ban on unprocessed tobacco), Bulgaria further reduced MFN tariffs under the 2001 Tariff Decree, as scheduled (¶30). In addition, the number of tariff bands was reduced from 25 to 22. The maximum tariff remained unchanged at 74 percent. Overall, during the program period, Bulgaria achieved major liberalization and rationalization of its trade regime, eliminating all quantitative trade restrictions and reducing average MFN tariffs by 6 percentage points, to 12.4 percent. As a result, Bulgaria's rating under the Fund's Index of Trade Restrictiveness has improved from 6 (moderately restrictive trade regime) to 2 (liberal trade regime). The authorities have also liberalized bilateral trade with EU and CEFTA countries under free-trade agreements: Bulgaria's trade in industrial products with these countries is already largely duty free, while trade in agriculture will be liberalized more gradually.

Box 4. Privatization: Progress and Prospects

Bulgaria had a slow start in privatization. Although privatization formally started in 1993, three years later only 7 percent of assets in state enterprises had been transferred to private hands, making Bulgaria a laggard compared with most other transition economies.

Over the past three years, however, substantial progress has been made. In 1997, the government adopted a strategy to accelerate privatization through a number of avenues. The most valuable assets were assigned a privatization agent (typically a private sector company) through a tender process funded by the EU, the second tier companies were placed in pools and assigned agents in a similar fashion, while the Privatization Agency remained responsible for privatizing all the other large enterprises. Line ministries remained responsible for the privatization of smaller enterprises, and the voucher privatization scheme initiated in 1994 was relaunched (although unlike in the Czech Republic, vouchers never became a major instrument of privatization in Bulgaria). The strategy was implemented quite successfully between 1997 and 2000, under two Fund-supported programs. 1999 in particular was a record year, with privatization proceeds totaling more than US$500 million. As regards large-scale privatization, Bulgaria now compares favorably with other transition countries, except the most advanced ones. It has also largely caught up in terms of private sector share in GDP and cumulative privatization revenues. The only indicator showing Bulgaria still lagging behind is the EBRD index of small-scale privatization.

While noninfrastructure enterprise privatization is now nearing its completion, utility and telecommunications privatization still has to take off, and improvements in the quality of privatization are needed. By end-2000, 78 percent of noninfrastructure assets had been divested. In contrast, limited progress had been made in second-stage privatization (involving assets in the energy, transport, and infrastructure sectors, accounting for about 34 percent of total long term state-owned assets). The sale of BTC (the dominant telecommunications operator) was suspended in summer 2000, following prolonged negotiations, and the government has prepared a new strategy for its privatization, including the sale of a third GSM license in the same package. (The sale of the second GSM license was completed in January 2001). The first attempt to sell Bulgartabac (the tobacco monopoly) was also suspended last summer, and the government is preparing a new strategy. Restructuring of large energy monopolies is underway, but privatization of parts of the companies will commence only after the mid-2001 elections, following the formulation and parliamentary approval of a comprehensive strategy for the privatization of energy assets. Regarding the quality of privatization, amendments to the Privatization Law were approved in November 2000, changing the management and structure of the Privatization Agency and increasing parliamentary oversight, and reducing incentives for insider deals. While the amendments have increased transparency, the requirement of parliamentary approval for strategies for major deals may slow down the completion of privatization.

Looking ahead, Bulgaria needs to address remaining legal and institutional weaknesses which hinder the restructuring and growth of the new privatized sector. The high share of insider deals (almost one half of the sales have been management-employee buyouts, or MEBOs) and weak corporate governance have been key problems. Survey evidence shows that restructuring tends to lag behind in firms sold to MEBOs, partly because most MEBOs retained the same management team. Lack of perspective, skills, contacts, and financial resources for investment also appeared as major constraints to restructuring and development of newly privatized firms, especially MEBOs. In the near term, more effective bankruptcy and liquidation proceedings are needed, to facilitate exit of inefficient firms and entry of more efficient ones. The authorities have made good efforts recently to simplify and accelerate procedures, including by passing amendments to the Commercial Code in October 2000. But the poorly functioning judicial system still results in long procedures and weak enforcement of bankruptcy cases, with low salaries, lack of support staff, and lack of training on frequently changing laws identified as the main bottlenecks. The government is taking a pro-active stance on these issues, including by seeking EU support. In the longer run, the further development of financial markets will also likely help to improve corporate governance in Bulgaria. As in more advanced economies, they could provide a mechanism for the discipline and removal of ineffective management.

30. **The staff and the authorities agreed that Bulgaria would draw major benefits from further tariff liberalization.**[7] Despite the major progress in recent years, Bulgaria's average tariff is still twice as high as in the EU, the difference being even sharper for industrial goods. In addition, the tariff regime remains complex and dispersed. The authorities agreed with the staff that the level and dispersion of MFN tariffs should be reduced toward EU standards. This would make Bulgaria more attractive to foreign investors, reduce the potential for trade diversion arising from the growing gap between MFN and preferential tariffs, and minimize the cost of adopting the EU Common External Tariff at the time of accession. The authorities had already started to work on a multi-year plan aimed at harmonizing Bulgaria's MFN tariffs with those of the EU, and intended to incorporate the first measures in the 2002 Customs Decree.

31. **The authorities were determined to maintain their prudent record in debt management.** While the ratio of external debt to GDP remained high, at 80 percent, the authorities and staff projected it to decline quickly in the medium term, reflecting rapid growth, real exchange rate appreciation, and relatively limited net borrowing needs (owing to moderate current account deficits that would be largely covered by inflows of FDI). A more immediate issue was how to deal with the bunching of debt service in the next two years: annual external debt service would rise by US$0.5 billion (4 percent of GDP) in 2001–02. The staff noted that FDI and official financing would likely cover the bulk of the financing needs in the medium term, but also encouraged Bulgaria (which has not contracted sovereign debt from private markets since the communist years) to adopt a more proactive attitude toward the management of its external debt, including through the gradual resumption of market borrowing. The staff cautioned, however, that any debt operations should be undertaken only if adequate liquidity remained in the Fiscal Reserve Account. The authorities were prepared to test the waters when conditions permitted, but did not see a need for this until late 2001 at the earliest. They also indicated that they were taking steps to improve their debt management framework (¶31). In particular, they had sent to parliament the legislative framework supporting their new debt management strategy, the Sovereign Debt Law. Moreover, they had settled the remaining bilateral debt dispute, entered into negotiations with several Paris Club creditors regarding debt service swaps, and agreed to open talks with HIPC-eligible countries to reconcile outstanding claims. As in previous years, the program's debt ceilings were set at levels ensuring a continued reduction in the debt-to-GDP ratio, while accommodating borrowing from multilateral agencies for investment and balance of payments support.

[7] Chapter II of the Selected Issues paper takes stock of the strengths and weaknesses of Bulgaria's present trade regime, explains the benefits from further trade liberalization, and outlines a medium-term reform strategy.

IV. Staff Appraisal

32. **During its three-year program, Bulgaria has achieved a remarkable turnaround, owing to strong macroeconomic policies and considerable progress in structural reform.** Following years of output decline and high inflation, GDP growth has picked up, inflation has been brought under control, and the external debt burden has been reduced significantly. The stable macroeconomic environment has been the result of the sound policies centered on a currency board arrangement in place since 1997. The authorities have maintained the strict financial discipline required by this arrangement through a cautious fiscal policy and a strict incomes policy on state enterprises. They have also pursued an ambitious structural reform agenda. Notable successes have been achieved in privatizing banks, strengthening banking regulation and supervision, initiating the overhaul of the health care and pension systems, and liberalizing trade and prices. Enterprise privatization has proceeded rapidly, but its quality has been marred by the large share of sales to management-employee teams. Less progress has been made in improving corporate governance and facilitating exit. Moreover, the authorities had a slow start in restructuring the energy sector and improving the business climate.

33. **In 2000, the economic outcomes and policy record were overall favorable, although inflation picked up and structural reform efforts were uneven.** Supported by a surge in exports and a recovery in private investment, growth accelerated to a robust 5 percent. Prudent fiscal and incomes policies helped to curb the current account deficit to a level comfortably covered by foreign direct investment, while not unduly restraining growth. However, a weakening of the euro and higher energy and food prices pushed inflation to above 10 percent in the latter part of the year. While significant progress was made in financial sector and fiscal reform and in improving the business environment, some major privatization transactions were not completed, and energy sector reform was delayed.

34. **The prospects for 2001 are good, but risks remain.** Building on last year's momentum, Bulgaria is well positioned to achieve another year of 5 percent growth. As oil prices are projected to be lower and the euro stronger than last year, inflation is expected to fall markedly and the current account deficit to narrow. Risks to this scenario include a sharper-than-projected slowdown in the EU, and uncertainty about oil prices and the euro-U.S. dollar exchange rate. The main downside risk would, however, stem from a relaxation of policy efforts in the run-up to the June 2001 elections.

35. **To minimize the risks, the authorities need to implement the 2001 budget conservatively, and respond flexibly to any upward pressure on inflation or the current account deficit.** The substantial cuts in direct taxes and social contribution rates in this year's budget are welcome, and the budget's revenue projections are realistic. Although parliament failed to remove the zero rating of VAT on tour packages, the authorities are taking compensating revenue measures in this year's budget, and have committed themselves to removing the zero rating from the beginning of 2002. On the spending side, frontloading of expenditure to the pre-election period should be avoided. In this regard, the authorities' commitment to save 10 percent of discretionary allocations through the first three quarters of

the year is reassuring. This practice should continue through the last quarter if inflation or the current account deficit threaten to exceed projections, unless revenues exceed budgeted levels. Discretionary spending should also be lowered if the cost savings from structural measures do not materialize. A revenue overperformance should not be used to undertake additional one-time spending at the end of the year, but be saved to create room for further tax cuts in the 2002 budget. In assessing the fiscal position, the authorities should view the proceeds from the sale of the second GSM license and from bank privatization as financing, and not as revenues that would allow additional spending beyond budgeted levels.

36. **To safeguard competitiveness and reduce unemployment, the authorities should continue the strict incomes policy for state enterprises and increase labor market flexibility.** To maintain financial discipline and allow inflation to come down as projected, a strong link needs to be preserved between wages and financial performance in state enterprises. In particular, the wage bills of the state enterprises accounting for the largest losses and arrears, state monopolies, and companies receiving state subsidies should be kept within strict limits. The recently approved amendments to the Labor Code are welcome, as the new provisions allow more flexibility in employment and working hours, promoting competitiveness and job creation.

37. **While the upcoming elections are making new initiatives difficult, every effort should be made to have pending legislation on key structural reform measures approved by parliament during its current session.** The main priority is for parliament to pass amendments to the Energy Act aimed at establishing a competitive and efficient energy sector and allowing the reform of the district heating sector to catch up with the original schedule. Without the proper framework provided by these amendments, the implementation of the government's ambitious energy sector strategy could result in a severe misallocation of resources and major fiscal risks. To keep the authorities' structural reform agenda on track, other important pieces of legislation need urgent approval as well. These include the Sovereign Debt Law, a new bank bankruptcy law to improve the legal tools to deal with closed banks, and amendments to the Civil Procedure Code to strengthen creditors' rights.

38. **To maintain the momentum of structural reform in the pre-election period, the authorities should take action on several nonlegislative fronts as well.** A key priority is to move ahead with the large outstanding privatizations. The long-delayed sale of Biochim Bank should be finalized, and the sales of the telecommunications and tobacco companies relaunched. With regard to fiscal reform, the authorities should build on the recent good progress to establish a fully functioning treasury and continue efforts to create a unified revenue agency. They also need to adopt an action plan to ensure the financial soundness of the second stage health care reform plan, and initiate a plan to make the fully funded second pillar of the pension system operational. To enhance financial sector soundness, efforts to strengthen the implementation of the regulatory and supervisory framework should continue. But, in view of the risk that banks would withdraw the added liquidity in foreign exchange deposits, further reductions in the minimum reserve requirement would be ill advised at this stage. Improving the business environment should also remain high on the agenda, and to this

end the government should revoke additional licensing and regulatory requirements and extend its "one-stop shop" program.

39. **The post-election government will face major economic challenges, to which it should respond by continuing the strategy that has proved successful in recent years.** To establish a fully functioning and competitive market economy and catch up with per capita income levels in other EU candidate countries, the new government will need to maintain a stable macroeconomic environment and make strong and sustained efforts to remove remaining structural impediments and to improve the quality of reforms. A strategy based on a currency board arrangement, prudent fiscal policy, and wage discipline offers the best prospects for macroeconomic stability. Implementing an ambitious structural reform agenda would help Bulgaria to achieve sustained robust growth. Priorities on this agenda should include: (i) completing privatization in a transparent manner, and strengthening corporate governance and exit procedures in the enterprise sector; (ii) developing nonbank financial institutions and securities markets; (iii) establishing a market-oriented and efficient energy sector; (iv) improving the business environment further, including through public administration reform; and (v) harmonizing Bulgaria's tariff regime with that of the EU.

40. **The staff supports the authorities' request for completion of the fifth review under the extended arrangement.** The authorities have continued to implement their ambitious program quite successfully, and all December 2000 performance criteria 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, and give the staff confidence that Bulgaria's financial obligations to the IMF will be discharged fully and in a timely manner.

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

Table 1. Bulgaria: Selected Economic Indicators, 1996-2000

	1996	1997	1998	1999	2000 Q1	2000 Q2	2000 Q3	2000 Q4
	(Percent change, from same period of previous year)							
Output, prices, and employment								
Real GDP	-10.9	-6.9	3.5	2.5	4.8	5.5	5.6	...
CPI (end-of-period)	310.8	578.5	1.0	6.2	9.5	11.7	12.0	11.4
Monthly, averaged during period	12.8	26.4	0.2	0.6	1.0	-0.2	2.0	0.8
Unemployment rate (percent, period average)	11.0	14.0	12.4	13.8	18.0	18.7	18.1	17.8
Retail sales, real (period average)	-9.7	-37.6	4.8	-2.0	6.9	1.2	2.2	0.0
Business climate indicator 1/	...	4.7	9.8	-4.7	3.9	2.8	6.3	9.9
Monthly dollar wages (level) 2/	86.3	80.5	111.0	120.6	115.3	119.7	118.1	118.7
Public sector wages, real (period average)	...	-19.5	23.5	10.7	1.1	2.7	1.4	4.2
Private sector wages, real (period average)	...	...	22.1	9.4	13.8	12.9	10.8	9.1
Consolidated government 3/	(In percent of GDP)							
Revenue	31.9	36.8	39.5	40.5	45.6	47.3	34.9	35.6
Noninterest expenditure	22.3	29.6	34.0	37.6	37.4	36.9	33.0	39.7
Primary balance	9.6	7.3	5.5	2.9	8.2	10.4	1.9	-4.1
Interest payments	19.7	8.5	4.4	3.9	7.9	2.0	6.2	1.7
Overall balance	-10.1	-1.2	1.0	-1.0	0.3	8.4	-4.3	-5.9
External financing	-2.9	0.3	-0.7	0.2	-2.8	-2.2	0.5	-2.3
Domestic financing	15.6	-2.7	-2.0	-1.3	1.9	-7.1	1.5	7.1
Privatization receipts	0.2	3.2	1.7	2.2	0.6	0.8	2.7	1.0
Public debt	105.8	110.4	80.2	86.7	77.4	76.1	85.3	80.6
Of which : Domestic 4/	22.0	25.8	19.3	19.6	18.1	16.9	18.5	16.9
Money and credit	(End-of-period; percent change, from same period of previous year)							
Broad money (millions of leva)	1,310	6,019	6,597	7,351	7,538	7,578	8,383	9,291
Broad money (M3)	124.5	359.3	9.6	11.4	20.4	22.5	25.7	26.4
Lev money	52.7	423.0	18.2	11.5	19.9	25.6	25.2	15.6
Credit, nongovernment	215.7	215.1	6.4	9.8	18.0	16.7	12.1	21.4
FX deposits (U.S. dollar millions)	1,357	1,477	1,543	1,477	1,533	1,552	1,562	1,958
FX deposits (percent of M3)	50.5	43.6	39.2	39.1	41.6	41.9	41.6	44.3
Broad money to foreign exchange reserves ratio	3.4	1.4	1.3	1.2	1.3	1.2	1.3	1.3
Interest rates (annualized)	(In percent; end-of-period)							
BNB basic rate	435.0	7.0	5.2	4.6	3.3	3.7	4.0	4.7
Time deposit (leva)	211.8	3.0	3.3	3.2	3.3	3.3	3.3	3.3
Balance of payments 5/	(In millions of U.S. dollars)							
Gross official reserves	793	2,474	3,056	3,222	2,875	3,145	2,959	3,460
(In months of GNFS imports)	1.5	5.2	6.1	5.9	4.9	5.2	4.6	4.9
Current account balance	131	288	-61	-685	-338	-81	75	-332
(In percent of GDP)	0.2	4.4	-0.5	-5.2	-12.9	-3.0	2.3	-9.8
Trade balance	188	402	-381	-1,081	-302	-236	-235	-402
Exports	4,890	4,906	4,193	4,006	1,110	1,171	1,249	1,276
Imports	4,703	4,505	4,574	5,087	1,412	1,407	1,483	1,678
External debt	9,516	9,732	10,025	9,890	10,110	10,382	10,289	10,371
(In percent of GDP)	96.8	96.0	81.8	79.7	78.3	82.3	83.7	86.0
Exchange rates								
Leva per U.S. dollar 6/	0.487	1.777	1.675	1.947	2.047	2.047	2.231	2.102
(yoy percent change, + means depreciation)	589.3	264.5	-5.7	16.2	12.4	8.1	21.7	8.0
REER (CPI)								
(yoy percent change, + means appreciation)	-38.8	77.5	5.2	0.5	2.1	5.1	0.6	-0.2

Sources: Bulgarian authorities; and staff estimates.

1/ Industry: average of public and private sectors. A number above zero indicates a positive average assessment of current business conditions.

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

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

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

5/ Starting 1998, a new methodology was adopted for the calculation of BOP data. Data for Q2 2000 are: April and May for current account and trade; June for reserves; and May for external debt.

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

Table 2. Bulgaria: Performance Criteria and Indicative Targets for September 2000 - December 2001 1/

	2000				2001			
	Sep. 30		Dec. 31		Mar. 31	June 30	Sep. 30	Dec. 31
	Target	Actual	Target	Actual	Target	Indicative	Indicative	Indicative
	(In millions of leva)							
Ceiling on overall deficit of the general government (minus = surplus)	61	-175	354	269	212	22	250	218
Indicative floor for revenue of the general government	7,446	7,526	10,361	10,241	2,483	5,184	7,910	10,762
Floor on the change in the balance of the Fiscal Reserve Account	-313	22	-319	-215	-102	-1	-291	-262
Floor on the level of deposits of Banking Department	680	892	680	964	680	680	680	680
Ceiling on changes in tax and social insurance arrears	-111	-132	-176	-185	-30	-60	-90	-120
Indicative ceiling on changes in tax arrears	-100	-102	-130	-147	-22.5	-45	-67.5	-90
Indicative ceiling on changes in social insurance arrears	-11	-30	-46	-38	-7.5	-15	-22.5	-30
Indicative ceiling on changes in total outstanding liabilities of monitored enterprises to customs	-2	0	-2	0	-1	-1	-2	-2
Indicative ceiling on changes in the stock of net bank credit to the general government	255	-257	386	314	69	-65	107	-7
	(In millions of U.S. dollars)							
Ceiling on outstanding stock of external debt of 1 year or under 2/	120	0	160	0	40	80	120	160
Ceiling on contracting or guaranteeing of non-concessional external debt of over 1 year	950	258	1,100	657	250	500	800	1,100
Ceiling on contracting or guaranteeing of 1-5 years non-concessional external debt	250	0	250	0	250	250	250	250
Structural and other performance criteria		All met (see Table 3)		All met (see Table 3)				

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

1/ 2000 figures are cumulative from January 1, 2000, and 2001 figures are cumulative from January 1, 2001, except the floor on the level of deposits of Banking Department. Also, 2000 figures use EFF Third Review definitions and exchange rates, with 1.94687 leva/U.S. dollar; and 2001 figures use EFF Fifth Review definitions and exchange rates, with 2.10191 leva/U.S. dollar.

2/ Excluding normal import-related credits.

Table 3. Bulgaria: Structural Performance Criteria and Benchmarks for September 30 and December 31, 2000

		Program Timing	Implementation Status
	Structural Performance Criteria		
1.	Ensure that the 121 closely monitored state-owned enterprises subject to a wage bill freeze keep their wage bill as a group for the third quarter (end-September test date) and fourth quarter (end-December test date) 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 on the list. Excluded from the list for both test dates will be those enterprises that are privatized, or ceased operations, and those that had profits in 1999 and the first two quarters of 2000, unless they are monopolies. If an enterprise is excluded from the list, the base wage bill will be reduced by the amount of that enterprises' wage bill in the third quarter of 1999.	September 2000 and December 2000	Met. Met. The group's total wage bill was reduced by 9.4 percent between the third quarter of 1999 and the fourth quarter of 2000. Out of 90 enterprises that remained on the list, only 8 violated the wage bill freeze, and their combined wage bill amounted to only 3.3 percent of the total wage bill.
2.	COM to adopt: (i) a decision to withdraw direct and indirect central government subsidies from 3 DHCs before the 2000-01 heating season; and (ii) a decision identifying 5 DHCs from the remaining 19 DHCs from which all central governments subsidies will be withdrawn effective July 1, 2001. The final draft of the 2001 budget will incorporate these decisions.	September 2000	Met.
3.	Issue a new tender to sell Biochim.	September 2000	Met.
	Structural Benchmarks		
1.	Initiate joint audits of social contribution and PIT withholdings.	September 2000	Met.
2.	The URA Commission is to ensure that tax and social insurance forms are streamlined based on a harmonized definition of "labor income" as a common part of the bases for PIT and all social contributions.	December 2000	Met.
3.	Incorporate the elimination of outstanding municipal expenditure arrears into the 2001 municipal budgets.	2001 budget	Met.
4.	Complete consolidation of 90 percent of all leva accounts of government held in the BNB into the Single Treasury Account (including budgetary, extra-budgetary, deposit and suspense accounts).	December 2000	Met.
5.	The Ministry of Finance, the National Social Security Institute, the Health Insurance Fund, and the Ministry of Health to jointly formulate a detailed plan to finance the next stage in hospital care from mid-2001.	December 2000 *Revised target March 2001*	Partly met. A framework plan prepared in November 2000, and a detailed plan is being drafted for discussion.
6.	Sell or irreversibly put up for sale through the centralized mass privatization auctions or other means 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.	December 2000 *Revised target December 2001*	Partly met. 70 enterprises privatized by end 1999 still have residual shares.

Table 3. Bulgaria: Structural Performance Criteria and Benchmarks for September 30 and December 31, 2000 (concluded)

		Program Timing	Implementation Status
7.	COM to amend regulation to allow privatization bodies to publish main parameters of all bids of interested buyers after a sale is completed.	September 2000	Met.
8.	Complete the sale of assets of Group B enterprises entered into liquidation.	December 2000 *Revised target June 2001*	Partly met. In 2000 assets of 5 out of 14 enterprises were sold.
9.	Enactment by parliament of legislation to expedite the completion of bankruptcy proceedings, including for state-owned enterprises.	September 2000	Met with delay on Oct 13, 2000.
10.	Submit to parliament the draft package of amendments to the Energy Law agreed with the World Bank.	September 2000 *Revised target Prior Action for Fifth Review (see above).*	Not met.
11.	Ensure that NEK does not enter into power purchase agreements with terms longer than one year unless approved by the standing commission appointed by the Prime Minister.	From July 1, 2000 through end-2001	Being observed. NEK has not signed any long-term power purchasing agreement.
12.	Until the implementation of the two-component tariff, apply an obligatory fixed payment for disconnected volumes in connected buildings with effect from November 1, 2000.	September 2000	Not met. Requires approval of amendments to the Energy Act.
13.	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.	Continuous	Being observed.
14.	Refrain from introducing new temporary tariff exemptions and temporary tariff quotas.	July 31, 1998 ongoing	Being observed.
15.	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).	December 2000	Met.
16.	Refrain from a conversion of outstanding privatization vouchers into government debt.	Continuous	Being observed.

Table 4. Bulgaria: Indicators of External Vulnerability, 1995-2001

	1995	1996	1997	1998	1999	2000-01	
						Latest Observation 1/	Date
(In percent, unless			(In percent, unless otherwise noted)				
Real indicators							
CPI end-of-period, 12-month change	32.9	310.8	578.5	1.0	6.2	8.7	Jan-01
Real GDP growth rate, year-on-year	2.1	-10.9	-6.9	3.5	2.5	5.6	Q3-00
Financial indicators							
Public sector debt (in percent of GDP, end-of-period)	106.2	105.8	110.4	80.2	86.7	80.6	Dec-00
Broad money (percent change, 12-month basis, end-of-period)	39.6	124.5	359.3	9.6	11.4	26.4	Dec-00
Non-government sector leva credit (percent change, 12-month basis end-of-period)	36.7	15.6	297.2	69.7	21.4	21.4	Dec-00
Non-government sector foreign exchange credit (percent share in domestic credit end-of-period)	23.4	43.5	49.9	50.5	51.0	39.5	Dec-00
Average monthly BNB basic interest rate, nominal annualized	65.2	262.7	176.0	5.5	4.8	3.9	Dec-00
BNB basic real interest rate, average basis	22.9	-30.1	-87.6	3.5	-2.1	-5.6	Dec-00
Banks' NFA position in US$ million	830	806	941	1,107	1,107	1,523	Dec-00
External indicators							
Exports (annual percent change, US$ basis)	35.8	-4.5	2.6	-12.9	-4.5	20.0	Dec-00
Imports (annual percent change, US$ basis)	32.2	-5.4	-3.0	3.5	11.2	17.6	Dec-00
Current account balance (percent of GDP)	-0.6	0.2	4.4	-0.5	-5.5	-5.8	Dec-00
Capital and financial account (percent of GDP)	4.1	-10.2	0.4	1.5	5.9	6.6	Dec-00
Portfolio investment (debt securities, etc.)	-0.5	-1.3	1.3	-1.5	-1.6	-1.4	Dec-00
Other investment (loans, trade credits, etc.)	1.5	11.3	-2.3	0.7	2.8	0.4	Dec-00
Foreign direct investment	0.8	1.4	5.0	4.4	6.4	8.1	Dec-00
Gross official reserves (end-of-period)							
In millions of U.S. dollars	1,546	793	2,474	3,056	3,222	3,273	Jan-01
In millions of euros	...	...	...	...	3,207	3,523	Jan-01
Official reserves in months of imports GNFS	2.7	1.5	5.2	6.1	5.9	5.1	Dec-00
Fiscal reserve account balance (in millions of U.S. dollars, end-of-period)	...	...	791	1,117	1,336	1,139	Dec-00
Broad money/ NFA (end-of-period)	5.3	3.4	1.4	1.3	1.2	1.3	Dec-00
Total short term external debt/ reserves (in percent)	12.2	15.9	16.6	9.2	12.0	19.4	Dec-00
Foreign exchange deposits/reserves (percent, end-of-period)	145.3	171.2	59.7	50.5	45.8	56.6	Dec-00
Total external debt (percent of GDP)	77.4	96.8	96.0	81.8	79.7	86.0	Dec-00
Of which: Public external debt (percent of GDP)	63.6	83.8	80.1	64.9	63.3	64.3	Dec-00
Total short-term external debt (percent of GDP)	1.4	1.3	4.1	2.3	3.1	5.6	Dec-00
External debt service/ exports of GNFS (in percent)	14.3	16.1	13.5	19.9	16.6	16.5	Dec-00
External debt service/GDP (in percent)	7.8	11.0	8.8	9.7	7.7	9.6	Dec-00
Exchange rate (per U.S. dollar, period average) 2/	0.067	0.178	1.682	1.760	1.836	2.123	Dec-00
REER depreciation, end-of-period (-) (12-months basis)	8.0	-38.8	77.5	5.2	0.5	-0.2	Dec-00
Financial market indicators							
Foreign currency debt rating (Moody's, long-term)	...	B3	B2 3/	B2 3/	B2 3/	B2 4/	Jul-00
Foreign currency debt rating (S&P, long-term)				B	B 3/	B+ 3/	May-00
Foreign currency debt rating (Fitch IBCA, long-term)				B+	B+	B+ 3/	Aug-00
Stripped spread of discount A bonds (basis points, end-of-period)	...	1,409	716	1,011	713	931	28-Feb-01

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.
3/ Outlook positive.
4/ Outlook stable.

Table 5. Bulgaria: Macroeconomic Framework, 1997-2006

	1997	1998	1999	2000 4th Rev. 1/	2000 Est.	2001 Proj.	2002	2003	2004	2005	2006
								Projections			
						(Percent change)					
GDP and prices											
Real GDP	-7.0	3.5	2.4	4.5	5.0	5.0	5.0	5.0	5.5	5.5	5.5
GDP deflator	948.7	22.3	3.1	7.5	7.0	7.0	3.3	3.4	3.5	3.5	3.5
CPI (end of period)	549.2	1.7	7.0	6.0	11.4	4.5	3.5	3.5	3.5	3.5	3.5
(period average)	1,061.2	18.8	2.6	7.9	10.4	8.5	3.2	3.5	3.5	3.5	3.5
Lev/US$ exchange rate (end of period)	264.5	-5.7	16.2	1.3	8.0	...	...	...	...	...	...
Real basic interest rate (average) 2/	-68.4	3.7	-2.0	0.6	-6.8	...	...	...	...	...	...
Unemployment rate (in percent, period average)	14.0	12.4	13.8	...	18.1	16.3	14.5	13.5	13.5	13.5	13.5
Monetary aggregates											
Broad money (real, percent change) 3/	-32.3	8.6	4.9	9.5	5.2	10.0	10.0	10.0	11.0	11.0	11.0
Credit to non-government (real, percent change) 4/	-53.6	5.3	13.6	...	5.0	15.0	15.0	15.0	15.0	13.0	11.0
						(In percent of GDP)					
Saving and investment											
Foreign saving 5/	-5.6	0.6	5.9	5.1	5.6	3.4	3.0	2.8	3.1	3.2	3.4
Gross national saving	15.8	14.2	13.5	14.2	10.2	12.1	13.0	13.8	14.1	14.6	15.1
Gross domestic saving 6/	17.0	14.2	13.2	13.6	10.1	13.1	13.9	14.4	14.4	14.6	14.9
Government	1.5	8.1	6.8	5.8	5.9	5.5	5.8	5.9	5.5	5.2	5.1
Non-government	15.5	6.1	6.4	7.8	4.2	7.7	8.1	8.4	8.9	9.5	9.8
Gross domestic investment	11.4	14.7	19.0	18.7	15.7	16.5	16.9	17.2	17.5	17.8	18.3
Gross fixed investment	11.6	13.2	15.9	16.7	16.2	16.2	16.4	16.7	17.0	17.3	17.8
Change in stocks	-0.2	1.5	3.1	2.0	-0.5	0.3	0.5	0.5	0.5	0.5	0.5
Government	1.0	3.8	4.7	3.9	3.7	3.2	4.1	4.1	3.7	3.3	3.3
Non-government	10.4	10.9	14.3	14.9	12.0	13.3	12.8	13.1	13.8	14.5	15.0
General government											
Revenue	31.7	39.5	40.3	40.5	40.0	37.4	38.0	38.0	38.0	38.0	38.0
Non-interest expenditure	25.8	34.0	37.4	37.4	36.8	34.1	35.0	35.0	35.0	35.0	35.0
Primary balance (excluding BNB transfers)	5.7	5.5	2.6	2.5	2.7	2.8	2.7	3.0	3.0	3.0	3.0
Interest payments	8.4	4.4	3.9	4.4	4.3	4.8	4.2	3.7	3.4	3.2	3.0
Overall balance (excluding external interest payments	0.5	4.2	2.1	2.0	2.2	2.2	1.7	1.8	1.8	1.9	1.8
Overall balance	-2.5	1.0	-1.0	-1.4	-1.0	-1.5	-1.2	-0.7	-0.4	-0.2	0.0
Total public debt	110.4	80.2	86.7	79.4	77.9	66.6	62.7	58.1	53.3	48.6	44.3
						(In millions of U.S. dollars)					
Balance of payments											
Current account	446	-62	-685	-585	-696	-608	-584	-552	-610	-637	-682
Trade balance	394	-381	-1,081	-1,128	-1,173	-1,107	-1,092	-1,069	-1,095	-1,106	-1,145
Exports	4,814	4,193	4,006	4,782	4,808	5,117	5,507	5,918	6,391	6,888	7,436
Imports	4,420	4,574	5,087	5,911	5,981	6,224	6,599	6,987	7,486	7,994	8,581
Services	-185	90	97	170	187	225	255	283	293	285	311
Receipts	1,542	2,094	2,053	2,358	2,497	2,659	2,861	3,011	3,173	3,351	3,527
Payments	1,727	2,005	1,956	2,188	2,310	2,434	2,606	2,728	2,880	3,066	3,216
Of which : Interest	521	530	480	561	513	668	698	656	615	587	514
Memorandum items											
Gross official reserves	2,468	3,056	3,222	3,427	3,460	3,636	3,850	4,258	4,634	4,901	5,199
(in months of imports of GNFS)	5.3	6.1	5.9	5.5	5.4	5.5	5.4	5.7	5.7	5.7	5.6
Current account balance (in percent of GDP)	4.4	-0.5	-5.5	-4.5	-5.8	-4.4	-3.8	-3.4	-3.4	-3.2	-3.2
External debt/GDP (in percent) 7/	91.9	79.5	76.6	75.1	80.4	68.8	62.8	57.6	52.1	46.7	41.2
External debt service/exports of GNFS (in percent) 7/	14.1	19.9	16.6	15.9	15.6	20.9	19.2	15.0	12.8	13.0	11.3
External debt service/GDP (in percent) 7/	8.8	9.7	7.7	8.8	9.1	11.4	10.2	7.8	6.5	6.5	5.5
Export volume (percent change)	9.0	-3.9	-4.7	12.9	15.9	6.4	6.4	6.5	6.5	6.4	6.4
Import volume (percent change)	1.3	20.1	8.2	5.5	3.1	4.8	6.2	6.7	6.7	6.5	6.5
Terms of trade (percent change)	-0.4	5.2	-2.5	-4.2	-9.2	1.3	1.4	1.7	1.0	1.0	0.7
Non-government consumption (real change)	-17.2	8.0	4.8	0.8	2.8	4.5	4.5	4.5	5.0	5.0	5.0
Nominal GDP (in millions of leva)	17,055	21,577	22,776	25,587	25,587	28,746	31,180	33,852	36,964	40,362	44,081
Nominal GDP	10,141	12,259	12,404	12,880	12,055	13,871	15,112	16,460	18,030	19,731	21,587

Sources: Bulgarian authorities; and staff projections.

1/ Projections for 2000 at the time of the Fourth Review under the Extended Arrangement.

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

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

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

5/ Net imports of goods and nonfactor services.

6/ 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.

7/ Medium- and long-term external debt.

Table 6. Bulgaria: Monetary Survey, 1997-2001

	1997	1998	1999				2000				2001			
	Dec.	Dec.	Mar.	June	Sep.	Dec.	Mar.	June	Sep.	Dec.	Mar. Proj.	June Proj.	Sep. Proj.	Dec. Proj.
							(In millions of leva)							
Broad money 1/	6,019	6,597	6,261	6,184	6,669	7,351	7,538	7,578	8,383	8,616	8,481	8,692	9,244	9,904
Lev money	3,395	4,013	3,670	3,504	3,913	4,475	4,400	4,401	4,899	5,174	5,023	5,176	5,519	6,261
Currency	1,314	1,742	1,567	1,479	1,687	1,957	1,824	1,875	2,110	2,374	2,153	2,218	2,365	2,744
Deposits	2,080	2,271	2,103	2,025	2,226	2,518	2,576	2,526	2,788	2,801	2,871	2,957	3,154	3,518
Foreign currency deposits 1/	2,624	2,584	2,591	2,679	2,757	2,876	3,138	3,177	3,484	3,442	3,458	3,516	3,725	3,643
Net foreign assets	4,851	5,272	4,907	4,886	5,237	5,994	6,161	6,461	7,266	7,019	6,771	6,920	7,191	7,418
Net domestic assets	1,167	1,325	1,354	1,298	1,433	1,357	1,377	1,117	1,117	1,597	1,710	1,772	2,053	2,486
Domestic credit	5,136	4,227	4,365	4,175	4,262	4,237	4,625	4,180	4,325	4,654	4,679	4,733	5,017	5,461
Government 2/	1,642	510	702	404	377	156	367	-116	137	488	507	481	530	612
Non-government	3,495	3,717	3,663	3,771	3,885	4,081	4,258	4,297	4,188	4,167	4,173	4,252	4,486	4,849
Public enterprise (SOE)	1,254	946	830	792	750	713	691	621	447	422	352	290	227	165
Private sector	2,241	2,772	2,833	2,979	3,135	3,368	3,567	3,675	3,741	3,745	3,821	3,962	4,259	4,684
Other items net	-3,969	-2,902	-3,011	-2,877	-2,829	-2,881	-3,248	-3,063	-3,208	-3,058	-2,969	-2,961	-2,964	-2,975
Reserve money	2,174	2,387	2,200	2,163	2,290	2,722	2,581	2,611	2,769	3,021	2,848	2,933	3,065	3,477
							(In millions of U.S. dollars)							
Net foreign assets	2,731	3,147	2,695	2,580	2,855	3,079	3,009	3,157	3,256	3,339	3,265	3,340	3,475	3,589
BNB	1,531	1,941	1,665	1,594	1,662	1,972	1,666	1,831	1,643	1,816	1,719	1,772	1,812	1,971
DMB	1,200	1,207	1,030	986	1,193	1,107	1,344	1,325	1,613	1,523	1,546	1,568	1,663	1,618
Foreign currency deposits	1,477	1,543	1,423	1,415	1,503	1,477	1,533	1,552	1,562	1,637	1,667	1,697	1,800	1,762
(percent of broad money)	(43.6)	(39.2)	(41.4)	(43.3)	(41.3)	(39.1)	(41.6)	(41.9)	(41.6)	(39.9)	(40.8)	(40.5)	(40.3)	(36.8)
Memorandum items:							(12-month growth rate in percent)							
Broad money	359.3	9.6	5.1	2.3	10.0	11.4	20.4	22.5	25.7	17.2	12.5	14.7	10.3	15.0
Lev money	423.0	18.2	12.2	3.5	14.9	1.0	19.9	25.6	25.2	15.6	14.2	17.6	12.7	21.0
Currency	939.1	32.6	21.9	4.4	15.3	12.4	16.4	26.7	25.1	21.3	18.0	18.3	12.1	15.6
Foreign currency deposits	296.8	-1.5	-3.5	0.8	3.7	11.3	21.1	18.6	26.4	19.7	10.2	10.7	6.9	5.8
Reserve money	780.1	9.8	5.0	4.3	12.0	14.0	17.3	20.7	20.9	11.0	10.3	12.3	10.7	15.1
CPI inflation	578.5	3.3	0.3	-0.8	4.1	7.0	9.5	11.7	12.0	11.4	11.5	11.4	4.9	4.5
Currency/broad money ratio	21.8	26.4	25.0	23.9	25.3	26.6	24.2	24.7	25.2	27.5	25.4	25.5	25.6	27.7
Currency/deposit ratio	27.9	35.9	33.4	31.4	33.8	36.3	31.9	32.9	33.6	38.0	34.0	34.3	34.4	38.3
Foreign currency deposits/total deposits	55.8	53.2	55.2	57.0	55.3	53.3	54.9	55.7	55.5	55.1	54.6	54.3	54.2	50.9
							(Real index, Dec. 1995=100)							
Broad money	38.6	41.6	39.2	39.7	40.5	43.4	43.1	43.6	45.4	45.6	43.5	44.8	47.7	50.2
Lev money	29.9	34.8	31.6	30.9	32.6	36.3	34.6	34.7	36.5	37.6	35.4	36.7	39.2	43.6
Credit, non-government	36.5	38.1	37.3	39.3	38.3	39.1	39.6	40.1	36.9	35.8	34.8	35.6	37.7	39.9
of which by operating banks 3/	36.5	50.8	51.0	54.6	54.8	57.7	57.8	60.1	60.4	60.6	58.9	60.6	64.8	69.7
							(In percent of GDP, end of period)							
Ratio to nominal GDP														
Broad money	27.1	28.4	33.1	30.8	26.1	28.3	36.9	32.5	28.4	29.9	35.6	33.7	27.9	30.7
Lev money	15.3	17.3	19.4	17.5	15.3	17.2	21.5	18.9	16.6	17.9	21.1	20.1	16.7	19.4
Reserve money	9.8	10.3	11.6	10.8	9.0	10.5	12.6	11.2	9.4	10.5	12.0	11.4	9.2	10.8

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

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

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

3/ Real index, December 1997 = 36.5.

Table 7. Bulgaria: Balance of Payments, 1998-2006

	1998	1999	2000		2001		2002	2003	2004	2005	2006
			Fourth Rev. Proj.	Estimate	Fourth Rev. Proj.	Projection	Proj.	Proj.	Proj.	Proj.	Proj.
					(In millions of U.S. dollars)						
Current account balance	-62	-685	-585	-696	-563	-608	-584	-552	-610	-637	-682
Trade balance	-381	-1,081	-1,128	-1,173	-1,109	-1,107	-1,092	-1,069	-1,095	-1,106	-1,146
Exports 1/	4,193	4,006	4,782	4,808	5,249	5,117	5,507	5,918	6,391	6,888	7,436
Imports 1/	4,574	5,087	5,911	5,981	6,358	6,224	6,599	6,987	7,486	7,994	8,581
Services and income balance	89	97	170	187	167	225	256	283	293	285	311
Receipts	2,094	2,053	2,358	2,497	2,571	2,659	2,861	3,011	3,173	3,351	3,527
Of which: Interest	307	223	258	...	297	253	308	335	364	389	411
Of which: Tourism	...	930	1,100	1,074	1,173	1,174					
Payments	2,005	1,956	2,188	2,310	2,403	2,434	2,606	2,728	2,880	3,066	3,216
Of which: Interest	531	480	561	513	662	668	698	656	615	587	514
Transfers, net	230	300	373	290	378	274	252	235	192	184	152
Capital account balance	181	731	651	796	895	958	1,057	1,062	1,081	1,046	1,134
Foreign direct investment, net	537	789	600	973	500	800	800	700	700	750	800
Portfolio investment, net	-180	-199	-80	-168	-70	-70	-70	-60	-60	-60	-60
Official grants (project related)	0	0	100	77	188	213	197	231	228	228	228
Medium- and long-term financial capital, net	115	353	234	-36	357	0	140	211	249	163	201
Disbursements	593	709	664	467	929	584	722	738	714	710	720
Amortization	479	356	430	503	572	584	582	528	466	547	519
Short-term trade credits, net	9	79	50	91	50	120	100	100	85	85	85
Other short-term capital, net 2/	-44	-88	-120	-84	-130	-105	-110	-120	-120	-120	-120
Errors and omissions, net	-256	-203	-133	-57	0	0	0	0	0	0	0
Overall balance	118	46	65	100	332	349	473	510	471	409	452
Financing	-117	-46	-65	-100	-477	-350	-474	-510	-472	-409	-451
Change in BNB gross foreign assets (increase:-)	-521	-208	-205	-238	-298	-176	-214	-408	-376	-267	-298
Obligations deferred/rescheduled	278	0	0	0	0	0	0	0	0	0	0
Change in arrears	-4	0	0	0	0	0	0	0	0	0	0
Use of Fund credit, net	130	162	140	138	-179	-174	-260	-102	-95	-142	-153
Financing gap	0	0	0	0	145	0	0	0	0	0	0
Memorandum items:											
Total external debt	10,025	9,890	10,255	10,371	10,397	9,923	9,876	9,860	9,771	9,606	9,271
Medium- and long-term external debt	9,744	9,504	9,869	9,699	10,011	9,537	9,490	9,474	9,385	9,220	8,885
of which: Public debt, incl guarantees	9,288	9,086	9,484	9,230	9,680	9,158	9,241	9,209	9,058	8,804	8,346
External debt service/exports of GNFS (in percent)	19.0	15.8	15.9	16.7	19.8	20.9	19.2	15.0	12.8	13.0	11.3
External debt service/GDP (in percent)	9.7	7.7	8.8	9.7	10.9	11.4	10.2	7.8	6.5	6.5	5.5
Gross official reserves (including gold)	3,056	3,222	3,427	3,460	3,725	3,636	3,850	4,258	4,634	4,901	5,199
(in months of imports of GNFS)	(6.1)	(5.9)	(5.5)	(5.1)	(5.5)	(5.5)	(5.4)	(5.7)	(5.7)	(5.7)	(5.6)
					(In percent of GDP)						
Current account balance	-0.5	-5.5	-4.5	-5.8	-3.9	-4.4	-3.8	-3.4	-3.4	-3.2	-3.2
Trade balance	-3.1	-8.7	-8.8	-9.7	-7.7	-8.0	-7.1	-6.5	-6.1	-5.6	-5.3
Total external debt	81.8	79.7	79.6	86.0	72.6	71.5	64.1	59.9	54.2	48.7	43.0
Medium- and long-term external debt	79.5	76.6	76.6	80.4	69.9	68.8	61.6	57.6	52.1	46.7	41.2
					(Percent change)						
Real GDP	3.5	2.4	4.5	5.0	5.0	5.0	5.0	5.0	5.5	5.5	5.5
Growth in domestic demand	13.9	7.1	1.5	0.9	4.7	4.4	4.3	5.3	5.2	5.2	5.2
Import volume	11.1	8.2	4.5	3.1	11.2	4.8	6.2	6.7	6.7	6.5	6.5
Export volume	-8.6	-4.7	11.4	15.9	9.4	6.4	6.4	6.5	6.5	6.4	6.4
Volume of partner imports	3.1	0.1	8.8	10.3	7.5	7.6	7.1	6.7	6.5	6.4	6.4
Import unit value	-8.2	2.8	13.3	14.0	-1.3	-1.5	-0.2	-0.8	0.4	0.3	0.8
Export unit value	-4.6	0.3	6.0	3.5	1.0	-0.2	1.2	0.9	1.4	1.3	1.5
Terms of trade	4.0	-2.5	-4.2	-9.2	1.8	1.3	1.4	1.7	1.0	1.0	0.7

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: Projected Payments to the Fund
(as at January 31, 2001 in millions of SDRs)
(Purchases under expectation schedule)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	Beyond	Total
Obligations from existing drawings											
1. Principal											
a. Repurchases	202.8	195.2	76.6	70.7	95.9	95.9	95.9	78.5	52.3	17.4	981.2
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
2. Charges and Interest 1/											
a. on Fund credit	49.9	37.2	29.4	25.8	21.7	16.7	11.6	6.7	2.8	0.6	202.5
b. on use of SDRs	(0.6)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.6)
Total obligations 2/	252.7	232.4	106.0	96.5	117.6	112.6	107.5	85.2	55.1	18.0	1,183.2
(percent of quota)	39.5	36.3	16.6	15.1	18.4	17.6	16.8	13.3	8.6	2.8	184.8
Obligations from prospective drawings											
1. Principal											
a. Repurchases	0.0	0.0	0.0	0.0	17.4	34.9	34.9	17.4	0.0	0.0	104.6
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
2. Charges and Interest 1/											
a. on Fund credit	3.3	5.5	5.5	5.5	5.5	4.1	2.3	0.5	0.0	0.0	32.4
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
Total obligations 2/	3.3	5.5	5.5	5.5	22.9	39.0	37.2	17.9	0.0	0.0	137.0
(percent of quota)	0.5	0.9	0.9	0.9	3.6	6.1	5.8	2.8	0.0	0.0	21.4
Cumulative (existing and prospective)											
1. Principal											
a. Repurchases	202.8	195.2	76.6	70.7	113.3	130.7	130.7	95.9	52.3	17.4	1,085.8
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
2. Charges and Interest 1/											
a. on Fund credit	53.2	42.7	35.0	31.3	27.2	20.8	13.9	7.2	2.8	0.6	234.9
b. on use of SDRs	(0.6)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(0.6)
Total obligations 2/	256.0	237.9	111.6	102.0	140.6	151.6	144.7	103.1	55.1	18.0	1,320.2
(percent of quota)	40.0	37.2	17.4	15.9	22.0	23.7	22.6	16.1	8.6	2.8	206.2

Source: Staff projections.

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 June 1, 2000.

Table 9. Bulgaria: General Government, 1999-2001
(In millions of leva)

	1999	2000			2001	
	Actual	Budget	Fourth Review	Prel. Actual	Fourth Review	Budget
Total revenue and grants	9,190	9,361	10,361	10,241	10,739	10,762
Tax revenue	6,992	7,763	8,271	7,968	8,607	8,455
Profit taxes	748	823	813	735	783	787
Income taxes	1,056	1,026	1,130	1,104	1,075	1,092
VAT	1,927	1,974	2,310	2,357	2,472	2,528
Excise duties	691	764	782	813	886	902
Customs duties	259	200	230	221	228	139
Social insurance contributions	1,883	2,348	2,429	2,203	2,567	2,410
Pension fund	1,563	1,722	1,786	1,604	1,866	1,775
Unemployment fund	148	192	169	149	193	163
Health Insurance Fund	173	434	475	450	508	472
Other taxes 2/	428	629	578	535	597	598
Nontax revenues	1,995	1,596	1,894	2,085	1,902	2,032
BNB transfers	90	0	137	137	130	130
Other	1,906	1,596	1,757	1,948	1,772	1,902
Grants and donations	203	1	196	188	230	275
Total expenditure and net lending	9,412	9,714	10,715	10,509	11,149	11,184
Noninterest expenditure, net lending, contingency	8,514	8,560	9,579	9,411	9,875	9,811
Current noninterest expenditure	7,151	7,434	8,254	8,083	8,588	8,634
Compensation	1,208	1,211	1,408	1,405	1,431	1,421
Wages and salaries	1,182	1,185	1,381	1,377	1,403	1,393
Scholarships	26	26	27	28	28	28
Maintenance and operations	1,749	1,660	1,802	1,976	1,678	1,797
Defense and security	998	878	980	905	998	998
Subsidies	391	208	319	247	264	237
Social expenditures	2,808	3,464	3,732	3,550	4,217	4,181
Pension fund	1,954	2,235	2,335	2,364	2,539	2,590
Assistance	491	571	625	615	642	669
EU/WB assistance	0	72	72	0	0	0
Unemployment	187	176	251	209	259	242
Health Insurance Fund	93	187	187	127	495	399
Other social expenditures	0	224	261	235	282	281
Extrabudgetary funds	-4	12	13	0	0	0
Capital expenditures	1,076	782	985	952	1,087	914
Of which: financed by the EU grants	...	...	...	...	...	100
State reserve	0	14	0	0	0	0
Net lending	-28	31	41	64	0	19
Contingency	315	299	299	311	200	245
Enterprise restructuring	291	69	69	110	40	60
Other contingency	0	200	200	165	120	145
Natural disaster	24	30	30	36	40	40
Primary balance	676	800	782	830	864	950
Interest	898	1,154	1,137	1,099	1,275	1,373
External	690	833	858	834	965	1,063
Domestic	208	321	279	265	310	310
Overall balance	-223	-354	-355	-269	-410	-423
Financing	223	354	355	269	410	423
External (net)	42	-47	-46	-404	-290	-31
Domestic (net)	-322	86	86	328	367	-6
Net banking system	-322	86	86	314	367	-6
Net nonbank	0	0	0	14	0	0
Privatization	503	315	315	345	333	460
Memorandum item:						
Total expenditure on pensions	...	2,294	2,394	2,529	2,539	2,590
Fiscal Reserve Account (in US$ million)	1,336	1,272	1,249	1,153	940	950
Nominal GDP in millions of leva	22,776	23,472	25,587	25,587	28,075	28,747

Sources: Ministry of Finance; and staff projections.

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

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

Table 10. Bulgaria: General Government, 1999-2001
(In percent of GDP)

	1999	2000			2001	
	Actual	Budget	Fourth Review	Prel. Actual	Fourth Review	Budget
Total revenue and grants	40.3	39.9	40.5	40.0	38.3	37.4
Tax revenue	30.7	33.1	32.3	31.1	30.7	29.4
Corporate income tax	3.3	3.5	3.2	2.9	2.8	2.7
Personal income tax	4.6	4.4	4.4	4.3	3.8	3.8
VAT	8.5	8.4	9.0	9.2	8.8	8.8
Excise duties	3.0	3.3	3.1	3.2	3.2	3.1
Customs duties	1.1	0.9	0.9	0.9	0.8	0.5
Social insurance contributions	8.3	10.0	9.5	8.6	9.1	8.4
Other taxes 2/	1.9	2.7	2.3	2.1	2.1	2.1
Nontax revenues	8.8	6.8	7.4	8.1	6.8	7.1
Grants	0.9	0.0	0.8	0.7	0.8	1.0
Total expenditure and net lending	41.3	41.4	41.9	41.1	39.7	38.9
Noninterest expenditure, net lending, contingency	37.4	36.5	37.4	36.8	35.2	34.1
Current non-interest expenditure	31.4	31.7	32.3	31.6	30.6	30.0
Compensation	5.3	5.2	5.5	5.5	5.1	4.9
Maintenance and operations	7.7	7.1	7.0	7.7	6.0	6.3
Defense and security	4.4	3.7	3.8	3.5	3.6	3.5
Subsidies	1.7	0.9	1.2	1.0	0.9	0.8
Social expenditures	12.3	14.8	14.6	13.9	15.0	14.5
Pensions	8.6	9.5	9.1	9.2	9.0	9.0
Assistance	2.2	2.4	2.4	2.4	2.3	2.3
EU/WB assistance	0.0	0.3	0.3	0.0	0.0	0.0
Unemployment	0.8	0.7	1.0	0.8	0.9	0.8
Health Insurance Fund	0.4	0.8	0.7	0.5	1.8	1.4
Other social expenditures	0.0	1.0	1.0	0.9	1.0	1.0
Extrabudgetary funds	0.0	0.1	0.1	0.0	0.0	0.0
Capital expenditures	4.7	3.3	3.9	3.7	3.9	3.2
Of which: financed by the EU grants	...	...	...	...	...	0.3
State reserve	0.0	0.1	0.0	0.0	0.0	0.0
Net lending	-0.1	0.1	0.2	0.3	0.0	0.1
Contingency	1.4	1.3	1.2	1.2	0.7	0.9
Primary balance	3.0	3.4	3.1	3.2	3.1	3.3
Interest	3.9	4.9	4.4	4.3	4.5	4.8
External	3.0	3.5	3.4	3.3	3.4	3.7
Domestic	0.9	1.4	1.1	1.0	1.1	1.1
Overall balance	-1.0	-1.5	-1.4	-1.0	-1.5	-1.5
Financing	1.0	1.5	1.4	1.0	1.5	1.5
External (net)	0.2	-0.2	-0.2	-1.6	-1.0	-0.1
Domestic (net)	-1.4	0.4	0.3	1.3	1.3	0.0
Privatization	2.2	1.3	1.2	1.3	1.2	1.6
Memorandum items:						
Total expenditure on pensions	...	9.8	9.4	9.9	9.0	9.0
Fiscal Reserve Account in US$ million	1,336	1,272	1,249	1,153	940	950
Nominal GDP in million leva	22,776	23,472	25,587	25,587	28,075	28,747

Sources: Ministry of Finance; and staff projections.

1/ To make 2001 projections comparable with the 2000 figures, the activities of the air traffic control fund, which exited the general government sphe enterprise, should be added back. This would increase non-tax revenues by 152 million leva, wages by 30 million leva, maintenance and operations by 5 capital expenditure by 123 million leva.

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

Bulgaria: Fund Relations

As of January 31, 2001

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	1,588.70	248.2
Reserve position in Fund	32.74	5.1

III. SDR Department:	SDR Million	%Allocation
Holdings	31.57	N/A

IV. Outstanding Purchases and Loans:	SDR Million	%Quota
Stand-by arrangements	350.43	54.7
Extended arrangements	523.00	81.7
Contingency and Compensatory	40.00	6.2
Systemic Transformation	67.80	10.6

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	523.00
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				
	1/31/2001	2001	2002	2003	2004	2005
Principal		202.8	195.2	76.6	70.7	95.9
Charges/Interest		49.9	37.2	29.4	25.8	21.7
Total		252.7	232.4	106.0	96.5	117.6

B. Nonfinancial Relations

VII. Exchange Rate Arrangement

On July 1, 1997, an amendment to the Law on the Bulgarian National Bank (BNB) effectively established a currency board arrangement. The deutsche mark was chosen as the peg currency, and the lev was pegged at the rate of lev 1,000 per DM 1, close to the market rate at that time. Effective January 1, 1999, the euro replaced the deutsche mark as a peg at the rate of lev 1,955.83 per € 1. The peg was changed to lev 1.95583 per € 1 with the redenomination of the Bulgarian lev on July 5, 1999. The BNB is required to sell and purchase on demand and without restriction currencies of the former EMU member countries for lev on the basis of spot exchange rates that may not differ from the official exchange rate by more than 0.5 percent.

VIII. Last Article IV Consultation

The last Article IV consultation was concluded on March 31, 2000 (see EBS/00/45). Bulgaria is on a 12–month cycle. The Acting Chairman's summing-up of the discussion was circulated as SUR/00/35. Bulgaria has accepted the obligations of Article VIII, Sections 2, 3 and 4 of the Articles of Agreement, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

IX. Resident Representative

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

X. Technical Assistance

Table 11 provides information on IMF technical assistance activities in Bulgaria.

Table 11. 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	Sep. 97-Sep. 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, Sep., Dec. 98	BNB
MAE	Information technology	Expert	Nov. 98	BNB
MAE	Cash processing	Expert	Dec. 98	BNB
MAE	Foreign exchange	Expert	98/99 various visits	BNB
MAE	Payment system	Expert	Jan. 99	BNB
MAE	Banking supervision, organization and management	Mission	Mar./Apr. 99	BNB
MAE	Accounting	Expert	June & Aug./Sep.99	BNB
MAE	Transparency Report/Based Core Principles	Mission	July 99	BNB
MAE	Deposit insurance	Mission	Oct. 99	BNB
MAE	Payment system/liquidity management/ bank bankruptcy legislation	Mission	May 00	BNB
MAE	Bank bankruptcy legislation	Expert	June 00	BNB
MAE	Foreign exchange	Mission	Nov. 00	BNB
MAE	Accounting	Mission	Dec. 00	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	Sep. 97	MOF
FAD	Tax and customs administration	Mission	Sep. 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	Sep. 99	MOF
FAD	Unified revenue agency (URA)	Mission	Jan.-Feb. 00	MOF
FAD	Tax administration	Mission	May 00	MOF
FAD	Short-term resident advisor on the URA	Expert	May-June 00	MOF
FAD	Social security administration	Expert	June 00	MOF
FAD	Long-term resident advisor	Expert	Sep. 00-Sep. 01	MOF
STA	Producer prices	Mission	Apr. -May 98	NSI
STA	BOP statistics	Mission	June-July 99	BNB
STA	GDDS	Mission	July 99	BNB
STA	National accounts	Mission	Nov. 99	NSI
STA	Price statistics	Mission	June 00	NSI
STA	BOP statistics	Mission	Dec. 00	BNB
EXR	Macroeconomic policies	Seminar	May 97	BNB/ Parliament

Bulgaria: World Bank Relations

Lending operations

1. The Bank has approved 23 loans to Bulgaria to date, of which 11 are active (Table 12). The most recent lending operation approved by the Bank's Board in September 2000, was the first phase of a proposed Adaptable Program Loan (APL) for Euro 15.3 million (US$14.4 million equivalent) for an Education Modernization Project in Bulgaria. The total amount of the APL is US$62 million equivalent, to be implemented in three phases over a nine-year period. The main objectives of the APL are to improve the efficiency of resource utilization and the quality and relevance of education at all levels.

2. The Bank's Board discussed a Country Assistance Strategy (CAS) for Bulgaria in May 1998. The priorities for Bulgaria's development strategy are as follows: (i) accelerating structural reforms 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 strategy 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. The IMF and World Bank staff maintain a close collaborative relationship in supporting the Government's structural reforms. Preparation for a new CAS has been initiated covering the period from fiscal year 2002 to 2004, and scheduled for completion in the fourth quarter of 2001.

I. Technical Assistance

3. The Bank continues to provide technical and advisory assistance to the Government in several areas, including bank and enterprise restructuring and divestiture, external debt monitoring, agricultural, environment and energy sectors reforms, reform of the social protection system, and legal and administrative reforms.

II. Economic and Sector Work

4. Since the first Country Economic Memorandum (Bulgaria: Crisis and Transition to a Market Economy) was distributed to the Executive Directors in February 1991, the Bank has undertaken several analytical work in a number of key areas. These include sector studies on agriculture, energy, environment, taxation, privatization, social, and telecommunications. Economic Progress Reports were also prepared for the Consultative Group Meetings.

5. A new CEM has recently been completed; it will present 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 12. Bulgaria: World Bank Lending Operations

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

[1] Of which US$4.8 million was cancelled in 1998.
[2] Of which US$13 million was cancelled in 2000.
[3] Of which US$40.9 million was cancelled in 1997.
[4] Of which US$41 million was cancelled and US$12 million reallocated to the District Heating component in 1997.
[5] Cancelled in 1997.
[6] Of which US$35.1 million was cancelled in 2000.

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

2. Bulgaria is a participant in the GDDS and has posted metadata on the Data Standards Bulletin Board since May 2000. Also, the authorities have made good progress toward provision of data to the Fund in the areas of reserves, external debt, and foreign-currency liquidity in line with SDDS-based benchmarks. A task force, which was created to implement these benchmarks, is finishing its work on official reserves and other foreign currency assets. The task force expects to finalize its work soon, and monthly information on the reserves according to the benchmarks will be published.

Real sector

3. The National Statistical Institute (NSI), with technical assistance from OECD, has established a 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.

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

5. The NSI has also compiled estimates of quarterly GDP by expenditure categories for the period beginning first quarter of 1994 through the second quarter of 2000, based on 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. However, significant progress has been made in the development of export and import deflators.

6. A new PPI that uses a Laspeyres index formula with 1995 as the base period was introduced in January 1998. The PPI is undergoing a revision in which detailed product

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

7. The consumer price index (CPI) provides a reasonable measure of inflation and price developments in Bulgaria. The short-term recommendations of the April-May 1998 technical assistance mission have all been implemented with the exception of a method for imputing missing indices for seasonal items. The mission recommended that a short-term relative method be used rather than the long-term relative method used by the CPI division. The NSI decided to implement this recommendation starting in 2001. The NSI has completed a linking exercise to link annual Laspeyres price indices together, producing a time series that begins in 1995. The series also follows the new classifications and index methods recommended by Eurostat and STA, and has been published as the official CPI. In 2000, a new price concept which is sensitive to seasonal changes in volume has been introduced into the heating component of the CPI. The June 2000 technical assistance mission recommended that either the old methodology be used or that the NSI revise the monthly series for the previous year to conform to the new concept. Following the STA recommendation, the NSI decided to revert to the old methodology in 2001, and will publish revised data for 2000. The flow of customs data has improved dramatically since the April-May 1998 mission and a new system for processing customs records is near completion. The development of export and import unit value indices is progressing smoothly and additional support is expected from Eurostat in this area. The current indices can be used effectively as deflators for the import and export components of the national accounts. The Import and Export Division meets monthly with the Bulgarian National Bank to review data issues and ensure consistency between the NSI export and import data and the balance of payments data.

8. The lack of comprehensive labor statistics hampers the assessment of developments in employment and wages, especially in the private sector. Annual data are collected by the NSI, using a census of all establishments. The NSI also obtains current estimates from a monthly survey of establishments using all public employers and a sample of private employers (excluding establishments with less than 5 employees, and including about 10,000 private employers out of approximately 69,000 qualifying establishments). The main shortcomings of these data include: (i) the under-reporting of private sector wages ; (ii) the reporting of only average gross earnings, not wages for time worked and wages by occupation ; and (iii) the lack of coverage of self-employed and employment in small firms. Plans for improvement include using National Social Security Institute (NSSI) data to estimate wages by occupation and age and the number of self-employed and employment in small firms. The household budget survey could provide an alternative source of data for private sector wages. Regarding employment, the NSI household labor force survey is an alternative source of data, but improvements are needed to make it more consistent with the

establishment survey, especially regarding agricultural employment. The survey also needs to be conducted on a consistent schedule, bi-annually or quarterly. It has been conducted twice a year since 1993 (three times a year since 1999), but at irregular intervals. From 2001 onward, the NSI intends to conduct the survey on a quarterly basis. Also, Eurostat has been providing support since mid-2000 in the context of a pilot project ending in mid-2001 to improve the labor force survey's compliance with Eurostat recommendations.

Government finance

9. 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 1999 reviewed progress under the budget execution reform program, assisted the MoF with the development of a new chart of accounts for the government sector, and provided advice on the implementation of accrual accounting for government, budgetary, and the statistical system. The mission also examined possible actions to improve fiscal transparency in line with the Experimental Report on the Implementation of Standards and Codes prepared in August 1999.

Money and banking statistics

10. 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

11. Bulgaria reports monthly balance of payments data on a regular and timely basis, but data are subject to frequent and substantial revisions. An IMF technical assistance mission in December 2000 made a number of recommendations to strengthen the balance of payments and external debt compilation systems, which included the development of a closed-type of international transactions reporting system, the development of estimates of "shuttle trade" with countries bordering Bulgaria, strengthening the methodology for travel transactions, and compiling information on trade credit liabilities.

Table 13. Bulgaria: Core Statistical Indicators as of February 28, 2001

	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. 28, 2001	Feb. 23, 2001	Feb. 23, 2001	Feb. 23, 2001	Feb. 16, 2001	Feb. 16, 2001	January 2001	December 2000	December 2000	Jan. 31, 2001	Q3 2000 (qtrly) 1999 (annual)	Jan. 2001
Date Received	Feb. 28, 2001	Feb. 26, 2001	Feb. 26, 2001	Feb. 26, 2001	Feb. 23, 2001	Feb. 23, 2001	Feb. 14, 2001	Feb. 27, 2001	Feb. 27, 2001	Feb. 20, 2001	Jan. 12, 2001	Feb. 22, 2001
Frequency of Data	Daily	Daily	Daily	Daily	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Bi-weekly	Quarterly Annually	Monthly
Frequency of Reporting	Daily	Weekly	Weekly	Weekly	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Bi-weekly	Quarterly Annually	Monthly
Source of Update	BNB	BNB	BNB	BNB	BNB	BNB	NSI	BNB	BNB	MoF	NSI	MoF and BNB
Mode of Reporting	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from NSI	Email from BNB	Email from BNB	Email/fax from RR	Email from NSI	Posted on the BNB website
Confidentiality	No	Yes	Yes	Yes	No	No	No	No	No	No	No	No
Frequency of Publication	Daily	Daily	Daily	Daily	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly

Sofia, Bulgaria, March 7, 2001

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

Dear Mr. Köhler:

The Government of Bulgaria has continued to implement sound stabilization and reform policies under its three-year economic program supported under the extended arrangement. Our fiscal policy has been prudent, and we observed all performance criteria for end-December 2000. Reflecting our sustained sound policies, recent macroeconomic developments have been broadly favorable. GDP growth in 2000 was very strong, and the current account deficit and inflation were kept under control.

We believe that our three-year program, which is nearing completion, has improved Bulgaria's economic situation dramatically. We have achieved macroeconomic stabilization, reduced the external debt burden, privatized the bulk of the enterprise and banking sectors, and initiated the restructuring of the infrastructure monopolies. Building on these achievements, we are now well positioned to put Bulgaria on the path of sustained robust growth and improved living standards, while preparing for EU accession.

Encouraged by the strong results, we are determined to stay on course and complete our three-year program successfully. The attached Memorandum on Economic Policies of the Government of Bulgaria describes the progress made and measures that we will implement during the remaining term of the program. On the basis of performance under the arrangement so far and the policies described in the Memorandum, we request the completion of the fifth review under the arrangement.

The Government of Bulgaria believes that the policies described in the Memorandum are adequate to achieve the objectives of its economic program, but also 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/	/s/
Muravei Radev	Svetoslav Gavriiski
Minister of Finance	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. **Over the past year, we have persevered with an ambitious adjustment and reform strategy based on a currency board arrangement (CBA).** Fiscal policy has remained prudent, with the general government deficit limited to 269 million leva (1 percent of GDP) in 2000. Incomes policy for state enterprises has been implemented strictly, with the total wage bill of the worst-performing companies continuing to decline. Notable achievements in structural reform during 2000 included the sale of our largest bank (Bulbank), the launching of the new pension and health care systems, the break-up of the electricity monopoly into its generation, transmission, and distribution components, and the removal of a large number of licensing and regulatory requirements.

2. **Our sustained policy efforts have paid off, as we are now experiencing a robust economic recovery.** Led by exports, GDP growth in 2000 is estimated to have reached 5 percent, the highest rate since the 1980s. This has helped to create a large number of jobs in the private sector, although unemployment remains high at 18 percent, in part reflecting labor shedding in the public sector. The rapid growth is remarkable as it was achieved despite a summer drought and high international energy prices. These factors, together with a weak euro, raised inflation and the current account deficit above the originally projected levels, but both remain under control. While consumer price inflation reached 11.4 percent during 2000, this did not weaken our competitiveness, as strong productivity growth helped our exports to increase by 20 percent in U.S. dollar terms. The current account deficit of US$696 million (5.8 percent of GDP) in 2000 was fully financed by foreign direct investment and other inflows. Confidence in the lev and the CBA remains strong, with gross official reserves at US$3.5 billion and the fiscal reserve account at US$1.1 billion at end-2000.

3. **Encouraged by the positive results, we remain fully committed to sound 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.** As in the past, the memorandum contains a comprehensive statement of our objectives and policy intentions. Hence, it describes our initiatives in a wide range of economic areas, with detailed steps and their timing outlined in the Appendix. The measures covered by Fund conditionality are listed in Table 1 and Annexes I–VIII.

B. Macroeconomic Objectives and Policy Framework

4. **Our main medium-term objectives remain sustained GDP growth of at least 5 percent annually and a fully competitive market economy.** These are key to lowering unemployment and enabling Bulgaria to join the EU.

5. **For 2001, we have updated our objectives in light of recent developments (see tabulation below).** With productivity gains from enterprise restructuring and a projected

favorable external environment, including continued strong growth in Europe, we expect to be able to maintain GDP growth at 5 percent. The projected lower international energy prices, a stronger euro, and maintained wage discipline should help inflation to decline to 4.5 percent. With good prospects for exports and a reduced oil import bill, we project the current account deficit to decline to 4.5 percent of GDP. Continued strong foreign direct investment flows and financing from multilateral institutions should allow us to maintain the fiscal and foreign exchange reserves at comfortable levels.

	2000		2001	
	4th Review	Est.	4th Review	Proj.
GDP growth (real; in percent)	4.5	5.0	5.0	5.0
CPI inflation				
(end of period; in percent)	6.0	11.4	3.5	4.5
Gross official reserves				
(end of period; in billions of US$)	3.4	3.5	3.7	3.6
(end of period; in months of imports)	5.5	5.4	5.5	5.5
External current account deficit				
(in percent of GDP)	4.5	5.8	3.9	4.5
Fiscal reserve account				
(in billions of US$)	1.1	1.1	1.0	1.0

6. **To achieve these objectives, we will continue to follow our CBA-based adjustment strategy which has served Bulgaria well.** Hence, we will implement prudent fiscal and incomes policies to underpin the CBA and preserve competitiveness, and vigorous structural reforms to promote private sector initiative and investment. Our priorities in the structural area include completing the privatization program in non-infrastructure areas, restructuring the energy monopolies, ensuring the success of ongoing major institutional reforms (including in health care and pensions), creating a better business climate, promoting a sound financial sector, and continuing trade liberalization.

C. Fiscal Policy

7. **We aim at a broadly neutral fiscal stance in 2001, while preserving flexibility to respond to unforeseen developments.** Last year, we maintained the general government deficit at 1 percent of GDP, well within the budgeted level. At the same time, owing to higher-than-projected revenues we were able to effect one-time spending increases above budgeted levels in priority areas, including social assistance and investment, and in wages and pensions. For 2001, parliament approved last December a budget with a general government deficit limit of 1.5 percent of GDP. In implementing this budget, we will follow the previous years' practice of limiting discretionary spending to 90 percent of the budget allocation during the first three quarters of the year. If inflation or the external current account deficit threaten to be higher than now projected, we are prepared to take any

measures necessary to preserve macroeconomic stability and a sustainable external position. Specifically, under these circumstances we are prepared to continue the 90 percent rule in the last quarter, unless there is a sizable revenue overperformance. Should revenues exceed budgeted levels, we would save the overperformance, primarily to create room for further tax cuts in 2002, provided the external position is not under threat. In assessing the fiscal position, we will count the proceeds from the sale of the second GSM license, net of associated costs of moving defense communications to different frequencies, toward financing the deficit.

8. **We aim to collect general government revenues equivalent to 37½ percent of GDP, while making significant cuts in direct taxes and social security contributions to promote private sector activity.** The tax cuts included reducing the personal income tax burden by 2 percentage points, the corporate profit tax rates by 5 points, and social contribution rates by 3 points. In addition, we allowed for accelerated depreciation of software products, streamlined patent (presumptive) taxation, and reduced the VAT refund period for non-exporters from 6 to 4 months. Finally, we continued to lower customs duties in line with our regional and multilateral commitments. With all these measures, we estimate tax revenue this year to be 1½ percent of GDP lower than last year. We had intended to offset some of the revenue loss by removing the zero rating of VAT on tour packages sold abroad, but parliament decided to postpone the removal by one more year. While we are resolved to remove the zero rating from the beginning of 2002, in the interim we have taken compensating measures. We have transferred certain large taxpayers in the services sector from presumptive to profit taxation, eliminated VAT refunds to those companies where false claims are discovered downstream, speeded up the collection of noncompliant VAT payments, and strengthened the fight against VAT fraud. Besides these measures, we are making every effort to further reduce arrears to the budget and the National Social Security Institute (NSSI). We are committed to reducing these arrears from the end-2000 level of 530 million leva by 30 million leva in the first quarter of this year, and by a further 90 million leva in the remainder of the year.

9. **We will contain general government expenditures to below 39 percent of GDP.** Given the increase in interest payments this year, noninterest expenditure will be limited to 34 percent of GDP, 2½ percentage points of GDP lower than last year. To achieve the targeted containment of expenditure, we will revert to our baseline expenditure levels following the one-time spending undertaken late last year that was afforded by the revenue overperformance. In addition, we will reduce subsidies to state enterprises through strengthened restructuring and improve financial discipline in the municipalities, as described below. We will also keep the budgetary sector wage bill on a comparable basis constant relative to GDP. As average staffing this year is expected to be 4½ percent below last year's level, reflecting reductions in 2000, we will be able to raise wages in April by 10 percent while leaving room for a moderate further increase in October. These wage increases, together with our World-Bank-supported efforts to link pay to performance and increase wage dispersion, should go some way toward enabling us to retain and attract high-quality staff. To preserve the real value of pensions while staying within the budget allocation, we will keep the July increase in pensions within 10 percent. We will also maintain the real

value of social assistance. Moreover, the budget includes expenditure contingencies of 0.9 percent of GDP, mainly to cover the unanticipated transitional costs of health and pension reform and one-time costs of enterprise restructuring.

10. **In 2001, we aim to strengthen the financial performance of the municipalities and the National Social Security Institute.** Last year, municipalities required 1 percent of GDP more central government support than budgeted. To prevent this from recurring, we have taken strong measures. In particular, we have increased penalties for fraud substantially, and improved the system to determine the allocation of central transfers to municipalities. Under this system, the central government transfers funds from municipalities with excess tax revenue to those with shortfalls, thus reducing the propensity to accumulate arrears, while giving municipalities an incentive to cover any residual revenue shortfall through nontax revenue which is under their full discretion. Regarding the NSSI, we are taking measures to ensure that its finances improve relative to last year. In 2000, the NSSI's financial position was weaker than budgeted, because the number of contributing employees fell markedly and because expenditures rose in part reflecting an unexpectedly large increase in early retirement before the start of the new pension system. Nevertheless, revenue collection began to pick up in the second half of the year as information sharing with the tax administration improved, targeted audits increased, and arrears collection strengthened. We will make every effort to continue this positive trend, including through increased cooperation with the tax administration, as described below.

11. **We are continuing efforts to create a unified revenue agency (URA) to strengthen our capacity to collect taxes and social contributions.** Guided by a comprehensive concept paper adopted by the Council of Ministers in June 2000, an inter-institutional commission has led this effort since last September. Under the supervision of this commission, the project team has helped to initiate joint audits of social contribution and personal income tax withholdings, draft laws to harmonize the bases for the income tax and social insurance and health contributions, produce a new income tax form, and prepare a concept paper for information technology (IT) in the URA. Looking forward, by mid-2001 the commission will approve a plan to concentrate the administration of central taxes in 28 district offices and to allocate local tax collection to the other offices. It will also prepare a plan to strengthen the large taxpayer offices. Moreover, an expert will be recruited to help refine the IT strategy. Revenue collection is also expected to benefit from amendments to the NSSI's regulation on elements of remuneration that will harmonize the base of social security contributions for the self employed with the personal income tax law. The Council of Ministers will adopt these regulations by end-March. To guide further work, the commission will approve and submit to the Council of Ministers a strategic plan for the next stages of the URA project by mid-2001. We will continue to work with World Bank and IMF experts in this area.

12. **We are at an advanced stage of our program to create a fully-functioning treasury.** By now, we have consolidated all government accounts in the Bulgarian National Bank into a Single Treasury Account (STA). We have also moved closer to consolidating the government's accounts in commercial banks into the STA by signing new contracts

with 19 commercial banks on the transit accounts. In addition, we have revised the chart of accounts for the general government and have started to set it up in the financial management and information system, which we have continued to modernize. First level budget units began operating under this system early this year, pilot second units will do the same in May, and the project will be completed in June 2001. To manage longer term IT infrastructure, we will issue a competitive tender.

13. **Pension reform is advancing on schedule.** The overhauled pay-as-you-go system remains widely accepted by the population. While we expect the new system's parameters to help restore the financial viability of this pillar, we are prepared to review the system periodically and adjust its parameters as necessary to ensure its continued sustainability. We are also preparing for the introduction of the fully funded second pillar at the beginning of 2002. We have already licensed 10 mandatory pension funds under this pillar, and most of the necessary regulations were issued in August 2000. To ensure the viability of the second pillar, we will by end-September prepare a development plan that (i) will include a clear definition of social security contributions to be allocated to this pillar and a scheme for financing the transition costs and (ii) will promote the efficient administration of workers' savings. Regarding voluntary pension insurance (the third pillar), we will continue to develop the regulatory framework and supervisory capacity further.

14. **Health care reform is entering its second stage.** The outpatient care reform that we launched in mid-2000 was successful, as we met our health care objectives while keeping the costs within budgeted limits. We are now gearing up to introduce hospital care reform in July. In preparation, we have transformed hospitals from budget units to commercial enterprises. To ensure the financial soundness of this stage of the reform, an interministerial working group prepared a framework plan in November 2000, and will finalize a detailed action plan in March 2001. The plan envisages that the National Health Insurance Fund will initially cover 20 percent of hospital care costs, and that this rate will increase gradually in the medium term. With World Bank assistance, we have also established cost and quality control measures on health services and drugs. Moreover, in March we will issue guidelines for wage formation in the health sector aimed at preventing cost escalation.

15. **We are constantly improving our medium-term fiscal framework.** We already make rolling three-year projections that are consistent with our medium-term strategy. We aim at a broadly balanced budget, with actual deficits of up to 2 percent of GDP to cover one-time costs of structural reform. On the revenue side, we aim to reduce those tax and social contribution rates that most distort economic activity, while improving revenue collection to maintain the revenue-to-GDP ratio at around 38–39 percent. On the expenditure side, we aim to keep noninterest spending within 35 percent of GDP. In preparation for the submission of our Pre-Accession Economic Program to the EU in May, we are in the process of defining our medium-term expenditure priorities, including the spending needs of NATO and EU accession. We will ensure that our medium-term fiscal projections and priorities remain consistent with fiscal and external sustainability.

D. Labor Market Policies

16. **To impose hard budget constraints and enhance productivity, we will maintain a strict incomes policy for state enterprises.** The incomes policy ordinance for 2000 was implemented successfully. In particular, the enterprises that we monitor most closely (97 companies with the largest losses and arrears, state monopolies, and enterprises receiving subsidies), reduced their combined wage bill by 8.4 percent between the third quarter of 1999 and the same period in 2000. For 2001, we recognize that wage discipline remains necessary to preserve competitiveness, and will issue an incomes policy ordinance broadly along the lines of that for 2000, maintaining a strong link between wages and financial performance in all state enterprises. We will, however, introduce two adjustments in the policy for the most closely monitored companies. First, since the magnitude of problems in the state enterprise sector has been significantly reduced during our IMF-supported program, we will streamline the list of monitored enterprises to include only those that have a significant macroeconomic impact. This will also enable us to enhance our monitoring of the most problematic companies. The updated list of 60 enterprises will include companies accounting for 90 percent of total losses and arrears in state enterprises with over 100 employees, all state monopolies, and the largest companies that receive state subsidies. Second, we will make a moderate adjustment to the nominal wage bill ceiling (so far a freeze) for the companies on the updated list, as the scope for complying with the freeze through reductions in overmanning has in many cases been exhausted and as the higher-than-projected inflation has made the incomes policy even stricter than intended. Specifically, the wage bills of the companies on the updated list will be allowed to rise in 2001 by up to 5 percent from the third quarter of 2000. The limit on the combined wage bill of these companies is a structural performance criterion for end-March 2001. As before, we will take measures, including fining and firing of management, in enterprises with excessive wage increases. Regarding **minimum wages**, we will continue with the system of twice-a-year raises in line with the increase in the average public sector wage.

17. **We have taken steps to increase labor market flexibility**. Following extensive consultations with social partners, parliament approved amendments to the Labor Code in early March 2001. The amendments are consistent with EU and ILO standards, and they make it easier for firms to adjust their workforce to changes in the economic environment. Important changes include making working hours and compensation more flexible, and allowing termination of contracts for economic reasons. To alleviate the costs of labor market adjustment, we continue to implement several active labor market programs. Since last October, the state budget has financed programs (including microprojects under regional and municipal employment programs) targeted at regions with high unemployment. More than 50,000 unemployed persons have participated in these programs, and the 2001 budget provides funds for their continuation through the winter months.

E. Financial Sector Policies

18. **Our bank privatization program is nearing completion.** A new tender was issued for the sale of Biochim bank in September 2000, and by the January 24, 2001 deadline one

bid was received. We aim to sign the sale contract by end-April. We also intend to sell the remaining 34.3 percent state's share in the Central Cooperative Bank to a strategic investor, and in preparation for this the Council of Ministers decided in February to transfer the share held by the State Fund for Agriculture to the Bank Consolidation Company. DSK bank (formerly the State Savings Bank) continues to be state owned, but it has been brought fully under the legal and regulatory framework governing commercial banks. Further restructuring of DSK is taking place to diversify its activities and improve the bank's competitiveness in its core small loans and deposit taking markets. In January, the Council of Ministers decided to transfer 25 percent of the state's shares in DSK to the Bank Consolidation Company. We are considering floating the 25 percent stake on the Sofia Stock Exchange, while exploring the longer-term options for the bank, including the involvement of a strategic investor.

19. **With the proper regulatory framework for banking supervision now in place, our efforts to strengthen supervision focus on the quality of inspections, monitoring systems, and the quarterly reports on the state of the banking system and on compliance and enforcement.** A new bank bankruptcy law, which we expect parliament to adopt by March, will provide the Deposit Insurance Fund (DIF) improved legal tools to deal with closed banks. These changes in the legal framework, improved information sharing between the Bulgarian National Bank and the DIF, and additional training and staffing will allow the DIF to carry out more effectively its responsibilities. The banking sector will also benefit from a new payment system that is expected to be operational by end-2001 and that will allow for real time gross settlement.

20. **We intend to improve the functioning of financial markets in two main ways: by reducing the risk inherent in providing credit to the private sector (small and medium-size enterprises in particular), and by stimulating the development of corporate securities and equity markets.** To facilitate **private sector credit**, insolvency procedures have been streamlined following the adoption of an amendment to the Commercial Code last October, and the information content of the central credit registry is being strengthened. Moreover, in discussions with the Association of Commercial Banks we have identified the main remaining obstacles for creditors, and will take measures to remove these obstacles. In particular, by end-February the Council of Ministers will send to parliament amendments to the Civil Procedure Code to strengthen creditors' rights, including through making the collection of collateral easier. We expect parliament to approve these amendments before the end of the current session in May. We will, however, proceed very cautiously with further reductions in the minimum reserve requirement, as the July 2000 reduction from 11 to 8 percent did not significantly stimulate lending to the private sector but rather resulted in increased foreign deposits by banks. To develop the **domestic securities markets,** we will publicly offer and sell on the stock exchange large packages of shares of companies still to be privatized, as well as residual government shares in already privatized enterprises. We will also review the taxation regime for securities transactions and investment income.

F. Structural Reform

Enterprise restructuring and privatization

21. **The first phase of our privatization program is almost completed, and the second phase related to infrastructure assets is underway.** Through end-2000, we had privatized 77.5 percent of state-owned assets excluding infrastructure, and 51.2 percent of total assets. To facilitate the privatization of infrastructure assets and in response to a need to reassess our strategy after the sales of two very large enterprises proved unsuccessful, **amendments to the Privatization Act** were passed in November 2000. The amendments increase parliamentary oversight, improve transparency, and further curb the privileges of management-employee teams. A supervisory board composed of 7 members of different political parties will oversee the privatization process, and strategies for important deals will be subject to parliamentary approval. Changes in the management structure of the Privatization Agency, and increased access to information and competition among bidders as required by the new law, will make the process more transparent. Regarding **large enterprises,** we aim to conclude the remaining deals this year. We have formulated a new privatization strategy for the telecommunications company (BTC), incorporating lessons learned from the previous failed attempt and the successful sale of the second GSM license in December. The new strategy envisages widening the circle of bidders and attracting high-quality investors by allowing participation of financial companies, the sale of minority stakes, full transfer of management control regardless of the stake acquired, and attaching a third GSM license to the sale. We will submit the strategy to parliament by end-March, and will proceed expeditiously once parliamentary approval is received. We will also submit a revised strategy for the privatization of Bulgartabak to parliament by end-March, and will relaunch the privatization procedure for Balkancar. Moreover, we will start preparing the privatization of infrastructure assets, especially in the energy sector. We have also made substantial progress in divesting **residual shares**. Out of 1,069 minority share packages in non-strategic enterprises privatized by end-1999, more than two thirds have already been sold, one fifth transferred to the Center for Mass Privatization, and 5 offered for sale on the Sofia Stock Exchange. Excluding packages held due to restitution or legal problems, we expect the process to be completed by end-2001. As the government's holdings do not exceed 20 percent in any of the remaining companies and as the state no longer has representatives in their governing bodies, we have essentially achieved our objective of removing state interference from companies where the state held minority shares.

22. **We are making substantial progress in speeding up liquidation and bankruptcy proceedings.** Despite difficult market conditions, we have continued to dispose of the assets of Group B enterprises (commercial enterprises under the isolation program) entered into liquidation in 1999. Out of 14 enterprises, we have sold 5 and prepared 6 others for sale, and expect the process to be completed this year. For other enterprises in liquidation or bankruptcy, the above-mentioned amendment to the Commercial Code that simplifies and accelerates exit procedures is being implemented. To familiarize judges and trustees with the changes, the Institute for Magisterial Training is organizing seminars and information sessions with the help of foreign experts. Moreover, an inter-ministerial committee set up in

July 2000 is enforcing stricter requirements for the selection, removal, and supervision of liquidators for state enterprises. We have also improved the administration of enterprises under the purview of the Ministry of Economy by setting up a specialized commission in March 2000 to supervise the selection and activities of trustees in bankruptcy. The commission has been active in responding to issues raised by creditors and state bodies with respect to the behavior of receivers.

23. **We will continue the restructuring of the national railway company (BDZ).** Despite good efforts to implement its financial recovery program, including additional measures taken since mid-year, the financial situation of BDZ was worse than expected last year, owing mainly to higher oil prices and the impact of the strong U.S. dollar on debt service payments. In 2001, the company is taking strong additional measures to reduce its losses to 104 million leva from 150 million leva last year (both figures exclude a state subsidy of 60 million leva), and to reduce its arrears (amounting to 100 million leva at end-2000) substantially. The measures include raising freight fares by 20 percent from the beginning of the year and passenger fares by 15 percent from the beginning of February, further reductions in overstaffing in line with the financial recovery program, and continued sales of nonoperational assets. Looking forward, we will undertake this year the preparation of the company for its impending breakup into freight, passenger, and infrastructure components, as foreseen in the new Railway Law.

Energy sector reform

24. **We will continue to implement our ambitious reform plan aimed at establishing a more competitive and efficient energy sector.** The 1999 Energy and Energy Efficiency Act created a legal basis for our energy strategy. In line with this Act, we remain committed to introducing from the beginning of 2002 energy prices at all levels that will allow full economic cost recovery plus an adequate margin to all producers, the transmission company, and the distribution companies—all this under the authority of the State Energy Regulatory Commission (SERC). In preparation for this, in 2001 we will continue to adjust district heating and electricity prices to consumers based on an analysis of the financial condition of the companies in these sectors. This analysis, taking into account full capital and operating costs, will be ready and made available to World Bank and IMF staff by mid-2001. Based on it, the Council of Ministers will by end-September take the necessary actions, if any, to ensure a smooth transition to the new pricing regime, including an appropriate strengthening of the social protection program. Regarding other aspects of the energy strategy, we have since last summer worked on amendments to the Act to clarify and underpin our sector reform strategy and make it fully effective. While the work has taken longer than anticipated, we are determined to submit to parliament amendments to the Energy Act agreed with the World Bank no later than mid-March, and we expect parliament to make every effort to approve the amendments during the current session. These amendments will enable Bulgaria to establish gradually a market-based competitive energy sector. The basic principles underlying the amendments include having private companies carry the responsibility and risk for investing in new projects; allowing competitive commercial transactions at all market levels; and separating policymaking and ownership functions from regulatory and licensing

ones among government bodies. The ownership functions will be defined more precisely in the privatization strategy for the energy sector to be adopted by the Council of Ministers and approved by parliament during 2001.The amendments will also provide the legal basis to proceed with the action plan to commercialize the ailing district heating sector, and they will strengthen SERC's independence.

25. **In the electricity sector, the separation of the National Electric Company (NEK) into generation, transmission, and distribution companies has proceeded according to plan.** Helped by a sharp increase in exports and our efforts to reduce technological losses and improve financial discipline, the separate entities are generally profitable, albeit with accounting for depreciation at understated historical costs that are far below the capital costs that will be incurred for replacing our capacity in the future. Accounting profits for 2000 amounted to 100 million leva for the generation companies as a group, 260 million leva for the transmission company, and 32 million leva for the 7 new distribution companies. None of these successor companies have incurred arrears to suppliers, the budget, or the NSSI since the separation in mid-2000. The transmission company reduced its arrears of 157 million leva to the two nuclear funds by 71 million in the second half of the year, but it still has arrears of 86 million leva that were inherited from the old NEK. Looking forward, we will make every effort to improve the efficiency and financial position of the electricity companies so that the increase, if any, in prices to consumers this year is minimized. We are also preparing a strategy for privatizing the distribution companies. This strategy will be submitted to the Council of Ministers and parliament for approval during 2001.

26. **We will make all the necessary efforts to strengthen the implementation of the Action Plan adopted in mid-2000 for the district heating sector.** In September 2000 the Council of Ministers decided to withdraw central government subsidies from 3 district heating companies (DHCs) before this heating season, and identified 5 other DHCs from which central government subsidies will be withdrawn effective mid-2001. Moreover, in line with the plan, we have developed investment programs for 8 DHCs until 2004–05, and we have started their implementation using our own funds and external financing. However, because of the long discussions over the amendments to the Energy Act we failed to implement some components of this plan, including applying an obligatory fixed payment for disconnected customers in connected buildings. The combined losses of the DHCs for 2000 amounted to 95 million leva of which 90 million leva was covered by direct and indirect subsidies. The 3 DHCs which did not receive subsidies and the 5 DHCs for which subsidies will be discontinued after the current heating season managed to limit their losses to 36 million leva in 2000 through disconnection of large industrial customers which had defaulted on their payments. These as well as other DHCs achieved partial improvement of their collection rate, which for the DHCs as a whole averaged 76 percent during 2000, compared with 58 percent in 1999. Nevertheless, without further measures, and assuming that fuel prices remain at last year's level, financial losses in 2001 are expected to exceed 130 million leva, only 50 million leva of which will be covered by direct subsidies, while investments to the tune of 40 million leva will be needed to prevent further deterioration in the infrastructure. In view of these worrisome developments and prospects, we are determined to catch up with the original timetable of the action plan to the extent possible,

including through strengthened collection efforts, further discussions on financial burden sharing with the municipalities in cities with DHCs, and transfer of ownership to interested municipalities or private investors.

27. **The rehabilitation program for Bulgargaz continues to be implemented.** The company, however, concluded 2000 with a 2 million leva loss from its core activities (the total loss taking into account several one-off financial charges was 95 million leva), while remaining current on all its obligations. The company intends to improve its economic and financial performance in 2001, including through intensifying its efforts to raise collection rates from 93 percent in 2000 to 95 percent this year. It will also act promptly to prevent the build-up of arrears by major customers, DHCs in particular. Moreover, a privatization strategy for the gas distribution companies will be submitted to the Council of Ministers and parliament for approval during 2001. We also expect that once the amendments to the Energy Act are in place, large customers will be able to contract gas supplies from suppliers other than Bulgargaz and have access to the gas network at a nondiscriminatory fee under secondary regulations to be developed by SERC.

28. **The restructuring of the coal sector is proceeding in line with the revised action plan adopted in June 2000.** This plan aims at closing unviable coal mine sections, and preparing viable mining companies for privatization. In line with the plan, in the second half of 2000 we put 5 nonviable coal mine companies into liquidation. Technical liquidation in these companies has already started and will be completed as soon as technically feasible, except in sections of mines for which private investors have expressed interest by mid-2001. The financing of the liquidation activities will be limited to the budgeted 35 million leva in 2001, and we will not allow budgetary support for technical liquidation to be used for the continuation of coal mining activities. In addition, we have opened the privatization procedure for 11 coal mining companies, and will complete the process following the approval by the Council of Ministers and parliament of a privatization strategy for the coal sector.

Improving the business climate

29. **We continue to give high priority to improving the business environment and attracting foreign direct investment.** Drawing on an interministerial review and in consultation with business associations, we have continued to streamline the licensing and regulatory regime. Last year, 121 requirements were revoked or simplified, and we aim to rationalize 40 more restrictions by mid-2001. In addition, a "one-stop shop" program limiting the interface between the administration and business to a single office has been introduced in all the ministries, all the 28 districts, and 14 municipalities, and will be expanded further. Moreover, the documentation of procedures to be followed to open a business is being improved. We have also taken steps to facilitate the day-to-day operation of existing enterprises by streamlining the procedures for tax payments and submitting to parliament a bill providing the proper legal basis for financial transactions and documentation in electronic form. To improve the environment for foreign investment, we are preparing a draft international arbitration law enabling companies with more than 50 percent foreign

participation to have access to international arbitration. We recognize that improving the business environment requires a more effective judicial system for corporate affairs and quicker and enhanced enforcement of court judgments in commercial disputes, and intend to provide specialized training in commercial legislation to the judiciary and take a more pro-active stance on enforcement issues. We also recognize that the quality of services provided by public administrations, at the local level in particular, continues to suffer from bureaucratic rigidities and a lack of transparency. To address these problems, we will continue our public administration reform, and seek World Bank and EU support for this effort.

External sector policies

30. **We have continued to liberalize our trade regime to improve competitiveness and attract foreign direct investment.** The 2001 Customs Tariff, which entered into force on January 1, reduced the simple unweighted average level of our most-favored nations (MFN) tariffs from 13.7 percent in 2000 to 12.4 percent. The average tariff for industrial goods came down from 11 to 10 percent, and that for agricultural products from 24 to 22 percent. The number of tariff bands has also been reduced, from 25 to 22. In addition, tenders for the privatization of the remaining state-trading companies have now been issued, except for two companies for which legal proceedings have caused a delay. Looking forward, we will further liberalize and simplify our trade regime. We have established an interministerial working group to develop a multiyear schedule aimed at gradually harmonizing our tariff policy with that of the EU, taking into account the implementation of WTO Agreements. A preliminary schedule will be ready by September 2001. The first MFN tariff reductions under this schedule will be included in the 2002 Customs Tariff.

31. **We will continue to give a high priority to prudent management of external debt.** In this, we will be guided by a new Sovereign Debt Law which we expect parliament to approve during 2001. In 2000, we set up a computerized system for registering and monitoring domestic and external debt as well as government guarantees, and put in place a committee coordinating operational debt management decisions. Following the recently reached understanding with Austria on outstanding bilateral obligations, we no longer have outstanding bilateral debt disputes. We will continue to seek agreement with individual members of the Paris Club on debt swaps for infrastructure, environment, and social development and will open discussions with HIPC-eligible countries to reconcile outstanding claims. We will undertake debt management operations only if overall liquidity is sufficient and if there are adequate reserves in the fiscal reserve account. IMF staff will be consulted prior to such operations.

Table 1. Bulgaria: Prior Action, Structural Performance Criteria, and Structural Benchmarks for the Fifth Program Review

		Program Timing	Implementation Status
New Measures			
	Prior Action		
1.	Submit to parliament the draft package of amendments to the Energy Law agreed with the World Bank.		
	Structural Performance Criterion		
1.	Ensure that 60 closely monitored state-owned enterprises keep their wage bill as a group for the first quarter (end-March test date) of 2001 under the level of the base wage bill, which is their aggregate wage bill in the third quarter of 2000 plus 5 percent. Within this total ceiling, no more than 10 percent of these enterprises may exceed their individual wage bill ceiling, which is their individual wage bill in the third quarter of 2000 plus 5 percent, unless their total wage bill remains below 10 percent of the aggregate wage bill of all the enterprises on the list. Excluded from the list for the test date will be those enterprises that have been privatized, or ceased operations, and those that had profits in 2000, unless they are monopolies, have arrears, or receive state subsidies. If an enterprise is excluded from the list, the base wage bill will be reduced by the amount of that enterprise's wage bill in the third quarter of 2000.	End-March 2001	
	Structural Benchmarks		
1.	COM to adopt amendments to the NSSI regulation on the components of renumeration to harmonize the bases for the PIT and the social insurance contribution for self insured.	March 2001	
2.	MOL, MOH and MOF to issue wage guidelines in the health sector for 2001 aimed at preventing cost escalation.	March 2001	
3.	Parliament to approve the draft package of amendments to the Energy Law agreed with the World Bank.	May 2001	
4.	Refrain from introducing tariff increases, new temporary tariff exemptions, and temporary tariff quotas.	Ongoing until the end of the arrangement.	

Table 1. Bulgaria: Prior Action, Structural Performance Criteria, and Structural Benchmarks for the Fifth Program Review

		Program Timing	Implementation Status
Previous Commitments			
	Structural Performance Criteria		
1.	Ensure that the 121 closely monitored state-owned enterprises subject to a wage bill freeze keep their wage bill as a group for the third quarter (end-September test date) and fourth quarter (end-December test date) 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 on the list. Excluded from the list for both test dates will be those enterprises that are privatized, or ceased operations, and those that had profits in 1999 and the first two quarters of 2000, unless they are monopolies. If an enterprise is excluded from the list, the base wage bill will be reduced by the amount of that enterprises' wage bill in the third quarter of 1999.	September 2000 and December 2000	**Met.** **Met. The group's total wage bill was reduced by 9.4 percent between the third quarter of 1999 and the fourth quarter of 2000. Out of 90 enterprises that remained on the list, only 8 violated the wage bill freeze, and their combined wage bill amounted to only 3.3 percent of the total wage bill.**
2.	COM to adopt: (i) a decision to withdraw direct and indirect central government subsidies from 3 DHCs before the 2000-01 heating season; and (ii) a decision identifying 5 DHCs from the remaining 19 DHCs from which all central governments subsidies will be withdrawn effective July 1, 2001. The final draft of the 2001 budget will incorporate these decisions.	September 2000	**Met.**
3.	Issue a new tender to sell Biochim.	September 2000	**Met.**
	Structural Benchmarks		
1.	Initiate joint audits of social contribution and PIT withholdings.	September 2000	**Met.**
2.	The URA Commission is to ensure that: (i) Tax and social insurance forms are streamlined based on a harmonized definition of "labor income" as a common part of the bases for PIT and all social contributions.	December 2000	**Met.**
3.	(ii) Draft legislative amendments are prepared, providing clear criteria for defining the employer-employee relationship, including for self-employed persons and the small business sector.	March 2001	
4.	Incorporate the elimination of outstanding municipal expenditure arrears into the 2001 municipal budgets.	2001 budget	**Met.**

Table 1. Bulgaria: Prior Action, Structural Performance Criteria, and Structural Benchmarks for the Fifth Program Review

		Program Timing	Implementation Status
5.	Complete consolidation of 90 percent of all leva accounts of government held in the BNB into the Single Treasury Account (including budgetary, extra-budgetary, deposit and suspense accounts).	December 2000	**Met.**
6.	The Ministry of Finance, the National Social Security Institute, the Health Insurance Fund, and the Ministry of Health to jointly formulate a detailed plan to finance the next stage in hospital care from mid-2001.	December 2000 *Revised target March 2001*	**Partly met. A framework plan prepared in November 2000, and a detailed plan is being drafted for discussion.**
7.	Sell or irreversibly put up for sale through the centralized mass privatization auctions or other means 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.	December 2000 *Revised target December 2001*	**Partly met. 70 enterprises privatized by end 1999 still have residual shares.**
8.	COM to amend regulation to allow privatization bodies to publish main parameters of all bids of interested buyers after a sale is completed.	September 2000	**Met.**
9.	Complete the sale of assets of Group B enterprises entered into liquidation.	December 2000 *Revised target June 2001*	**Partly met. In 2000 assets of 5 out of 14 enterprises were sold.**
10.	Enactment by parliament of legislation to expedite the completion of bankruptcy proceedings, including for state-owned enterprises.	September 2000	**Met with delay on Oct 13, 2000.**
11.	Submit to parliament the draft package of amendments to the Energy Law agreed with the World Bank.	September 2000 *Revised target Prior Action for Fifth Review (see above).*	**Not met.**
12.	Ensure that NEK does not enter into power purchase agreements with terms longer than one year unless approved by the standing commission appointed by the Prime Minister.	From July 1, 2000 through end-2001	**Being observed. NEK has not signed any long-term power purchasing agreement.**
13.	Until the implementation of the two-component tariff, apply an obligatory fixed payment for disconnected volumes in connected buildings with effect from November 1, 2000.	September 2000	**Not met. Requires approval of amendments to the Energy Act.**
14.	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.	Continuous	**Being observed.**
15.	Refrain from introducing new temporary tariff exemptions and temporary tariff quotas.	July 31, 1998 ongoing	**Being observed.**
16.	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).	December 2000	**Met.**

Table 1. Bulgaria: Prior Action, Structural Performance Criteria, and Structural Benchmarks for the Fifth Program Review

		Program Timing	Implementation Status
17.	Refrain from a conversion of outstanding privatization vouchers into government debt.	Continuous	**On track.**

Performance Criterion on the Overall Deficit and Indicative Target on Revenues of the General Government

	Overall deficit ceilings 1/	Revenues (Indicative)
	(In millions of leva)	
January 1, 2001–March 31, 2001	212	2,483
January 1, 2001–June 30, 2001 (indicative)	22	5,184
January 1, 2001–September 30, 2001 (indicative)	250	7,910
January 1, 2001–December 31, 2001 (indicative)	218	10,762

1/ The figures denote the largest allowable level of the deficit excluding contingency expenditure.

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. For calculating the performance against this ceiling, privatization receipts include the dividends from the Bank Consolidation Company and the proceeds from the sale of the second GSM license (net of expenditure to move defense communications out of the frequencies covered by the license, up to a limit of 48 million leva).

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 cumulative adjustment will not exceed BGN 5 million at end-March, BGN 15 million at end-June, BGN 50 million at end-September, and BGN 205 million at end-December 2001.

The deficit ceilings will be reduced by the amount external interest payments fall short of the following cumulative amounts: 411 million leva by end-March; 497 million leva by end-June; 890 million leva by end-September; and 1,063 million leva by end-December, 2001.

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

	FRA
Level on December 31, 2000	2,260
Cumulative change from level on December 31, 2000	
March 31, 2001	-102
June 30, 2001 (indicative)	-1
September 30, 2001 (indicative)	-291
December 31, 2001 (indicative)	-262

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. 4 of the 2001 Budget Law, the National Social Security Institute, and the Health Insurance Fund.

The limits will be monitored from the accounts of the banking system, to be provided 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, 2000 exchange rates (2.10191 leva, and 1.30291 SDR per US dollar).

Performance Criterion on the 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, 2001 until December 31, 2001, 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 April 1, 2001 to December 31, 2001.

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, 2001.

(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.

Performance Criterion on the Ceiling on Tax and Social Insurance Arrears

	Total	GTD (indicative)	NSSI (indicative)
		(In millions of leva)	
Outstanding as of:			
December 31, 2000 (actual)	530	313	217
Cumulative change from level on December 31, 2000:			
March 31, 2001	-30	-22.5	-7.5
June 30, 2001 (indicative)	-60	-45.0	-15.0
September 30, 2001 (indicative)	-90	-67.5	-22.5
December 31, 2001 (indicative)	-120	-90.0	-30.0

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

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
32. Nefteks Petroleum
33. Toplofikatsia Pernik
34. Stomaneni trabi
35. Orfei
36. Chernomorsko Zlato
37. Korabno mashinostroene
38. NITI EAD Kazanlyk
39. Stara reka
40. Shumensko pivo
41. Agroteknika
42. Vineks Preslav
43. Cherno more
44. Liteks Dzus
45. Varnensko Pivo
46. Kitka
47. Svetlina
48. Burgasbas
49. Blagoustroisveni Stroeji Burgas
50. LVK Gamza

The enterprises mentioned 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. Proinveks EOOD, Sofia
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. Kremikovtski

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, 2000;
- 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, 2000 on writing off or rescheduling outstanding liabilities to tax authorities or the NSSI will not reduce amounts counted as outstanding liabilities;
- enterprises in the list which are entered into liquidation or bankruptcy proceedings will not drop out of the monitored total until they are struck from the register of active enterprises in Bulgaria; however, the total will no longer include new interest and penalty charges accruing after their entry into bankruptcy or liquidation.
- NEK will include all generation, transmission and distribution companies that were a part of the electricity monopoly prior to its unbundling.

Indicative Ceilings on the Monitored Total Outstanding Liabilities to Customs

	(In millions of leva)
Outstanding as of:	
December 31, 2000 (actual)	6.7
Cumulative change from level on December 31, 2000:	
March 31, 2001	-1
June 30, 2001	-1
September 30, 2001	-2
December 31, 2001	-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, 2000 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

Performance Criteria on the Ceilings on Contracting and Guaranteeing Public 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, 2000:			
March 31, 2001	40	250	250
June 30, 2001 (indicative)	80	500	250
September 30, 2001 (indicative)	120	800	250
December 31, 2001 (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.. The term debt has the meaning set forth in point No. 9 of the IMF Guidelines on Performance Criteria with Respect to Foreign debt adopted on August 24, 2000 (Executive Board Decision No. 12274-(00/85)). Excluded from this performance criterion are (i) normal import-related financing credits; and (ii) outstanding balances under bilateral payments arrangements. The actual stock of short-term debt outstanding (according to this definition) as of December 31, 2000 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. This performance criterion applies not only to debt as defined in point No. 9 of the IMF Guidelines on Performance Criteria with Respect to Foreign debt adopted on August 24, 2000 (Executive Board Decision No. 12274-(00/85)) but also to commitments contracted or guaranteed for which value has not been received. Excluded from this performance criterion 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, 2000:	
March 31, 2001	69
June 30, 2001	-65
September 30, 2001	107
December 31, 2001	-7

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 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 31, 2000 (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 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 8 percent of eligible liabilities. 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.

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.**
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	**Done in 2001 budget.**
		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 laws for 2000 and 2001, but implemented through a separate Council of Ministers decree.**
		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. Of the 15 extrabudgetary funds in 2000, one was closed and another is being reorganized as a commercial enterprise.**
		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. 2001 budget document contains improved analysis.**
		Finalize a new unified chart of accounts for the general government based on national accounting standards and generally following GFS requirements.	December 2000	**Done. The first level budget units began to implement it from the beginning of 2001.**
1.3 Tax policy	Improve the efficiency of the tax system.	Eliminate VAT exemption for tourism services abroad.	Budget 2001 *Revised target Budget 2002*	**Not done. Delayed by one year through parliamentary decision.**
		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. Done in 2001 budget.**
		Transform the Tax Policy Directorate into a Revenue Policy Division to quantify overall revenue implications of policy options contemplated in the budget preparation process.	2001 budget	**Done with delay. The Directorate included non-tax revenues in its analysis in the second half of 2000. In February 2001 it also included social insurance contributions in its analysis.**
		Simplify the presumptive (patent) tax to make it easier for small businesses to employ additional workers.	2001 budget	**Done. Presumptive tax is no longer based on number of employees.**
		Reduce the national corporate profit tax rate to 20 percent for enterprises with profits over 50,000 leva, and 15 percent for others.	2001 budget	**Done. In 2001 budget.**

[1]Text in italics refers to measures added or modified during the fifth review. Except where explicitly noted, the structural measures listed in this matrix do not represent program conditionality.

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
		Lower the PIT burden by raising the threshold for nontaxable income up to 100 leva per month and adjusting tax brackets upward.	2001 budget	**Done. In 2001 budget.**
1.4 Tax, Social Security and Health Insurance administration	Improve collection, enhance enforcement and compliance while reducing compliance costs.	Complete computerization of customs in accordance with the PHARE-supported program document in three phases: • Phase I • Phase 2 • Phase 3	December 2000 May 2001 *Revised target December 2001* December 2002	**Done. All customs offices except for Customs Bureau Gorublyane were covered. Revised in light of the new strategy adopted by the supervisory board of the National Customs Agency.**
		Strengthen taxpayers services, including advance rulings.	1999 onward	**On track.**
		Develop computerization strategy for Unified Revenue Agency.	September 2000	**Modified in light of Concept Paper.**
		Prepare and submit to the COM legislative amendments to harmonize the bases for the PIT, the social insurance contribution and the health insurance contribution including a common definition of labor income.	September 2000	**Partly done. Amendments to the Obligatory Health Insurance Act are adopted by parliament; amendments to the relevant NSSI regulations are drafted but not yet submitted to the COM.**
		COM adopt amendments to the NSSI regulation on the components of renumeration to harmonize the bases for the PIT and the social insurance contribution for self insured.	*March 2001* **Structural Benchmark**	
		Prohibit the offsetting of tax liabilities against SOE inter-enterprise arrears.	EFF period	**On track.**
		Implement a selective audit program to control VAT fraud instead of relying on a full audit of each VAT client.	December 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.**
		Review the process of taxpayer registration, submission of processing of returns, collection, audit and taxpayer services to make them compatible with the future processes of the URA	December 2000	**Done with delay. Review completed January 15, 2001.**
		Initiate joint audits of social contribution and PIT withholdings.	September 2000 **Structural Benchmark**	**Done. 36 audits in six regions. Results are being analyzed and summarized.**

[1]Text in italics refers to measures added or modified during the fifth review. Except where explicitly noted, the structural measures listed in this matrix do not represent program conditionality.

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
		Develop and start implementing a computerization strategy for GTD.	December 2000	**Partly done. A Concept Paper for the information technologies of URA (and TA as part of it) approved by URA Commission on 16 Jan. 2001.**
		The URA Commission is to ensure that: (i) A detailed implementation plan is prepared based on the agreed concepts with activities, timelines and projected costs for the first stage.	September 2000	**Done.**
		(ii) Formal procedures are established for effective information exchange on an ongoing basis between GTD and NSSI.	December 2000	**Done. An agreement between GTD and NSSI, providing for exchange of information on annual income and insurance contributions, is signed.**
		(iii) Tax and social insurance forms are streamlined based on a harmonized definition of "labor income" as a common part of the bases for PIT and all social contributions.	December 2000 **Structural Benchmark**	**Done. A new income tax return, and a two-page insertion that replaced Annex K for the reconciliation of the income tax bases were prepared.**
		(iv) Draft legislative amendments are prepared, providing clear criteria for defining the employer-employee relationship, including for self-employed persons and the small business sector.	March 2001 **Structural Benchmark**	
		(v) PIT is included in the monthly NSSI withholding form.	December 2000	**Not done. Necessary legislative changes were delayed.**
		(vi) A redesigned Annex K for year 2000 is filed with the NSSI.	December 2000	**Done (see (iii)).**
		(vii) Staff in the regions and the external community are educated about the project.	December 2000	**Done. Territorial Units Managers kept informed on a regular basis.**
		(viii) A program is developed for acquisition of buildings and rationalization of the current accommodation.	December 2000	**Not done. Pending the conclusion of the analysis of the structure of the tax administration and local taxes and fees.**
		Provide proper resources and office spaces for the URAC and project team.	2001 budget	**Done. The budget of the Commission is part of the MoF 2001 budget. The project team has adequate office space and equipment.**
		Prepare an action plan to separate the payment of short term benefits from collection of social insurance contributions.	December 2000 *Revised target June 2001*	**Not done.**

[1] Text in italics refers to measures added or modified during the fifth review. Except where explicitly noted, the structural measures listed in this matrix do not represent program conditionality.

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
		Prepare first draft of a strategy to rationalize the structure of tax administration as outlined in the Concept Paper, assessing the need for the 5 regional directorates, concentrating activities connected with the central taxes in the 28 territorial and 5 large taxpayer directorates, and isolating activities connected with municipal taxes and fees.	December 2000	**Not done. Pending the conclusion of the analysis of local taxes and fees, review of the business processes, and the future of the large tax payer offices.**
		Reduce the refund period for non-exporter VAT taxpayers from 6 to 4 months.	2001 budget	**Done. In 2001 budget.**
		Recruit experienced IT expert to lead the development of the IT strategy and implement a modern IT system.	*March 2001*	
		Develop IT strategy, including specifications for hardware, software, networks, and communications, together with an implementation timetable and an estimate of cost.	*June 2001*	
		Submit a plan to the URA commission to strengthen and streamline the large taxpayer offices' structure.	*March 2001*	
		Submit a proposal on the structure and accommodation of tax offices to the URA commission, to make them compatible with URA.	*June 2001*	
		URA Commission to adopt a strategic plan for the next stages of the URA project	*June 2001*	
		URA Commission to adopt a plan to concentrate the administration of central taxes in 28 district offices and to allocate local tax collection to the other offices.	*June 2001*	
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.**
		Issue a tender for handling the Financial Management Information System IT infrastructure and service requirements	*October 2001*	
		Transfer remaining 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, except where disallowed by donors.	December 2000	**Done. All first level accounts and extrabudgetary accounts, with the exception of Type 3 suspense accounts and extra-budgetary accounts for private donations, are in the STA.**
		Continue reducing the number of second level spending units.	2001 budget	**Done. Second level spending units in the education sector reduced by 300.**
		Incorporate the elimination of outstanding municipal expenditure arrears into the 2001 municipal budgets.	2001 budget **Structural Benchmark**	**Done.**

[1]Text in italics refers to measures added or modified during the fifth review. Except where explicitly noted, the structural measures listed in this matrix do not represent program conditionality.

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
		Complete consolidation of 90 percent of all leva accounts of government held in the BNB into the Single Treasury Account (including budgetary, extra-budgetary, deposit and suspense accounts).	December 2000 **Structural Benchmark**	**Done. On July 18, 2000, all leva accounts were consolidated.**
		Start limited testing of the electronic budgetary payments system.	October 2000	**Done.**
		Regularly disseminate timely information on central budget execution and composite parts of the consolidated budget.	Continuous	**On track. Bi-weekly fiscal figures are disseminated regularly.**
		Ensure timely payment of district heating bills by budget-dependent organizations.	September 2000 onward	**On track. In the second half of 2000, state transferred funds to municipalities to clear arrears to district heating companies.**
	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. Done in the 2001 budget report.**
		In line with Inter-Ministerial Committee recommendations, coordinate the Public Investment Program with the budget preparation process.	June 2000	**Done in 2001 budget.**
		Create mechanism to ensure incorporating into the budget only cost-effective projects included in the PIP that fall within the external debt ceilings.	2001 budget	**Done. Budgeted investments within the external debt ceilings.**
1.6.1 Social assistance	Improve equity, targeting, and administration of Social Assistance Program.	Prepare strategy paper on targeting child allowances in consultation with the World Bank.	April 2000	**Not done. Strategy still under discussion.**
		Council of Ministers approval of a strategy paper on targeting child allowances.	June 2000	**Not done.**
		Target child allowances.	Budget 2001 onward	**Not done.**
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. Preparations are ongoing for launching second pillar on January 1, 2002.**
		Complete the licensing of voluntary pension funds registered by June 2000.	September 2000	**Done by end-2000.**
		Review the pay-as-you-go system annually, with a view to adjusting the parameters to maintain the viability of the system.	*2001 onward*	
		Continue to develop the regulatory framework and supervisory capacity in the pension system.	*2001*	

[1]Text in italics refers to measures added or modified during the fifth review. Except where explicitly noted, the structural measures listed in this matrix do not represent program conditionality.

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
1.6.3 Health	Rationalize and make more cost-effective supply of public health services.	Implement health insurance system.	2000–01	**On track. Preparations are ongoing for launching hospital care reform in July 2001.**
		Sign individual contracts with outpatient health providers.	June 2000	**Done.**
		The Ministry of Finance, the National Social Security Institute, the Health Insurance Fund, and the Ministry of Health to jointly formulate a detailed plan to finance the next stage in hospital care from mid-2001.	December 2000 **Structural Benchmark** *Revised target March 2001*	**Not done. A framework plan prepared in November 2000, and a detailed plan is being drafted for discussion.**
		MOL, MOH and MOF to issue wage guidelines for 2001 aimed at preventing cost escalation.	*March 2001* **Structural Benchmark**	
2. Labor Market Policies		Ensure that the 121 closely monitored state-owned enterprises subject to a wage bill freeze keep their wage bill as a group for the third quarter (end-September test date) and fourth quarter (end-December test date) 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 on the list. Excluded from the list for both test dates will be those enterprises that are privatized, or ceased operations, and those that had profits in 1999 and the first two quarters of 2000, unless they are monopolies. If an enterprise is excluded from the list, the base wage bill will be reduced by the amount of that enterprise's wage bill in the third quarter of 2000.	September 2000 and December 2000 **Structural Performance Criteria**	**Done.** **Done. The group's total wage bill was reduced by 9.4 percent between the third quarter of 1999 and the fourth quarter of 2000. Out of 90 enterprises that remained on the list, only 8 violated the wage bill freeze, and their combined wage bill amounted to only 3.3 percent of the total wage bill.**
		Ensure that 60 closely monitored state-owned enterprises keep their wage bill as a group for the first quarter (end-March test date) of 2001 under the level of the base wage bill, which is their aggregate wage bill in the third quarter of 2000 plus 5 percent. Within this total ceiling, no more than 10 percent of these enterprises may exceed their individual wage bill ceiling, which is their individual wage bill in the third quarter of 2000 plus 5 percent, unless their total wage bill remains below 10 percent of the aggregate wage bill of all the enterprises on the list. Excluded from the list for the test date will be those enterprises that have been privatized, or ceased operations, and those that had profits in 2000, unless they are monopolies, have arrears, or receive state subsidies. If an enterprise is excluded from the list, the base wage bill will be reduced by	*End-March 2001* **Structural Performance Criterion**	

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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
		the amount of that enterprise's wage bill in the third quarter of 2000.		
		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	**On track.**
3. Structural Reform				
3.1 Privatization and enterprise restructuring				
3.1.1 Enterprise privatization		Sell or irreversibly put up for sale through the centralized mass privatization auctions or other means 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.	December 2000 **Structural Benchmark** *Revised target December 2001*	**Partly done. 70 enterprises privatized by end 1999 still have residual shares.**
		Residual shares in enterprises privatized from January 1, 2000 will be sold within six months of their privatization under the above-mentioned conditions.	Continuous	**On track.**
		COM to amend regulation to allow privatization bodies to publish main parameters of all bids of interested buyers after a sale is completed.	September 2000 **Structural Benchmark**	**Done.**
		Complete the sale of assets of Group B enterprises entered into liquidation.	December 2000 **Structural Benchmark** *Revised target June 2001*	**Partly done. In 2000 assets of 5 out of 14 enterprises were sold.**
3.1.2 Financial discipline and transparency	Increase financial transparency.	Implement enhanced disclosure requirements for nonfinancial enterprises.	June 2000	**Not done. Will be implemented in the context of further improving accounting standards.**
		Enactment by parliament of legislation to expedite the completion of bankruptcy proceedings, including for state-owned enterprises.	September 2000 **Structural Benchmark**	**Done with delay on Oct 13, 2000.**
		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.	March 2000 onward	**On track.**
		No new commercial bank lending to BDZ from June 30, 1999	Continuous	**On track.**

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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 BDZ Financial Rehabilitation Plan adopted by the COM in November 1999, keeping subsidies within the parameters agreed with the IMF and without incurring arrears.	2000-01	**On track. Measures implemented according to the plan through mid-2000, but higher-than-projected energy costs resulted in increased subsidy needs. Additional measures taken in response as listed below.**
		Sell non-operational assets of BDZ worth at least 20 million leva.	December 2000 *Revised target. June 2001*	**Partly done. Assets worth 3.6 million lev sold and assets worth 7 million leva offered for sale.**
		Cut operations and maintenance spending and achieve additional savings in labor costs equivalent to 9 million leva.	December 2000	**Done.**
		Raise BDZ's freight tariffs by 20 percent, with an estimated revenue impact of 35 million leva in 2001.	*January 2001*	**Done.**
		Raise BDZ's passenger tariffs by 15 percent with an estimated revenue impact of 11 million leva in 2001.	*February 2001*	**Done.**
		Cut operations and maintenance spending in line with the special 2001 Action Plan to achieve savings equivalent to 24 million leva.	*2001*	
3.1.3 Business Climate		Publish information on tax regimes and administrative regulations applying to the opening and operating of businesses on the government website. Publicize the availability of this information.	December 2000	**Done.**
		Undertake a review of the progress made so far in reducing the number of licensing regimes by each ministry. Determine new targets for 2001.	December 2000	**Done.**
		Remove 40 licensing requirements.	*June 2001*	
		Expand the "one-stop shop" program to all municipalities	*June 2001*	
		Submit to parliament amendments to the Civil Procedure Code to strengthen creditors rights.	*March 2001*	
3.2 Energy Sector Reform		According to the Energy Action Plan: . Adjust electricity tariffs . Liberalize the prices of: - briquettes . Phase out state subsidies for coal mining. . Cease mining operations in non-viable sections of coal mines.	 Continuous October 2000 December 2001 December 1999	 **Revised (see below).** **Done September 2000.** **Done, mining operations ceased in 9 sections.**
		Complete the preparation for liquidation or privatization of remaining unviable coal mine sections.	September 2000	**Done.**

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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
		Enter additional 3 coal mine sections into liquidation.	November 2000	**Done.**
		Submit tender documents to Privatization Agency for accelerated privatization for 7 coal mines.	December 2000	**Done.**
		Proceed with technical liquidation except for sections of mines for which private investors have expressed interest.	*June 2001*	
		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 . Implement privatization of distribution activities	EFF period December 2001	**Off-track. Price increases since summer 2000 behind original schedule. Revised (see below)**
		Submit to COM and parliament a strategy to privatize the electricity distribution companies.	*2001*	
		Liberalize household gas supply sector.	EFF period	**On track.**
		Submit to COM and parliament a strategy to privatize the gas distribution companies.	*2001*	
		Submit to parliament the draft package of amendments to the Energy Law agreed with the World Bank.	September 2000 **Structural Benchmark** ***Revised Target Prior Action for Fifth Review***	**Not done.**
		Parliament to approve amendments to the Energy Law agreed with the World Bank.	*May 2001* **Structural Benchmark**	
		Appoint qualified auditors to complete a diagnostic audit of the opening financial statements and internal controls of the newly created power sector enterprises.	August 2000	**Done. A list of certified accountants who will perform a full audit was approved.**
		Complete audit of the opening financial statements and internal controls of the newly created power sector enterprises.	December 2000 *Revised target June 2001*	**Not done.**
		Put in place individual contracts between NEK and the generation and distribution companies, consistent with NEK's demand forecast and approved legislation.	September 2000	**Done.**
		Ensure that NEK does not enter into power purchase agreements with terms longer than one year unless approved by the standing commission appointed by the Prime Minister.	From July 1, 2000 through end-2001 **Structural Benchmark**	**On track. NEK has not signed any long-term power purchasing agreement.**
		Reduce the average cost of electricity purchased by the Single	From July 2000	**On track.**

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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
		Buyer by purchasing electricity from the least-cost suppliers.	onward	
		Complete drafting the full set of secondary legislation to the Energy Law.	December 2000	**Not done. A number of regulations are still pending and their finalization depends on the approval of amendments to the Energy Act.**
		Monitor monthly the implementation of the business plans of the newly formed companies from NEK.	July 2000 onward	**On track.**
		Reduce technological losses of electricity sector companies by 70 million leva.	December 2000	**Done.**
		Adopt all secondary legislation related to the Energy Law as amended.	March 2001 *Revised target June 2001*	**Not done.**
		Implement Bulgargaz Rehabilitation Plan adopted by COM.	2000-01	**On track.**
		Introduction of differentiated prices and tariffs for transport and distribution of natural gas.	December 2000	**Not done. Requires approval of amendments to the Energy Act.**
		COM will adopt a program with the objective of attracting strategic private investors to develop the gas distribution market according to Bulgargaz rehabilitation plan.	September 2000	**Not done. Requires approval of amendments to the Energy Act.**
		Cut off gas and electricity to state-owned enterprises who do not pay bills on time.	EFF period	**On track.**
		Improve revenue collection of Bulgargaz to 95 percent.	December 2000 *Revised target March 2001*	**Collection rate at the end of 2000 was 93 percent.**
		Do not use transit revenues of Bulgargaz to offset customer arrears.	July 2000 onward	**Being observed.**
		Install control and metering devices in all substations supplied by district heating companies outside Sofia.	September 2000	**Done.**
		Install control and metering devices in all substations supplied by Sofia district heating companies.	June 2001 *Revised target September 2001*	**Plan revised.**
		Supply heat on the basis of a single general contract between building occupants and DHCs with effect from November 1, 2000.	September 2000	**Not done. Will be allowed by the pending amendments to the Energy Act.**
		Enable district heating companies to disconnect buildings which are not cost-effective to supply with heat, or in which more than 50 percent of building space has been disconnected.	September 2000	**Not done. Requires approval of amendments to the Energy Act.**
		Implement a two-component district heating tariff (a fixed capacity charge for all building occupants, and a variable charge according to actual heat consumption), with effect from	December 2001	

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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
		January 1, 2002.		
		Until the implementation of the two-component tariff, apply an obligatory fixed payment for disconnected volumes in connected buildings with effect from November 1, 2000.	September 2000 **Structural Benchmark**	**Not done. Requires approval of amendments to the Energy Act.**
		COM to adopt: (i) a decision to withdraw direct and indirect central government subsidies from 3 DHCs before the 2000-01 heating season; and (ii) a decision identifying 5 DHCs from the remaining 19 DHCs from which all central governments subsidies will be withdrawn effective July 1, 2001. The final draft of the 2001 budget will incorporate these decisions.	September 2000 **Structural Performance Criterion**	**Done.**
		Close down uneconomical services in the remaining 14 DHCs.	June 2001	
		Agree with the municipalities in cities with district heating companies on sharing DHCs financial burden.	September 2000 *Revised target June 2001*	**Not done. Discussions with municipalities are ongoing.**
		Determine which DHC ownership to transfer to the respective municipalities.	December 2000 *Revised target June 2001*	**Not done. Discussions with municipalities are ongoing.**
		Refrain from merging DHCs with other state-owned enterprises.	July 1, 2000 onward	**On track.**
3.3 Financial Sector Reform		Reduce minimum reserve requirement ratio from 11 percent to 8 percent.	July 1, 2000	**Done.**
		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.	Continuous **Structural Benchmark**	**On track.**
		Implement a program to further develop banking supervision.	1998–2000	**Done.**
		Further enhance the quality of quarterly reports on compliance and the condition of the banking system.	December 2000	**Done.**
		The Banking Supervision Department to maintain regular meetings with banks' managements.	Continuous	**On track.**
		Close the tender on hiring a supervisor to manage the projects related to BISERA 4.	October 2000	**Not done. The project BISERA 4 has been cancelled and replaced by another project to introduce an RTGS system, a tender for the project is being prepared.**
		Link the system developments within the institutions involved in the payment system.	December 2000	**Not done. The terms of reference have been adjusted to reflect the switch from the BISERA 4 system.**

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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
		Launch the next generation payment system BISERA 4.	2001	**Revised in view of the decision not to continue the BISERA system (see below).**
		Launch the RTGS system.	*2001*	
		Prepare and adopt secondary legislation related to the law on electronic signature.	December 2000	**Not done. Working Groups at the State Telecommunications Commission have been set up to draft the regulations.**
		Expand the coverage of the credit registry to include information on credits from abroad.	September 2000	**Done.**
		Refrain from issuing bearer bonds.	Continuous	**On track.**
		Issue government securities with a view to: . Maintaining sufficient stock of government security collateral in the interbank market . Avoiding liquidity shocks stemming from large movements in government accounts, coordinating with the BNB . Lengthening the maturity structure of lev-denominated domestic debt.	2001 onward	**On track. The 2001 schedule envisages a slight increase in the net stock of government securities and lengthening of their maturity.**
		Issue a new tender to sell Biochim.	September 2000 **Structural Performance Criterion**	**Done.**
		Sign the sale contract of Biochim.	March 2001 *Revised target April 2001*	**Target revised in light of the tender results.**
		Transform the State Savings Bank (SSB) into a full commercial bank.	December 2000	**Done. Has been brought fully under the legal and regulation framework governing commercial bank activity.**
		SSB: . Start improving branch network . Introduce foreign exchange services on a pilot basis . Upgrade the information system.	 September 2000 September 2000 2000-2001	 **Done.** **Done.** **On track.**
		Design a new administrative system for bank insolvencies and submit necessary draft legislation to parliament.	September 2000	**Done.**
		Increase the capacity of the DIF to adequately handle insolvent banks.	September 1999 and onward	**On track.**
		Submit to the Council of Ministers draft amendments to the Law on Deposit Insurance to improve its effectiveness.	September 2000	**Done.**
		Provide regular information on deposit distribution of the commercial banks to the Deposit Insurance Fund.	September 1999 onward	**On track.**
		Transfer the state's share in the Central Cooperative Bank to the Bank Consolidation Company.	*April 2001*	**On February 12, 2001 the COM agreed to the transfer.**

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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
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.**
		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. 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.	EFF period	**Done. Loans of long-term lending limited to 27 million leva in 2000, with guarantees of 11 million leva.**
		Complete restitution and titling of agricultural land.	December 2000	**Done. 99.7 percent land restituted as of end-December 2000.**
		Establish an Agency for the Cadastre to implement the parcel-based registration system for land.	December 2000	**Done.**
		Include any SFA guarantee on commercial bank credit against warehouse receipts in the SFA's lending ceilings.	Continuous	**Being observed.**
		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.	December 2000 *Revised target March 2001.*	**Delayed. 76 percent done.**
		Reduce the stake of state entities in the Central Cooperative Bank to under 33 percent.	September 2000 *Revised target April 2001.*	**Not done.**
		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.	 December 2001 December 2000 March 2000 onward September 2000	 **On track.** **Done.** **On track.** **Done.**
		Fully implement GDDS.	December 2000	**Since May 2000, participates in the GDDS and metadata posted on the Data Standards Bulletin Board.**
		Use the GDDS as the framework for the development of statistics.	Continuous	**On track.**
4. External Sector Policies				

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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
4.1 Trade Policy		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	**Being observed. Reduction envisaged during 2001, would only be in the context of free trade agreements.**
		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).	December 2000 **Structural Benchmark**	**Done.**
		Reduce the number of tariff bands to 22 by January 1, 2001.	December 2000	**Done. Number of tariff bands reduced from 25 to 22.**
		Issue tenders for the privatization of the remaining 5 state trading companies with foreign trading operations.	June 2000	**Partly done. Privatization tenders announced for 3 companies—legal obstacles caused delays in remaining 2 companies that no longer have trading operations.**
		Complete privatization of all 33 state trading companies with foreign trading operations.	December 2000	**Partly done. Most companies are privatized or liquidated, but privatization tenders of some companies failed.**
		Develop a multi-year schedule to gradually harmonize the trade policy with that of the EU.	*September 2001*	
4.2 Debt Management	Improve debt management.	Refrain from a conversion of outstanding privatization vouchers into government debt.	Continuous **Structural Benchmark**	**On track.**
		Submit the draft Sovereign Debt Law to COM.	September 2000	**Done. Draft law in parliament.**
		BNB and MOF to agree on terms of reference for Joint Committee to improve coordination between the two institutions on cash and debt management issues.	August 2000	**Done. Committee in place.**
		Joint Committee for cash and debt management to begin meeting on a monthly basis to discuss relevant debt and asset management issues.	October 2000	**Done. Committee meets on a monthly basis. Four meetings have been held to date.**
		Develop a plan to improve fiscal risk assessment of government-guaranteed debt.	September 2000	**Done. The system is being developed. It covers procedures and criteria for the selection of projects to be financed with government guarantees.**
		Begin implementing fiscal risk assessment plan.	March 2001	
		Finish implementing the first stage of system for management of public debt.	December 2000	**Done.**

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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
		Assess operation of the first stage of the debt management strategy and prepare an action plan for 2001.	December 2000	**Done.**
		Develop a 3-year plan regarding the contracting of public debt, specifying the level of aggregate external and domestic debt as well as various categories of debt.	March 2001	

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Statement by the IMF Staff Representative
March 23, 2001

1. This statement provides an update of economic and policy developments in Bulgaria since the circulation of the staff report for the 2000 Article IV consultation and fifth review under the extended arrangement (EBS/01/28). This information does not alter the thrust of the staff appraisal.

2. The latest data broadly confirm the picture drawn in the staff report. In January, industrial export sales rose by 7 percent year on year, led by electricity, chemicals, and tobacco. However, total industrial output registered a 6.5 percent year-on-year decline, in part owing to the closure of inefficient mines. Unemployment at 18.7 percent in February remains high, but seasonally adjusted figures indicate that the downward trend since the mid-2000 peak has continued. 12-month inflation eased to 8.5 percent in February, in part reflecting the moderation of energy prices. The current account position in January was comfortable. On a comparable basis (counting the US$135 million fee from the second GSM license as a capital account item), the US$155 million deficit was well below that in the same month a year ago (US$245 million). The improvement is attributable to a reduction in the trade deficit by US$70 million, owing to continued robust export growth (21 percent year on year in U.S. dollar terms) and stable imports (a slight decline of 1 percent).

3. Policy implementation remains on track. The government completed the prior action by submitting to parliament a draft package of amendments to the Energy Act agreed with the World Bank (Council of Ministers' Decision 121 of March 13). Fiscal performance in 2001 so far has been broadly in line with projections. Through end-February, the general government primary position was close to balance, with an overall deficit of 343 million leva (1.2 percent of annual GDP). With a seasonal surplus expected in March, the first-quarter deficit target of 217 million leva is within reach, but achieving it will require strict control over expenditure. In the first two months, total revenue was in line with projections, although collections from the profit tax and VAT were somewhat weaker than projected. Expenditure was kept under control, with the authorities limiting monthly transfers for discretionary spending to at most 90 percent of the budgeted amounts, as planned. In the structural area, the government on March 8 completed the transfer of a 32.77 percent stake in the Central Cooperative Bank to the Bank Consolidation Company. Regarding the sale of Biochim bank, the authorities have made further progress in negotiations with the sole bidder, and aim to agree on a price by April 5.

INTERNATIONAL MONETARY FUND
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April 3, 2001

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

IMF Concludes Article IV Consultation with Bulgaria

On March 23, 2001, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bulgaria.[1]

Background

Bulgaria has come a long way in three years. Having fallen by more than a third between 1989 and 1997, real GDP has since increased by 11 percent, inflation has been brought under control from near-hyperinflationary levels in 1996–97, and external debt has declined from nearly 100 percent of GDP in 1997 to about 80 percent now. This outcome has been facilitated by prudent fiscal policy, which has kept the general government position in approximate balance, and a strict incomes policy for state enterprises, subjecting the worst-performing firms to wage bill freezes. Bulgaria's currency board arrangement continues to have broad political and public support, and shows no signs of strain, as interest rates are low and stable, fiscal reserves ample, and banks liquid. An ambitious structural reform agenda has also been implemented quite successfully. Starting from almost scratch, in three years over one half of enterprise assets and four fifths of bank assets have been privatized. In addition, the authorities have improved banking supervision, started the overhaul of the pension and health care systems, and liberalized trade and prices. Less progress has been made in reducing inefficiencies in the enterprise sector, restructuring the energy sector, and improving the business climate.

Policy performance remained strong in 2000, albeit with some slowdown in structural reform. Fiscal policy continued to be prudent, with the general government deficit contained to

[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. This PIN summarizes the views of the Executive Board as expressed during the March 23, 2001 Executive Board discussion based on the staff report.

1 percent of GDP in 2000, and state enterprises maintained wage discipline. Major advances were made in structural reforms, although toward the end of the year signs emerged of a slowdown in sensitive areas: the submission to parliament of amendments to the Energy Law (to create an efficient and competitive energy sector) was delayed by six months, and the parliamentary approval of amendments to the Labor Code (aimed at making wages and employment more flexible) was delayed by nine months, both to March 2001. Moreover, while an amended Privatization Law aimed at increasing transparency was approved expeditiously in November 2000, new strategies to sell the telecommunications and tobacco monopolies have yet to be put in place.

As regards the recent macroeconomic situation, GDP growth in 2000 is estimated at 5 percent, slightly better than targeted, with net exports and domestic demand contributing roughly equally. Although inflation rose to above 11 percent by end-2000, this mainly reflected temporary factors, including high international energy prices and a drought. In fact, by February 2001, inflation receded to 8.5 percent. Competitiveness seems to remain adequate, as evidenced by the rapid growth of exports, a stable real effective exchange rate, and sharply lower unit labor costs, stemming from productivity gains as a result of restructuring and investment. The current account deficit amounted to 5.8 percent of GDP in 2000, roughly the same as in the previous year, as increased receipts from exports and tourism offset the impact of a sharp rise in energy imports. The record-high foreign direct investment easily covered the current account gap, and gross official reserves rose to US$3.5 billion at end-2000, providing reserve cover of over five months of imports of goods and nonfactor services. The contagion from financial turmoil in Turkey and Argentina has been limited.

Despite the encouraging developments, challenges remain. First, unemployment remains high at over 18 percent, in part owing to labor shedding related to restructuring. Second, Bulgaria is still far from its goal of EU accession. To reduce unemployment and join the EU, the authorities need to remove major structural obstacles to growth and a fully competitive economy. The bottlenecks include: inefficiencies in the enterprise sector, owing to the large share of insider deals in privatization and slow exit procedures; a low level of financial intermediation; the high energy intensity of production, stemming from an exceptionally high reliance on energy under central planning and a slow start in restructuring the energy sector; and burdensome bureaucracy and red tape.

Executive Board Assessment

Executive Directors commended the authorities on the turnaround in economic performance that has been achieved under their three-year Fund supported program, reflected in higher growth, a sharp drop in inflation, and containment of the external debt.

Directors credited these results in large part to the success of the currency board arrangement, supported by tight fiscal and incomes policies and generally good progress in implementing a broad structural reform agenda. However, Directors noted the scale of what remains to be done to create a dynamic market economy, to reduce unemployment, and to meet the conditions for accession to the European Union. To meet these challenges, it will be vital that the authorities maintain their prudent macroeconomic policies and push firmly ahead with the structural reform agenda.

Directors expected economic performance to continue to improve in 2001, provided there are no policy slippages in the roundup to the midyear general elections, and downside risks do not materialize. These risks include the possibility of a sharper-than-projected slowdown in the industrialized economies and possible adverse movements in energy prices.

Directors considered the 2001 budget stance to be appropriate but suggested that the authorities be prepared to tighten fiscal policy in the event of unanticipated upward pressure on inflation or the external current account deficit. They welcomed the substantial cuts in income and social security tax rates in the budget. Directors urged the authorities not to frontload expenditure in the pre-election period, and to use the one-time proceeds from the sale of the second GSM license and from bank privatization to reduce the public debt and not to raise spending. To provide the basis for a continuing sound fiscal policy in the medium term, Directors encouraged the authorities to maintain their efforts to establish a fully functioning treasury and a unified revenue agency, and to complete the health care and pension reforms.

Directors emphasized that the upcoming elections should not undermine the momentum of the structural reform program, the overall aim of which is to open opportunities for further private sector growth and to enhance the economy's competitiveness and flexibility. They noted that unemployment was high and, for both economic and social reasons, urgently needed to be reduced. They considered that a further substantial reduction in the tax on labor income would be important in this regard, provided that the tax base is widened and the tax and social security administrations are strengthened so as to minimize the revenue loss. Directors also endorsed the strict incomes policy currently being pursued in the state enterprise sector, as well as efforts to increase labor market flexibility and improve the business environment so as to allow the private sector to become a more powerful generator of employment opportunities than hitherto. They welcomed the recently approved amendments to the Labor Code that allow more flexibility in employment and working hours, the intention to further streamline the business licensing regime and introduce a "one-stop shop " system for investors to reduce bureaucracy, and the drafting of an international arbitration law. Directors considered that these measures and, more generally, steps to improve governance would be helpful in creating an attractive environment for foreign direct investment, on which the success of the authorities' efforts would heavily depend.

While Directors considered the banking sector to be generally sound, they were concerned that significant problems still exist for a number of smaller banks, and that credit to the private sector remains low. They stressed the need to further strengthen bank supervision and to improve corporate governance, and enforce creditors' rights to reduce the perceived risks of lending to the private sector. Directors cautioned against further reductions in the reserve requirement at this stage, in view of the risk that banks would withdraw the added liquidity in foreign exchange deposits.

Directors identified other main reform priorities as completing privatization in a rapid and transparent manner, making the energy sector more competitive and efficient, and liberalizing trade further. They considered it vital for pending legislation on key measures to be approved by parliament before the end of its current session. Amendments to the Energy Act that would establish a competitive and efficient energy sector were particularly important in this regard. Directors stressed the importance of finalizing the long-delayed sale of Biochim bank and relaunching the sales of the telecommunications and tobacco companies.

Directors commended the authorities for the significant advances in trade liberalization, noting that nontariff barriers have been eliminated and the average tariff rate lowered. They considered that major benefits would result from further tariff liberalization as the tariff regime remains complex and dispersed, and the average tariff is still high.

Directors welcomed the authorities' continued efforts to enhance transparency and observe international standards and codes, and noted the update to the Report on the Observance of Standards and Codes. They also commended the authorities on participating in the General Data Dissemination System and on taking steps towards subscribing to the Special Data Dissemination Standard.

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.

Bulgaria: Selected Economic Indicators

	1997	1998	1999	2000	2001 1/
Real economy	(Percent change)				
Real GDP 2/	-7.0	3.5	2.4	5.0	5.0
CPI, 12-month (end of period)	549.2	1.7	7.0	11.4	4.5
Unemployment rate (percent)	14.0	12.4	13.8	18.1	16.3
Public finance	(In percent of GDP)				
General government balance	-2.5	1.0	-1.0	-1.0	-1.5
Public debt	110.4	80.2	86.7	80.6	66.6
Money and credit	(Percent change, end of year)				
Real broad money	-32.3	8.6	4.9	5.2	10.0
Real credit to the non-government sector	-53.6	5.3	13.6	5.0	15.0
Interest rates (annualized)	(In percent)				
BNB basic rate (end-month average)	7.0	5.2	4.6	4.7	...
Time deposits (end-month average)	3.0	3.3	3.2	3.3	...
Balance of payments	(In millions of U.S. dollars)				
Gross official reserves	2,474	3,056	3,222	3,460	3,636
(in months of GNFS imports)	5.2	6.1	5.9	5.4	5.5
Current account (percent of GDP)	4.4	-0.5	-5.2	-5.8	-4.4
Trade balance (percent of GDP)	3.9	-3.1	-8.7	-9.7	-8.0
Exchange rates					
Exchange rate regime	Currency board since July 1, 1997 3/				
Present exchange rate (March 15, 2001)	2.1578 leva/USD				
Nominal effective exchange rate (1995=100) 4/	5.5	5.4	5.8	5.9	...
Real effective exchange rate (1995=100) 4/ 5/	102.6	116.4	118.7	120.0	...

Sources: Bulgarian authorities; and IMF staff estimates.

1/ Projection.
2/ The 2000 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.

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

IMF Completes Bulgaria Review and Approves US$66 Million Credit Tranche

The Executive Board of the International Monetary Fund (IMF) today completed the fifth review of Bulgaria's economic performance under the three-year Extended Arrangement, enabling Bulgaria to draw the equivalent of SDR 52.3 million (about US$66 million) from the IMF immediately.

This was the final review of Bulgaria's economic performance under the three-year Extended Arrangement, which was approved in September 1998 for SDR 627.62 million (about US$864 million)—(See Press Release No. 98/44). So far, Bulgaria has drawn the equivalent of SDR 523 million (US$664 million). The final disbursement of SDR 52.3 million is contingent on observance of performance criteria for end-March 2001.

Following the Executive Board discussion on Bulgaria, Stanley Fischer, First Deputy Managing Director and Acting Chairman, said:

"The Bulgarian authorities have continued to implement prudent fiscal and incomes policies during the final year of their three-year economic program. They have also made further progress in important structural areas, although the pace of reform has slowed in large-scale privatization and energy sector restructuring. Growth has been robust and inflation and the current account deficit have remained under control. Bulgaria's economic prospects for this year are favorable, with growth expected to remain strong. However, for Bulgaria to fully achieve its goal of creating a competitive market economy capable of self-sustaining rapid growth, the authorities need to maintain sound macroeconomic policies and pursue further structural reform.

"Fiscal policy needs to remain prudent, and will need to be adjusted if there is upward pressure on inflation and the current account deficit. Frontloading of expenditure in the pre-election period should be avoided, and any revenue overperformance saved to create room for further tax cuts in the 2002 budget. To ensure fiscal sustainability in the medium term, continued efforts are needed to strengthen the capacity to collect taxes and social contributions, create a fully-functioning treasury, and complete health care and pension reform.

"In the area of structural reform, a strict incomes policy for state enterprises and steps to improve labor market flexibility and the business environment will help enhance competitiveness and reduce unemployment. The financial sector needs to be strengthened through more vigorous implementation of prudential regulations and through steps to increase corporate governance and enforce creditor rights. Other priorities are to complete the privatization of state-owned enterprises in a transparent manner, to make the energy sector more competitive and efficient, and to liberalize trade further.

"Overall, while noting that many challenges remain to be addressed as Bulgaria continues its transition to a full market economy, Directors recognized that a great deal has already been achieved," Fischer said.

Statement by J. Wijnholds, Executive Director for Bulgaria March 23, 2001

The Bulgarian authorities welcome the set of papers and would like to express their appreciation for the continued support and candid advice from staff and management. I am pleased to announce to the Board that all quantitative and structural performance criteria, as well as the single prior action have been met. My Bulgarian authorities remain fully committed to carrying forward the reform agenda to ensure sustained economic growth and foster a fully functioning market economy that will lead to lower unemployment and faster convergence to European living standards.

Reform Progress 1997-present

As this is the last review of the EFF-supported program, this is a good occasion to look back and review the results achieved during the EFF and its stand-by predecessor. The reform progress in Bulgaria can best be characterized by two important achievements. First, the authorities have proved their ability to resolve successfully the financial turmoil in 1996 and the beginning of 1997 and to achieve and maintain macroeconomic and financial stability since then. The second achievement is that since the adoption of the currency board arrangement, the Bulgarian authorities have pressed firmly ahead with microeconomic structural reforms and have made significant progress as compared to the period before 1997. There is little doubt in Bulgaria that without this second set of reforms, and without the Fund's active involvement in them, macroeconomic stability would have been hard to maintain and growth would not have materialized.

The fruits of these reform efforts are now evident in a strong economic recovery. During the last three years, real GDP growth accelerated and exceeded 5 percent in 2000, the highest growth rate achieved since the 1980s. The currency board arrangement has served Bulgaria well: the inflation rate is low, the current account deficit is under control, the external debt burden has been reduced significantly, and official reserves are at comfortable levels. It is also worth mentioning that the economy grew by a cumulative 11 percent during the last three years despite the difficult external environment as the Bulgarian economy was hit by a number of shocks (the global financial crises, the Kosovo conflict, high oil prices, and weather related shocks).

A. Fiscal Policy

Prudent fiscal policy combined with a properly restrictive income policy for state-owned enterprises helped preserve competitiveness of the economy and the viability of the currency board arrangement. To respond adequately to the rapidly changing external environment, the authorities have executed their budget in a prudent and flexible manner. This flexibility consists of releasing only 90 percent of discretionary spending allocations until late in the year, conservative revenue estimates, and special contingency funds. For example in 2000, when a strong U.S. dollar and high oil prices threatened the current account, appropriate fiscal savings prevented second round effects and excessive current account imbalances and resulted in a budget deficit of only 1 percent of GDP. These savings, however, did not result in unsustainable expenditure cuts, as there was ample room resulting from revenue over performance.

A number of structural reforms, outlined in the Memorandum of Economic Policies, have been initiated in order to further improve revenue collection and expenditure management of the budget. The authorities are continuing their efforts to create a Unified Revenue Agency (URA), which will strengthen the revenue collection capacity of the government. They are at an advanced stage of establishing a fully functioning treasury, the implementation of which will improve further expenditure management and budget monitoring. Furthermore, pension reform is proceeding on schedule and health care reform is entering into its second stage.

To support private sector growth and job creation, the 2001 budget envisaged tax cuts that would lower the personal income tax burden by 2 percentage points, the corporate profit tax rates by 5 percentage points and social contribution rates by 3 percentage points. Furthermore, the VAT refund period for nonexporters was reduced, an accelerated depreciation of software products was allowed, custom duties have been reduced and presumptive taxation was alleviated.

B. Microeconomic Restructuring

The authorities have made substantial progress with privatization of state-owned enterprises. By end-2000, 78 percent of state-owned assets excluding infrastructure, and 51 percent of total assets have been privatized. To enhance the transparency of the privatization process, Parliament approved the amendments to the Privatization Act in November 2000. The authorities are working on new strategies to privatize the Bulgarian Telecommunication Company, (BTC) and Bulgartabak.

C. Financial Sector Reforms

The authorities are committed to improving the legal framework to facilitate the functioning of financial markets and to alleviate information asymmetries between banks and small and medium private enterprises. Insolvency procedures have been streamlined by the adoption of the amendment of the Commercial Code in October 2000, the information in the central credit registry is being improved, and creditors' rights are being strengthened through amendments to the Civil Procedure Code. With the sale of Bulbank, the largest bank, to a strategic foreign investor, 82 percent of the banking sector is now in private hands. The authorities have recently transferred almost all of the remaining state shares in the Central

Cooperative Bank to the Bank Consolidation Company, and are going forward with the sale of Biochim bank and further restructuring of the State Savings Bank, SSB.

D. Energy Sector Reform

The Bulgarian authorities recognize that the energy sector needs further restructuring and competition and, despite the nearing elections, have given priority to working with the World Bank on key amendments to the Energy Law. The appropriate amendments have already been submitted to Parliament, meeting the prior action for the completion of the fifth review.

These amendments signal the authorities' intentions to create a competitive and efficient energy market in Bulgaria. They envisage a separation of policymaking and ownership functions from regulatory and licensing ones among government bodies, while having private companies carry the responsibility and risk for investing in new projects and allowing competitive commercial transactions at all market levels.

E. Business Climate

The authorities believe that the most efficient way to enhance private sector development is to direct their efforts towards improving the business climate. The most important measures in this direction have been (i) the reduction of red tape through the removal or simplification of 121 licensing and regulatory requirements, (ii), the introduction of "one-stop shop" programs in the ministries, districts, and 14 municipalities, (iii) improved quality of public sector services through redesigning the organizational structure of ministries and government bodies.

These impressive results would not have been possible without the strong ownership of and the commitment to the reforms by the Bulgarian authorities and Bulgarian society more broadly. Once seen as a laggard in its transition process, today Bulgaria is a front-runner in the region. My Bulgarian authorities remain fully committed to continue their reform efforts towards sustainable economic growth and a fully competitive market economy and will maintain the momentum of their reform efforts in the pre-election period. In line with these objectives, the authorities' orientation has shifted from crisis management towards pro-growth policies.

Reform Agenda in the Near- and Medium-Term

The authorities continue to view macroeconomic stability as a necessary condition for the attainment of high and sustainable growth rates. In the context of Bulgaria's accession to the EU/EMU, the authorities feel that the currency board arrangement remains an appropriate arrangement until joining EMU while maintaining a prudent fiscal policy, external sustainability and the competitiveness of the economy. High growth rates would stimulate faster convergence to European living standards and would ease macroeconomic management.

Fiscal sustainability will continue to be an important objective of the authorities, also because sound fiscal management is crucial for the viability of the currency board arrangement. To ensure fiscal sustainability, the authorities will continue to work on their medium-term fiscal framework, which will be supported by ongoing institutional reforms. The stabilizing role of fiscal policy is achieved through targeting low and prudent fiscal deficits, improving tax administration, introducing a single treasury account, and completing the URA project.

Fiscal policy will remain prudent. In 2001, the government's strategy is to limit the consolidated budget deficit to at most 1.5 percent of GDP. During the last three years, the Bulgarian authorities have demonstrated their skillful economic management through an adequate and timely policy response to a sequence of external shocks. In 2001, the authorities will continue to maintain the built-in flexibility of the budget, will implement the 2001 budget conservatively and will stand ready to respond adequately to any unforeseen inflationary pressures or current account deterioration.

Improved enterprise access to credit is another important precondition for healthy private sector growth. Because bank financing plays a dominant role on the domestic financial market, it will be important to stimulate banks' credit activity beyond the supply of short-term credits. An increase of bank competition can stimulate the supply of long-term bank credits, necessary to finance business investment.

Transparency and the Observance of International Standards and Codes

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. Bulgaria is a participant in the GDDS (General Data Dissemination System). The GDDS metadata for Bulgaria are being circulated to other countries in the region as an example. Moreover, the authorities participated in the preparation of a Report on Observance of Standards and Codes (ROSC), covering data dissemination, fiscal transparency, monetary and financial policy transparency and bank supervision, which was published last year. An update of this report has been issued to the Board, and will be published shortly.

Pursuant to their policy of transparency, the Bulgarian authorities intend to publish the entire set of documents for the 2000 Article IV Consultation as well as for the final review of the extended arrangement.

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