August 2002
IMF Country Report No. 02/174

Bulgaria: 2002 Article IV Consultation and First Review Under the Stand-By Arrangement and Request for Waiver of Non-observance and Waiver of Applicability—Staff Report; Staff Statement; Public Information Notice; and News Brief on the Executive Board Discussion

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 2002 Article IV consultation with Bulgaria and First Review Under the Stand-By Arrangement and Request for Waiver of Non-observance and Waiver of Applicability, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation and First Review Under the Stand-By Arrangement and Request for Waiver of Non-observance and Waiver of Applicability, prepared by a staff team of the IMF, following discussions that ended on **May 23, 2002**, 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 **July 3, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a staff statement of **July 22, 2002** updating information on recent economic developments;

- the Public Information Notice (PIN) and the News Brief summarizing the **views of the Executive Board as expressed during the July 22, 2002 Executive Board discussion** of the staff report that concluded the Article IV consultation.

The document(s) listed below will be separately released.

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

*May also be 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.

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

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623 7430 • Telefax: (202) 623 7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

BULGARIA

Staff Report for the 2002 Article IV Consultation and First Review Under the Stand-By Arrangement and Request for Waiver of Non-observance and Waiver of Applicability

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

Approved by Carlo Cottarelli and Liam P. Ebrill

July 3, 2002

Contents Page

I. Introduction ... 3

II. Background and Recent Developments ... 3

III. Report on the Discussions ... 13
- A. The Overall Economic Strategy Centered on the CBA ... 13
- B. The Macroeconomic Outlook ... 17
- C. Fiscal Policies ... 19
- D. Incomes Policy and Labor Market Flexibility ... 21
- E. Financial Sector Policies ... 22
- F. Other Structural Reform Policies ... 22
- G. External Sector Policies ... 24
- H. Monitoring and Review Issues ... 25
- I. Data Issues, Standards and Codes, and Safeguard Assessment ... 25

IV. Staff Appraisal ... 27

Text Boxes
1. Inflation in 2002 ... 10
2. Competitiveness and Recent Export Performance ... 15
3. Conclusions of the FSAP Report ... 23
4. Structural Conditionality ... 26

Figures

1. Selected Economic Indicators, 1991–2002 5
2. Real Sector Developments, 1998–2002 6
3a. External Sector Developments, 1996–2002 7
3b. External Sector Developments, 2001–2002 8
4. Unemployment Indicators, 1998–2002 11
5. Monetary and Financial Indicators, 1996–2002 12
6. Indicators of Competitiveness, 1998–2001 16
7. Medium-Term Projections, 2000–06 18

Tables

1. Selected Economic Indicators, 1997–2002 30
2. Balance of Payments, 2000–04 31
3. Monetary Survey, 1997–2002 32
4. General Government 2000–02 (in millions of leva) 33
5. General Government 2000–02 (in percent of GDP) 34
6. Macroeconomic Framework, 1999–2006 35
7. Medium-Term Balance of Payments, 2000–07 36
8. Indicators of Financial and External Vulnerability, 1999–2002 37
9. Quantitative Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2002 38
10. Schedule of Purchases Under the Proposed Stand-By Arrangement, 2002–04 40

Appendices

I. World Bank Relations 41
II. Statistical Issues 43
III. Fund Relations 47

Appendix Tables

11. World Bank Lending Operations 42
12. Core Statistical Indicators as of June 10, 2002 46
13. ROSCs 49
14. Technical Assistance, 1998–2002 50

Attachment

I. Letter of Intent and Supplementary Memorandum on Economic Policies of the Government of Bulgaria 51

I. Introduction

1. **A staff team[1] visited Sofia during May 8–23, 2002 to hold discussions for the 2002 Article IV consultation and the first review under the Stand-By arrangement.** The mission, joined by World Bank staff, also presented the conclusions of the Financial Sector Assessment Program. The two-year arrangement for SDR 240 million (37 percent of quota) was approved on February 27, 2002. One purchase has been made under the arrangement to date. Policy implementation under the program has been good (see section III. H.). A purchase of SDR 26 million (4 percent of quota) will become available upon completion of this review. Bulgaria's economic program is supported by the World Bank (Appendix I), the EU, and other donors.

2. **The popularity of the coalition has leveled off at fairly low levels, but there is no immediate threat to its remaining in power.** Following a sharp drop in the aftermath of the June 2001 elections amid dissatisfaction with the government's inability to deliver on some major campaign promises, the ratings of the prime minister and cabinet have stabilized in recent months. Tensions within the ruling coalition and between the cabinet and the President—a member of the opposition Socialist party—have eased, and a change in coalition is unlikely in the foreseeable future. While the government has managed to forward its legislative and economic agenda in line with the program, its lower popularity has reduced its ability to advance decisively socially sensitive reforms.

II. Background and Recent Developments

3. **A lack of financial discipline early in the transition culminated in a severe crisis in 1996–97 and the switch to a new policy strategy centered on the CBA.** This strategy—involving tight fiscal and income policies, fiscal flexibility in the face of external risks and ambitious structural reforms—succeeded in restoring macroeconomic stability and narrowing the reform gap with more advanced transition countries. As a result, output growth picked up, inflation decelerated to single digits, and the external debt position improved markedly. Macroeconomic stability, the privatization of a large fraction of non-infrastructure enterprises, the creation of a mostly privately-owned and sound banking sector, and trade liberalization have removed important obstacles to growth.

---

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

4. **However, efforts in several structural reform areas have fallen short of targets.** Tax administration and budget preparation and execution still suffer from significant shortcomings, while the pace of reforms in health care, energy and transportation has been slow. The completion of the privatization of non-infrastructure enterprises has been delayed, and the restructuring of already privatized companies hampered by insider deals. Procedures to impose payment discipline and force the exit of non-viable entities remain inadequate. Finally, further improving the quality of public institutions and reducing burdensome bureaucracy remains an important challenge. In the absence of substantial progress in these areas, budgetary pressures stemming from inadequate revenue collection and unproductive spending will persist and the potential for strong productivity gains and robust growth will not be fully realized.

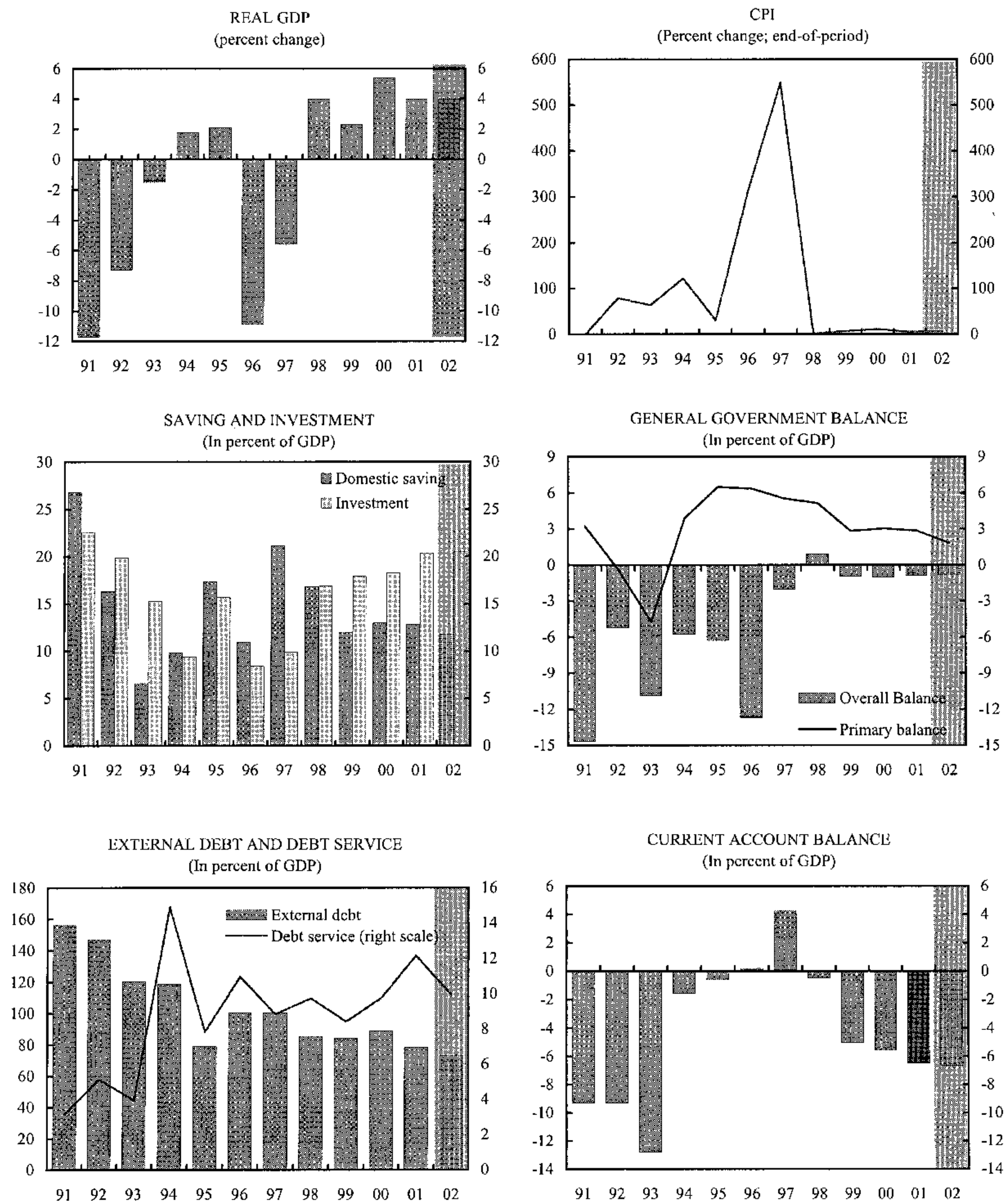
5. **In concluding the 2000 Article IV consultation, Executive Directors emphasized that reaching the goals of a fully competitive economy and rapid sustained growth would require a continuation of the macroeconomic policies that had proved successful under the 1998–2001 extended arrangement, but also an acceleration in the pace of structural reform.** The government that came to office in mid-2001 has adopted and implemented an economic program in line with these prescriptions. In addition, more active debt management has accelerated the decline in the external debt-to-GDP ratio and reduced external risk. The government intends to continue these policies in the medium term. In particular, a deficit of at most 0.8 percent of GDP is targeted for this year, and the budget framework for 2003–05 envisages lowering the deficit from 0.7 percent of GDP in 2003 to zero two years later. The reform agenda is slated for completion in the context of the proposed Programmatic Adjustment Loans (PALs) with the World Bank. On the basis of these policies, the government targets medium-term annual growth of 5–6 percent, a narrowing in the external current account deficit to below 5 percent of GDP by 2007, and a reduction in inflation toward Euro-area levels. EU accession is targeted for end-2006.

6. **Recent output and external developments reflect the slowdown in the EU, while inflation has temporarily accelerated due to domestic factors** (Table 1 and Figures 1 and 2):

- **Output growth has moderated.** In spite of an unfavorable external environment, growth in 2001 as a whole still reached 4 percent. Year-on-year growth decelerated to 3.2 percent in the first quarter as the impact of a slump in industrial output outweighed that of a continued strong performance in services. A tight fiscal stance and weakening household consumption contributed to the slowdown, which was tempered, however, by the loosening in monetary conditions. Industrial output and sales indicators suggest that growth bottomed-out in April.

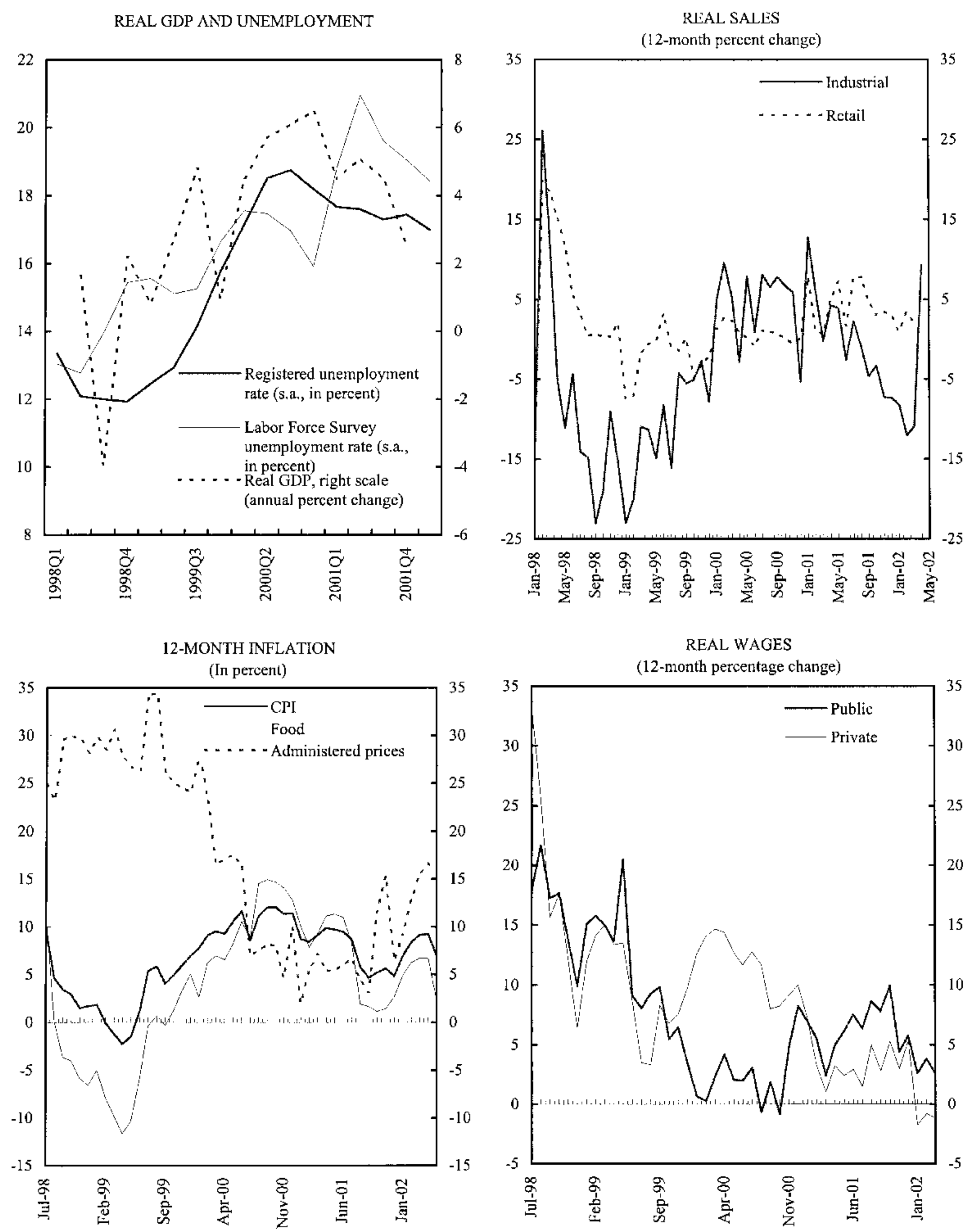
- **The external position remains under pressure.** The current account deficit widened to 6½ percent of GDP in 2001 as a whole. It was broadly unchanged from its level one year ago in the first quarter, but on a twelve-month basis continued to exceed 6 percent of GDP (Table 2 and Figures 3a and 3b). An improvement in the income balance resulting from lower external interest payments was offset by a widening

Figure 1. Bulgaria: Selected Economic Indicators, 1991-2002 1/



Sources: Bulgarian authorities; and Fund staff estimates and projections.
1/ Data for 2002 are projections.

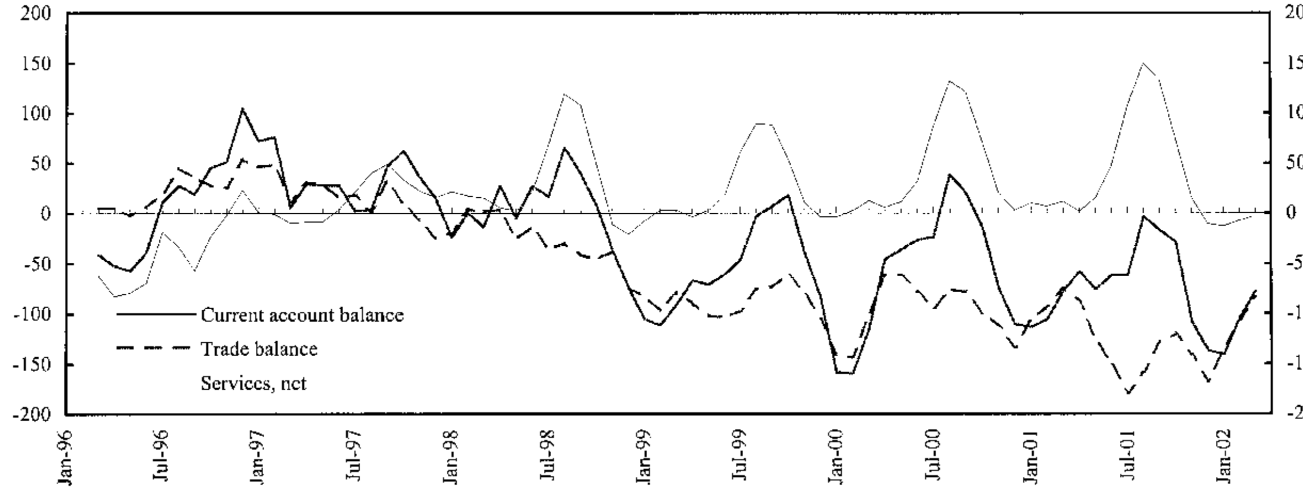
Figure 2. Bulgaria: Real Sector Developments, 1998-2002



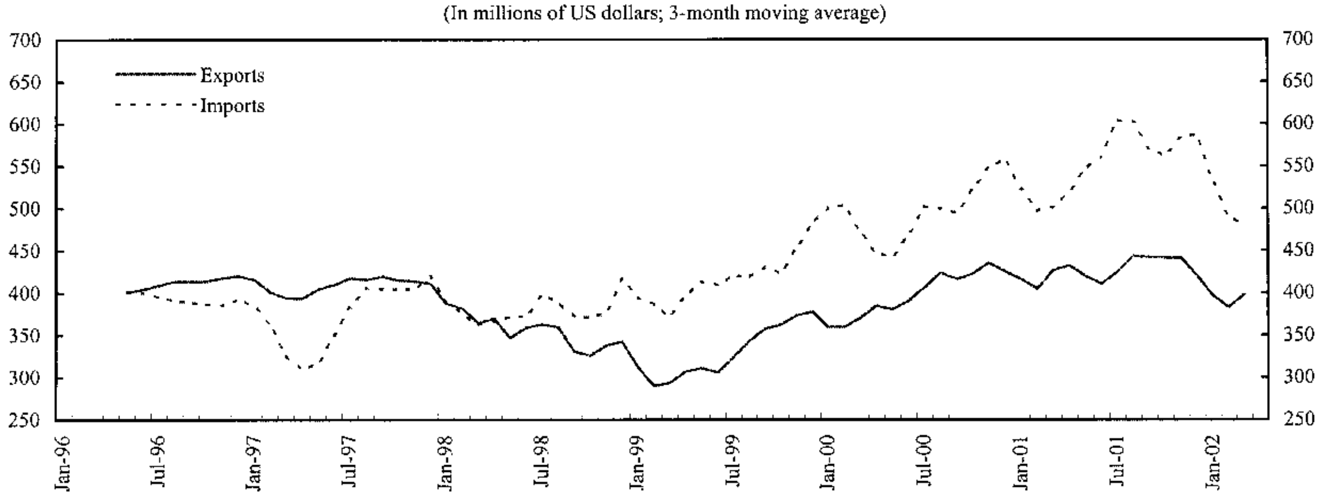
Sources: Bulgarian authorities; and Fund staff estimates.

Figure 3a. Bulgaria: External Sector Developments, 1996-2002

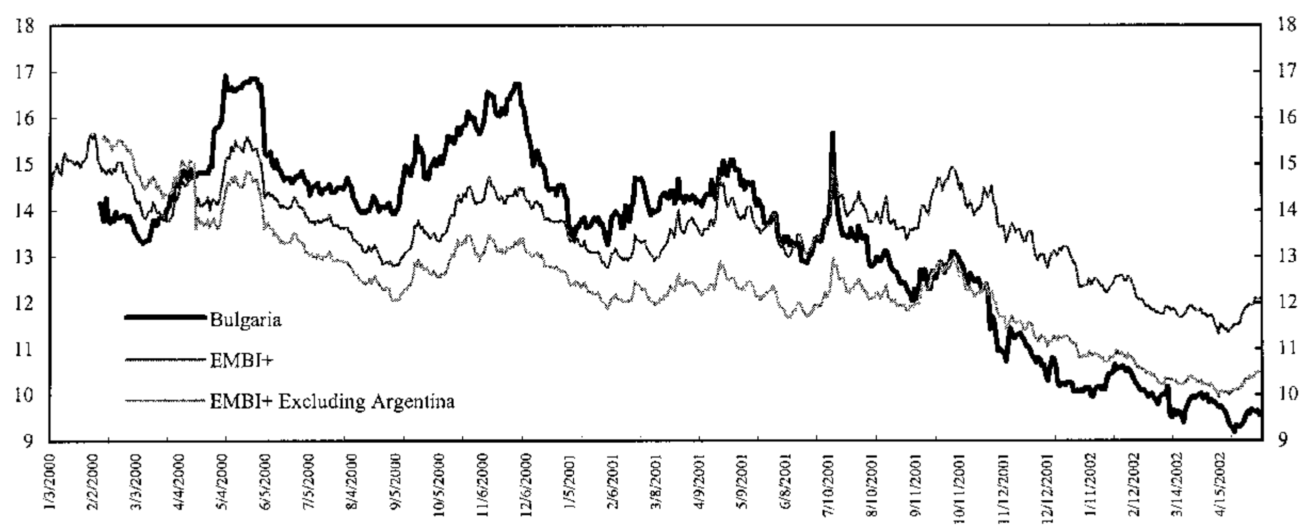
EXTERNAL BALANCE
(In millions of US dollars; 3-month moving average)



TRADE
(In millions of US dollars; 3-month moving average)

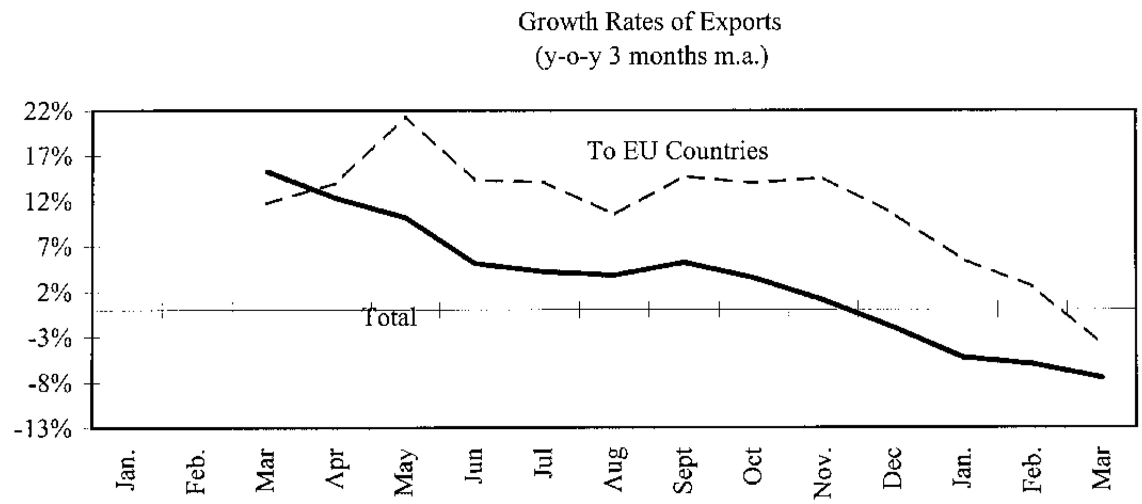


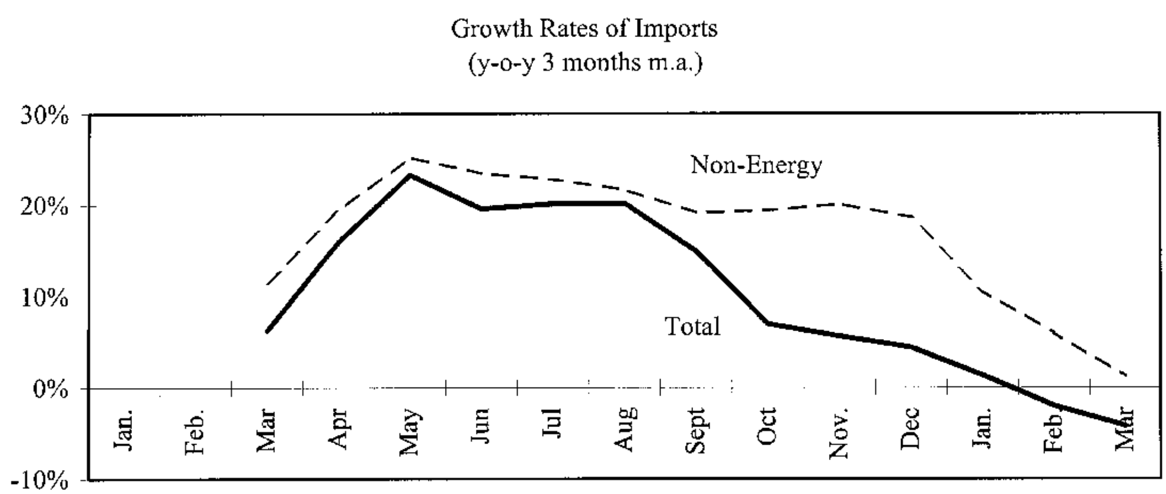
DISCOUNT BRADY BONDS
(Annual stripped yield; in percent)

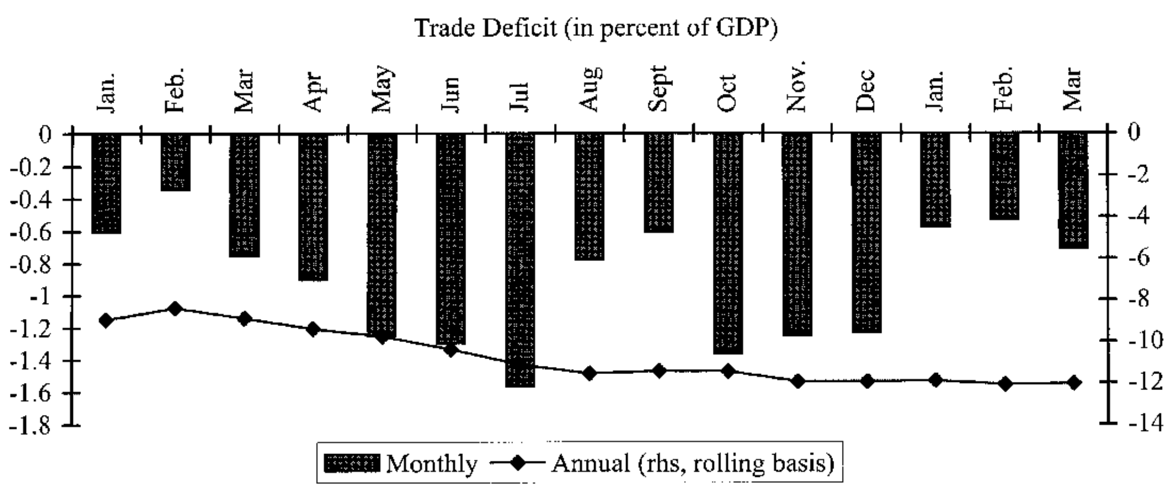


Sources: Bulgarian authorities; Bloomberg; and Fund staff estimates.

Figure 3b. Bulgaria: External Sector Developments, 2001-2002







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

trade deficit. While energy imports declined and growth in non-energy imports slowed in recent months, overall export growth fell at an even faster pace, mainly as a result of weak demand in Bulgaria's EU markets. Exports of non-traditional consumer goods continue to perform well, however, and industrial export sales data for April showed strong year-on-year growth. The financial account weakened in the first quarter as a result of a decline in net foreign direct investment (FDI), to less than US$50 million (compared with a quarterly average of around US$170 million in 2001). While this decline partly reflects the timing of privatizations, indications are that foreign investor interest, in particular in greenfield projects, is weaker than in previous years.

- **Following an acceleration in the first quarter, inflation has moderated significantly** (Box 1).

- **The unemployment rate has stabilized at somewhat below 18 percent** (Figure 4). Unemployment has been little affected by the recent slowdown and continues to mainly reflect structural factors.

7. **Driven by the sound condition of the banking system and the conversion of Euro-zone currencies, monetary and credit aggregates have expanded rapidly**. During the twelve months ending in April, M2 expanded by 17½ percent in real terms, with foreign currency deposits rising by 25 percent (Table 3 and Figure 5). This increase partly reflects the one-off effect of the deposit of cash holdings of former EMU currencies in the banking system, which has funded both additional placements in banks abroad and more domestic lending. Also reflecting an underlying trend toward more intermediation, bank credit to the private sector increased by 16 percent in real terms in the same period, but remained low at about 15 percent of GDP. As banks remain cautious in extending enterprise credit, the growth in loans to households—which in part masks lending to unincorporated small businesses—significantly outpaced that of corporate lending.

8. **The execution of the 2002 budget has been particularly prudent, but the implementation of structural reform measures this year has been mixed.** In the first quarter, the general government recorded a deficit of around 0.1 percent of annual GDP, some 0.3 percent of GDP less than budgeted (Tables 4 and 5). Revenues came in broadly as planned, as an increase in indirect taxes, while having a larger-than-projected effect on inflation, had the predicted revenue impact. On the expenditure side, sizable interest savings materialized as a result of favorable domestic and international interest rate developments while discretionary spending was limited to 90 percent of quarterly budgeted levels. The arrears situation in the district heating companies, public sector hospitals, and municipalities, while continuing to be worrisome, did not deteriorate. Preliminary information suggests that fiscal policy continued to be prudent in the second quarter. In the structural area, however, some reforms have fallen behind schedule. Parliamentary approval of the bank bankruptcy law and the announcement of a schedule for household energy price increases have been delayed and district heating and health care reforms lag. On the positive side, several

Box 1. Inflation in 2002

Cumulative inflation in January-May, at 2.9 percent, raised the 12-month inflation rate to 6.9 percent—above the program projection of 3 ½ percent for end-year inflation. Earlier this year, inflation had exceeded 9 percent before a spike in food prices (beyond seasonal effects) was sharply reversed in May.

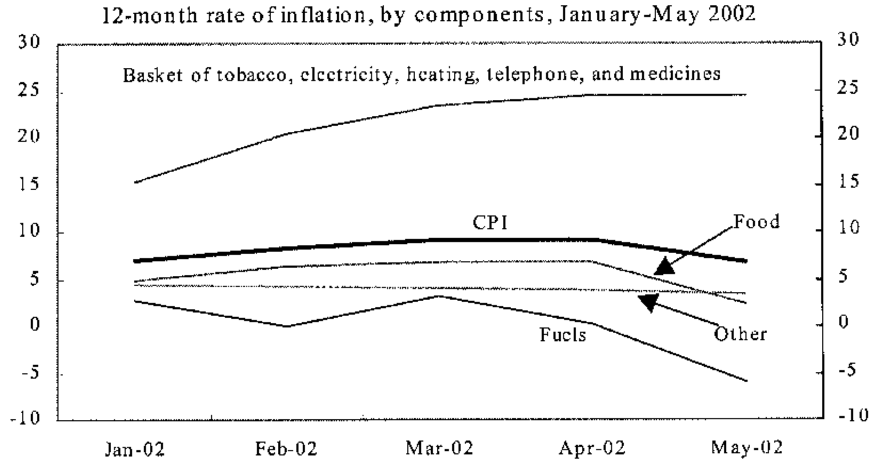
The overshooting is mostly accounted for by:

- A larger-than-expected adjustment in the regulated prices of medicines and cigarettes following an increase in indirect taxes. This raised the CPI by about 2 percentage points, or twice the projection.
- The re-introduction of hikes in administered tariffs for electricity and district heating that had been rescinded by a court decision in late 2001. This accounts for about 0.4 percentage points of the increase in the CPI.

Underlying inflation remained subdued, however, as the price of a basket excluding food and administered items increased by about 3½ percent in the 12 months through May 2002. The producer price index—with a larger impact from higher oil prices—increased by 1.6 percent in the 12 months through May. Moreover, the impact on competitiveness of the temporary upshot in headline inflation is expected to be limited as long as it thus far has not translated into wage increases.

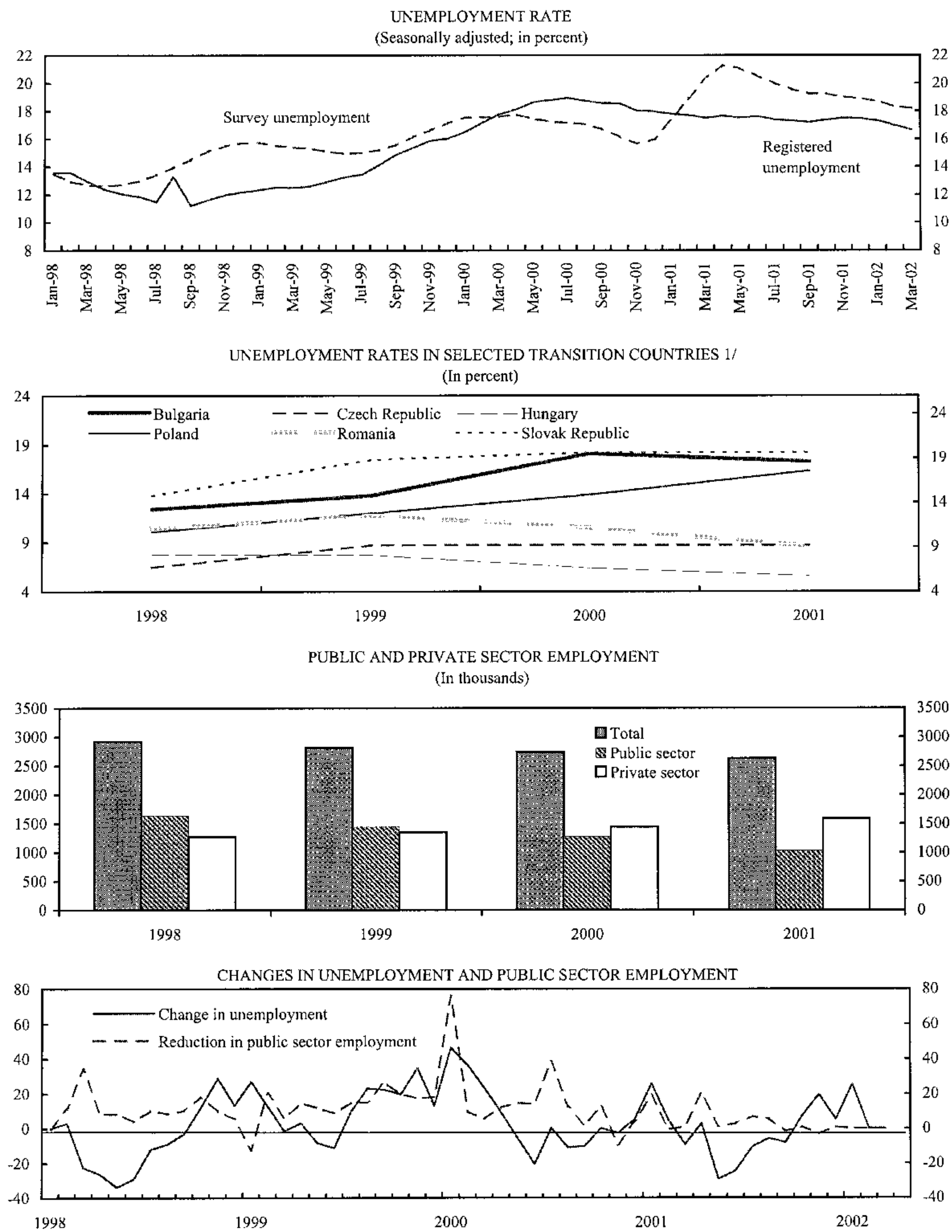
Looking ahead, owing to further adjustments of administered energy prices towards cost-recovery levels, inflation is expected to remain around 7 percent through the end of 2002. Food prices, with a weight of above 40 percent in the CPI basket, will continue to be an important source of volatility.

12-month rate of inflation, by components, January-May 2002



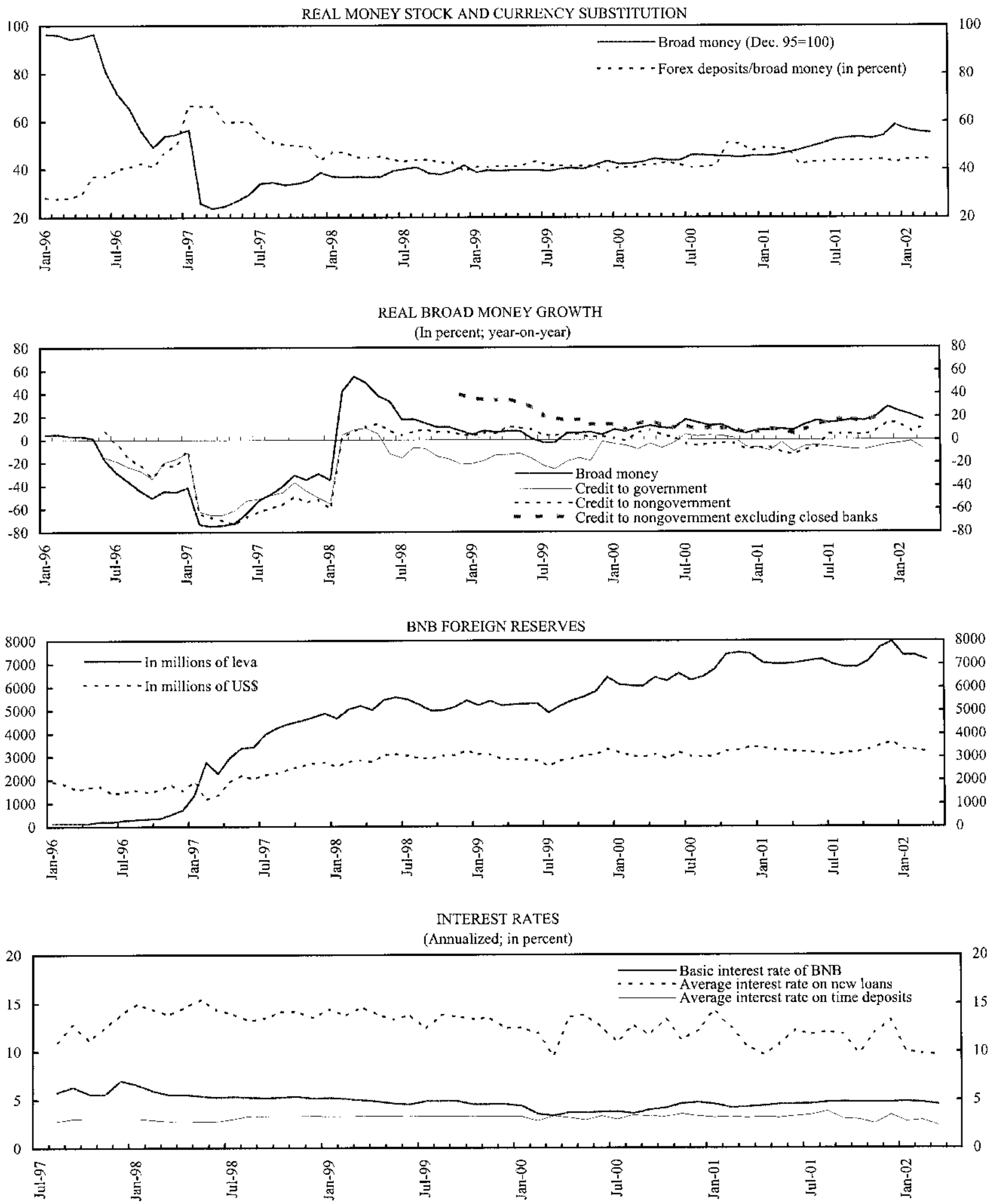
Source: National Statistical Institute.

Figure 4. Bulgaria: Unemployment Indicators, 1998-2002



Sources: World Economic Outlook; National Statistical Institutes; OECD-CCET Labor Market Database on EU applicants; and Unicef.
1/ 2002 data are projections.

Figure 5. Bulgaria: Monetary and Financial Indicators, 1996-2002



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

measures to strengthen the banking sector have been implemented, a program for rationalization in education approved, and steps to improve the business climate taken.

9. **A successful Brady bond exchange has improved the external financing outlook both this year and in the medium term.** The March bond exchange brought down gross external financing obligations by US$30 million in 2002 and by an average of US$45 million per year during 2003–11, but at the cost of somewhat higher annual interest payments from 2003 and a peak in repayment obligations in 2013–15, when the new bonds mature (see Selected Economic Issues Paper). It also reduced the sensitivity of the external debt service burden to U.S. dollar exchange rate volatility and fluctuations in short-term interest rates.

III. Report on the Discussions

10. **Bulgaria's economy continues to face major challenges in spite of the overall strong policy record and improved fundamentals.** Some unfavorable economic developments observed in recent months—growth has decelerated, the external position weakened, and FDI inflows fallen notably short of the current account deficit—could pose significant risks if they were to persist and were perceived as signaling shortcomings of the current strategy rather than a temporary weakening in the external economic and financial environment. The still high level of external public debt and the fiscal pressures stemming from the need for additional spending on social programs and EU accession and from revenue collection problems also remain a challenge. Further, strong productivity gains are needed to improve export performance, cope with the increased competition from further opening to the EU, and raise living standards. Finally, problems of widespread poverty—which, despite falling by two-thirds in the last five years, remains well above 1995 levels—and high joblessness need also to be addressed. Tackling these challenges will require politically difficult choices, and there is a risk that voter disaffection, opposition to socially sensitive measures, and resistance from vested interests may prevent the government from acting decisively.

11. **Discussions focused on the economic strategy to best address these challenges and the associated risks.** The authorities are committed to the continuation of the CBA-centered strategy of prudent fiscal policy, wage discipline, and deep structural reform. Staff fully agreed that this strategy continued to be well-suited to Bulgaria's needs, but stressed that its continued viability required strong policy discipline—on the fiscal front in particular—and increased flexibility in response to external shocks.

A. The Overall Economic Strategy Centered on the CBA

12. **The authorities reconfirmed their commitment to the CBA as macroeconomic policy anchor and their intention to maintain the arrangement until EMU membership.** The CBA continues to enjoy widespread support both inside and outside the government. The arrangement is still credited as the catalyst of the successful stabilization after the 1996–97 crisis, and the confidence of the broader population in both the currency and the banking system continues to hinge on it. Opposition is voiced by some managers of domestic

companies, on the grounds that the fiscal requirements and limits on credit expansion associated with the arrangement stymie growth. But on the whole, industrial and commercial associations, trade unions, economic think tanks, and major foreign investors all support its continuation.

13. **The authorities emphasized that their policy record showed a willingness and ability to operate within the constraints imposed by the CBA.** They indicated that the 2002 budget and the 2003–05 budget plan enshrined further prudent conduct of fiscal policy, while planned public sector reforms would increase the scope for managing fiscal risks and absorbing shocks. Staff welcomed these intentions, but expressed concern that fiscal policy alone would not suffice to cope with large current account deficits and possible shortfalls in FDI, and associated pressures on the foreign exchange reserves position. There was agreement in this regard that the fiscal strategy had to be supplemented by a reform program agreed with the World Bank to make the Bulgarian economy more competitive and more attractive as an investment destination, with the goal of lowering over time the current account deficit and external debt financing needs.

14. **In this respect, staff and the authorities agreed that the large current account deficits did not reflect an exchange rate misalignment but rather the stage of structural and institutional reform.** The ongoing structural transformation of the Bulgarian economy renders any assessment of the equilibrium level of the exchange rate tentative. Staff and the authorities shared the view, however, that standard indicators did not suggest exchange rate misalignment (Box 2). There was also a recognition that recent current account and FDI developments had to be interpreted in view of the slowdown in the advanced economies and the weakened financial position of many international companies. The main obstacles to stronger growth and an improved current account position and sustained increase in FDI inflows were, however, structural and institutional—including slow restructuring in privatized enterprises, weaknesses in the business climate, and inadequacies in the legal and judicial systems.

15. **The authorities noted that their ambitious reform agenda—to be completed by the middle of the decade—would enhance output growth and export potential.** Reform priorities included finalizing the privatization process and the restructuring of key infrastructure sectors—energy in particular—improving entry and exit procedures and the business climate, strengthening institutions, deepening the financial sector, and harmonizing the trade regime with that of the EU. Complemented by measures aimed at making labor markets more flexible, reforms in these areas would also help ensure that, given the constraints of the CBA, fiscal policy would not shoulder an excessive burden in the adjustment to shocks. Staff emphasized that reforms should conform to World Bank recommendations, and that the proposed PALs constituted a solid and comprehensive three-year program for completing the reform agenda. The authorities argued, however, that in addition to implementing this agenda, active measures to steer the restructuring in key industries and promote investment in new activities with high value added should be considered. Such measures included the use of tax privileges and tariff policies to support specific industries, government loan guarantee facilities, and government-financed venture

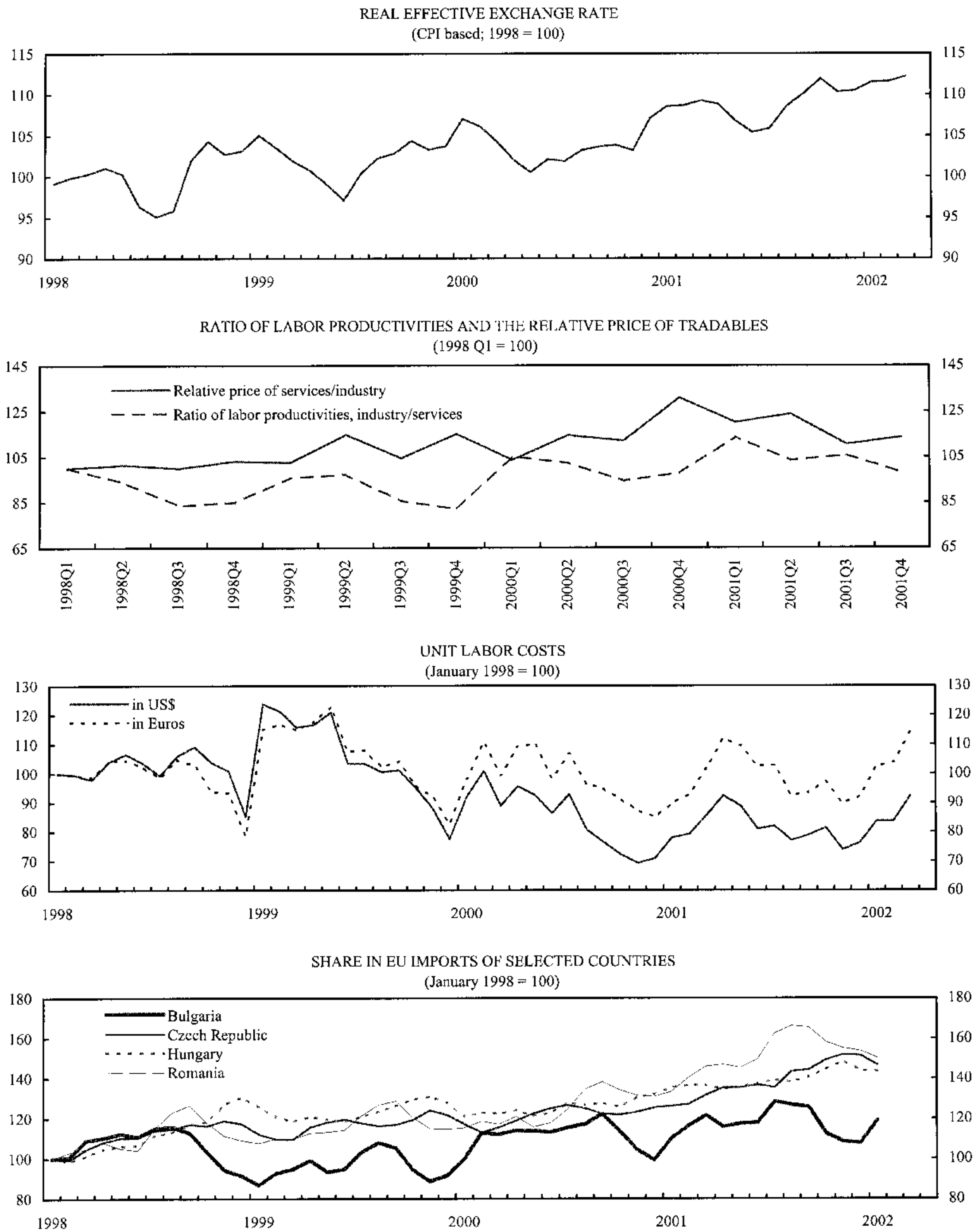
Box 2. Competitiveness and Recent Export Performance

The poor performance of exports in Q1 2002 compared to a year earlier largely reflects the economic downturn in the EU and in other major trading partners, and associated falls in world prices of key Bulgarian exports. The commodity groups that have shown declines are raw materials (minus 10 percent compared to a year earlier) and energy goods (minus 40 percent), where an electricity supply contract with the Former Republic of Yugoslavia came to an end in the second quarter of 2001. On the other hand exports of consumer goods—and in particular of clothing and footwear—have continued to expand. Exports to the EU in this category grew by 12 percent in Q1 2002, and by between 22 and 30 percent year on year in the three previous quarters. A number of other eastern European countries similarly experienced drops in exports and FDI. Bulgarian market shares in the EU have continued to expand, albeit at a slower pace than for other eastern European countries. The real effective exchange rate appreciated by almost 15 percent in 1998–2001. This appreciation was, however, largely in line with productivity gains relative to Bulgaria's main trading partners. Moreover, while the CPI-based real effective exchange rate further appreciated in the first quarter as a result of the acceleration in inflation, over the last two years, Euro-denominated unit labor costs have not shown any upward trend (Figure 6).While the level of the exchange rate is broadly appropriate, structural and institutional weaknesses continue to hold back productivity growth and improvements in export performance.

capital funds. Staff warned that these measures would distort incentives and resource allocation, stimulate tax evasion and rent-seeking, and waste scarce government funds.

16. **The authorities view a further improvement in the business environment as key to spur investment and private sector restructuring and growth.** For both domestic and foreign investors, cumbersome licensing procedures, protracted and unpredictable commercial dispute resolution, and enforcement of court judgments were major concerns. Staff shared the authorities' emphasis on the need to bring the business climate up to EU standards and welcomed recent government initiatives to simplify licensing, but cautioned that further ambitious steps, in line with World Bank PAL recommendations, would be needed to in this area.

Figure 6. Bulgaria: Indicators of Competitiveness, 1998-2001



Sources: National Statistical Institute; and Fund staff calculations.

B. The Macroeconomic Outlook

17. **The 2002 macroeconomic outlook remains overall favorable and substantially in line with the program's targets, with the exception of inflation, which is now projected to be significantly higher.**

- The authorities were confident that the 4 percent growth projected under the program remained within reach, provided EU activity rebounded as anticipated. Staff agreed but noted that, in view of the unsettled external environment and a weaker performance in the first quarter, risks were mainly on the downside.

- In light of the first quarter outcome, the authorities and staff raised the projection for end-year CPI inflation to 7¼ percent.

- Reflecting developments in the first quarter, the authorities projected the current account deficit at 6½ percent of GDP for 2002 as a whole—about ½ percentage point higher than under the program—but were of the view that its financing would pose no problems as FDI was expected to rebound from its first quarter low and cover the bulk of the deficit. The authorities and the staff considered a delayed recovery in the EU, higher oil prices, and delays in privatization of large state enterprises as the main downside risks to the outlook for the remainder of the year, while a depreciation of the US dollar would improve the outlook. Staff calculations indicate that, other things equal and relative to the Spring 2002 WEO projections, a 1 percent reduction in nominal import demand in the EU would translate in a ¼ percent of GDP deterioration in the current account deficit; a 1 percent increase in international interest rates in a ½ percent of GDP deterioration; and a US$4 increase in international oil prices in a 1 percent of GDP deterioration, respectively. A depreciation of the US dollar by 10 percent would result in a 1.2 percent of GDP narrowing in the current account deficit as the effect on interest payments on US dollar-denominated debt and the energy import bill outweigh the loss in competitiveness vis-à-vis the United States, which is a relatively minor trade partner.

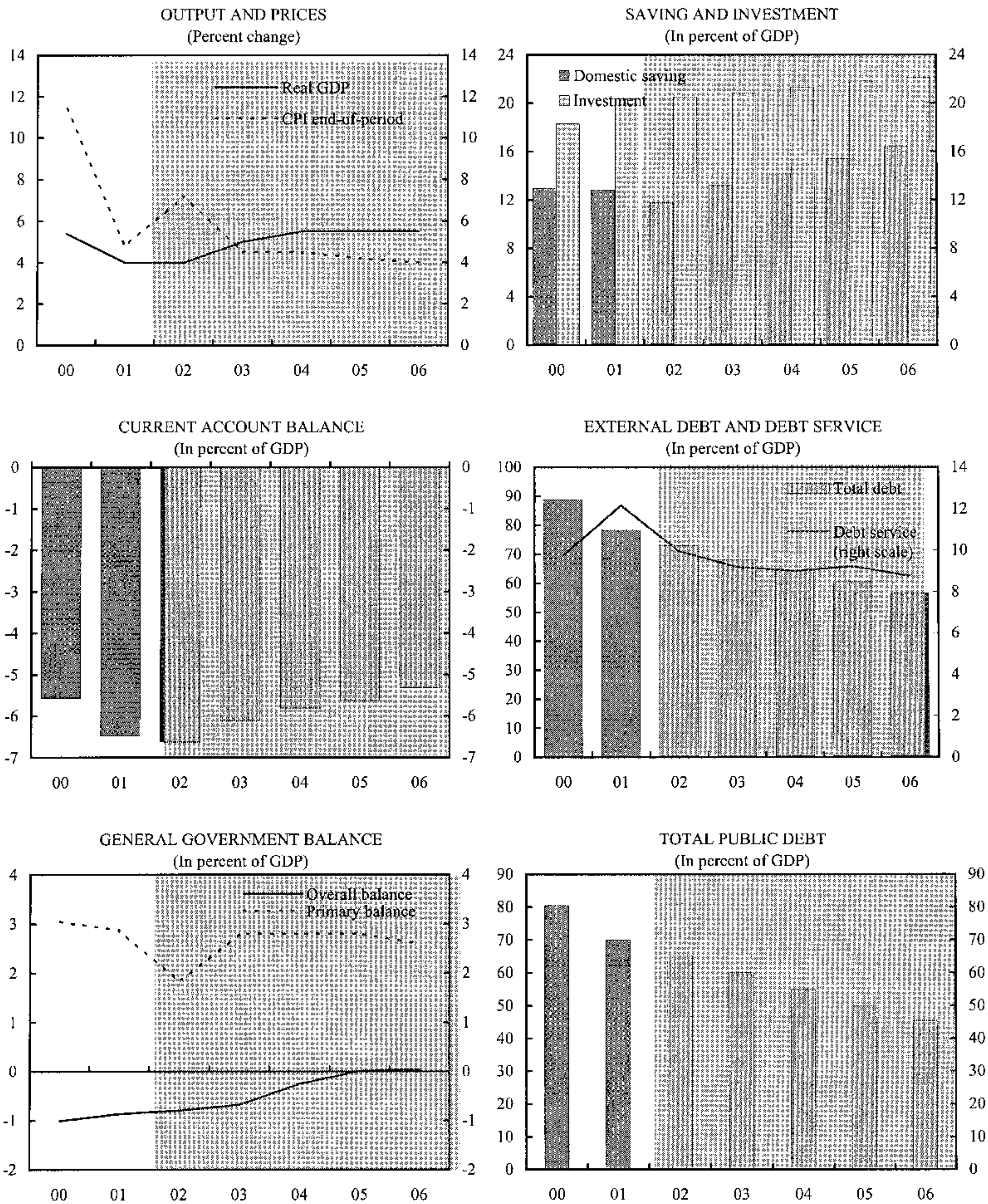
18. **The medium-term outlook—also largely unchanged from that underlying the program—envisages robust growth, a gradual narrowing in the external current account deficit, and a reduction in inflation** (Tables 6 and 7, Figure 7 and ¶6).[2] [3] The

---

[2] Paragraph numbers refer to the Supplementary Memorandum of Economic Policies, Attachment I.

[3] The authorities have revised the historical GDP series, and ratios to GDP have changed accordingly.

Figure 7. Bulgaria: Medium-Term Projections, 2000-06



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

authorities and staff continued to view annual growth of 5–6 percent in the medium term as well within reach. Such growth would require a gradual increase in the investment rate to above 20 percent of GDP, further restructuring to foster productivity growth, and a modest rise in the employment rate. Economic growth, more effective financial intermediation and increased corporate profitability are expected to contribute to an increase in the private saving rate while a continued tight fiscal policy and shift from current to capital expenditure would raise government saving (Selected Issues and Statistical Appendix, SM/02/205). Consistent with these developments, the current account deficit would decline to about 4½ percent of GDP by 2007 and be largely covered by FDI over the medium term, helping to bring down the external debt-to-GDP ratio. Given that the upshot in inflation this year appears to be temporary, the rise in consumer prices in 2003 and beyond is projected to exceed Euro-area levels only as a result of further adjustments to administered prices and continued productivity gains in the tradable goods sector and associated relative price adjustment.

19. **A medium-term sustainability analysis suggests that the risk of debt service difficulties is limited.** At the end of the first quarter of 2002, the total external debt stock stood at 71 percent of projected 2002 GDP, with public external debt amounting to 58 percent of GDP. Gross official reserves exceeded twice short term debt measured on a remaining maturity basis (Table 8). The Brady debt swap has reduced the interest rate sensitivity of the bonded debt, with the share of floating interest rate debt falling to 74 percent. Given a conservative public debt policy and some moderate increase in private external debt, the total external debt-to-GDP ratio is expected to fall from 78 percent in 2001 to about 50 percent over the next five years. A sensitivity analysis indicates that the debt service will not be strongly affected by even major movements in interest or the US dollar exchange rates. For instance, an immediate return of interest rates from their current low levels to longer-run averages would increase the NPV of the public debt service by only about 3 percent. Should the recent depreciation of the US dollar persist, this would result in a sizable reduction in the lev value of the 58 percent of the public external debt stock that is US dollar-denominated, bringing total public debt to below 60 percent of GDP already this year.

C. Fiscal Policies

20. **There was a common understanding that the program's overall deficit target of 0.8 percent of GDP for 2002 remained appropriate for now.** In spite of an upward revision of nominal GDP, revenue was not expected to overperform relative to the budget, in part because the revision reflects the inflationary impact of a budgeted increase in indirect taxes (see above). The moderate worsening of the current account position in the first quarter relative to program targets was viewed as largely reflecting external factors that would turn around in the second half of the year. In addition, there were downside risks to economic growth which would be exacerbated by tightening the deficit target. Accordingly, it was agreed to leave open the option that, to the extent the overall deficit target would be met, the projected 0.4 percent of GDP in savings on interest payments could be used for additional non-interest expenditures according to budget priorities. In view of the sizable risks to the external outlook, however, such spending would only be made in the fourth quarter, and

provided that at that time the external position would be consistent with the original program projections and that staff would have been consulted on these spending plans. In this case, the corresponding modest decline in the primary surplus could be justified accordingly. To provide an additional cushion, the authorities also agreed to continue to apply the 90 percent rule, not spend most of the structural reform contingency, and save any revenue overperformance and the accrued interest realized from the March debt swap until the fourth quarter, and then only use these resources under the above-mentioned conditions.

21. **However, staff noted, and the authorities concurred, that should the current account deficit widen or international reserves decline significantly relative to program projections before the fourth quarter, additional fiscal adjustment would be needed.** While such tightening could have a modest negative impact on growth in the short run, it would be necessary to stem the unfavorable developments and maintain confidence domestically and abroad. In these circumstances, staff would initiate a consultation on the nature and timing of further adjustment and the authorities would stand ready to implement a number of identified contingency measures, which could reduce the deficit by some ¾ percent of GDP (¶12-13)

22. **The authorities fully understand that accelerating reforms in the public enterprise, health and education sectors is key to limiting subsidy needs (¶16).** The staff expressed concern that slower-than-programmed progress on structural reforms—delays in district heating company restructuring, energy price increases, and health care reforms in particular—could complicate budget implementation in the second half of the year, as pressures for increased subsidies or arrears clearance would build. The authorities indicated their firm intention to resist any demand for more subsidies, but noted that reform delays could aggravate the arrears problem and make a one-time clearance operation in the fourth quarter advisable. The staff argued that priority should be given to keep reform efforts on track, and that such operation should only be considered if the conditions for additional fourth-quarter spending were satisfied and additional deep reforms to prevent the build-up of new arrears were imposed. In this regard, they welcomed the planned reform of fiscal decentralization, which would strengthen the revenue and expenditure autonomy of the municipalities and reduce their incentives to incur arrears (see Selected Issues paper).

23. **Ongoing efforts to enhance tax administration and expenditure management will help achieve fiscal objectives both this year and in the medium term (¶14–15).** The authorities indicated their intention to implement the recommendations of the IMF's Fiscal Affairs Department (FAD) technical assistance in tax administration, and in particular to ensure the implementation of the Unified Revenue Agency (URA) project according to schedule, and were confident that the targets for including additional accounts in the Treasury Single Account by year-end would be met. They also noted that efforts to make the budget process more transparent and results-oriented would allow government spending to be focused increasingly on high priority programs.

24. **The authorities argued that their medium-term fiscal program, including the plan to balance the budget, was tailored to the requirements of the CBA.** The 2003–05

budget framework envisages to eliminate the deficit by 2005, and to reduce the overall tax burden, while shifting from direct to indirect taxes (¶17). In particular, the plans are to cut the corporate profit tax rate—from the current 23.5 percent to 15 percent in 2005—and the personal income tax rates for the lowest and middle brackets, while raising excise taxes for alcohol, tobacco, and fuels toward EU levels. In addition to a lower corporate tax rate, investment will also be stimulated by a more rapid depreciation of certain classes of assets. Reductions in the social security contribution rate planned for 2004 would be linked to improvements in tax collections. Non-interest expenditure as a share of GDP would be cut in tandem with the reduction in the tax burden, as improved budget preparation and management would help raise the efficiency of spending programs, and public sector wage growth would be capped. Staff supported this medium-term framework, noting that the tax policy proposals were largely in line with the FAD technical assistance recommendations. While the projected return of growth to its medium-term potential in 2003 and beyond would help boost revenue, continued efforts to improve tax administration would also be necessary. Staff emphasized that the successful implementation of the medium-term program would require more specific plans to cut subsidies and unproductive spending, better target social assistance, advance the pension reform program, and make room for EU accession-related spending, and strong efforts to meet the targets in these areas.

25. **A public debt strategy that aims to bring down the debt-to-GDP ratio and reduce exposure to exchange and interest rate risks would further reduce vulnerabilities.** The planned elimination of the budget deficit by 2005, and the March debt swap were major steps toward achieving these objectives. The authorities also reiterated their intention to increase the share of domestic debt to both diversify funding sources and stimulate the development of local securities markets (see Selected Economic Issues Paper). The staff endorsed this debt management strategy, but strongly encouraged the authorities to formulate explicitly and publish it. It was also important to have Parliament approve the Sovereign Debt Law, which provided the legal underpinnings for the strategy and put in place additional safeguards in the form of strict ceilings on general government debt aimed at meeting the Maastricht debt norm and control over external debt issuances by municipalities.

D. Incomes Policy and Labor Market Flexibility

26. **The authorities have continued to implement a strict incomes policy but have refrained from further initiatives to increase labor market flexibility.** The authorities reconfirmed their view that their incomes policy—which maintains a close link between financial performance and wages in state-owned enterprises—was essential to strengthen financial discipline in the state enterprises and guide wage formation in the broader economy. The wage bill for 60 closely monitored enterprises (monopolies, enterprises receiving subsidies, and those with largest losses and arrears) in the first quarter of 2002 was virtually unchanged from that in the third quarter of 2001 (a program performance criterion allowed for an increase of up to 2 percent). Facing strong opposition from the unions, however, the authorities expressed reluctance to move ahead quickly with amendments to the labor code that would enhance the flexibility of the labor market—for now they are planning only to bring the labor code in line with EU requirements (¶ 18). While the authorities agreed that

increased labor market flexibility could be useful in bringing down unemployment, they considered their active labor market policies and measures to improve the business environment to be more effective.

E. Financial Sector Policies

27. **In line with the FSAP recommendations, the authorities envisage to strengthen banking supervision and develop nonbank financial institutions and securities markets** (Box 3). The authorities agreed that conditions were now in place for a healthy expansion in bank credit to the private sector, and that such expansion would require a strengthening in banks' risk management practices and banking sector supervision. They were, however, contemplating a more pro-active approach to stimulating the equity market than recommended in the FSAP, including through tax incentives and floating state-owned share packages. Staff argued that the authorities should consider carefully the scope for government-sponsored initiatives to stimulate equity market development and avoid measures that distort the allocation of savings. In particular, while welcoming amendments to the Securities Act to strengthen minority shareholders' rights, staff argued that further steps to strengthen legislation relating to information provision, shareholder protection and corporate governance would offer the best way forward to foster equity markets. But staff questioned the authorities' plans to float shares, noting the likely negative impact on their attractiveness to potential strategic investors and reiterated concerns with tax incentives to spur equity transactions.

28. **Discussions also focused on recent initiatives to further strengthen the health of the banking sector, including those to finalize its privatization (¶19–20).** The authorities are continuing to enhance banking supervision, improve the legal and institutional frameworks for anti-money laundering, and tighten bank accounting standards. As the adoption by parliament of the bank bankruptcy law (end-March 2002 benchmark) had been delayed once more, the authorities had intensified their efforts to ensure its passage no later than by end-July 2002—when the current parliamentary session ends. The privatization of Biochim bank and the State Insurance Institute (DZI) are headed for completion by end-year, while a tender was issued for the selection of a consultant to advise the privatization of the State Saving Bank (DSK), the completion of which is planned for mid-2003.

F. Other Structural Reform Policies

29. **The authorities are implementing ambitious plans to finalize the privatization of non-infrastructure companies, but risks remain (¶21).** Staff welcomed the new privatization law which eliminates preferential treatment for management and employees, and increases transparency. While the authorities were confident that the sale of majority packages in Bulgartabac and the state telecommunications company would be completed by August 2002, the staff expressed concern that operational and employment requirements, the retention of a golden share, and the lack of profitability of some of Bulgartabac's units would affect the price offers and could delay the completion of the sales. Regarding minority holdings, the authorities reiterated their commitment to finalize their divestiture by year-end.

Box 3. Conclusions of the FSAP Report

The FSAP mission found that the Bulgarian banking system is generally well supervised, highly capitalized, profitable, and risk-averse. Stress tests suggest that the banking system is resilient to foreign exchange and interest rate risks and can absorb considerable credit risk. This speaks well of the efforts by the Bulgarian authorities to restore the soundness of the banking system in the aftermath of the 1996–97 crisis. These efforts resulted in consolidation, privatization, and restructuring in the banking system. Banks have maintained prudent lending policies, contributing to a low level of intermediation. However, over the past 12 months, private sector credit has accelerated, which requires that bank supervisors redouble their vigilance. In particular, the BNB should deepen its expertise in modern risk management, while ensuring that banks enhance their risk management systems. In the coming years, additional vulnerabilities could result from the increased competition smaller banks are expected to face and from remaining weaknesses in the legal and judicial framework and corporate financial transparency.

The nonbank financial sector is underdeveloped and does not in the short run pose a systemic risk. However, there is a need to implement a sound pension reform to ward off future fiscal costs, while bolstering the institutional and regulatory frameworks in the insurance and pension fund areas.

The main recommendations of the FSAP mission include:

- Allow regulatory authorities to vet the identity and suitability of direct and indirect shareholders in financial institutions.
- Heighten monitoring of smaller banks and be prepared to deal with those not able to withstand the expected increase in competition.
- Seek expeditious parliamentary approval of the Bank Bankruptcy Law.
- Continue the program to build expertise in assessing and supervising banks' risk management.
- Develop and disclose a Debt Management Strategy and pass in Parliament the draft Public Debt Law.
- Improve the legal and judicial frameworks for creditor rights and insolvency, corporate governance and financial transparency.
- Strengthen the supervisory capacity of the State Insurance Supervisory Agency, and the governance of pension insurance companies and pension funds by revising the legislation in these areas.

The authorities were in a broad agreement with all the assessments and recommendations of the FSAP mission. They have begun to act on them, as indicated in the FSSA, and are already using the FSAP in their accession negotiations with the European Union.

The assessment of anti-money laundering and combating the financing of terrorism (AML/CFT) policies found that the legal and regulatory framework is consistent with international AML/CFT standards and good practices, but it also pointed to a number of improvements, the most important of which is to strengthen the independence and resources of the Financial Investigation Bureau (FIB) and other AML/CFT services. The newly appointed management of the FIB has undertaken to reorganize the Bureau. The computer systems, working methods, and tools are being upgraded with technical and financial assistance from USAID, and additional staff hired. The agencies involved in AML/CFT have enhanced the coordination of their activities, and legislative amendments to strengthen and broaden AML/CFT operations are being prepared.

30. **The restructuring of the railway is broadly on track, but the authorities have been hesitant to move ahead with energy sector reforms (¶22).** Railway restructuring has progressed through the upgrade of equipment and lines and downsizing the workforce. Staff welcomed this progress but underscored the need to accelerate restructuring and limit government subsidies (about ¾ percent of GDP) to high priority social goals. As to the energy sector, staff underlined that bringing household electricity prices to full cost-recovery levels was crucial both for fiscal reasons and to eliminate significant distortions in the economy. The authorities accepted these arguments, indicating that the announcement of a schedule to achieve cost recovery had been delayed only to ensure that accompanying social protection plans could be put in place, and planned to announce the increases before end-June.

31. **Maintaining financial discipline in both state-owned and private enterprises will require strict measures to ensure that all payment obligations on account of energy deliveries are fully met (¶23).** The mission impressed upon the authorities the need to ensure that current payments to state-owned energy utilities were made on time and the stock of arrears—which exceeds 1½ percent of GDP—reduced. Staff and the authorities agreed on measures that would strengthen the finances of these utilities, allow them to undertake critical maintenance and investment, and facilitate their restructuring. In addition, they would eliminate implicit subsidies to nonpaying enterprises and reinforce hard budget constraints in the enterprise sector.

G. External Sector Policies

32. **The external debt management policy for 2002 aims to reduce the outstanding public sector component of the debt and maintain ample liquidity in the fiscal reserve account (FRA)** (¶24). In the wake of the Brady bond swap, the authorities' stated policy for the remainder of the year is not to issue new Eurobonds and take a conservative approach in contracting and guaranteeing other external public debt. As a result, the external public debt is projected to fall by US$171 million, or 1¼ percent of GDP, between end-2001 and end-2002. The authorities also intend to manage more actively the foreign currency-denominated assets in the FRA—while safeguarding adequate liquidity—and outstanding external claims (with a face value of about US$2.3 billion). In this regard, they agreed that claims on HIPC-eligible countries would not be sold in the secondary market but be settled directly on terms comparable to those under the HIPC initiative.

33. **The staff urged the authorities to set ambitious targets for further tariff reduction and refrain from protectionist measures.** The authorities target a reduction in the average most favored nation (MFN) import tariff to 6 percent by 2006. To achieve this objective, they brought down the MFN rate from 12.4 to 11.1 percent in the 2002 customs tariff and aim to approve a schedule of medium-term MFN tariff reductions. The authorities explained that the first application of a temporary safeguard measure (on fertilizers) and an antidumping investigation (on certain food imports from Turkey) did not represent a shift towards discretionary protection. Bilateral trade in industrial products with the EU was now free of tariffs, and government procurement procedures in line with WTO requirements. The

authorities have refrained from granting selective investment incentives and guaranteed equal treatment of foreign investors.

H. Monitoring and Review Issues

34. **Policy implementation under the program has been good as all quantitative performance criteria for end-March were met, and those for end-June are expected to be met (Table 9).** As the macroeconomic policies initially envisaged under the program remain appropriate, staff proposes that all indicative targets for end-September and end-December be converted to performance criteria. The external debt limits (for over one year debt, excluding Eurobonds) for end-September and end-December are proposed to be raised slightly from the indicative targets to reflect possible higher disbursement under World Bank loans and movements in the US dollar-euro exchange rate (Annex VI of the SMEP).

35. **There have been delays, however, in some areas of structural reform, as one structural benchmark for end-March was not implemented and one structural performance criterion for end-April was not observed** (Box 4). Consequently, understandings on a number of remedial actions were reached (Table 1 in the SMEP):

- Parliamentary approval of the bank bankruptcy law, originally a benchmark for end-March, is now a structural benchmark for end-July;
- The announcement of a schedule for household electricity price increases, initially a performance criterion for end-April (for which the authorities are requesting a waiver) will now take place as a prior action for Board consideration of the first review;
- Completing the privatization of Biochim Bank, a key step toward enhancing financial intermediation, is also a structural benchmark for end-September;
- Finally, with a view to speeding energy sector reform, and encouraging further economic restructuring, an understanding was reached on a quantitative performance criterion limiting arrears to the two major state-owned energy companies.

I. Data Issues, Standards and Codes, and Safeguard Assessment

36. **The staff and the authorities discussed further steps to improve the quality of data provision and compliance with international standards and codes.** The quality and timeliness of data provision is generally adequate for program monitoring and surveillance, but important deficiencies remain in a number of areas (Appendix II). The authorities were interested in having an in-depth assessment of the quality of Bulgaria's economic statistics through participation in a data quality ROSC. In the context of the FSAP, detailed assessments were prepared of the observance of standards and codes in the financial area, summaries of which are included in the FSSA. In addition, the authorities prepared a self-assessment based update of the data dissemination and fiscal transparency ROSCs. The safeguard assessment was completed on June 12 (Appendix IV).

Box 4. Structural Conditionality

Coverage of Structural Conditionality in the Program

A key component of the program is an ambitious structural reform agenda. This agenda is motivated by the need to cement macroeconomic stability, given the constraints of the currency board arrangement, and to complete the transition process. Conditionality for the remainder of 2002 focuses on areas that are macro-crucial and fall within the Fund's expertise (Table 2 of SMEP). Given the key role played by fiscal policy and the medium-term fiscal challenges, completing the Unified Revenue Agency and Treasury Single Accounts projects, and improving the budget process are subject to structural benchmarks. To complete the move toward a competitive and fully-functioning market economy, a strict incomes policy for major state enterprises, adopting a bank bankruptcy law, completing financial sector privatization, and further trade liberalization are also covered by such conditionality. The program subjects to conditionality in the form of performance criteria or benchmarks a number of measures that are outside the Fund's core competence but that, in view of their fiscal implications, are critical for the program's objectives. These measures, the design of which are based on World Bank inputs, aim to advance reforms in the education and health care sectors, and announce a schedule to raise household electricity and district heating prices to cost recovery levels.

A number of other measures that are relevant to achieve the program's objectives and are within the Fund's core competence—in such areas as tax policy, public expenditure policy, financial sector development, and external debt management—are monitored in the context of reviews but are not subject to structural performance criteria or benchmarks. Reforms that are relevant for the program's macroeconomic objectives but are outside the Fund's core responsibility—including advancing labor market and pension system reform, completing privatization in a transparent manner, raising the efficiency of the energy sector, and improving the business climate—will be closely monitored by Fund staff, but covered by World Bank conditionality.

Status of Structural Conditionality from Earlier Programs

Bulgaria has complied with the main structural conditionality measures under the EFF arrangement that expired in September 2001. However, two structural benchmarks were not met as the outgoing Parliament failed to approve draft amendments to the Energy Law, which also put on hold the enactment of corresponding secondary legislation. Parliament at the end of 2001 approved amendments that allow a full implementation of the rehabilitation program for the district heating sector. The other amendments from the package will be part of a new Energy Act which is expected to be prepared by September 2002. In view of the important fiscal implications, the program includes structural conditionality on having this new Act finalized. In addition, two privatization-related structural benchmarks are still outstanding, as the process of divesture of residual state shares and the sale of assets of a number of liquidated enterprises has not been completed. Finalizing these measures is expected to be subject to World Bank conditionality.

Structural Areas Covered by World Bank Lending and Conditionality

The World Bank is preparing a Programmatic Adjustment Loan (PAL) which will take a comprehensive approach toward identifying Bulgaria's remaining reform needs and include detailed structural conditionality in a number of areas that are relevant to the new program. The PAL is expected to be approved in the late summer of 2002 and will be structured as three one-year operations. The first operation would focus on private sector development and would include measures to (i) complete the privatization of financial institutions and non-infrastructure enterprises and advance the restructuring of the energy and infrastructure sectors; (ii) strengthen the legal and regulatory framework governing business activities; (iii) increase the flexibility of labor markets and alleviate the social costs of labor retrenchment and reallocation; and (iv) stimulate the development of contractual savings institutions and financial markets. The main focus of the second operation would be public administration reform, with an emphasis on strengthening the judicial system. The third operation would aim at completing the reform agenda. The World Bank has also completed a Public Expenditure Review, the results of which will help support Fund advice on expenditure policies.

Other Relevant Structural Conditions not Included in Current Program

The program does not any longer cover agricultural policies. While the agricultural sector continues to have important macroeconomic relevance, as it accounts for more than 10 percent of GDP, progress in reforming the sector is covered by a World Bank loan operation and has been steady while accession-related EU involvement is growing.

IV. Staff Appraisal

37. **Bulgaria has made impressive progress since adopting in 1997 a policy framework centered on a CBA, prudent fiscal policies and comprehensive structural reforms, but important medium-term challenges remain.** Economic growth has picked up and inflation and the public sector debt burden have declined sharply. Major steps have also been taken toward achieving a competitive and flexible market economy. However, external debt is still high and the current account deficit will likely remain sizable over the medium-term, constraining policy options. Unemployment has yet to decline from the high levels reached following the initial impact of restructuring, and poverty rates are still above pre-crisis levels. More generally, the transition in Bulgaria is still less advanced than in most other EU accession candidates.

38. **In responding to these challenges, the government is committed to continuing the present broad policy approach, in particular reaffirming its intention to maintain the CBA until euro adoption, continue prudent macroeconomic policies, and accelerate structural reform.** Staff supports this approach, as the CBA has served Bulgaria well, remains viable, and anchors the government's sound economic policies. Moreover, the authorities have indicated in word and, more importantly, action, their willingness and ability to implement the fiscal and structural policies necessary to support the CBA. The level of the exchange rate is broadly appropriate, but completing the structural reform agenda will be key to ensure that Bulgaria can face the increased competition associated with EU accession and will achieve the strong productivity gains needed for income convergence.

39. **The authorities' response to heightened external risks in the past nine months has been appropriate, and underlines their commitment to policies consistent with the CBA.** While the slowdown in the EU and other trading partners has contributed to a rising external current account deficit and declining FDI, the risks have been managed in large part through the flexible implementation of fiscal policy. The government has reaffirmed its commitment to prudent policies by its overperformance on the fiscal side in the first quarter of 2002 and in the steps taken to ensure that fiscal adjustment can be successfully implemented if required later in the year. Further, despite higher-than-anticipated inflation, the authorities have held the line against demands for additional increases in public sector wages, which could have adversely affected competitiveness. Nevertheless, these developments illustrate Bulgaria's vulnerability—as an open economy operating under a CBA—to external developments, and underline the need to complete economic restructuring and ensure the needed flexibility to handle future shocks.

40. **The medium-term fiscal strategy is also appropriate, but its successful implementation relies on an acceleration of structural and public sector reforms.** The authorities intend to continue the pro-growth policy of gradually lowering income tax rates and, to the extent possible, social security contributions while strengthening spending in key areas, including for the social safety net and EU accession. To maintain a prudent fiscal stance and eliminate the budget deficit by 2005 as planned, it is crucial that these steps be supported by rapid progress on structural reforms to cut subsidies and other less productive

expenditures. In addition, the government needs to move ahead forcefully on improving tax administration and expenditure management. Staff support the authorities medium-term intentions to further lower the public debt-to-GDP ratio while, in the wake of the successful Brady swap, seeking additional opportunities to lower risk by improving the currency composition and maturity structure of the debt.

41. **The authorities' structural reform program is ambitious, but implementation needs to be stepped up.** In particular, while the energy sector reform program aims appropriately at privatization and increased competition, delays in restructuring district heating companies and increasing energy prices toward cost-recovery levels need to be overcome. The privatization program for remaining large state enterprises is moving forward largely as planned, but risks remain. Further delays in increasing the flexibility of labor markets should be avoided. Finally, some progress has been achieved in improving the business climate, but much remains to be done, including to strengthen the legal system.

42. **The authorities should resist the temptation to involve the government more actively into decisions of resource allocation.** Rather, structural reforms should continue to focus on removing obstacles to investment and growth. In this regard, staff urges the authorities to forgo efforts to set up public venture capital funds, expand existing government loan guarantee facilities or utilize tariff policies to shelter industries from competition, and eliminate implicit subsidies in the form of arrears to government-owned utilities. Similarly, using the tax system to stimulate specific industries can create distortions in incentives and open up new avenues for tax evasion and other rent-seeking behavior.

43. **The financial sector is healthy and oversight is strong, but neither has been fully tested.** The FSAP underlined that systemic risks to the sector are currently small, as financial intermediation remains limited. It is important that the authorities continue their strong efforts aimed at ensuring that the sector can handle the risks of more rapid growth in private sector credit—the beginnings of which we already observe—and medium-term challenges presented by EU accession. The expected successful privatization of Biochim Bank and initial steps toward sale of DSK augur well for the development of the banking system. However, staff strongly urges the authorities to have the bank bankruptcy law adopted during the current parliamentary session.

44. **The authorities have made substantial progress in improving data quality and transparency.** Data are adequate for purposes of surveillance and program monitoring, but the authorities should follow up on their intentions to take action to address remaining weaknesses.

45. **The staff supports the authorities' request for completion of the first program review under the stand-by arrangement.** Solid implementation of policies to date and policy intentions as signaled in the Supplementary Memorandum of Economic Policies provide a sound basis for continued Fund support. Staff supports the authorities' request for a waiver for non-observance with the end-April performance criterion on the basis of the corrective action entailing the announcement of a schedule for household electricity price

increases. The delay reflected the need to develop a complementary plan for social assistance to the poorest households and the schedule will be announced as a prior action. Staff also supports the request for waivers of applicability of the end-June 2002 quantitative performance criteria (other than the external debt performance criteria) as data necessary to assess their observance are not available and staff fully expects these performance criteria to have been observed.

46. **It is proposed that Bulgaria move to a 24-month consultation cycle as long as the current stand-by arrangement remains on track.**

Table 1. Bulgaria: Selected Economic Indicators, 1997-2002

	1997	1998	1999	2000	2001	2002 QI
Output, prices, and employment			(Period average; percent change, from same period of previous year)			
Real GDP	-5.6	4.0	2.3	5.4	4.0	3.2
Real retail sales	-37.6	5.3	-2.2	0.8	4.4	2.2
Real industrial sales	-6.9	-7.6	-10.8	4.6	0.2	-10.4
Consumer price index (average)	1246.5	39.9	2.6	10.4	7.5	8.2
(End-of-period)	549.2	1.7	7.0	11.4	4.8	9.2
Unemployment rate (in percent)						
Registered unemployment	14.0	12.4	13.8	18.1	17.5	17.8
Labor force survey	14.4	14.1	15.7	16.9	19.8	19.5
Real public sector wages	-19.5	23.5	10.7	2.4	6.4	3.0
Real private sector wages	...	22.1	9.4	11.6	3.6	-1.2
Consolidated government 1/			(In percent of GDP)			
Revenue	30.7	35.4	38.6	38.7	37.7	8.0
Noninterest expenditure	25.0	30.2	35.8	35.7	34.8	7.1
Primary balance	5.7	5.2	2.8	3.0	2.9	0.9
Interest payments	7.8	4.2	3.8	4.0	3.7	1.0
Overall balance	-2.0	0.9	-0.9	-1.0	-0.9	-0.1
External financing	-0.7	-0.9	0.2	-1.5	-0.3	-0.5
Domestic financing	-0.3	-1.4	-1.4	1.2	-1.7	0.5
Privatization receipts	3.1	1.5	2.1	1.3	2.9	0.1
Total public debt 2/	107.5	93.0	84.7	80.5	70.0	63.7
Domestic public debt	16.0	13.8	12.5	6.6	6.3	5.8
Money and credit			(End-of-period; percent change, from same period of previous year)			
Broad money (millions of leva)	6018.6	6597.2	7351.1	9290.7	11594.1	11504.0
Broad money (M3)	359.3	9.6	11.4	26.4	24.8	21.3
Lev money	423.0	18.2	11.5	15.6	28.1	23.3
Leva credit to nongovernment	297.2	69.7	21.4	21.4	26.9	29.0
FX deposits (U.S. dollar millions)	1477.1	1542.7	1477.1	1958.4	2236.9	2280.4
FX deposits (percent of M3)	43.6	39.2	39.1	44.3	42.8	44.4
Broad money to FX reserves ratio	1.4	1.3	1.2	1.3	1.5	1.6
Interest rates (annualized)			(In percent; end-of-period)			
BNB basic rate	7.0	5.2	4.6	4.7	4.8	4.5
Time deposit (leva)	3.0	3.3	3.2	3.3	3.4	2.4
Balance of payments 3/			(In millions of US dollars)			
Gross official reserves	2474.0	3056.0	3222.0	3460.0	3579.0	3210.0
(In months of prospective imports of GNFS)	5.0	5.6	5.0	4.9	4.6	3.9
Current account balance	1046	-61	-652	-701	-878	-233
(In percent of GDP)	4.3	-0.5	-5.0	-5.6	-6.5	-1.6
Trade balance	321	-381	-1081	-1175	-1566	-251
Exports	4809	4193	4006	4812	5099	1194
Imports	4488	4574	5087	5988	6665	1445
External debt 4/	10409	10892	10914	11202	10616	10398
(In percent of GDP)	100.4	85.5	84.2	88.9	78.3	70.6
Exchange rates						
Leva per U.S. dollar 5/	1.777	1.675	1.947	2.102	2.219	2.242
(yoy percent change, + means depreciation)	264.5	-5.7	16.2	8.0	5.6	1.2
REER (end-of period; CPI based)						
(yoy percent change, + means appreciation)	77.4	5.2	0.5	3.3	3.2	2.7

Sources: Bulgarian authorities; and staff estimates.

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

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

3/ Starting 1998, a new methodology was adopted for the calculation of BOP data.

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

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

Table 2. Bulgaria: Balance of Payments, 2000-04
(In millions of U.S. dollar)

	2000	2001	2002				2002	EBS/02/24 2002	2003	2004
			QI	Q2	Q3	Q4				
			Prel.		Proj.			Prog.	Proj.	
CURRENT ACCOUNT	-701	-878	-233	-269	64	-538	-976	-838	-988	-1,032
Trade Balance	-1,175	-1,566	-251	-507	-424	-622	-1,804	-1,569	-1,837	-1,955
Exports (f.o.b.)	4,812	5,099	1,194	1,320	1,460	1,420	5,394	5,450	5,937	6,503
y-o-y growth (percent)	20.1	6.0	-6.8	7.1	10.1	12.7	5.8	7.2	10.1	9.5
Imports (f.o.b.)	-5,988	-6,665	-1,445	-1,827	-1,884	-2,043	-7,198	-7,019	-7,774	-8,458
y-o-y growth (percent)	17.7	10.8	-4.0	8.5	10.0	15.9	8.0	5.8	8.0	8.8
Services, net	505	546	-8	133	431	-37	519	615	603	681
Income, net	-321	-344	-60	-15	-73	-23	-171	-358	-320	-381
of which: Interest Payments of the Centr. Governm	-438	-457	-133	-36	-99	-45	-312	-405	-405	-479
of which: Income to Direct Investors	-107	-150	-10	-45	-45	-45	-146	-225	-208	-234
Current Transfers	290	486	85	120	130	145	480	474	566	623
CAPITAL AND FINANCIAL ACCOUNT	839	1,275	-76	346	442	462	1,173	945	1,262	1,646
Capital Transfers	25	0	0	0	0	0	0	0	0	0
Foreign Direct Investment, net	1,003	641	46	220	240	292	798	900	880	950
of which: privatization receipts	366	38	13	45	160	80	298	300	200	150
Portfolio Investment, net	-179	82	-166	-50	-18	20	-214	-317	-236	-161
Other Investment, net 1/	59	281	190	176	220	151	735	362	618	857
General Government, net	-216	-308	-39	-34	85	21	32	25	82	257
Domestic Money Banks, net	-383	-75	52	60	45	40	197	-262	110	150
Other Private Sector, net	658	664	177	150	90	90	507	599	426	450
Errors and Omissions	-70	271	-147	0	0	0	-147	0	0	0
OVERALL BALANCE	137	398	-310	77	506	-75	197	108	275	614
FINANCING	-137	-398	310	-77	-506	75	-197	-108	-275	-614
Change in Gross International Reserves (increase: -) 1/	-409	-300	338	-29	-484	84	-91	0	-309	-558
Use of Fund Credit (purchase: +)	136	-169	-28	-48	-22	-9	-106	-108	34	-56
Purchases	275	0	40	32	32	32	137	139	130	33
Repurchases	-139	0	-68	-80	-54	-41	-244	-246	-96	-89
Exceptional Financing, net	136	71	0	0	0	0	0	0	0	0
Financing Gap (gap: +)	0	0	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS										
Gross International Reserves 2/	3,460	3,579	3,210	3,400	3,884	3,800	3,800	3,579	4,109	4,666
in months of prospective gnfs imports	4.9	4.6	3.9	4.1	4.6	4.6	4.6	4.4	4.5	4.8
Current account in percent of GDP	-5.6	-6.5	-1.6	-1.8	0.4	-3.7	-6.6	-5.9	-6.1	-5.8
Trade account in percent of GDP	-9.3	-11.6	-1.7	-3.4	-2.9	-4.2	-12.3	-11.1	-11.4	-11.0
FDI (net) in percent of the current account deficit	143	73	...	...	...	...	82	107	89	92
Gross external debt	11,202	10,616	10,398	...	...	...	10,745	10,231	10,975	11,515
in percent of GDP	88.9	78.3	70.6	...	...	...	73.0	72.2	67.9	64.7
public	9,311	8,650	8,518	...	...	...	8,479	8,551	8,409	8,549
private	1,891	1,966	1,880	...	...	...	2,266	1,680	2,566	2,966
External Debt Service of the Central Government 3/	639	1102	275	170	272	83	799	909	784	857
GDP	12,605	13,553	...	...	...	...	14,726	14,165	16,170	17,790

Sources: Bulgarian Authorities, and Fund staff estimates.

1/ excluding valuation changes.
2/ historical figures include valuation changes.
3/ includes the largest share of obligations to the IMF.

Table 3. Bulgaria: Monetary Survey, 1997-2002

	1997	1998	1999	2000				2001				2002			
	Dec.	Dec.	Dec.	Mar.	June	Sep.	Dec.	Mar.	June	Sep.	Dec.	Mar.	June Proj.	Sep. Proj.	Dec. Proj.
								(In millions of leva)							
Broad money 1/	6,019	6,597	7,351	7,538	7,578	8,383	8,616	8,824	9,679	10,303	11,594	11,497	12,115	12,963	13,929
Lev money	3,395	4,013	4,475	4,400	4,401	4,899	5,174	5,184	5,502	5,822	6,630	6,385	6,602	7,209	8,002
Currency	1,314	1,742	1,957	1,824	1,875	2,110	2,374	2,225	2,427	2,601	3,081	2,855	2,890	3,004	3,410
Deposits	2,080	2,271	2,518	2,576	2,526	2,788	2,801	2,959	3,075	3,220	3,549	3,529	3,712	4,205	4,592
Foreign currency deposits 1/	2,624	2,584	2,876	3,138	3,177	3,484	3,442	3,640	4,176	4,481	4,964	5,113	5,512	5,753	5,928
Net foreign assets	4,851	5,272	5,994	6,161	6,461	7,266	7,019	7,397	8,167	7,907	9,245	8,637	8,982	10,135	10,084
Net domestic assets	1,167	1,325	1,357	1,377	1,117	1,117	1,597	1,427	1,512	2,395	2,349	2,860	3,133	2,827	3,846
Domestic credit	5,136	4,227	4,237	4,625	4,180	4,325	4,654	4,865	4,514	5,308	5,471	5,963	6,241	5,905	6,768
Government 2/	1,642	510	156	367	-116	137	488	724	96	717	442	958	903	868	709
Non-government	3,495	3,717	4,081	4,258	4,297	4,188	4,167	4,141	4,418	4,590	5,029	5,005	5,337	5,037	6,058
Public enterprise (SOE)	1,254	946	713	691	621	447	422	342	356	334	342	289	384	362	339
Private sector	2,241	2,772	3,368	3,567	3,675	3,741	3,745	3,799	4,062	4,257	4,687	4,716	4,953	4,675	5,719
Other Items Net	-3,969	-2,902	-2,881	-3,248	-3,063	-3,208	-3,058	-3,439	-3,002	-2,913	-3,122	-3,103	-3,107	-3,078	-2,922
Reserve money	2,174	2,387	2,722	2,581	2,611	2,769	3,021	2,928	3,085	3,367	4,033	3,794	3,901	4,089	4,546
								(In millions of U.S. dollars)							
Net foreign assets	2,731	3,147	3,079	3,009	3,157	3,256	3,339	3,340	3,541	3,692	4,166	3,853	4,007	4,530	4,517
BNB	1,531	1,941	1,972	1,666	1,831	1,643	1,816	1,567	1,779	1,899	2,471	2,137	2,107	2,521	2,434
DMB	1,200	1,207	1,107	1,344	1,325	1,613	1,523	1,773	1,762	1,793	1,694	1,716	1,900	2,009	2,083
Foreign currency deposits	1,477	1,543	1,477	1,533	1,552	1,562	1,637	1,644	1,811	2,092	2,237	2,280	2,459	2,572	2,655
(percent of broad money)	(43.6)	(39.2)	(39.1)	(41.6)	(41.9)	(41.6)	(39.9)	(41.3)	(43.1)	(43.5)	(42.8)	(44.5)	(45.5)	(44.4)	(42.6)
Memorandum items:								(12-month growth rate in percent)							
Broad money	359.3	9.6	11.4	20.4	22.5	25.7	17.2	17.1	27.7	22.9	34.6	30.3	25.2	25.8	20.1
Lev money	423.0	18.2	1.0	19.9	25.6	25.2	15.6	17.8	25.0	18.8	28.1	23.2	20.0	23.8	20.7
Currency	939.1	32.6	12.4	16.4	26.7	25.1	21.3	22.0	29.5	23.3	29.8	28.3	19.1	15.5	10.7
Foreign currency deposits	296.8	-1.5	11.3	21.1	18.6	26.4	19.7	16.0	31.5	28.6	44.2	40.5	32.0	28.4	19.4
Reserve money	780.1	9.8	14.0	17.3	20.7	20.9	11.0	13.4	18.2	21.6	33.5	29.6	26.4	21.4	12.7
CPI inflation	578.5	3.3	7.0	9.5	11.7	12.0	11.4	9.2	9.5	4.7	4.9	9.2	9.1	7.3	7.3
Currency/broad money ratio	21.8	26.4	26.6	24.2	24.7	25.2	27.5	25.2	25.1	25.2	26.6	24.8	23.9	23.2	24.5
Currency/deposit ratio	27.9	35.9	36.3	31.9	32.9	33.6	38.0	33.7	33.5	33.8	36.2	33.0	31.3	30.2	32.4
Foreign currency /total deposits	55.8	53.2	53.3	54.9	55.7	55.5	55.1	55.2	57.6	58.2	58.3	59.2	59.8	57.8	56.3
								(Real index, Dec. 1995=100)							
Broad money	38.6	41.6	43.4	43.1	43.6	45.4	45.6	46.2	50.8	53.3	58.5	55.2	58.3	62.6	65.5
Lev money	29.9	34.8	36.3	34.6	34.7	36.5	37.6	37.3	39.7	41.4	46.0	42.1	43.6	47.8	51.7
Credit, non-government	36.5	38.1	39.1	39.6	40.1	36.9	35.8	35.3	37.7	36.3	38.9	37.5	40.2	38.0	44.8
of which by operating banks 3/	36.5	50.8	57.7	57.8	60.1	60.4	60.6	62.5	67.6	70.8	76.4	76.7	77.3	73.4	87.9
								(In percent of GDP, end of period)							
Ratio to nominal GDP															
Broad money	27.1	28.4	28.3	37.2	32.6	27.9	30.6	35.0	35.5	31.0	35.3	41.5	39.8	34.9	38.2
Lev money	15.3	17.3	17.2	21.7	18.9	16.3	18.4	20.6	20.2	17.5	20.2	23.0	21.7	19.4	21.9
Reserve money	9.8	10.3	10.5	12.7	11.2	9.2	10.7	11.6	11.3	10.1	12.3	13.7	12.8	11.0	12.5

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 4. Bulgaria: General Government, 2000-02
(In millions of leva)

	2000	2001 1/		2002					
	Actual	Budget	Actual	Budget	MoF Proj	Proj.- Budget	Q1 Budget	Q1 Prel.Act.	Q1 Act. - Budget
Total revenue and grants	10,352	10,762	11,163	11,719	11,699	-20	2,647	2,623	-24
Tax revenue	7,994	8,455	8,516	8,996	8,896	-100	2,148	2,075	-73
Profit taxes	736	787	1,150	809	885	76	233	318	85
Nonfinancial enterprises	619	658	812	695	771	76	196	281	85
Financial enterprises	117	129	339	115	114	-1	37	37	-1
Income taxes	1,098	1,092	1,063	1,094	1,094	0	245	235	-10
VAT	2,359	2,528	2,454	2,780	2,780	0	654	638	-16
Excise and fuel duties	1,038	1,125	1,107	1,380	1,279	-101	278	245	-33
Excise duties	815	902	778	1,023	938	-84	213	173	-40
Customs duties	221	139	195	100	145	45	25	40	15
Social insurance contributions	2,230	2,410	2,310	2,521	2,405	-116	604	536	-68
Pension and unemployment contributions 2/	1,780	1,938	1,822	1,955	1,840	-116	466	417	-50
Health Insurance Fund	451	472	489	565	565	0	138	120	-18
Other taxes	312	375	236	313	309	-4	109	62	-46
Nontax revenues	2,154	2,032	2,284	2,220	2,289	69	466	515	50
BNB transfers	137	130	175	150	173	23	0	0	0
Other	2,018	1,902	2,109	2,070	2,116	46	466	515	50
Grants and donations	204	275	363	502	513	11	33	32	-1
Total expenditure and net lending	10,620	11,184	11,418	11,976	11,959	-17	2,784	2,662	-122
Noninterest expenditure, net lending, contingency	9,538	9,811	10,312	10,972	11,096	125	2,411	2,330	-81
Current noninterest expenditure	8,127	8,634	8,873	9,704	9,779	74	2,217	2,187	-30
Compensation 3/	1,283	1,421	1,196	1,233	1,233	0	293	285	-8
Wages and salaries 3/	1,256	1,393	1,159	1,198	1,198	0	283	276	-7
Scholarships	28	28	37	35	35	0	10	9	-1
Maintenance and operations 3/	2,167	1,797	1,925	1,851	1,933	82	418	409	-9
Defense and security	885	998	957	1,082	1,118	36	239	232	-8
Subsidies 3/	250	237	722	733	747	13	164	146	-18
Social expenditures	3,543	4,181	4,074	4,690	4,632	-58	1,103	1,116	13
Pension fund	2,372	2,590	2,586	2,882	2,882	0	688	682	-6
Assistance and unemployment 4/	853	911	858	1,049	1,049	0	251	261	10
Health Insurance Fund	98	399	404	487	487	0	96	128	32
Other social expenditures	221	281	225	272	215	-58	68	45	-24
Extrabudgetary funds	0	0	0	0	0	0	0	0	0
Capital expenditures	1,037	914	1,145	1,038	1,088	50	179	142	-37
State reserve	0	0	0	0	0	0	0	0	0
Net lending	63	19	50	0	0	0	0	0	0
Contingency	311	245	245	230	230	0	15	1	-14
Enterprise restructuring	110	60	60	180	180	0	10	0	-10
Other contingency	165	145	145	0	0	0	0	0	0
Natural disaster	36	40	40	50	50	0	5	1	-4
EU accession 4/				116	116	0	0	0	0
Primary balance	814	951	850	747	602	-145	236	293	57
Interest	1,083	1,373	1,106	1,004	862	-142	374	332	-42
External	818	1,063	853	785	664	-121	307	280	-27
Domestic	265	310	253	219	198	-21	67	52	-14
Overall balance	-269	-422	-255	-257	-260	-3	-137	-39	99
Financing	269	422	255	257	260			39	
External (net)	-404	-31	-100	-106	173			-170	
Domestic (net)	328	-7	-506	-255	-532			161	
Privatization	345	460	861	619	619			48	
Memorandum items:									
Fiscal Reserve Account (inUS$ million)	1,139	950	1,265	...	...		...	1,116	
Nominal GDP in millions of leva	26,753	28,210	29,618	30,783	32,953	2,170	5888.3	6,926	1,038

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 became a commercial 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 leva, and capital expenditure by 123 million leva.

2/ Pension and unemployment contributions were combined in January 2002.

3/ To make the 2001 projections comparable with the 2001 budget figures, the impact of the health care reform should be taken into account as follows: the 2001 budget figures on wages should be reduced by 169 million leva, maintenance and operations reduced by 136 million leva, and subsidies increased by 365 million leva

4/ To make the 2002 budget figures comparable with the 2001 numbers, 75 million leva from the EU accession item should be added to Capital expenditures and the remainder 40.7 million leva to Maintenance and operations.

Table 5. Bulgaria: General Government, 2000-02
(In percent of GDP)

	2000	2001 1/		2002		
	Actual	Budget	Actual	Budget	MoF Proj	Proj.- Budget
Total revenue and grants	38.7	38.1	37.7	38.1	35.5	-2.6
Tax revenue	29.9	30.0	28.8	29.2	27.0	-2.2
Profit taxes	2.8	2.8	3.9	2.6	2.7	0.1
Nonfinancial enterprises	2.3	2.3	2.7	2.3	2.3	0.1
Financial enterprises	0.4	0.5	1.1	0.4	0.3	0.0
Income taxes	4.1	3.9	3.6	3.6	3.3	-0.2
VAT	8.8	9.0	8.3	9.0	8.4	-0.6
Excise and fuel duties	3.9	4.0	3.7	4.5	3.9	-0.6
Excise duties	3.0	3.2	2.6	3.3	2.8	-0.5
Customs duties	0.8	0.5	0.7	0.3	0.4	0.1
Social insurance contributions	8.3	8.5	7.8	8.2	7.3	-0.9
Pension and unemployment contributions 2/	6.7	6.9	6.2	6.4	5.6	-0.8
Health Insurance Fund	1.7	1.7	1.6	1.8	1.7	-0.1
Other taxes 2/	1.2	1.3	0.8	1.0	0.9	-0.1
Nontax revenues	8.1	7.2	7.7	7.2	6.9	-0.3
BNB transfers	0.5	0.5	0.6	0.5	0.5	0.0
Other	7.5	6.7	7.1	6.7	6.4	-0.3
Grants and donations	0.8	1.0	1.2	1.6	1.6	-0.1
Total expenditure and net lending	39.7	39.6	38.6	38.9	36.3	-2.6
Noninterest expenditure, net lending, contingency	35.7	34.8	34.8	35.6	33.7	-2.0
Current noninterest expenditure	30.4	30.6	30.0	31.5	29.7	-1.9
Compensation 3/	4.8	5.0	4.0	4.0	3.7	-0.3
Wages and salaries 3/	4.7	4.9	3.9	3.9	3.6	-0.3
Scholarships	0.1	0.1	0.1	0.1	0.1	0.0
Maintenance and operations 3/	8.1	6.4	6.5	6.0	5.9	-0.1
Defense and security	3.3	3.5	3.2	3.5	3.4	-0.1
Subsidies 3/	0.9	0.8	2.4	2.4	2.3	-0.1
Social expenditures	13.2	14.8	13.8	15.2	14.1	-1.2
Pension fund	8.9	9.2	8.7	9.4	8.7	-0.6
Assistance and unemployment	3.2	3.2	2.9	3.4	3.2	-0.2
Health Insurance Fund	0.4	1.4	1.4	1.6	1.5	-0.1
Other social expenditures	0.8	1.0	0.8	0.9	0.7	-0.2
Extrabudgetary funds	0.0	0.0	0.0	0.0	0.0	0.0
Capital expenditures	3.9	3.2	3.9	3.4	3.3	-0.1
State reserve	0.0	0.0	0.0	0.0	0.0	0.0
Net lending	0.2	0.1	0.2	0.0	0.0	0.0
Contingency	1.2	0.9	0.8	0.7	0.7	0.0
Enterprise restructuring	0.4	0.2	0.2	0.6	0.5	0.0
Other contingency	0.6	0.5	0.5	0.0	0.0	0.0
Natural disaster	0.1	0.1	0.1	0.2	0.2	0.0
EU accession 4/				0.4	0.4	0.0
Primary balance	3.0	3.4	2.9	2.4	1.8	-0.6
Interest	4.0	4.9	3.7	3.3	2.6	-0.6
External	3.1	3.8	2.9	2.6	2.0	-0.5
Domestic	1.0	1.1	0.9	0.7	0.6	-0.1
Overall balance	-1.0	-1.5	-0.9	-0.8	-0.8	0.0
Financing	1.0	1.5	0.9	0.8	0.8	
External (net)	-1.5	-0.1	-0.3	-0.3	0.5	
Domestic (net)	1.2	0.0	-1.7	-0.8	-1.6	
Privatization	1.3	1.6	2.9	2.0	1.9	
Memorandum items:						
Fiscal Reserve Account in US$ million	1,139	950	1,265	...		
Nominal GDP in million leva	26,753	28,210	29,618	30,783	32,953	

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 became a commercial 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 leva, and capital expenditure by 123 million leva.

2/ Pension and unemployment contributions were combined in January 2002.

3/ To make the 2001 projections comparable with the 2001 budget figures, the impact of the health care reform should be taken into account as follows: the 2001 budget figures on wages should be reduced by 169 million leva, maintenance and operations reduced by 136 million leva, and subsidies increased by 365 million leva

4/ To make the 2002 budget figures comparable with the 2001 numbers, 75 million leva from the EU accession item should be added to Capital expenditures and the remainder 40.7 million leva to Maintenance and operations.

Table 6. Bulgaria: Macroeconomic Framework, 1999-2006

	1999	2000	2001	2002	2003	2004	2005	2006	2007
				Projections					
GDP and prices (annual percent change)									
Real GDP	2.3	5.4	4.0	4.0	5.0	5.5	5.5	5.5	5.5
GDP deflator	3.7	6.7	6.5	7.0	4.0	3.8	3.6	3.5	3.5
CPI (end of period)	7.0	11.4	4.8	7.2	4.5	4.5	4.0	3.5	3.5
(period average)	2.6	10.4	7.5	8.0	4.5	4.5	4.0	3.5	3.5
Monetary aggregates									
Broad money (real, percent change) 1/	4.9	5.3	28.3	12.0	10.0	11.0	11.0	11.0	11.0
Credit to non-government (real, percent change) 2/	13.6	4.8	26.0	15.0	15.0	15.0	13.0	11.0	12.0
Saving and investment (in percent of GDP)									
Foreign saving 3/	5.9	5.3	7.5	8.7	7.6	7.2	6.4	5.7	5.0
Gross national saving	12.9	12.7	13.9	13.9	14.7	15.5	16.2	16.8	17.1
Gross domestic saving 4/	12.0	13.0	12.8	11.8	13.2	14.1	15.4	16.4	16.8
Government	6.5	5.9	5.9	4.5	6.0	6.3	6.3	6.2	5.9
Non-government	5.5	7.1	7.0	7.2	7.2	7.8	9.1	10.3	10.9
Gross domestic investment	17.9	18.3	20.4	20.5	20.8	21.3	21.8	22.1	21.8
Gross fixed investment	15.1	15.7	17.8	18.7	19.7	20.5	21.2	21.5	21.3
Change in stocks	2.8	2.6	2.6	1.8	1.1	0.8	0.7	0.6	0.4
Government	4.5	3.9	3.9	3.3	3.8	4.0	4.0	4.0	4.0
Non-government	13.4	14.4	16.5	17.2	17.0	17.3	17.8	18.1	17.8
General government (in percent of GDP)									
Revenue	38.6	38.7	37.7	35.5	35.4	35.2	35.0	34.7	34.4
Non-interest expenditure	35.8	35.7	34.8	33.7	32.6	32.4	32.2	32.1	32.1
Primary balance	2.8	3.0	2.9	1.8	2.8	2.8	2.8	2.6	2.3
Interest payments	3.8	4.0	3.7	2.6	3.5	3.0	2.8	2.6	2.3
Overall balance (excluding external interest payments)	2.0	2.1	2.0	1.2	2.2	2.3	2.3	2.2	1.9
Overall balance	-0.9	-1.0	-0.9	-0.8	-0.7	-0.2	0.0	0.0	0.0
Total public debt	84.7	80.5	70.0	65.2	60.1	54.8	49.9	45.5	41.7
Of which: External	73.0	73.9	63.8	59.5	54.8	50.0	45.5	41.4	38.0
Balance of payments (in millions of US dollars)									
Current account	-652	-701	-878	-976	-988	-1,032	-1,099	-1,138	-1,081
Trade balance	-1,081	-1,175	-1,566	-1,804	-1,837	-1,955	-2,024	-2,069	-2,108
Exports	4,006	4,812	5,099	5,394	5,937	6,503	7,110	7,842	8,646
Imports	5,087	5,988	6,665	7,198	7,774	8,458	9,135	9,911	10,754
Services, net	314	505	546	519	603	681	768	849	947
Receipts	1,788	2,175	2,425	2,584	2,831	3,120	3,392	3,704	4,045
Payments	1,474	1,669	1,880	2,065	2,228	2,439	2,624	2,855	3,099
Income, net	-185	-321	-344	-171	-320	-381	-463	-583	-612
Memorandum items									
Gross official reserves (in millions of US dollars)	3,222	3,460	3,579	3,800	4,109	4,666	5,154	5,625	5,896
(in months of prospective imports of GNFS)	5.9	5.4	5.0	4.9	4.9	5.1	5.3	5.3	5.1
Current account balance (in percent of GDP)	-5.0	-5.6	-6.5	-6.6	-6.1	-5.8	-5.6	-5.3	-4.6
External debt/GDP (in percent) 5/	84.2	88.9	78.3	73.0	67.9	64.7	60.5	55.2	50.0
External debt/exports of GNFS (in percent) 5/	188.3	160.3	141.1	134.7	125.2	119.7	112.6	102.5	91.3
External debt service/exports of GNFS (in percent) 5/	18.0	16.7	21.0	16.3	15.4	15.3	16.3	16.0	17.2
Export growth (percent change)	-4.5	20.1	6.0	5.8	10.1	9.5	9.3	10.3	10.2
Import growth (percent change)	11.2	17.7	10.8	8.0	8.0	8.8	8.0	8.5	8.5
Terms of trade (percent change)	-6.0	-8.8	0.5	0.3	0.3	0.3	0.1	0.0	0.0
Nominal GDP (in millions of leva)	23,790	26,753	29,618	32,952	35,984	39,406	43,070	47,029	51,352
Nominal GDP (in millions of US dollars)	12,956	12,605	13,553	14,726	16,170	17,790	19,533	21,433	23,403

Sources: Bulgarian authorities; and staff projections.

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

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

3/ Net imports of goods and nonfactor services.

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

5/ Medium- and long-term external debt.

Table 7. Bulgaria: Medium-Term Balance of Payments, 2000-07
(In millions of U.S. dollar)

	2000	2001	2002	2003	2004	2005	2006	2007
					Proj.			
CURRENT ACCOUNT	-701	-878	-976	-988	-1,032	-1,099	-1,138	-1,081
Trade Balance	-1,175	-1,566	-1,804	-1,837	-1,955	-2,024	-2,069	-2,108
Exports (f.o.b.)	4,812	5,099	5,394	5,937	6,503	7,110	7,842	8,646
y-o-y growth (percent)	20.1	6.0	5.8	10.1	9.5	9.3	10.3	10.2
Imports (f.o.b.)	-5,988	-6,665	-7,198	-7,774	-8,458	-9,135	-9,911	-10,754
y-o-y growth (percent)	17.7	10.8	8.0	8.0	8.8	8.0	8.5	8.5
Services, net	505	546	519	603	681	768	849	947
Income, net	-321	-344	-171	-320	-381	-463	-583	-612
of which: Interest Payments of the Centr. Governme	-438	-457	-312	-405	-479	-499	-482	-448
of which: Income to Direct Investors	-107	-150	-146	-208	-234	-313	-456	-551
Current Transfers	290	486	480	566	623	621	664	691
CAPITAL AND FINANCIAL ACCOUNT	839	1,275	1,173	1,262	1,646	1,756	1,865	1,593
Capital Transfers	25	0	0	0	0	0	0	0
Foreign Direct Investment, net	1,003	641	798	880	950	1,000	1,000	1,000
of which: privatization receipts	366	38	298	200	150	50	0	0
Portfolio Investment, net	-179	82	-214	-236	-161	-86	-86	-369
Other Investment, net 1/	59	281	735	618	857	842	951	961
General Government, net	-216	-308	32	82	257	172	1	11
Domestic Money Banks, net	-383	-75	197	110	150	170	200	200
Other Private Sector, net	658	664	507	426	450	500	750	750
Errors and Omissions	-70	271	-147	0	0	0	0	0
OVERALL BALANCE	137	398	197	275	614	657	727	512
FINANCING	-137	-398	-197	-275	-614	-657	-727	-512
Change in Gross International Reserves (increase: -) 1/	-409	-300	-91	-309	-558	-488	-471	-271
Use of Fund Credit (purchase: +)	136	-169	-106	34	-56	-169	-256	-241
Purchases	275	0	137	130	33	0	0	0
Repurchases	-139	0	-244	-96	-89	-169	-256	-241
Exceptional Financing, net	136	71	0	0	0	0	0	0
Financing Gap (gap: +)	0	0	0	0	0	0	0	0
MEMORANDUM ITEMS								
Gross International Reserves 2/	3,460	3,579	3,800	4,109	4,666	5,154	5,625	5,896
in months of prospective gnfs imports	4.9	4.6	4.6	4.5	4.8	4.8	4.9	4.7
Current account in percent of GDP	-5.6	-6.5	-6.6	-6.1	-5.8	-5.6	-5.3	-4.7
Trade account in percent of GDP	-9.3	-11.6	-12.3	-11.4	-11.0	-10.4	-9.7	-9.1
FDI (net) in percent of the current account deficit	143	73	82	89	92	91	88	92
Gross external debt	11,202	10,616	10,745	10,975	11,515	11,827	11,833	11,581
in percent of GDP	88.9	78.3	73.0	67.9	64.7	60.5	55.2	50.0
public	9,311	8,650	8,479	8,409	8,549	8,461	8,067	7,415
private	1,891	1,966	2,266	2,566	2,966	3,366	3,766	4,166
External Debt Service of the Central Government 3/	639	1102	799	784	857	1016	1096	1437
GDP	12,605	13,553	14,726	16,170	17,790	19,533	21,433	23,148

Sources: Bulgarian Authorities, and Fund staff estimates.

1/ excluding valuation changes.
2/ historical figures include valuation changes.
3/ includes the largest share of obligations to the IMF.

Table 8. Bulgaria: Indicators of Financial and External Vulnerability, 1999-2002

	1999	2000	2001	2002 Latest Observation 1/	2002 Date
Real indicators					
CPI end-of-period, 12-month change	7.0	11.4	4.8	6.9	May-02
Real GDP growth rate, year-on-year	2.3	5.4	4.0	4.2	Q4-01
Financial indicators					
Public sector debt (in percent of GDP, end-of-period)	84.7	80.5	70.0	63.7	Mar-02
Broad money (percent change, 12-month basis, end-of-period)	11.4	26.4	24.8	25.5	Apr-02
Non-government sector leva credit (percent change, 12-month basis end-of-period)	21.4	21.4	26.9	26.1	Apr-02
Non-government sector foreign exchange credit (percent share in domestic credit end-of-period)	51.0	39.5	37.9	34.5	Apr-02
Average monthly BNB basic interest rate, nominal annualized	4.8	3.9	4.6	4.2	Apr-02
Banks' NFA position in US$ million	1,113	1,472	1,717	1,482	Apr-02
Banking system capital adequacy ratio (in percent, end-of-period)	41.3	35.5	31.3	29.5	Mar-02
Standard performing interest earning assets (in percent, end-of-period)	88.3	91.7	93.0	93.2	Mar-02
External indicators					
Exports (annual percent change, cumul. since January)	-4.5	20.1	6.0	-6.8	Mar-02
Imports (annual percent change, cumul. since January)	11.2	17.7	10.8	-4.0	Mar-02
Current account balance (percent of annual GDP)	-5.0	-5.6	-6.5	-1.6	Q1-02
Capital and financial account (percent of annual GDP)	5.8	6.7	9.4	-0.5	Q1-02
Portfolio investment (debt securities, etc., percent of annual GDP)	-1.5	-1.4	0.6	-1.1	Q1-02
Other investment (loans, trade credits, etc., percent of annual GDP)	1.5	0.5	2.1	1.3	Q1-02
Foreign direct investment (percent of annual GDP)	6.2	8.0	4.7	0.3	Q1-02
Gross official reserves (end-of-period)					
In millions of U.S. dollars	3,222	3,460	3,579	3,687	7-Jun-02
In months of prospective imports of GNFS	5.0	4.9	4.6	4.8	7-Jun-02
Fiscal reserve account balance (in millions of U.S. dollars, end-of-period)	1,336	1,139	1,194	1,211	Apr-02
Broad money/ NFA (end-of-period)	1.2	1.3	1.5	1.5	Apr-02
Total short term external debt/ reserves (in percent)	18.5	41.9	33.8	35.2	Mar-02
Foreign exchange deposits/reserves (percent, end-of-period)	45.8	56.6	62.5	68.3	Mar-02
Total external debt (percent of annual GDP)	84.2	88.9	78.3	70.6	Mar-02
Public external debt (percent of annual GDP)	73.0	73.9	63.8	57.8	Mar-02
Total short-term external debt (percent of annual GDP)	4.6	11.5	8.9	7.7	Mar-02
External debt service/ exports of GNFS (in percent)	18.0	16.7	21.0	25.2	Q1-02
External debt service/GDP (in percent)	8.1	9.3	11.7	13.5	Q1-02
Exchange rate (per U.S. dollar, period average) 2/	1.836	2.123	2.185	2.142	May-02
REER depreciation, end-of-period (-) (12-months basis)	0.5	3.3	3.2	3.5	Apr-02
Financial market indicators					
Foreign currency debt rating (Moody's, long-term)	B2 3/	B2 3/	B2 3/	B1 3/	Jun-02
Foreign currency debt rating (S&P, long-term)	B 3/	B+ 3/	B+ 3/	BB-	Jun-02
Foreign currency debt rating (Fitch IBCA, long-term)	B+	B+	B+	BB-	Jun-02
Stripped spread of discount A bonds (basis points, end-of-period)	713	932	500	398	12-Jun-02

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.

Table 9. Bulgaria: Quantitative Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2002 1/
(In millions of leva, unless otherwise indicated)

Variable and Periods	Target		Outcome	
I. Ceiling on the overall deficit of the				
general government		138		39
Jan. 1, 2002-Mar. 31, 2002		-103		
Jan. 1, 2002-Jun. 30, 2002		173		
Jan. 1, 2002-Sep. 30, 2002		260		
Jan. 1, 2002-Dec. 31, 2002				
II. Floor on the balance of the fiscal reserve				
account		1,900		2,477
Mar. 31, 2002		1,900		
Jun. 30, 2002		1,900		
Sep. 30, 2002		1,900		
Dec. 31, 2002				
III. Ceiling on the wage bill of the 60				
monitored SOEs 2/		141.8		139.1
Jan. 1, 2002-Mar. 31, 2002		141.8		
Apr. 1, 2002-Jun. 30, 2002		141.8		
Jul. 1, 2002-Sep. 30, 2002		141.8		
Oct. 1, 2002-Dec. 31, 2002				
	GTD	NSSI	GTD	NSSI
IV. Indicative ceiling on tax on social insurance arrears				
Cumulative change from level on: Dec. 31, 2001				
Mar. 31, 2002	-25	-5	-111	-7
Jun. 30, 2002	-50	-10		
Sep. 30, 2002	-75	-15		
Dec. 31, 2002	-100	-20		
	Up to one year	Over 1 year (excluding Eurobonds)	Up to one year	Over 1 year (excluding Eurobonds)
V. Ceiling on contracting and guaranteeing public sector external debt (millions of U.S. dollars)				
Cumulative change from level on Dec. 31, 2002:				
Mar. 31, 2002	0	230	0	46
Jun. 30, 2002	0	560		
Sep. 30, 2002	0	690		
Dec. 31, 2002	0	690		

Table 9. Bulgaria: Quantitative Performance Criteria and Indicative Targets Under the Stand-By Arrangement, 2002 1/
(In millions of leva, unless otherwise indicated) (concluded)

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

1/ Definitions of the performance criteria and indicative targets are included in the Annexes to the Supplementary Memorandum of Economic Policies.
2/ Adjusted downward after the privatization of one of the monitored enterprises.

Table 10. Bulgaria: Schedule of Purchases Under the Proposed Stand-By Arrangement, 2002-04

Amount of Purchase	Available on or After	Contingent on
SDR 32 million (5 percent of quota)	Board approval (February 2002)	Board approval
SDR 26 million (4 percent of quota)	May 15, 2002	Observance of end-March 2002 performance criteria and completion of first review under the SBA 1/
SDR 26 million (4 percent of quota)	August 15, 2002	Observance of end-June 2002 performance criteria
SDR 26 million (4 percent of quota)	November 15, 2002	Observance of end-September 2002 performance criteria and completion of second review under the SBA 1/
SDR 26 million (4 percent of quota)	February 15, 2003	Observance of end-December 2002 performance criteria 1/
SDR 26 million (4 percent of quota)	May 15, 2003	Observance of end-March 2002 performance criteria and completion of third review under the SBA 1/
SDR 26 million (4 percent of quota)	August 15, 2003	Observance of end-June 2002 performance criteria
SDR 26 million (4 percent of quota)	November 15, 2003	Observance of end-September 2003 performance criteria and completion of fourth review under the SBA 1/
SDR 26 million (4 percent of quota)	February 15, 2004	Observance of end-December 2003 performance criteria 1/

1/ In addition to standard clauses on an overdue financial obligation to the Fund or failure to meet a repurchase expectation, on the exchange and trade system, and the performance criterion on the non-accumulation of external arrears.

Bulgaria: World Bank Relations

Lending operations

1. The Bank has approved 27 loans to Bulgaria to date, of which 11 are active (Table 11). The last loan approved by the Bank's Board was the Second Agriculture Sector Adjustment Loan (US$50 million equivalent in June 2001).

2. The Bank's Board discussed a new Country Assistance Strategy (CAS) for Bulgaria on May 9, 2002. The overarching objectives of the CAS include: (i) reducing poverty and raising living standards, and (ii) supporting the country's move towards EU accession. The Bank will strive for achieving these objectives by focusing assistance in the framework of the main CAS themes, including (i) promotion of competitive private sector led growth, (ii) strengthening public administration reforms and anti-corruption initiatives, and (iii) mitigating the social impact of restructuring and delivering social services more effectively. The strategy also envisages an important role for the IFC, especially through support for privatization and restructuring of state-owned enterprises and new investments in private companies. Under the most likely scenario, the World Bank assistance program over the next three years is expected to involve lending of up to US$750 million. The IMF and World Bank staff maintain a close collaborative relationship in supporting the Government's structural reforms.

3. Up to three Programmatic Adjustment Loans (PALs) comprising lending of up to US$450 million would support the Government's policy framework that underpins the Bank's overall assistance program in FY03–05. The policy framework would, over time, (a) enable the Government to maintain a sound fiscal stance that would represent a strong effort for financing the Government program, (b) help create conditions necessary for reducing the stock of public debt; (c) foster completion of privatization and restructuring in energy and infrastructure; (d) improve the environment for private sector led growth; (e) lead to reduced poverty, improved human capital and better delivery of social services; and (f) support public administration reform and anti-corruption programs. Reforms to be tackled under the Bank supported adjustment operations would include regulatory and institutional reforms in the real sectors, including energy, public administration and legal/judicial reforms, including anti-corruption initiatives, and labor market and social sector policies, including long-term sustainability of social protection and restructuring of health and education.

4. To maintain a robust base-case lending program, the Bank will ensure satisfactory progress towards a set of triggers that provide the basic conditionality for the Banks assistance program. Besides supportive macroeconomic framework and portfolio implementation, satisfactory progress will be necessary towards specific goals in key areas of reform, including privatization of large SOEs and banks, establishing separate generation, transmission and distribution companies in electricity, and adoption of rational tariff system for power and district heating; terminating loss-making railway services outside areas of public service obligations, reducing red-tape for company registration and building permits, consolidating the unified revenue information system, completion of functional reviews for civil servants in two ministries and improving insolvency provisions in the Codes. Moreover, to ensure social sustainability, progress will be required towards establishment of a multi-pillar pension system, ensuring transparent allocation of pension contributions and

strengthening a district heating subsidy program. Fiduciary responsibilities will be strengthened by completing the financial accountability assessment and implementing an action plan for public procurement. Some additional triggers will condition processing of the third PAL, including evidence of improved public debt ratios, satisfactory spreads on sovereign borrowing, improved trend in the fiscal balance, growing SME share in total employment and adequate progress towards reducing arrears.

I. Technical Assistance

5. The Bank continues to provide technical and advisory assistance to the Government in a number of areas, including poverty monitoring and alleviation, reform of the social protection system, energy sector reforms, enterprise divestiture, improving market institutions, governance, health and education sector reforms, and some technical aspects of EU accession.

II. Economic and Sector Work

6. The most recent Country Economic Memorandum "Bulgaria: The Dual Challenges of Transition and Accession" was completed in March 2001. A Public Expenditure Review was discussed with the Government, development partners, and civil society in June 2002 and is being finalized. An update of the Poverty Assessment (2001) are being discussed with the Government and other stakeholders and will be finalized shortly there after. Important new initiatives for technical assistance, advisory services and studies will cover social programs, including the pension reform, the energy sector, gender and ethnicity issues, service and fiscal decentralization, agriculture, private sector development and transport.

Table 11. Bulgaria: World Bank Lending Operations

	Lending Operation	Amount	Board Date
1.	Water Companies Restructuring Project	US$98 million	1994
2.	Railway Rehabilitation Project	US$95 million	1995
3.	Social Insurance Administration Project	US$24 million	1997
4.	Environmental Remediation Pilot	US$16 million	1998
5.	Environment and Privatization Support Adjustment Loan	US$50 million	2000
6.	Trade and Transport Facilitation in Southeast Europe Project	US$7 million	2000
7.	Health Sector Reform Project	US$63 million	2000
8.	Education Modernization Project	US$14 million	2000
9.	Child Welfare Reform Project	US$8 million	2001
10	Registration and General Cadastre	US$30 million	2001
11.	Agriculture Sector Adjustment Loan II	US$50 million	2001

Bulgaria: Statistical Issues

1. Bulgaria compiles and submits data to the Fund of sufficient quality and in a regular timely manner to adequately permit program monitoring and surveillance (Table 12). Despite a comprehensive economic database, problems remain in national accounts and producer price statistics, particularly in the coverage of the emerging private sector, as well as in the balance of payments statistics, where frequent and substantial revisions have hampered economic analysis. In addition, work remains to be done in fully reconciling high frequency data on economic activity with quarterly and annual national accounts data. Annual international investment position statistics are compiled and reported to STA for publication.

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

Real sector

3. The National Statistical Institute (NSI), with technical assistance from OECD, has established a system to compile national accounts according to the recommendations of the European System of Accounts, 1995. GDP by activity and expenditure categories are compiled and reconciled within the annual supply and use framework. In addition, Bulgaria publishes national accounts including current and capital accounts for the five main domestic sectors (general government, financial corporations, nonfinancial corporations, nonprofit institutions serving household, and households). As for most countries, the financial account and the balance sheets are missing.

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

5. The NSI has also compiled estimates of quarterly GDP by expenditure categories for the period beginning first quarter of 1994 through the second quarter of 2000, based on new significantly improved quarterly surveys. Problems remain in the methods for the deflation of some components of the national accounts, such as household consumption, capital formation, and external trade, and in the coverage of private sector activities. However, significant progress has been made in the development of export and import deflators.

6. A new PPI that uses a Laspeyres index formula with 1995 as the base year 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 recommendations provided by STA missions have been broadly implemented. The NSI has completed the exercise to link annual Laspeyres price indices together, producing a time series that begins in 1995. This series also follows the new classifications and index methods recommended by Eurostat and STA, and has been published as the official CPI. The coverage of the index was extended, a new method for imputing missing observations of new products is being applied, and quality adjustment procedures are applied in a few particular cases (e.g., the heating component).

8. The flow of customs data has improved dramatically since the April-May 1998 mission and a new system for processing customs records is near completion. The development of export and import unit value indices is progressing smoothly and additional support is expected from Eurostat in this area. The current indices can be used effectively as deflators for the import and export components of the national accounts. The Import and Export Division meets monthly with the Bulgarian National Bank to review data issues and ensure consistency between the NSI export and import data and the balance of payments data.

9. The lack of comprehensive labor statistics hampers the assessment of developments in employment and wages, especially in the private sector. Annual data are collected by the NSI, using a census of all establishments. The NSI also obtains current estimates from a monthly survey of establishments using all public employers and a sample of private employers (excluding establishments with less than 5 employees, and including about 10,000 private employers out of approximately 69,000 qualifying establishments). The main shortcomings of these data include: (i) the under-reporting of private sector wages; (ii) the reporting of only average gross earnings, not wages for time worked and wages by occupation; and (iii) the lack of coverage of self-employed and employment in small firms. Plans for improvement include using National Social Security Institute (NSSI) data to estimate wages by occupation and age and the number of self-employed and employment in small firms. The household budget survey could provide an alternative source of data for private sector wages. Regarding employment, the NSI household labor force survey is an alternative source of data, but improvements are needed to make it more consistent with the establishment survey, especially regarding agricultural employment. The survey was conducted twice a year in 1993-98 (and three times a year in 1999 and 2000), but at irregular intervals. Beginning in 2001, the NSI has conducted the survey on a quarterly basis. Also,

Eurostat has been providing support since mid-2000 in the context of a pilot project ending in mid-2001 to improve the labor force survey's compliance with Eurostat recommendations.

10. The Population Census was conducted in early 2001 and will be a source for redesign of the household surveys conducted by the NSI, particularly the household budget survey and the labor force survey.

Government finance

11. A combined STA/FAD mission in September 1999 reviewed progress under the budget execution reform program, assisted the MoF with the development of a new chart of accounts for the government sector, and provided advice on the implementation of accrual accounting for government, budgetary, and the statistical system. The mission also examined possible actions to improve fiscal transparency in line with the Experimental Report on the Implementation of Standards and Codes prepared in August 1999. Consolidated data on central government operations are routinely reported for publication in the *GFS Yearbook* and in *IFS*. The *GFS Yearbook* also has annual data on local governments.

Money and banking statistics

12. 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*. The BNB has now begun to progressively harmonize its data collection and compilation methods in line with the European Central Bank's framework for monetary statistics. It is expected that in 2002, a number of enhancements in sectoral and instrument classification will be reflected in the revised data covering 1995 and onward published in IFS.

Balance of payments

13. Bulgaria reports monthly balance of payments data on a regular and timely basis, but data are subject to frequent and substantial revisions. An IMF technical assistance mission in December 2000 made a number of recommendations to strengthen the balance of payments and external debt compilation systems, which included the development of a closed-type of international transactions reporting system, the development of estimates of "shuttle trade" with countries bordering Bulgaria, strengthening the methodology for travel transactions, and compiling data on trade credit liabilities. However, most recommendations of this mission are yet to be implemented. The treatment of the license to operate a mobile telephone service has been clarified and agreed with the BNB. The GSM license purchase has been recorded under foreign direct investment, in Bulgaria equity capital component in the first quarter of 2001, with no changes in the country's external debt position. Balance of payments transactions related to the mobile phone license are no longer recorded for the subsequent periods.

Table 12. Bulgaria: Core Statistical Indicators as of June 10, 2002

	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	June 10, 2002	June 7, 2002	June 7, 2002	June 7, 2002	April 30, 2002	June 7, 2002	May 2002	March 2002	March 2002	March, 2002	Q4 2001 (qtrly) 2001 (annual)	March 31, 2002
Date Received	June 10, 2002	June 10, 2002	June 10, 2002	June 10, 2002	June 3, 2002	June 10, 2002	June 10, 2002	May 22, 2002	May 22, 2002	May 14, 2002	April 25, 2001	May 15, 2002
Frequency of Data	Daily	Daily	Daily	Daily	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly Annually	Monthly
Frequency of Reporting	Daily	Weekly	Weekly	Weekly	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly Annually	Monthly
Source of Update	BNB	BNB	BNB	BNB	BNB	BNB	NSI	BNB	BNB	MoF	NSI	MoF and BNB
Mode of Reporting	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from BNB	Email from NSI	Email from BNB	Email from BNB	Email/fax from RR	Email from NSI	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

BULGARIA: FUND RELATIONS
As of May 31, 2002

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

II. **General Resources Account**:	SDR million	%Quota
Quota	640.20	100.0
Fund holdings of currency	1411.55	220.49
Reserve position in Fund	32.78	5.12

III. **SDR Department**:	SDR million	%Allocation
Holdings	5.85	N/A

IV. **Outstanding Purchases and Loans**:	SDR million	%Quota
Stand-by	137.75	21.52
EFF	627.62	98.03
STF	38.74	6.05

V. **Latest Financial Arrangements**:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
Stand-by	02/27/2002	02/26/2004	240.00	32.00
EFF	09/25/1998	09/24/2001	627.62	627.62
Stand-by	04/11/1997	06/10/1998	371.90	371.90

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2002	2003	2004	2005	2006
Principal	84.40	76.60	82.70	129.30	134.80
Charges/Interest	12.10	21.30	19.10	16.30	12.20
Total	96.50	97.90	101.80	145.60	147.00

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, the Bulgarian National Bank (BNB) is subject to a full safeguards assessment with respect to the stand-by arrangement, which was approved on February 27, 2002, and is scheduled to expire on February 26, 2004 (a transitional assessment of the BNB was completed on March 21, 2001). This assessment of the BNB, which was completed on June 12, 2002, concluded that safeguards in place at the BNB appear generally adequate. The BNB publishes, within four months of the financial year end, its annual financial statements that are audited by an international accounting firm in accordance with International Standards on Auditing. However, certain weaknesses were identified in the internal audit, financial reporting, and control systems. The safeguards assessment recommended the following priority measures to address the identified vulnerabilities: (i) strengthening of internal audit function by reorganizing the Internal Audit Department and establishing a risk-based approach in internal audit; (ii) modifying control procedures to better facilitate identification, assessment, and prevention of potential inaccuracies in the reporting system; and (iii) ensuring the consistency and integrity of the economic data provided to the Fund. As indicated in the authorities' response letter, some of the recommended measures have already been implemented or are in the process of being implemented. The implementation of these and other recommendations will be monitored by staff in the context of program reviews.

VIII. **Exchange Arrangements**:

An amendment to the Law on the Bulgarian National Bank (BNB) effectively established a currency board arrangement in July 1997. The deutsche mark was chosen as the peg currency, which has since been replaced with the euro at the rate of lev 1.95583 per ε 1. The BNB is required to sell and purchase on demand and without restriction currencies of EMU member countries for leva on the basis of spot exchange rates that may not differ from the official exchange rate by more than 0.5 percent. Bulgaria maintains an exchange system free of restrictions on the making of payments and transfers fur current international transactions.

IX. **Article IV Consultation**:

The last Article IV consultation was concluded on March 9, 2001 (see EBS/01/28). Bulgaria has been on a 12-month cycle. The Acting Chairman's summing-up of the discussion was circulated as SUR/01/36. Bulgaria has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, and maintains an exchange rate system that is free of restrictions on the making of payments and transfers for current international transactions.

X. **FSAP Participation and ROSCs**:

Bulgaria participated in an FSAP held from October 29 to November 14, 2001. Table 13 provides information on the production of ROSCs.

XI. **Technical Assistance**

Table 14 provides information on IMF technical assistance activities in Bulgaria.

XII. **Resident Representatives**:

Mrs. Piritta Sorsa took up the resident representative position on July 16, 2001.

Table 13. Bulgaria: ROSCs

Standard/code assessed	Date of issuance	Document number
ROSC update - Data dissemination, fiscal transparency, transparency of monetary and financial policies, banking supervision, deposit insurance, insurance supervision, securities market supervision	03/08/2001	---
ROSC – Data dissemination, fiscal transparency, transparency of monetary policy, banking supervision, system of deposit insurance, insurance supervision, securities market supervision	03/17/2000	EBS/00/46 (revised version of EBS/99/158)
Experimental ROSC – Data transparency, fiscal transparency, transparency of monetary policy, banking supervision, system of deposit insurance, insurance supervision, securities market supervision, insurance supervision, accounting and auditing practices	08/27/1999	EBS/99/158

Table 14. Bulgaria: Technical Assistance, 1998-2002

Dept.	Subject/Identified Need	Action	Timing	Counterpart
MAE	Banking supervision/debt management	Mission	Apr. 98	BNB
MAE	Organization and management	Expert	Jun., Sep., Dec. 98	BNB
MAE	Information technology	Expert	Nov. 98	BNB
MAE	Cash processing	Expert	Dec. 98	BNB
MAE	Foreign exchange	Expert	98-99 various visits	BNB
MAE	Payment system	Expert	Jan. 99	BNB
MAE	Banking supervision, organization and management	Mission	Mar.-Apr. 99	BNB
MAE	Accounting	Expert	Jun. & Aug./Sep.99	BNB
MAE	Transparency Report/Based Core Principles	Mission	Jul. 99	BNB
MAE	Deposit insurance	Mission	Oct. 99	BNB
MAE	Payment system/liquidity management/ bank bankruptcy legislation	Mission	May 00	BNB
MAE	Bank bankruptcy legislation	Expert	Jun. 00	BNB
MAE	Foreign exchange	Mission	Nov. 00	BNB
MAE	Accounting	Mission	Dec. 00	BNB
MAE	Short-term advisor payment system	Expert	Jun. 01	BNB
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-Jun. 00	MOF
FAD	Social security administration	Expert	Jun. 00	MOF
FAD	Long-term resident advisor	Expert	Sep. 00-Sep. 01	MOF
FAD	Mission for workshop	Mission	Jun. 01	MOF
FAD	Tax administration - follow-up	Mission	Sep. 01	MOF
FAD	Customs administration	Mission	Oct.-Nov. 01	MOF
FAD	Tax administration	Mission	Sep. 01	MOF
FAD	Long-term resident advisor	Expert	Apr. 02- Mar. 03	MOF
STA	Producer prices	Mission	Apr. -May 98	NSI
STA	BOP statistics	Mission	Jun.-Jul. 99	BNB
STA	GDDS	Mission	Jul. 99	BNB
STA	National accounts	Mission	Nov. 99	NSI
STA	Price statistics	Mission	Jun. 00	NSI
STA	BOP statistics	Mission	Dec. 00	BNB
STA	Producer prices	Mission	Nov. 01	NSI
STA	Producer prices	Mission	Apr. 02	NSI

Sofia, Bulgaria, July 5, 2002

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

Dear Mr. Köhler,

The Attached Supplementary Memorandum of Economic Policies (SMEP) describes our performance to date under the program supported by the stand-by arrangement (SBA) and presents the policies that the Government of Bulgaria and the Bulgarian National Bank (BNB) intend to implement during the remainder of this year and in 2003. The thrust of our policy intentions remains as described in the Memorandum of Economic Policies (MEP) dated February 12, 2002. We will continue to strive to maintain macroeconomic stability and achieve high sustainable economic growth. In this regard, our policies will continue to emphasize prudent fiscal policy and the expeditious implementation of structural reforms necessary to spur productivity and create a fully functioning market economy.

We have strived to implement fully our program and have observed all quantitative performance criteria for end-March. However, the end-April structural performance criterion on the announcement of a schedule for increases in household prices of electricity was not observed on time, as it took more time than expected to develop accompanying measures. In light of our subsequent announcement of this schedule prior to the consideration by the IMF Board of the first review of our program, we request a waiver of the non-observance of this performance criterion. We also request waivers of applicability of the end-June quantitative performance criteria, other than the external debt performance criteria. Our program remains on track and we believe that these end-June quantitative performance criteria have been observed.

We stand ready to consult with IMF staff at any time if circumstances spelled out in the Letter of Intent dated February 12, 2002 materialize or if the need to achieve our policy objectives so requires. Should the recent unfavorable external developments persist during the remainder of the year, we will consult with IMF staff on additional adjustment measures necessary to ensure that program implementation remains on track and the currency board arrangement safe. We agree to publish the SMEP after the IMF Board has approved the completion of the first review of our program.

Sincerely yours,

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

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

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

A. Introduction

1. **Bulgaria continues on its path toward a fully functioning and stable market economy that can reap the benefits of globalization and lead to EU accession as planned**. So far in 2002, we have maintained macroeconomic stability in the face of a difficult external environment, primarily by implementing cautious fiscal and incomes policies. At the same time, we have accelerated our program of structural reforms, in close consultation with the World Bank, with the aim of generating high and sustained growth and reducing unemployment and poverty. Recognizing, however, that some individuals are suffering from temporary adverse effects of economic transition, we have strengthened significantly the social safety net.

2. **We will continue to implement strong policies to maintain the viability of the currency board arrangement (CBA) over the medium term.** The CBA has provided a stable monetary environment and an anchor for our economic policies more generally, while engendering confidence in our economy both domestically and abroad. To support the CBA, we will continue to implement a prudent and flexible fiscal policy, aiming in the medium term at a balanced budget and a reduction of public debt to below 60 percent of GDP. At the same time, we will continue to reduce gradually the tax burden to spur economic activity, while increasing spending in high priority areas, in particular public investment—including for EU accession requirements—and the social safety net. To help create room for these tax cuts and focused spending increases, as well as to foster the competitiveness and flexibility of the economy, we intend to continue implementing wide-ranging structural reforms and to maintain stringent income policies for the remaining public enterprises.

3. **Despite a few delays, our economic program—supported by a stand-by arrangement approved by the IMF's Executive Board in February 2002—is essentially on track**. All quantitative performance criteria for the first quarter of 2002 were met (Table 1). One structural benchmark and one performance criterion due by end-March and end-April 2002, respectively, were not observed. The structural benchmark on parliamentary adoption of the bank bankruptcy law is now scheduled to be implemented by end-July and the performance criterion on household electricity price increases is now a prior action before consideration of the first review of our program by the IMF Board (Table 2). We stand ready as well to take all additional steps as may prove necessary during the course of the program to meet our economic objectives.

B. Recent Economic Developments

4. **While adverse external and domestic developments have delayed attainment of some of our macroeconomic objectives, we expect overall macroeconomic performance by the end of the year to be consistent with our program.** GDP growth declined to 4 percent in 2001 as imports by the EU and Turkey slowed and prices of key exports fell. As a result, the external current account has remained under pressure, with the twelve-month

deficit growing to about 6½ percent of GDP, foreign direct investment has slackened, and gross international reserves of the BNB have declined modestly, although remaining at a healthy 4½ months of prospective imports. As the recovery in the EU solidifies in the second half of 2002, Bulgaria's growth is expected to pick up, reaching 4 percent this year. Consumer price inflation rose sharply in the first three months of 2002, and stands at 7 percent for the twelve months ending May 2002, significantly overshooting projections. As this increase largely reflects the one-time impact of adjustments in administered prices and indirect taxes and a spike in food prices, and underlying inflation remains subdued, we expect the twelve-month inflation rate to decline during the coming months, reaching some 7 percent by end-year.

5. **Our economy continues to be externally competitive, although scope remains for continued large improvements.** In spite of an appreciation of the CPI-based real effective exchange rate, resulting from the recent pickup in consumer price inflation, there are no indications that the exchange rate is overvalued. Productivity growth remains strong and real wages and unit labor costs lower than in most of our competitors. Exports of non-traditional consumer goods have continued to grow robustly even during the economic downturn. Nevertheless, to ensure that competitiveness continues to improve, we will need to act forcefully to improve the business climate and enhance the flexibility of the economy.

6. **We are successfully implementing a cautious fiscal program.** Our revised fiscal target for 2001 of 0.9 percent of GDP was met as a result of a sizable fiscal adjustment in the fourth quarter of the year. The execution of the 2002 budget is on track as well, with end-March performance criteria on the general government deficit and the fiscal reserve account (FRA) observed with comfortable margins. Revenue in the first four months of 2002 was approximately in line with the program while control over spending remained tight. We have intensified our efforts to ensure that subsidies are brought under control. A school redeployment plan designed to restructure the school network, optimize teacher employment, and increase efficiency was approved by the Council of Ministers (CoM) and a system for making child allowance more effective and better targeted was approved by parliament. Progress was made in restructuring the health care sector including by advancing the hospital accreditation process and reducing hospital overcapacity, although targets have not been fully met. In the tax administration area, we are taking steps to implement the unified revenue agency (URA) and to address weaknesses in VAT administration and the system of VAT refunds.

7. **We have implemented reforms in the financial sector to strengthen the supervision of financial institutions and increase financial intermediation.** Amendments providing the BNB legal authority to investigate the identity and suitability of direct and indirect shareholders of banks were tabled in parliament. A consultative council on financial supervision was established and the independence and resources of the Financial Investigation Bureau were strengthened to enhance anti-money laundering actions. To stimulate the interbank market we have helped introduce the Sofibor, which tracks the interest rate charged on overnight interbank lending. We adopted a strategy for the privatization of DSK Bank and issued tenders for the sale of Biochim and DZI (State Insurance Institute). The adoption by parliament of the bank bankruptcy law (structural

benchmark for end-March 2002) was delayed, but the law has passed the first reading in parliament and we have redoubled our efforts to ensure passage during this parliamentary session, which ends in July 2002. We have begun implementing the recent recommendations of the Fund's Safeguards Assessment of the BNB with regard to the auditing, staff training, and accuracy of reporting.

8. **We have made progress with the restructuring of our economy to increase its efficiency and ensure that Bulgaria becomes an increasingly attractive place to do business.** Our privatization program gained momentum with the passage of the new privatization law. Tenders were issued for the privatization of the telecommunication company (BTC) and the tobacco holding (Bulgartabac). Our medium-term energy strategy was adopted by the CoM and tabled in parliament. Preparations were made for the privatization of the electricity distribution companies and the creation of gas distribution companies. We announced the schedule for a gradual increase in household electricity prices consistent with World Bank recommendations (prior action for first review) and aimed at full cost recovery by end-2004. At the same time, we announced an increase in the upper limit of heating prices for those district heating companies that are subsidized, in line with our energy strategy. To mitigate the impact of the increase in household electricity prices, we introduced on a temporary basis two-block tariff systems, which will keep prices unchanged for a minimum level of electricity and heating. We have continued to promote trade liberalization with the announcement in June 2002 of a multi-year plan for halving the average most favored nation tariff rate.

9. **We have conducted a successful Brady bond exchange, which has furthered our debt management objectives.** In March, we swapped US$1,328 million Brady bonds (28 percent of the outstanding Brady debt) for new U.S. dollar and Euro-denominated bonds. The exchange resulted in net present value savings of US$94 million and a reduction of the face value of the external debt. In line with our objectives, the duration of the bonded debt has increased from 5.5 to 5.9 years, the share of the Euro-denominated instruments has risen from around 5 percent to over 20 percent, bringing the currency composition of this debt more in line with that of trade, and the share of fixed interest rate debt has approximately doubled, to about 25 percent.

C. Policies for the Remainder of 2002 and 2003

10. **We will continue to adhere firmly to our policy framework, which emphasizes macroeconomic stability anchored by the CBA and the expeditous implementation of structural reforms.** We see this approach as the most effective avenue to achieve high sustainable growth and address social ills while preserving external viability. We are thus prepared to take all necessary adjustment measures to safeguard the CBA, while pressing ahead with our structural reform program.

11. **The macroeconomic framework underlying the program remains valid, although we have revised the inflation projection upward.** We continue to aim for a growth rate of 4 percent in 2002 and 5-6 percent over the medium term. End-year consumer price inflation is now projected at 7¼ percent, significantly outstripping the programmed

3½ percent. However, we see inflation continuing at moderate levels of 4-4½ percent over the medium term, differing from euro area inflation only insofar as productivity growth is higher in Bulgaria and additional administrative price increases are implemented and indirect tax rises remain necessary. While the external current account deficit of 6 percent of GDP underlying the program may still be attainable, developments to date and risks owing to potential delays in recovery in the EU or higher oil prices suggest that the deficit could be larger. Over the medium-term we continue to see a steady decline in the current account deficit, as private savings increasingly finance investment, with the deficit largely financed by FDI.

Fiscal policy and fiscal sector reforms

12. **To guard against further negative external developments, we will continue to implement fiscal policy cautiously and flexibly, taking adjustment measures as needed.** At this stage, we consider the budgeted fiscal deficit for 2002 of 0.8 percent of GDP as a limit rather than a target. We seek to maximize the scope for flexibility in our fiscal management and to ensure that we can deal quickly and decisively with any increased risk. Therefore, we will take the following steps in the first three quarters of the year. First, we will continue to curb discretionary spending under the 90 percent rule. Second, unless and until it is clear that our external position is in line with initial expectations underlying our program, we will:

- Refrain from using the structural reform contingency, except for spending already allocated for NATO-related reforms in the third quarter.

- Save any revenue overperformance that may emerge.

- Save all of the 20 million leva accrued interest for 2002 realized from the release of collateral as a result of the March debt swap, and at least 50 million leva out of the 140 million leva interest savings associated with this debt swap and lower international interest rates (a total saving of 70 million leva, or ¼ percent of GDP). The remaining 90 million leva interest savings are planned to be used for a one-time clearance of arrears of public sector institutions. This operation would be carried out as part of a broader plan to restructure the remaining stock of arrears and eliminate the emergence of future arrears.

Third, we will refrain from implementing any tax cuts during the remainder of 2002.

We intend to use the above-mentioned savings and revenue overperformance for additional non-interest expenditures if and when it is clear that the external position is in line with the program. In no event will this additional spending be made before the fourth quarter of 2002.

13. **Should the potential risks materialize, we stand ready to consult with IMF staff on the need for adjustment measures, their nature and timing.** In particular, IMF staff will request consultation procedures if the current account deficit worsens or reserves decline significantly compared to program projections. In any case, we would consult with IMF staff

on fourth quarter spending plans in the context of the planned September staff visit. We have already identified the following contingency measures which provide for more than ¾ percent of GDP in potential savings: (i) continuing the 90 percent rule for some categories of discretionary expenditure through the end of the year (a cushion of 0.2 percent of GDP); (ii) limiting the share of the interest savings that is used for arrears clearance by imposing additional reform measures; (iii) fully saving the accrued interest revenue and remainder of the interest saving (0.2 percent of GDP); (iv) not spending part of the structural reform contingency (0.1 percent of GDP); and (v) postponing a number of investment projects planned for this year (0.2 percent of GDP).

14. **To ensure that our medium-term fiscal program can be successfully carried out, we will continue to modernize our tax administration.** We remain fully committed to the URA project and are taking all necessary steps to ensure it can begin operations next year. In addition, consistent with the recommendations of the recent IMF Fiscal Affairs Department's tax administration mission, we intend to strengthen the large taxpayers unit, by increasing its coverage and developing a risk-based audit strategy. The VAT refund system is being improved—including through the introduction of VAT accounts and the implementation of IMF technical assistance recommendations—with the aim of ensuring that legitimate taxpayers receive their refunds promptly (within 45 days) while focusing our audits on high-risk taxpayers. We will implement the recommendation of the Crown Agents report in the area of customs reform, aimed at achieving harmonization with the EU, increasing revenue collection, reducing corruption, and facilitating legitimate trade.

15. **We are enhancing our expenditure management to ensure our spending is increasingly efficient and focused on high priority areas.** Beginning with the 2003 budget, we have established a more adequate time frame for the budget process and are enhancing the transparency of budget documents. To make the budget more result-oriented, we are preparing a pilot program budget in one ministry in 2003, and will extend this to at least three ministries the following year.

16. **We will continue efforts to ensure that subsidies are limited and targeted to socially important activities, including by:**

- Pursuing a restructuring of the energy sector, and ensuring that prices increasingly cover economic costs; and implementing our plan to create an efficient state railway, operating on a commercial basis, with limited and transparent subsidies (see below).

- Implementing, beginning in September 2002 the recently completed school redeployment plan, including by rationalizing the school network and reducing redundant employment in the upcoming academic year.

- Increasingly focusing the proportion of National Health Fund (NHF) spending devoted to hospital care on high quality hospital service, including through completion of the accreditation process and expansion of the number of the clinical paths financed by the NHF.

- Implementing the plan adopted by the CoM in June to reform the system of intergovernmental finances, including by: clarifying expenditure responsibilities and ensuring revenues consistent with these responsibilities; developing a simple and transparent basis for intergovernmental transfers; and providing incentives for efficient provision of services at the local level.

17. **Our budget for 2003 will aim to further reduce the deficit as a percent of GDP.** This will help us to achieve our objective of eliminating the deficit by 2005. The expected return of growth to potential in 2003 will help buoy revenue, and ongoing structural reforms will limit unproductive spending. The three-year tax policy plan announced at the end of April will contribute to a simple transparent tax system and broaden the tax base, and will lead to a decline in corporate and personal income tax burdens. The budget will be based on conservative assumptions with regard to the macroeconomic environment and the supply side response to tax cuts, and would continue to be implemented flexibly.

Labor market and competitiveness

18. **We will foster stronger employment creation to reduce poverty on a permanent basis.** This would require increasing the efficiency of the labor market, while ensuring that workers have the training and resources to successfully participate in the economy. We are endeavoring, in close cooperation with social partners, to bring the labor code in line with EU requirements. The continued implementation of a prudent incomes policy will help ensure that our economy remains competitive and reduce the scope for a wage-inflation spiral to take hold in the broader economy.

Financial sector policies

19. **Although our banking system is generally sound and well supervised, we will strengthen further our regulatory and supervisory framework in preparation for the expected increase in intermediation and EU accession**. We are taking steps to improve the risk assessment capabilities of the BNB including by training BNB inspectors in the use of the recently completed manual on risk assessment. We will ensure that, by January 2003, all banks have complied with international accounting standards. In light of the expansion of credit to the private sector, we will monitor loan quality closely and continue efforts to strengthen the financial condition of smaller domestic banks. In addition, we will press for the adoption by parliament of a workable bank bankruptcy law by the end of its current session, no later than end-July 2002, (structural benchmark). Also, we have completed the drafting of amendments to the anti-money laundering law, which together with the recently drafted anti-terrorist finance law were endorsed by the CoM in June and are expected to be passed in parliament by end-July 2002.

20. **We are implementing measures to increase financial intermediation and to improve the efficiency and security of banking operations.** By end-September 2002, we intend to settle the sale of Biochim Bank (structural benchmark) and finalize the sale procedures of the State Insurance Institute. We will expedite the DSK Bank privatization process. Also steps are being taken to amend the commercial code to facilitate the realization

of collateral and improve foreclosure procedures. We will complete the Real Time Gross Settlements (RTGS) project—which will enhance the security and speed of payments transactions, while improving banks' liquidity management—by November 2002, and expedite the use of electronic signature in the banking system. The necessary legislative changes to allow these improvements to go forward have already been made. We will implement the recommendations of the Report on the Observance of Standards and Codes (ROSC) module on the transparency of the monetary and financial policies.

Other structural reform policies

21. **We are strongly committed to completing the privatization of our state-owned enterprises expeditiously and transparently.** Following the passage of the new privatization law, we aim to complete the privatization of the Bulgartabac holding by end-July and the State Telecommunication Company by end-August. At the same time, in compliance with the privatization law, the line ministries will submit to the Privatization Agency all documents necessary so that tenders and auctions for more than 400 majority state-owned companies can be issued by year end. We will finalize the divestiture of residual state-owned shares in a large number of companies through flotation on the stock exchange.

22. **We will continue reforming the energy and railways sectors.** We will seek the early adoption by parliament of our medium-term energy strategy. We have advanced the process of privatizing seven electricity distribution companies and intend to sell them by mid-2003. We aim to bring the restructuring of the district heating sector back on track by fully implementing the plan adopted in mid-2000. In addition, we have taken initial steps to open the domestic electricity and gas markets for large industrial customers by allowing them to purchase energy directly from producers. Approval by the CoM of the Energy Act that was due by June is now expected by end-September. We will continue the restructuring of the railways company, including by clearly determining those activities that would be operated on a commercial basis and those that would continue to receive government subsidies.

23. **While these efforts will go a long way to ensuring that state enterprises operate efficiently and with financial discipline, special efforts will be required to ensure that arrears are kept under control.** In particular, Bulgargaz and NEK will reschedule arrears payments owed to them and ensure that they do not face any arrears on current due and rescheduled payments from commercial activities irrespective of ownership (performance criterion, see Annex VII). In this context, Bulgargaz and NEK will take all necessary measures envisaged in the law regarding any commercial customer with payments overdue by more than one month over the normal payment period. We will make financial assistance above the budgeted level to the Sofia district heating company conditional on the concrete and full implementation of its restructuring plan.

External sector policies

24. **Our external sector policies will continue to focus on reducing vulnerability.** Our tight fiscal policy, which has resulted in the decline of public sector external indebtedness, goes a long way in lowering external vulnerability. We will continue to make sure that the

FRA balance is in excess of 1.9 billion leva—more than 100 percent of projected 2002 external debt service payments (performance criterion under the program). The FRA assets in excess of this floor will be managed prudently with a view to achieving a proper risk/return tradeoff, taking into account the FRA's role as a fiscal safeguard mechanism. We will seek to ensure that the new public debt law is approved by parliament, and will publish our medium-term external debt management strategy.

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

Variable and Periods	Target		Outcome	
I. Ceiling on the overall deficit of the				
general government		138		39
Jan. 1, 2002-Mar. 31, 2002		-103		
Jan. 1, 2002-Jun. 30, 2002		173		
Jan. 1, 2002-Sep. 30, 2002		260		
Jan. 1, 2002-Dec. 31, 2002				
II. Floor on the balance of the fiscal reserve				
account		1,900		2,477
Mar. 31, 2002		1,900		
Jun. 30, 2002		1,900		
Sep. 30, 2002		1,900		
Dec. 31, 2002				
III. Ceiling on the wage bill of the 60				
monitored SOEs 2/		141.8		139.1
Jan. 1, 2002-Mar. 31, 2002		141.8		
Apr. 1, 2002-Jun. 30, 2002		141.8		
Jul. 1, 2002-Sep. 30, 2002		141.8		
Oct. 1, 2002-Dec. 31, 2002				
	GTD	NSSI	GTD	NSSI
IV. Indicative ceiling on tax on social insurance arrears				
Cumulative change from level on: Dec. 31, 2001				
Mar. 31, 2002	-25	-5	-111	-7
Jun. 30, 2002	-50	-10		
Sep. 30, 2002	-75	-15		
Dec. 31, 2002	-100	-20		
	Up to one year	Over 1 year (excluding Eurobonds)	Up to one year	Over 1 year (excluding Eurobonds)
V. Ceiling on contracting and guaranteeing public sector external debt (millions of U.S. dollars)				
Cumulative change from level on Dec. 31, 2002:				
Mar. 31, 2002	0	230	0	46
Jun. 30, 2002	0	560		
Sep. 30, 2002	0	690		
Dec. 31, 2002	0	690		

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

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

1/ Definitions of the performance criteria and indicative targets are included in the Annexes to the Supplementary Memorandum of Economic Policies.
2/ Adjusted downward after the privatization of one of the monitored enterprises.

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

	Measures	Program Timing	Level of Conditions	Status	Review
		MEP, February 2002			
1.	Parliament to adopt a 2002 State budget consistent with paragraphs 8–12.	Before IMF Board meeting	Prior action	Met	First
2.	Council of Ministers (CoM) to adopt an ordinance on income policies consistent with paragraph 16.	Before IMF Board meeting	Prior action	Met	First
3.	Finalize the school redeployment plan, and submit it to CoM (paragraph 13).	End-March 2002	Benchmark	Met	First
4.	Adopt a child allowance allocation system, limiting allowances to most needy families (paragraph 11).	End-March 2002	Benchmark	Met	First
5.	Bank Consolidation Company (BCC) to adopt a privatization strategy for DSK Bank (paragraph 19).	End-March 2002	Benchmark	Met	First
6.	Issue a tender either to privatize the State Insurance Institute, or to transfer the management of the company to a strategic investor as an interim step toward privatization (paragraph 19).	End-March 2002	Benchmark	Met	First
7.	Parliament to adopt the Bank Bankruptcy law (paragraph 21).	End-March 2002	Benchmark	Not met	First
8.	Announce a schedule to bring household electricity prices to full cost-recovery levels (paragraph 25).	End-April 2002	Performance Criterion	Not met	First
9.	Submit to parliament a law to establish the unified revenue agency (paragraph 14).	End-June 2002	Benchmark		Second
10.	Complete accreditation process for all hospitals (paragraph 13).	End-June 2002	Benchmark		Second
11.	Have the Council of Ministers approve the final draft of a new Energy Act as described in paragraph 25.	End-June 2002	Benchmark		Second

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

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

Measures	Program Timing	Level of Conditions	Status	Review
12. Make the new energy pricing regime fully operational (paragraph 25).	End-June 2002	Benchmark		Second
13. Announce a reform of the import tariff schedule, to be phased over the period to January 2006, reducing the unweighted average MFN tariff to no more than 6 percent with significant annual reductions (paragraph 27).	End-June 2002	Benchmark		Second
14. Further improve the Treasury Single Account (TSA) by ensuring that the funds of the autonomous budgets (BNT, BN Radio, judiciary system, and the HIF) as well as the suspense accounts in Leva are also included in the TSA (paragraph 14).	December 2002 onward	Benchmark		Second
Supplementary MEP, July 2002 2/				
15. Announce a schedule to bring household electricity prices to full cost-recovery levels (paragraph 3).	IMF Board presentation of the review	Prior Action		First
16. Parliament to adopt the Bank Bankruptcy law (paragraph 19).	End-July 2002	Benchmark		Second
17. Settlement of the sale of Biochim Bank (paragraph 20)	End-September 2002	Benchmark		Second

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

Performance Criterion on the Overall Deficit of the General Government

	Overall deficit ceilings
	(In millions of leva)
January 1, 2002–March 31, 2002	138
January 1, 2002BJune 30, 2002	-103
January 1, 2002–September 30, 2002	173
January 1, 2002–December 31, 2002	260

The general government accounts are defined to comprise the consolidated budget (including the republican budget, the budgets of ministries and local governments, and the social security fund) as well as all extrabudgetary funds and accounts both at the central and local government levels.

The quarterly limits will be cumulative and will be monitored from the financing side as the sum of net credit from the banking system to the general government, including deposits and accounts abroad, net nonbank credit to the general government, privatization receipts of the budget, and receipts from external loans for direct budgetary support minus amortization paid. For calculating the performance against this ceiling, privatization receipts include the dividends the Bank Consolidation Company (BCC) distributed to the general government and taxes collected from BCC related to the sale of assets, and all the proceeds from the sale of GSM licenses. External drawings and repayments will be converted into leva at the BNB daily exchange rate. Valuation changes in deposits and accounts that are denominated in foreign currencies will be recorded daily and reported by the BNB and the Ministry of Finance at the end of each quarter, and such changes will be netted out.

Performance Criterion on the Floor on the Balance of the Fiscal Reserve Account

	FRA
	(In millions of leva)
March 31, 2002	1,900
June 30, 2002	1,900
September 30, 2002	1,900
December 31, 2002	1,900

The Fiscal Reserve Account (FRA) consists of (1) the balances in leva and in foreign exchange of the following accounts: all budgetary and deposit accounts in the banking system, including the central budget, ministries and agencies, central government extrabudgetary funds as defined in Annex No. 4 of the 2001 Budget Law, the National Social Security Institute, and the Health Insurance Fund, and (2) other highly liquid foreign assets of the central government.

The limits will be monitored from the accounts of the banking system and marked-to-market data of other highly liquid foreign assets of the central government, to be provided monthly by the BNB and the Ministry of Finance. For the purposes of the program, deposit accounts and assets that are denominated in foreign currencies will be converted into leva at the December 31, 2001 exchange rates (2.21926 leva, and 1.25673 SDR per US dollar).

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

	Wage Bill of 60 SOEs
	(In millions of leva)
July 1, 2001—September 30, 2001 (actual)	140.3
January 1, 2002–March 31, 2002	143.1
April 1, 2002BJune 30, 2002	143.1
July 1, 2002–September 30, 2002	143.1
October 1, 2002–December 31, 2002	143.1

The ceiling on the aggregate wage bill of the 60 state-owned enterprises closely monitored for their large losses or arrears, for receiving subsidies, or for being monopolies, is two percent above the level of their aggregate wage bill in the third quarter of 2001. The wage bill is defined to include wages and payroll taxes paid by the employer.

Those enterprises that have been privatized or ceased operations will be excluded from the list for the respective test dates. Those enterprises that register profits in each of the first two quarters of 2002 will also exit the list in the second half of 2002, unless they are monopolies, have arrears, or receive state subsidies. If an enterprise is excluded from the list, the wage bill ceiling will be adjusted down by the amount of that enterprise's wage bill in the third quarter of 2001 plus 2 percent. The 60 enterprises monitored (enterprises number 1 to 17 are considered monopolies):

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

Indicative Ceiling on Tax and Social Insurance Arrears

	Total	GTD	NSSI
	(In millions of leva)		
Outstanding as of:			
December 31, 2001 (actual)	683.1	471.7	211.4
Cumulative change from level on December 31, 2001:			
March 31, 2002	-30	-25	-5
June 30, 2002	-60	-50	-10
September 30, 2002	-90	-75	-15
December 31, 2002	-120	-100	-20

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

1. Lukoil - Neftochim
2. Energokabel AD
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. Dupnitsa BT
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. Zahar Bio AD
34. Stomaneni trabi
35. Orfei
36. Chernomorsko Zlato
37. Korabno mashinostroene
38. NITI EAD Kazanlyk
39. Stara reka
40. Shumensko pivo
41. Agroteknika
42. Vineks Preslav
43. Cherno more
44. Liteks Dzus
45. Varnensko Pivo
46. Kitka
47. Svetlina
48. Burgasbas
49. Blagoustroisveni Stroeji Burgas
50. LVK Gamza

The enterprises monitored for arrears to the NSSI:

1. Agrotechnika AD - Karlovo
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. Arkus AD – Lyaskovets
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. Bulgarska Roza Sevtopolis AD - Kazanluk
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. Mak AD - Gabrovo
59. Orfey OOD,
60. Radomir Le Co Co EOOD
61. Darvodobiv i Stroitelstvo
62. Dobrichka Mesna Kompania
63. Prikom EAD
64. Kyustendilski Stroitel AD
65. Dunarit AD
66. Burya AD
67. Mediket EAD
68. Harmonia
69. Pektin EOOD
70. Uvion OOD
71. S-M 33
72. Svetlina AD – Sliven
73. Rilski Len AD – Samokov
74. Filteks AD - Kazanluk
75. Rodopa 95 AD
76. Semena Dobrich AD – Dobrich
77. Elastic EAD
78. ZMD Nikopol AD
79. Beta AD – Cherven Briag
80. Sukmo EOOD
81. Purvi Mai K – Kazanluk
82. Struma OOD
83. Balkan Bank – Headquarters
84. Arsenal EAD
85. Alukom – Pleven
86. ZMM Technotronica
87. Incoms EIM
88. Chepino EAD
89. Ruen Elite AD – Sofia
90. Proinveks EOOD, Sofia
91. Elko OOD
92. Niva AD – Kostinbrod
93. Kachestvena Metalurgia AD
94. Dobrich Mel
95. Kartal EAD
96. Balkankar Zarya AD – Pavlikeni
97. ZSK Kremikovtsi - Sofia
98. YAH & CO Ahrida AD – Kurdjali
99. Simpto AD – Aytos
100. Kremikovtski

For the purpose of assessing compliance with these indicative targets:

- 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, 2001;
- 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, 2001 on writing off or rescheduling outstanding liabilities to tax authorities or the NSSI will not reduce amounts counted as outstanding liabilities;
- enterprises in the list which are entered into liquidation or bankruptcy proceedings will not drop out of the monitored total until they are struck from the register of active enterprises in Bulgaria; however, the total will no longer include new interest and penalty charges accruing after their entry into bankruptcy or liquidation.
- NEK will include all generation, transmission and distribution companies that were a part of the electricity monopoly prior to its unbundling.

Other Performance Criteria[1]

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

2. The BNB shall not increase credit to the government at any time during the period of the CBA, except as allowed under the Law of the BNB, nor shall it purchase Bulgarian government securities.

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

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

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

	One year and Under 3/	Over 1 year 4/		1-5 years 4/
		Excluding Eurobonds	Eurobond issuance 5/	
Cumulative change from level on December 31, 2001				
March 31, 2002	0	230	300	0
June 30, 2002	0	560	300	0
September 30, 2002	0	690	300	0
December 31, 2002	0	690	0	0

1/ The public sector comprises the central government, the local government, the social security fund and all other extrabudgetary funds and the Bulgarian National Bank.

2/ The term "debt" has the meaning set forth in point No. 9 of the IMF Guidelines on Performance Criteria with Respect to Foreign debt adopted on August 24, 2000 (Executive Board Decision No. 12274-(00/85)). Excluded from this performance criterion are (i) normal import-related financing credits; and (ii) outstanding balances under bilateral payments arrangements. Debt and commitments falling within the ceilings shall be valued in U.S. dollars at the exchange rate prevailing at the time the contract or guarantee becomes effective

3/ The ceilings apply to debt with original maturities of up to and including one year. The actual stock of short-term debt outstanding (according to this definition) as of December 31, 2001 was zero.

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

5/ Gross value of Eurobond issuance , net of the cumulative value of own tradable external debt acquired by the general government in 2002 up to the test date, whether through separate transactions, or in a debt exchange operation. Operations will be valued at the market value on the day of the transaction. Following the end of each quarter, the Minister of Finance will report to the IMF: (i) the contracting and guaranteeing of external debt falling both inside and outside the ceilings, and (ii) the amount of own tradable external debt acquired by the general government. Following the end of each month, information on the contracting and guaranteeing of external debt falling both inside and outside the ceilings will be reported to the IMF by the Ministry of Finance.

Performance Criteria—Ceilings on Changes to Arrears Owed to Bulgargaz and NEK 1/

	Bulgargaz	NEK
	(In millions of leva)	
Stock of arrears outstanding as of May 31, 2002	86	199
Cumulative changes in the stock of arrears from level on May 31, 2002:		
September 30, 2002	0	0
December 31, 2002	0	0

1/ The performance criteria apply separately on the arrear targets for Bulgargaz and NEK. Arrears owed by the district heating companies, state-owned railways company (BDZ), and public hospitals will be excluded from the performance criteria given the ongoing restructuring of these entities, but all other public sector entities will be included. Bulgargaz and NEK shall reschedule all the arrears considered for the performance criteria by July 12, 2002. For the purpose of these performance criteria, (i) arrears include overdue payments on current and rescheduled receivables; (ii) arrears are defined to include overdue payments of more than one month after the normal settlement period and interests and penalties, if any; (iii) arrears will not include new interest and penalties accruing for enterprises that enter into bankruptcy or liquidation; and (iv) arrears of companies that have been disconnected will not be included. The Ministry of Finance shall provide to the IMF data on the stock of arrears owed to Bulgargaz and NEK on a monthly basis and detailed entity-by-entity arrears on a quarterly basis.

Statement by the IMF Staff Representative
July 22, 2002

This statement provides information that has become available since the issuance of the staff report for the Article IV consultation and first review under the stand-by arrangement for Bulgaria (EBS/02/121). This information does not change the staff's appraisal in that report.

- June inflation data were favorable, with a fall in the 12-month inflation rate to 5.2 percent. While a further pick-up is expected with the announced increase in energy prices, end-year inflation is likely to remain within the revised target of 7¼ percent. The most recent indicators of economic activity present a mixed picture, with May industrial output showing a robust rise year-on-year, but industrial sales declining. As of July 12, foreign reserves of the central bank totaled US$4,043 million (4.9 months of prospective imports) compared with US$3,579 million at end-2001.

- Indications are that all performance criteria for end-June were observed. Staff has confirmed that ceilings on contracting and guaranteeing public sector debt have been met. Preliminary data point to a general government fiscal surplus of about 300 million leva (0.9 percent of annual GDP) through end-June, meeting the performance criterion with a margin of some 200 million leva. Similarly, the floor on the fiscal reserve account appears to have been observed with a comfortable margin.

- On the structural side, there have been several positive developments. A schedule of increases for household electricity prices—the prior action for this Board discussion—was announced in late June, with an average 20 percent increase effective on July 1. The end-June benchmark to make the energy pricing regime fully operational has been met as well. Negotiations for the sale of Biochim Bank (an end-September benchmark) have been completed with Bank Austria, and a contract is expected to be signed on July 26. Finally, legislation to create a unified revenue agency was submitted to parliament (end-June benchmark) albeit several weeks late.

- However, several end-June benchmarks—which are subject to the second review under the program—have not been observed. First, the accreditation process for hospitals has not yet been completed, although ¾ of all hospitals have gone through the process, with the remainder expected by end-year. Second, a draft of the new Energy Act is still being prepared, and is now expected to be presented to the Council of Ministers only by end-September. Finally, the authorities have indicated to staff that they no longer intend to implement the planned reform of the MFN tariff schedule, as they have been advised by the European Union that no tariff changes should be envisaged prior to accession.

- The authorities have indicated their intention to publish the staff report and selected issues papers without deletions.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 02/82
FOR IMMEDIATE RELEASE
August 5, 2002

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

IMF Concludes 2002 Article IV Consultation with Bulgaria

On July 22, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Bulgaria.[1]

Background

Bulgaria has made a rapid recovery from the crisis it suffered in 1996–97. A robust turnaround took hold in 1998 and by end-2001, real GDP had increased by 16½ percent over four years, inflation had been lowered from near-hyperinflation levels to single digits, and external debt had declined from more than a 100 percent of GDP to 70 percent of GDP. These results owe to a policy framework anchored on a currency board arrangement and featuring a prudent fiscal policy, strict incomes policies for state-owned enterprises, and a comprehensive structural reform program aimed at creating a fully-functioning and competitive market economy. The currency board continues to enjoy broad support domestically and has engendered confidence in foreign investors, contributing to its continued viability. In support of the CBA, fiscal policy has been cautious and flexible, allowing the fiscal deficit to decline to near balance. In the same vein, caps put on the wage bills of struggling state-owned enterprises have contributed to moderate wages increases in the economy, keeping inflation in check and safeguarding Bulgaria's competitiveness. Significant progress has been made in

[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.

reforming the economy. Almost all non-infrastructure enterprise assets and four fifths of bank assets have been privatized; bank supervision has been improved; trade and price liberalization have been achieved; and the overhaul of the pension and health care systems is well advanced. However, progress has been more limited in improving the efficiency of the public administration, and in rationalizing the health care and education systems. Also, key enterprises have yet to be privatized and the pace of reforms in the energy and transportation sectors has been slow. In addition, Bulgaria still has to reform key institutions and laws to increase the country's attractiveness as a place to do business.

Policy implementation in 2001–2002 remained strong in the face of unfavorable external developments. Consistent with its policy framework, Bulgaria has maintained a prudent fiscal policy, with the general government registering a small deficit of 0.9 percent of GDP in 2001 and a surplus of about 0.9 percent of GDP through June 2002. Also, strict wage ceilings were maintained on public enterprises. In early 2002, Bulgaria conducted a debt swap operation, which limited external risks by reducing the face value of the debt, lengthening the maturity structure, and increasing the share of Euro-denominated and fixed interest rate instruments. Progress in restructuring the economy included passage of the privatization law, issuance of tenders for the sale of several key public enterprises, and reforms in the energy sector. The latter included notably, increases in electricity and district heating prices toward cost-recovery levels and preparations for the privatization of the electricity distribution companies.

Macroeconomic performance in 2001–2002 has been good. Despite the slowdown in Bulgaria's main trading partners, particularly the European Union (EU), 12-month real GDP growth reached 4 percent in 2001 and 3.2 percent in the first quarter of 2002, slightly lower than at the end of the same quarter in 2001. Year-on-year inflation accelerated moderately from 4.8 percent at end-2001 to 5.2 in end-June 2002, reflecting temporary factors, including increases in administrative prices, but underlying inflation remains low. The external current account deficit in 2001 amounted to 6½ percent, as an improvement in the income balance was offset by a widening trade deficit, but was largely covered by foreign direct investment. In this context, gross international reserves, at US$3.6 billion, continued to cover 5 months of prospective imports of goods and nonfactor services. So far in 2002, the external current account deficit remains on pace for a similar outcome as in 2001. While the income balance is due to improve owing to lower external interest payments, the trade balance is expected to widen mainly due to lower exports. Lackluster foreign direct investment in the first quarter of 2002 partly reflected the timing of privatization and the import cover of gross international reserves is expected to remain at close to 5 months. Bulgaria's competitiveness remains adequate, as its market share in the EU has continued to expand and the appreciation of the real effective exchange rate in 2001 and early 2002 was in line with productivity gains relative to Bulgaria's main trading partners.

Bulgaria continues to face challenges to sustain high-quality growth. High unemployment and poverty levels have to be reduced to increase living standards and preparations for EU accession still have a long way to go. Also, the country remains vulnerable to exogenous shocks. To overcome these challenges, Bulgaria would need to keep its discipline in implementing macroeconomic policies and accelerate the implementation of crucial structural reforms to increase the efficiency of the economy.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They acknowledged the impressive progress made by Bulgaria since the adoption in 1997 of a policy framework centered on a currency board arrangement (CBA), prudent fiscal and incomes policies, and comprehensive structural reforms. Nevertheless, the country continues to face challenges. Although growth has been robust, unemployment remains high, and poverty is above the levels of before the 1996–97 crisis. External debt and the external current account deficit also remain high, and the economy is vulnerable to exogenous shocks. Directors agreed that further structural reforms need to be implemented in key areas in order to strengthen the economy's productivity and competitiveness in preparation for EU accession.

Directors supported the approach taken by the government to deal with these challenges, namely, continued adherence to the CBA, supported by prudent macroeconomic policies and an acceleration of structural reforms. In this context, the authorities' response to heightened external risks during the past nine months had been appropriate. Despite the prolonged slowdown in the EU and declining foreign direct investment, the authorities had met—with comfortable margins—their fiscal deficit target for the first quarter of 2002, had adopted contingent fiscal measures to cope with further potential stress during the rest of the year, and had resisted demands for additional increases in public sector wages. Directors underscored that the completion of the restructuring of the economy would increase the flexibility to deal with future shocks.

Directors considered that Bulgaria's prospects for 2002 were good, but depended on the strength of the recovery in the EU and continuation of a cautious and flexible fiscal policy. A delayed recovery in the EU, higher oil prices, and delays in the privatization of large state enterprises could worsen the external outlook. The authorities should stand ready to implement the agreed contingent fiscal measures, if needed.

Directors encouraged the authorities to implement measures to further promote competitiveness and improve the business climate. Strict limits on the wage bill of public enterprises help keep inflation low and promote restructuring in the state-owned sector, while guiding wage formation in the broader economy. Bulgaria's competitiveness remains adequate, but it needs to continue to be monitored closely, and additional measures are needed to increase labor market flexibility. Directors welcomed the recent passage of the privatization law, which increases transparency in the privatization process, and encouraged the authorities to accelerate pending reforms, notably the strengthening of corporate governance and the simplification of foreclosure procedures, that would make Bulgaria a more attractive place in which to do business. More generally, Directors encouraged the authorities to strengthen the legal and institutional framework to discourage rent-seeking activities and facilitate sound investment decisions.

Directors commended the authorities for their prudent public debt management, particularly the recent Brady bond swap, which helped improve the external debt profile. They encouraged the authorities to continue their conservative approach to contracting and guaranteeing external public debt.

Directors considered the government's medium-term fiscal strategy appropriate, but cautioned that its successful implementation would hinge on an acceleration of structural and public sector reforms. They agreed with the authorities' pro-growth policy of lowering income tax and social security contributions, while strengthening spending in key areas, including for the social safety net and EU accession. Reaching a balanced budget by 2005 is also a desirable objective. However, in order to achieve these goals, the authorities need to accelerate structural reforms, cut subsidies and less productive expenditures, and improve tax administration and expenditure management. In this context, Directors advised the authorities to speed up preparations for making the Unified Revenue Agency operational in 2003, as planned.

Directors encouraged the authorities to step up the implementation of other aspects of their ambitious structural program. In particular, they urged the authorities to accelerate the restructuring of the district heating companies, continue to increase energy prices toward cost recovery levels, and enhance efficiency in education and health care. They also stressed the need to accelerate the privatization of large state-owned enterprises. Directors were concerned that efforts to set up public venture capital funds might mark a weakening in the structural reform agenda, which they stressed should remain sharply focused on encouraging a high level of sustainable investment and growth. Similarly, the authorities were urged to refrain from unduly using the tax system to stimulate specific industries.

Directors expressed satisfaction with the soundness of the financial sector and strength of supervision, but recommended that the authorities redouble their vigilance to ensure that the system withstands the risks associated with the recent more rapid growth in private sector credit. Directors welcomed the positive developments in bank privatization, but stressed the importance of the adoption by parliament of the bank bankruptcy law before its summer recess. Directors urged the authorities to implement the recommendations of the Financial Sector Assessment Program mission.

Directors noted that the strengthening of the Financial Investigation Bureau would complement the existing legal and regulatory framework for countering money-laundering and the financing of terrorism.

Directors welcomed the quality and timeliness of the data provided by the Bulgarian authorities, while urging them to address the remaining weaknesses. They encouraged the authorities to participate in a data quality module of the Report on the Observance of Standards and Codes, with a view to eventual participation in the Special Data Dissemination Standard.

It is expected that the next Article IV consultation with Bulgaria will be held on a 24-month cycle, subject to the provisions of the decision on consultation cycles approved on July 15, 2002.

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

	1998	1999	2000	2001	2002 1/
Real Economy			Percentage change		
Real GDP	4.0	2.3	5.4	4.0	4.0
CPI, 12-month (end of period)	1.7	7.0	11.4	4.8	7.2
Unemployment	12.4	13.8	18.1	17.5	17.8
Public Finance			(In percent of GDP)		
General Government balance	0.9	-0.9	-1.0	-0.9	-0.8
Public debt	93.0	84.7	80.5	70.0	65.2
Money and Credit			(Percent change, end of year)		
Real broad money	8.6	4.9	5.3	28.3	12.0
Real credit to the non-government sector	5.3	13.6	4.8	26.0	15.0
Interest rates (annualized)			(In percent)		
BNB basic rate (end-month average)	5.2	4.6	4.7	4.8	...
Time deposits (end-month average)	3.3	3.2	3.3	3.4	...
Balance of payments			(In millions of US dollars)		
Gross official reserves	3056	3222	3460	3579	3800
(In months of GNFS imports)	6.1	5.9	5.4	5.0	4.9
Current account (percent of GDP)	-0.5	-5.0	-5.6	-6.5	-6.5
Trade balance (percent of GDP)	-3.1	-8.7	-9.3	-11.6	-12.3
Exchange rates					
Exchange rate regime			Currency board since July 1, 1997 3/		
Present exchange rate (July 15, 2002)			1.9511 leva/USD		
Nominal effective exchange rate (1995=100) 3/	5.4	5.8	5.9	6.2	...
Real effective exchange rate (1995=100) 3/ 4/	116.4	118.7	120.0	126.5	...

Sources: Bulgarian authorities; and IMF staff estimates

1/ Projection.
2/ 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.
3/ Annual average level.
4/ CPI-based.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 02/70
FOR IMMEDIATE RELEASE
July 22, 2002

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

IMF Completes First Review of Bulgaria's Stand-By Credit and Approves US$35 Million Tranche

The Executive Board of the International Monetary Fund (IMF) today completed the first review of Bulgaria's economic performance under the two-year stand-by credit. This will enable Bulgaria to draw SDR 26 million (about US$35 million) from the IMF immediately.

The stand-by credit for a total amount of SDR 240 million (about US$322 million) was approved on February 27, 2002 (see Press Release No. 02/12). So far, Bulgaria has drawn SDR 32 million (about US$43 million) from the IMF.

Following the Executive Board discussion, Shigemitsu Sugisaki, Deputy Managing Director and Acting Chairman, said:

"Building on the impressive progress made by Bulgaria since the establishment of the currency board arrangement in 1997, the authorities have continued to implement prudent fiscal and income policies under their economic program supported by the Stand-By Arrangement. They have also made further progress in key structural reform areas, including the adoption by parliament of the privatization law, the announcement of a schedule to raise household electricity prices toward cost recovery levels, and measures to make the education and health sectors more efficient. The authorities are also taking steps to further strengthen the already sound financial system. These policies have helped maintain macroeconomic stability and external competitiveness, and have allowed the continuation of robust growth in spite of unfavorable external developments in late 2001 and early 2002. However, in order to sustain high growth and reduce the high unemployment rate and poverty, the Bulgarian authorities need to complete the remaining crucial structural reforms, particularly those related to the energy sector, business environment, and public sector. Prospects for achieving strong growth and keeping the current account in control during the remainder of this year are broadly favorable, but subject to a sustained rebound in the European Union and the maintenance by Bulgaria of strict macroeconomic discipline.

"In the face of external uncertainties, the authorities' commitment to keeping a cautious and flexible fiscal policy is welcome. In this regard, the contingent fiscal measures that they have identified provide sufficient cushion against further deterioration in external conditions during the remainder of 2002. Over the medium term, fiscal policy will target a balanced budget, with a declining tax burden offset by cuts in subsidies and unproductive spending. The achievement of this objective will be greatly helped by the establishment of the Unified Revenue Agency and other efforts to strengthen tax administration and collection.

"Crucial reforms to enhance the competitiveness and medium-term growth prospects of the Bulgarian economy need to be implemented. Measures to improve corporate governance, enhance judicial procedures and foreclosure, and improve labor market flexibility are key to attracting more investment and reducing unemployment. In the same vein, the privatization of the remaining public companies and the strengthening of the financial sector should be pursued. The Fund commends the Bulgarian authorities for their efforts so far and encourages them to sustain the momentum of reforms," Mr. Sugisaki said.