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

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

- the staff report for the second review under the Stand-By Arrangement and request for waiver of applicability of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **December 20, 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 January 22, 2003**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **February 7, 2003** updating information on recent developments.

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

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

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

*May also be included in Staff Report

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

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

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BULGARIA

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

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

Approved by Carlo Cottarelli and Liam P. Ebrill

January 22, 2003

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Executive Summary

Background: Bulgaria has continued to adhere to a policy framework centered on the currency board arrangement (CBA). A prudent and flexible fiscal policy and strict income policies have helped keep inflation in check and reduce the external current account deficit, underpinning macroeconomic stability. This combined with progress in structural reforms—albeit slower than expected—and strong growth in credit to the private sector have supported robust growth, despite weak economic conditions in Bulgaria's main trade partners. Further, EU's endorsement of Bulgaria's plans for accession in 2007 have raised the country's international standing. Bulgaria also receive invitation to join NATO. A second Brady debt swap contributed to lowering external vulnerabilities. These favorable developments have led to higher ratings and lower spreads on sovereign debt. However, the increased political pressure stemming from still-low standards of living and the declining popularity of the government have exacerbated demands for higher public spending and slowed the momentum of reforms.

Discussions: With a broad consensus on keeping the CBA until entry into the European Monetary Union, the government aims to balance the budget by 2005, while reducing the tax burden and raising social and EU accession-related spending. In that regard, while the 2003 budget deficit target of 0.7 percent of GDP is appropriate, executing the budget would be challenging, as there are uncertainties regarding the scheme to collect more social security contributions and spending overruns are possible in key sectors where structural reforms have not sufficiently advanced. Discussions focused on ways to achieve the deficit target as well as the government's medium-term fiscal objectives. While staff argued for a revised, more conservative budget, the authorities insisted that this was politically impossible. However, understandings were reached on a number of measures that would help ensure that the deficit target would be met, including a tighter-than-usual limit on discretionary spending in the first three quarters of the year and monthly monitoring, with Fund staff, of revenue performance. In this context, the authorities committed to implementing reforms that would boost the declining tax collection. Staff underscored the importance of accelerating the implementation of structural reforms in the key railways, energy, health, and municipality sectors that would reduce subsidies, making it possible to achieve medium-term fiscal objectives. Staff also urged rapid implementation of reforms to improve the business climate. While welcoming the recent rapid increase in private sector credit from a low base, staff urged more vigilance, particularly to limit foreign currency credit-related vulnerabilities.

Staff appraisal: Over the last six-month period, Bulgaria's macroeconomic stability has strengthened further. However, political pressures have made it more challenging to maintain a prudent and flexible fiscal policy and have weakened the momentum of structural reforms. The authorities' determination to achieve their medium-term fiscal objectives should be backed up by a new impetus to complete the remaining major fiscal and structural reforms, which would also spur growth and enhance readiness to join the EU. In the period ahead, continued slow growth in the EU, a spike in oil prices, or a rebound in interest rates could weaken the economy's outlook. In this regard, the authorities' track record of implementing a flexible fiscal policy, as well as comfortable international reserves are reassuring.

I. Introduction

1. **A staff team[1] visited Sofia during November 6–20 and December 16–20, 2002 to hold discussions on the second review under the Stand-By arrangement.** The two-year arrangement for SDR 240 million (37 percent of quota) was approved on February 27, 2002. Three purchases totaling SDR 84 million have been made under the arrangement to date. A purchase of SDR 26 million (4 percent of quota) would become available upon completion of this review.[2] The authorities have indicated their willingness to consider converting the program to precautionary should the recent strengthening of the external position prove durable.

2. **Performance under the program has been good.** All end-June, end-September, and continuous quantitative performance criteria were observed (Table 1 of Attachment I). Ten of thirteen structural benchmarks and the one structural performance criterion under the program have been observed as well, some with a delay (Table 2 of Attachment I). Bulgaria's economic program is supported by the World Bank (Appendix I), the European Union (EU), and the EBRD.

3. **Despite positive macroeconomic developments and international reviews, the low popularity of the governing coalition is increasing pressure to weaken policies.** The recent EU's endorsement of Bulgaria's timetable for accession by 2007 has enhanced the country's international standing and represents support for its policies. NATO has also invited Bulgaria to become a member. However, owing in part to high unemployment and the failure to complete high-profile privatizations, the government remains less popular than the socialist opposition. In this context, the coalition's junior partner has stepped up demands for higher spending in key areas. These pressures have made it harder to implement difficult policies and municipal elections scheduled for later this year could exacerbate these trends. However, maintaining the currency board arrangement (CBA) and EU accession are objectives broadly shared across the political spectrum.

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

[2] Due to the delay in conducting the second review of the SBA, performance criteria for both end-September and end-December apply for this purchase.

II. Background and Recent Developments

4. **Macroeconomic performance in 2002 has been better than initially programmed (IMF Country Report No. 02/49) despite slow growth among Bulgaria's main trade partners** (Table 1 and Figures 1 and 2)

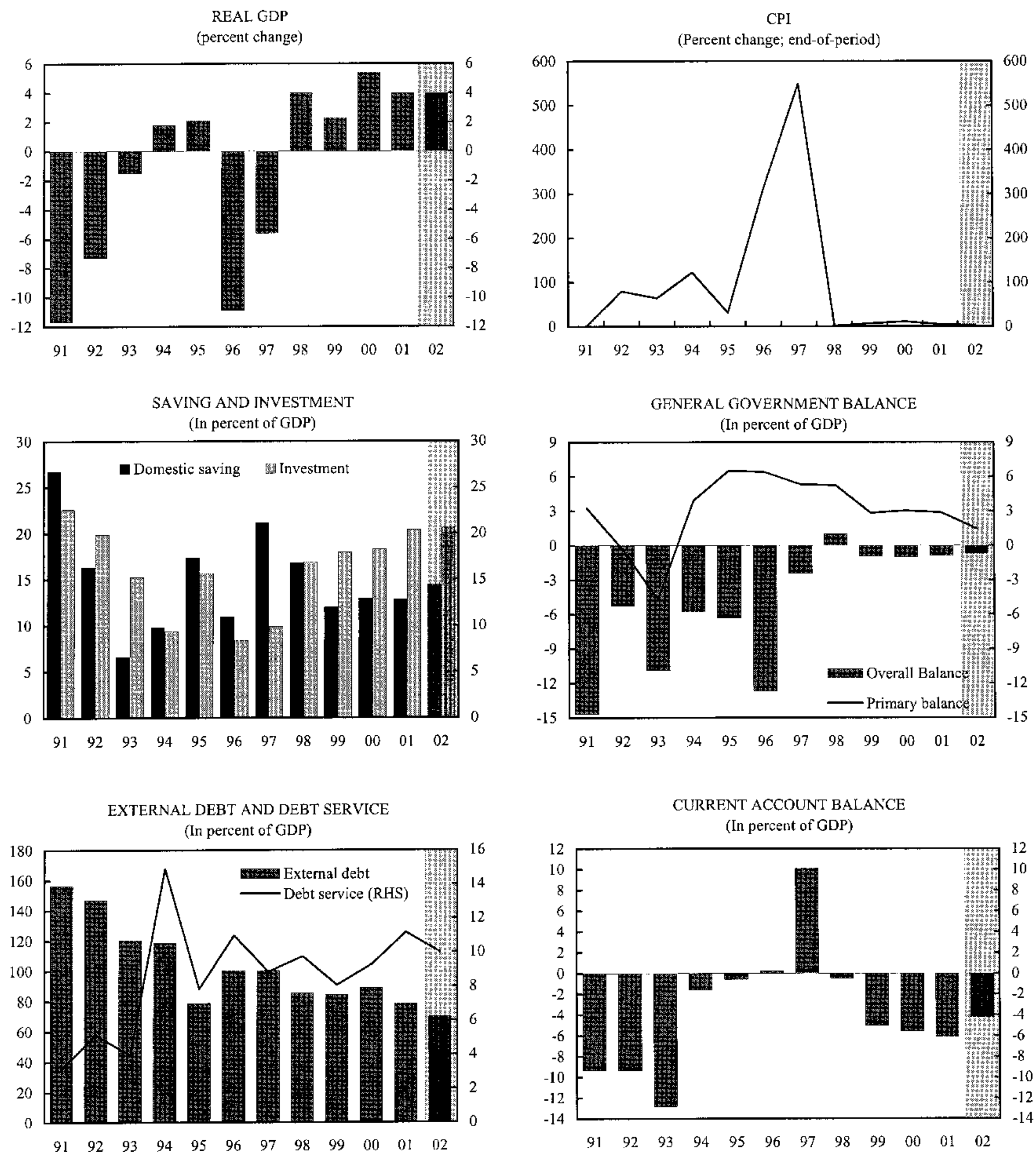
- Real growth has been higher, reaching 4.5 percent through the third quarter, and the programmed end-year growth of 4 percent is expected to be achieved. A strong increase in fixed investment and a turnaround in exports in the second half of the year are the main factors driving growth. While still high, registered unemployment declined to 16.8 percent at end-November, a fall of nearly 2 percentage points since the start of 2002.

- Inflation has been lower, with the twelve-month rate decelerating to 3.2 percent at end-November, reflecting the appreciation of the Euro, moderate wage increases, and lower food prices.

- The external position is stronger. The twelve-month external current account deficit narrowed to 3.1 percent of GDP at end-September 2002, reflecting strong exports and tourism receipts during the second and third quarters; subdued imports; and lower interest payments compared to the program (Table 2 and Figures 3 and 4). Growth in merchandise exports was led by non-traditional sectors, including light manufacturing, textiles, and investment goods. The appreciation of the Euro and the large fiscal surplus during the first three quarter of the year helped contain imports, while lower international interest rates and debt management operations lowered interest payments. The current account deficit is projected to increase to 4.2 percent of GDP for the year as a whole (5.9 percent of GDP in the program), reflecting higher oil prices, and fiscal expansion in the fourth quarter. Despite delays in completing major privatizations, FDI has covered more than 100 percent of the current account deficit, contributing to a rise in gross international reserves to US$4.5 billion or more than 5½ months of prospective imports at end-November. The Bulgarian economy remains competitive, as labor productivity growth has outstripped the real effective exchange rate appreciation and wage increases remain moderate (Figure 5). The external debt-to-GDP ratio and spreads on Bulgaria's sovereign debt continued to decline, pointing to lower external vulnerability (Table 3).

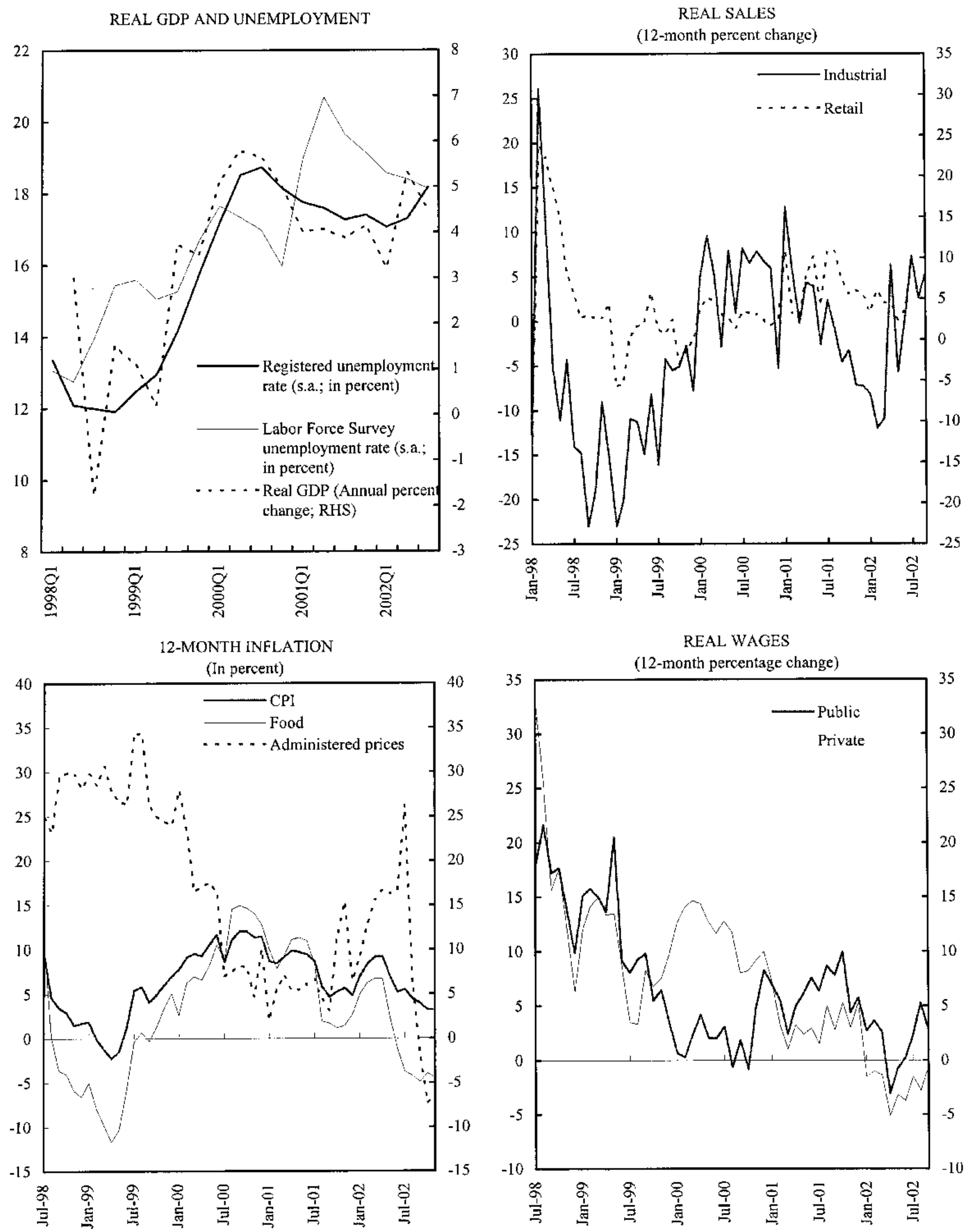
5. **Financial intermediation is increasing rapidly, but from a low base, and prudential indicators suggest that the banking system is sound**. Twelve-month real broad money rose by 11½ percent in November, while real credit to the nongovernment surged by 38 percent—reaching 17½ percent of projected GDP—as banks reshuffled their portfolio in favor of domestic assets in response to lower interest rates abroad and better lending opportunities in Bulgaria (Table 4 and Figure 6). Growth in foreign currency credit outstripped that of leva credit, as banks sought to match deposits—the majority of which are in foreign currency—with loans. Prudential indicators remained positive, as by September,

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



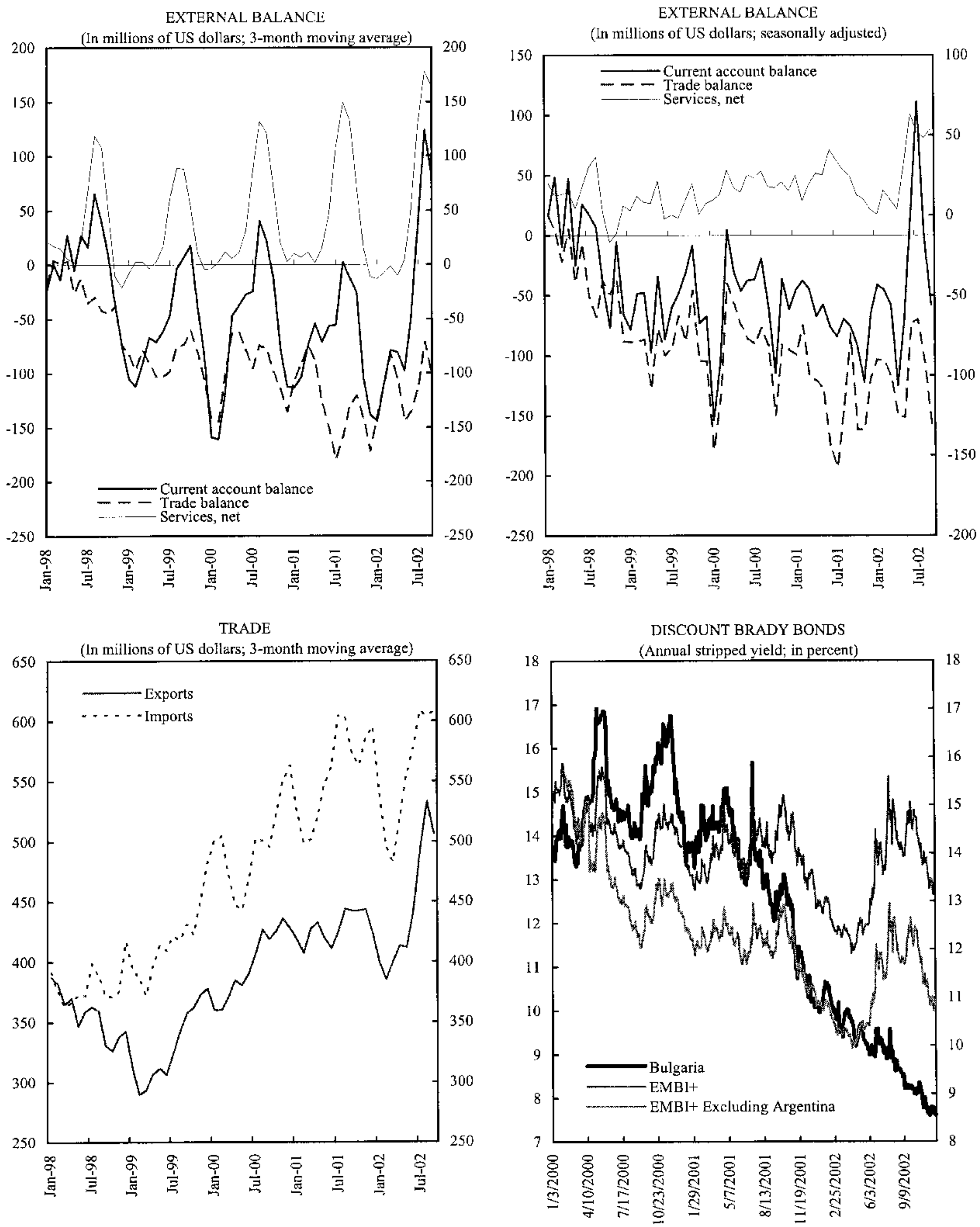
Sources: Bulgarian authorities; and Fund staff estimates and projections.
1/ Data for 2002 are projections.

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



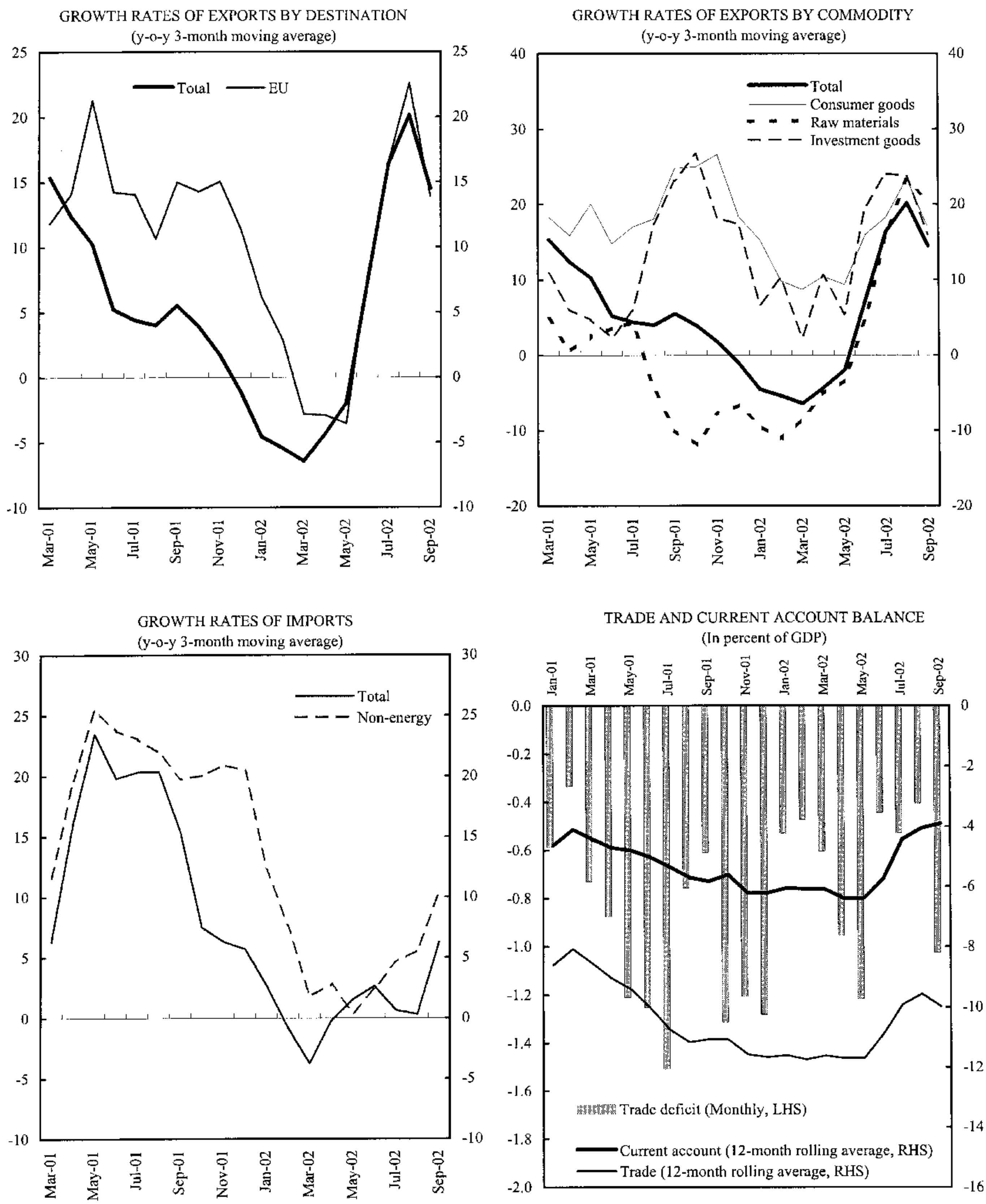
Sources: Bulgarian authorities; and Fund staff estimates.

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



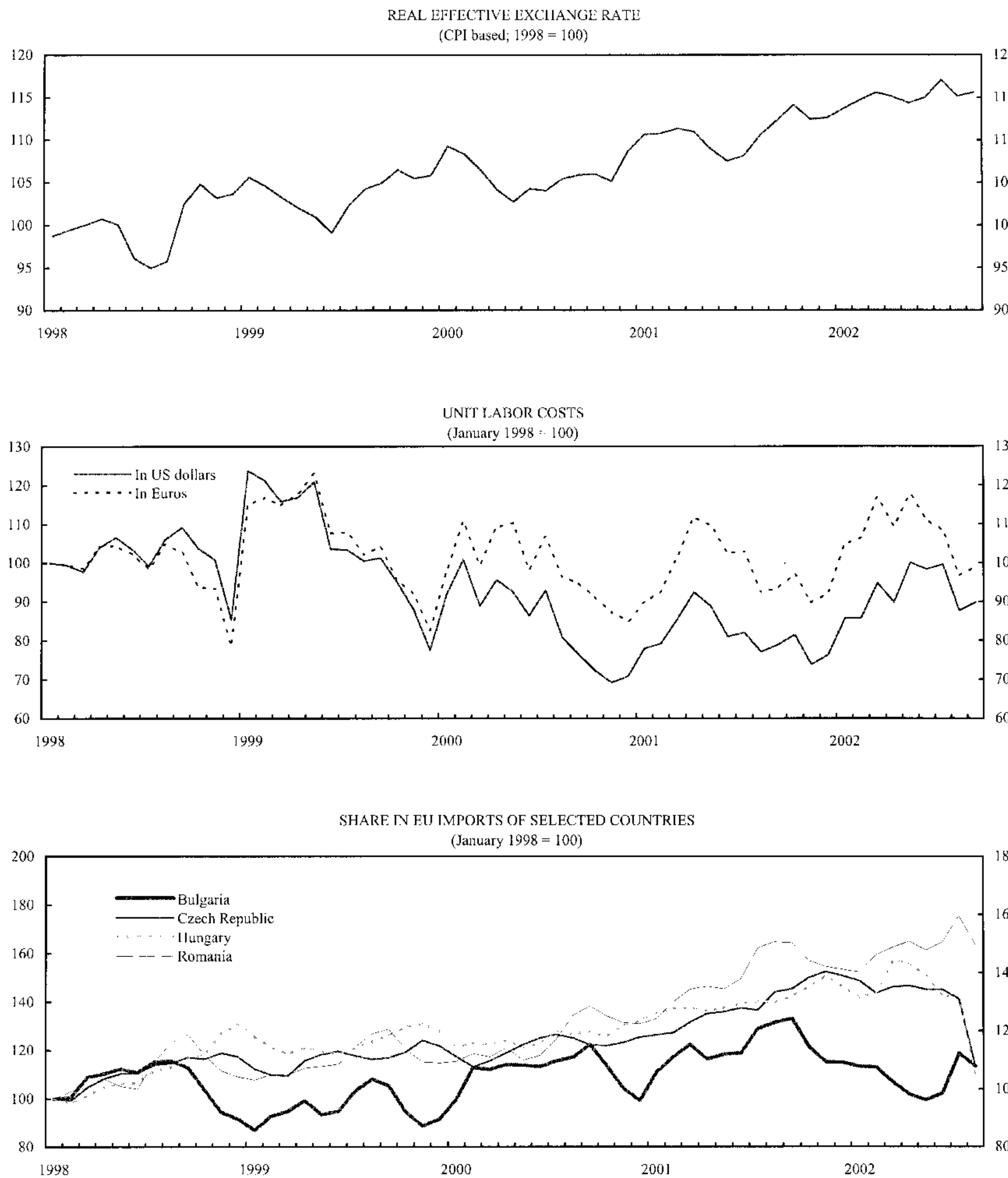
Sources: Bulgarian authorities; Bloomberg; and Fund staff estimates.

Figure 4. Bulgaria: External Sector Developments, 2001-2002



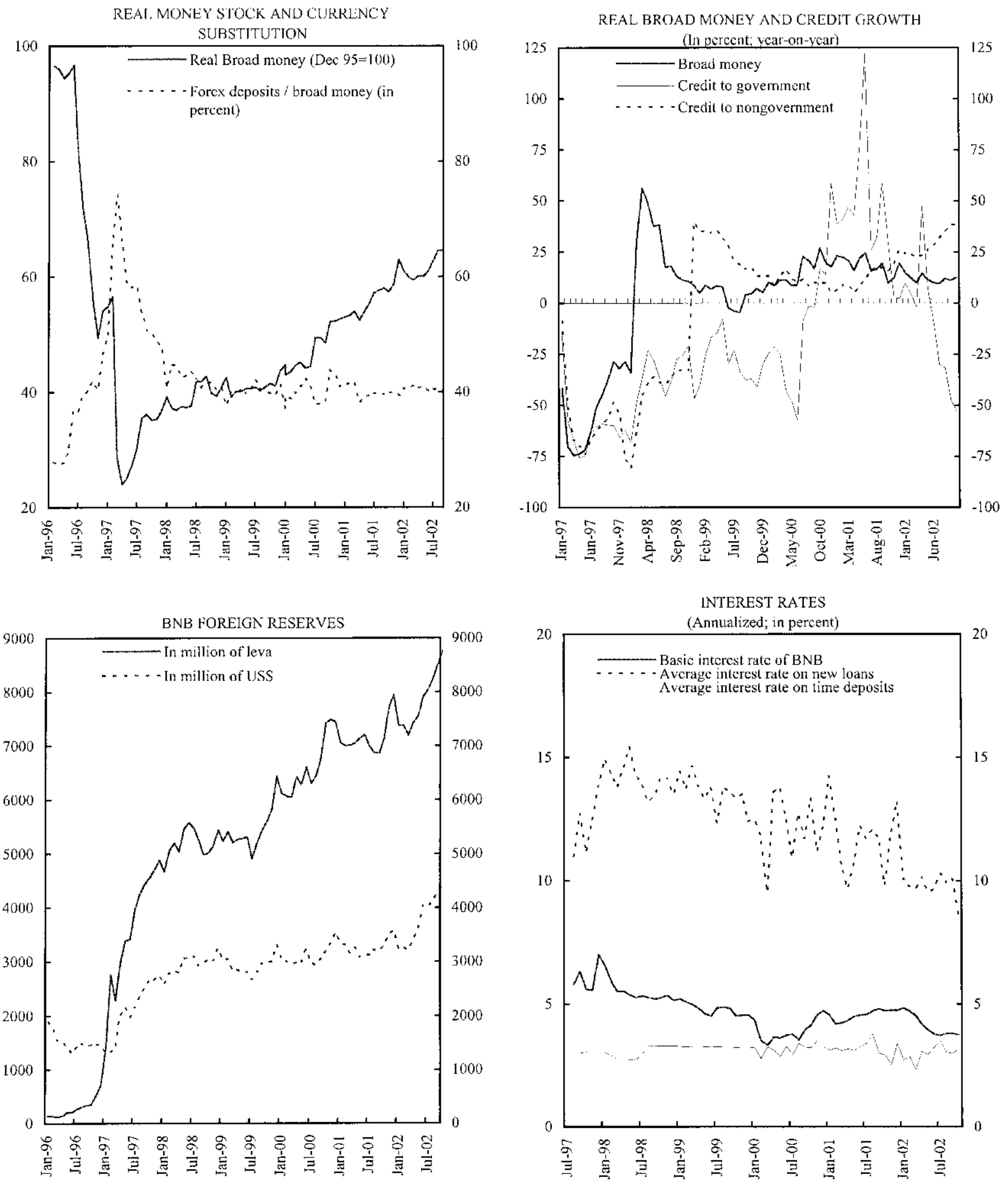
Sources: Bulgarian authorities; Bloomberg; and Fund staff estimates.

Figure 5. Bulgaria: Indicators of Competitiveness, 1998-2002



Sources: National Statistical Institute; and Fund staff calculations.

Figure 6. Bulgaria: Monetary and Financial Indicators, 1996-2002



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

the ratio of nonperforming loan (NPL) to total loans declined slightly to 5½ percent, capital adequacy ratio remained above 20 percent, and bank liquidity was comfortable.

6. **Prudent execution of the 2002 budget led to an overperformance in the first three quarters, which was largely offset by an expansion in the fourth quarter**. The government accumulated a fiscal surplus of some 1½ percent of annual GDP through September, on account of higher nontax revenue, lower expenditures due to the execution of only 90 percent of budgetary allocations for discretionary spending, and lower interest payments owing to lower international interest rates. However, a substantial increase in expenditures in the fourth quarter, in part to clear municipal and hospital arrears and pay wage and pension bonuses, is expected to turn the surplus into a deficit. Given the program's deficit target of 0.8 percent of annual GDP, a fiscal expansion of more than 2 percent of GDP is likely to have taken place in the fourth quarter of the year alone (Tables 5 and 6).

7. **There has been progress on structural reforms, but some key reforms have lagged**. On the bright side, two privatizations in the financial sector (Biochim Bank and the State Insurance Institute) were completed and DSK bank—the last major state-owned bank—was opened for bidding. Parliament passed the bank bankruptcy law and amendments to the bank law allowing the Bulgarian National Bank to fully vet the identity and suitability of bank shareholders. Electricity prices for households and district heating prices were raised toward cost recovery levels by 15 percent and 10 percent, respectively. However, after winners of the bidding process had been selected, completion of the privatization of both the state-owned tobacco holding (Bulgartabac) and telecommunication company (BTC) has been delayed by court decisions. In addition, while the restructurings of the district heating and railways sectors have progressed modestly, more fundamental reforms are to start only in 2003, and the restructuring of the hospital sector has made little progress.

8. **A second Brady bond swap furthered key goals of Bulgaria's public debt strategy.** In September 2002, Bulgaria exchanged US$888 million—26½ percent of the outstanding Brady debt—for US$759 million of US dollar fixed interest rate bond maturing in 2015. While the swap yielded modest net present value savings, it allowed the government to lock in historically low interest rates, released collaterals worth US$130 million, and increased further the duration of the bonded debt.

III. Report on the Discussions

9. **Despite stronger fundamentals, there are risks going forward and discussions centered on policies that would address these risks while furthering the objective of rapid sustainable growth.** The main challenge is to maintain macroeconomic stability—largely via a prudent and flexible fiscal policy—while striving to reach full growth potential through completion of structural reforms. The authorities' commitment to maintain their policy framework centered on the CBA until accession into the European Monetary Union (EMU) was bolstered by the EU's support for Bulgaria's accession plans. However, social and political pressures have increased, as illustrated by difficulties in reaching understandings within the governing coalition and with Fund staff on the 2003 budget. In

addition, a rebound in interest rates, higher oil prices, or persistent slow growth in the EU could worsen the short-run macroeconomic outlook. Over the medium term, failure to address problems in tax administration and expenditure management or to complete sectoral reforms required to reduce subsidies could threaten the government's medium-term fiscal objectives. In this context, discussions focused on making underlying policies consistent with the targeted 2003 fiscal deficit of 0.7 percent of GDP and on the need to accelerate structural reforms.

A. The Macroeconomic Outlook

10. **The macroeconomic outlook for 2003 and the medium-term remains in line with the original program and envisages robust growth, subdued inflation, and a gradual narrowing of the external current account deficit** (Tables 7 and 8, Figure 7, and ¶ 10).

- With the expected modest rebound in EU growth, acceleration of structural reforms, and increase in investment, the Bulgarian economy should grow by 5 percent in 2003 and by an average of 5½ percent in the medium term. Such growth would continue to be supported by robust credit expansion—albeit lower than 2003—as the credit-to-GDP ratio moves closer toward levels of other accession countries.[3] The identified risks could, however, slow growth.

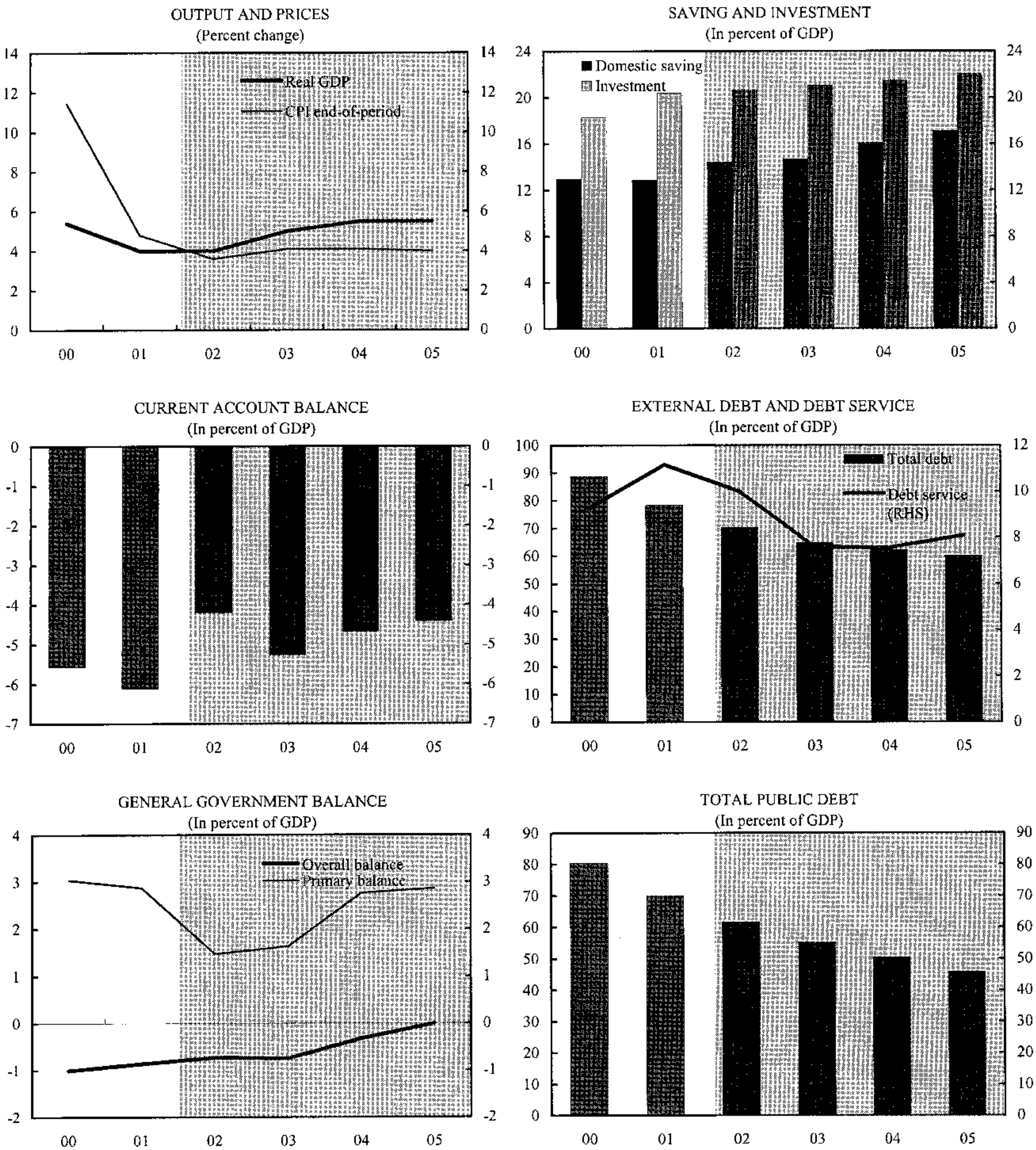
- In the context of the peg to the euro, inflation is expected to remain subdued over the medium-term, diverging from the EU levels only because of remaining administrative price increases and the Balassa-Samuelson effect.

- The external current account deficit is expected to rise by 1 percentage point to 5.3 percent of GDP in 2003, reflecting the considerable fiscal expansion that likely took place at the tail end of 2002, higher oil prices, and lower growth of tourism receipts due to stronger regional competition. However, FDI is expected to rebound with the completion of major privatizations and again cover at least 90 percent of the current account deficit, while reserves would rise slightly. The current account deficit is expected to decline gradually in the medium term, reflecting, in part, a rise in private savings toward levels in other Central and East European countries (see IMF Country Report No. 02/173). Combined with the expected increased transfers from the EU and strong FDI in the run-up to accession this would allow gross international reserves to remain at comfortable levels and the external debt-to-GDP ratio to decline to below 50 percent by 2007.

11. **A medium-term sustainability analysis highlights that debt and debt service developments would remain positive, except under fairly extreme scenarios.** Under most

[3] The three Baltic countries, with similar monetary regimes, have seen their credit-to-GDP ratios rise steadily to an average of 26 percent of GDP in 2001, well in excess of Bulgaria's.

Figure 7. Bulgaria: Medium-Term Projections, 2000-2005



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

stress test scenarios, Bulgaria's external debt stock indicators would remain within the Maastricht criteria and debt service would be sustainable (Box 1 and Tables 9, 10, and 11).

B. Fiscal Policy

12. **The 2003 budget seeks to further the medium-term objectives of fiscal policy.** These objectives include balancing the budget by 2005 while increasing social and EU accession-related spending and reducing the overall tax burden gradually, while shifting from direct to indirect taxation [¶ 13].[4] Compared to the projected outcome for 2002, revenues would decline by half a percent of GDP to 35½ percent of GDP, with a projected decrease in corporate and income taxes and nontax revenue partially offset by a rise in indirect taxes, social insurance contributions, and grants. Expenditures would also decline by half a percent of GDP to 36.3 percent of GDP, as the decline in wage and salaries, maintenance and operations, and subsidies would slightly exceed the projected increase in social expenditures—notably for active labor market policies to support job creation—and interest and capital outlays (Table 5 and 6).[5]

13. **The government's 2003 budget deficit target of 0.7 percent of GDP is sufficiently prudent and would help foster support for continued reforms.** While both the primary surplus and overall deficit would be virtually unchanged compared to 2002, the deficit target is consistent with a further significant decline in the public debt-to-GDP ratio, and, in light of the improved external position, is fully consistent with the maintenance of macroeconomic stability. The authorities' track record of responding to shocks with a flexible fiscal policy provides further assurances that the fiscal stance is appropriate. The increased allocation for priority EU accession-related and social spending, as well as the modest reduction in the direct tax burden would strengthen public support for reforms.

14. **The government's plans to use fiscal reserve account (FRA) resources to set up a new venture capital fund and acquire other assets represent a step in the wrong direction, and effectively add up to ½ percent of GDP in additional expenditure.**[6] These unwelcome steps reflect the political difficulties to balance spending priorities within the overall resource envelope projected for 2003 and significant weaknesses in the budget preparation process. Staff emphasized that such activities were not transparent and could generate fiscal risks. Given the uncertainty regarding the timing and size of these operations, staff has opted to monitor them separately from the budget deficit. In this context, in addition

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

[5] Projected expenditures in 2002 include arrears clearance of about ½ percent of GDP.

[6] The FRA is defined in Annex II of Attachment I. It mainly consists of all government deposits in the banking system, of which about 90 percent are with the Bulgarian National Bank.

Box 1. Debt Sustainability Analysis

Debt Stocks

External debt sustainability would be maintained under all adverse scenarios, but the outlook is highly sensitive to large nominal depreciations or high domestic inflation. The external debt-to-GDP ratio would decline consistently in the medium-term under the baseline scenario, given projected improvements in the current account deficit and subdued inflation, reaching 50 percent by 2007 (Table 9). The outlook would remain similar to the baseline under shocks to nominal interest rates, given the rather low standard deviation in past years. The debt-to-GDP ratio would still decline in the medium term under unfavorable scenarios for real GDP growth or the non-interest current account deficit, reaching around 65 percent of GDP by 2007, after rising in 2003-2004. The outlook is most sensitive to shocks to the exchange rate or domestic inflation, with the debt-to-GDP ratio rising sharply in the short-term and declining to about 80 percent and 75 percent, respectively in 2007.

The outlook for public sector debt would remain favorable under a number of macroeconomic shocks, but there is again high sensitivity to large real depreciations. The public debt- to-GDP ratio is projected to decline by over 20 percentage points in the baseline scenario, reaching less than 40 percent by 2007 (Table 10). This scenario is based on favorable developments for growth, interest rates and exchange rates, and on achieving fiscal balance by 2005. The outlook would remain fairly close to the baseline under shocks to the primary balance. A much more modest decline in the public debt-to-GDP ratio would be achieved under adverse shocks to GDP growth, real interest rates or fiscal revenue, reaching around 50 percent by 2007. Sustainability could be jeopardized in the event of a large real depreciation, with the debt to GDP ratio rising sharply in the short term to decline to only 62 percent of GDP by 2007.

Debt Dynamics

To complement the analysis on public sector debt stocks, an analysis of the dynamics of the financing requirements and sources of the public debt has been prepared, based on a model developed by ICM . Under the baseline scenario, the authorities have a comfortable financing cushion in 2004–2005, which they could use to conduct debt management operations (e.g. buybacks or swaps) in order to improve the debt profile in 2006-2007, when large repayments are due (Table 11). The dynamic outlook is especially sensitive to real interest rate and exchange rate shocks. In case of a large increase in real interest rates and assuming no rollover of the long-term domestic and all external debt that matures, the net financing needs reach 6.6 percent of GDP in 2003 and 4.8 percent of GDP in 2004, respectively. In case of a large nominal exchange rate depreciation, net financing needs of 1.6 percent of GDP and 2.1 percent of GDP appear in 2006 and 2007, respectively. Overall, there is considerable scope for liability management operations with the goal of achieving sustainable public debt flows.

to the floor in FRA balances, the net outflow from the FRA for such purposes has also been limited under the program to 150 million leva or ½ percent of GDP (performance criterion) [¶ 16].[7] The authorities understand that such operations do not constitute best fiscal practices, and agreed that during the program period no new extrabudgetary funds or state enterprises would be created (structural benchmark).

15. **Achieving the government's budget deficit target will be a challenge.** Considerable uncertainties remain regarding social security contributions, in part owing to the untested new scheme of minimum insurable income thresholds by sectors and occupations. While the authorities expect this scheme to address the significant underreporting of wages, it could reduce revenue if companies respond by moving to the informal sector. In addition, the budget does not fully fund mandated municipal spending and relies on spending cuts that will be achievable only with significant progress in reforms, notably to improve municipal financing and restructure the hospital, railways, and district heating sectors. Without this progress, there is a risk that hospitals and municipalities may overspend which would require central government support or lead to arrears accumulation.

16. **The program includes measures to help ensure that the budget deficit target can be met.** First, the authorities aim to stem the trend in recent years of a declining taxpayer compliance including by accelerating the implementation of the National Revenue Agency (NRA), broadening the coverage of the large taxpayer office, and improving arrears collection [¶ 14]. In this context, floors on tax and social insurance arrears collections were changed to performance criteria. Second, measures were identified to limit spending overruns by hospitals [¶ 22]. Third, the authorities agreed to monthly revenue indicative targets (Table 12), significant deviations from which would trigger consultations with Fund staff on possible offsetting measures, including reductions in spending commitments. Fourth, discretionary spending during the first three quarters of the year will be limited to 88 percent (down from 90 percent) of budgetary allocations—providing flexibility on the order of 1¼ percent of GDP through September 2003, which could be used for fiscal adjustment should weaknesses identified in the underlying policies or external risks materialize.

17. **Addressing budget concerns in this manner—rather than via a more conservative budget—is not the first best approach, but appeared the most that could be achieved.** Given the authorities' proven ability to control cash expenditures and the measures described above, the fiscal deficit is likely to be met. While there may be less scope for using fiscal policy to respond to exogenous shocks than in the past, Bulgaria is in a

[7] Two-thirds of this amount represents the government's planned contribution to the venture capital fund. However, government will proceed with this spending only if a private investor is found to match the contribution. The remainder reflects capitalization of a sport development fund and an environmental fund—which are meant to be profit-making—and the state airline—which the government aims to sell during 2003—as well as for net lending to the Agricultural Fund.

stronger external position. However, should it prove necessary to limit spending significantly below budgeted levels to meet the fiscal target, hospitals and municipalities could accumulate arrears and there would be less efficient allocation of resources and fiscal transparency.

18. **While supporting the authorities' medium-term fiscal agenda, staff underscored a number of steps that needed to be taken to ensure its successful implementation**. Staff urged the authorities to maintain a broad tax base, and step up efforts to enhance tax administration. In this context, staff cautioned that schemes such as the newly introduced zero corporate income tax rate for enterprises locating in high unemployment regions do not usually achieve their intended objectives and tend to increase tax evasion. The authorities argued that the zero rate was well-targeted and committed themselves to reviewing its cost effectiveness after a year [¶ 13]. Expenditure reductions would need to focus on discretionary current spending, as public investment needs remain large. In this context, staff stressed that structural reforms in the railways and energy sectors needed to be accelerated to help reduce subsidies. The authorities have reiterated their commitment to improving the budget process and expenditure management, including with the help of the FAD long-term advisor. However, staff emphasized that technical improvements were not sufficient and that political will to make difficult choices is at least as important [¶ 16]. Staff also welcomed plans to put the municipal finance reform on a sound legal footing in early 2003 and to prepare a 2004 budget that is fully consistent with the reform principles, including by ensuring adequate funding of mandated spending [¶ 17].

C. Incomes and Labor Market Policies and the Business Climate

19. **The authorities understand the importance of labor market flexibility and strict incomes policy for the viability of the CBA and to reduce unemployment.** They have expanded their active labor market programs to provide community jobs to 100,000 long-term unemployed. Staff cautioned that these programs, while useful, are no panacea and that reforms to promote flexible forms of employment and reduce hiring and dismissal costs are more likely to reduce unemployment substantially and durably. In this context, the authorities agreed to reform the labor code in this direction, in consultation with the World Bank. Staff also cautioned that the planned minimum insurable income thresholds could increase rigidity in the labor market. The authorities remained committed to limiting the wage bill growth of 60 closely-monitored state-owned enterprises to 2 percent in 2003 (performance criterion) [¶ 18].

20. **The authorities also recognize that a business-friendly environment is key to stimulating job creation and growth, but have been slow to take appropriate steps**. The authorities have rightly identified numerous licensing regimes to be eliminated or simplified, initiated a "one-stop-shop" program to facilitate business dealings with the public administration, and proposed legislation to simplify bankruptcy procedures and strengthen creditor rights [¶ 19]. However, full implementation of these reforms needs to be accelerated to enhance Bulgaria's capacity to attract more private investment.

D. Financial Sector Policies

21. **The banking system remains sound, but the already good supervision should be enhanced to address new risks arising from the rapid increase in credit to the private sector**. Aggregate prudential indicators suggest that the banking system is healthy and banks are tightly supervised [¶ 23]. As competition is reducing profit margins the authorities have strengthened monitoring of banks' lending practices. Owing to lower international interest rates and better lending opportunities domestically, foreign currency credit has been soaring to match the still relatively high level of foreign currency deposits in the banking system (which has declined from 50 percent of broad money in 1996 to an average of 40 percent in 2002), raising concerns about (i) apparent mismatches between the still mostly U.S. dollar-denominated liabilities and the increasingly euro-denominated assets and (ii) potential credit risks from increased foreign currency lending to non-foreign currency earners. There already exist tight limits on open foreign currency positions and most banks—many of which are subsidiaries of bigger international banks—have internal policies to hedge against currency mismatches or to secure loans with same currency collaterals. However, the authorities are cautious and, as a first step, from January 2003 banks are required to report data on the currency denomination of balance sheet items and additional early warning indicators. The authorities are prepared to mandate more systematic measures to match currency denomination of assets and liabilities should the analysis of data reveal worrying trends in this area.

22. **Further progress in financial sector reforms is envisaged, but a government initiative to foster equity financing using public funds marks a step backward.** The last major state-owned bank (DSK Bank) is expected to be privatized by end-June 2003 (structural benchmark). Citing the need to increase the independence and effectiveness of regulators, the authorities plan to unify the supervision of nonbank financial institutions. Staff supports this decision, although more preparatory work would have been useful. There are also plans to improve the payments system [¶ 23], and deepen capital markets [¶ 24]. The latter will be pursued by a number of means, including setting up an investment fund for equity financing in the private sector. Staff voiced strong reservations with the proposed fund, expressing doubts about the efficacy of having government attempt to "pick winners." The authorities emphasized that they are committed to the state being a minority shareholder and that a number of firewalls will be put in place to help ensure that the fund invests solely on economic grounds. Recent amendments to the anti-money laundering legislation would enhance the capacity of the Bureau for Financial Investigation to monitor transactions suspected to be related to the financing of terrorism and strengthen its independence. In line with safeguard assessment recommendations, the Bulgarian National Bank has taken steps to improve its internal audit function [¶ 7].

E. Other Structural Reform Policies

23. **Reforms in a number of sectors remain key to spur growth and consolidate macroeconomic stability, notably in view of the growing fiscal pressures.** Limiting subsidies to railways and district heating companies are a key part of the government's fiscal

program, while moving the energy sector to a more market-based system will play an important role in increasing the efficiency of the economy.

24. **The authorities plan to expedite the privatization of non-infrastructure companies and accelerate the restructuring of the railways sector.** They remain committed to completing the privatization of Bulgartabac and BTC during 2003. While not crucial from a financing point of view, staff emphasized that the completion of these sales in a transparent manner was key to maintaining investor confidence in the business climate more broadly. In consultation with the World Bank, steps are being taken to (i) put the transport railways company on a stronger commercial footing, including by raising cost recovery on intercity passenger services and (ii) limit government subsidies and make them more transparent [¶ 21].

25. **Significant energy sector reforms, including major privatizations, are expected in 2003**. In line with the objective of raising utility prices to cost recovery levels in the medium term, household electricity and district heating prices are to be raised again by 15 and 10 percent, respectively, by end-June (structural benchmarks). The state electricity company (NEK) and gas company (Bulgargaz) would continue efforts to reduce arrears owed to them (ceiling on arrears are indicative targets). With World Bank and EBRD support, the restructuring plan of the Sofia district heating company would accelerate with the introduction of private management and, beginning in the spring, needed infrastructure upgrades. A new, improved energy law, providing the legal basis for further reforms in the energy sector, is to be adopted by parliament by end-March. Several companies in the electricity distribution, district heating, coal mine, and water power sectors are slated for privatization, while the privatization process for electricity generation companies is to begin. Also a small portion of the high voltage electricity market will be opened for competition. [¶ 20].

F. External Sector Policies

26. **The authorities intend to continue to manage their debt and foreign assets with the aim to reduce external vulnerability and ensure ample liquidity.** Staff supports the authorities' efforts to continue to lower the debt-to-GDP ratio, increase the shares of Euro-denominated and fixed interest rate debt, and lengthen maturity. Staff also supports plans to more actively manage fiscal reserve account (FRA) resources, which have accumulated to close to twice the floor under the initial program. Such management would allow a reasonable rate of return while ensuring sufficient liquidity to deal with exogenous shocks and prepay official debt as appropriate. It would also help to preempt political pressure for more spending. Staff urged the authorities to publish their debt management strategy, which would increase transparency [¶ 25].

G. Monitoring and Review Issues

27. **It is proposed that the program incorporate two new PCs to address concerns regarding fiscal policy, and structural conditions critical for macroeconomic success**

(Box 2). One proposed performance criterion would cap net outflows from the FRA for the purpose of acquiring policy-related financial assets. The second proposal is to convert the ceiling on tax and social insurance arrears to a performance criterion to address concerns about taxpayer compliance. However, the performance criteria on ceilings to arrears owed to the state utility companies NEK and Bulgargaz would be converted to indicative targets, as progress in reducing these arrears has made this a less pressing issue (Annexes I to VIII of the SMEP). Staff supports granting of a waiver of applicability for the December 2002 performance criteria on the overall fiscal deficit of the general government and the limit on growth of the wage bill for 60 closely-monitored state-owned enterprises, data for which are not yet available, as we are fully confident that they have been observed.

H. Data Issues

28. **The authorities take seriously the need to continue to improve data quality**. The quality and timeliness of data provision is adequate for program monitoring, but there remain areas in need of improvement (Appendix 2). Bulgaria has fully implemented requirements for participation in the GDDS and is looking to move to the SDDS. To that effect, a data quality ROSC mission took place in January 2003. The authorities will begin to post on the web site of the Ministry of Finance monthly data on budget execution and the FRA [¶ 25].

IV. Staff Appraisal

29. **Bulgaria's macroeconomic performance has been impressive during the last six months, but risks remain.** Despite the slowdown in the EU, the economy has continued to grow robustly; inflation has decelerated; and the external current account deficit has narrowed. However, with per capita GDP still barely higher than the pre-crisis level and unemployment substantial, these gains have not yet translated into broad improvements in living standards. The resulting political pressures are making it more difficult to implement a cautious fiscal policy and difficult reforms. In addition, continued slow growth in the EU, a spike in oil prices, or a rebound in interest rates could significantly weaken the outlook of the Bulgarian economy and the CBA.

30. **While appropriate, the government's 2003 fiscal deficit target of 0.7 percent of GDP will be challenging to achieve**. Given the improved external sector position, the authorities' fiscal deficit is consistent with macroeconomic stability. However, putting an end to the decline in taxpayer compliance and implementing structural reforms to lower subsidies remain critical. Because of difficult political circumstances, the authorities were not prepared to meet the staff's preference for a budget based on more conservative underlying policies. Measures agreed with the authorities—notably limiting discretionary spending during the first three quarters to 88 percent of budget allocations and monthly indicative revenue targets—would ensure that the budget deficit target is achieved, albeit in a manner that is not fully transparent or efficient.

Box 2. Structural Conditionality

Coverage of Structural Conditionality in the Program

Measures subject to structural benchmarks continue to be motivated by the same preoccupations as in IMF Country Report No. 02/174 including the need to alleviate pressure on fiscal policy. Conditionality for 2003 focuses on areas that are macro-crucial and fall within the Fund's expertise (Table 3 of SMEP). Given the need to improve tax collection and administration, expanding the operations of the large taxpayer office and introducing the Bulstat number as the single identification for all tax operations are crucial. The publication of data on budget execution and the fiscal reserve account and the inclusion of remaining funds and accounts still outside into the treasury single account would increase transparency and strengthen budget implementation. The benchmark preventing the establishment of new extrabudgetary funds or state-owned enterprises is justified by the need to limit pressures for higher spending. The sale of DSK Bank would further strengthen the financial sector. Despite being out of the Fund's core competence, increases in district heating and household electricity prices are critical to reduce subsidies and improve energy efficiency. These measures have been closely coordinated with the World Bank.

The program will continue to include measures in the same areas that were identified in IMF Country Report No. 02/174 as relevant to achieve program's objectives, but were not structural performance criteria or benchmarks. These measures will continue to be monitored in the context of reviews or through World Bank conditionality.

Status of Structural Conditionality from Earlier Programs

Bulgaria implemented ten of thirteen structural benchmarks under the program in 2002, several of which with a delay. The sole structural performance criterion was also met with a delay. The delayed structural benchmarks related to the approval of the new Energy Act and the Treasury single account are expected to be observed during 2003. However, the announcement of a reform of the import tariff schedule will not be implemented due to commitments taken in the context of EU accession negotiations.

Structural Areas Covered by World Bank Lending and Conditionality

World Bank operations remain as described in IMF Country Report No. 02/174, but the programmatic adjustment loan (PAL) in support of these operations is now expected to be approved in early 2003.

31. **The government's medium-term fiscal objectives remain appropriate, although they will become increasingly hard to achieve unless key fiscal and structural reforms are implemented rapidly**. The government intends to lower the tax burden, increase social and EU accession-related spending, and balance the budget by 2005. These goals are laudable, but their achievement requires the steadfast implementation of reforms. To improve tax administration, the NRA needs to be made operational and the effectiveness and coverage of the LTO increased rapidly. Temptations to grant more tax exemptions and holidays should be resisted. The 2003 budget process highlighted problems engendered by sluggish reforms in this area. Serious improvements are needed to allow budget targets to be met without undue reliance on cash controls and to ensure more coherent prioritization and efficient expenditure management . In this regard, staff views the introduction of several new extra-budgetary funds and state enterprises as a step backward, and welcomes the commitment to put a halt to this development. The completion of the reform of the municipal finances is also critical to improving expenditure efficiency and control. At the same time, reforms in the health, railways, and district heating sectors would reduce subsidies, freeing up resources for priority spending and making it easier to keep fiscal policy on the right tracks.

32. **The acceleration of other structural reforms is also needed to sustain high quality growth, attract foreign investment, and enhance readiness to join the EU**. Bulgaria remains fraught to some extent with poor infrastructure, cumbersome regulations, and inefficient public administration, all of which represent obstacles to private investment, notably FDI, and growth. Removing these obstacles would help make Bulgaria a more attractive place to do business. In this context, the authorities should expeditiously complete delayed privatizations and avoid reinserting government in an ownership role in commercial enterprises.

33. **Although the financial sector remains sound and well supervised, the sharp rise in credit to the private sector calls for more vigilance**. Credit to the private sector—particularly foreign currency credit—has been increasing rapidly, but from a low base. Despite strict limits on foreign currency open positions, this has raised concerns about currency mismatches. In this context, staff welcomes the authorities' decision to start compiling data on currency denomination of assets and liabilities and analyze it with a view to taking appropriate measures if necessary. Traditional prudential indicators do not point to problems at this juncture but, as they usually lag, vigilance should be redoubled. In addition, attention should also be devoted to assessing potential vulnerabilities arising mismatches in borrowers' balance sheets. Bank profitability has declined recently, as competition has intensified and supervisors have rightly stepped up monitoring of lending practices.

34. **The government's debt strategy, focusing on lowering the debt-to-GDP ratio, improving the currency and interest rate structure, and lengthening maturity, is appropriate**. Staff supports continuation of this strategy and the government's intention to prepay debt owed to official creditors as circumstances allow. The authorities are also right to preempt political pressure for higher spending funded by FRA resources. The authorities should make their debt strategy available for public debate.

35. **Data quality is adequate for program monitoring, but further improvements are needed.** In this context, we would urge the authorities to implement recommendations of the recently completed ROSC mission. Efforts to increase transparency on budget execution and the level of FRA resources should be pursued.

36. **The staff supports the authorities' request to complete the second program review under the stand-by arrangement.** Bulgaria has had a commendable performance in 2002 and policy intentions signaled in the SMEP provide a solid basis for continued Fund support. Staff supports granting of a waiver of applicability as discussed in paragraph 25.

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

	1997	1998	1999	2000	2001	2002 Q1	2002 Q2	2002 Q3
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	5.3	4.5
Real retail sales	-37.6	5.3	-2.2	0.8	4.4	2.2	1.1	...
Real industrial sales	-6.9	-7.6	-10.8	4.6	0.2	-10.4	1.2	5.1
Consumer price index (average)	1246.5	39.9	2.6	10.4	7.5	8.2	7.1	4.6
(End-of-period)	549.2	1.7	7.0	11.4	4.8	9.2	5.2	4.0
Unemployment rate (in percent)								
Registered unemployment	14.0	12.4	13.8	18.2	17.5	17.8	17.5	17.5
Labor force survey	14.4	14.1	15.7	16.9	19.8	19.5	17.6	17.3
Real public sector wages	-19.5	23.5	10.7	2.4	6.4	3.0	-1.2	3.4
Real private sector wages	...	22.1	9.4	11.6	3.6	-1.3	-4.0	-1.6
Consolidated government 1/	(In percent of GDP)							
Revenue	30.7	35.4	38.6	38.7	37.7	8.1	9.6	9.0
Noninterest expenditure	25.0	30.2	35.8	35.7	34.8	7.2	8.3	8.0
Primary balance	5.7	5.2	2.8	3.0	2.9	0.9	1.3	1.0
Interest payments	7.8	4.2	3.8	4.0	3.7	1.0	0.3	0.7
Overall balance	-2.0	0.9	-0.9	-1.0	-0.9	-0.1	1.0	0.3
External financing	-0.7	-0.9	0.2	-1.5	-0.3	-0.5	1.3	0.4
Domestic financing	-0.3	-1.4	-1.4	1.2	-1.7	0.5	-2.5	-1.0
Privatization receipts	3.1	1.5	2.1	1.3	2.9	0.1	0.3	0.3
Total public debt 2/	107.5	93.0	84.7	80.5	70.0	60.2	60.3	60.1
Domestic public debt	16.0	13.8	12.5	6.6	6.3	5.7	5.7	6.3
Money and credit 3/	(End-of-period; percent change, from same period of previous year)							
Broad money (millions of leva)	5,986.0	6,660	7,548	9,881	12,447	12,394	12,198	12,945
Broad money (M3)	354.4	11.3	13.3	30.9	26.0	20.9	16.2	16.0
Lev money	440.5	17.0	14.3	22.9	28.9	21.9	14.8	15.1
Leva credit to nongovernment	241.2	78.8	20.1	25.0	32.0	30.8	28.8	27.1
FX deposits (U.S. dollar millions)	1,375.0	1,502	1,443	1,931	2,227	2,284	2,507	2,636
FX deposits (percent of M3)	40.8	37.8	37.2	41.1	39.7	41.3	40.3	40.4
Broad money to FX reserves ratio	1.4	1.3	1.2	1.4	1.6	1.7	1.5	1.5
1/ Data for 2002 are projections.								
Interest rates (annualized)	(In percent; end-of-period)							
BNB basic rate	7.0	5.2	4.6	4.7	4.8	4.5	3.8	3.8
Time deposit (leva)	3.0	3.3	3.2	3.3	3.4	2.4	3.3	3.0
Balance of payments 3/	(In millions of US dollars)							
Gross official reserves	2,474.0	3,056	3,222	3,460	3,579	3,210	4,033	4,283
(In months of prospective imports of GNFS)	5.0	5.6	5.0	4.9	4.8	4.0	4.9	5.2
Current account balance	1,046	-61	-652	-702	-828	-232	-149	244
(In percent of GDP)	10.1	-0.5	-5.0	-5.6	-6.1	-1.5	-1.0	1.6
Trade balance	321	-381	-1,081	-1,176	-1,568	-247	-442	-305
Exports	4,809	4,193	4,006	4,825	5,107	1,200	1,254	1,519
Imports	-4,488	-4,574	-5,087	-6,000	-6,674	-1,447	-1,697	-1,824
External debt 4/	10,409	10,892	10,914	11,202	10,616	10,426	10,735	10,691
(In percent of GDP)	100.4	85.5	84.2	88.9	78.3	67.0	69.0	68.7
Exchange rates								
Leva per U.S. dollar 5/	1.777	1.675	1.947	2.102	2.219	2.242	1.961	1.984
(yoy percent change, + means depreciation)	264.5	-5.7	16.2	8.0	5.6	1.2	-15.0	-7.4
REER (end-of period; CPI based)								
(yoy percent change, + means appreciation)	77.5	6.2	2.1	2.7	3.7	3.8	7.0	4.5

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

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, 2000-2004
(In millions of U.S. dollar)

	2000	2001	2002				2002	2003	2004
			Q1 Act.	Q2 Act.	Q3 Act.	Q4		Proj.	
CURRENT ACCOUNT	-702	-828	-232	-149	244	-517	-654	-929	-910
Trade Balance	-1,176	-1,568	-247	-442	-305	-618	-1,612	-1,741	-1,704
Exports (f.o.b.)	4,825	5,107	1,200	1,254	1,519	1,369	5,342	5,846	6,408
y-o-y growth (percent)	20.4	5.8	-6.4	1.8	14.6	8.1	4.6	9.4	9.6
Imports (f.o.b.)	-6,000	-6,674	-1,447	-1,697	-1,824	-1,987	-6,955	-7,588	-8,112
y-o-y growth (percent)	17.9	10.8	-3.9	0.7	6.4	12.3	4.2	9.1	6.9
Services, net	506	545	-3	171	492	-17	642	618	655
Income, net	-321	-304	-69	-13	-97	-1	-181	-377	-501
of which: Interest Payments of the Centr. Governme	-438	-457	-133	-29	-89	-27	-277	-379	-497
of which: Income to Direct Investors	-107	-149	-19	-31	-78	-43	-170	-196	-266
Current Transfers	290	498	87	136	155	120	498	571	639
CAPITAL AND FINANCIAL ACCOUNT	839	1,201	-77	600	34	784	1,341	1,058	1,402
Capital Transfers	25	0	0	0	0	0	0	0	0
Foreign Direct Investment, net	1,003	685	116	112	67	235	530	850	900
of which: privatization receipts	366	38	13	50	30	137	230	400	150
Portfolio Investment, net	-179	82	-172	136	-47	120	38	-202	-122
Other Investment, net	59	244	172	558	74	429	1,233	410	625
General Government	-216	-308	-39	-67	-53	209	50	60	305
Domestic Money Banks	-383	-75	53	349	-88	80	393	50	70
Other Private Sector	658	627	159	277	215	140	790	300	250
Errors and Omissions	-69	191	-194	-205	-61	0	-460	0	0
OVERALL BALANCE	137	373	-310	452	279	267	687	129	492
FINANCING	-137	-373	310	-452	-279	-267	-687	-129	-492
BNB International Reserves (increase: -) 1/	-409	-275	338	-384	-290	-257	-593	-165	-433
Use of Fund Credit (purchase: +)	136	-169	-28	-81	11	-9	-108	36	-59
Purchases	275	132	40	0	34	34	109	138	35
Repurchases	-139	-301	-68	-81	-58	-44	-251	-101	-94
Exceptional Financing, net	136	71	0	13	0	0	13	0	0
Financing Gap (gap: +)	0	0	0	0	0	0	0	0	0
1/ Data for 2002 are projections.									
MEMORANDUM ITEMS									
Gross International Reserves 2/	3,460	3,579	3,210	4,033	4,283	4,545	4,545	4,710	5,143
in months of prospective gnfs imports	4.9	4.8	4.0	4.9	5.2	5.6	5.6	5.4	5.5
Current account in percent of GDP	-5.6	-6.1	-1.5	-1.0	1.6	-3.3	-4.2	-5.3	-4.7
Trade account in percent of GDP	-9.3	-11.6	-1.6	-2.8	-2.0	-4.0	-10.4	-9.9	-8.8
FDI (net) in percent of the current account deficit	143	83	...	...	...	...	81	91	99
Gross external debt	11,202	10,616	10,426	10,735	10,691	...	10,933	11,416	12,080
in percent of GDP	88.9	78.3	67.0	69.0	68.7	...	70.3	64.8	62.2
public	9,311	8,650	8,474	8,493	8,373	...	8,667	8,850	9,113
private	1,891	1,966	1,952	2,241	2,318	...	2,266	2,566	2,966
External Debt Service of the Central Government 3/	639	1102	275	163	266	67	771	741	850
GDP	12,605	13,553	...	...	...	...	15,554	17,626	19,431

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: Selected Vulnerability Indicators, 2000-2002

	2000	2001	2002	
Key Economic and Market Indicators				
Real GDP growth (in percent) 1/	5.4	4.0	4.0	-
CPI inflation (period average, in percent) 2/	10.4	7.5	3.2	Nov-02
Short-term (ST) interest rate (in percent)	4.7	4.8	3.8	Nov-02
EMBI + secondary market spread (bps, end of period) 3/	932	500	321	3-Dec-02
Exchange rate NC/US$ (end of period)	2.1	2.2	2.0	Nov-02
External Sector				
Exchange rate regime	Currency board, peg to Euro			-
Current account balance (percent of GDP)	-5.6	-6.1	-3.5	Q3-02
Net FDI inflows (percent of GDP)	8.0	5.1	3.2	Q3-02
Export growth (US$ value, GNFS) 4/	20.4	5.8	3.6	Q3-02
Real effective exchange rate (1995 = 100)	127.7	132.3	135.9	Sep-02
Gross international reserves (GIR) in US$billion	3.5	3.6	4.3	Q3-02
GIR in percent of ST debt at remaining maturity	238.6	296.2	309.2	Q3-02
Net international reserves (NIR) in US$billion	-	-	-	-
Total gross external debt in percent of GDP	88.9	78.3	68.7	Q3-02
o/w ST debt (original maturity in percent of GDP)	11.5	8.9	8.9	Q3-02
Private sector debt (in percent of GDP)	15.0	14.5	14.9	Q3-02
Total gross external debt in percent of exports of GNFS 1/	160.0	140.9	134.1	-
Public Sector 5/				
Overall balance (percent of GDP)	-1.0	-0.9	0.3	Q3-02
Primary balance (percent of GDP)	3.0	2.9	1.0	Q3-02
Debt-stabilizing primary balance (percent of GDP)	-	-	-	-
Gross public sector financing requirement (in percent of GDP)	-	-	-	-
Public sector gross debt (in percent of GDP)	80.5	70.0	60.1	Q3-02
o/w External debt from official creditors (in percent of total)	38.8	36.1	35.9	Q3-02
External debt from private creditors (in percent of total)	50.2	52.6	50.0	Q3-02
Domestic debt linked to foreign currency (in percent of total)	3.5	3.5	2.1	Q3-02
Domestic debt linked to ST interest rate or inflation (in percent of total)	0.0	0.0	0.0	Q3-02
Public sector net debt (in percent of GDP) 6/	71.5	60.7	49.4	Q3-02
Financial Sector 7/				
Capital adequacy ratio (in percent)	35.5	31.3	27.4	Q3-02
NPLs in percent of total loans	8.3	7.0	5.6	Q3-02
Provisions in percent of NPLs	78.3	74.1	76.0	Q3-02
Return on average assets (in percent)	2.9	2.6	2.4	Q3-02
FX deposits (in percent of total deposits)	54.1	52.8	52.8	Oct-02
FX deposits (in percent of gross international reserves)	55.8	62.2	60.9	Oct-02
FX loans (in percent of total loans)	37.4	36.7	38.3	Oct-02
Net open forex position (sum of on- and off- balance sheet exposure) (in percent of capital) 8/	-5.2	-5.2	-5.1	Q3-02
Ratio of gross national off-balance sheet exposure to capital	-	-	-	-

Sources: Bulgarian authorities; and Fund staff estimates.

1/ Data for 2002 are projections.
2/ The latest figure is the 12-month rate of inflation as of the indicated period.
3/ Stripped spread of discount A bonds.
4/ Year-on-year growth rate.
5/ General government.
6/ Public sector gross debt minus balance of the fiscal reserve account.
7/ Commercial banks.
8/ Does not include off-balance sheet items, data on which is not available.

Table 4. Bulgaria: Monetary Survey, 1996-2003 1/

	1996	1997	1998	1999	2000	2001	2002				2003
							Q1 Act.	Q2 Act.	Q3 Act.	Q4 Proj.	Proj.
						(In millions of leva)					
Broad money	**1,317**	**5,986**	**6,660**	**7,548**	**9,881**	**12,447**	**12,394**	**12,198**	**12,945**	**14,370**	**16,269**
Lev money	656	3,544	4,145	4,737	5,822	7,505	7,273	7,282	7,717	8,909	9,843
Currency in circulation	126	1,316	1,743	1,958	2,374	3,081	2,855	2,828	3,022	3,374	3,661
Deposits	529	2,228	2,402	2,779	3,448	4,424	4,418	4,454	4,695	5,535	6,182
Foreign currency deposits	662	2,442	2,515	2,810	4,059	4,942	5,121	4,916	5,228	5,461	6,426
Net foreign assets	**-112**	**5,235**	**5,806**	**6,488**	**8,007**	**9,201**	**8,604**	**8,569**	**9,235**	**9,245**	**9,555**
BNB NFA	90	3,209	3,570	3,996	4,661	5,485	4,791	5,831	6,385	6,101	6,238
DMB NFA	-201	2,026	2,235	2,492	3,346	3,716	3,813	2,738	2,850	3,144	3,317
Net domestic assets	**1,429**	**751**	**854**	**1,060**	**1,874**	**3,245**	**3,790**	**3,629**	**3,710**	**5,125**	**6,714**
Domestic credit	2,029	3,929	3,598	3,806	5,001	6,205	6,789	6,439	6,904	8,153	9,709
General government	932	2,430	1,374	1,031	1,800	1,891	2,184	1,440	1,255	2,330	2,430
Central Government	931	2,430	1,357	999	1,768	1,851	2,142	1,434	1,245	2,300	2,400
Local government	0	0	17	32	32	41	42	7	10	30	30
Non-government	1,098	1,499	2,223	2,775	3,201	4,313	4,605	4,998	5,649	5,823	7,279
Public enterprise (SOE)	463	700	565	401	187	203	277	308	295	300	300
Private sector	635	799	1,658	2,375	3,014	4,111	4,328	4,690	5,355	5,523	6,979
Capital and reserves	-1,079	-1,757	-2,051	-2,301	-2,684	-2,867	-2,887	-2,802	-3,058	-3,070	-3,511
Other items net	479	-1,421	-692	-445	-443	-92	-112	-7	-137	42	516
Memorandum items:											
Reserve money	247	2,166	2,387	2,722	3,021	4,033	3,794	3,692	3,841	4,258	4,750
Foreign currency credit to non-government	871	863	922	1,142	1,196	1,584	1,712	1,935	2,305	1,935	1,935
						(In millions of US dollars)					
Net foreign assets	-229	2,947	3,466	3,333	3,809	4,146	3,838	4,370	4,656	4,628	4,791
BNB NFA	184	1,806	2,131	2,053	2,217	2,471	2,137	2,974	3,219	3,054	3,128
DMB NFA	-413	1,140	1,334	1,280	1,592	1,675	1,701	1,396	1,437	1,574	1,663
Foreign currency deposits	1,358	1,375	1,502	1,443	1,931	2,227	2,284	2,507	2,636	2,734	3,222
(percent of broad money)	50.2	40.8	37.8	37.2	41.1	39.7	41.3	40.3	40.4	38.0	39.5
						(12-month growth rate in percent)					
Broad money	123.9	354.4	11.3	13.3	30.9	26.0	20.9	16.2	16.0	15.5	13.2
Lev money	52.6	440.5	17.0	14.3	22.9	28.9	21.9	14.8	15.1	18.7	10.5
Currency in circulation	105.2	940.8	32.4	12.4	21.2	29.8	28.3	16.5	16.1	9.5	8.5
Foreign currency deposits	43.8	320.9	7.8	15.7	24.1	28.3	18.1	13.7	14.4	25.1	11.7
Reserve money	91.8	776.4	10.2	14.0	11.0	33.5	29.6	19.7	14.1	5.6	11.5
Money multiplier	5.33	2.76	2.79	2.77	3.27	3.09	3.27	3.30	3.37	3.37	3.43
CIC / broad money ratio	9.6	22.0	26.2	25.9	24.0	24.8	23.0	23.2	23.3	23.5	22.5
CIC / deposit ratio	10.6	28.2	35.4	35.0	31.6	32.9	29.9	30.2	30.5	30.7	29.0
Foreign currency deposits/total deposits	55.6	52.3	51.2	50.3	54.1	52.8	53.7	52.5	52.7	49.7	51.0
						(12-month change relative to broad money at the beginning of the period)					
Currency in circulation	11.0	90.3	7.1	3.2	5.5	7.2	6.1	3.8	3.8	2.4	2.0
Deposits	27.4	128.9	2.9	5.7	8.9	9.9	6.6	5.1	5.3	8.9	4.5
Foreign currency deposits	85.5	135.1	1.2	4.4	16.5	8.9	8.1	7.2	7.0	4.2	6.7
NFA	-17.2	405.8	9.5	10.2	20.1	12.1	5.4	2.4	10.7	0.3	2.2
NDA	141.1	-51.4	1.7	3.1	10.8	13.9	15.4	13.8	5.4	15.1	11.1
Of which,											
Credit to General government	108.8	113.7	-17.6	-5.2	10.2	0.9	1.0	-0.7	-8.3	3.5	0.7
Credit to SOE	51.3	18.0	-2.2	-2.5	-2.8	0.2	0.8	0.9	0.9	0.8	0.0
Credit to private sector	75.8	12.5	14.3	10.8	8.5	11.1	11.2	11.9	15.0	11.3	10.1
						(Real index; December 1995=100)					
Broad money	54.8	39.1	42.5	44.7	52.7	63.0	59.4	60.9	64.5	69.4	75.8
12-month change	-45.2	-28.6	8.7	5.1	17.8	19.5	10.1	10.1	11.3	10.2	9.2
Credit to non-government	76.8	17.9	24.9	28.3	29.7	37.5	37.6	42.6	48.0	47.2	57.0
12-month change	-23.2	-76.7	39.4	13.6	5.0	26.0	22.6	28.4	38.1	26.0	20.6
Leva credit to non-gov	28.8	15.1	26.6	29.8	33.5	42.1	41.7	46.2	50.3	...	...
12-month change	-71.2	-47.4	75.8	12.3	12.2	25.9	19.9	22.5	22.2	...	...
Forex credit to non-gov	141.7	21.6	22.7	26.3	24.7	31.2	32.1	37.7	44.9	...	...
12-month change	41.7	-84.7	5.1	15.8	-6.0	26.3	27.6	39.7	71.9	...	...
						(In percent of GDP; end of period)					
Broad money	74.8	34.3	29.7	31.7	36.9	42.0	38.2	37.6	39.9	44.3	45.9
Lev money	37.2	20.3	18.5	19.9	21.8	25.3	22.4	22.5	23.8	27.5	27.8
Reserve money	14.0	12.4	10.6	11.4	11.3	13.6	11.7	11.4	11.8	13.1	13.4
Credit to the private sector	62.3	8.6	9.9	11.7	12.0	14.6	14.2	15.4	17.4	18.0	20.6
Of which forex credit	49.4	4.9	4.1	4.8	4.5	5.3	5.3	6.0	7.1	6.0	5.5
Foreign currency deposits	37.6	14.0	11.2	11.8	15.2	16.7	15.8	15.2	16.1	16.8	18.1

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

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

Table 5. Bulgaria: General Government Operations, 2000-2003
(In millions of leva)

	2000	2001	2002				2003
	Actual	Actual 1/	Budget	MoF Proj.	Q1-Q3 Budget	Q1-Q3 Prel.Act.	Program 2/
Total revenue and grants	10,352	11,163	11,719	11,679	8,482	8,672	12,532
Tax revenue	7,994	8,516	8,996	8,853	6,531	6,475	9,656
Profit taxes	736	1,150	809	977	633	773	947
Nonfinancial enterprises	619	812	695	873	540	687	839
Financial enterprises	117	339	115	103	93	85	109
Income taxes	1,098	1,063	1,094	1,053	798	757	1,073
VAT	2,359	2,454	2,780	2,672	2,002	1,923	2,943
Excise and fuel duties	1,038	1,107	1,380	1,325	910	951	1,501
Customs duties	221	195	100	184	68	133	180
Social insurance contributions	2,230	2,310	2,521	2,346	1,858	1,713	2,698
Pension and unemployment contributions 3/	1,780	1,822	1,955	1,828	1,576	1,331	2,118
Health Insurance Fund	451	489	565	518	417	382	580
Other taxes	312	236	313	297	261	226	314
Nontax revenues	2,154	2,284	2,220	2,535	1,637	1,978	2,376
BNB transfers	137	175	150	173	150	173	150
Other	2,018	2,109	2,070	2,362	1,487	1,805	2,226
Grants and donations	204	363	502	290	314	219	501
Total expenditure and net lending	10,620	11,418	11,976	11,916	8,655	8,180	12,795
Noninterest expenditure, net lending, contingency	9,538	10,312	10,972	11,202	7,790	7,537	11,957
Current noninterest expenditure	8,127	8,873	9,629	9,957	6,932	6,889	10,559
Compensation	1,283	1,196	1,233	1,373	916	943	1,427
Wages and salaries	1,256	1,159	1,198	1,334	890	915	1,389
Scholarships	28	37	35	39	25	28	38
Maintenance and operations	2,167	1,925	1,891	2,034	1,345	1,390	1,992
Defense and security	885	957	1,082	1,092	730	705	1,150
Subsidies	250	722	733	786	502	479	717
Social expenditures	3,543	4,074	4,690	4,672	3,439	3,372	5,274
Pension fund	2,372	2,586	2,882	2,940	2,136	2,112	3,063
Assistance and unemployment	853	858	1,049	985	759	700	1,299
Health Insurance Fund	98	404	487	524	340	411	666
Other social expenditures 4/	221	225	272	224	204	150	246
Capital expenditures	1,037	1,145	1,113	1,038	783	587	1,230
Net lending	63	50	0	0	0	0	0
Contingency	311	245	230	207	75	61	168
Enterprise restructuring	110	60	180	157	45	42	20
Other contingency	165	145	0	0	0	0	96
Natural disaster	36	40	50	50	30	19	52
Primary balance	814	850	747	477	692	1,136	576
Interest	1,083	1,106	1,004	715	864	644	839
External	818	853	785	545	692	510	640
Domestic	265	253	219	170	172	133	199
Overall balance	-269	-255	-257	-238	-173	492	-263
Financing	269	255	257	238	173	-492	263
External (net)	-404	-100	-106	524	-500	87	-57
Domestic (net)	328	-506	-255	-584	39	-809	-231
Privatization	345	861	619	298	634	229	550
Memorandum items:							
Nominal GDP in millions of leva	26,753	29,618	30,783	32,466	21,855	23,458	35,214

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/ Differs from the budget approved by Parliament in certain revenue items.

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

4/ Includes additional compulsory social security contributions for public sector employees.

Table 6. Bulgaria: General Government Operations, 2000-2003
(In percent of GDP)

	2000	2001	2002				2003
	Actual	Actual 1/	Budget	MoF Proj.	Q1-Q3 Budget	Q1-Q3 Prel.Act.	Program 2/
Total revenue and grants	38.7	37.7	38.1	36.0	38.8	37.0	35.6
Tax revenue	29.9	28.8	29.2	27.3	29.9	27.6	27.4
Profit taxes	2.8	3.9	2.6	3.0	2.9	3.3	2.7
Nonfinancial enterprises	2.3	2.7	2.3	2.7	2.5	2.9	2.4
Financial enterprises	0.4	1.1	0.4	0.3	0.4	0.4	0.3
Income taxes	4.1	3.6	3.6	3.2	3.7	3.2	3.0
VAT	8.8	8.3	9.0	8.2	9.2	8.2	8.4
Excise and fuel duties	3.9	3.7	4.5	4.1	4.2	4.1	4.3
Customs duties	0.8	0.7	0.3	0.6	0.3	0.6	0.5
Social insurance contributions	8.3	7.8	8.2	7.2	8.5	7.3	7.7
Pension and unemployment contributions 3/	6.7	6.2	6.4	5.6	7.2	5.7	6.0
Health Insurance Fund	1.7	1.6	1.8	1.6	1.9	1.6	1.6
Other taxes	1.2	0.8	1.0	0.9	1.2	1.0	0.9
Nontax revenues	8.1	7.7	7.2	7.8	7.5	8.4	6.7
BNB transfers	0.5	0.6	0.5	0.5	0.7	0.7	0.4
Other	7.5	7.1	6.7	7.3	6.8	7.7	6.3
Grants and donations	0.8	1.2	1.6	0.9	1.4	0.9	1.4
Total expenditure and net lending	39.7	38.6	38.9	36.7	39.6	34.9	36.3
Noninterest expenditure, net lending, contingency	35.7	34.8	35.6	34.5	35.6	32.1	34.0
Current noninterest expenditure	30.4	30.0	31.3	30.7	31.7	29.4	30.0
Compensation	4.8	4.0	4.0	4.2	4.2	4.0	4.1
Wages and salaries	4.7	3.9	3.9	4.1	4.1	3.9	3.9
Scholarships	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Maintenance and operations	8.1	6.5	6.1	6.3	6.2	5.9	5.7
Defense and security	3.3	3.2	3.5	3.4	3.3	3.0	3.3
Subsidies	0.9	2.4	2.4	2.4	2.3	2.0	2.0
Social expenditures	13.2	13.8	15.2	14.4	15.7	14.4	15.0
Pension fund	8.9	8.7	9.4	9.1	9.8	9.0	8.7
Assistance and unemployment	3.2	2.9	3.4	3.0	3.5	3.0	3.7
Health Insurance Fund	0.4	1.4	1.6	1.6	1.6	1.8	1.9
Other social expenditures 4/	0.8	0.8	0.9	0.7	0.9	0.6	0.7
Capital expenditures	3.9	3.9	3.6	3.2	3.6	2.5	3.5
Net lending	0.2	0.2	0.0	0.0	0.0	0.0	0.0
Contingency	1.2	0.8	0.7	0.6	0.3	0.3	0.5
Enterprise restructuring	0.4	0.2	0.6	0.5	0.2	0.2	0.1
Other contingency	0.6	0.5	0.0	0.0	0.0	0.0	0.3
Natural disaster	0.1	0.1	0.2	0.2	0.1	0.1	0.1
Primary balance	3.0	2.9	2.4	1.5	3.2	4.8	1.6
Interest	4.0	3.7	3.3	2.2	4.0	2.7	2.4
External	3.1	2.9	2.6	1.7	3.2	2.2	1.8
Domestic	1.0	0.9	0.7	0.5	0.8	0.6	0.6
Overall balance	-1.0	-0.9	-0.8	-0.7	-0.8	2.1	-0.7
Financing	1.0	0.9	0.8	0.7	0.8	-2.1	0.7
External (net)	-1.5	-0.3	-0.3	1.6	-2.3	0.4	-0.2
Domestic (net)	1.2	-1.7	-0.8	-1.8	0.2	-3.4	-0.7
Privatization	1.3	2.9	2.0	0.9	2.9	1.0	1.6
Memorandum items:							
Nominal GDP in million leva	26,753	29,618	30,783	32,466	21,855	23,458	35,214

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/ Differs from the budget approved by Parliament in the composition of revenue.

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

4/ Includes additional compulsory social security contributions for public sector employees.

Table7. Bulgaria: Macroeconomic Framework, 1999-2007

	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	5.4	3.3	4.0	3.6	3.5	3.5
CPI (end of period)	7.0	11.4	4.8	3.6	4.1	4.1	4.0	4.0	3.5
(period average)	2.6	10.4	7.5	5.8	3.0	4.1	4.0	4.0	3.5
Monetary aggregates									
Broad money (real, percent change)	5.1	17.8	19.5	10.2	9.2	6.0	5.7	5.7	5.5
Credit to non-government (real, percent change)	13.6	5.0	26.0	26.0	20.6	15.6	12.2	10.1	10.0
Saving and investment (in percent of GDP)									
Foreign saving 1/	5.9	5.3	7.5	6.2	6.4	5.4	4.9	4.5	4.4
Gross national saving	12.9	12.7	14.3	16.4	15.8	16.8	17.6	18.2	18.3
Gross domestic saving 2/	12.0	13.0	12.8	14.4	14.7	16.1	17.1	17.8	17.9
Government	6.5	5.9	5.9	4.1	4.6	5.9	6.5	6.2	5.9
Non-government	5.5	7.1	6.9	10.3	10.1	10.2	10.6	11.6	12.0
Gross domestic investment	17.9	18.3	20.4	20.7	21.1	21.5	22.0	22.3	22.3
Government	4.5	3.9	3.9	3.2	3.5	3.6	4.0	4.0	4.0
Non-government	13.4	14.4	16.5	17.5	17.6	17.9	18.0	18.3	18.3
General government (in percent of GDP)									
Revenue	38.6	38.7	37.7	36.0	35.6	35.6	35.3	34.9	34.5
Non-interest expenditure	35.8	35.7	34.8	34.5	34.0	32.8	32.4	32.4	32.4
Primary balance	2.8	3.0	2.9	1.5	1.6	2.8	2.9	2.5	2.1
Interest payments	3.8	4.0	3.7	2.2	2.4	3.1	2.9	2.5	2.1
Overall balance (excluding external interest payments)	2.0	2.1	2.0	0.9	1.1	2.3	2.5	2.2	1.9
Overall balance	-0.9	-1.0	-0.9	-0.7	-0.7	-0.3	0.0	0.0	0.0
Total public debt	84.7	80.5	70.0	61.7	55.2	50.4	45.9	41.9	38.3
Of which: External	73.0	73.9	63.8	55.7	50.2	46.9	44.3	39.4	33.9
Balance of payments (in millions of US dollars)									
Current account	-652	-702	-828	-654	-929	-910	-942	-961	-1,034
Trade balance	-1,081	-1,176	-1,568	-1,612	-1,741	-1,704	-1,746	-1,775	-1,876
Exports	4,006	4,825	5,107	5,342	5,846	6,408	6,999	7,549	8,138
Imports	5,087	6,000	6,674	6,955	7,588	8,112	8,745	9,323	10,014
Services, net	314	506	545	642	618	655	696	733	756
Receipts	1,788	2,175	2,426	2,630	2,834	3,042	3,261	3,473	3,699
Payments	1,474	1,670	1,880	1,988	2,215	2,386	2,565	2,741	2,944
Income, net	-185	-321	-304	-181	-377	-501	-537	-604	-628
Memorandum items									
Gross official reserves (in millions of US dollars)	3,222	3,460	3,579	4,545	4,710	5,143	5,637	5,724	5,598
(in months of prospective imports of GNFS)	5.0	4.9	4.8	5.6	5.4	5.5	5.6	5.3	4.8
Current account balance (in percent of GDP)	-5.0	-5.6	-6.1	-4.2	-5.3	-4.7	-4.4	-4.1	-4.0
External debt/GDP (in percent) 3/	84.2	88.9	78.3	70.3	64.8	62.2	60.1	55.6	50.2
External debt/exports of GNFS (in percent) 3/	188.3	160.0	140.9	137.1	131.5	127.8	125.0	117.9	108.6
External debt service/exports of GNFS (in percent)	18.0	16.7	20.1	18.8	15.1	15.6	16.8	17.1	18.8
Export growth (percent change)	-4.5	20.4	5.8	4.6	9.4	9.6	9.2	7.8	7.8
Import growth (percent change)	11.2	17.9	10.8	4.2	9.1	6.9	7.8	6.6	7.4
Terms of trade (percent change)	-6.0	-2.5	0.3	0.2	1.3	1.9	0.8	0.8	0.1
Nominal GDP (in millions of leva)	23,790	26,753	29,618	32,466	35,214	38,637	42,230	46,112	50,351
Nominal GDP (in millions of US dollars)	12,956	12,605	13,553	15,554	17,626	19,431	21,355	23,386	25,604

Sources: Bulgarian authorities; and staff projections.

1/ Net imports of goods and nonfactor services.

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

3/ Medium- and long-term external debt.

Table 8. Bulgaria: Balance of Payments, Medium-Term Projections, 2000-2007
(In millions of U.S. dollar)

	2000	2001	2002	2003	2004	2005	2006	2007
					Projections			
CURRENT ACCOUNT	-702	-828	-654	-929	-910	-942	-961	-1,034
Trade Balance	-1,176	-1,568	-1,612	-1,741	-1,704	-1,746	-1,775	-1,876
Exports (f.o.b.)	4,825	5,107	5,342	5,846	6,408	6,999	7,549	8,138
y-o-y growth (percent)	20.4	5.8	4.6	9.4	9.6	9.2	7.8	7.8
Imports (f.o.b.)	-6,000	-6,674	-6,955	-7,588	-8,112	-8,745	-9,323	-10,014
y-o-y growth (percent)	17.9	10.8	4.2	9.1	6.9	7.8	6.6	7.4
Services, net	506	545	642	618	655	696	733	756
Income, net	-321	-304	-181	-377	-501	-537	-604	-628
of which: Interest Payments of the Centr. Governme	-438	-457	-277	-379	-497	-529	-513	-478
of which: Income to Direct Investors	-107	-149	-170	-196	-266	-345	-435	-531
Current Transfers	290	498	498	571	639	645	685	714
CAPITAL AND FINANCIAL ACCOUNT	839	1,201	1,341	1,058	1,402	1,615	1,319	1,164
Capital Transfers	25	0	0	0	0	0	0	0
Foreign Direct Investment, net	1,003	685	530	850	900	950	1,000	1,000
of which: privatization receipts	366	38	230	400	150	50	0	0
Portfolio Investment, net	-179	82	38	-202	-122	-93	-43	-323
Other Investment, net	59	244	1,233	410	625	758	362	487
General Government	-216	-308	50	60	305	368	-38	17
Domestic Money Banks	-383	-75	393	50	70	90	100	120
Other Private Sector	658	627	790	300	250	300	300	350
Errors and Omissions	-69	191	-460	0	0	0	0	0
OVERALL BALANCE	137	373	687	129	492	673	359	130
FINANCING	-137	-373	-687	-129	-492	-673	-359	-130
BNB International Reserves (increase: -) 1/	-409	-275	-593	-165	-433	-494	-87	125
Use of Fund Credit (purchase: +)	136	-169	-108	36	-59	-179	-271	-255
Purchases	275	132	109	138	35	0	0	0
Repurchases	-139	-301	-251	-101	-94	-179	-271	-255
Exceptional Financing, net	136	71	13	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	4,545	4,710	5,143	5,637	5,724	5,598
in months of prospective gnfs imports	4.9	4.8	5.6	5.4	5.5	5.6	5.3	4.8
Current account in percent of GDP	-5.6	-6.1	-4.2	-5.3	-4.7	-4.4	-4.1	-4.0
Trade account in percent of GDP	-9.3	-11.6	-10.4	-9.9	-8.8	-8.2	-7.6	-7.3
FDI (net) in percent of the current account deficit	143	83	81	91	99	101	104	97
Gross external debt	11,202	10,616	10,933	11,416	12,080	12,829	12,992	12,854
in percent of GDP	88.9	78.3	70.3	64.8	62.2	60.1	55.6	50.2
public	9,311	8,650	8,667	8,850	9,113	9,463	9,225	8,688
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	771	741	850	1023	1137	1470
GDP	12,605	13,553	15,554	17,626	19,431	21,355	23,386	25,604

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 9. Bulgaria: External Sustainability Framework, 1997-2007
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
						I. Baseline Medium-Term Projections					
1 **External debt**	100.4	85.5	84.2	88.9	78.3	**70.3**	**64.8**	**62.2**	**60.1**	**55.6**	**50.2**
2 Change in external debt	3.4	-14.9	-1.3	4.6	-10.5	-8.0	-5.5	-2.6	-2.1	-4.5	-5.3
3 Identified external debt-creating flows (4+8+11)	-19.7	-22.7	-0.1	1.1	-2.9	-8.2	-6.2	-4.4	-4.2	-4.0	-3.4
4 Current account deficit, excluding interest payments	-14.3	-3.7	1.3	1.5	2.2	2.0	2.7	1.7	1.6	1.6	1.9
5 Deficit in balance of goods and services	-11.3	-0.6	5.9	5.3	7.5	6.2	6.4	5.4	4.9	4.5	4.4
6 Exports	67.6	47.0	44.7	55.5	55.6	51.3	49.2	48.6	48.0	47.1	46.2
7 Imports	56.4	46.4	50.6	60.8	63.1	57.5	55.6	54.0	53.0	51.6	50.6
8 Net non-debt creating capital inflows (negative)	-5.3	-4.5	-3.8	-6.8	-2.8	-2.3	-3.2	-3.1	-3.0	-2.9	-2.6
9 Net foreign direct investment, equity	4.7	4.4	3.6	6.5	3.4	2.3	3.2	3.1	3.0	2.9	2.6
10 Net portfolio investment, equity	0.5	0.2	0.1	0.4	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
11 Automatic debt dynamics 1/	-0.1	-14.5	2.3	6.4	-2.3	-7.9	-5.7	-3.1	-2.8	-2.7	-2.7
12 Contribution from nominal interest rate	4.2	4.2	3.7	4.1	3.9	2.2	2.6	3.0	2.8	2.5	2.1
13 Contribution from real GDP growth	5.2	-3.3	-1.9	-4.7	-3.3	-2.7	-3.1	-3.2	-3.1	-3.0	-2.8
14 Contribution from price and exchange rate changes 2/	-9.5	-15.4	0.5	7.0	-2.9	-7.3	-5.2	-2.8	-2.5	-2.2	-2.0
14 Residual, incl. change in gross foreign assets (2-3)	23.1	7.8	-1.1	3.6	-7.6	0.1	0.7	1.8	2.1	-0.5	-2.0
External debt-to-exports ratio (in percent)	148.5	181.9	188.3	160.0	140.9	137.1	131.5	127.8	125.0	117.9	108.6
Gross external financing need (in billions of US dollars) 3/	0.4	1.9	2.2	2.0	3.3	2.6	2.9	2.9	3.3	3.5	4.1
in percent of GDP	4.3	15.1	17.1	15.5	24.1	17.0	16.5	15.0	15.3	15.1	15.9
Key Macroeconomic and External Assumptions											
Real GDP growth (in percent)	-5.6	4.0	2.3	5.4	4.0	4.0	5.0	5.5	5.5	5.5	5.5
Exchange rate appreciation (US dollar value of local currency, change in perc	-89.4	-4.5	-4.1	-13.5	-2.9	4.7	4.5	0.5	0.6	0.3	0.3
GDP deflator in US dollars (change in percent)	10.9	18.2	-0.6	-7.7	3.4	10.3	7.9	4.5	4.2	3.8	3.8
Nominal external interest rate (in percent)	4.6	5.1	4.4	4.7	4.7	3.2	4.1	5.0	5.0	4.6	4.1
Growth of exports (US dollar terms, in percent)	6.1	-14.6	-3.2	20.8	7.6	5.8	8.9	8.9	8.6	7.4	7.4
Growth of imports (US dollar terms, in percent)	-5.0	1.2	10.9	16.9	11.5	4.5	9.6	7.1	7.7	6.7	7.4
						II. Stress Tests for External Debt Ratio					
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2003-2						**70.3**	**62.3**	**55.6**	**49.3**	**40.5**	**30.5**
2. Nominal interest rate is at historical average plus two standard deviations in 2003 and 2004						**70.3**	**66.9**	**65.6**	**63.4**	**58.7**	**53.2**
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004						**70.3**	**72.9**	**79.1**	**76.2**	**71.0**	**64.9**
4. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2003 and 2004						**70.3**	**82.4**	**97.3**	**93.6**	**87.6**	**80.7**
5. Non-interest current account is at historical average minus two standard deviations in 2003 and 2004						**70.3**	**73.4**	**80.0**	**77.1**	**71.8**	**65.7**
6. Combination of 2-5 using one standard deviation shocks						**70.3**	**82.4**	**97.6**	**93.9**	**87.9**	**80.9**
7. One time 30 percent nominal depreciation in 2003						**70.3**	**96.6**	**92.5**	**89.0**	**83.2**	**76.5**

Historical Statistics for Key Variables (past 5 years)	Historical Average	Standard Deviation
Current account deficit, excluding interest payments	-2.6	7.0
Net non-debt creating capital inflows	4.6	1.5
Nominal interest rate (in percent)	4.7	1.4
Real GDP growth (in percent)	2.0	4.4
GDP deflator in US dollars (change in percent)	4.8	10.0

Sources: Bulgarian authorities; and Fund staff estimates.

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

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

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

Table 10. Bulgaria: Public Sector Debt Sustainability Framework, 1997-2007
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
1 Public sector debt 1/	113.5	88.5	89.8	79.8	71.1	59.9	55.8	50.9	46.4	42.4	38.7
o/w foreign-currency denominated	107.6	80.9	82.0	76.0	67.3	56.1	52.3	48.2	45.2	40.5	35.4
2 Change in public sector debt	-206.3	-25.0	1.3	-10.1	-8.7	-11.2	-4.1	-4.9	-4.5	-4.0	-3.7
3 Identified debt-creating flows (4+7+12)	-185.5	-25.9	14.7	0.7	-1.0	-9.2	-3.1	-3.3	-2.5	-2.0	-1.9
4 Primary deficit	-5.7	-5.2	-2.8	-3.0	-2.9	-1.5	-1.6	-2.8	-2.9	-2.5	-2.1
5 Revenue and grants	30.7	35.4	38.6	38.7	37.7	36.0	35.6	35.6	35.3	34.9	34.5
6 Primary (noninterest) expenditure	25.0	30.2	35.8	35.7	34.8	34.5	34.0	32.8	32.4	32.4	32.4
7 Automatic debt dynamics 2/	-179.3	-25.8	11.6	0.5	0.0	-9.6	-2.4	-2.1	-1.7	-1.5	-1.5
8 Contribution from interest rate/growth differential 3/	-279.7	-21.0	-1.3	-5.9	-4.0	-4.0	-2.3	-1.9	-1.5	-1.4	-1.4
9 Of which contribution from real interest rate	-281.5	-17.5	0.6	-1.6	-1.1	-1.4	0.5	0.9	1.1	1.0	0.7
10 Of which contribution from real GDP growth	1.8	-3.5	-1.9	-4.3	-2.9	-2.6	-2.8	-2.8	-2.6	-2.3	-2.1
11 Contribution from exchange rate depreciation 4/	100.4	-4.8	12.9	6.4	4.0	-5.5	-0.1	-0.3	-0.2	-0.1	-0.1
12 Other identified debt-creating flows	-0.5	5.1	5.9	3.3	1.9	1.8	1.0	1.6	2.0	2.0	1.7
13 Privatization receipts (negative)	-3.1	-1.5	-2.1	-1.3	-2.9	-0.9	-1.6	-0.8	-0.2	0.0	0.0
14 Recognition of implicit or contingent liabilities	2.6	6.6	8.0	4.6	4.8	2.7	2.5	2.4	2.2	2.0	1.7
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
16 Residual, including asset changes (2-3)	-20.8	0.8	-13.3	-10.8	-7.7	-2.0	-1.0	-1.6	-2.0	-2.0	-1.7
Public sector debt in percent of revenues 1/	369.7	250.0	232.5	206.1	188.6	166.4	156.8	143.0	131.4	121.4	112.2
Gross financing 5/	6.6	8.1	8.8	8.1	8.4	6.3	4.8	3.0	3.4	3.8	4.7
in billions of U.S. dollars	0.7	1.0	1.1	1.0	1.1	1.0	0.8	0.6	0.7	0.9	1.2
Key Macroeconomic and Fiscal Assumptions											
Real GDP growth (in percent)	-5.6	4.0	2.3	5.4	4.0	4.0	5.0	5.5	5.5	5.5	5.5
Average nominal interest rate on public debt (in percent) 6/	24.1	4.8	4.5	5.1	5.2	3.4	4.3	6.1	6.1	6.0	5.5
Average real interest rate (nominal rate minus change in GDP deflator, in pe	-924.2	-18.9	0.8	-1.6	-1.3	-2.0	1.0	2.1	2.5	2.5	2.0
Nominal appreciation (increase in US dollar value of local currency, in perce	-72.6	6.1	-14.0	-7.4	-5.3	9.6	0.3	0.6	0.4	0.3	0.3
Inflation rate (GDP deflator, in percent)	948.3	23.7	3.7	6.7	6.5	5.4	3.3	4.0	3.6	3.5	3.5
Growth of real primary spending (deflated by GDP deflator, in percent)	5.3	25.9	21.1	5.0	1.6	3.1	3.3	2.0	4.2	5.2	5.5

	2002	2003	2004	2005	2006	2007
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2003-2007	59.9	51.7	44.0	37.1	30.8	24.9
2. Real interest rate is at historical average plus two standard deviations in 2003 and 2004	59.9	62.4	63.5	58.6	54.2	50.1
3. Real GDP growth is at historical average minus two standard deviations in 2003 and 2004	59.9	63.0	65.4	60.2	55.6	51.3
4. Primary balance is at historical average minus two standard deviations in 2003 and 2004	59.9	56.3	53.0	48.4	44.4	40.6
5. Combination of 2-4 using one standard deviation shocks	59.9	61.0	62.3	52.0	42.4	33.5
6. One time 30 percent real depreciation in 2003 7/	59.9	82.9	76.9	71.6	66.7	62.2
7. 10 percent of GDP increase in other debt-creating flows in 2003	59.9	65.8	60.5	55.7	51.4	47.4
8. Impact on **debt-to-GDP ratio** if revenue-to-GDP ratio is at historical average minus two standard deviations in 2003-04	59.9	61.9	62.9	58.0	53.6	49.5
8a. Impact on **debt-to-revenue ratio** if revenue-to-GDP ratio is at historical average minus two standard deviations in 2003-04	166.4	209.8	213.1	164.2	153.5	143.5

Historical Statistics for Key Variables (past 5 years) 8/	Historical Average	Standard Deviation
Primary deficit	-3.9	1.4
Real GDP growth (in percent)	2.0	4.4
Nominal interest rate (in percent) 6/	4.9	0.3
Real interest rate (in percent)	-5.2	9.1
Inflation rate (GDP deflator, in percent)	10.1	9.1
Revenue to GDP ratio	36.2	3.4

Sources: Bulgarian authorities; and Fund staff estimates.

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

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α= share of foreign-currency denominated debt; and ε= nc

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

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

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

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

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

8/ The historical statistics for nominal interest rate, real interest rate and inflation rate are calculated for the past 4 years.

Table 11. Bulgaria: Public Debt Dynamics, 2003-2007
(In BGN million except where stated)

	2003	2004	2005	2006	2007
Gross financing requirement					
Baseline scenario	1827.7	1298.6	1416.8	1729.5	2936.1
(percent of GDP)	5.2	5.2	5.7	3.8	5.8
Interest rate shock 1/	4168.4	3855.5	1715.8	2037.4	3235.6
(percent of GDP)	5.2	5.2	5.7	3.8	5.8
Exchange rate shock 2/	2195.0	2252.6	2473.5	2857.3	4458.2
(percent of GDP)	7.3	7.2	8.0	4.6	6.7
Growth rate shock 3/	1827.7	1300.9	1427.5	1751.3	2968.3
(percent of GDP)	5.9	6.6	7.2	4.8	7.4
Financing sources 4/	1840.4	1994.1	2397.5	1729.4	2936.1
IMF (SDR)	104.0	26.0	0.0	0.0	0.0
Multilateral (excl. IMF) (USD)	278.6	481.1	606.4	244.0	324.5
Bilateral and other 5/	211.6	188.3	165.7	15.0	15.0
Privatization	549.4	298.3	98.9	0.0	0.0
Fiscal reserve account (- increase	-283.6	-84.0	386.4	293.1	269.1
Bonds	350.0	400.0	400.0	940.2	2013.8
(percent of GDP)	1.0	1.0	0.9	2.0	4.0
External	0.0	0.0	0.0	540.2	1363.8
Domestic	350.0	400.0	400.0	400.0	650.0
Net financing needs 6/					
Baseline scenario	-12.7	-695.5	-980.7	0.0	0.0
(percent of GDP)	0.0	-1.8	-2.3	0.0	0.0
Interest rate shock	2328.0	1861.4	-681.8	307.9	299.5
(percent of GDP)	6.6	4.8	-1.6	0.7	0.6
Exchange rate shock	-380.3	-533.6	-921.8	738.3	1065.5
(percent of GDP)	-1.1	-1.4	-2.2	1.6	2.1
Growth rate shock	-12.7	-693.1	-970.0	21.9	32.2
(percent of GDP)	0.0	-2.3	-2.9	0.1	0.1

Sources: Bulgarian authorities; and staff estimates.

1/ 1300 basis points increase in real interest rates in 2003.
2/ 50 percent depreciation of the nominal exchange rate in 2003.
3/ 6.75 percentage point decline in the real growth rate in 2003.
4/ Under the baseline exchange rate assumptions. Calculations for exchange rate shock not shown.
5/ Including the recovery of debt to Bulgaria from HIPC and other countries.
6/ Gross financing requirement minus projected financing available under the baseline scenario.

Table 12. Bulgaria: Monthly Revenue Targets, 2003 1/
(In millions of leva)

	2003 Total	January	February	March	April	May	June	July	August	September	October	November	December
Total revenue	11,300.0	804.0	804.7	942.2	971.0	1,100.7	863.8	1,010.1	889.9	914.3	1,001.5	956.0	1,041.7
Tax revenue	9,957.0	751.3	742.2	873.5	872.3	832.5	736.5	832.3	796.5	817.5	915.4	860.8	926.2
Profit tax	938.2	65.6	68.2	168.5	141.0	70.6	57.8	64.2	61.6	58.1	62.8	58.0	59.0
Income tax	1,072.1	97.2	70.0	74.8	83.6	114.1	81.1	93.1	83.4	76.8	96.1	90.7	111.0
VAT	2,927.4	232.5	236.7	243.4	230.0	228.3	195.5	263.2	222.7	250.1	298.4	258.4	268.2
Excises	1,018.5	74.2	72.4	67.8	82.5	91.5	85.5	71.2	85.4	89.2	99.5	95.0	104.3
Customs duties, customs and export charges	180.0	8.0	12.0	12.4	15.0	14.0	16.0	15.0	14.8	17.0	18.5	20.3	17.0
Social security contributions	3,506.9	245.3	257.3	277.5	296.5	289.2	273.1	302.1	304.0	298.9	315.7	311.7	335.5
Property taxes	166.9	16.6	14.9	17.9	12.9	11.8	14.4	12.3	11.3	13.7	12.3	12.3	16.4
Other taxes	146.9	9.0	10.8	11.1	10.6	12.9	13.2	11.1	13.4	13.7	11.9	14.4	14.8
Nontax revenue	1,343.6	52.7	62.5	68.8	98.8	268.3	127.3	177.9	93.4	96.9	86.1	95.3	115.5
State, local and judicial fees revenue	225.8	12.6	15.7	16.6	17.6	22.0	23.2	15.6	19.4	20.5	15.7	19.7	27.1
Other revenue	1,117.8	40.2	46.8	52.2	81.2	246.3	104.0	162.4	74.0	76.3	70.4	75.6	88.4

Source: Ministry of Finance

1/ Program for the revenues in the central budget , social security budget, and municipalities.

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

Bulgaria: World Bank Relations

Lending operations

1. The Bank has approved 27 loans to Bulgaria to date, of which 8 are active (Table 14). The last loan approved by the Bank's Board was the Registration and Cadastre project (US$30 million equivalent in June 2001). In addition, a Wetlands Restoration and Pollution Reduction project (GEF grant of $7.5 million) was approved in June 2002.

2. The Bank's Board discussed a new Country Assistance Strategy (CAS) for Bulgaria on May 9, 2002. The overarching objectives of the CAS are: (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, namely (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 International Finance Corporation (IFC), especially through support for privatization and restructuring of state-owned enterprises and new investments in private companies. The IMF and World Bank staff maintain a close collaborative relationship in supporting the Government's structural reforms.

3. Up to three Programmatic Adjustment Loans (PALs) would support the Government's policy framework that underpins the Bank's overall assistance program in FY03-05. The policy framework supported by the PAL would, over time, (a) foster completion of privatization and restructuring in energy and infrastructure; (b) improve the environment for private sector led growth; (c) help deepen the financial sector; (d) lead to reduced poverty, improved human capital and better delivery of social services; and (e) support public administration reform and anti-corruption programs. Reforms to be tackled under the Bank supported PAL program 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 Bank's assistance program. Besides a 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 an energy 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" (Report No. 22109-BUL) was completed in March 2001. An update of the Poverty Assessment (2001) is being discussed with the Government and other stakeholders and will be finalized shortly thereafter. A Public Expenditure and Institutional Review (Report No. 23979-BUL) was finalized in August 2002. 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 14. Bulgaria: World Bank Lending Operations

	Lending Operation	Amount	Board Date
1.	Water Companies Restructuring Project	US$98 million	1994
2.	Environmental Remediation Pilot	US$16 million	1998
3.	Environment and Privatization Support Adjustment Loan	US$50 million	2000
4.	Trade and Transport Facilitation in Southeast Europe Project	US$7 million	2000
5.	Health Sector Reform Project	US$63 million	2000
6.	Education Modernization Project	US$14 million	2000
7.	Child Welfare Reform Project	US$8 million	2001
8.	Registration and Cadastre	US$30 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 15). Despite a comprehensive economic database, problems remain in national accounts and price statistics, particularly in the coverage of the emerging private sector, as well as in the balance of payments statistics, where frequent and substantial revisions have hampered economic analysis. In addition, work remains to be done in fully reconciling high frequency data on economic activity with quarterly and annual national accounts data. Annual international investment position statistics are compiled and reported to STA for publication.

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

Real sector

3. The National Statistical Institute (NSI), with technical assistance from OECD, has established a system to compile national accounts according to the recommendations of the European System of Accounts, 1995. GDP by activity and expenditure categories are compiled and reconciled within the annual supply and use framework. 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 2002, based on new significantly improved quarterly surveys. Problems remain in the methods for the deflation of some components of the national accounts, such as household consumption, capital formation, and external trade, and in the coverage of private sector activities. However, significant progress has been made in the development of export and import deflators.

6. Work to change the base year of the PPI from 1995 to 2000 is to be completed by end-2002. 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 50 of 90 branch classes completed to date. 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 new work program calls for completing 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 also needs to be conducted on a consistent schedule, semi-annually or quarterly. It has been conducted twice a year since 1993 (three times a year since 1999), but at irregular intervals. From 2001 onward, the NSI intended to conduct the survey on a quarterly basis. Also, Eurostat has been providing support since mid-2000 in the context of a pilot project ending in mid-2001 to improve the labor force survey's compliance with Eurostat recommendations.

10. The Population Census was conducted in early 2001 and 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. The Ministry of Finance prepares data on the execution of the consolidated government on a monthly basis. These data do not conform to *GFS* standards and are not published.

Money and banking statistics

12. 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 began to progressively harmonize its data collection and compilation methods in line with the European Central Bank's framework for monetary statistics. In particular, a significant number of enhancements in sectoral and instrument detail and classification were made in the data for 1995 and onward. These were reflected in the revised monetary statistics published in the August 2002 issue of *IFS*.

Balance of payments

13. Bulgaria reports monthly balance of payments data on a regular and timely basis, but data are subject to frequent and substantial revisions. An IMF technical assistance mission in December 2000 made a number of recommendations to strengthen the balance of payments and external debt compilation systems, which included the development of a closed-type of international transactions reporting system, the development of estimates of "shuttle trade" with countries bordering Bulgaria, strengthening the methodology for travel transactions, and compiling data on trade credit liabilities. The treatment of the license to operate a mobile telephone service has been clarified and agreed with the BNB. The GSM license purchase has been recorded under foreign direct investment, in Bulgaria's equity capital component in the first quarter of 2001. As there is no repayment obligation, the transaction does not change the country's external debt position. Balance of payments transactions related to the mobile phone license are no longer recorded for the subsequent periods.

Table 15. Bulgaria: Core Statistical Indicators as of December 20, 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	Dec 20, 2003	Dec 14, 2002	Dec 14, 2002	Dec 14, 2002	Dec 14, 2002	Dec 14, 2002	November 2002	September 2002	September 2002	September 2002	Q3 2002 (qtrly) 2001 (annual)	October 2002
Date Received	Dec 20, 2003	Dec 20, 2002	Dec 20, 2002	Dec 20, 2002	Dec 20, 2002	Dec 20, 2002	Nov 16, 2002	Nov 29, 2002	Nov 29, 2002	Oct 30, 2002	Dec 20, 2002	Dec 13, 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	Email from BNB
Confidentiality	No	Yes	Yes	Yes	No	No	No	No	No	No	No	No
Frequency of Publication	Daily	Daily	Daily	Daily	Weekly and Monthly	Weekly	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly

BULGARIA: FUND RELATIONS
As of November 30, 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	1386.97	216.65
Reserve position in Fund	32.78	5.12

III. **SDR Department**:	SDR million	%Allocation
Holdings	8.32	N/A

IV. **Outstanding Purchases and Loans**:	SDR million	%Quota
Stand-by	122.85	19.19
EFF	627.62	98.03
STF	29.06	4.54

V. **Financial Arrangements**:

Type	Approval date	Expiration date	Amount approved (SDR million)	Amount drawn (SDR million)
Stand-by	02/27/2002	02/26/2004	240.00	84.00
EFF	09/25/1998	09/24/2001	627.62	627.62
Stand-by	04/11/1997	06/10/1998	371.90	371.90
Stand-by	07/19/1996	04/11/1997	400.00	80.00

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

	Forthcoming				
	2002	2003	2004	2005	2006
Principal	7.78	76.60	89.20	155.32	154.26
Charges/Interest		19.47	17.55	14.75	10.58
Total	7.78	96.06	106.75	170.07	164.84

VII. **Safeguards Assessments**:

Under the Fund's safeguards assessment policy, Bulgarian National Bank (BNB) is subject to an assessment with respect to the SBA arrangement, which was approved on February 27, 2002 and is scheduled to expire on February 26, 2004. A safeguards assessment of the BNB was completed on June 12, 2002. The assessment identified certain weaknesses and made appropriate recommendations, as reported in IMF Country Report No. 02/174.

As of end-November 2002, the BNB has implemented the bulk of the other recommendations of the safeguard assessment and is taking steps to implement the remaining recommendations.

VIII. **Exchange Arrangements**:

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

IX. **Article IV Consultation**:

The last Article IV consultation was concluded on July 22, 2002 (see IMF Country Report No. 02/174). Bulgaria is on a 24-month cycle. The Acting Chairman's summing-up of the discussion was circulated as SUR/02/80. Bulgaria has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, and maintains an exchange rate system that is free of restrictions on the making of payments and transfers for current international transactions.

X. **FSAP Participation and ROSCs**:

Bulgaria participated in an FSAP held from October 29 to November 14, 2001. Table 16 provides information on the production of ROSCs.

XI. **Technical Assistance**

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

Table 16. Bulgaria: ROSCs

Standard/code assessed	Date of issuance	Document number
ROSC update – Data dissemination and fiscal transparency.	08/07/2002	IMF Country Report No. 02/172
ROSC update – Data dissemination, fiscal transparency, transparency of monetary and financial policies, banking supervision, deposit insurance, insurance supervision, securities market supervision	03/08/2001	http://www.imf.org
ROSC – Data dissemination, fiscal transparency, transparency of monetary policy, banking supervision, system of deposit insurance, insurance supervision, securities market supervision	03/17/2000	http://www.imf.org
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	http://www.imf.org

XII. **Resident Representatives**:

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

Table 17. 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
MAE	Review of TA needs resulting from FSAP	Mission	May 02	BNB
FAD	Tax administration	Expert	Feb.-Aug. 98	MOF
FAD	Public expenditure management	Mission	Mar. 98	MOF
FAD	Tax administration	Mission	Aug. 98	MOF
FAD	Resident treasury advisor	Expert	Since Oct. 98	MOF
FAD	Collection of tax and social security contributions	Mission	May 99	MOF
FAD	Treasury system	Mission	Sep. 99	MOF
FAD	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	Budget reform	Mission	Jan.-Feb. 01	MOF
FAD	Budget and treasury reform	Mission	Jun. 01	MOF
FAD	Tax administration - follow-up	Mission	Sep. 01	MOF
FAD	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
FAD	Tax policy	Mission	Apr. 02	MOF
STA	Producer prices	Mission	Apr. -May 98	NSI
STA	BOP statistics	Mission	Jun.-Jul. 99	BNB
STA	GDDS	Mission	Jul. 99	BNB
STA	National accounts	Mission	Nov. 99	NSI
STA	Price statistics	Mission	Jun. 00	NSI
STA	BOP statistics	Mission	Dec. 00	BNB
STA	Producer prices	Mission	Nov. 01	NSI
STA	Producer prices	Mission	Apr. 02	NSI
STA	Price statistics	Mission	May 02	NSI

Sofia, Bulgaria, January 22, 2003

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

Dear Mr. Köhler,

The attached Supplementary Memorandum of Economic Policies (SMEP) describes our performance under the program supported by the stand-by arrangement (SBA) with the Fund and discusses the policies that the Government and the Bulgarian National Bank plan to implement in 2003. The core of our policy objectives remains as described in the Memorandum of Economic Policies (MEP) dated February 12, 2002 and the SMEP dated July 5, 2002. We will continue to strengthen macroeconomic stability in support of the currency board arrangement and promote sustainable economic growth.

Performance under our economic program has been strong. The macroeconomic situation has improved considerably in recent months, and we expect growth to remain robust and inflation subdued in 2003. All quantitative performance criteria through end-September were observed, as were most structural benchmarks through end-December. Given the delay in completing the second review, end-December performance criteria are legally controlling for the purchase associated with this review. In this context, we request a waiver of applicability for the end-December performance criteria on the general government fiscal deficit and on the wage bill of the 60 closely-monitored state-owned enterprises, both of which we fully expect to be met.

In support of this program, we request that the second review under the SBA be completed. In addition to analyzing economic policies and conditions in general, the third review will focus on measures to strengthen tax administration and on reforms in the financial sector, while the fourth review will focus on the 2004 budget and related reforms. We will continue to consult with the Fund on a regular basis regarding any additional measures that may become appropriate to ensure that program implementation remains on track. We agree to publish the SMEP after the IMF Board has approved the second review.

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. **The past six months have seen Bulgaria continue to make strong progress toward achieving rapid and sustainable economic growth and significant improvements in the well-being of our citizens.** This progress has been achieved through the implementation of our economic strategy, which rests on three main pillars. First, our fiscal policy has continued to be aimed at strengthening macroeconomic stability and the currency board arrangement and promoting private sector growth. Second, our ongoing program of structural reforms focuses on eliminating the remaining barriers to growth and improving the quality of public services. Finally, we have strengthened our social safety net and labor market policies to further reduce the poverty rate and increase employment opportunities.

2. **Our economic program—supported by a stand-by arrangement from the Fund—remains on track.** All quantitative performance criteria (PCs) for end-June and end-September were observed. Ten of thirteen structural benchmarks through end-September have been observed as well, although some were achieved with a delay (Table 2). We aim to meet remaining benchmarks in the coming months, and stand ready to take all additional steps as may prove necessary during the course of the program to meet our economic goals.

B. Recent Economic Developments

3. **The macroeconomic situation has improved markedly in recent months, despite the continued slow growth among Bulgaria's main trade partners.**

- Real GDP growth picked up to 4½ percent year-on-year in the first three quarters of 2002, led by a rise in investment. Growth in Bulgaria has been one of the highest among EU accession candidates, and should reach at least 4 percent for the year as a whole. The registered unemployment rate remains high, but has declined significantly, by 1.7 percentage points during 2002 through October.

- Consumer inflation remains subdued, with a twelve-month rate of 3.2 percent at end-November.

- Export performance improved significantly in the second half of 2002, helping to limit the twelve-month external current account deficit to just over 3 percent of GDP by end-September, and contributing to a rise in international reserves to US$4.5 billion, or more than five months of prospective imports, at end-November. Export growth has been driven in part by non-traditional sectors, such as textiles and light manufacturing, underlining Bulgaria's competitiveness on international markets.

- Financial intermediation continues to rise robustly. Over the twelve months through November, real credit to the private sector grew by 38 percent, as competition in the banking sector increased and lending opportunities improved. Banks remain sound, as by September the average ratio of nonperforming loans declined slightly from last year to 5½ percent and the capital adequacy ratio remained above 20 percent.

4. **These positive developments have been underpinned by a cautious approach to fiscal policy.** Preliminary data indicate that the general government fiscal deficit for 2002 was contained to below 0.8 percent of GDP, slightly better than budgeted. Nominal revenues were broadly on track, as higher nontax revenue offset a shortfall in income taxes, VAT, and social security contributions. Lower interest payments were largely dedicated to meeting priority spending needs, including clearance of hospital and, in preparation for our reform of intergovernmental finances, municipal arrears (paragraph 17).

5. **A second Brady bond swap in September furthered the government's objective to reduce the public debt-to-GDP ratio and improve the debt structure**. The exchange allowed net present value saving of about US$30 million to be realized, while locking in historically low interest rates. The operation also allowed the release of collateral worth US$130 million and increased the duration of the bonded debt. The swap, combined with our tight fiscal stance, helped reduce the public debt-to-GDP ratio to below 60 percent by the end of 2002 and to increase the Fiscal Reserve Account (FRA) to 3.3 billion leva, well over two years of expected debt service payments. Additionally, we have adopted a debt law, which will ensure that general government debt remains below 60 percent of GDP, impose more stringent conditions for extending state guarantees, and provide for a tighter monitoring of municipal debt.

6. **We have moved ahead with our privatization program, plans to improve the business climate, and reforms in key sectors.** Preliminary work required for the sale of minority packages has been completed and several auctions have been announced. A financial intermediary was chosen to conduct the offerings at the Stock Exchange, expected for May 2003. Winning bidders for the state telecommunication company (BTC) and the state tobacco holding company (Bulgartabak) have been identified, but finalization of the sales has been delayed by court challenges. We are, in addition, taking steps to enhance market entry and exit including by simplifying business licensing and registration, accelerating bankruptcy and foreclosure procedures and enhancing the protection of creditors. Reform of health care, the district heating companies and the railway have proved challenging, but we continue to progress on these fronts as well.

7. **We have continued to implement reforms in the financial sector aimed at strengthening supervision and enhancing financial intermediation**. Two key financial sector privatizations (Biochim Bank and the State Insurance Institute) were successfully completed. The Bank Bankruptcy law was passed in September 2002 and became effective at end-December. Amendments to the bank law allowing the Bulgarian National Bank to fully vet the identity and suitability of banks' shareholders were passed. In line with recommendations from the Fund's safeguard assessment, we have taken steps to strengthen

the internal audit function of the BNB by introducing risk-based audit methods, improving control procedures, and training staff on new methodologies and international accounting standards. We have also clarified the responsibilities of the Chief Auditor and the Internal Audit Department.

8. **Bulgaria's strong economic performance has been reflected in enhanced confidence on the part of the international community.** In October, the European Union (EU) conferred on Bulgaria the status of a "functioning market economy," and the December Copenhagen summit endorsed our timetable for accession by 2007. Standard & Poor's and Fitch have raised Bulgaria's credit rating in recent months and the spread on Bulgarian sovereign bonds has continued to decline.

C. Economic Policies for 2003

9. **We aim to maintain our broad economic strategy, anchored by the currency board arrangement and focused on prudent fiscal policy and an acceleration of structural reforms.** The improvement in the external position, even in a still-difficult world economic environment, points to the continued viability of the currency board. Further, with the EU's support of Bulgaria's accession timetable, our medium-term strategy to retain the currency board until accession has been clarified and strengthened. Nevertheless, we recognize that important external risks—including the possibility of much higher oil prices and continued slow growth in the EU—require the maintenance of prudent and flexible macroeconomic policies. Moreover, Bulgaria still has a long way to go to fully realize its economic potential and increase standards of living toward levels reached by the more advanced accession countries. Achieving this will require steadfast efforts to complete our economic transformation while ensuring that the gains from this transition are more widely shared.

Macroeconomic Framework

10. **Bulgaria's medium-term outlook is favorable.** We believe that Bulgaria has the potential to grow at 5 to 6 percent per year over the medium term, as investment rises, restructuring is completed, and employment increases. Next year, with an expected modest improvement in economic conditions in the EU, we anticipate that we will move close to that potential, registering growth of 5 percent. Gradually rising savings would allow the external current account deficit to decline to 4½ percent over the medium term, after rising modestly to about 5 percent of GDP in 2003. The current account deficit would be largely covered by foreign direct investment, allowing the public and external debt-to-GDP ratios to continue to decline. Inflation is expected to average 4 percent over the medium term, as administrative prices are raised to cost-recovery levels.

Fiscal policy and reforms

11. **The 2003 budget aims to further our objectives of balancing the budget over the next three years, reducing the tax burden, and focusing spending on high priority areas.** The budget targets a small decline in the deficit, to 0.7 percent of GDP. The revenue-to-GDP

ratio is expected to decline modestly as measures to reduce direct taxation are partially offset by increases in excise taxes and improvements in tax and customs administration. On the spending side, we continue to implement policies to reign in subsidies and allow increased expenditures on the social safety net, active labor market policies, and support for agriculture.

12. **We recognize that the implementation of the 2003 budget will not be without challenges, and are committed to taking those measures necessary to ensure that our deficit target can be achieved.** First, to address potential risks arising from external shocks or revenue shortfalls relative to budget targets, we intend to limit discretionary spending to 88 percent of budgeted levels in the first three quarters of 2003—a further element of caution compared with the previous "90 percent rule." Second, we have set monthly targets on central government revenues and social security contributions. Significant deviations from these targets will trigger consultations with IMF staff on offsetting measures, including reductions in spending commitments. Finally, we are taking steps to limit spending overruns or arrears accumulation in municipalities and hospitals. In this regard, we have already cleared most municipal and hospital arrears from previous years, putting these institutions on more secure financial footing to start 2003, and are moving ahead with structural reforms to help address these problems in future years (see paragraphs 17 and 22).

13. **Our three-year tax policy strategy focuses on reducing corporate and personal income tax burdens to enhance incentives to work, save and invest in Bulgaria.** On the corporate side, we have introduced more rapid depreciation for a number of asset types and have announced a schedule for further gradual reductions in corporate tax rates from 2004, from the current 23½ percent to 15 percent by 2005. We have also lowered personal income tax rates in 2003 for low- and middle-income taxpayers. To help compensate for foregone revenue, and to ensure a gradual harmonization with EU tax regimes, we have introduced increases in excise taxes on tobacco, alcoholic beverages and petroleum products. We continue to view Bulgaria's broad tax base—with few exemptions or limited other special tax treatment—as a strength. Thus, while the introduction of a zero corporate income tax rate for enterprises locating in high unemployment regions is a key element of our economic development strategy, we have designed this measure with a view to ensuring that tax benefits are well-targeted and revenue losses are minimal. In particular, all eligible assets and 80 percent of the workers must reside in a region with an unemployment rate exceeding the national average by 50 percent. Further, we intend to evaluate our experience with this provision after one year, with a view to determining its cost effectiveness. We do not intend to introduce any new tax exemptions during the remainder of the Fund-supported program.

14. **The success of our fiscal strategy rests in part on efforts to improve taxpayer compliance.** These efforts focus on accelerating the implementation of the National Revenue Agency (NRA), enhancing the effectiveness of the large taxpayer office (LTO) and improving auditing and arrears collections. The NRA is a legal entity as of January 1, 2003, and will become operational by the start of next year. In the meantime, we have already begun joint audits between the National Social Security Institute (NSSI) and the General Tax Directorate (GTD) and will expand these audits next year, with a focus on large taxpayers. In

that context, we will expand the operations of the LTO to have it cover, by end-June 2003, taxpayers contributing at least 60 percent of total revenue (structural benchmark). We are developing selective audit programs using risk-analysis methods and, to enhance the effectiveness of auditing, we will implement the Bulstat number as the single key identification for all tax operations by end-June 2003 (structural benchmark). The Council of Ministers has approved a program for improvement of tax collection and tax authorities will establish specialized teams of tax inspectors for different economic sectors. To support improved arrears collection, we will enhance the monitoring and analysis of arrears, increase the efficiency of our efforts by focusing on those arrears most likely to be collectible, and make use of arrears rescheduling and repayment plans based on individual restructuring programs where appropriate. We anticipate to reduce net arrears from all enterprises to the GTD by 200 million leva in the course of 2003 (quarterly floors on the reduction of NSSI and GTD arrears from the largest debtors are performance criteria under the program). With respect to customs, we are continuing our reform with Crown Agents, which has already begun to show good results. We expect as well that our revenue collection will be positively affected by the occupational- and sector-specific minimum insurable income levels—which will limit the extent of underreporting of income—as well as by the rigorous implementation of new requirements that all labor contracts be registered.

15. **Equally important to our fiscal strategy are our efforts to reduce unproductive expenditure and create room for increases in spending on priority areas, including active labor market programs**. In order to target subsidies to the most socially important activities, we are continuing to restructure district heating and railways (see paragraphs 19 and 20). A major priority in the 2003 budget and for the medium-term are measures to reduce unemployment and, in that regard, we are expanding our active labor market programs for the long-term unemployed (paragraph 17). We are also increasing our support to the agriculture sector, which will be focused on improving sector productivity and preparing for EU accession.

16. **We are taking steps to ensure that the budget process and expenditure management enhance public sector effectiveness.** A program budget was prepared on a pilot basis for one ministry for the 2003 budget, and this will be expanded to 2 additional ministries next year. We will also take steps to improve the efficiency of public investment, including through streamlining the process for utilizing EU resources. We are committed to have the Financial Management Information System fully operational in the Ministry of Finance by end-2003 (structural benchmark) and to prepare for its implementation in the line ministries. We believe that fiscal transparency is key to good governance and, accordingly, no later than March 2003, will publish on the Ministry of Finance website monthly data on consolidated government budget implementation on a cash basis and on the FRA (structural benchmark). We will also ensure that no new extrabudgetary funds or state enterprises are set up during 2003 (structural benchmark). We will limit the use of the FRA for the acquisition of policy-related assets to no more than 150 million leva (½ percent of GDP) in 2002 (performance criterion). Finally, we will, by end-September 2003, include all non-participating leva-denominated extrabudgetary funds and autonomous budget units in the Treasury Single Account (structural benchmark).

17. **A broad reform of intergovernmental relations has begun, aimed at providing local governments with increased autonomy and responsibility while limiting the scope for arrears accumulation.** The reform's main objectives are: (i) a more clear delineation of the expenditure responsibilities of the state and the municipalities; (ii) adequate funding of state expenditure responsibilities mandated to municipalities; (iii) providing an element of revenue autonomy for local governments; and (iv) improving the legal framework for municipal budget preparation and execution. It is expected also that this reform will help arrest the accumulation of municipal arrears while providing local governments with the proper incentives for improving revenue collection and the efficiency of public service provision In the 2003 budget we have taken important steps toward meeting these goals, but have not yet been able to fund fully all mandated expenditures. To advance the fiscal decentralization reform, we will put it on a sound legal footing by, in the first half of the year, submitting to Parliament amendments to the municipal budget act and to the state and municipal property acts. We also will, in cooperation with the Association of Municipalities, prepare minimum standards for the provision of municipal services.

Labor Market Policies and Competitiveness

18. **Continued strict income policies for remaining state-owned enterprises and further steps to increase labor market flexibility are crucial for maintaining our competitiveness and reducing unemployment.** The Council of Ministers will pass a regulation on wage bill allocation in companies with more than 50 percent of state or municipal ownership that is fully consistent with these objectives. In line with this ordinance, we will limit wage bill growth in the 60 closely-monitored public-owned companies to no more than 2 percent in 2003 relative to the third quarter of 2002 (performance criterion under the program). We will continue efforts to amend the labor code in order to deregulate labor relations. In particular, revisions would aim to decentralize collective labor negotiations to the enterprise level and increase the role and responsibility of involved parties, including through adequate representation of employers and employees in the tripartite councils. We will initiate public discussions to push forward amendments to reduce procedural costs of dismissing workers, and facilitate more flexible forms of employment, organization of work, as well as wage agreements. Finally, we envisage providing up to 100,000 community services jobs for long-term unemployed through our expanded active labor market policies. A work test has been introduced for the first time and refusal to take public works jobs will result in losing eligibility for social assistance for one year. We will closely monitor and evaluate the program to avoid abuse, limit pressures on the state budget, and prevent crowding out of jobs which could be otherwise provided by the market.

19. **A key to stimulating job creation will be to continue to improve the business climate in Bulgaria.** In order to ease the entry of dynamic new private sector firms we have identified 200 regulatory regimes to be eliminated or simplified, and these changes will be implemented by end-June 2003. In order to arrest the multiplication of such regimes in the future and ensure that they are based on sound economic analysis, we also intend to enact a law on limiting administrative regulations by end-June 2003. We have moved forward with the implementation of the "one-stop-shop" program. The government has adopted a

conceptual framework for improving the provision of administrative services in the context of this program as well as a base model for their provision. We have made the program already operational in five pilot projects. It is also critical that we facilitate the exit of non-viable enterprises and, toward this end, have submitted amendments to the Commercial Code to simplify and speed bankruptcy procedures and provide more rights to creditors, and we anticipate enactment of these changes by end-June 2003.

Other structural reforms

20. **Energy sector reforms will be expedited, with a view to ensure that medium-term fiscal objectives can be reached and obstacles to growth removed.** The State Energy Regulatory Commission (SERC) has committed to raise prices for electricity to cost-recovery levels in three years. In this context, the SERC will announce increases in average household electricity prices of 15 percent by June 30, 2003 (structural benchmark), to take effect on July 1, 2003. Additionally, increases in average district heating prices of 10 percent will be announced by June 30, 2003 (structural benchmark), in line with the government's energy strategy. At the same time, targeted assistance to poor households will be strengthened. We are, in conjunction with the World Bank and the EBRD, accelerating the restructuring of the Sofia district heating company and plan to undertake a major upgrade of its infrastructure beginning in the spring. Steps are also being taken to introduce private management of the company, and complete installation of individual heat allocators and meters. It is anticipated that the need for government subsidies to this company will be eliminated by 2005. Our state-owned electricity and gas companies (NEK and Bulgargas) will take all necessary measures, in coordination with other public sector creditors, to limit arrears owed to them (ceilings on arrears to NEK and Bulgargas are indicative targets under the program.) More generally, we are moving ahead with the implementation of our energy sector strategy, based on privatization, the opening of energy markets to competition, and strengthened regulation. In this context, a draft of the new Energy Law has been developed, the public discussion of which is currently being held. After its approval by the Council of Ministers, we expect parliament to adopt it by end-March 2003. We anticipate the sale of seven electricity distribution companies and of a number of companies in the district heating, coal mining and water power plants sectors during 2003. Also, the procedures for selecting consultants for the privatization of electricity generation companies will start in mid-2003. We plan by mid-2003 to open 15 percent of the high voltage electricity market and begin the sale of licenses for low pressure gas markets.

21. **We will press ahead with reform of the railways, aimed at creating an efficient commercial operation with adequate infrastructure and limited and transparent government subsidies.** Toward this end, we have undertaken a 2 year action plan in consultation with the World Bank. We aim to increase cost-recovery on intercity passenger services to at least 70 percent by mid-2003 and 90 percent by mid-2004, while eliminating a number of loss-making services and reducing employment by 20 percent by mid-2004 with respect to 2001. We also plan, by mid-2003, to restructure the operating company into separate units for freight and passenger service, with separate accounting for each unit. Finally, we intend to have, by end-2003, a preliminary agreement between the Government

and the railway company BDZ: (i) specifying all non-commercial passenger services that will receive Government subsidies via public service obligation contracts, to enter fully in force as of January 1, 2005, and (ii) providing a plan for termination or other disposition of all other non-commercial passenger services, the implementation of which will start in 2004.

22. **Efforts to advance reforms in health care, in coordination with the World Bank, will aim at enhancing service quality and expenditure efficiency.** Within this broader reform, we plan to accelerate the rationalization of the hospital system along two tracks. First, we will implement a series of policies to help ensure that public spending on hospital care is increasingly focused on high quality institutions, and that the financing mechanism will provide incentives to provide services more efficiently. To achieve this we will: (i) increase the share of hospital care expenditures financed by the NHIF to at least 25 percent of total spending in the first quarter and 30 percent in the second quarter of 2003; (ii) strengthen the hospital accreditation process, with a focus on the capacity of hospitals to carry out medical activities based on explicit standards, and with hospitals not meeting accreditation requirements ineligible for NHIF financing; (iii) make expanded use of clinical pathways; and (iv) have the Ministries of Health and Finance jointly sign detailed performance contracts with individual hospitals under the Ministry of Health. Second, a national hospital restructuring plan approved in November by the Council of Ministers aims, over the medium-term, to improve the quality of, and access to, health care by investing in large regional hospitals and eliminating less productive spending in the sector.

23. **We are taking all necessary steps to further enhance our oversight of the financial sector and complete bank privatization.** The recent acceleration in credit to the private sector is welcome, but requires increased vigilance to ensure that credit quality remains high. We will maintain our policy of conducting unscheduled on-site inspections of banks determined to be problematic by our new and more comprehensive early warning system. In addition, we will continue to require full and expeditious implementation of the measures mandated to banks that are in violation of prudential regulations. We are building expertise in assessing and supervising banks' risk, especially through training provided to commercial banks and BNB staff. We will, by end-March 2003, set up a unified supervision of non-bank financial institutions. We continue preparations for the introduction of a real time gross settlements system (RGTS) by March 2003. In this context, banks and the BNB have set up a small credit reserve fund of Lev10 million at the BNB financed by banks' contributions, to provide room for settling temporary daily shortage of liquidity in the banking system. With the adoption by parliament of amendments to the anti-money laundering law, we have enhanced our ability to monitor suspicious foreign currency transactions and financial activities suspected to be related to terrorism, and strengthened the independence of the Bureau for Financial Investigation. Finally, all necessary steps have been taken to allow the remaining major state-owned bank, DSK Bank, to be sold by end-June 2003 (structural benchmark).

24. **Further development of capital markets remains a priority of this government.** We are focusing our effort on eliminating remaining obstacles to development, including through the improvement of corporate governance and shareholders protection. In particular,

we have prepared amendments to the Commercial Code to promote independence of companies' management boards, while establishing obligations regarding information disclosure and restricting conflicts of interest of board members. Additionally, we have included provisions for the enforcement of best practices in corporate governance. In order to aid in the development of the Bulgarian Stock Exchange, we plan to list the government's minority shares in 80 enterprises during 2003. The draft amendments to the Law on Public Offerings of Securities are intended to promote stock sales from minority shareholders. The development of the second and third pillars of the pension system will also serve to deepen our financial markets. We also intend to create an investment fund to increase the opportunity for equity financing for private enterprises. To guarantee that all decisions of this fund are made on a market basis and that fiscal risks are minimized, we will ensure that the government is a minority shareholder and its participation limited to 100 million leva, the fund is under private management with appropriate firewalls, and that government divestment or liquidation of the fund will take place within five years.

Debt and Asset Management

25. We will continue to manage our foreign debts and assets with a view to reducing external vulnerability and ensuring ample liquidity. We have made significant progress during the past year in reducing our public external debt as a share of GDP from 63.8 percent to 49.5 percent, reducing the share of U.S. dollar denominated debt, lengthening maturity, and raising the proportion of fixed-rate instruments. In the aftermath of the second Brady bond swap, our focus will be on reducing our overall debt burden, further developing our domestic debt market and managing risks arising from repayment peaks in future years. These issues merit public debate in the context of the government's debt strategy, which we intend to publish. In addition, we are developing a more comprehensive debt management strategy, with Fund technical assistance. We are committed to ensuring that our Fiscal Reserve Account (FRA) balance remains large enough to cover one year of external debt service payments, even under severe external shocks (a floor on the level of the FRA is performance criterion under the program). While we target a significantly larger balance than would be implied by this rule, we would also seek to make use of the FRA to prepay external debt owed to official creditors as circumstances allow. In any case, we will limit our use of FRA resources for acquiring equity in state or private enterprises during 2003, to 150 million leva (performance criterion under the program).

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				
Jan. 1, 2002-Mar. 31, 2002		138		39
Jan. 1, 2002-Jun. 30, 2002		-103		-271
Jan. 1, 2002-Sep. 30, 2002		173		-488
Jan. 1, 2002-Dec. 31, 2002		260		
II. Floor on the balance of the fiscal reserve account				
Mar. 31, 2002		1,900		2,477
Jun. 30, 2002		1,900		3,223
Sep. 30, 2002		1,900		3,539
Dec. 31, 2002		1,900		
III. Ceiling on the wage bill of the 60 monitored SOEs 2/				
Jan. 1, 2002-Mar. 31, 2002		141.8		139.1
Apr. 1, 2002-Jun. 30, 2002 3/		141.6		140.1
Jul. 1, 2002-Sep. 30, 2002 4/		141.1		140.0
Oct. 1, 2002-Dec. 31, 2002		141.1		
	GTD	NSSI	GTD	NSSI
IV. Indicative ceiling on tax on social insurance arrears				
Cumulative change from level on: Dec. 31, 2001				
Mar. 31, 2002	-25	-5	-111	-7
Jun. 30, 2002	-50	-10	-195	-5
Sep. 30, 2002	-75	-15	-250	-5
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	0	205
Sep. 30, 2002	0	690	0	238
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) (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	-79	0
	Sep. 30, 2002	300	0	-79	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	0	0
	Sep. 30, 2002	0	0	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 (EBS/02/121).
2/ Adjusted downward after the privatization of one of the monitored enterprises.
3/ Adjusted downward after the privatization of three of the monitored enterprises.
4/ 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	Form of Conditionality	Status	Review
		MEP, February 2002			
1.	Parliament to adopt a 2002 State budget consistent with paragraphs 8–12.	Before IMF Board meeting	Prior action	Met	First
2.	Council of Ministers (CoM) to adopt an ordinance on income policies consistent with paragraph 16.	Before IMF Board meeting	Prior action	Met	First
3.	Finalize the school redeployment plan, and submit it to CoM (paragraph 13).	End-March 2002	Benchmark	Met	First
4.	Adopt a child allowance allocation system, limiting allowances to most needy families (paragraph 11).	End-March 2002	Benchmark	Met	First
5.	Bank Consolidation Company (BCC) to adopt a privatization strategy for DSK Bank (paragraph 19).	End-March 2002	Benchmark	Met	First
6.	Issue a tender either to privatize the State Insurance Institute, or to transfer the management of the company to a strategic investor as an interim step toward privatization (paragraph 19).	End-March 2002	Benchmark	Met	First
7.	Parliament to adopt the Bank Bankruptcy law (paragraph 21).	End-March 2002	Benchmark	Met, with a delay	First
8.	Announce a schedule to bring household electricity prices to full cost-recovery levels (paragraph 25).	End-April 2002	Performance Criterion	Met, with a delay	First
9.	Submit to parliament a law to establish the unified revenue agency (paragraph 14).	End-June 2002	Benchmark	Met	Second
10.	Complete accreditation process for all hospitals (paragraph 13).	End-June 2002	Benchmark	Met, with a delay	Second
11.	Have the Council of Ministers approve the final draft of a new Energy Act as described in paragraph 25.	End-June 2002	Benchmark	Not met	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	Form of Conditionality	Status	Review
12. Make the new energy pricing regime fully operational (paragraph 25).	End-June 2002	Benchmark	Met	Second
13. Announce a reform of the import tariff schedule, to be phased over the period to January 2006, reducing the unweighted average MFN tariff to no more than 6 percent with significant annual reductions (paragraph 27).	End-June 2002	Benchmark	Not met	Second
14. Further improve the Treasury Single Account (TSA) by ensuring that the funds of the autonomous budgets (BTV, BN Radio, judiciary system, and the HIF) as well as the suspense accounts in Leva are also included in the TSA (paragraph 14).	December 2002	Benchmark	Not met	Second
Supplementary MEP, July 2002 2/				
15. Announce a schedule to bring household electricity prices to full cost-recovery levels (paragraph 3).	IMF Board presentation of the review	Prior Action	Met	First
16. Parliament to adopt the Bank Bankruptcy law (paragraph 19).	End-July 2002	Benchmark	Met, with a delay	Second
17. Settlement of the sale of Biochim Bank (paragraph 20)	End-September 2002	Benchmark	Met	Second

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

Table 3. Bulgaria: Structural Performance Criteria and Benchmarks, 2002–03

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

Performance Criterion on the Overall Deficit of the General Government

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

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

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

Performance Criterion on the Floor on the Balance of the Fiscal Reserve Account (FRA)

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

The Fiscal Reserve Account (FRA) consists of (1) the balances in leva and in foreign exchange of the following accounts: all budgetary and deposit accounts in the banking system, including the central budget, ministries and agencies, central government extrabudgetary funds as defined in Annex No. 7 of the 2003 Budget Law, the National Social Security Institute, and the Health Insurance Fund, and (2) other highly liquid foreign assets of the central government.

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

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

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

The limits will be monitored from the accounts of the banking system and marked-to-market data of other highly liquid foreign assets of the central government, to be provided monthly by the BNB and the Ministry of Finance. For the purposes of the program, deposit accounts and assets that are denominated in foreign currencies will be converted into leva at the December 31, 2002 exchange rates (1.88496 leva, and 0.73555 SDR per US dollar).

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

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

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

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

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

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

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

The ceiling on the aggregate wage bill of the 60 state-owned enterprises closely monitored for their large losses or arrears, for receiving subsidies, or for being monopolies, is two percent above the level of their aggregate wage bill in the third quarter of 2002. The wage bill is defined to include wages and payroll taxes paid by the employer.

Those enterprises that have been privatized or ceased operations will be excluded from the list for the respective test dates. Those enterprises that register profits in each of the first two quarters of 2003 will also exit the list in the second half of 2003 unless they are monopolies, have arrears, or receive state subsidies. If an enterprise is excluded from the list, the wage bill ceiling will be adjusted down by the amount of that enterprise's wage bill in the third quarter of 2002 plus 2 percent. The 60 enterprises monitored (enterprises number 1 to 17 are considered monopolies):

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

Performance Criteria on Ceiling on Tax and Social Insurance Arrears

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

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

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

The enterprises monitored for arrears to the NSSI:

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

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

For the purpose of assessing compliance with these 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, 2002;
- VAT refund positions (negative outstanding liabilities) will not be netted against liabilities of other enterprises, i.e., if an enterprise has a net refund position, it will count as zero in the total tax arrears for the monitored enterprises;
- agreements entered into after December 31, 2002 on writing off or rescheduling outstanding liabilities to tax authorities or the NSSI will not reduce amounts counted as outstanding liabilities;
- enterprises in the list which are entered into liquidation or bankruptcy proceedings will not drop out of the monitored total until they are struck from the register of active enterprises in Bulgaria; however, the total will no longer include new interest and penalty charges accruing after their entry into bankruptcy or liquidation.
- NEK will include all generation, transmission and distribution companies that were a part of the electricity monopoly prior to its unbundling.

Other Performance Criteria[1]

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

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

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

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

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

	One year and Under 3/	Over 1 year 4/		1-5 years 4/
		Excluding Eurobonds	Eurobond issuance 5/	
Cumulative change from level on December 31, 2002				
March 31, 2003	0	400	0	0
June 30, 2003	0	450	250	0
September 30, 2003 (indicative)	0	450	250	0
December 31, 2003 (indicative)	0	500	150	0

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

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

3/ The ceilings apply to debt with original maturities of up to and including one year. The actual stock of short-term debt outstanding (according to this definition) as of December 31, 2002 was zero.

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

5/ Gross value of Eurobond issuance, net of the cumulative value of own tradable external debt acquired by the general government in 2003 up to the test date, whether through separate transactions, or in a debt exchange operation. Operations will be valued at the market value on the day of the transaction. Following the end of each quarter, the Minister of Finance will report to the IMF: (i) the contracting and guaranteeing of external debt falling both inside and outside the ceilings, and (ii) the amount of own tradable external debt acquired by the general government. Following the end of each month, information on the contracting and guaranteeing of external debt falling both inside and outside the ceilings will be reported to the IMF by the Ministry of Finance.

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

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

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

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

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

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

- Macroeconomic developments continue to be favorable. Industrial production rose by 11 percent year-on-year in November, supporting the view that real GDP growth for the year likely exceeded the 4 percent projected under the program. The unemployment rate continued to fall in December, reaching 16.3 percent or more than 2½ percentage points below the level at the start of 2002. Balance of payments data through October show a continued recovery in exports and an external current account deficit of 1.2 percent of estimated annual GDP, suggesting that the external current account deficit for the year as a whole remained within the projected 4.2 percent of GDP. Inflation in December picked up to 3.8 percent annually from 3.2 percent in November reflecting, in part, higher oil prices.

- Indications are that all performance criteria for end-December were observed. Staff has confirmed that ceilings on contracting and guaranteeing public sector debt have been met; that the floor on the balance of the Fiscal Reserve Account has been exceeded by a comfortable margin; and the end-December performance ceilings on arrears to the state energy companies have been observed. Preliminary data indicate that the general government fiscal deficit for 2002 reached 0.7 percent of GDP, some 0.1 percentage points of GDP below the ceiling. However, the end-December indicative target on social insurance arrears collection was not observed.

- There have been positive developments with regard to structural reform. First, three foreign banks have made indicative offers for the last major state-owned bank, DSK Bank, and the sale remains on track for completion in the first half of 2003. Second, the supreme court has ruled that the privatization of the state telecommunications company (BTC) can go forward as planned, and the sale is now expected to be completed in the first quarter of the year. Finally, the Ministry of Finance has launched a new website which includes monthly data on the consolidated general government budget implementation. This is a positive step toward enhancing fiscal transparency and is line with structural conditionality under the program.

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

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FOR IMMEDIATE RELEASE
February 7, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Review and Approves US$36 Million Tranche Under Stand-By Credit for Bulgaria

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Bulgaria's economic performance under the stand-by credit. The decision will enable Bulgaria to draw SDR 26 million (about US$36 million) from the IMF after February 14.

The two-year Stand-By Arrangement was approved on February 27, 2002 (see Press Release No. 02/12) in a total amount of SDR 240 million (about US$330 million). So far, Bulgaria has drawn SDR 84 million (about US$115 million) under the stand-by credit from the IMF.

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

"Macroeconomic performance has been impressive in Bulgaria since the first program review, despite weak economic conditions in its main trade partners. The authorities' economic program, supported by the Stand-By Arrangement, continues to be centered on the Currency Board, which has been supported by a prudent and flexible fiscal policy and a strict incomes policy. These policies have contributed to robust growth, decelerating inflation, and a stronger-than-programmed external position. Unemployment, while still high, declined significantly in 2002. The authorities have made progress in some critical structural reform areas, including key privatizations in the financial sector, the enactment of the bank bankruptcy law, and increases in household electricity and district heating prices toward cost recovery levels. However, progress has lagged in other important areas, and there have been delays in the completion of privatizations of the state-owned tobacco holding and telecommunication companies.

The authorities' 2003 budget deficit target is appropriate and necessary to maintain macroeconomic stability. However, achieving this target will present challenges. In this context, we welcome the authorities' decision to proceed cautiously with discretionary spending during the first three quarters of the year and to monitor revenue developments monthly. Over the medium term, fiscal policy continues to target a balanced budget, with a lower tax burden and increased social and EU-related spending to be offset by cuts in subsidies and other unproductive spending. To achieve these goals, it is critical that the National Revenue Agency be made operational and that other efforts to strengthen tax administration and collection be increased. On the expenditure side, the reform of municipal finances, and the hospital, railways, and heating sectors, continues to be key.

Structural measures to strengthen further the financial sector, enhance competitiveness, and sustain high quality growth are also important. The sharp rise in credit to the private sector from a low base has contributed to economic growth, but will require increased vigilance in banking supervision. Reforms to simplify business regulations and increase labor market flexibility will be necessary for attracting more investment and reducing unemployment. In the same vein, the authorities should move forward to complete their privatization programs," Ms. Krueger said.