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

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

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

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

Fiscal Policy

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

Economic Restructuring

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

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

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

Financial Sector

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

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

Energy sector reform

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

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

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

Progress towards Transparency

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

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