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**NOTE**

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from: Mr Dimiter TZANTCHEV, Ambassador, Permanent Representative of  
Republic of Bulgaria to the EU

date of receipt: 14 May 2013

to: Mr Uwe CORSEPIUS, Secretary-General of the Council of the European  
Union

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Subject: Convergence programme of Bulgaria (2013-2016)

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Please find enclosed the Convergence Programme (including corrigendum) of Bulgaria.

(Complimentary close.)

(s.) Dimiter Tzantchev

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Encl.:



REPUBLIC OF BULGARIA  
Ministry of Finance

# CONVERGENCE PROGRAMME

2013–2016 update

Ministry of Finance

Sofia, April 2013

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## List of abbreviations

BDB	Bulgarian Development Bank
GDP	Gross Domestic Product
GVA	Gross Value Added
BNB	Bulgarian National Bank
SLSU	Second-level spending unit
LTI	Large Taxpayers and Insurers
GGB	Government guaranteed debt
VAT	Value Added Tax
PSS	Public Social Security
GS	Government Securities
EIB	European Investment Bank
EC	European Commission
EU	European Union
ESA'95	European System of Accounts'95
ECB	European Central Bank
LSB	Law on the State Budget
LSBRB	Law on State Budget of the Republic of Bulgaria
GDA	Government Debt Act
LA	Law Amending
MDA	Municipal Debt Act
PFL	Public Finances Law
CP	Convergence Programme
FLSU	First-level Spending Unit
SGP	Stability and Growth Pact
FDI	Foreign Direct Investments
PPP	Private-Public Partnership
RIEDTWA	Rules for Implementation of the Excise Duties and Tax Warehouses Act
HICP	Harmonised Index of Consumer Prices
SSC	Social Security Code
CFP	Consolidated Fiscal Programme
IMF	International Monetary Fund
MH	Ministry of Health
ICM	International Capital Markets
MF	Ministry of Finance

NAIRU	Non-accelerating inflation rate of unemployment
NHIF	National Health Insurance Fund
NRA	National Revenue Agency
NSI	National Statistical Institute
NSSI	National Social Security Institute
NRP	National Reform Programme
ULC	Unit Labour Costs
MTO	Medium-term budgetary objective
MSTI	Medium-sized Taxpayers and Insurers
SSF	Social Security Funds
MTFF	Medium-term Fiscal Framework
CB	Central Budget
BGN	Bulgarian lev
EDP	Excessive Deficit Procedure
EUR	Euro
ERM	Exchange Rate Mechanism
ESA	European System of Accounts
LIBOR	London Interbank Offered Rate
OMT	Outright Monetary Transactions
SEPA	Single Euro Payment Area
USD	US Dollar

# 1. Overall Policy Framework and Objectives



The current update of the Convergence Programme is implemented within the term of office of a Caretaker Government<sup>1</sup>, which has declared its commitment to ensure continuity and to keep as key priority the maintenance of the country's macroeconomic, financial and fiscal stability. This in its turn is a basic prerequisite for enhancing economic growth.

In the context of preserving macroeconomic stability Bulgaria guarantees to maintain the Currency Board Arrangement at the existing fixed exchange rate of BGN 1.95583 to EUR 1 until the country joins the euro area.

The main drivers of economic growth will be the policies focused on improving the work of public institutions and the business environment by speeding up e-governance, energy market liberalisation and reforms in education, the latter ensuring skilled labour force and better matching between the demand and the supply of labour. The accelerated and targeted absorption of EU funds in a tight fiscal environment is another important factor for achieving higher growth rates.

The medium term fiscal objectives remain focused on maintaining the sustainable budgetary framework in the context of Bulgaria's commitments both under the Stability and Growth Pact and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. This should be considered as part of an overall concept to enhance the stability, predictability, transparency and effectiveness of the work of fiscal institutions, which in its turn will have a positive impact on the investment plans of economic agents.

In the context of uncertain international economic and political environment an important priority of Bulgaria's economic policy is to create favourable business conditions as a main factor for economic growth. In this regard the Government will follow policies focused on streamlining the public sector share, lowering the regulatory burden, enhancing competition in network industries, redirecting public expenditure towards areas such as healthcare, education, research and development and investment in infrastructure. These policies are expected to have a long-term positive effect on economic growth.

The tax policy of the Republic of Bulgaria is characterised with predictability while being oriented towards promoting business development and investment activity. The Government will maintain the policies aimed at improving compliance and addressing the shadow economy.

The effective management and use of EU funds, which is an important prerequisite for achieving the long-term objectives of the country's economic policy, continues to be a key priority.

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<sup>1</sup> On 13 March 2013 the President of the Republic of Bulgaria issued a Decree to appoint a Caretaker Government with Mr Marin Raykov as Prime Minister and Minister of Foreign Affairs. By another Decree on 15 March 2013 the Head of State dissolved the 41st National Assembly and set the date for the parliamentary elections on 12 May 2013.

The Convergence Programme (CP) is approved by the government and is discussed by the National Assembly. Given the fact that the President of the Republic of Bulgaria has dissolved the National Assembly and set the date for the parliamentary elections on 12 May 2013, the present CP update will not be tabled for discussion in Parliament.

The CP comprises of seven chapters. The first chapter contains the overall framework of the government economic policies and objectives. The second one presents an analysis of the macroeconomic developments of the country with regard to key macroeconomic indicators and respective forecasts.

The third chapter provides an overview of strategic fiscal policy objectives with regard to the budget balance and government debt. This chapter outlines the current budgetary position and the expected developments in the reference period, with emphasis on the structural and cyclically-adjusted balance. Major trends in debt development position over the programme period are also presented here, as well as the budgetary effects of certain policies. The medium-term budgetary objective (MTO) is a structural deficit of 0.5%. It was achieved in 2012 and after a temporary deviation within the current programme period it is expected to be met in 2017.

The fourth chapter presents a sensitivity analysis of the forecasts in the baseline macroeconomic scenario. This chapter also contains an alternative scenario and main fiscal risks. Special attention is paid to the sensitivity of budgetary projections to the alternative scenario and assumptions.

Chapter five is dedicated to the sustainability of public finances. The main focus here is on the long-term budgetary outlook with a view to impact of ageing populations.

The sixth chapter deals with the quality of public finances. It presents the government policy strategy in this area, as well as revenue and expenditure side developments.

The seventh chapter provides an overview of the institutional characteristics of public finances in Bulgaria – budgetary procedures and fiscal rules. Special emphasis is put on the fiscal rules provided for in the Public Finance Law whereby Bulgaria introduces the new rules for strengthened economic governance in the EU. This part of the Programme also focuses on reforms in the field of revenue administration, institutional and legislative changes related to public finances and improving tax collection.

The current Convergence Programme takes into account measures and developments under two of the seven Council Recommendations of 10 July 2012 on the National Reform Programme 2012 of Bulgaria and the Council Opinion on the Convergence Programme of Bulgaria for the period 2012–20152, namely:

- **Specific recommendation 1:** Continue with sound fiscal policies to achieve the MTO by 2012. To this end, implement the budgetary strategy as envisaged, ensuring compliance with the expenditure benchmark, and stand ready to take additional measures in case risks to the budgetary scenario materialise. Strengthen efforts to enhance the quality of public spending, particularly in the education and health sectors and implement a comprehensive tax-compliance strategy to further improve tax revenue and address the shadow economy. Further improve the contents of the medium-term budgetary framework and the quality of the reporting system.
- **Specific recommendation 2:** Take further steps to reduce risks to the sustainability and to improve adequacy of the pension system by making the statutory retirement age the same for men and women with full career contributions. Introduce stricter criteria and controls for the allocation of invalidity pensions. ▼

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2 2012/C 219/03.

## 2. Economic Outlook

### 2.1 World economy/technical assumptions

The current Convergence Programme is based on the macroeconomic framework for the period 2013-2016, developed using the medium-term macroeconomic model of the Ministry of Finance with some key assumptions for the external environment as of the middle of March 2013, provided by the European Commission. When the medium-term macroeconomic forecast was developed, the effects from policy changes, envisaged in the National Reform Programme of the Republic of Bulgaria (2012-2020), were not taken into account.

**Table 1: Assumptions on Key Macroeconomic Indicators**

	2013	2014	2015	2016
World economy (real growth, %)	3.5	4.1	4.4	4.5
EU GDP (real growth, %)	0.1	1.6	1.9	2.0
USD/EUR Exchange rate, annual average	1.349	1.351	1.351	1.351
International commodity prices (dollar-denominated, %)				
Oil Brent (USD/barrel)	1.5	-6.4	-3.8	-3.0
Non-energy goods	-3.3	-2.9	-2.0	-2.0
Food	-5.6	-4.3	-2.6	-3.0
Beverages	-10.1	1.9	-5.5	-6.5
Agricultural raw materials	3.3	-0.4	-3.2	-3.7
Metals	-2.3	-3.1	0.1	0.8
Six-month LIBOR on USD-denominated deposits	0.50	0.61	0.65	1.33
Six-month LIBOR on EUR-denominated deposits	0.31	0.51	0.78	1.17

Source: EC, MF

### 2.2 Cyclical developments and current prospects

#### — Economic growth

Bulgarian GDP growth stood at 0.8% in 2012, while being 1.8% in 2011. The slow-down was mainly due to weaker external demand which resulted in real drop in Bulgarian exports compared to 2011. A change in the basic components contributing to the GDP dynamics was also registered during the year. While in 2010 and 2011 exports had a positive contribution, in 2012 the main growth driver was domestic demand. During the fourth quarter of 2012 domestic demand also slowed down which resulted in GDP growth of 0.3% compared to the same period of the previous year.

Final consumption rose by 1.8%, compared to 1.5% for 2011, driven by the increase in households' expenditures by 2.5% while public consumption decreased by 1.4%. The first half of the year was characterised by lower inflation and improvement of the consumer confidence indi-

cator. These developments resulted in accelerated household consumption growth, but in the second half of the year the real wage growth slowed down together with household spending growth. The latter reached only 0.5% in the fourth quarter of the year.

The recovery in investment activity in 2012 was more sluggish than expected. For the first time since 2008 gross fixed capital formation registered a positive change, up to 0.8% in 2012. However, the recovery of investment activity at the beginning of the year could not be maintained due to the unstable external environment that increased uncertainty among investors in the second half of the year. According to the investment survey in the industry as of October, the initially planned investment growth of 17.5% has dropped to 4.3% which is indicative of the worsened expectations and postponed investment projects.

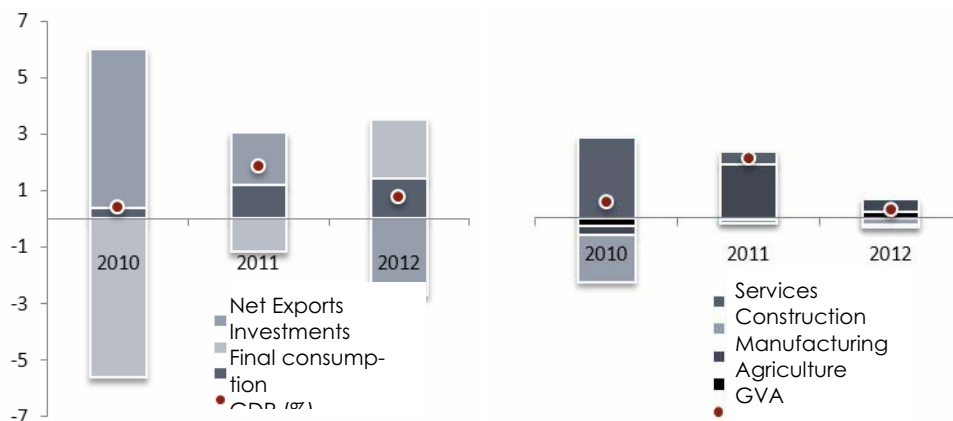
Due to the weakening of external demand the export of goods in 2012 dropped by 1% in real terms. At the same time the higher consumption resulted in growth of import of goods by 4.8%. As a result, the external sector had a negative contribution to the growth of the economy.

The slow-down of the economic activity in the country affected also supply, the gross value added growth being 0.3% in real terms with positive contribution by manufacturing and the agricultural sector.

A lower value added growth rate in manufacturing was registered during the year (1.9% compared to 8.4% in 2011). The turnovers in the sector also slowed down and the production index dropped. Factors contributing to those developments were the recession in the Euro area and in the EU as a whole, as well as the slow-down in domestic demand in the second half of the year.

After having narrowed to just 2.2% in 2011, the slump in construction production widened again and reached 3.5% in 2012. The latter was due to the negative developments at the end of the year when the construction production index dropped. During the year the civil engineering output improved, up to 7% for the first nine months, but during the last quarter its growth rate slowed to 3.2%.

**Figure 1: Contributions to the GDP and GVA annual growth, by components (pps)**



Source: NSI

In 2012 the value added in the services sector decreased by a marginal 0.2%. Only "Wholesale and retail trade; repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities" and "General government" sectors had positive contributions. "Financial and insurance activities" registered a drop in value added of 1.9%, while there was 3.5% increase in the agricultural sector.

## — Cyclical position

According to the Ministry of Finance estimates, the potential GDP growth in 2012 was 0.6% and is expected to reach 1.4% in 2013. The total factor productivity will remain a key factor for the moderate acceleration of growth over the whole forecast period until 2016.<sup>3</sup> Positive contribution will come also from the gradual capital restoration following the long period of drop in investments in the economy. On the other hand, the slow labour market recovery will keep high the NAIRU. This, together with the negative demographic characteristics, will determine the negative contribution of labour as a factor for potential growth over the forecast period.

In 2013 the output gap will reach 1.7%. Over the period 2014-2016 the economy will move towards the potential, but will remain below it.

## 2.3 Medium-term scenario

We expect the slow-down in domestic demand observed at the end of 2012 to continue in the first months of 2013. In line with the EC forecasts for recovery of the European economy in the second half of this year, we expect the export of Bulgarian goods and services to rise. The contribution of domestic demand to GDP growth over the year will shrink by 2 pps compared to 2012, and that of net exports will narrow from -2.7 to -0.5 pps. As a result of these developments the economic growth of the country is expected to reach 1%. Growth will accelerate over the period 2014-2016 driven by both domestic demand and exports, though it is expected to be slower compared to the last year forecast.

The continuing drop in employment in 2013 and the lower wage growth will restrain consumption. The real growth of household expenditure will slow down by almost 1 pps compared to 2012 and will reach 1.6%. In the coming years, as a result of the reversal of the negative labour market trends and the increasing consumer confidence, the growth in consumer expenditure is envisaged to accelerate gradually to 4.4% in 2016.

The uncertainty among investors caused by the unstable external environment will continue in 2013. The dynamics of gross fixed capital formation is expected to be close to that in 2012. In the medium term, with the improvement of future expectations investment projects which have been postponed will be realised, thus investments in the economy will increase by an average of 4.4% over the period 2014-2016.

Due to lower domestic demand the increase of imports in 2013 will be slower, up by 2.6%. The acceleration of growth in non-EU countries, which are important trading partners of Bulgaria and the recovery of the EU economy towards the end of 2013, will have a positive effect on our exports and they will rise by 2% in real terms. Until 2016, imports and exports are expected to increase gradually, and the negative contribution of net exports to GDP will reach 1.1 pps.

## 2.4 Sectoral Balances

### — Labour market, incomes and labour productivity

In 2012 the drop in employment deepened to 4.3%<sup>4</sup> on an annual basis as a result of the unfavourable dynamics of employed in agriculture, the turning of the trend of cyclical improvement of employment in industry in 2011, as well as the drop in the number of people employed

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<sup>3</sup> See Table 5 of Annex A.

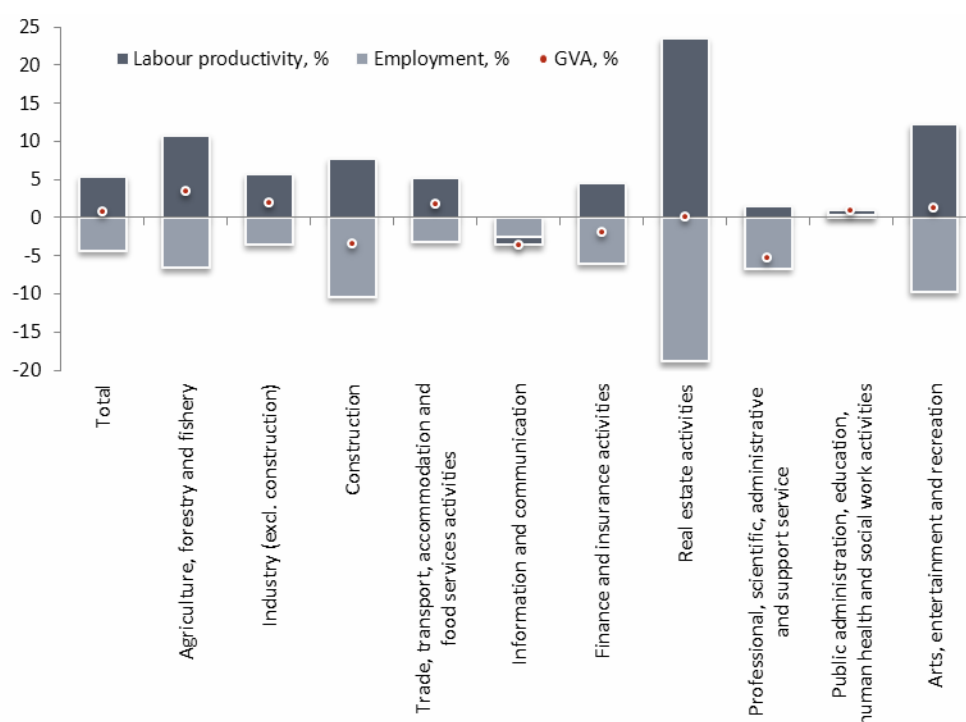
<sup>4</sup> The analysis of employment developments is based on National accounts data.

in certain activities of the services sector where until 2012 a retention of employment was observed.

Agriculture contributed significantly to the accelerated drop in employment in 2012. The number of people employed in the sector registered a double decrease of 6.6% compared to the previous year due mainly to the shrinking of the number of self-employed. Nevertheless, for the first time since 2009 the GVA in the sector has increased in real terms supported by a significant increase of labour productivity of 10.8% compared to 2011 (Figure 2).

With the new negative cycle in external demand from the second half of 2011 the drop of employment in industry accelerated to 3.5%, in contrast to 2011 when the improved development of the manufacturing industries was the main factor for decelerating the negative dynamics of the total employment in the country to 3.4% on an annual basis. The turning of the employment trend in industry in 2012 was neutralised by the continuing for a second year slow-down in the drop of those employed in the construction sector, as a result of which the total drop in industry (industry and construction) kept around the rate of decrease from the previous year.

**Figure 2: Dynamics of GVA, employment and labour productivity by economic activity**

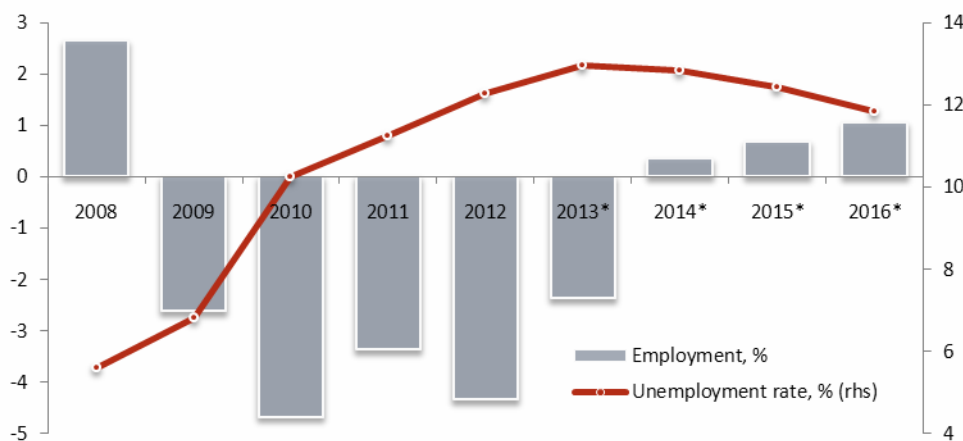


Source: NSI, MF

Part of the economic activities in the services sector also had an impact on the deepening of the drop in the total number of the people employed in 2012. In the period 2008-2011 there was no serious change of employment in the information and communication; financial and insurance activities; real estate activities, professional, scientific and technical activities; administrative and support service activities sectors. However, in 2012, a more substantial drop in employment was observed therein (between 2.5% and 18.9%) combined also with decrease of gross value added (only in the real estate activities sector the GVA kept its level from the previous year). The activity "Wholesale and retail trade; repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities" continued to decisively contribute to the continuing drop of the number of people employed in the services sector (3.2%).

According to Labour Force Survey data, in 2012 unemployment reached 12.3% - a historical maximum for the last nine years. At the same time the labour force registered a slight increase. The number of discouraged persons decreased by 3.2% compared to 2011, while the participation rate increased to 53.1%<sup>5</sup>.

**Figure 3: Employment growth and unemployment rate, %**



Source: NSI, MF

The expectations for the labour market development in 2013 are linked with continuing drop of employed persons of 2.4%<sup>6</sup> and increase of unemployment rate to 13%<sup>7</sup>. Although great part of the cuts in employment has already been made, the unfavourable external environment will continue to have influence towards optimisation of labour costs especially in the export oriented economic activities. Domestic demand also remains weak and will continue to act as a deterrent for employment recovery in the services and construction sectors. However, the considerable cuts in employment in these sectors since the beginning of the crisis until 2012 give grounds to expect a slow-down in the rate of dismissals in 2013.

In 2014 employment is expected to gradually stabilise, and a slight average annual growth rate of 0.4% of the employed, as well as drop of unemployment to 12.8%, are also expected. A more significant improvement in labour market indicators is expected in the next two years when economic activity growth will result in accelerated employment growth and faster decrease in unemployment. The moderate increase of employment in 2015 and 2016 will be combined with accelerated growth of labour productivity, to 2.2-2.3%.

The slow-down in economic activity in 2012 was related to the continuing process of optimisation of labour costs. The share of the compensation of employees in gross value added decreased to 43.2% for the economy as a whole, being due mainly to the services sector. A downward dynamics was observed in the wholesale and retail trade; repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities sector where the number of employed and income<sup>8</sup> decreased by 3.4% and 1.5% respectively. Similar developments were observed in the financial and insurance activities where these indicators registered a decrease of 6% and 2.9%. In sector "Industry" the share of the compensation of employees in GVA increased to 42.5%. The accelerated growth of the compensation of

5 In age group 15+.

6 Based on the definition of employment in the System of National Accounts.

7 As defined in the Labour Force Survey.

8 According to the System of National Accounts (SNA) concept the compensation of employees includes wages and social security contributions.

employees compared to that of the value added in industry was conditioned by the shrinking of external demand from the beginning of 2012. The tradable sector<sup>9</sup>, which is subject to competition on the global markets, managed to adapt the labour costs to the changed economic environment in the second half of the year but that was not sufficient to lower the annual figure of the indicator.

**Table 2: Share of the compensation of employees (CE) in GVA by economic activity in %**

Economic activities (CEA 2008)	CE/GVA (%)		Nominal change of CE per em- ployee	Nominal change of GVA per em- ployee
	2011	2012	2012/2011	2012/2011
Total	43.8	43.2	5.6	6.9
Agriculture	18.1	15.9	17.3	29.7
Industry	41.1	42.5	11.4	7.1
Mining and quarrying; Manufac- turing; Electricity, gas, steam and air conditioning supply; Water supply	42.6	43.2	9.8	7.8
Construction	35.4	39.5	18.3	4.1
Services	47.2	46.3	2.6	4.3
Wholesale and retail trade; repair of motor vehicles and motorcy- cles, transportation and storage, accommodation and food ser- vice activities	50.9	48.4	-1.5	3.1
Information and communication activities	43.9	47.2	7.7	-0.2
Financial and insurance activities	29.6	27.0	-2.9	6.7

Source: NSI (SNA), MF

The continuing process of employment optimisation conditioned also the high real growth of 5.4%<sup>10</sup> of labour productivity in 2012, mainly due to the tradable sector, wholesale and retail trade and real estate activities. The upward dynamics of labour productivity on its part supported the shrinking by 2%<sup>11</sup> of the real unit labour costs (RULC), and during the current period they remained lower compared to 1999.

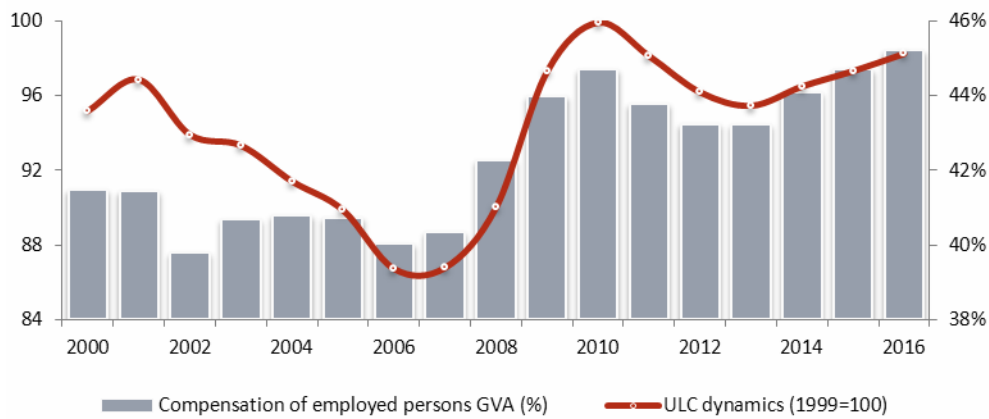
The expected high levels of unemployment will continue to act as a deterrent for the growth in labour income, which is expected to increase at moderate rates of about 4.5-6% in nominal terms within the programming period (2013-2016). The gradual increase in labour demand will result in slow increase in the share of compensation of employees in GDP. The dynamics of nominal labour income in the next three years, albeit expected to be slightly faster than the labour productivity one, is to be close to the latter, which will not have a negative impact on the cost competitiveness of the economy.

**Figure 4: Real Unit labour costs (RULC) developments**

<sup>9</sup> As per SNA data the tradeables sector covers industry (construction excluded).

<sup>10</sup> The indicator is calculated as a ratio between GDP at constant prices and the number of employed people (SNA).

<sup>11</sup> The indicator is calculated as a ratio between compensation per person employed and GDP per person employed in current prices (SNA).

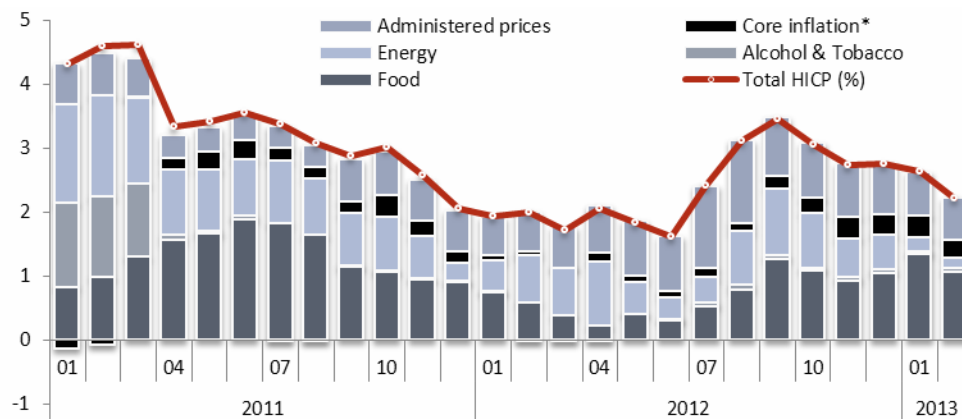


Source: NSI (SNA), MF

## — Inflation

Inflation in 2012 remained relatively low, as its average rate of increase measured by the HICP stood at 2.4%. Annual inflation continued to slow down in the first half of the year. The subsequent accelerated rise in cereals prices on international markets, as well as the one-off effect of the electricity price hikes in July, resulted in acceleration of inflation during the third quarter. In the last three months of the year domestic inflationary pressures eased and inflation at the end of the year decelerated to 2.8%.

**Figure 5: Inflation rate (%) and contributions (pps) by main HICP components (compared to the corresponding month of the previous year)**



\* The total index excluding food, alcoholic beverages, tobacco products and energy.

Source: NSI, MF

Food prices annual rate of increase continued to slow in the first half of the year largely influenced by the favourable dynamics on the international markets. However, in July the data for modest cereals harvest worldwide resulted in acceleration of cereals price which reached 28.3%<sup>12</sup> yoy in BGN terms. Food prices rose by 4.6% as of December, contributing the most (1.05 pps) to the end-of-period (eop) inflation.

<sup>12</sup> According to World Bank data.

Energy prices dynamics followed developments in international crude oil prices. The increase in the excise duties on diesel in January has contributed by 0.03 pps to the eop inflation. With the calming of the market situation in the last quarter and the strengthening of the Euro vis-à-vis the US Dollar fuels registered price decrease over three consecutive months and the increase of their prices slowed down to 6% at the end of 2012.

The still fragile recovery of domestic demand and the relatively subdued core inflation once again had a restricting effect on the rise of consumer prices. The prices of non-energy industrial goods continued to register negative rates of change throughout 2012, thus their cumulative decrease reached 1.2% at the end of the period. The drop in consumer durables prices again had leading contribution thereto. Market services prices followed a gradual upward trend reaching a 2.2% yoy increase as of December.

The average increase in administratively regulated prices at the end of 2012 was 5.4% thus accounting for approximately 30% of the total index increase. Energy prices hike, up 13.2% as of July, largely contributed to the considerable acceleration in the inflation rate at the beginning of the third quarter.

Inflation in the first two months of 2013 slowed further down to 2.2% yoy, which resulted mainly from the considerable easing of automotive fuel prices compared to a year earlier as well as the downward corrections in administered prices of natural gas and central heating. The harmonisation of excise duties on vehicle fuels was also completed at the beginning of the year. The excise duty on gasoil was increased by 2.4% and its influence for the increase of the total index is estimated at 0.04 pps.

**Table 3: Inflation forecast for the 2013-2016 period**

	2013	2014	2015	2016
<b>End-of-period inflation (%)</b>				
Total HICP	2.0	2.5	2.6	2.6
Food and non-alcoholic beverages	3.8	2.8	2.6	2.4
Alcohol and tobacco products	0.9	1.0	1.0	1.0
Non-energy industrial goods	1.0	1.8	2.0	2.3
Energy	-1.0	1.8	1.7	1.7
Services	2.9	3.4	3.8	3.8
<b>Annual average inflation (%)</b>				
Total HICP	1.8	2.7	2.6	2.6

Source: MF

Inflation in 2013 will remain comparatively low under the influence of the expected favourable situation on the international markets of raw materials and the decreases in administered prices of natural gas, electricity and heating. According to our projections the increase of the total HICP at the end of the year will be 2%, energy having a negative contribution. The still weak labour market and the limited consumer demand for durable goods and services will continue to keep core inflation at a relatively low level. With the on-going recovery of domestic demand inflation in non-energy industrial goods is expected to gradually increase to 1% at the end of 2013 and inflation in the services sector to register slight acceleration to 2.9%.

The annual average inflation rate is expected to slow down to 1.8% in 2013, to be followed by acceleration to 2.6-2.7% in the period 2014-2016. In the coming years, dollar-denominated international commodity prices are not expected to rise and, assuming a stable Euro, inflation is not expected to accelerate under the influence of external factors. With economic recovery, expectations are for higher relative consumer prices of services in comparison with those of

foods and non-foods. During this period the core inflation is estimated at around 3% and is expected to be above the overall inflation.

The contribution of administered prices to the overall inflation during the period 2014-2016 is expected to be low – about 0.1-0.2 pps. The tax policy is not expected to influence the dynamics of consumer prices as the harmonisation of excise duties on liquid fuels has been finalised at the beginning of this year and the planned increase of the overall excise duty on cigarettes in 2014 and 2015 has been cancelled by Decision No 820 of the Council of Ministers of 11 October 2012 amending Decision No 298 of the Council of Ministers of 2012 on approving the main assumptions and the budget forecast for the period 2013-2015. The planned increase of the excise duty on natural gas as motor fuel will not have any impact on HICP either, since methane is not included in the basket used to calculate inflation and an introduction of excise duty for natural gas used by households for heating purposes is not envisaged.

The main risks to the inflation forecast relate mainly to developments in international prices and the speed of economic growth in Bulgaria. International prices of crude oil may increase more substantially as a result of the political crises or increased demand. The limited supply of some agricultural goods, especially cereals, on a global scale as a result of adverse weather conditions, could further trigger higher inflation in Bulgaria. At the same time, a lower economic growth of the Bulgarian economy will limit increases in prices of non-food goods and services (core inflation).

#### — External Sector

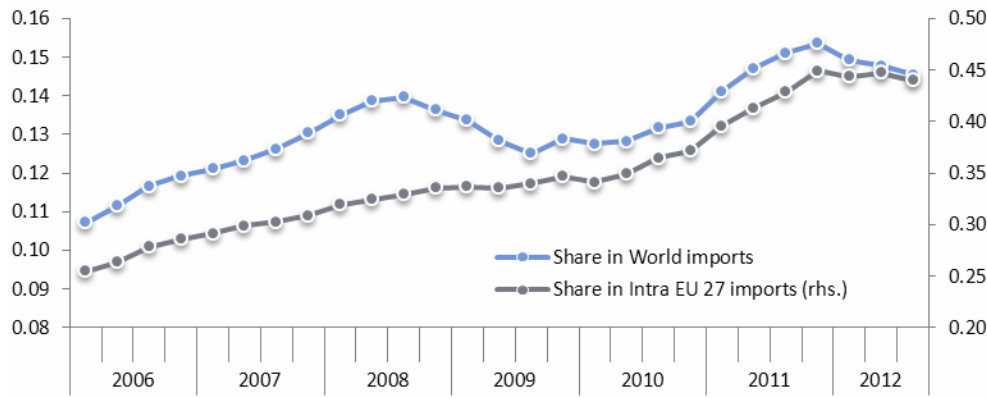
In 2012 the overall balance of the current and the capital account was a minimum surplus of EUR 8.6 million compared to EUR 536.0 million (1.4% of GDP) in 2011.

The lower positive balance was mainly influenced by the increase of the trade deficit. The reduction resulted from the stable imports due to the recovery of domestic demand. At the same time the unfavourable external environment, the recession in the EU inclusive, resulted in substantial slow-down of exports. The worsening terms of trade also contributed to the increased trade deficit. As a result, the negative trade balance reached EUR 3.6 billion in 2012 which was by EUR 1.5 billion more compared to 2011.

In 2012 Bulgaria maintained its competitive position on the international markets. Bulgaria's share in the global trade remained close to that in 2011, while trade within the EU registered a minor drop. Comparison with the other EU New Member States shows similar dynamics of Bulgaria's total exports in Euro. An accelerated increase of Bulgaria's exports to third countries was observed, reflecting the diversification of exports and the flexibility shown in a dynamic external environment.

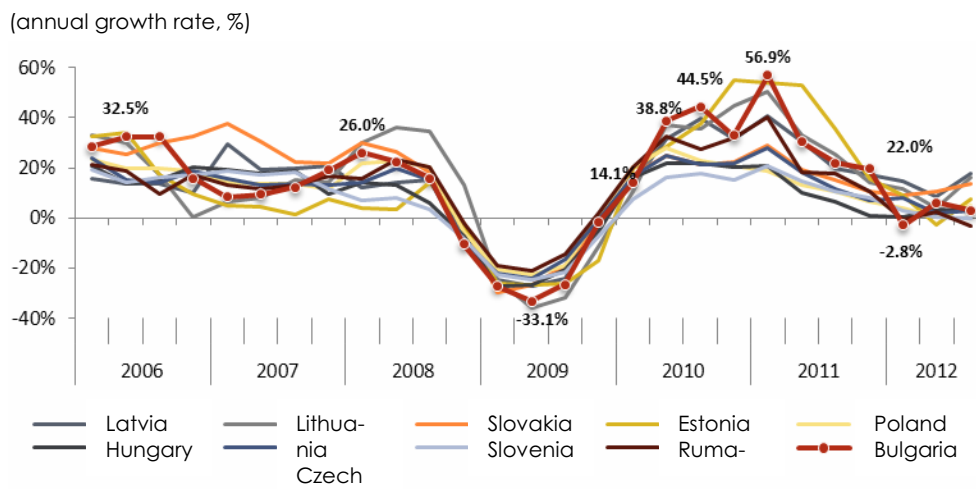
#### **Figure 6: Bulgaria's share in international trade**

(quarterly moving average, %)



Source: MF staff estimates based on WTO and Eurostat data

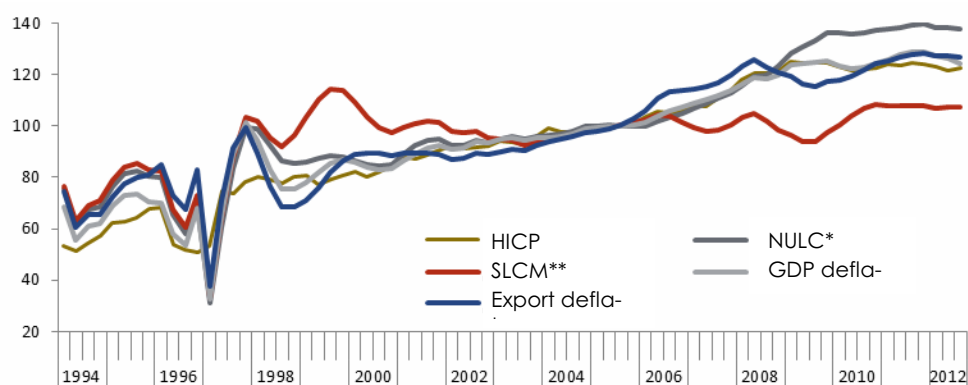
**Figure 7: Dynamics of the total exports in Euro of the new EU Member States**



Source: Eurostat

Real effective exchange rate (REER) developments supported the statement above that Bulgaria preserved its competitive position. Data for REER based on different deflators showed that the indicator has considerably slowed down its growth rate in the post-crisis period and in 2012 it has even registered declines compared to the same quarter a year earlier. As a result, the speed of appreciation over 2005 slowed down considerably. This is particularly obvious for REER based on the share of labour costs in manufacturing. The latter measures more reliably the competitiveness of Bulgarian economy since it compares the increase of labour costs in the tradable sector of the economy with that in Bulgaria's main trade partners.

**Figure 8: Real effective exchange rate, Bulgaria vis-a-vis 35 industrial countries, 2005=100**



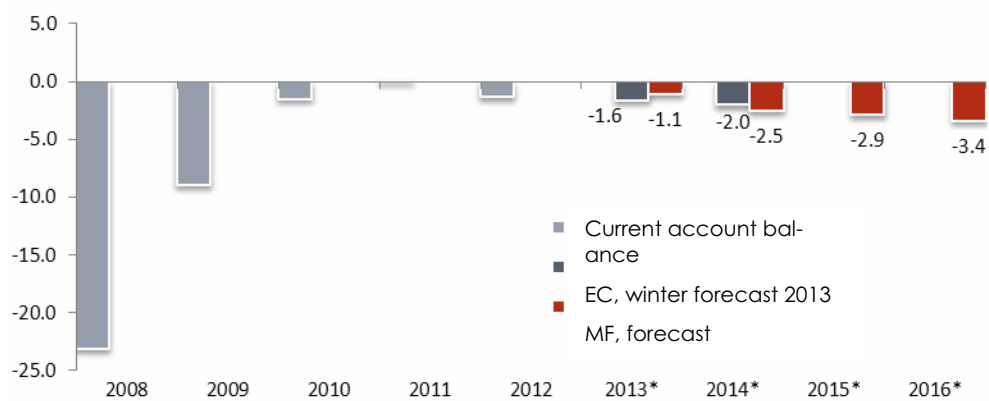
\* Nominal unit labour costs for the total economy  
 \*\* Share of labour costs in manufacturing (EC methodology)

Source: EC

In the medium term REER of Bulgarian lev is expected to continue appreciating as a result of the positive differential of labour productivity growth and the economic convergence towards the more advanced EU Member States. The slow-down in domestic demand in 2013 will reflect in a more moderate imports growth. At the same time the low base from 2012 together with the expected slight recovery of the European economy in the second half of 2013 and the stable development of non-EU countries will lead to improved external demand and exports growth. Therefore the current account balance is expected to improve in 2013. With the acceleration of consumption and investment activity in 2014 the current account deficit is expected to increase moderately in the medium term and to reach 3.4% of GDP at the end of the forecast horizon. The trade balance will remain negative but will be almost fully compensated by the surplus on transfers, mainly from the EU, and the positive balance of services, which throughout the forecast period will exceed 5.5% of GDP. The expectations are for growth in travel receipts, while the acceleration in the merchandise import, which will also support the growth of transportation services import, will act as a deterrent to the net change in the services balance.

After two consecutive years with negative financial account balance, determined by the low investment activity in the economy and the repayment of external liabilities by the banking sector, in 2012 the capital inflows in the country recovered. The surplus reached EUR 2.2 billion or 5.6% of GDP. The inflows were mainly in the form of foreign direct investment (FDI). The latter amounted to EUR 1.5 billion or 3.7% of GDP, registering an increase of 12.5% yoy. The issue of Bulgarian Eurobond with nominal value EUR 950 million on the international capital markets in July 2012 was another decisive factor for the financial account surplus. Commercial banks transactions also contributed to the surplus. In 2012 banks increased both their assets (portfolio and other investment) and their liabilities (portfolio and other investment). That was mainly due to transactions with one-off effect in November.

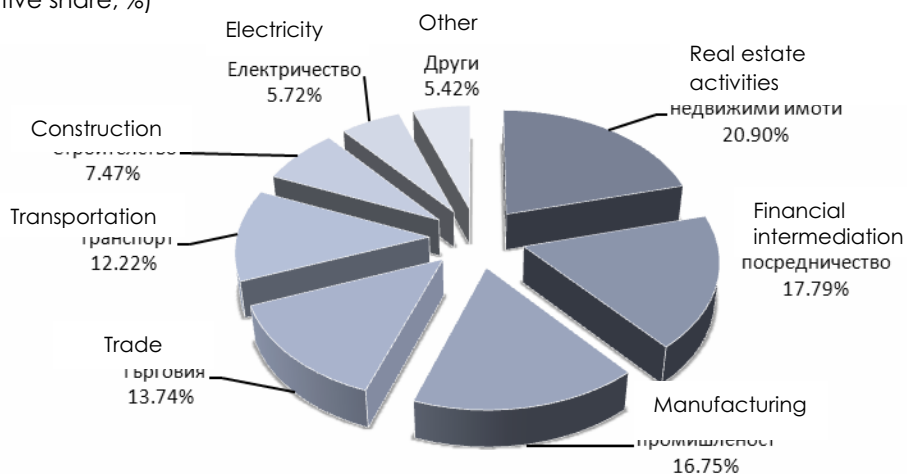
**Figure 9: Current account balance (% of GDP)**



\*Forecast  
Source: BNB, EC, MF

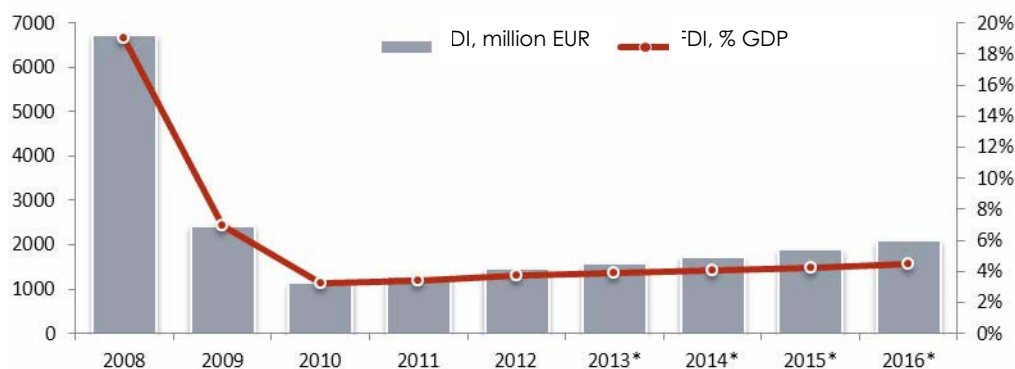
**Figure 10: FDI stock by economic sector, 2012**

(relative share, %)



Source: BNB

**Figure 11: FDI dynamics**



\*Forecast  
Source: BNB, MF

FDI are expected to remain at lower levels compared to the pre-crisis period and to increase to 4.4% of GDP in 2016, thus providing a full coverage of the current account deficit. At the same time, as a result of the comparatively high liquidity maintained by banks, in the medium term no large financial inflows in the sector will be observed. The contribution of the net portfolio investments to the financial account will be determined by the repayment of principal under the government debt in global bonds maturing in 2013, 2015 and 2017.

## — Monetary Sector

The main objective of the monetary policy in Bulgaria is to maintain price stability through securing the stability of the national currency. This objective is achieved within the framework of the Currency Board Arrangement and a fixed exchange rate of the national currency to the euro.

As of the end of February 2013 the international reserves of the country reached EUR 13.9 billion and increased by 8.8% as compared to the same month of the previous year, thus covering 166% of the monetary base. At the end of January the reserves covered 6.1 months of imports of goods and non-factor services, and the reserves to short-term external debt ratio amounted to 137.7%.

In 2012 monetary aggregates reported slowdown in growth rates compared to the previous year. As of December 2012 broad money reported an annual growth of 8.5% as compared to 12.2% as of the end of 2011. The lower growth rate of broad money was driven by the dynamics of both M1 and quasi money, with the latter recording a 7.9% growth at the end of the year. In the first two months of 2013 compared to the end of 2012, the annual growth of broad money registered a slight slowdown to 7.9% in February, which was determined by the lower growth of monetary aggregate M1. The comparatively weak credit demand on the domestic market, the cautious lending policy of banks and the low interest rates at the euro area money market were the reason for banks to keep most of their liquidity as excess reserves in the BNB and as available resources on their accounts in the TARGET2 payment system.<sup>13</sup> In 2012 the claims on non-financial enterprises increased by 4.7% (6.1% as of December 2011) and the claims on households contracted by 1% (-0.4% as of December 2011). According to the data of the bank lending survey conducted by the BNB, in 2012 the banks reported a slight tightening of lending standards for enterprises and easing of standards for consumer and housing loans. Main demand factors for credit dynamics were the low investment activity of enterprises and the unfavourable labour market situation which weighed on household consumption and contributed to households maintaining a high savings rate and remaining cautious in taking on new loans. During the first two months of 2013 the growth in bank claims remained close to that at the end of 2012. For non-financial enterprises it amounted to 4.9% and for households it registered a drop of 1% on an annual basis.

Interest rate on deposits in Bulgaria continued decreasing as a result of the sustainable increase in funds attracted from residents and the comparatively weak credit activity. As of February 2013 the weighted average interest rate on new<sup>14</sup> term deposits<sup>15</sup>, presented as weighted average on a 12-month basis, declined to 4.0% and was by 0.4 pps lower compared to the same month in 2012. The weighted average interest rate on new loans<sup>16</sup> decreased by 0.6 pps for the same period to 8.5%, and average interest rate for bank claims on households

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13 TARGET2 (Trans-European Automated Real-time Gross settlement Express Transfer system) is the main system for settlement between the credit institutions in the euro area. BNB joined TARGET2 on 1 February 2010 when the national component system TARGET2-BNB was launched.

14 The terms "new" deposit agreements and "new" loan agreements refer to the statistic category "new business".

15 Weighted average interest rate on term deposits for the household and non-financial enterprises sectors, weighted in terms of currency and term.

16 Weighted average interest rate on loans for the household and non-financial enterprises sectors, weighted in terms of currency and term.

decreased by 0.1 pps to 9.8%, while interest rates on loans for enterprises decreased by 0.8 pps to 8.1%.

In 2012 the Bulgarian banking sector operated in an environment of global financial and economic instability. Against the background of the recession in the euro area and a decline in the external demand for goods and services from the EU, economic growth in Bulgaria slowed down. The uncertainty about the prospects for recovery of the euro area contributed to the deterioration of the conjuncture indicators in Bulgaria in the second half of 2012. To meet the challenges related to the negative impact on the business environment, the banking system relied on its sound financial buffers built in the favourable stage of the economic cycle. The liquidity position of banks and the banking system as a whole remained strong and adequate to the structure of deposits and the processes in the business environment. In the first half of 2012 banks continued to use the high inflow of deposits not only for lending, but also for repayment of their foreign liabilities and for increasing their foreign assets. In the second half of the year banks continued to decrease their foreign liabilities, while the foreign assets of banks declined.<sup>17</sup> In 2012 the liquid assets to total liabilities ratio was between 25-26%, and at the end of the year the highest value for the last five years was reached – 25.96%.

The capital adequacy of the banking system is high, at a level of 16.64% at the year-end, including the capital adequacy of the Tier 1 capital of 15.13%. When analysing and assessing the value of capital indicators, the national discretionary policy applied by the BNB should be taken into account. Pursuant to Ordinance No. 9 banks are obligated to allocate specific provisions for credit risk applying a standardised approach and these specific provisions are directly deducted from their own funds. In the absence of this additional mechanism the capital adequacy of the banking system at the end of 2012 would have been by around 3 pps higher, i.e. about 20% and the Tier 1 capital adequacy - by around 2 pps higher or 17%.

In 2012 the Bulgarian National Bank continued applying the best practices in regulating banks' activities. In April the Governing Council of the BNB adopted an ordinance amending and supplementing Ordinance No. 22 on the Central Credit Register (CCR). The amendments expand the scope of the CCR, as in addition to the current participants - banks, foreign bank branches and financial institutions – the CCR scope also includes payment institutions and electronic money companies that can extend loans in relation to the payment services under Article 19 of the Law on Payment Services and Payment Systems. Expanding the CCR scope aims to enhance informativeness of the users of the CCR data and creates better conditions for analysis and evaluation of the credit risk. In July the Governing Council of the BNB adopted amendments to Ordinance No. 26 on Financial institutions. The Ordinance sets the conditions for exemption from the registration requirement of financial institutions operating with funds provided for implementation of targeted projects and programmes of the European Union. A requirement is introduced for financial institutions to maintain at any time own funds in an amount not less than the minimum required paid-in capital for the respective activity. In July the Governing Council of the BNB also adopted amendments to Ordinance No. 3 on the Terms and Procedure for the Execution of Payment Transactions and Use of Payment Instruments, whereby additional provisions are introduced regarding electronic money that aim to facilitate providers of payment services and merchants in accepting pre-paid cards. The additional provisions provide for transactions using prepaid cards over POS terminals at merchant locations and requirements for their processing and settlement. When making payments in euro payment service providers must comply with the newly adopted Regulation (EU) No 260/2012 of the European Parliament and the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro.

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<sup>17</sup> The trend exists if the impact of transactions with a one-off effect that took place in November 2012 is not considered. Those transactions caused concurrent increase in banks foreign assets and liabilities that raised their level at the end of 2012.

In the process of adapting and improving the internal supervisory framework Guidelines on the management of operational risks in market-related activities which are based on the relevant Guidelines of the European Banking Authority were published. Thereby the aim is to specify and enhance the understanding of the operational risks arising from business transactions. Specific principles and measures for identification, control and monitoring of these operational risks are introduced. They are divided into three separate groups: within the management mechanisms, internal controls and reporting systems. Guidelines on banks' internal management, that have also been developed, aimed at enhancing and improving the internal management framework. The new guidelines further develop the applicable principles and requirements for maintaining reliable and effective bank structures, adequate staffing and competencies of the governing bodies and the committees supporting their activity, as well as for independent risk management and internal control consistent with the market strategy and the risk profile of the institution.

The forecasted annual growth rate of broad money supply is expected to be 7.2% at the end of 2013, and to be within the range of 8–10.5% in the period until 2016. The net foreign assets of the banking system will increase during the current year since the accumulated funds from deposits of resident economic agents will again exceed those necessary to finance the lending activity of the banks. Starting in 2014, these assets will start decreasing again as a result of the strengthening credit activity of banks and the lower growth rates of the private sector savings. Private sector credit growth will slightly accelerate to around 4% at the end of 2013, with the contribution of loans to households expected to gradually increase. Until 2016 private lending will continue to recover relatively slowly and at the end of the period its growth will not exceed 9%. ▼

# 3. Government Balance and Debt



In the adopted in April 2012 budget forecast for the period 2013-2015 the Government provided for the implementation of fiscal policy based on low tax rates, limited redistributive role of the state and compliance with the restrictions provided for in the Stability and Growth Pact. In the 2013 Budget the Council of Ministers maintained the conservative budgetary policy given the continuing global financial and economic uncertainty. The level of the redistributive function of the state has also been maintained close to that in 2012, observing the criteria that it should be below 40% of GDP.

Based on the 2013 Budget approved by the National Assembly, the Council of Ministers adopted a decision amending its decision of the spring of 2012 on approval of the main assumptions and the budget forecast for the period 2013-2015 and on the adoption of the expenditure ceilings by first level spending units without changing the fiscal targets set for each year of the period, thus ensuring the observance of the fiscal rules - for the balance, for the level of expenditure and for the debt.

## 3.1 Policy strategy

The objectives set by the Caretaker Government within its term of office are entirely related to the maintenance of the country's macroeconomic, financial and fiscal stability within the framework of the 2013 Budget adopted by Parliament. The Government is committed to ensure the implementation of the parameters laid down in the 2013 Budget, as well as the policy measures adopted thereby.

In January 2013 the Public Finance Law was adopted. It transposes the provisions of Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, as part of the strengthened Stability and Growth Pact, and also reflects Bulgaria's commitment to apply Title III of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union signed in Brussels on 2 March 2012. With the entry into force of this Law as of 1 January 2014, complete and reliable practices for forecasting and monitoring the sub-sectors of the "General Government" Sector will be introduced. National fiscal rules for the general government balance, the budget balance of the consolidated fiscal programme calculated on a cash basis, the maximum level of expenditure under the consolidated fiscal programme, the nominal consolidated debt of the general government, are summarised. The introduced definition for the consolidated debt of "General Government" Sector is unified with the requirements of Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit procedure. A considerably more conservative approach in defining the structure and size of the general government consolidated debt is also presented by fixing the debt ceiling at 40% of GDP, while the MTO for the structural deficit of the general government sector on an annual basis should not exceed 0.5% of GDP. The Law also envisages concrete measures for adjustment in case the reference debt criterion (60% of GDP) is exceeded.

With a view of minimizing the impact of market risks, one of the main objectives set in the Government Debt Management Strategy for the period 2012-2014 is focused on issuing gov-

ernment debt by priority denominated in BGN and euro and at fixed interest rates. In addition, the legislative framework of government debt management gives the Minister of Finance an opportunity to execute debt transactions related to the optimisation of the sovereign debt servicing costs, such as to issue government securities for redemption of external and internal debts of the country, to conclude agreements for reducing the refinancing risk and settling the maturity structure of the debt, provided that the nominal value of the debt at the end of the year is not increased.

The Republic of Bulgaria will continue its efforts to ensure higher quality and better effectiveness of public finances within the existing fiscal restraints.

The perspectives for the development of public finances in the period 2014-2016 are related to the maintenance of stable and predictable fiscal policy with the purpose of contributing to upholding foreign investor confidence in the sustainability of Bulgaria's fiscal position. The medium-term budgetary framework for the period 2014-2016 is prepared on the basis of a baseline scenario for horizontal policies development and the relevant main assumptions. It is based on the last technical update of the budgetary forecast for the period 2013-2015 made in January 2013 with a view of ensuring consistency with the decisions taken by the Parliament while adopting the 2013 Law on the State Budget of the Republic of Bulgaria. The tendency of the policy developments has been kept also for the period until 2016.

The proposed scenario foresees, after a one-off loosening of the balance target, Bulgaria to continue with the fiscal consolidation implemented so far. Major factors for the economic activity and growth will be the sustainability of the tax policy and the internal restructuring of expenditure within and between the separate budgets/sectors, while maintaining the total fiscal aggregates. The higher effectiveness achieved in the expenditure side of the budget is expected to allow for redirection of resources to priority areas and target groups. The revenue forecast for the period 2014-2016 is prepared taking into account developments in the legislative framework and the macroeconomic forecast presented in the second chapter of this Programme. The policies laid down in the budgetary forecasts of the first level spending units for the period 2014-2016 have been prepared in compliance with a baseline scenario for their development, while reflecting the measures set forth in the National Reform Programme of the Republic of Bulgaria. The assumptions regarding the development of the main horizontal policies as per the last update of the budgetary forecast and expenditure ceilings have been kept. The assumptions for 2015 have been kept for 2016. With regard to the income policy in the budget sector for 2016 the nominal amount of the funds on wages has been kept at the 2015 level.

In the budgetary forecast for the period 2014-2016 new initiatives and proposals for changes in the legislative framework (new commitments to incur expenditure) are included only where financing is ensured for already undertaken commitments and for current obligations for expenditure within the approved expenditure ceilings for 2014 and 2015. The 2016 forecast is in line with the expenditure trends of the two previous years while eliminating the one-off expenditure. Undertaking new commitments to incur expenditure is allowed only when the liabilities of spending units to suppliers have been kept at the level of the previous year or decreased. The new initiatives and proposals generating additional expenditure are fitted within the expenditure ceilings balanced by internally compensated budgetary adjustments. The same principle is also observed when changes in the quantitative and qualitative parameters of the policy objectives are reflected in the budgetary forecasts.

### **3.2 Medium-term objectives**

The more pessimistic economic growth forecasts and the related thereto risk for the revenue side of the budget are the reason to revise the budget balance targets in the medium-term

budgetary forecast for the period 2014-2016, while observing the restrictions imposed by the fiscal rules.

The balance targets are for a deficit of 1.3% of GDP for 2014, 1.0% of GDP for 2015 and 0.8% of GDP for 2016, these being relevant for the balance under the consolidated fiscal programme and the general government sector balance. In nominal terms in the three-year forecast the deficit under the consolidated fiscal programme for 2014 is kept at the level of the 2013 plan, while for the other two years of the period the consolidation effort level is the same as the one in the previous budgetary forecast. The main reasons for this policy change are the new macroeconomic forecasts revising the main macroeconomic indicators and the indirect effect thereof on the revenue side of the budget. The baseline scenario followed for policy developments in the expenditure side relates to decreasing the overall amount of expenditure as a percentage of GDP. The deficit targets set in the medium term are achieved at decreasing trends/relative shares of revenue and expenditure as a percentage of GDP but starting from the revised higher levels compared to the forecast for the period 2013-2015.

### 3.3 Actual balances and updated budgetary plans for the current year

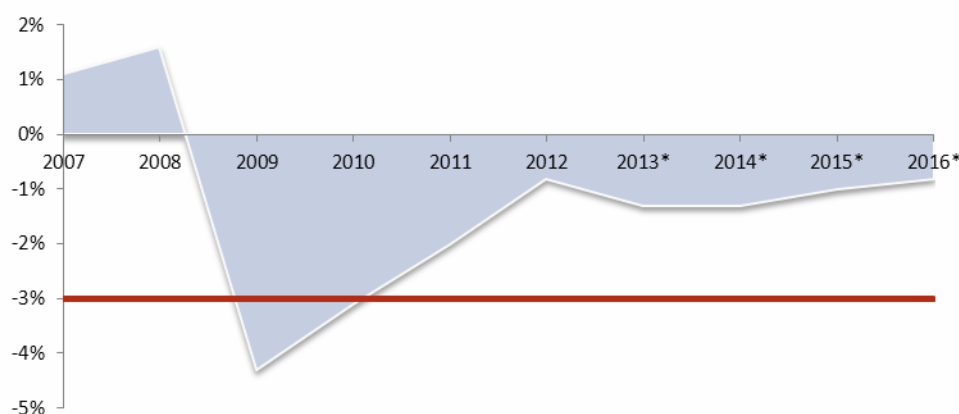
The main objective of the fiscal consolidation implemented since 2009 was to ensure a sustainable fiscal position and to put an end to the excessive deficit situation within a short period of time. Over a period of four years Bulgaria achieved cumulative fiscal improvement of 3.5 pps applying strict restrictions regarding deficit and debt.

#### — Budgetary developments in 2012

According to preliminary estimates, government deficit for 2012 stood at 0.8% of GDP which over achieved the fiscal target set in the Convergence Programme of the Republic of Bulgaria for 2012–2015. The fiscal improvement resulted mainly from the domestic demand recovery, enhanced revenue collection, consolidation measures in expenditure and strengthening of fiscal discipline in all budget sectors.

The improvement of the budgetary position by 1.2 pps of GDP compared to the previous year was achieved on the revenue side through keeping the relative share of expenditure to GDP close to its level from the previous year. The favourable effects in revenues were mainly due to an improvement in final consumption, accelerated implementation of projects under the EU Structural and Cohesion Funds, measures to address shadow economy, improved collection of government receivables, etc.

Figure 12: Budget balance (ESA'95, % of GDP)



\*Forecast

Source: Eurostat, MF

The freeze of the main tax rates in 2012, on the one hand, ensured a predictable business and investment environment, and on the other – facilitated domestic demand recovery. On the tax revenue side the proceeds from taxes on production and imports as a ratio to GDP rose by 0.6 pps compared to the previous year, driven mainly by domestic demand and measures to address shadow economy. The unspecified current revenue, EU grants included, had also a considerable contribution (0.6 pps) to the increase of total revenue which resulted from the increased absorption and payments related to projects financed by the EU Structural and Cohesion Funds.

The austerity measures undertaken during the year kept total expenditure close to their previous year level – total expenditure amounted to 35.7 % of GDP for 2012 compared to 35.6 % of GDP for 2011. Interest expenditure increased by 0.2 pps of GDP mainly due to the new Eurobond issue in July 2012. More significant decrease was observed in public wages whose ratio to GDP decreased by 0.3 pps yoy, mainly due to the fixed expenditure ceilings on the personnel remuneration at the level of 2011. Social payments dropped by a marginal of 0.2 pps; which reflected the lower relative share of pension expenditure in GDP. As from 2012, the reforms in the pension system have introduced increase in years-of-service and statutory retirement age. Actions have been taken to limit early retirement. The long-term objective of the measures is to stabilise the pension system and to ease the pressure on expenditure.

The debt management policy in 2012 was focused on keeping Bulgaria's stable economic development and public finances sustainability. The main objective of the debt policy was to ensure the availability of the funds necessary to finance government priorities and refinance the outstanding debt while keeping government debt and government guaranteed debt at reasonable levels.

In 2012 international financial markets operated in an environment of price volatility, global interest rate decrease, uncertainty related to the euro area debt crisis and the worsening of the economic perspectives both in the euro area and worldwide. The entry into force of the European Stability Mechanism and the new Outright Monetary Transactions (OMT) programme of ECB were crucial for easing the tension on the EU financial markets. The aim of this programme is to reduce the spreads of sovereign bonds of some euro area Member States where considerable deviation is observed. The measures taken by the ECB to lower the interest rates on the basic refinancing operations and the percentage of the minimum reserve requirements, as well the continuing application of unconventional monetary policy tools helped to ease the international capital markets (ICM) turmoil and resulted in considerable drop in the yield on EU Member States sovereign bonds.

The positive development of the US economy, as well as the new liquidity provision programmes of the Federal Reserve, the British and Japanese central banks, also contributed for positive trends on international monetary and capital markets in the second half of the year.

Bulgaria's good fiscal indicators and the strong investor interest in Bulgarian GS in the past years, on the one hand, and the favourable market conditions in play after the ECB provided high liquidity in the European banking system, on the other, created optimum preconditions for debt issuance on international capital markets. In July 2012 Bulgaria successfully issued a 5-year Eurobond on international financial markets amounting to EUR 950 million at a favourable yield, under strong investor interest. As a result, the issue was more than 6 times oversubscribed. Thereby the funds necessary to repay euro denominated Global Bond matured in January 2013 were provided.

At the end of 2012 the nominal consolidated debt of the general government amounted to BGN 14 390.15 million. Its ratio to GDP increased compared to the end of 2011, reaching 18.5%

in the context of the need to raise funds to service an already accumulated debt. After the repayment of the principal amounting to EUR 818 million of the Global Bond matured in January 2013, general government debt decreased to 16.5%.

The lower consolidated debt-to-GDP ratio as of 31.12.2012 (18.5%), compared to the preliminary forecast in the 2012-2015 CP is due to the following:

- Lower amount of the actual disbursements by BGN 190 million (EUR 95 million) compared to initial estimates, including lower nominal amount of the Euro Bond issue by BGN 140 million (EUR 72 million) compared to the maximum amount of BGN 2 billion (EUR 1.022 billion) envisaged in the 2013 State Budget;
- Higher growth of the social security funds sector (SSF) assets in the form of GS issued by the general government sector which constitute an element of the general government debt. An important factor behind the 2012 consolidation was also the loans granted to municipalities by the public Fund for Local Authorities and Governments - FLAG. The total amount of the consolidation exceeded the estimates for 2012 by BGN 100 million;
- Lower debt growth rate of the local government by BGN 120 million due to the accelerated absorption of funds under the EU operational programmes and the Rural Development Programme, as well as a result of the restrictive measures taken by Municipal Councils after the elections held at the end of 2011, focused on fiscal consolidation of municipal budgets;
- Lower debt level - by EUR 256 million (BGN 500 million) due to the partial inclusion of the loans in the annual balance sheet of BDZ Passenger Services Ltd (a subsidiary of BDZ Holding single member JSC) for 2012, in line with Eurostat guidelines received in the notification process of April 2013 and compliance with the requirements of the Manual on Government Deficit and Debt and the Manual on the Classification of Holding Corporations in the Public Sector and their Subsidiaries in the National Accounts of 2 March 2009.

### — 2013 Fiscal priorities

The 2013 fiscal framework envisages general government deficit for 2013 of about 1.3% of GDP. On the expenditure side an increase of the national co-financing under the EU operational programmes is foreseen due to their implementation entering a more advanced stage, as well as an increase of funds for social policies, including the pension indexation as from April and an increase of the minimum salary.

#### **Main characteristics of the policy on the revenue side for 2013 are as follows:**

- Rate freeze of direct taxes and VAT;
- Increase of rates only for selected excise goods in line with the transition periods in the Treaty on the Accession of the Republic of Bulgaria to the EU and related to the commitments made to reach the minimum EU excise duty rates for certain energy products (expected additional revenue is estimated at 0.04% of the projected GDP);
- Increase of 20 pps in the social security contributions to the Public Pension Fund for military officials, Ministry of Interior employees, investigators and those working in penitentiary establishments. The increase aims at covering the pension expenditure for already granted pensions of retired military officials while observing the principles of the pay-as-

you-go pension schemes<sup>18</sup>. The expected effect on both revenue and expenditure is 0.3 % of the projected GDP.

- Freeze of the social security contributions for all other categories of workers, as well as concerning the Teachers' Pension Fund, Fund "Guaranteed Claims of Workers and Employees" and the contributions to the additional mandatory retirement insurance;
- Freeze of the health insurance contribution;
- The minimum insurance thresholds for the main economic activities and occupational groups will be increased by 3.3% on average in 2013 yoy, with positive effect on revenue at around 0.03 % of the projected GDP;
- Maximum monthly insurance threshold will be increased from BGN 2 000 to BGN 2 200; the effect on revenue is estimated at around 0.05% of the projected GDP;
- The options granting non-taxable income under the Taxes on the Income of Natural Persons Law are limited by excluding the interest income on deposit accounts within any commercial bank or a branch of a foreign bank established in a Member State of the European Union, or in another State in the European Economic Area. The positive effect on revenue is expected to be 0.02% of the projected GDP;
- Facilitating the administration of corporate tax; change in regimes determining the advance payments during the year for different groups of taxable entities according to net proceeds from sales which is aimed at enhancing business climate. In addition, the changes entering into force as of 2013 shift these advance payments in regular periods during the year which leaves more free resources available to the companies;
- A possibility to use a single payment order administered by the National Revenue Agency in order to pay taxes, social security contributions, etc. is introduced. Until the beginning of 2013 the payments due had been made in a number separate payment orders for each individual revenue code while after the introduction of this possibility the companies would save transaction costs.

The priorities on the expenditure side for 2013 are: the policies promoting economic growth, facilitation of the implementation of projects and programmes co-financed under EU operational programmes and funds, investment in public infrastructure and environment, reduction of poverty, encouragement of social inclusion, protection of the most vulnerable groups and improvement of public services quality and access.

In 2013, a key priority in the social sphere is the reduction of poverty and encouragement of social inclusion, as well as the protection of low income groups through measures in the pension system. Such a measure is the indexation of all pensions by the accumulated HICP change for the period from mid-2009 until the end of 2012. The increase compensates the temporary halt of pension indexation in the period 2010-2012 which has been one of the measures to limit public expenditure during the period of economic crisis. The average increase is 9.3%. The minimum old-age pension is increased from BGN 145 to BGN 150 and the social pension for old age from BGN 100.86 to BGN 110. The maximum amount of the pensions received by one person becomes BGN 770. The effect on total expenditure from the pension indexation is estimated to be 0.6% of the projected GDP. A similar measure is the increase of the minimum salary from BGN 290 to BGN 310 as from January, the effect thereof on expenditure being minor - 0.01% of the projected GDP. An increase of the funds for healthcare is also provided for this year.

Another key priority on the expenditure side is public investment in basic transport and environmental infrastructure whereby expenditure for gross fixed capital formation for 2013 rise by

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<sup>18</sup> The increase of the proceeds to the PSS budget from social security contributions of the security agencies corresponds to an increase of the expenditure for social security contributions of the security agencies. It has no impact on the balance at consolidated fiscal programme level.

2.2 pps compared to the previous year. Expenditures in this area are an important tool for encouraging economic activity. In 2013, the active measures to accelerate EU funds absorption continue to be applied. The completion of a number of major projects which have been pending will trigger an increase in the national co-financing. Investment in infrastructure contributes to the overall improvement of the business environment and they are an important prerequisite for enhancing internal and external investment activity.

Pension reform measures continue in 2013. Since then, national defence officials are required to reach a certain minimum age in order to be granted a pension in addition to the existing at the moment requirement for years served.

As part of the measures for efficient budget management and expenditure control, admissible maximum size of commitments of the institutions as of 31.12.2013 has been approved with the 2013 State Budget Law. The ceilings approved are lowered by around 0.1 pps of GDP compared to the 2012 ceilings.

In support of the debt policy implemented by the Government during the last several years, focused on targeting the debt level within reasonable, low risk levels well below the convergence criterion, the 2013 State Budget Law provides for the following ceilings:

- The maximum amount of the new government debt that may be issued in 2013 is EUR 1.022 billion (BGN 2.0 billion);
- The maximum amount of the new government guarantees that may be issued in 2013 is EUR 0.1 billion (BGN 0.2 billion);
- The maximum amount of the government debt as of the end of 2013 may not exceed EUR 7.46 billion (BGN 14.6 billion).

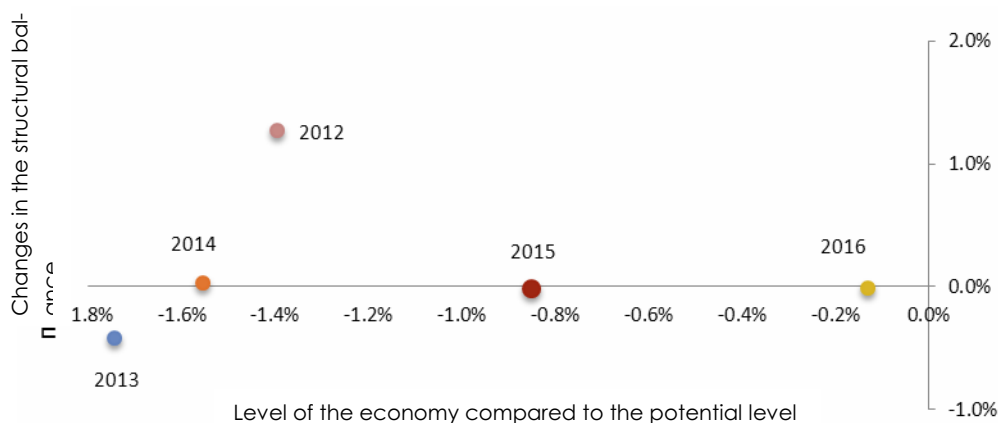
Debt ceilings set by the State Budget Law every year regulate further the increase of debt as well as its sustainability to imported external shocks.

### **3.4 Structural Balance (cyclical component of the balance, one-off and temporary measures), fiscal stance, including in terms of expenditure benchmark**

In 2012 the cyclically-adjusted budget balance amounted to a deficit of 0.4% of GDP. The fiscal consolidation in structural terms thus reached 1.3 pps. In the period 2013-2016, resulting from the revised macroeconomic expectations, the structural deficit amounted to 0.8% of GDP. The change in the expectations for a recovery of the Bulgarian economy, as described in Part 2, influences the structural deficit in several directions, namely:

- lower potential growth due to the slower recovery of employment and the delayed investment in the period; the output gap is respectively smaller than that in the previous update, which lowers the effect of the cyclical component when calculating the structural budget balance;
- the deficit increases due to the lower levels of nominal GDP and the respective adjustments in the revenue side of the budget (the nominal amount of expenditure remains unchanged against the framework of the previous update);

**Figure 13: Cyclical position of the fiscal position**



Source: MF

The real growth of modified public expenditure in 2013 is estimated at 0.9% and is below the reference value. In 2014 public expenditure's growth in real terms exceeds the benchmark value. However, general government expenditure is decreasing as a share of GDP throughout the whole programme period. The assumption for a delayed absorption of EU funds in the beginning of the next programming period up to 2016 should also be considered as a factor influencing the structural balance formation.

In the context of the above analysis it should be noted that within the limited budget resources there is a process of reallocation of key budget expenditure items by function (see the analysis in Part 6). The trend is to allocate more funds to sectors that contribute more to growth or are related to higher investment costs<sup>19</sup>. This is also evident from the relative increase of the share of investment in fixed capital from 3% of GDP in 2012 to 5.9% of GDP in 2016.

### 3.5 Debt levels and developments, analysis of below-the-line operations and stock-flow adjustments

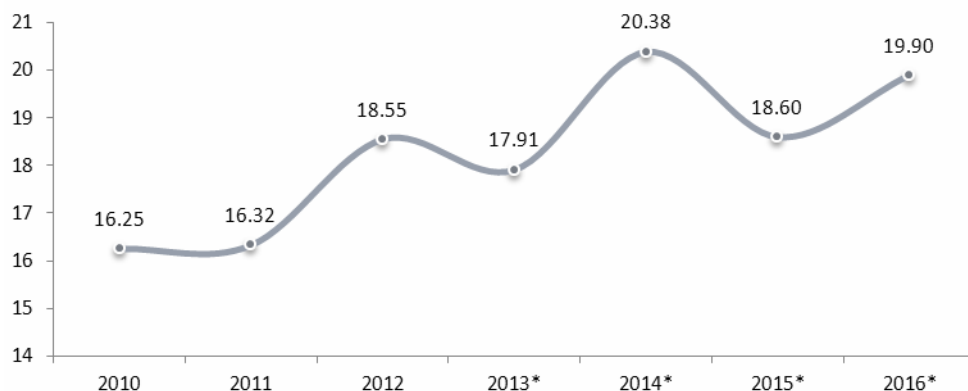
The forecast General Government debt as a share of GDP for 2014 is expected to reach higher levels compared to the plans of the CP 2012-2015. A key factor for this is determined by the necessary securing of resources needed for the forthcoming payment at the beginning of 2015 of the USD-denominated global bonds for the amount of USD 1.086 billion (around EUR 815 million). This in turn requires envisaging a potential option for going out on ICM in 2014. The existence of a budget deficit for 2014 and the high concentration of maturing debt of the Central Government in 2015 exert further influence on the current forecast of the value of the indicator under consideration.

The preliminary expectations for the period 2015-2016 show that following the payment of the USD-denominated global bonds in January 2015, the share of the General Government debt in GDP will be varying between 17%-20% and will reach its highest level at the end of 2014 (20.4%). The forecasts are based on the need for securing the financial resources for payment of the debt maturing in 2017. Assumptions for an ICM pre-emptive issue of up to EUR 1 billion (BGN 1.96 billion) in 2016 for this purpose could be envisaged.

<sup>19</sup> See Table 2a of Annex A.

The possible expansion of the scope of the sector by implementing the Eurostat requirements for re-classification of the debts of enterprises, 50% of the income of which are formed by transfers and state subsidies, and meeting the requirements as to the scope of the General Government according to the up-to-date and revised European System of Accounts (ESA) in 2014, may influence the forecasted size of the consolidated General Government debt over the period under consideration.

**Figure 14: General government debt (ESA 95, % of GDP)**



\*Forecast

Source: MF

By end-2012, Central Government represents the major share in the structure of the General Government debt with 94% followed by Local Government debt with 6%. Their relative share is expected to vary between 94% and 93% for the Central Government and between 6% and 7% for the Local Government in the period under consideration. The share of the SSF debt is negligibly small and, according to its schedule of payment, it will be fully repaid in 2016.

The currency structure of the General Government debt over the period 2013-2016 preserves the trend towards an increase in the relative share of the debt, denominated in BGN and in EUR, from 81% in 2012 to 98% in 2016 at the account of the debt denominated in other currencies. The positive changes in the currency composition of the debt will become effective as a result of the forthcoming maturing of the USD-denominated global bond issue in 2015 and its successful refinancing, as well as of the new financing, mostly in BGN and EUR, planned in the period.

The debt at fixed interest rates remains prevalent in the interest rate structure of the General Government debt for the period under consideration and is planned to increase from 71.9% at end-2012 to 82% at end-2016. This in turn predetermines the reduction in the relative share of the debt with floating interest rates.

This currency and interest rate structure minimises the impact of the market risks relating to fluctuations in the exchange rates and in the interest rates on the international capital markets on both the size of government liabilities and the expenses for servicing them.

Interest payments for 2013 on accrual basis are expected to remain within 1% of GDP. The approach applied when undertaking new government debt predominantly at fixed interest rates minimises significantly the size of the interest payments both on cash and accrual basis for the period under consideration.

Following the best practices for sovereign debt management worldwide, a new Government Debt Management Strategy 2012-2014 was drafted and adopted by the Council of Ministers in

the first half of 2012 which identifies the underlying principles and guidelines of sovereign debt management policies in the medium term. The paper describes the indicative measures and tools for attainment of the strategic objectives that allow pursuing a judicious and consistent sovereign debt management policy aimed at maintaining macroeconomic stability and preserving the country's fiscal sustainability. The subject of this strategy is sovereign debt, both external and domestic, which is the major part of the General Government debt reported according to the ESA 95 methodology.

The priorities and objectives, as laid down in the strategic document, are a continuation of the consistent and targeted debt policy conducted in the recent years aimed at ensuring the necessary resources to finance the state budget and to refinance the outstanding debt at an optimal cost and level of risk. Maintaining a reasonable level of government debt upon strengthening the position of the Republic of Bulgaria as a stable debt issuer in the region and in the European Union and preserving a balanced and market risk-resistant debt structure that furthers the optimisation of the government debt service costs are among the key priorities of debt management. The actions aimed at securing the debt sources of financing needed and those related to the maintenance of a well-functioning GS market and an investor base diversification will take an important place in the debt policy conducted.

The efforts will be targeted at a predictable and balanced assuming of new financial liabilities to supply the required sources of refinancing of the outstanding debt, cover budget deficits and maintain an adequate level of fiscal reserve.

A clear trend towards a reduction in the yield of government securities has been witnessed since the second half of 2012. A record low yield of the placed GS was reported at the end of 2012 and at the beginning of 2013. This sustainable trend of dropping yield has affected the whole debt curve. The lower risk premium achieved on the domestic market is indicative of the positive perception of GS as an appropriate investment alternative. The positive trends reported on the Bulgarian debt market secure the possibilities of the country for free market-oriented financing both on the domestic and on the international capital markets. In this context and throughout the period of consideration, government bond issues stand out as the key debt instrument for supply of the financing needed to implement the budget priorities set. The gross annual size of issues is planned to reach BGN 1.2 billion (EUR 611 million). As the financing on domestic market is the leading one and it is influenced by the still strongly dynamic international environment, a predictable and adequate issuance policy will continue to be implemented by offering government securities along the whole benchmark curve which are BGN- and EUR-denominated and issued on the principle of open issues with fixed coupon rates. The offering of benchmark issues and the diversification of the maturity structure of securities issued on the domestic market contribute to the preservation of the broad investor interest in Bulgarian debt instruments. In order to make the net flows of the single account smooth, MF is planning to issue short-term treasury bills.

After the successful early refinancing of the EUR-denominated global bonds maturing in January 2013, the Republic of Bulgaria does not envisage a new issue of bonds on the international capital markets in 2013, so this source of financing is not included in the 2013 State Budget Law.

In order to secure the next peak repayment of USD-denominated global bonds, a possible pre-financing is planned to take place through a new bond issue on ICM, which would contribute to the normal debt payment servicing in January 2015 by averting any liquidity risks.

The external financing from international financing institutions will continue to have a supplementary role and will be targeted at the implementation of investment projects and specific programmes under external loan agreements already signed. The annual disbursement under the Loan Agreement for Structured Programming Loan Bulgaria – co-financing of the EU Funds 2007-2013, concluded between the Republic of Bulgaria and the European Investment Bank,

of around BGN 280 million (EUR 140 million) is expected in this period. In order to finance already launched investment projects and specific programmes in priority economic areas, funds of around BGN 300 million (EUR 150 million) are expected to be disbursed by 2016.

### 3.6 Budgetary implications of major structural reforms

In its 2013 Annual Growth Survey the European Commission highlights the significance of structural reforms as the basis for enhancing the competitiveness and the economic growth of Member States. The structural reforms implemented in the context of Europe 2020 Strategy and the European Semester are described in detail in the updated National Reform Programme of the Republic of Bulgaria (2013). The presented positive budgetary implications could be considered as resulting from the policies carried out by the Republic of Bulgaria in response to the 2012 specific Council recommendations. As a result, this part of the Convergence Programme presents the implications of some of the reforms for the public finance.

#### — Implications for the Expenditure Side of the Budget

The pension reform undertaken in 2011 aims at ensuring stable revenue in the pension system, as well as to make pensions more adequate in view of the demographic challenges for the country. Furthermore, the reform will have a positive impact on the public finance in view of the reduction in the public expenditure related to pension scheme financing. As displayed in the table below, pension scheme expenditure in the medium-term reference programme drop from 9.8% to 9.3% of GDP. Long-term forecasts show that by 2030 expenditures should have dropped down to around 7.95% of GDP. The European Commission 2012 Ageing Report<sup>20</sup> states that the gross average public social insurance expenditures in EU27 in the period 2010-2020 are expected to be around 11.3% of GDP and around 12.3% of GDP in the euro area.

The pension reform has a positive effect on the structural deficit indicator which Bulgaria may allow itself to maintain by meeting the condition for long-term sustainable fiscal policy in the meantime.

**Table 4: Estimated pension expenditures<sup>21</sup>**

Year	Pension expenditures	
	BGN M	% of GDP
2013	7852.6	9.8
2014	8158.8	9.8
2015	8386.6	9.6
2016	8650.5	9.3
2030	12318.0	7.95

Source: NSSI, MF

As to the dynamic effects, the reform may have a positive influence on the growth factors in the medium term. The smooth increase in the retirement age, for instance, may have a positive influence on the labour supply. Combined with proper policies in support of labour demand, greater consumption and more economy savings may be expected<sup>22</sup>. As a result, tax revenues are expected to increase while budget expenditures are expected to decrease. The

<sup>20</sup> European Commission (2012), „The 2012 Ageing Report“, Economic and budgetary projections for the 27 EU Member States (2010-2060).

<sup>21</sup> Data up to 2016 are based on forecast of revenue and expenditure of the consolidated PSS budget for 2014-2016 dated 26 March 2013. Data up to 2030 are based on the information from DG ECFIN and from the member states within the Ageing Working Group to the Economic Policy Committee.

<sup>22</sup> Barrell,R.Hurst. IandKirby.S, (2010) “Macroeconomic Implications of Pension Reform or How to Pay for the Crisis”, inbook: “Pension Reform, Fiscal Policy and Economic Performance”, Banka D’Italia.

public finance savings could be transferred to investment in capital and innovation so as to increase the productivity of the real sector and to enhance competitiveness in the long run. All this would generate potential long-term economic growth, which implies new jobs. In a more unfavourable scenario, where labour demand does not correspond to the higher supply of labour force, unemployment and social benefits could put some pressure on the budget expenditure, but they would probably be partially or fully compensated by lower pension expenditure.

## — Implications for the Revenue Side of the Budget

### I. Legislative Amendments in the Tax Policy

**Table 5: Revenue implications of the amendments to tax and social security legislation<sup>23</sup>**

Amendments to tax legislation	2013	2014
Budgetary implications of the legislative amendments to CITA (revenue carried forward from the current to the next financial year)	BGN -90 million	BGN 90 million <sup>24</sup>
Revenue implications of the introduction of a final tax on deposit earnings in commercial banks	BGN 132 million	
Revenue implications of the increase of some excise duty rates in line with the agreed transition period to reach to the minimum Community levels of excise duties	BGN 30 million	
Budgetary implications of the changed rate for natural gas used as motor fuel		BGN 40 million
Budgetary implications of the changed rate for natural gas used for heating		BGN 10 million
Budgetary implications of the liberalisation of trade on the basis of the bilateral agreements between EU and third countries		BGN -5 million
Budgetary implications of the amendments to VAT legislation, including the new excise duty rates for fuels	BGN 10 million	
Budgetary implications of the changes to the maximum contributory income	BGN 43.8 million	
Budgetary implications of the changed minimum thresholds for social security contributions for the main economic activities and groups of professions	BGN 27 million	
Total revenue implications for 2013	BGN 152.8 million	
Total revenue implications for 2014		BGN 135 million

Source: MF

### *Corporate Taxes*

The corporate tax rate remains 10% and the rate for the dividend tax and the liquidation quota tax remains 5%, but there is an increase in the threshold from BGN 200 000 to BGN 300 000 for net sales revenues for determination of the taxable persons that do not make corporate tax prepayments. In addition to that, there is a change concerning the taxable persons subject to monthly and quarterly corporate tax prepayments, i.e. the taxable persons whose net sales revenues for the previous year exceed BGN 3 000 000 are subject to monthly prepayments, while the persons whose net sales revenues for the previous year vary between BGN 300 000 and BGN 3 000 000 shall be subject to quarterly prepayments. The base for determination of corporate tax prepayments is the estimated tax profit as declared by the taxable person.

<sup>23</sup> No amendments to tax legislation are currently planned for 2015 and 2016.

<sup>24</sup> Budgetary implications of the legislative amendments to CITL (revenue carried forward from the previous to the current financial year).

The tax on expenses, the tax on the public financed enterprises' income and the tax on vessels operation activity become annual taxes and will be paid by a one-off payment by the 31<sup>th</sup> of March of the following year.

As a result of these legislative amendments, the regime of declaration and payment of some of the taxes regulated by the Corporate Income Tax Act has been simplified significantly. There are more persons that do not make prepayments, fewer persons are subject to monthly prepayments, tax administration costs are reduced. This leads to the transfer of revenue from the current to the next financial year on a cash basis, which represents a one-off reduction by BGN 90 million in the revenue from prepayments in 2013.

In addition to the discretionary measures related to legislative amendments, the amount of revenue from this group of taxes for the period 2013-2016 depends on some other factors such as: the macroeconomic developments; the high level of tax loss generated in 2009-2010 which the companies may deduct in the next five years; the exports of export-oriented enterprises; the prices of imported raw materials and energy, the cost and the access to company lending, the level of productivity, the grey economy, etc.

### *Personal Income Taxes*

The estimate for the revenue under the Personal Income Tax Act (PITA) for 2013-2016 has been made upon preserving the single tax rate of 10% (with no income-tax-free threshold) for all taxpayers, except for the income from economic activities of sole owners for which the tax rate is 15%. The implications of the final tax of 10%, introduced on 1 January 2013, on the gross amount of deposit earnings of persons in commercial banks and branches of foreign banks established in an EU member or in another state which is a party to the European Economic Area Agreement are also taken into account. The income is considered to be earned as of the date of assessing the interest. As a type of final tax it is withheld and paid by the payer of the income, i.e. by the commercial banks. The current account earnings are not subject to final tax. The direct effect of this amendment for 2013 is estimated at BGN 132 million.

### *Value Added Tax (VAT) Law*

The forecast of the VAT revenue for 2013-2016, based on the assumption for preservation of the standard tax rate of 20% and the hotel accommodation rate of 9% and following the dynamics of the respective macroeconomic indicators, takes into account the effect of the measures taken to legalise the economy, the forthcoming changes to some excise duty rates, as well as the amendments to the Value Added Tax Act in connection with the alignment of national legislation with EU directives and the case law of the Court of Justice of the European Union. They refer to the EU requirements concerning the place of service delivery and the common VAT system in connection with the invoicing rules for supplies<sup>25</sup>. The budgetary implications for 2013 of the legislative amendments to the VAT Law, including the new excise duty rates, amount to BGN 10 million.

### *Excise Duties*

The planned increase of some excise duty rates in line with the agreed transition period for achievement of the minimum levels of Community excise duty rates<sup>26</sup> for the period 2013-2016 is given in the table below.

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<sup>25</sup> The purpose is to demarcate the member state whose invoicing rules are applied, to specify the information mentioned in the invoices so as to achieve more efficient control and equal treatment of cross-border and national supplies, as well as the invoicing

<sup>26</sup> The amendments to the Excise Duties and Tax Warehouses Law, effective as from 1 April 2013, update the excise duties in connection with the commitments for gradual increase of the excise duty for fuels until reaching the minimum EU levels of taxation.

Resulting from the increased rate of gas oil, there are conditions for an increase in the state budget revenue for 2013 by BGN 30 million. No budgetary implications are expected from the increased rate of kerosene, since it is mostly used for aircraft in international races and the excise duty paid is refunded to the persons in the period provided for in the Excise Duties and Tax Warehouses Act. Resulting from the increase in natural gas rates in 2014, a total of BGN 50 million are expected to be collected.

**Table 6: Changes in the excise duty rates in the period 2013-2016**

Excise duties		2012	2013	2014	2015	2016
Excise duty of gas oil	BGN/1000 l	630	645	645	645	645
Excise duty of kerosene	BGN/1000 l	630	645	645	645	645
Excise duty of natural gas used as motor fuel	BGN/GJ	0.85	0.85	5.1	5.1	5.1
Excise duty of natural gas used as heating fuel	BGN/GJ	0.10	0.10	0.6	0.6	0.6

Source: MF

## II. Measures for Improving Collection and Addressing Shadow Economy

### *National Revenue Agency (NRA)*

In order to improve the collection of tax and social insurance liabilities, NRA has undertaken several extremely important structural reforms. One of the key measures relates to the annual risk analysis and taking of adequate actions in the context of the problem areas identified. As a result of the introduction of the risk assessment system in 2008, there has been an improvement by 24% of the initial number of persons at risk. The active segmentation of persons by degree of risk will continue in the future through improving and expanding the scope of the automatic risk assessment.

NRA data show that the peak in VAT loss due to fraud reached in 2008 was followed by four consecutive years of a downward trend, as a result of which in 2012 the VAT loss due to fraud accounts for 44.9% of their size in 2008. The VAT registers mark all persons suspected for participation in VAT fraud as persons with a high degree of risk.

NRA authorities made 13,418 tax audits in 2012 which found additional liabilities totalling BGN 3.07 billion. As a result, the effectiveness of the audits has improved - the share of assessments for over BGN 10,000 has increased by almost 2 pps. In view of the higher priority of the risks related to the social insurance liabilities of persons, there is an increase in the share of audits and inspections of abiding by social insurance legislation.

A number of specific actions were taken in 2012 to improve the collection of overdue public receivables (campaigns and optimisation of enforcement processes). As a result of these actions, almost half (49.3%) of the new tax and social insurance liabilities overdue in 2012 were paid within the calendar year. This is by 9.2 pps more than the collection of new debts in 2011. The collection of liabilities whose deadline for voluntary payment expired has also been improved. The collected overdue public receivables transferred to the creditors are in 2012 by 9% (BGN 2.7 million) more than those in 2011.

In addition to the above, NRA continues working on the refinement of the existing services and on the development and introduction of new electronic services. The introduction of a remote connection of fiscal devices to the NRA system has been launched in 2010. This is important for

the identification of the real turnover of traders, for the increase in the number of VAT-registered companies, etc.

### *National Customs Agency*

The establishment of the Bulgarian Excise Centralised Information System (BECIS) and the establishment of the Fuel Control Information System of NRA began last year. This enables the exchange of information and the real-time tracing of the movement of excise duty goods, imports and exports, as well as the correspondence between the excisable goods released and the goods really consumed, which will help to achieve a more effective control of the entire chain of excisable goods across the Republic of Bulgaria. An obligation is introduced for the persons to submit electronically the excise tax documents, debit/credit statements and documents of certification of purpose of the excisable goods to which reduced excise duty rates apply.

In order to ensure the effective control of the customs authorities and to improve the collection of more revenue from excise duties and VAT on import, the National Customs Agency has taken a number of measures starting with adoption of the Law Amending the Penal Procedure Code effective as from 1 January 2012 which expands the scope of investigation authorities in pre-trial proceedings and creates a status of the investigating customs inspector. As a result, 799 pre-trial proceedings were instituted in 2012 only.

The control of revenue administrations on the activities of excise duty warehouses and the systematic implementation of the measures pursuant to Ordinance No H-18/2006 on the Registration and Reporting of Sales in Retail Sites through Fiscal Devices and Ordinance No 3/2010 on the Specific Requirements and the Control of the Customs Authorities on the Tools for Measurement of Excisable Goods are expected to have a long-term disciplinary influence on the grey economy. As a whole, the effect from this in 2013 is estimated at around BGN 150 million. In addition, the trend of increasing the relative share of VAT proceeds in consumption is expected to be preserved and to reach 12.1% in 2013 against 11.5% in 2012. This ratio is an indicator of tax collection and shows the efficiency of revenue administrations. ▼

# 4. Sensitivity Analysis and Comparison with the Previous Update

## 4.1 Alternative scenarios and risks (deeper downturn of the European economy)

The baseline scenario of the economic development in Bulgaria is based on the assumption that EU GDP growth will turn slightly positive at 0.1% in 2013 and will accelerate to 1.6% in 2014<sup>27</sup>.

Downside risks for the European economy are still sizeable, which is also included in the winter forecast of the Commission published in February 2013. The strict fiscal restrictions, the need for structural reforms in the EU Member States experiencing financial difficulties and the high levels of public deficit and debt create risks for growing social unrest and increase the political and economic uncertainty. This in turn may have a negative impact on the recovery in the EU and in the euro area.

In the alternative scenario a further drop of the economic activity in the EU is expected to reach 1% in 2013 and a delay of the recovery for 2014, with a far lower growth, though. The devaluation of the euro against the dollar is expected to continue.

**Table 7: Comparison between the baseline and the alternative assumptions**

	2013		2014		2015		2016	
	Alternative scenario	Difference compared to the baseline scenario, pps	Alternative scenario	Difference compared to the baseline scenario, pps	Alternative scenario	Difference compared to the baseline scenario, pps	Alternative scenario	Difference compared to the baseline scenario, pps
EU GDP, (real growth, %)	-1.0	-1.1	0.5	-1.1	1.4	-0.5	2.0	0.0
USD/EUR Exchange rate, annual average	1.27	-0.08	1.35	0.0	1.35	0.0	1.35	0.0

Source: MF

With this slowdown of the economic activity in the EU, a substantial decline in the external demand is expected and a drop in the Bulgarian exports to EU Member States, respectively. Meanwhile, the recession in the EU will lead to depreciation of the single currency and competitiveness improvement against third countries. The expected growth of exports to non-EU

<sup>27</sup> See Table 1 of CP.

countries will not offset the drop in intra-Community trade, and the real growth of exports of goods from Bulgaria will contract by 0.6%. The deteriorated external environment and the slow recovery will affect the consumer confidence and the investment plans of enterprises. The final consumption growth will slow down compared to the baseline scenario, while investment in fixed capital will become negative again after the reported slow growth in 2012.

As a result, the GDP is expected to drop by 0.4% in real terms. The lack of imports of raw materials for export-oriented industries along with the limited growth of domestic demand will narrow the growth of imports of goods to 0.8% in real terms and 1.9% in nominal terms. With regard to services, a growth deceleration is expected for all items, but the net contribution of the article will remain positive. The influence on the income and current transfers balances will be negligible and as a result the trade balance will remain the key factor for the higher current account deficit. The balance of the current account is expected to reach -1.4% of GDP in 2013.

The slow recovery of the European economy in 2014 will affect positively the exports growth. At the same time, the continued slowdown of the domestic demand will act as a deterrent to the imports and its increase will be mostly driven by the supply of raw materials for the export production. The Bulgarian economy will register a small growth of 0.3% mostly due to the smaller negative contribution of net exports. A gradual recovery of the domestic demand is expected to take place from 2015 onwards, which will result in an accelerated import growth which will outpace that of the exports and will lead to a higher current account deficit.

In the context of significantly lower economic activity in the following three years compared to the baseline scenario, the key labour market indicators will also deteriorate. In 2013, the decline of the employment goes deeper, with the deviation from the baseline scenario being -0.8 pps. Unlike the baseline scenario, where a recovery and slow increase in the number of people employed is expected in 2014, the employment number in the alternative scenario drops on an annual base. A stabilisation of the labour market is expected as early as 2015, with the employment dynamics continuing to be slightly negative. The unemployment rate will thus register an increase in 2013 and 2014, and will become stable in 2015. A drop in the unemployment rate is expected in 2016 supported by the expected employment growth which is by 0.2 pps lower than the baseline scenario.

The expected further devaluation of the euro against the US dollar in 2013 will result in a greater increase of international prices in BGN terms compared to the baseline scenario. Thus the influence of external factors on domestic inflation dynamics will become stronger, though the expected substantially weaker economic activity in the country and the related deterioration of labour market conditions will limit the overall price increase. The effects from these assumptions will thus offset each other and the inflation will remain unchanged against the baseline scenario. End-of-period inflation will continue slowing down in 2014, while the average annual HICP will remain relatively low. As early as 2015-2016, the increase of domestic consumer prices will accelerate along with the expected stabilisation of the labour market and the gradual recovery of the domestic demand, but the average annual inflation will be lower than that in the baseline scenario.

**Table 8: Effects on the main macroeconomic indicators**

Indicators	2013		2014		2015		2016	
	Alternative scenario	Difference compared to the baseline scenario,	Alternative scenario	Difference compared to the baseline scenario,	Alternative scenario	Difference compared to the baseline scenario,	Alternative scenario	Difference compared to the baseline scenario,
Real GDP growth, %	-0.4	0.4	0.3	0.7	1.7	1.4	3.1	1.8
Final consumption, %	0.9	-0.7	0.8	-1.5	2.1	-1.2	3.7	-0.1
Gross fixed capital formation, %	-1.7	-2.6	-1.3	-3.6	2.5	-2.9	4.2	-1.9
Exports of goods and services, %	-0.5	-2.5	1.6	-2.2	2.9	-1.1	3.6	-0.5
Imports of goods and services, %	0.6	-2.0	1.7	-2.8	3.5	-1.6	4.6	-0.7
GDP deflator, %	2.0	0.0	2.1	-0.3	2.0	-0.2	2.0	-0.2
Current account balance, % of GDP	-1.4	-0.3	-2.3	0.2	-2.4	0.4	-2.8	0.6
Harmonised inflation, average annual, %	1.8	0.0	2.1	-0.6	2.0	-0.6	2.4	-0.2
Employed, %	-3.2	-0.8	-0.6	-0.9	-0.1	-0.7	0.8	-0.2
Unemployment rate, %	13.6	0.6	13.9	1.1	14.0	1.6	13.5	1.7

Source: MF

## 4.2 Sensitivity of budgetary projections to the alternative scenario

Domestic demand dynamics, particularly final consumption and imports of goods and services, have a considerable impact on the revenue side of the budget through the proceeds from indirect taxes. The estimated effect from the lower nominal growth of final consumption and imports of goods and services in comparison to the baseline scenario (by 0.7 and 2 pps respectively) would result in about BGN 80 million losses of proceeds from indirect taxes in 2013. The latter could be offset to some extent by the implemented and envisaged measures aimed at improving the collection of indirect tax revenue. In addition, the lower export growth (by 2.6 pps in nominal terms) reduces the amount of refundable VAT due.

Due to some lag effects, the difference of the forecasted parameters of the economic activity with the baseline scenario is most considerable in 2014, therefore the negative impact on the budget balance is strongest. The loss from indirect taxes for the revenue side of the budget reaches BGN 340 million. The drop in the investment activity in 2013 and 2014, combined with the deterioration of the key labour market indicators, will have a negative impact on the proceeds from direct taxes and social security contributions, as well as on some types of social payments. With the alternative scenario, revenue from income taxes and social security contributions are estimated to be lower by a total of around BGN 200 million in 2013 and by BGN 500 million in 2014.

Assuming the same nominal level of budget expenditure as in the baseline scenario and owing to lower proceeds from taxes and social security contributions, according to alternative scenario the budget deficit is expected to reach around 1.8% of GDP in 2013, 1.9% of GDP in 2014, while from 2015 onwards to resume the process of fiscal consolidation. It should be noted that despite the deterioration of the budget outturn due to the negative influence of the eco-

conomic factors, the budget deficit remains within the limit of the Public Finance Law<sup>28</sup> (2% of GDP on a cash basis).

### 4.3 Comparison with the previous programme

The revision of the medium-term macroeconomic forecast of the growth of the Bulgarian economy was required mostly because of the delayed recovery of the European economy. The previous Convergence Programme was drafted upon the assumption of EU GDP growth of 1.5% in 2013 in line with the autumn forecast of the European Commission from November 2011. For comparison, this Convergence Programme has been drafted with an expected growth of the European economy of 0.1% in 2013.<sup>29</sup>

The uncertainty related to the fiscal and financial stability of the euro area Member States continued in 2012 as well and was reflected in the slower than expected performance of the European economy. The weaker domestic demand in the EU, which is the key trading partner of Bulgaria, had a negative impact on Bulgarian exports. The global economy growth was also smaller than expected. The drop in metal prices, which account for a sizeable share in the Bulgarian exports, also contributed to the poor execution throughout the year. As a result, a drop in exports by 0.4% was reported in 2012 against the expected growth of 3.7% in real terms in the previous Convergence Programme. The recovery of EU domestic demand delayed for 2014 has led to a change in the forecast of the Bulgarian exports growth for 2013 by 2.2 pps. The deteriorated expectations for the external environment also led to a slowdown in the private consumption growth and to a weak domestic investment activity.

**Table 9: Main macroeconomic indicators**

Real growth rates, %	2012			2013			2014		
	CP 2013	CP 2012	Differ- ence, pps	CP 2013	CP 2012	Differ- ence, pps	CP 2013	CP 2012	Differ- ence, pps
GDP	0.8	1.4	-0.6	1.0	2.5	-1.5	1.8	3.5	-1.7
Private consump- tion	2.6	0.6	2.0	1.7	2.3	-0.7	2.7	3.9	-1.2
Gross fixed capital formation	0.8	7.1	-6.3	0.9	5.9	-5.0	2.4	7.3	-5.0
Exports of goods and services	-0.4	3.7	-4.1	2.0	4.2	-2.2	3.9	4.4	-0.6
Imports of goods and services	3.7	3.6	0.1	2.6	5.0	-2.4	4.4	5.8	-1.3

Source: MF



<sup>28</sup> Promulgated in SG, issue 15 from 15.02.2013, effective as from 01.01.2014.

<sup>29</sup> Winter forecast of the European Commission from February 2013.

# 5. Sustainability of Public Finances

## 5.1 Policy strategy

The current fiscal position guarantees the long-term sustainability of the policy and fully complies with the long-term budgetary restriction, according to which the present value of the structural primary balance shall cover the current government debt level. The test whether this condition is met is reflected in the sustainability indicators S1 and S2.

**Table 10: Comparison between sustainability indicators under the old and the new Programme scenario**

	Programme scenario 2012		Programme scenario 2013	
	S1	S2	S1	S2
Value	-2.61	0.02	-2.52	-0.26
of which:				
Initial budgetary position	-1.2	-0.79	-0.3	0.06
Debt ceiling in 2060	-1.46	-	-0.92	-
Future changes in the budgetary position	0.05	0.82	-1.31	-0.32

Source: MF

Both indicators, S1 and S2, reflect the difference between the Programme fiscal position in the long run and this position which ensures the sustainability of public finance. The difference between these indicators is that S1 monitors the observance of the Maastricht criterion for a government debt below 60% of GDP at the end of the period, i.e. 2060, while S2 is subject to the stricter condition for applying this budgetary limitation for an infinite period of time. The negative values of both indicators show that the current fiscal position as well as its planned adjustment in the long run, given the effects of the ageing population fully meet the requirement for budgetary sustainability. The literal interpretation of the S2 indicator means that the current structural primary budget balance may be reduced by the value of the indicator without deteriorating the sustainability of public finance in the long run. The primary balance levels in this analysis are adjusted to the phase of the economic cycle. The negative values of both indicators are due to the strong fiscal position with regard to the budget deficit and debt which are expected to be reached during the programming period. The reforms undertaken in the pension system as from the beginning of 2012 have resulted in decreasing the dependency of the budget on the expected long-term demographic changes and in improving the values of the S2 indicator of the stability of public finances.

## 5.2 Long-term budgetary prospects, including the implications of ageing populations (pension reform)

This part of the Convergence Programme is in line with specific recommendation 2 of the Council for acceleration of the pension reform in the Republic of Bulgaria.

### 1. Measures Aimed at Improving the Pension Adequacy:

- In 2013 pensions will be raised by of 9.3% on average as from 1 April 2013.
- The maximum amount of the newly granted pensions will be abolished as from 1 January 2014 and the maximum amount of the old pensions will be gradually increased;
- The accrual rate will increase from 1.1% to 1.2% as from 2017 for newly granted pensions;
- Upon acquiring entitlement to pension pursuant to Article 68, paragraphs 1 and 2 of the Social Insurance Code and regularly employed after the date of acquiring this right, without a pension being granted, the weight of each year of length of service in the pension system after that date is 3%, and 4% as from 1 January 2012.
- The social security contribution to universal pension funds in the second pillar of the pension system shall be increased from 5% to 7% as from 1 January 2017.

### 2. Measures Aimed at Improving the Financial Sustainability of the Pension System:

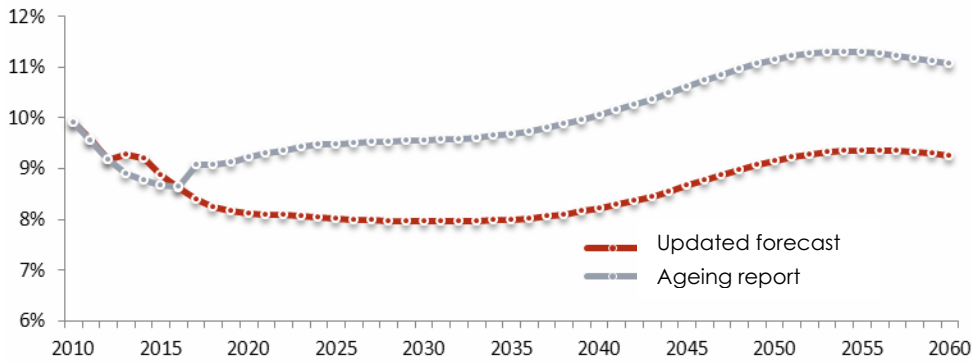
- From 2012 instead of 2021, the retirement age is increasing with 4 months each and every year, for both males and females and for all categories of workers, until the age of 65 years is reached for males in 2017 and the age of 63 years is reached for females in 2020;
- The length of service needed for acquiring entitlement to pension for professional military employees is increased by two years from 25 to 27 years; A minimum retirement age for professional military employees employed at the Ministry of Defence is introduced as from the beginning of 2013 - 52 years for sergeants, officer candidates and officers with junior officer ranks, and 54 years for officers with senior and higher officer ranks;
- From 2014 on, the pensions shall be indexed by the average increase of the consumer price index for the preceding calendar year, instead of the Golden "Swiss rule";

When preparing the pension expenditure projections, both the latest Eurostat demographic projections of EUROPOP 2010 and the macroeconomic forecast, developed by the Ageing Working Group (AWG) to the Economic Policy Committee of the European Commission in connection with the 2013 update of the pension fiche of the Republic of Bulgaria, have been used. The NSSI model for long-term forecasting of public pension expenditure was implemented.

Due to the ageing population in Bulgaria and the increasing life expectancy at birth and in view of the current amount of the social security contribution, the pension system will face a greater fiscal pressure to maintain an adequate level of pensions.

The figure below shows the estimated results in terms of the public pension expenditures as a share of GDP in the period 2010 – 2060 in line with the latest measures for acceleration of the pension reform and as reflected in the updated pension fiche.

**Figure 15: Estimated pension expenditures (relative share of GDP)**



Source: NSSI, MF

The estimated results included in the 2012 Ageing Report<sup>30</sup> have shown an accelerated rate of increasing public pension expenditures which grow from 9.9% of GDP in 2010 to 11.1% of GDP in 2060. The new results on the basis of the reforms undertaken and the latest amendments to pension legislation show a constraint of pension expenditure as a share of GDP. Thus, till 2030 the expenditures decrease to 7.95% of GDP, while the value of this indicator increases to 9.3% at the end of the forecasting period, or 1.8 pps less than the figures specified in the above report. The change in the pension indexation rule (an increase by the consumer price index as from 2014 rather than following the Golden Swiss rule, i.e. 50% of the growth of the average contributory income + 50% of the growth of the consumer price index) has the greatest contribution to this reduction, followed by the effects from accelerating the increase in the statutory retirement age (which started in 2012 instead of 2021).

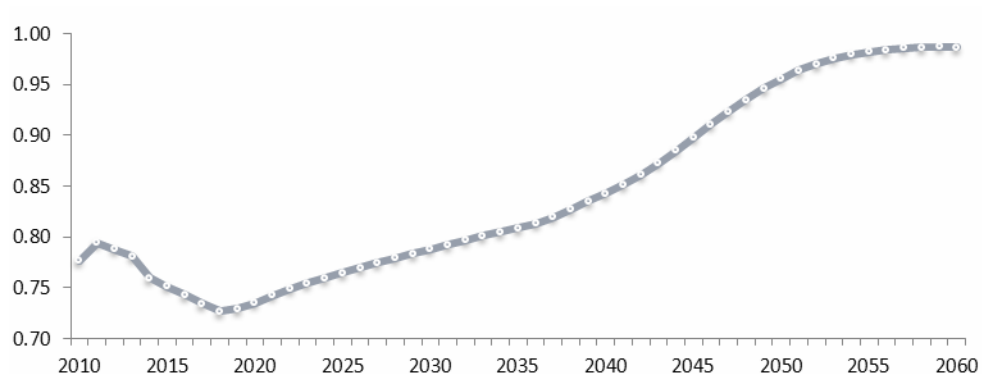
Pension expenditures at the end of 2012 accounted for 9.3% of GDP. Pension expenditures as percentage of GDP decrease in the period up to 2030, with the lowest values expected between 2030 and 2035. The main reasons behind this decrease are the reduction in the number of pensioners and the indexations of pensions by using the consumer price index only as from 2014. After 2035 the impact of the ageing population and the reduced number of working age people due to the low birth rate becomes more tangible and the pension expenditures as a percentage of GDP begin to grow until reaching 9.3% in 2060.

The ageing population and the increasing life expectancy, on the one hand, and the decreasing number of working age population, on the other hand, significantly affect the public social security system in the long term. 100 socially insured individuals corresponded to 78 pensioners in 2010. There is an improvement in the dependency ratio in the next couple of years<sup>31</sup>, because of the projected lower number of newly granted pensions in those years due to the increase in the retirement age and in the length of service, the limitation of early retirement, as well as due to the existence of incentives for longer presence of older workers on the labour market. There is an upward trend of the dependency ratio after 2020 due to the ageing population, the growing average life expectancy and the decreasing number of employed persons, while it will reach 98.6% in 2060.

<sup>30</sup> "The 2012 Ageing Report"

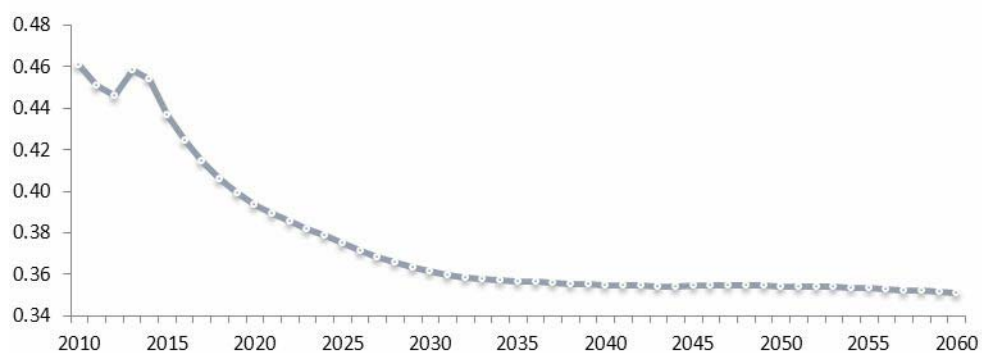
<sup>31</sup> The ratio between the number of pensioners and the number of socially insured people, also known as dependency ratio, is a key indicator for the financial status of the pay-as-you-go pension schemes.

**Figure 16: Number of pensioners to number of socially insured individuals (dependency ratio) 2010-2060**



Source: NSSI

**Figure 17: Average pension to average contributory income (replacement rate) 2010-2060**



Source: NSSI

The upward trend of the dependency ratio is accompanied by a long-term downward trend of the replacement rate<sup>32</sup>. The replacement rates for the first pillar are expected to decline due to the gradual linking of the amount of the pension with the personal social security contribution over the whole working life, not only in the last years. Another reason for the lower replacement rate for the first pillar in the long term is the decrease in the amount of the first-pillar pension for the individuals insured in the second pillar as well. The amount of this decrease depends on the insurance period in both pillars and the amount of the social security contribution, which is transferred from the first to the second pillar.

The replacement rate is affected most strongly by the transition from annual indexation of pensions using 50% of the consumer price index and 50% of the increase of the average contributory income over the previous year to an indexation only equal to inflation.

In the long term, factors such as an increased average life expectancy, ageing population and a reduced number of employed persons would exert an increasingly stronger impact on the public pension system and put a challenge on the financial stability of the Bulgarian social security system. At the same time, the indexation of pensions by using the consumer price index only and the reduction in the amount of the public pensions, given the participation in the

<sup>32</sup> The ratio between the average pension and the average contributory income.

second pension pillar lead to a sizeable drop in the first-pillar replacement rate. The three-pillar pension model favours the improvement in the replacement rate. The future adequacy of pensions, in this sense, would largely depend on the extent to which the second and the third pillar would be able to improve the income of the future pensioners.

### 5.3 Contingent liabilities

Government guarantees are inherently a contingent liability of the government and there is the risk for them not to be realised in time, therefore it is important to take account of the potential risk for their activation. In this context and in view of applying a conservative approach to the assuming of new contingent liabilities, the Public Finance Law imposes a total ban on SSF and on the entities outside the scope of the state budget to issue government guarantees. The Law also keeps the limitation for municipalities according to which the nominal value of the municipal guarantees issued in the respective year must not exceed 5 per cent of the sum total of municipal revenues and the general equalising subsidy under the latest annual report on budget execution of the respective municipality.

The forecast of the level of the government guaranteed debt of the General Government in the period under consideration plans a reduction in absolute terms and as a share of GDP. These values for 2012 and 2013 are expected to remain at a level of 1.3% of GDP, while for the period 2014-2016 they are expected to drop down to 0.7% due to gradual repayment of the government guaranteed loans undertaken by beneficiaries.

The deteriorated financial status of the national railway company BDZ Holding single member JSC does not have a substantial impact on state budget expenditure, since the residual amount of the government guaranteed debt of the holding is BGN 3.1 million (EUR 1.6 million) in 2012, while the government guaranteed loan expires in June 2015. In accordance with Eurostat requirements, the residual amount of the government guaranteed debt of BDZ Holding single member JSC has been re-classified as part of the General Government debt.

All other government guaranteed loans are serviced in line with the agreed timetables and payment schedules. ▼

# 6. Quality of Public Finances



## 6.1 Policy strategy

The medium-term budget forecast for the period 2014-2016 was developed following a baseline scenario for policy development, which to a large extent predetermines the composition, effectiveness and efficiency of expenditure. Regardless of this predetermination with respect to the technical efficiency, with the new Public Finance Law Bulgaria makes a serious step towards a refinement of the national system for public finance management.

The budget forecast for the period 2014-2016 and the draft State Budget Law for 2014 are the first papers to be drafted in line with the Public Finance Law which is to become effective as from the start of next year.

The elements in the new medium-term budget framework aim to enhance the sustainability of the medium-term solutions by means of clear-cut limitations and responsibilities of the individual sub-sectors of the General Government, as well as to enhance the role of the top-down approach in the process of prioritising and taking of budgetary and governance decisions.

The main short-term challenge to the system will be to make the two elements of the framework operational, i.e. to determine the maximum size of the expenditure commitments and the maximum size of the new obligations for expenditures that could be incurred during the year by the first-level spending units. It should be noted that their linking to the policy objectives as well as to the target values of the performance indicators of the programme budgets of ministries and state agencies in the medium term will contribute to enhancing the predictability, hence to the greater sustainability of the decisions taken. In the long run, this will contribute to enhancing the allocation efficiency, as well as to strengthening the budget discipline.

The broader scope of fiscal rules, the meeting of which will be ensured by the fiscal and budgetary parameters of the current medium-term budget forecast, enhances the financial discipline on the sub-sectoral level as well as on the level of the General Government sector.

The efforts are currently targeted at the establishment of an independent body within the meaning of Article 6 of Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, thereby observing the provision of § 18 of the Transitional and Final Provisions of the Public Finance Law.

During the reference period of the Convergence Programme the tax policy will be aimed to support the macroeconomic stability and the economic growth, to improve budget performance and to enhance the fiscal sustainability in the long term. The tax and social insurance policy and the effective actions of the revenue administrations aim to ensure the resources needed for implementation of the government's fiscal policy, to improve the business climate and to stimulate the economic activity, to limit tax fraud and decrease the grey economy. These measures will contribute to maintaining the trust of foreign investors in the Bulgarian economy.

Tax policy development in this period complies with the requirements of the European Union law in force, as well as with the international agreements whereto the Republic of Bulgaria is a party. Bulgarian tax legislation has been fully aligned with EU legislation, as regulated by the directives in the area of direct and indirect taxation, as well as in the area of international co-operation and exchange of information among the Member States.

The taxation strategy aimed at lower direct tax rates as one of the most important incentives for investment and economic growth has been preserved. There is an ongoing process of shifting the tax burden from direct to indirect taxes through the increase in some of the excise duty rates in line with the commitments taken to achieve the minimum European levels.

## 6.2 Composition, efficiency and effectiveness of expenditure (analysis of expenditure based on the COFOG methodology)

**Table 11: Budget expenditure by function**

	% of GDP			% of the total budget expenditure		
	2011	2016	EU27 2011	2011	2016	EU27 2011
1. General public services	3.9	4.3	6.6	10.8	11.9	13.4
2. Defence	1.3	1.1	1.5	3.5	3.0	3.1
3. Public order and safety	2.5	2.3	1.9	7.1	6.3	3.9
4. Economic activities	4.2	5.7	4.0	11.8	15.7	8.1
5. Environmental protection	0.7	0.9	0.9	2.1	2.5	1.8
6. Housing and community amenities	1.2	1.5	0.9	3.4	4.1	1.8
7. Health	4.6	4.0	7.3	12.9	11.0	14.9
8. Recreation, culture and religion	0.7	0.6	1.1	2.1	1.7	2.2
9. Education	3.6	3.4	5.3	10.2	9.4	10.8
10. Social protection	12.9	12.5	19.6	36.2	34.4	39.9
11. Total expenditure	35.6	36.3	49.1	100	100	100

Source: Eurostat, MF

Bulgarian budget expenditures report a drop by 6 pps of GDP, which is the third biggest drop in the EU, in the period 2009-2011. Bulgarian expenditures in 2011 were therefore the lowest ones in the EU (35.6% of GDP) and are expected to grow by just 0.9 pps. The expenditures reported in 2012 accounted for 35.7% of GDP, which is close to the level of 2011.

- The expenditures for the "General public services" function are one of the largest expenditure items. It includes the maintenance expenditure of the judiciary and of other government institutions, the R&D expenditure, etc. There is a sizeable drop here from 2009 to 2011 - from over 7% down to 3.9% of GDP. This drop is mostly due to the reduction in the maintenance expenditure of government institutions from 5.9% of GDP to 2.8% of GDP. The expenditure for basic research remains at 0.3% of GDP, which is in line with the average expenditure for this item in the other EU Member States. The expenditure for general government activities are expected to grow slightly by around 0.4 pps in the medium term.

- The defence expenditure of Bulgaria reached 1.3% of GDP in 2011, which is the lowest value thus far. This trend will be preserved until 2016 when the defence expenditure will be 1.1% of GDP, or 3.0% of all budget expenditure.
- The security expenditure also reports a drop down to 2.5% of GDP in 2011. This level remains comparatively high, though, as EU Member States allocated an average of 1.9% of GDP for security in 2011 against 2.5% of GDP in Bulgaria. In the medium term these expenditures will continue to decrease, but will remain relatively high as a share of GDP and of the total budget expenditure.
- The expenditures for economic activities such as agriculture, transport, communications and energy are higher than the EU average, but are similar to the levels in the states with close income levels. Bulgarian expenditures in this area are mostly allocated for transport (2.9% of GDP). 0.5% of GDP is allocated for agriculture. These expenditures will continue having a sizeable and growing share in the Bulgarian budget until 2016, which will be mostly due to the growing significance of EU funds and the related national co-financing.
- Bulgarian public healthcare expenditures as a share of GDP are not high compared to the EU average, but their growth rate is highest in comparison with the other EU Member States in the period 2007-2011. At the end of 2011 public healthcare expenditures as a share of GDP per capita are relatively high compared to those in the other EU Member States. The overall trend for these expenditures is that they will drop across the EU. Healthcare expenditures in Bulgaria in the medium run will drop slightly as a result of the implementation of a number of measures aimed at optimisation of costs and greater efficiency.
- The education expenditures in Bulgaria have registered a slight drop in recent years, remaining far below the EU average. There is a substantial difference in the funds for pre-school and school education for which 0.7% of GDP are allocated and they remain relatively constant over the years. Education expenditure in Bulgaria as a share of the total budget expenditure is currently relevant to the EU average level.
- Environmental protection expenditure in Bulgaria account for 0.7% of GDP and this is close to the EU average.
- Social expenditure account for the greatest share of expenditures by function. They are far lower than the EU average as a share of GDP but are quite similar to the EU12 levels varying between 12 and 14% of GDP. Bulgaria allocated 36.2% of its budget expenditure for this area, and this is close to the EU average of 39.9% in 2011. There are differences in the structure of these expenditures. 9.8% of GDP are allocated for pensions in Bulgaria, which is among the highest shares in the EU. The share of expenditures supporting families and children is 2.4% of GDP and is relatively similar to that in other EU Member States.

### 6.3 Structure and efficiency of revenue systems

#### — Institutional Changes and Legislative Amendments Related to Public Finances and Improving the Collection Rate of Tax Revenues

This part of the Programme outlines measures and policies largely addressing specific recommendation 1 of the Council, in particular revenue collection, fight against smuggling, tax crimes, informal economy, etc.

## *Tax Policy and Legislation*

The major amendments to tax laws in the short and medium term are related to the refinement of tax legislation and removing any inconsistencies with EU law, including policy changes and amendments to EU legislation.

The new amendments to the Value Added Tax Act are connected to the need for alignment of Bulgarian tax legislation with the requirements of EU directives and the judgements of the Court of Justice of the European Union in the area of indirect taxation, as well as to the need for making precise the provisions that create difficulties for the practical implementation of the Law. The amendments to the Excise Duties and Tax Warehouses Act are related to the commitments for achieving the minimum EU levels of excise duties for certain products, as well as to make precise the provisions in order to facilitate the practical implementation of the Law. In accordance with Chapter 10 "Taxation" of the Treaty of Accession of the Republic of Bulgaria to the EU, a transition period has been negotiated by 1 January 2013 within which to achieve the minimum excise duty rates for gas oil and kerosene of EUR 330 /1,000 litres. (645 BGN /1000 litres).

The amendments to the Tax and Social Insurance Procedure Code, the Corporate Income Tax Act (CITA) and the Personal Income Tax Act (PITA) are related to the draft reduction in NRA bank accounts and the codes for the types of payment that individualise the type of tax or the mandatory social security contribution and are aimed at a considerable reduction in the costs of taxable persons for bank charges for the payment of their liabilities, as well as at a reduction in the errors made in this process. An order of liability payment is thus introduced on the basis of the maturity regardless of the manner of ascertaining, which aims to improve the collection of overdue liabilities.

Another group of amendments to CITA and PITA results in a decrease of the administrative burden through a reduction in the costs for payment of tax liabilities by the taxable persons. The regime of declaration and payment of corporate taxes and personal income taxes is simplified enormously. A new order for determination of corporate tax prepayments has been introduced on the basis of the estimated tax profit as declared by the taxable person. Amendments to CITA have been made with regard to the taxation of gambling in connection with the new Gambling Law to the provisions regulating the gambling tax, including regulation of the taxation of the activities performed by the organisers of remote gambling. The scope of the tax-free income under PITA has been narrowed. As of 1 January 2013, it excludes the deposit earnings of persons in commercial banks and branches of foreign banks established in a member state of the European Union or in another state which is a party to the European Economic Area Agreement are also taken into account.

## *NRA*

The effective and efficient collection of taxes and social security contributions and the encouragement of voluntary compliance are a key priority and a strategic objective of NRA. The activities performed by the Agency in view of improving the level of compliance (including voluntary compliance) of the tax and social security liabilities of the persons may be divided into three main directions:

### **1) Management of the Risks for a Failure to Comply with Tax and Social Insurance Legislation**

In 2008 the National Revenue Agency launched the introduction of a system for management of the risks for a failure to comply with the tax and social insurance legislation which is mostly aimed at directing the available administrative resources to those priority risks that threaten the compliance. The system uses a single approach to risk management and prevention re-

ardless of the process in which they appear, i.e. registration, filing of returns, tax and social insurance control, repayment of liabilities.

Every year NRA prioritises the risks by the degree of importance. A **Compliance and Risk Minimisation Programme** has been drafted every year since 2009 which, on the basis of this prioritisation, plans all the measures (by type, volume and timing) to be taken the following year in order to minimise the risks. The type of the measures for risk treatment in the programme is selected depending on the type of behaviour of the treated persons at risk, while planning a greater number of "enforcement" measures such as audits and inspections for those who deliberately make default; concerning the treatment of persons whose risky behaviour is due to the lack of knowledge of or failure to comply with the rules, the measures are rather "communication" ones, i.e. information campaigns, brochures, phone calls, notices, etc. The so-called "dissuasive" measures are applied in the case of risks reflected in a greater number of persons. Such a measure is, for instance, the remote connection between the fiscal devices and the NRA, which not only facilitates the control of the failure to report retail sales but has a very good dissuasive impact on the behaviour of the persons at risk and, as a whole, contributes to reducing the share of grey economy in the country.

The use of the risk management system since the year of first prioritisation has resulted in 84% reduction of the original damages as follows:

- reduction of damages resulting from economic conditions – 17 pps, which accounts for 20% of the change;
- reduction of damages resulting from treatment – 67 pps, which accounts for 80% of the change.

The Compliance and Risk Minimisation Programme for 2013 includes the treatment of risks in the following areas:

- Concealing turnover (grey economy);
- Failure to pay the social insurance liabilities;
- VAT fraud;
- Any other risks not covered by the programmes thus far.

## **2) Improvement of the Quality of Services and Enhancement of the Tax and Social Insurance Culture**

The increase in the number and the use of e-services and the signing of an agreement with the National Statistical Institute for the submission of the annual reports on NRA activities in either organisation save 600,000 visits of the taxpayers to the NRA offices a year. The on-line submission of returns has doubled since 2009 and for some of the types of returns is already almost 100%.

### **E-services Realised and Introduced in 2012**

In 2012 NRA started granting a PIC (personal identification code) to the persons for requesting and using the new services that require a PIC. The personal identification code ensures a reliable identification of the persons when using e-services without an electronic signature (QES). There are PIC services for natural persons (inquiry about the actual status of all employment contracts; inquiry about the insurance income; inquiry about the personal batch with the mandatory supplementary pension insurance; filing a request about the issuance of documents; inquiry about the liabilities of persons from their tax and social insurance account) and for legal persons (inquiry about the actual status of employment contracts; filing a request about the issuance of documents to legal persons; inquiry about the liabilities of persons from their tax and social insurance account). In addition to that, the following QES services have

been introduced: submission of a request for VAT registration; submission of a request for VAT deregistration; submission of lists of the assets available as of the date of registration or of the services received before the date of VAT registration under Article 60, paragraph 5 of the Rules for Implementation of the Value Added Tax Act and submission of lists of goods and services received in connection with the succession under Article 10 of the Value Added Tax Act for which there is the right to deduct credit for input tax pursuant to Article 61, paragraph 1 of the Rules for Implementation of the Value Added Tax Act.

The introduction of e-services (including those related to the single account) is planned for 2013, as well as the broadening of the channels of communication with the NRA Call Centre.

### **Communication Measures**

A campaign was prepared jointly with the Ministry of Education, Youth and Science and launched in 2012 to acquaint pupils and young people with the tax and social security system. It aims to change the perception of young people about the payment of taxes and social security contributions. The campaign includes meetings with pupils aged 14-18 in 100 general schools of education in the 28 regional centres in Bulgaria, i.e. a total of 2 000 periods. The next stage is planned to be the development of the project "Taxes for Young People", which will introduce tax lessons in the official curriculum of secondary schools.

### **3) Enhancement of the Operational Efficiency, Including by Better Coordination and Interaction with Other Institutions**

The good cooperation among all law enforcement authorities continued in 2012 and a great progress was made in the coordination with the specialised prosecutor's office. In order to improve the effectiveness of collection of overdue receivables, measures have been taken to regulate a procedure and to effect an electronic exchange of data and documents with part of the commercial banks agreeing to such an exchange, with the Geodesy, Cartography and Cadastre Agency, with the Chamber of Private Bailiffs and with the public bailiffs.

From the end of 2010 to the end of March 2012 a remote connection between fiscal devices and NRA was gradually introduced. As of the end of 2012, a total of 368,724 fiscal devices were registered in NRA. The following groups of taxable persons were connected to the NRA servers by the end of 2012:

1. Traders in liquid fuels (by 31 December 2010);
2. The persons registered under the VAT Law:
  - 2.1. Retail traders in medicinal products in pharmacies and drug stores in accordance with the Medicinal Products in Human Medicine Law (by 31 August 2011);
  - 2.2. Traders in grain registered under the Grain Storage and Grain Trade Law (by 30 November 2011);
3. Any other persons outside the above groups (by 31 March 2012);
4. In addition to the remote connection and given the specifics of the goods and services offered, the sales of vending machines were regulated (by 31 October 2012).
5. The traders in liquid fuels were also obliged to connect the measuring systems in the sites for trading in liquid fuels to the remote connection in order to submit data enabling to measure the quantities of fuel available in reservoirs (by 31 March 2013).

Two other sectors, i.e. transport by road and the so-called "company petrol stations", are to be connected in 2013.

1. The persons delivering transport services along provincial and international bus lines (by 3 April 2013);
2. The persons delivering transport services along urban lines (by 31 December 2013);
3. The so-called "company petrol stations" (including the installation of level indicators) (by 31 March 2013).

By introducing the remote connection, NRA receives information about the real turnover of business sites on the basis of the fiscal devices operating therein. The positive effects are manifested in the following aspects:

- Ascertaining the traders' real turnover;
- Increasing the size of the turnover reported – after a seasonal data review, the estimated effect of the introduction of the remote connection is a 4.8% increase in the VAT tax base in the months following the introduction of the connection compared to the time before that;
- Increasing the tax base for assessment and payment of taxes;
- Increasing the number of VAT-registered persons;
- Enhancing the preventive supervision of sites at risk;
- Improving the selection and directing the actions of control mostly towards business sites at risk - before the introduction just 20% of all inspections were made of high-risk sites, while after its introduction in the summer of 2012 the share of selected high-risk sites reached 35% with using the information received from the remote connection with fiscal devices;
- Improving the financial and tax compliance of taxable persons towards a reduction in the share of grey economy;
- Decreasing the number of direct contact between traders and controlling bodies, with inspections mostly made on the basis of the information received by NRA, with the exception of the cases where data analysis shows differences that require specification by means of an on-site inspection.

The business selling liquid fuels are one the first to connect their fiscal devices to NRA (some of them did it as far back as at the end 2010). As from the start of 2012 and in accordance with the legislative amendments, they were obliged to submit to NRA information not only about their turnover, but about the quantities of fuels sold as well. These are the first two steps prior to the introduction of the Fuel Control Information System of NRA and of the Bulgarian Excise Centralised Information System (BECIS) of NCA in 2013. They aim to provide NRA with reliable and quick information about the trade in fuels and about the physical circulation of fuels so as to enable a further improvement in the control of the proper assessment and payment of VAT. After the introduction of the requirements for a remote connection between fiscal devices and NRA, a 30% growth of the turnover of retail traders in fuels is reported. Naturally, in addition to turnover legalisation, the changes in fuel prices and in consumption also contribute to this growth rate. In order to make an indirect estimation of the legalisation of turnover, one can compare the increase in the turnover of small and big petrol stations. The turnover data showing an almost 43% growth of the small traders in fuels, who are usually more risky, confirm the hypothesis that the remote connection between fiscal devices and NRA would have a positive influence on the legalisation of grey economy.

The amendments to Ordinance No H-18 of 2006 of MF on the setting up of a constant remote connection between the fiscal devices installed in the business sites of the taxable persons and a NRA server for the submission of turnover data will provide for a much more effective operational control manifested in:

- a reduction in the time needed by the inspection teams engaged in physical control to check and monitor the business sites of taxable persons – before the introduction of the remote connection, in order to find out the real turnover, the method of open monitoring of revenue authorities physically present at the inspected site between 3 and 7 days had been applied;
- monitoring and comparison of the turnover generated by similar business sites by: type, capacity, location and other parameters;
- a possibility to make an analysis of the information submitted to NRA and a selection of sites on the basis of different criteria (by type of business activity, by branch, for certain periods of time, etc.);
- finding substantial differences between the data submitted remotely and the reported turnover;
- automatic tracing of the daily turnover of selected fiscal devices by entering in the software the size of the turnover found out during the physical on-site monitoring;
- enhancing the protection of the turnover data against manipulation based on the possibility for exercising remote control of the registration of the sales made;
- a possibility for monitoring and analysis of the turnover before and after the operational checks;

NRA prepared some legislative amendments, which were passed and became effective in 2012, introducing the so-called **Single account for payment of taxes and social security contributions** with the following main characteristic features:

- As from 1 January 2013, taxes and social security contributions will be paid to a single bank account, without any codes for type of payment and without specification of the type of payment, the grounds for payment, the period, etc., i.e. the number of payment orders to NRA is substantially reduced (the expectations are for BGN 50 million of taxpayer savings for bank charges from the reduction in the number of the payment orders to the budget by over 50%), as well as the errors made and the need for specification thereof.
- Payments are automatically distributed depending on the dates of voluntary payment of all liabilities, as reflected in the individual tax and social security account of each client, whether natural or legal person, i.e. a new order of liability payment is established by the order of the maturity of the relevant liability, which galvanises the payment of old liabilities and allows to pay all old liabilities by a single payment order and to pre-pay any future liabilities.
- As from 1 January 2013, the default interest due for unpaid tax and social security liabilities is standardised, i.e. 10% plus the basic interest rate of BNB.
- Access to a new e-service for on-line access to all liabilities by using PIC only (without electronic signature) in connection to the launch of the Single account.
- Reduction in the frequency (number) of filing tax and insurance returns to NRA:
  - a) The deadline for submission of returns (25th day of the month following the rendering of service) is standardised - there were various hypotheses thus far and various deadlines for each hypothesis, which often led to violations;
  - b) Shift from monthly to quarterly declaration of CITA taxes for 42.6 thousand persons;
  - c) Shift from quarterly to annual declaration of taxes for 14.0 thousand persons;
- Another positive influence of this introduction is the reduction in the number of errors made by taxable persons and commercial banks resulting from the numerous codes

for type of payment and the different bank accounts for taxes and social security contributions. This benefits both the NRA administration and its clients for it results in a reduction in the number of requests for corrections submitted by the persons in case of any errors they have made and in a further reduction in the payment documents for correction of the incorrect payments.

The successful cooperation between NRA and the revenue administrations of the other EU Member States in the area of joint actions of control aimed at fighting tax fraud and avoidance of double taxation continued in 2012. NRA auditors have taken part in two projects for multi-lateral audits with counterparts from Germany, Denmark, Latvia and Sweden. A project connected to a proposal of the Bulgarian administration for joint actions of control with the tax administrations of Germany and Italy is also under way.

### *Customs Agency*

In 2012 the Customs Agency and the National Revenue Agency (NRA) launched a joint project for setting up of a Bulgarian excise centralized information system (BECIS) and for setting up of a "Control of fuel" information system for NRA which will enable electronic exchange of information between the revenue agencies. The purpose of BECIS is to improve control on and collection of excise duty and VAT as well as to ensure equality among economic operators. The system will create a real possibility for exchange of data between the information systems of the NRA and the Customs Agency in view of minimizing the risk of fraud. The introduction of permanent control on excisable goods' movement on the territory of the country will contribute to largely solving the problem of establishing the actual recipients of excisable goods as well as to exercising control of greater quality on the reported in documents and actually sold quantities of excisable goods throughout the chain – from traders to final consumers.

**In view of the forthcoming implementation of BECIS the Law on Excise Duties and Tax Warehouses (EDTWA) was amended in 2012.** The amendments to the Law allow taxable persons to submit electronically applications, requests, notifications, reports on the excise labels. It is provided for to validate a paper document, containing the data of the electronic administrative document, in case of extraordinary circumstances, when the information system of the National Customs Agency is unavailable. A certain time limit is set, in which persons are to submit electronically the documents issued within that period.

The scope of persons subject to compulsory registration under the Law has been extended, and in view of the introduced different excise duty rates depending on the consumption purpose of natural gas the Law defines the terms gas for "household purposes" and "industrial purposes".

Some definitions in the Law have been made more precise which leads to unification of the terms and avoidance of their conflicting interpretation. EDTWA also includes other amendments referring to the application of the European provisions on the control and movement of excisable goods.

For example, Article 126b includes new paragraph 2 according to which any ticket the fine whereunder is not voluntarily paid within 7 days is considered effective penal order. The provision aims to stimulate the voluntary execution of the penalty and in case the fee is not paid then forced execution is applied.

The obligation for registration under this Act of the persons who sell natural gas used as motor fuel only has been dropped out. The purpose is to relieve the persons performing sale of natural gas used only as motor fuel and thus they will purchase the energy product with paid excise tax.

There is a new additional requisite in the excise tax document under Article 85 of EDTWA where the legal grounds for exemption from excise duty should be filled in which would lead to greater clarity in the application of the legal framework for the purpose of excise duty exemption. The requisites of the excise tax document under Article 84, paragraph 6 of EDTWA have been complemented.

The new revision of the terms of "suspensive arrangement or customs-approved treatment or use" and "import of excisable goods" aims to achieve full compatibility with the terms introduced by Directive 2008/118/EC concerning the general arrangements for excise duty.

**In connection with the forthcoming implementation of BECIS amendments were made to Ordinance No 3 on the Specific Requirements and Control Exercised by the Customs Authorities over Measuring Instruments of Excisable Goods.**

The amendments to Ordinance № 3 have been developed in conjunction with the Law Amending the EDTWA, effective from 1 January 2012, with on 1 June 2012 new excise duty rates for natural gas depending on its consumption purpose - for business and household purposes and for motor fuel was introduced with. Due to the different rates on natural gas and in connection with the control exercised by the customs authorities, the persons under Article 57a of EDTWA need to report the quantities depending on the utilization purpose of the natural gas.

The amendments are effective from 31.03.2013 because BECIS should be implemented from 01.04.2013 and thus the persons will have enough time to adapt their activities regarding to the transmission of data electronically from the measuring and controlling devices to the automated system for reporting by the persons as well as to the information system of the Customs Agency. The system will ensure automation of the process of information exchange and more effective control on the overall chain of sale of excisable goods as well as the electronic exchange of information between the Customs Agency and the National Revenue Agency.

In order to further develop the idea connected with the setting up of BECIS, a draft has been prepared of Rules Amending and Supplementing the Rules for Implementation of the Excise Duties and Tax Warehouses Act (RIEDTWA) by setting in detail the administrative control and simplified procedures for economic operators.

The proposed changes in this direction will help to automate the process of exchange of information about and control on the overall chain in the sale of excisable goods as well as the exchange of information electronically between the two revenue agencies. The changes in EDTWA that have led to unification of terminology and avoidance of conflicting interpretations of the Law, are further developed with the draft Rules.

A revision has been proposed of the current formula in Article 58, Paragraph 3 of the Rules on Implementation of EDTWA for calculating the amount of collateral in order to avoid conflicts when determining the collateral for the amount of the excise duty.

In order to unify the practices the creation of a new Article 79b has been proposed, which is to regulate the requirements to the functional characteristics of the automated system of reporting by taxable persons. The amendments to Article 80 regulate the procedure for issuance of registered electronic excise tax documents and cancellation of incorrectly prepared registered electronic documents.

In connection to the provision of Article 103a of EDTWA there is a new requirement the authorized warehouse keepers to provide electronically data on the unique identifier of the control point and transaction number prior to starting any movement under excise duty suspension arrangement with an electronic administrative document. On receipt of excisable goods under excise duty suspension arrangement, the recipient on the territory of the country is required

simultaneously with the filing of a notice of receipt to provide to the competent customs office information about the unique identifier of the control point and transaction number electronically.

Measures have been taken for upgrading and purchasing of new equipment for the purposes of customs control. In 2012 two of the existing X-ray systems located at the external land borders of the EU were upgraded. Purchased were two stationary systems for container scanning for the port complexes in Varna and Burgas; supplied were six high-energy mobile x-ray systems to cover the whole customs territory of the country; purchased were ten specialized vans for the purposes of the customs intelligence and investigation in connection with the activity of investigating customs inspectors; purchased were thirty new off-road vehicles for the needs of the operational control at the regional customs offices.

The Act on Forfeiture to the Exchequer of Unlawfully Acquired Assets was adopted In 2012. According to Article 30, Paragraph 1 of that Law in view of the achievement of the purpose of the Law the prosecution office, the Ministry of Interior, State Agency "National Security", the National Revenue Agency and the National Customs Agency, in accordance with their competence, make checks of the sources for the acquisition of the property.

In 2012 a new sample of Declaration of Cash, approved by an order of the Minister of Finance, was prepared, to be applied from 01.01.2013. Its introduction leads to harmonization of the procedure for declaration of cash in excess of EUR 10 000 or its equivalent in another currency upon entering/ leaving the territory of the EU. ▼

# 7. Institutional Features of Public Finances

In the beginning of 2012 some amendments to the Organic Budget Law entered into force, which institutionalized the national fiscal rules, introducing restrictions on the amount of expenditures under the consolidated fiscal programme to 40% of GDP and of the deficit under it to 2% of GDP. The effect of these rules is in support of the striving for a balanced budget position on a consolidated level in the medium term, while providing a cushion to meet the reference value for the budget deficit under the Stability and Growth Pact.

In 2012 the Ministry of Finance significantly accelerated its work on developing a new Organic Budget Law. The Public Finance Law adopted at the end of January 2013 is an expression of the government's intentions for a comprehensive reform of the medium-term budgetary framework. It transposes Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States and creates conditions for implementation of the new rules for reinforced economic governance in the EU, adopted in late 2011. The Law also introduces a framework connected with the provisions of Title III ("Fiscal Compact") of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union signed on 2 March 2012 in Brussels.

The Public Finance Law provides the medium-term budgetary framework with the central place in the national system of public finance management and institutionalizes it as a real tool for medium-term forecasting and planning, placing it in the competence and under the responsibility of central and local government.

The Public Finance Law strengthens the interaction between the legislative, executive and judicial powers and municipalities to conduct prudent fiscal policy while complying with the reference values for budget deficit and the amount of consolidated debt established for the EU Member States with the Maastricht criteria. Expansion of the interaction between them, particularly in terms of their contribution to the observance of the general restrictions and the achievement of the objectives of the fiscal rules for the general government sector is provided while respecting the autonomous nature of their budgets.

The Public Finance Law contains provisions for enhanced budgetary transparency and publicity and creates preconditions for increasing access to budgetary information as well as for improving the quality and range of the latter.

The Public Finance Law also institutionalizes comprehensive, consistent and reliable practices for forecasting and monitoring of the sub-sectors of the general government sector. Summarized are also the national fiscal rules – on the balance of the general government sector, on the budget balance under the consolidated fiscal programme on a cash basis, on the maximum amount of the expenditures under the consolidated fiscal program, on the nominal amount of the consolidated debt of the general government sector.

Maintaining strict budgetary discipline continues to be government priority by means of exercising strengthened expenditure control, especially on the stage of budget execution. This

approach is supported by the rule for approval by the National Assembly in the annual budget law of the maximum admissible amount of spending units' liabilities as of the end of the year. The Public Finance Law contains provisions which envisage that the indicators for the maximum amount of commitments for expenditures and for the maximum amount of the new liabilities for expenditures that may be incurred during the year by first-level spending units are part of the indicators under the budgets of first-level spending units, which are approved with the annual budget law. The Public Finance Law envisages that the state budget law may also determine limits for personnel costs under the budgets of first-level spending units whose budgets are part of the state budget.

In 2013 the efforts of the Ministry of Finance are oriented towards implementing the Council Recommendation of 10 July 2012 on the National Reform Programme 2012 of the Republic of Bulgaria and the Council Opinion on the Convergence Programme (2012–2015) of the Republic of Bulgaria.

A serious challenge this year is to organize the preparation for the implementation of the Public Finance Law, which will repeal, from 2014, the current Organic Budget Law and the Law on Municipal Budgets.

Other important areas in the efforts to improve financial management and accountability practices will include further development of reporting on an accrual basis in state-owned enterprises and municipalities, as well as the provided in the 2014 budgetary procedure different types of assessments and estimates for maximum amounts of expenditure commitments and for maximum amounts of the new liabilities for expenditures that may be incurred and accordingly accrued during the year by first-level spending units.

## **7.1 National budgetary rules**

Since the beginning of 2012, with the entry into force of the amendments to the Organic Budget Law, Bulgaria applies three types of fiscal rules – regarding balance, expenditures and debt. The first two are included in the Organic Budget Law, and the third one – in the Government Debt Act and the Municipal Debt Act.

The budget balance rule sets a ceiling on the deficit under the consolidated fiscal programme on a cash basis as a percentage of GDP. If the budget balance under the consolidated fiscal programme is a deficit, it may not exceed 2 percent of the gross domestic product.

The expenditure rule sets a ceiling on the expenditure under the consolidated fiscal programme as a percentage of GDP. It may not exceed 40 percent of the projected gross domestic product.

In 2010 an additional rule for approval with the annual law on the state budget of maximum admissible amounts of spending units' liabilities, as well as specific rules on changes in the liabilities' amount and on making compensated changes were introduced.

According to the rule on the debt ceiling, defined in the Government Debt Act, the ratio of the outstanding consolidated government debt as at the end of each year to the projected GDP may not exceed the previous year ratio, until this ratio is above 60 percent. The consolidated government debt comprises the nominal values of the government debt, the municipal debt and the debt of the social security funds.

At local government level the debt rule is supported by rules setting limits on the maximum annual amount of debt payments and on the nominal value of issued municipal guarantees. Pursuant to the rule, the annual amount of debt payments during each year may not exceed 15 percent of the total amount of own revenues and the general equalization subsidy in the

latest certified annual report on the execution of the municipal budget. The second rule states that the nominal value of issued municipal guarantees may not exceed 5 percent of the total amount of own revenues and the general equalization subsidy in the latest certified annual report on the execution of the municipal budget.

Chapter Two of the new Public Finance Law contains the fiscal rules which, from the beginning of 2014, will extend the scope of the existing rules and will impose additional and strengthened restrictions on the fiscal policy in the long run. The rules are consistent with the internationally accepted definitions and criteria as well as with the requirements for coordination of national fiscal planning with the preventive and corrective arms of the Stability and Growth Pact.

The Public Finance Law preserves the structure of three fiscal rules (balance, debt and expenditure) on a cash basis – on the budget balance and the maximum amount of expenditures under the consolidated fiscal programme as well as on the nominal amount of the consolidated debt of the general government sector as at the end of each year. The rules are further developed with the inclusion of specific provisions for cases of deviation from the target (the rule on the balance under the consolidated fiscal programme) and correction mechanism for returning to the limit specified with the rule (the rule on the nominal amount of the consolidated debt of the general government sector).

The strengthening of the sustainability of public finances and budgetary discipline is ensured by the inclusion in the scope of the rules of all authorities and funds that are not part of the regular budgets at sub-sector level, with a view to assessing their overall impact on the general government sector and their presentation in the medium-term strategic and annual budgetary documents.

Provisions are also included for the medium-term budgetary objective as regards the structural deficit of the general government sector with the relevant rules governing any cases of deviation or non-compliance, for the balance of the general government sector and for the cases of potential deficit, as well as for limits on the annual growth of expenditures.

The new law further develops the set of fiscal rules for the local government sub-sector. It also strengthens the currently existing debt rules. It lays down a medium-term objective for adherence to a balanced budget under the municipal budgets on a cash basis. There are also provisions limiting the average growth rate of expenditures on local mandates under municipal budgets and further strengthening the existing debt rules. It envisages that the law on the state budget for the relevant year may also determine a maximum amount of the debt that may be incurred by municipalities during the budget year.

The inclusion of restrictions on the undertaking of debt by the social security subsector in the scope of the fiscal rules of the Public Finance Law aims at achieving full coverage of the sub-sectors of the general government sector. They limit the possibilities of social security funds to incur debt and to issue guarantees. Similar restrictions are also set for state universities, Bulgarian Academy of Sciences, Bulgarian National Television, Bulgarian National Radio and Bulgarian News Agency, as well as for the entities whose budgets are not part of the state budget but are included in the consolidated fiscal programme.

The Public Finance Law has preserved the requirement the annual law on the state budget to determine the minimum level of the fiscal reserve as at the end of the relevant year.

## **7.2 Budgetary procedures**

On 24 January 2013 the Council of Ministers adopted a decision on the 2014 budgetary procedure, which defines the main rules to be followed in the annual budgetary process, the individual steps for the implementation of the main stages, the responsibilities for preparing the

necessary information and the deadlines for its submission to the Ministry of Finance, the Council of Ministers and the National Assembly.

The 2014 budgetary procedure adheres to the practice established over the past few years, which aims at sustainability and continuity of the processes and procedures. The time limits of the 2014 budgetary procedure are in conformity with the forthcoming parliamentary elections.

The 2014 budgetary procedure was adopted a week before the final adoption by the National Assembly of the Public Finance Law. The Transitional and Concluding Provisions of the Public Finance Law provide for its entry into force on 1 January 2014 as the budgetary procedure for the preparation of budgets and the estimates of the accounts for the European Union funds in 2014 will be carried out in accordance with the provisions laid down therein.

The 2014 budgetary procedure is consistent with the deadlines for implementation of the mechanisms and measures laid down in the main stages of the third consecutive cycle of the European Semester. Ensured is the achievement of the required by the semester consistency between the main fiscal and budgetary documents of the government, e.g. the medium-term budget forecast for the period 2014-2016 and the draft law on the 2014 state budget, with the commitments under the National Reform Programme within "Europe 2020" Strategy and the Convergence Programme.

The fiscal policy for the next three-year period will be developed in compliance with the fiscal rules and restrictions as regards the objective for the structural deficit of the general government sector, the medium-term budget objective for the structural deficit, the objective for the balance of the general government sector, the annual growth of expenditure and the amount of the consolidated debt of the general government sector. The fiscal policy will also comply with the restrictions on the maximum amount of expenditure and on the budget balance under the consolidated fiscal programme.

Participants in the budgetary procedure are all first-level spending units and other legal entities recipients of budget resources. Included are also the legal entities controlled by the state and/or municipalities that are not part of the consolidated fiscal programme but fall within the scope of the general government sector. In this regard the responsibilities of the Ministers are expanded, as they are required to present to the Minister of Finance summarized forecasts and indicators for the legal entities that are outside the state budget or fall under the general government sector. The National Statistical Institute is to provide information about the persons that fall under the general government sector, including by sub-sectors.

The 2014 budgetary procedure is divided into two main stages. The first stage concludes in mid-April 2013 with the approval by the Council of Ministers of a decision for approval of the medium-term budget forecast for the period 2014-2016 and for the approval of an update of the Government Debt Management Strategy.

The medium-term budget forecast for the period 2014-2016 will be developed on the basis of the Law on the 2013 State Budget of the Republic of Bulgaria, the approved with the latest medium-term budget forecast fiscal targets, policies and expenditure ceilings and/ or budget relations, the Council Recommendation of 10 July 2012 on the 2012 National Reform Programme of the Republic of Bulgaria and the Council Opinion on the Convergence Programme of the Republic of Bulgaria (2012-2015), the most likely or the more conservative macroeconomic scenario based on the Spring macroeconomic forecast, the assessment of the direct impact of planned policies on the long-term sustainability of public finances, the budget forecasts of first-level spending units for the next three years, the Ministry of Finance's assessments of the forecasts of first-level spending units as well as other assessments and forecasts.

The second stage of the procedure concludes at the end of October 2013 with the approval by the Council of Ministers of an update of the medium-term budget forecast for the period 2014-2016 and the Draft Law on the 2014 State Budget of the Republic of Bulgaria and respec-

tively with the submission of the Draft Law on the 2014 State Budget of the Republic of Bulgaria together with the budgetary documents in the National Assembly. The second stage of the procedure is extended; it includes a possible update of the medium-term budget forecast for the period 2014-2016 (in line with the parameters of the laws adopted by the National Assembly on the state budget, the budget of the state social security and the budget of the National Health Insurance Fund for 2014) and the adoption by the Council of Ministers of a Decree on the implementation of the 2014 State Budget of the Republic of Bulgaria.

Basis for development of the Draft Law on the 2014 State Budget and of the updated medium-term budget forecast for the period 2014-2016 will be: the medium-term budget forecast for the period 2014-2016 and the update of the Government Debt Management Strategy; the current execution of the budget as of 30 June 2013; the expected execution of the 2013 budget; the most likely or the more conservative macroeconomic scenario based on the Autumn forecast of the Ministry of Finance; the Council recommendation on the National Reform Programme and the Council opinion on the Convergence Programme of the Republic of Bulgaria and the European Commission's guidelines on the development and updating of the National Reform Programme and the Convergence Programme in line with the deadlines under the European Semester for 2013.

An important new element in the 2014 budget are the provisions laid down in the Public Finance Law the National Assembly, with the annual law on the state budget, to approve maximum amounts for new liabilities for expenditures that may be incurred during the year by first-level spending units, as well as the maximum amount of the expenditure commitments to be made during the year. The municipal councils are to determine similar indicators under municipal budgets.

The 2014 budgetary procedure also integrates two additional procedures, the results whereof are included in the preparation of the draft law on the 2014 state budget. The first procedure refers to the approval by the Council of Ministers of the projects to be funded by government and/ or government guaranteed loans in 2014 while the other is in pursuance of the Law on Public-Private Partnership and provides for review and approval by the Council of Ministers of the Operational Plan with included projects for state PPP or PPP of state public organizations.

To support medium-term budget forecast planning, development and updating, as well as the planning and preparation of draft budgets of spending units for 2014, including in programme format, the Minister of Finance gives detailed instructions, initiating the two major stages of the procedure.

At the stage of development of the medium-term forecast for the period 2014-2016 and at the stage of development of the 2014 draft budget coordination is to be made with first-level spending units to specify the parameters of the budget forecasts and the draft budgets for 2014, including by programmes, as well as consultations are to be held with the National Association of Municipalities in the Republic of Bulgaria on the total amount of the relations between municipal budgets and the central budget and on the draft Law on the 2014 State Budget of the Republic of Bulgaria in its part referring to municipalities.

### **7.3 Other institutional developments in relation to public finances**

The Transitional and Concluding Provisions of the Public Finance Law foresee the Council of Ministers to submit to the National Assembly, within six months of the promulgation of the Law in the State Gazette, a proposal to determine an independent authority within the meaning of Article 6 of Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States. ▼

# Annex A

**Table 1a — Macroeconomic Prospects**

	ESA code	2012	2012	2013	2014	2015	2016
		Level (EUR million)	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. Real GDP (at 2011 prices.)	B1*g	38 803	0.8	1.0	1.8	2.9	3.4
2. Nominal GDP	B1*g	39 667	3.0	3.0	4.2	5.1	5.7
<b>Components of real GDP</b>							
3. Private consumption	P.3	25 516	2.6	1.7	2.7	3.9	4.4
4. Government consumption expenditure	P.3	6 165	-1.4	1.0	0.6	0.8	1.1
5. Gross fixed capital formation	P.51	8 487	0.8	0.9	2.4	5.4	6.1
6. Change in inventories and net acquisition of valuables (% of GDP)	P.52+P.53	965	2.3	2.5	2.5	2.5	2.5
7. Exports of goods and services	P.6	26 429	-0.4	2.0	3.9	4.0	4.1
8. Imports of goods and services	P.7	27 895	3.7	2.6	4.4	5.1	5.3
<b>Contributions to real GDP growth (In percentage points)</b>							
9. Final domestic demand		-	1.6	1.4	2.3	3.8	4.4
10. Change in inventories and net acquisition of valuables	P.52+P.53	-	1.9	0.1	0.0	0.1	0.1
11. External balance of goods and services	B.11	-	-2.7	-0.5	-0.6	-0.9	-1.1

**Table 1b — Price Developments**

	ESA code	2012	2012	2013	2014	2015	2016
		Level	Rate of change <sup>33</sup>	Rate of change	Rate of change	Rate of change	Rate of change
1. GDP deflator		100	2.2	2.0	2.4	2.2	2.2
2. Private consumption deflator		100	3.5	1.8	2.3	2.2	2.2
3. HICP <sup>34</sup>		100	2.4	1.8	2.7	2.6	2.6
4. Public consumption deflator		100	3.4	1.0	1.7	1.5	1.3
5. Investments deflator		100	2.2	1.2	2.2	1.5	1.1
6. Export price deflator (goods and services)		100	3.6	1.9	2.4	2.1	2.0
7. Import price deflator (goods and services)		100	5.0	1.2	2.1	1.7	1.4

33 Percentage change as compared to the previous year.

34 Optional for Stability Programmes.

**Table 1c — Labour Market Developments**

	ESA code	2012	2012	2013	2014	2015	2016
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. Employment (persons) <sup>35</sup>		3 281.9	-4.3	-2.4	0.4	0.7	1.1
2. Employment (millions of hours worked) <sup>36</sup>		5 421.7	-4.3	-2.4	0.4	0.7	0.9
3. Unemployment rate <sup>37</sup>		12.3	12.3	13.0	12.8	12.4	11.8
4. Labour productivity (EUR per person employed) <sup>38</sup>		12 086.5	5.4	3.5	1.4	2.2	2.3
5. Labour Productivity (EUR per hour worked) <sup>39</sup>		7.3	5.3	3.5	1.3	2.2	2.4
6. Compensation of employees (thousand EUR )	D.1	14 728 855.3	1.0	2.2	5.5	6.2	6.9
7. Compensation per employee		6 174.4	5.6	4.7	5.0	5.3	5.6

**Table 1d. — Sectoral Balances**

% of GDP	ESA code	2012	2013	2014	2015	2016
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	0.0	0.3	-1.5	-1.6	-2.1
of which:		-3.1	-3.3	-3.7	-4.3	-4.9
- Balance of goods and services						
- Balance of primary incomes and transfers		1.8	2.2	1.2	1.5	1.5
- Capital account		1.4	1.3	1.0	1.3	1.3
2. Net lending/borrowing of the private sector	B.9	0.8	1.6	-0.2	-0.6	-1.3
3. Net lending/borrowing of the general government	EDP B.9	-0.8	-1.3	-1.3	-1	-0.8
4. Statistical discrepancy						

35 Occupied population, national accounts definition – in thousands.

36 National accounts definition.

37 Harmonised definition, Eurostat; levels.

38 Real GDP per person employed.

39 Real GDP per one hour worked.

**Table 2a. — General government budget projections**

	ESA 95	2012	2012	2013	2014	2015	2016
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
<b>Net lending (EDP B.9) by sub-sector</b>							
1.General government	S.13	-318.9	-0.8	-1.3	-1.3	-1.0	-0.8
2. Central government	S.1311	-453.3	-1.1	-1.4	-1.3	-1.1	-0.9
3.State government	S.1312	0.0	0.0	0.0	0.0	0.0	0.0
4. Local government	S.1313	100.9	0.3	-0.1	0.0	0.0	0.1
5. Social security funds	S.1314	33.5	0.1	0.1	0.1	0.1	0.0
General government (S13)							
6. Total revenue	TR	13 861.5	34.9	37.2	36.5	36.5	35.5
7. Total expenditure	TE	14 180.5	35.7	38.5	37.8	37.5	36.3
8. Net lending / borrowing	EDP B.9	-318.9	-0.8	-1.3	-1.3	-1.0	-0.8
9. Interest expenditure	EDP D.41	343.0	0.9	1.1	0.8	0.8	0.8
10. Primary balance		24.1	0.1	-0.3	-0.5	-0.3	0.0
11.One-off and other temporary measures		0.0	0.0	0.0	0.0	0.0	0.0
<b>Selected components of revenue</b>							
12. Total taxes (12=12a+12b+12c)		8 065.7	20.3	21.1	21.4	21.4	21.6
12a. Taxes on production and imports	D.2	5 982.0	15.1	15.6	15.9	15.9	16.1
12b. Current taxes on income, wealth, etc.	D.5	1 986.9	5.0	5.3	5.3	5.3	5.3
12c. Capital taxes	D.91	96.8	0.2	0.2	0.2	0.2	0.2
13. Social contributions	D.61	2 861.2	7.2	7.6	7.4	7.3	7.1
14. Property income	D.4	430.0	1.1	0.7	0.4	0.5	0.5
15.Other		2 504.7	6.3	7.7	7.2	7.2	6.4
16=6. Total revenue	TR	13 861.5	34.9	37.2	36.5	36.5	35.5
Tax burden (D.2+D.5+D.61+D.91-D.995)		10 926.9	27.5	28.7	28.9	28.8	28.7
<b>Selected components of expenditure</b>							
17. Compensation of employees + intermediate consumption	D.1+P.2	5 806.8	14.6	15.2	14.7	14.6	13.8
17a. Compensation of employees	D.1	3 517.6	8.9	9.0	8.7	8.7	8.3
17b. Intermediate consumption	P.2	2 289.1	5.8	6.2	6.0	5.8	5.5
18. Social payments (18=18a+18b)		5 355.9	13.5	14.2	14.1	13.7	13.2
<i>of which Unemployment benefits</i>							
18a. Social transfers in kind	D.6311. D.63121. D.63131	712.7	1.8	2.0	2.0	1.9	1.8
18b. Social transfers other than in kind	D.62	4 643.2	11.7	12.2	12.1	11.8	11.4
19=9. Interest expenditure	EDP D.41	343.0	0.9	1.1	0.8	0.8	0.8
20. Subsidies	D.3	340.7	0.9	0.9	0.9	0.8	0.8
21. Gross fixed capital formation	P.51	1 293.9	3.3	5.5	5.5	5.8	5.9
22. Capital transfers	D.9	281.5	0.7	0.4	0.4	0.4	0.4
23. Other		758.6	1.9	1.3	1.5	1.4	1.4
24=7. Total expenditure	TE1	14 180.5	35.7	38.5	37.8	37.5	36.3
Government consumption (nominal)	P.3	6 186.0	15.6	15.4	15.1	14.7	14.2

**Table 2b. No-policy change projections**

	2012	2012	2013	2014	2015	2016
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	13 862.0	34.9	36.7	36.4	36.5	35.5
2. Total expenditure at unchanged policies	14 180.5	35.7	37.1	37.6	37.4	36.2

**Table 2c. Amounts to be excluded from the expenditure benchmark**

	2012	2012	2013	2014	2015	2016
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	819.3	2.1	2.0	1.3	1.9	0.9
2. Unemployment benefit expenditure at unchanged policies	183.4	0.5	0.5	0.5	0.5	0.4
3. Effect of discretionary revenue measures	54.2	0.1	0.2	0.2	0	0
4. Revenue increases mandated by law	0	0	0	0	0	0

**Table 3. General government expenditure by function**

% of GDP	ESA code	2011	2016
1. General public services	1	3.9	4.3
2. Defence	2	1.3	1.1
3. Public order and safety	3	2.5	2.3
4. Economic affairs	4	4.2	5.7
5. Environmental protection	5	0.7	0.9
6. Housing and community amenities	6	1.2	1.5
7. Health	7	4.6	4.0
8. Recreation, culture and religion	8	0.7	0.6
9. Education	9	3.6	3.4
10. Social protection	10	12.9	12.5
11. Total expenditure (=item 7=24 in Table 2)	TE1	35.6	36.3

**Table 4. General government debt**

% of GDP	ESA code	2012	2013	2014	2015	2016
1. Gross debt <sup>40</sup>		18.5	17.9	20.4	18.6	19.9
2. Change in gross debt ratio		2.2	-0.6	2.5	-1.8	1.3
<b>Contributions to changes in gross debt</b>						
3. Primary balance <sup>41</sup>		0.1	-0.3	-0.5	-0.3	0.0
4. Interest expenditure <sup>42</sup>	EDP D.41	0.9	1.1	0.8	0.8	0.8
5. Stock-flow adjustment		1.22	-1.4	2.2	-2.3	0.5
of which:						
Differences between cash and accruals <sup>43</sup>						
Net accumulation of financial assets <sup>44</sup>		1.3	-1.6	1.9	-2.4	0.4
of which: privatisation proceeds		0.1	0.2	0.2	0.0	0.0
Valuation effects and other <sup>45</sup>		0.1	0.1	0.1	0.1	0.1
Implicit interest rate on debt <sup>46</sup>		4.7	6.0	3.8	4.2	4.1
<b>Other relevant variables</b>						
6. Liquid financial assets <sup>47</sup>						
7. Net financial debt (7=1-6)						
8. Debt amortization since the end of the previous year		1.3	3.7	1.4	2.5	1.3
9. Percentage of debt denominated in foreign currency		24.0	31.1	29.1	35.8	36.9
10. Average maturity		6.2	6.5	5.7	6.2	6.0

40 As defined in Regulation 3605/93 (not an ESA concept).

41 Cf. item 10 in Table 2.

42 Cf. item 9 in Table 2.

43 The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.

44 Including liquid assets, government securities, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.

45 Changes above the exchange rate movements, and operation in secondary market could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.

46 Proxied by interest expenditure divided by the debt level of the previous year.

47 AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

**Table 5. Cyclical developments**

% of GDP	ESA code	2012	2013	2014	2015	2016
1. Real GDP growth (%)		0.8	1.0	1.8	2.9	3.4
2. Net lending of general government	EDP B.9	-0.8	-1.3	-1.3	-1.0	-0.8
3. Interest expenditure	EDP D.41	0.9	1.1	0.8	0.8	0.8
4. One-off and other temporary measures						
5. Potential GDP growth (%)		0.6	1.4	1.6	2.2	2.7
contributions:						
labour		-1.6	-0.8	-0.7	-0.3	0.0
capital		0.9	0.8	0.8	0.9	1.0
total factor productivity		1.3	1.4	1.5	1.6	1.7
6. Output gap		-1.4	-1.7	-1.6	-0.9	-0.1
7. Cyclical budgetary component		-0.4	-0.6	-0.5	-0.3	0.0
8. Cyclically-adjusted balance (2 - 7)		-0.4	-0.8	-0.8	-0.8	-0.8
9. Cyclically-adjusted primary balance (8 + 3)		0.5	0.3	0.0	0.0	0.0
10. Structural balance (8 - 4)		-0.4	-0.8	-0.8	-0.8	-0.8

**Table 6. Divergence from previous update**

	ESA code	2012	2013	2014	2015	2016
Real GDP growth (%)						
Previous update		1.4	2.5	3.5	4.0	
Current update		0.8	1.0	1.8	2.9	3.4
Difference (pps)		-0.6	-1.5	-1.7	-1.1	
General government net lending (% of GDP)	EDP B.9					
Previous update		-1.6	-1.3	-0.5	0.0	
Current update		-0.8	-1.3	-1.3	-1.0	-0.8
Difference (pps)		0.8	0.0	-0.8	-1.0	
General government gross debt (% of GDP)						
Previous update		19.8	18.4	18	16.4	
Current update		18.5	17.9	20.4	18.6	19.9
Difference (pps)		-1.3	-0.5	2.4	2.2	

**Table 7. Long-term sustainability of public finances**

<b>% of GDP</b>	<b>2007</b>	<b>2010</b>	<b>2020</b>	<b>2030</b>	<b>2040</b>	<b>2050</b>	<b>2060</b>
Total expenditure	39.2	37.4	35.3	35.6	36.5	37.9	38.2
Of which: age-related expenditures	15.5	18.2	16.0	16.4	17.3	18.7	18.9
Pension expenditure	7.8	9.9	8.1	8.0	8.2	9.2	9.3
Social security pension	7.5	9.6	7.8	7.7	8.0	8.9	9.0
Old-age and early pensions	5.9	8.0	6.2	6.0	6.3	7.2	7.3
Other pensions (disability, survivors)	1.6	1.6	1.6	1.7	1.7	1.7	1.7
Occupational pensions (if in general government)	-	-	-	-	-	-	-
Health care	4.1	4.8	4.3	4.6	5.3	5.6	5.6
Long-term care	-	-	-	-	-	-	-
Education expenditure	3.8	3.8	3.3	3.5	3.5	3.7	3.8
Other age-related expenditures	0.1	0.4	0.3	0.3	0.3	0.3	0.3
Interest expenditure	1.2	0.6	0.6	0.3	0.3	0.3	0.4
Total revenue	40.4	34.3	34.5	34.5	34.5	34.5	34.5
Of which: property income	1.3	1.1	1.0	0.3	0.3	0.3	0.3
Of which: from pensions contributions (or social contributions if appropriate)	6.0	7.4	8.1	8.1	8.1	8.1	8.1
Pension reserve fund assets	-	-	-	-	-	-	-
Of which: consolidated public pension fund assets (assets other than government bonds)	-	-	-	-	-	-	-
Systemic pension reforms <sup>48</sup>							
Social contributions diverted to mandatory private scheme <sup>49</sup>	0.8	1.0	-	-	-	-	-
Pension expenditure paid by mandatory private scheme <sup>50</sup>	0.0	0.0	-	-	-	-	-
Assumptions							
Labour productivity growth	3.1	5.3	2.8	2.5	2.3	1.6	1.5
Real GDP growth	6.4	0.4	1.7	1.4	1.0	0.7	0.3
Participation rate males (aged 20-64)	78.3	77.3	76.9	75.6	74.8	75.7	77.1
Participation rates females (aged 20-64)	68.4	68.0	68.9	67.1	65.6	66.7	68.8
Total participation rates (aged 20-64)	73.3	72.6	74.0	71.9	71.3	72.2	74.0
Unemployment rate (%. aged 15-64)	6.9	10.2	9.4	7.3	7.3	7.3	7.3
Population aged 65+ over total population	17.3	17.7	21.0	24.3	27.6	31.2	32.6

**Table 7a. Contingent liabilities**

<b>% of GDP</b>	<b>2012</b>	<b>2013</b>
Government guaranteed debt	1.3%	1.1%

48 Pension reforms, including mandatory additional pension insurance.

49 Revenue from social security contributions or other revenue for the mandatory additional pension insurance, with which the accounts payable can be covered.

50 Pension expenditure or other social benefits paid by the mandatory additional pension insurance.

Of which: linked to the financial sector

0.12%

0.08%

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**Table 8. Basic assumptions**

	2012	2013	2014	2015	2016
Short-term interest rate (annual average). 6-month LIBOR in EUR, %	0.57	0.31	0.51	0.78	1.17
Short-term interest rate (annual average). 6-month LIBOR in USD,%	0.69	0.50	0.61	0.65	1.33
Long-term interest rate (annual average), %	4.5	3.9	4.0	4.3	4.5
USD/EUR exchange rate (annual average)	1.28	1.35	1.35	1.35	1.35
Nominal effective exchange rate, percentage change, previous year = 10051					
EUR/BGN exchange rate (annual average)	1.95583	1.95583	1.95583	1.95583	1.95583
World economy, GDP growth, %	3.1	3.5	4.1	4.4	4.5
EU GDP growth, %	-0.3	0.1	1.6	1.9	2
Growth of relevant foreign markets. %					
World import volumes, excluding EU, %					
Oil prices (Brent, USD/barrel)	112.0	113.7	106.4	102.3	99.3
International prices of non-energy goods (% yoy)	-9.8	-3.3	-2.9	-2.0	-2.0
International prices of food products (% yoy)	-1.8	-5.6	-4.3	-2.6	-3.0
International prices of agricultural raw materials (% yoy)	-12.6	3.3	-0.4	-3.2	-3.7
International prices of metals (% on an annual basis)	-16.8	-2.3	-3.1	0.1	0.8

51 The positive values reflect appreciation, the negative – depreciation