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date of receipt:	28 April 2016
To:	Mr Carsten PILLATH, Director General, Council of the European Union
Subject:	Convergence Programme of Bulgaria 2016-2019

Delegations will find attached the Convergence Programme of Bulgaria 2016-2019 in English.

REPUBLIC OF BULGARIA
Ministry of Finance

CONVERGENCE PROGRAMME

(2016–2019)

April, 2016
Sofia, Bulgaria

CONVERGENCE PROGRAMME

OF THE REPUBLIC OF BULGARIA

2016–2019

Sofia, April 2016

Ministry of Finance

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List of abbreviations

BNB	Bulgarian National Bank
CITL	Corporate Income Tax Law
CP	Convergence Programme
EC	European Commission
ECB	European Central Bank
EIB	European Investment Bank
ESA'2010	European System of Accounts '2010
EU	European Union
EUR	Euro
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
GS	Government Securities
GVA	Gross Value Added
HICP	Harmonised Index of Consumer Prices
HIL	Health Insurance Law
IMF	International Monetary Fund
LIBOR	London Interbank Offered Rate
MF	Ministry of Finance
MOI	Ministry of the Interior
MTO	Medium Term Budgetary Objective
NAWRU	Non-accelerating wage rate of unemployment
NHIF	National Health Insurance Fund
NRA	National Revenue Agency
NRIC	National Railway Infrastructure Company
NSI	National Statistical Institute
NSSI	National Social Security Institute
OPAC	Operational Programme "Administrative Capacity"
PIC	Personal Identification Code
PITL	Personal Income Tax Law
PFL	Public Finances Law
pp	percentage point
PSS	Public Social Security
R&D	Research and Development
SBA	State Budget Act
SGP	Stability and Growth Pact
SSC	Social Security Code
USD	US Dollar
VAT	Value Added Tax

1 Overall Policy Framework and Objectives

The Convergence Programme of the Republic of Bulgaria (2016–2019) outlines the key policy priorities in support of economic growth within a framework of sustained macroeconomic and fiscal stability.

With regard to public finances, a major policy goal is to keep fiscal sustainability and to overcome the macroeconomic imbalances through gradual fiscal consolidation and measures to support economic growth. Consistent, transparent and predictable fiscal policy-making is of paramount importance for improving the business environment, promoting investment and encouraging labour market development.

An important strategic policy aspect is aimed at increasing the productivity and competitiveness of the economy in order to achieve balanced growth, sustainable convergence and higher living standards in the long run. In this regard, policies to improve the quality of education, reduce the administrative burden, ensure effective and transparent absorption of EU funds, promote infrastructure investment, eliminate barriers to private sector investment, including within the third pillar of the Investment Plan for Europe (the so called "Juncker" Plan), are of high priority.

In the medium term, fiscal policy is aimed at maintaining the sustainability of budgetary framework in the context of Bulgaria's commitments under the Stability and Growth Pact, as well as under Title III of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. In this regard, strict budgetary discipline is a fundamental commitment of the government. Fiscal parameters are prepared based on a realistic forecast of the key macroeconomic indicators, a conservative assessment of revenues, and more restrictive planning of expenditures.

Medium- and long-term sustainability of public finances is seen as a major priority with regards to enhancing confidence and creating a predictable investment and business environment. In this update of the Convergence Programme Bulgaria retains its medium term objective for a structural deficit of 1%.

Tax and social security policies are supportive to investment, employment and economic growth, thus aiming at fiscal and macroeconomic stability. Increasing the tax collection and effective combat against tax fraud and tax evasion are of high priority. Lowering tax compliance cost for citizens and businesses and reducing administrative burdens are also of paramount importance.

In the context of preserving macroeconomic stability, Bulgaria keeps its firm commitment 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.

This Convergence Programme has been approved by the Council of Ministers and examined by the National Assembly. It comprises seven chapters.

The first chapter contains the overall framework of the government economic policies and objectives. The second one presents an analysis of the key macroeconomic developments and medium term forecast.

The third chapter makes 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 during the reference period, with emphasis on the structural and cyclically-adjusted balance. Major trends in the debt development over the programme period are also outlined. The main policy actions provided for in the medium term strategy of the government and an assessment of their quantitative effects are also included.

The fourth chapter presents a sensitivity analysis of the forecasts, with an alternative medium term economic development scenario. Special attention is paid to the sensitivity of budgetary projections. The impact of changed assumptions under the macroeconomic baseline scenario on government debt is also outlined.

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 the impact of ageing population.

The sixth chapter deals with the quality of public finances. It presents the government policy strategy in this area, the composition of expenditure and the structure and efficiency of revenue systems.

The seventh chapter provides an overview of the institutional characteristics of public finances in Bulgaria – budgetary procedures and national fiscal rules. This chapter of the Programme also focuses on the key legislative changes relevant to public finances.

The current Convergence Programme presents measures and developments addressing the first out of the five Council Recommendations of 14 July 2015 on the 2015 National Reform Programme of Bulgaria, containing the Council Opinion on the 2015 Convergence Programme of Bulgaria[1], namely:

- **Country Specific Recommendation 1:** Avoid a structural deterioration in public finances in 2015 and achieve an adjustment of 0.5 of GDP in 2016. Take decisive measures to improve tax collection and address the shadow economy, based on a comprehensive risk analysis and evaluation of past measures. Improve the cost-effectiveness of the health care system, in particular, by reviewing the pricing of health care and strengthening outpatient and primary care.

[1] OJ C 272, 18.08.2015

2 ECONOMIC OUTLOOK

2.1 World economy/technical assumptions

The current Convergence Programme is based on the macroeconomic framework for the period 2016–2019, developed using the medium term macroeconomic model of the Ministry of Finance with key assumptions for the external environment as of mid-March 2016, provided by the International Monetary Fund, the World Bank, the European Commission, and the Bulgarian Ministry of Finance.

Table 2-1: Assumptions on Key Macroeconomic Indicators

	2016	2017	2018	2019
Global economy (real growth, %)	3.2	3.6	3.7	3.9
EU GDP (real growth, %)	2.0	2.0	1.9	1.9
USD/EUR exchange rate, annual average	1.09	1.09	1.09	1.09
International commodity prices (in USD %)				
Oil Brent (USD/barrel)	-24.2	14.1	8.6	6.9
Non-energy goods	-9.5	-0.7	0.1	0.6
Food	-5.6	-0.9	-0.5	0.0
Beverages	-15.2	0.2	1.1	0.0
Agricultural raw materials	-10.3	0.4	0.4	0.0
Metals	-14.1	-1.5	0.4	2.2
Six-month LIBOR on USD-denominated deposits	0.88	1.52	2.47	3.25
Six-month LIBOR on EUR-denominated deposits	-0.32	-0.37	-0.24	-0.03

Source: IMF, WB, EC, MF

2.2 Cyclical developments and current prospects

2.2.1 Economic growth

In 2015 the Bulgarian GDP growth reached 3% - the highest value since 2008, driven by both external (2.1 pp) and domestic (0.9 pp) demand.

Improved demand from the EU trading partners led to accelerated increase of goods and services to 7.6%, and, with moderate growth in import (4.4%), resulted in a positive contribution of net export to GDP growth in 2015.

At the same time, growth in final consumption slowed down to 0.7% against 2.2% in 2014. This development was influenced by the consumption of households. The negative price dynamics could not fully compensate the slower increase of nominal income, mainly as regards the compensation of employees. As a result, the increase in the real disposable income of households slowed down against 2014 and the consumer expenditures increased by only 0.8%.

Growth in fixed capital investment came out at 2.5% and for the third consecutive year was formed by public capital expenditures which increased due to the funds disbursed under EU Operational

Programmes, including national co-financing. Private investment[2] decreased further. Growth in the gross operating surplus – the indicator showing the financing sources of investment projects – slowed down during the year.

The economic activity in the country slowed down on the supply side. The gross value added growth was 1.5% in 2015 compared to 1.8% in 2014. This was a result of the worse performance of services compared to 2014 and of a decline in agriculture whereas the dynamics in industry was positive.

GVA in industry increased by 3.1% in 2015, supported by the strong performance of exports. Value added in construction also improved (1.4%). Construction output increased by 2.4% on average for the year and both civil engineering and building construction contributed positively to the reported growth. Lower consumption resulted in slower growth of value added in services to 1.2% against 1.9% in 2014. Growth was reported for all activities in the sector. *Real estate operations* were the largest contributor due to the higher number of real estate transactions in 2015.

2.2.2 Cyclical position[3]

According to the Ministry of Finance estimates, the potential GDP growth in 2015 was 2.7% and is expected to slow down to 2.4% in 2016. The gradual increase in total factor productivity will contribute to the progressive acceleration of growth in the following years and in 2019 growth is expected to reach 2.6%. The positive dynamics of the labour market observed in 2015 resulted in a decline in NAWRU. Its gradual decline, along with an increase in the participation rate, will compensate for the reduction in the working age population and will lead to a positive contribution of labour as a factor to potential growth over the forecast period. The slowdown in investment in 2016 will slightly reduce the contribution of capital stock to potential growth over the forecast period and growth in investment in 2018 and 2019 is expected to result in increased capital stock at the end of the period.

Higher growth of potential output compared to the actual one is expected in 2016 and, as a result, the negative output gap will increase to 0.7%. In the period 2017-2019, the economy will come closer to its potential but the negative output gap will persist, at 0.5% in 2019.

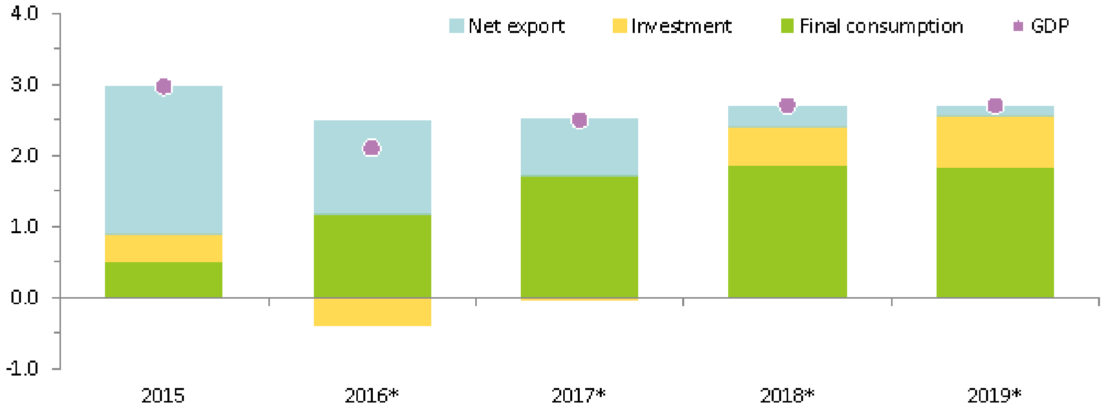
2.3 Medium term scenario

In 2016, the growth of the Bulgarian economy is expected to slow down to 2.1% as a result of the lower positive contribution of net exports and the decline in public capital expenditure. Moderate growth of export is expected due to the high basis from 2015. The change in resource requirements of the export-oriented sectors will restrict import growth, although the deceleration will be limited by the stronger increase in consumption of households. The decline in public investment in 2016 is associated with the time needed to technically adjust and launch the implementation of projects under the programmes financed from the EU funds in the new 2014–2020 financial framework. Private investment in dwellings is projected to increase due to the higher real estate demand and the increase in real house prices. Investment in machinery and equipment will also improve as a result of the increased capacity utilisation in industry but growth in private investment will not be able to compensate the decline in public investment. At the same time, the favourable development of employment and the increase in the real disposable income of households are expected to support the increase in consumer expenditure and the growth registered in the second half of 2015 is expected to continue, to 2.1% in 2016.

[2] Private investment is measured as the difference between investment for the whole economy and investment for General Government sector.

[3] Cyclical development of the economy is measured by the output gap indicator. It is calculated as a ratio to potential GDP of the difference between the actual output of an economy and its potential output. The potential GDP of the Bulgarian economy was calculated using the production function based on a methodology developed by the EC: Karel Havik & Kieran Mc Morrow & Fabrice Orlandi & Christophe Planas & Rafal Raciborski & Werner Roeger & Alessandro Rossi & Anna Thum-Thysen & Valerie Vandermeulen, 2014. "The Production Function Methodology for Calculating Potential Growth Rates & Output Gaps," European Economy – Economic Papers 535

Figure 2-1: Contributions to GDP growth, by components (pp)



* Forecast

Source: NSI, MF

In 2017, the growth of the Bulgarian economy will accelerate to 2.5%, private consumption being the main contributor affected positively by an increase in employment and the more favourable consumer attitude with regard to the income of households. Investment is expected to remain neutral (with zero contribution) to GDP growth in 2017 despite the slowdown in public investment decrease and the accelerated growth of private investment. The contribution of net export will remain positive but will continue to slow down, as a result of accelerated import supported by activated domestic demand.

During the 2018–2019 period the economic growth will gradually accelerate to 2.7%, with private consumption and investment being the main contributors. They are expected to be positively affected by the improved business climate in the country and the increased credit activity. Public capital expenditure is expected to increase starting from 2018. The export of goods and services will go up and, coupled with the increased domestic demand, will result in accelerated import growth. Thus the positive contribution of net export will gradually decrease to 0.1 pp at the end of the forecast period.

The risks to the realisation of the outlook for growth of the Bulgarian economy are balanced. The fragile external environment poses a negative risk[4]. In the autumn of 2015, the international institutions revised downwards their expectations about global and Euro area growth. The migration pressure on some EU Member States and the border control between certain countries could restrict trade in the region. The weaker performance of the European economy poses a risk not only to the growth of Bulgarian export; it could result in lower investment activity and lower consumer confidence in Bulgaria. On the other hand, the positive development observed in the labour market could contribute to higher than forecast consumer expenditure. Taking measures to improve the investment environment would result in increased private investment in the economy. The migration flow to EU Member States could also lead to a policy of higher than expected government expenditure for all countries in the region and to higher final consumption in the short term. In the medium term, the effect will be determined by the degree of labour market integration of refugees.

[4] An alternative economic development scenario which addresses this risk is described in Chapter 4.

2.4 Sectoral Balances

2.4.1 Labour market, incomes and labour productivity

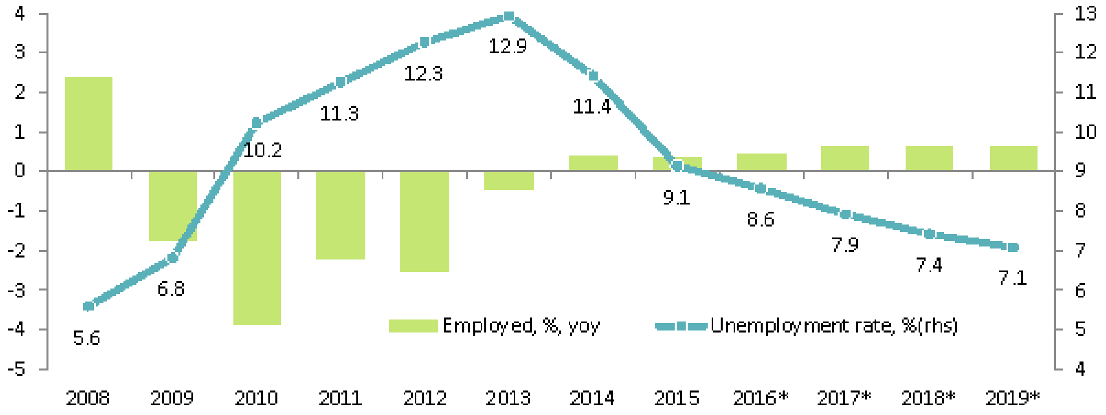
In 2015, the labour market in Bulgaria continued to recover. The main source of employment growth in the country was due to high external demand. The upward trend of employment in services was determined by growth in internal demand.

As a result of the buoyant economic activity in 2015 the demand for labour in the country accelerated and the number of employed people increased by 0.4%[5]. Higher employment in industry (2.0%) was influenced by growth in industrial production and by the strong performance of export. The number of people employed in construction also went up (2.5%), supported by the increased economic activity in civil engineering. The number of people employed in services registered growth at 0.6%, the main contributor being some high-tech activities like information and communication. The number of people employed in agriculture decreased compared to a year earlier as a result of a lower added value.

The unemployment rate continued its downward trend, reporting a decrease of 2.3 pp to a level of 9.1%[6] in 2015. Lower unemployment was due to higher employment but also due to a shrinking workforce as a result of the negative demographic developments. The downward trend in unemployment was also confirmed by the data on registered unemployed. The reported increase of employed people and the decrease in newly-registered unemployed proved a subsiding of employment shedding processes and increased demand for labour in the real sector of the economy. The favourable development reported for unemployment was related to improvement in the structural indicators of the labour market, including long-term unemployment rates and youth unemployment rates.

The positive development registered in the labour market in 2015 is expected to continue in 2016. Based on short-term business statistics data, in the first two months of 2016 employers' perceptions of recruiting personnel improved both in industry and in services. Furthermore, in January consumer perceptions of unemployment in the next 12 months registered improvement. Current data on registered unemployment in January and February confirmed that the downward trend in the annual development of unemployment continues.

Figure 2-2: Employment developments and unemployment, %



*Forecast

Source: NSI (ESA, HIPC), MF

[5] According to ESA 2010 data

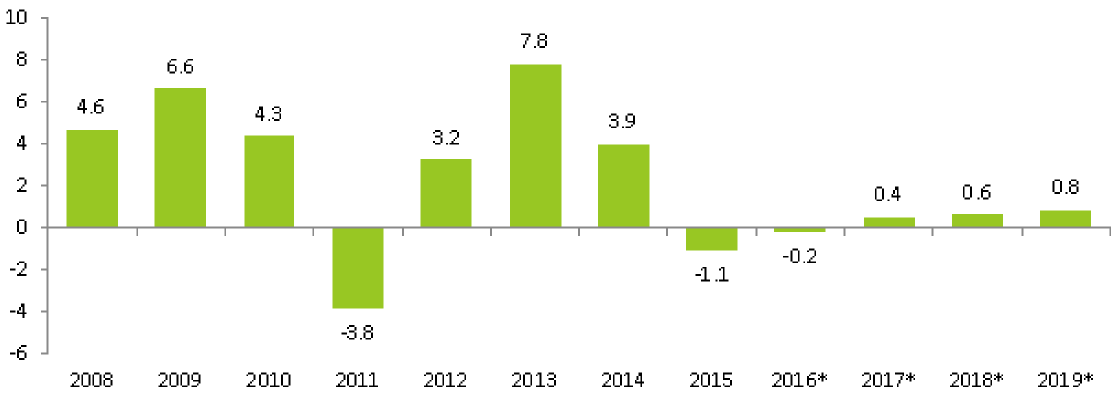
[6] Based on Labour Force Survey (LFS) data

Employment growth in the economy will slightly accelerate to 0.5% in 2016, supported by the favourable development expected in the private sector. With the gradual acceleration of growth in domestic demand and strengthening the positive impact of the external environment on the economic activity in the country, in the 2017-2019 period employment growth is expected to accelerate to an annual average of 0.6% over the review period. Increased demand for labour will lead to further decrease in unemployment to 8.6% in 2016. The indicator is expected to show more limited decrease compared to the development reported in 2014 and 2015 because of the smaller reduction of the workforce as a result of the measures taken to increase retirement age and length of service. The latter are expected to have stronger effect on the economically active population towards the end of the forecast period because of the gradual increase of the retirement age and length of service by months over the years. At the end of the forecast period the unemployment rate will go down to 7.1%.

The positive development of employment was accompanied by an upward trend in labour productivity of the Bulgarian economy, with real labour productivity accelerating to 2.6% in 2015. All economic sectors were positive contributors, topped by industry. The current development of the discussed indicator contributes to improved cost competitiveness of undertakings, as measured by the development of unit labour costs. In 2015, the latter decreased by 0.7% in nominal terms and by 1.1% in real terms.

Along with the employment recovery in the country, the compensation per employee was characterised by a significantly lower growth rate of 1.8% in 2015, as compared to previous years. The main contributor of lower growth were services where wages changed negligibly (0.2%). Decreased compensation per employee was reported also in trade. It was a result of limiting labour costs other than those related to the basic wage. It should be noted that a significant wage increase was reported for some of the activities in services which were characterised by increased demand of highly qualified workforce. Unlike services, wage growth in industry came at a considerably higher rate of 5.3%, the greatest contributor being the export-oriented activities in the sector.

Figure 2-3: Real Unit Labour Costs, %



*Forecast

Source: MF

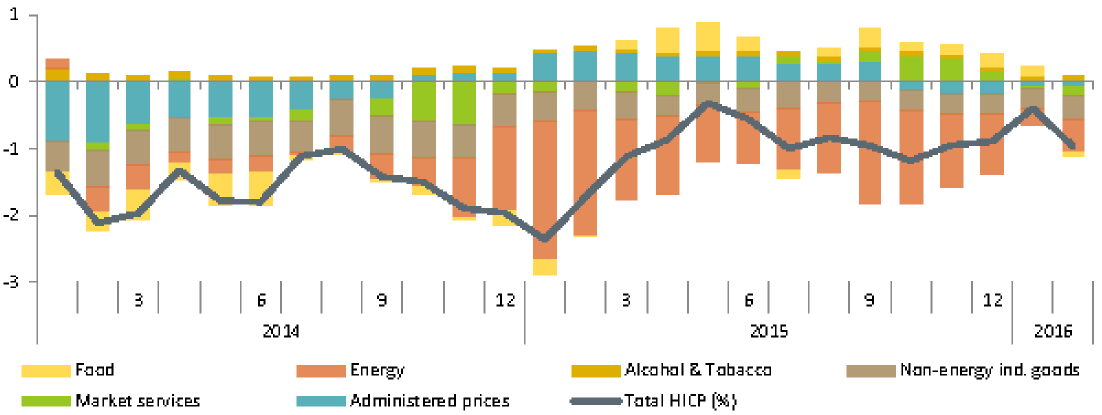
The favourable development registered in the labour market in 2015 is expected to continue in 2016. Real labour productivity will increase to 2-2.5% on average for the whole forecast period and will have more favourable development compared to the levels reported for 2013 and 2014. Unlike 2015, in the following years incomes will increase at a higher pace, given the higher demand for labour and the continuing increase in labour productivity which, in turn will, support higher consumption of households over the forecast period.

Compensation per employee and labour productivity are expected to develop at similar rates. The share of compensation per employee in gross value added will increase slightly and thus growth of unit labour costs will be limited to 0.4% and 1.5% in real and nominal terms accordingly, on average for the 2016–2019 period.

2.4.2 Inflation

The annual HICP inflation rate in the country remained negative throughout the entire 2015, slowing down to -0.9% in December. The average annual inflation rate was -1.1%.

Figure 2-4: Inflation rate (%) and contributions (pp) by main HICP components, compared to the corresponding month of the previous year



Source: NSI, MF

Lower transport fuel prices as a result of the decline of crude oil prices on global markets were the main driver behind the headline index dynamics during the year. The negative core inflation also slowed down significantly and turned positive as of September 2015. The appreciation of the US dollar against the Euro contributed to limiting the decreases in prices of non-energy industrial goods and durables in particular At the same time, the downward trend in services' prices has reversed in the second half of the year as a result of the waning of one-off effects on communication service prices, as well as the higher prices in catering and tourism.

Regulated prices reported a decrease of 1.1% on average at the year-end. Prices of central gas and heating supply posted the largest declines, down by 20 and 15% yoy respectively as in December 2015.

In January 2016 the decrease in the headline rate narrowed to -0.4% but widened again to -1.0% yoy in February, due to the continuing fall in prices of transport fuels.

Consumer prices are expected to report a positive change at the end of 2016 as the negative inflation rate is assumed to decelerate and turn to positive values in the second half of the year. However, the average annual inflation rate will remain negative, at -0.8%.

Energy will largely account for the negative change in the headline rate at the year-end as a result of the expected decline in international oil prices and the lower domestic fuel prices. The depreciation of the Euro against the US dollar will provide for a further slowdown in the negative change in prices of non-energy industrial goods. The increase in food prices will be close to that in the previous year and the increase in services' prices is expected to accelerate slightly, supported by the higher domestic demand.

The annual average inflation rate in 2017 is projected at 1.1% and it is expected to accelerate in 2018-2019 under the assumption for higher international prices of crude oil and the other major non-energy commodities, as well as stronger domestic demand.

Table 2-2: HICP forecast for the 2016–2019 period

	2016	2017	2018	2019
Annual average inflation (%)	-0.8	1.1	1.2	1.4
End-of-period inflation (%)	0.3	1.0	1.3	1.4

Changes in the tax policy over the projection horizon will have a relatively weak impact on consumer price dynamics. The envisaged increase of excise duty on cigarettes in 2016-2018 is expected to raise their prices by an average of 4% at the end of 2016 and 3.6% in 2017, contributing thus by 0.17 and 0.15 pp to the change in the headline rate in the corresponding year. Prices of cigarettes in 2018 are expected to increase by 1.8% which will add 0.08 pp to the end-of-period inflation.

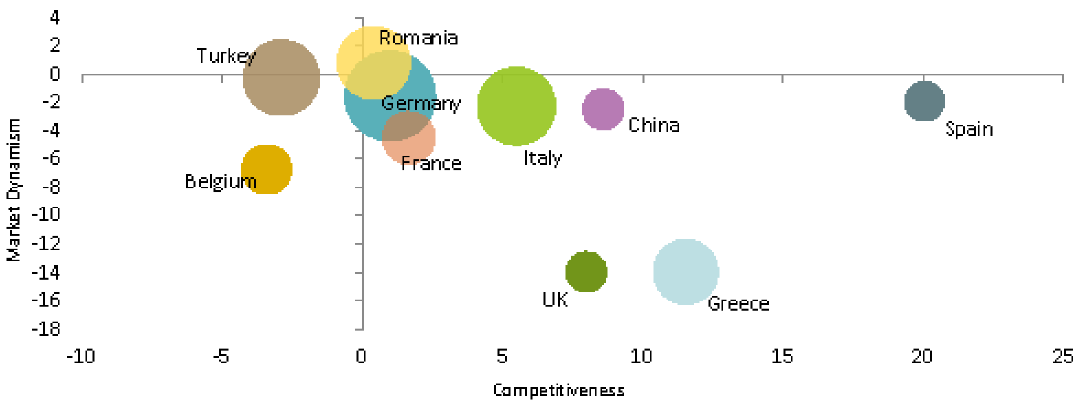
Risks to the inflation outlook are largely tilted to the downside. Stronger-than-assumed fall in prices of crude oil and other non-energy commodities would trigger a larger decrease in the headline rate. At the same time, weaker domestic demand could result in more subdued core inflation than currently expected.. On the other hand, supply disruptions of major agricultural commodities, especially food products, on a global scale as a result of adverse weather conditions could cause higher inflation in Bulgaria. A possible supply freeze agreement among OPEC members could also result in a faster-than-assumed rebound in international oil prices.

2.4.3 External sector

In 2015, the balance of the *current* and of the *capital* account improved. The overall balance reached a surplus of EUR 2 billion (4.6% of GDP) against EUR 1.3 billion (3.1% of GDP) in 2014.

The improvement came on the back of positive balance on *Goods* and *Services*, as well as the higher balances on *Secondary Income* and *Capital Transfers*, which traditionally post surpluses. The better performance in *services* was driven by an accelerated increase in export of *other business services* (in particular, of technical, trade-related and other business services). Export of goods increased by 5.5%, and surpassed the rise in import (1.3%). Since the decrease in international prices resulted in negative deflators, the reported nominal increase in both export and import was due to large quantities traded. The import growth was driven by the raw material requirements of the export-oriented sectors, while the export dynamics was influenced by one-off effects as well as by improved competitiveness.

Figure 2-5: Export competitiveness vis-à-vis 10 leading trade partners[7] (pp)



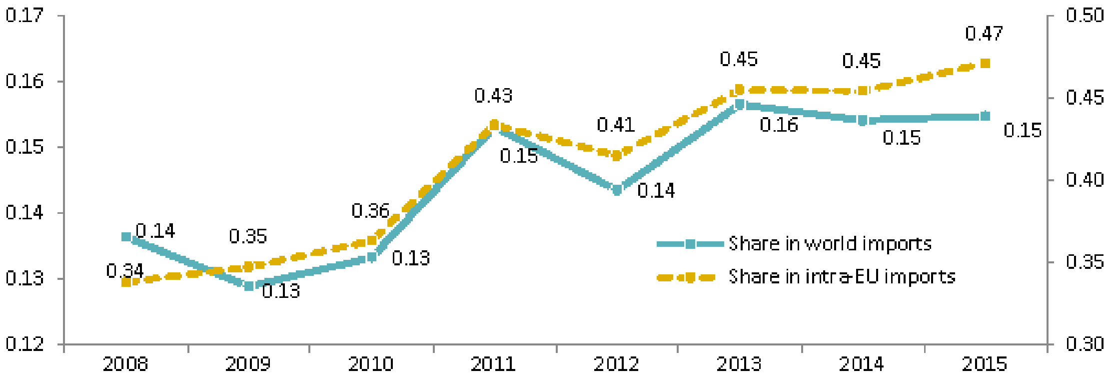
Source: International Trade Centre, MF

[7] The size of the bubbles reflects the country's share in Bulgaria's export in the period January – September 2015. Market dynamics is calculated as the difference between the national and the global annual increase in import in the period January-September 2015. Competitiveness is the difference between the increase of Bulgaria's export to those countries and the increase in their import.

In 2015, most of Bulgaria's foreign trade partners reported weak market dynamism characterised by low total import. Nevertheless, the competitiveness of Bulgaria towards most of them improved.

The dynamics of export resulted in improvement of Bulgaria's market positions. The share of Bulgaria's export in world imports remained unchanged on average during the January-September period. However, growth in export was higher than growth in intra-EU imports.

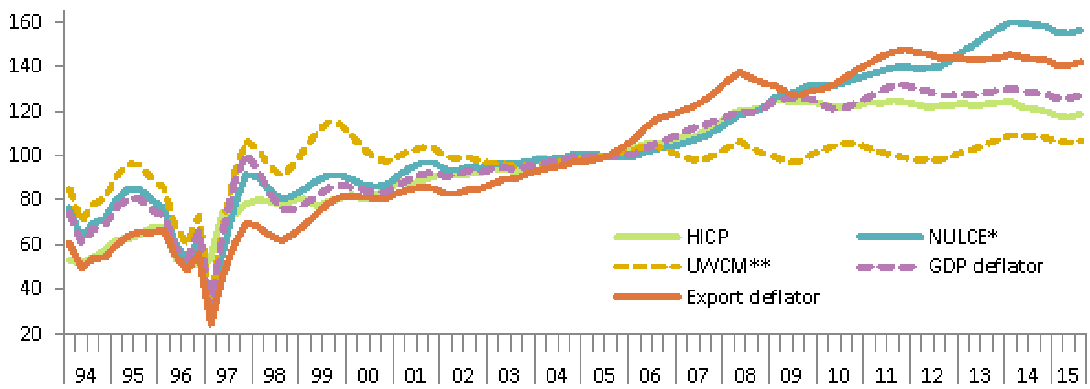
Figure 2-6: Bulgaria's share in international trade (%)



Source: MF estimates based on WTO and Eurostat data

The development of the real effective exchange rate (REER) based on different deflators showed that the indicator has considerably slowed down its growth rate in the post-crisis period and has even registered separate periods of decline compared to the same quarter a year earlier. Only REER based on nominal unit labour costs for the total economy reported accelerated growth in 2013 till mid-2014 mainly as a result from the accelerated increase in unit labour costs. There was also an influence, though not as significant, coming from the observed appreciation of the Euro and the related increase in the nominal effective exchange rate. Since early-2015, however, an adjustment was observed and REER with this deflator reported a decrease on an annual basis during the first three quarters of the year.

Figure 2-7: REER, Bulgaria vis-à-vis 36 industrial countries, 2005=100



* Nominal unit labour costs in total economy

** Unit wage cost in manufacturing (EC methodology)

Source: EC, MF

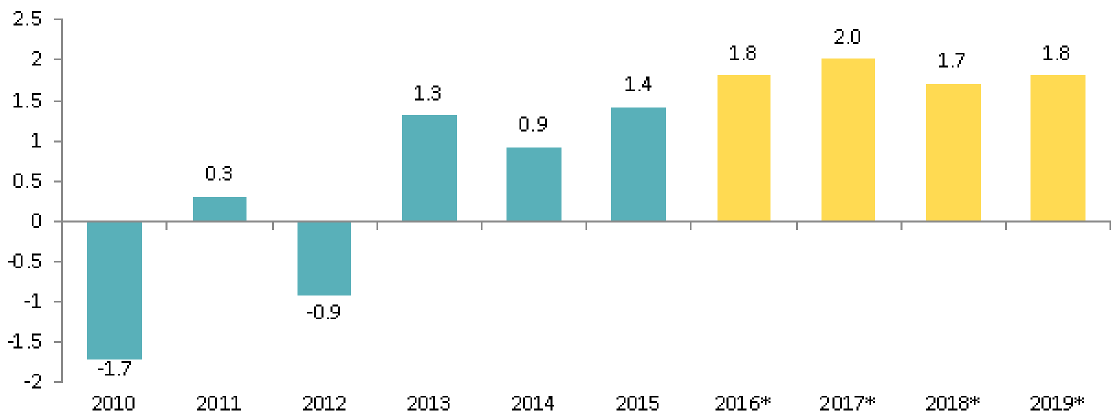
REER based on the nominal unit wage costs in manufacturing (compensation of employees to GVA) is considered a more reliable measure of competitiveness as it compares the increase in labour costs in the tradable sector of the economy with that in Bulgaria's main trade partners. The lowest accumulated increase compared to the base year 2005 is observed exactly with this indicator and, what is more, its development in the past year generally follows that of the nominal effective exchange rate.

In the medium term, REER of the Bulgarian lev is expected to continue appreciating as a result of the positive differential of labour productivity growth and the pace of economic convergence towards the more advanced EU Member States.

In 2016, export will continue to grow in real term, but at a more moderate pace. The change in resource requirements of the export-oriented sectors will restrict import growth, although the deceleration will be limited by the stronger increase in consumption. The continuing downward dynamics of international prices in 2016 will keep the trade deflators negative but the decrease in export prices will be smaller than the decline in import and positive trading conditions will persist, just as in 2015. Therefore, we expect an improvement in the balance of trade. The balance on *Services* and on *Primary income* will remain practically unchanged as a share of GDP. As final payments under the operational programmes of the 2007–2013 period are made and work under the new programming period (2014–2020) is starting, there will be a decrease in the related current and capital transfers in 2016. Nevertheless in the current year the improved trade deficit will fully compensate for the lower surplus on *Secondary income* and the *Current account balance* will improve to 1.8% of GDP. The *Capital account* surplus will be below 2% of GDP.

With the acceleration in domestic demand starting from 2017 imports growth will also speed up. Still, real growth in export is expected to outpace that of import till 2018. The expected price dynamics of main commodities will result in import price deflator surpassing the export price deflator, leading to negative terms of trade. Reflecting both price and volume dynamics trade deficit will continue to improve up to 2017 and will gradually increase afterwards. Throughout the forecast period the negative trade balance will be entirely offset by the surplus on *Services* which will amount to 6.2-6.3% of GDP, supported by a moderate increase in revenues from tourism and intensified trade in other services. There will be a smooth increase in the surplus on *Secondary income*, through transfers from the EU. After the initial improvement, the *Current account* balance will remain at the level of 1.7-2% of GDP over the forecast period.

Figure 2-8: Current account (% of GDP)



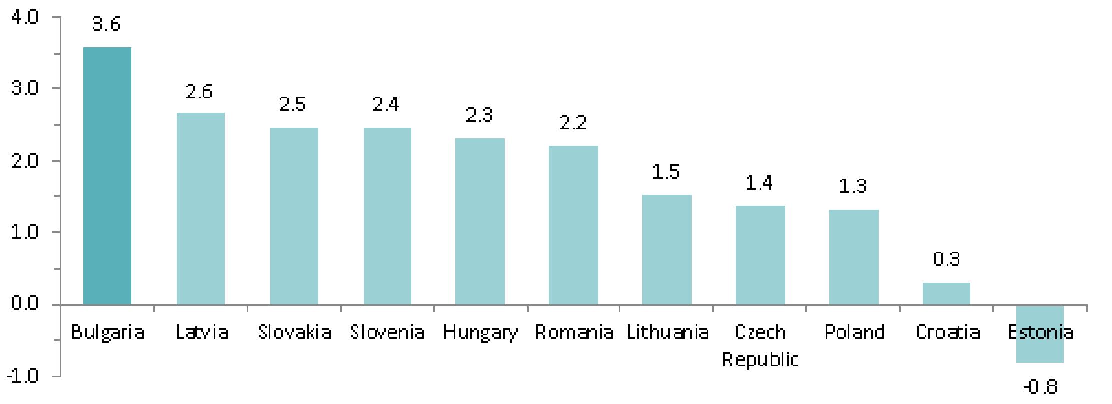
* Forecast, MF

Source: BNB, NSI, MF

In 2015 there were net financial flows in Bulgaria worth EUR 940 million, recorded under the *Financial account*[8] *of the Balance of Payments*. The main contribution came from *foreign direct investment*. Inward FDI amounted to EUR 1.6 billion, making up 3.6% of GDP, and took the form of equity holdings and reinvested earnings by parent companies to local entities.

[8] Analytical presentation of the balance of payments

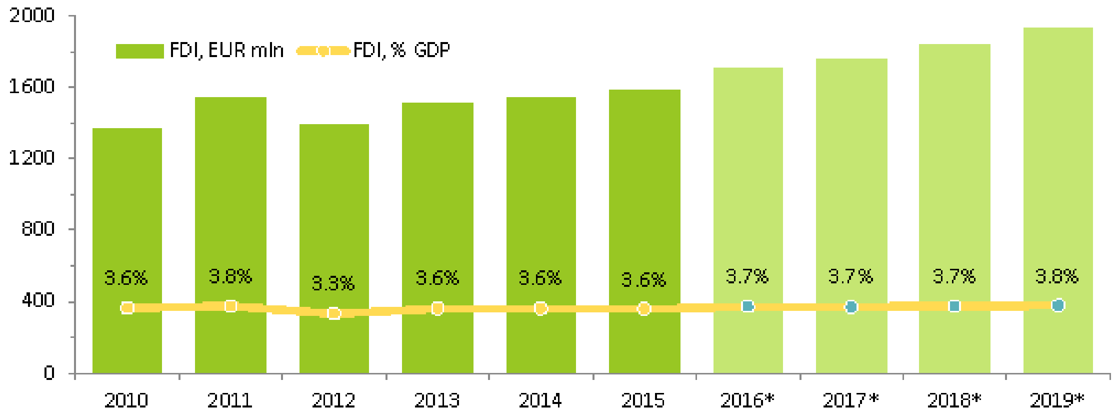
Figure 2-9: FDI flow in the country – EU-10 (% of GDP, 2015)



Source: Eurostat, MF calculations

FDI levels in the country are expected to remain at about 3.7% of GDP over the 2016–2019 period. The contribution of net *Portfolio investments* to the *Financial account* will be determined by government's incurring new debt and by the repayment of principal under the government debt in Euro bonds maturing in 2017.

Figure 2-10: FDI dynamics, Bulgaria



Source: BNB, NSI, MF

The negative risks to the forecast result from the unstable external environment. Possible unfavourable developments in the EU countries and Turkey which are Bulgaria's major trading partners could considerably limit export, while the uncertainty in the region would lower investors' interest and thus the inflow of FDI.

2.4.4 Monetary sector

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

As of December 2015, the market value of Bulgaria's international foreign currency reserves – the assets in the balance of BNB's Issue Department[9] - increased by EUR 3.8 billion year-on-year, to EUR

[9] The market value of international foreign currency reserves includes adjustments covering transactions, exchange differences and price revaluations.

20.3 billion. Foreign currency reserves covered 8.5 months of import of goods and non-factor services, and the reserves to short-term external debt ratio amounted to 257.3%. As of February 2016, international foreign currency reserves amounted to EUR 19.7 billion, going up by EUR 2.6 billion year-on-year mainly as a result of increased liabilities to the government and to budget organisations and liabilities to banks, as well as, to a lesser extent, as a result of increasing money in circulation.

According to the currency board operating principles, the increase in the international foreign currency reserves corresponded to an increase in the book value of the liabilities of the Issue Department. The increase in the banks' deposits at the BNB was the main contributor to the increase in liabilities year-on-year at the end of 2015. In the context of limited investment opportunities, banks preferred to keep their excess liquidity, resulting from the continued increase of deposits in the banking system in the context of weak lending activity, in the form of excess reserves with the BNB. The measures taken by the BNB to counteract external risks to the banking sector in Bulgaria also contributed to a stronger liquidity position of banks. In December, the excess reserves of banks, estimated as the amount with which the funds, kept by banks in accounts with BNB, exceed the required minimum reserves under Ordinance No. 21, amounted to a daily average of 127.8% (56.5% at the end of 2014).

On 26 November 2015, the Governing Council of the BNB approved new Ordinance No. 21 on Minimum Required Reserves Maintained with the Bulgarian National Bank by Banks, effective as of 4 January 2016. The ordinance introduces a definition of "excess reserves"[10] maintained by banks with the BNB and a negative value of the interest rate on excess reserves when the interest rate on the deposit facility of the European Central Bank (ECB) is negative. The zero interest rate on excess reserves when the interest rate on ECB's deposit facility is positive or equal to zero is preserved. Under the new ordinance funds kept by the banks in accounts with the national system component TARGET2-BNB are no longer recognized as reserve assets. In February 2016, the amount with which the funds kept by banks in accounts with BNB exceeded the required minimum reserves, amounted to a daily average of 108.1%.

In 2015, the dynamics of monetary and credit aggregates was determined mainly by the continuing increase in deposits of households and of non-financial corporations and their reluctance to take on new liabilities in the context of a still uncertain economic environment.

The funds held by the non-government sector in the banking system followed an upward trend throughout 2015 There was a change in households' preferred form of savings during the year. The changes in the coverage of the personal income tax on interest from deposits[11] and the relatively higher yield of deposits with agreed maturity encouraged households to prefer term deposits over deposits redeemable at notice which were their preferred form of savings in 2014. There was also increase in the overnight deposits held by households, but to a lower extent compared to term deposits. The non-financial corporations maintained the long-term trend of keeping their funds mainly in overnight deposits. The upward trend of funds attracted from the non-financial sector determined overnight deposits as the main contributor to the annual growth of broad money at the end of 2015, with lower contribution of money outside MFI and deposits with agreed maturity. In December 2015, annual broad money growth amounted to 8.8% (1.1% as of December 2014[12]). In

[10] According to Article 5(1) of the new Ordinance No. 21, "excess reserves" is the excess of the holdings in reserve assets by more than 5 per cent over the required amount of minimum required reserves.

[11] The coverage of the pesonal income tax was extended to interest on all types of deposits with the exception of child deposits with an amendment to the Personal Income Tax Law, with effect from the beginning of 2015.

[12] As a result of the revocation of Corporate Commercial Bank's (CCB) licence for banking activities, CCB was excluded as a reporting unit from the scope of monetary statistics with effect from November 2014.As a result, the annual change in monetary and credit aggregates from November 2014 till November 2015 reflects the effect of the bank's exclusion from the scope of monetary statistics. The annual dynamics of monetary and deposit indicators was influenced also by the payment of guaranteed deposits in CCB, which started on 4 December 2014, most of which remained in the banking system.

January 2016, broad money increased by 6.6% yoy, with overnight deposits remaining the main contributor to the growth of M3 monetary aggregate.

As of December 2015, deposits held by households and non-financial corporations registered increase at 8.5% and 18.7% respectively, compared to end-2014, contributing 5.8 and 5.0 pp accordingly to the overall yearly growth of deposits held by the non-government sector. In January 2016, the annual growth in deposits held by households slowed down to 7.1%, and of deposits held by non-financial corporations – to 12.6%.

The weak demand for loans from non-financial corporations and households and the continuing prudent policy of banks in granting new loans determined the low lending activity in 2015. Furthermore, the actions taken by banks to optimise their balances, including by selling portions of their credit portfolios, also affected the dynamics of lending. As of December, claims on the non-government sector decreased by 1.6% compared to end-2014. Decrease yoy was observed in claims on non-financial corporations (-1.6%), as well as in claims on households (-1.3%). Loans for housing needs were the main contributor to the negative growth in loans to households. Decrease was observed also in overdraft and in other loans, whereas consumer loans had slightly positive contribution for the most part of the year. As of January 2016, claims on non-financial corporations and on households decreased by 1.9% each yoy.

According to the data from the quarterly bank lending survey conducted by the BNB, in 2015 the demand for loans from households and from non-financial corporations increased but remained at relatively low levels. The increased demand for loans from households was somewhat stronger in terms of consumer loans compared to loans for housing purposes. The banks reported loans granted to corporations to finance working capital and inventories, as well as for investment purposes, as the factors contributing to the increased demand for corporate loans. In the first two quarters of 2015 lending standards were eased for loans to non-financial corporations as well as for loans to households. In the second half of the year the credit policy with regard to corporate lending remained almost unchanged, whereas easing of lending standards continued with regard to consumer loans and, to a lesser extent, with regard to loans for housing purposes. Banks offered more favourable terms in respect of interest rates, fees and commissions, motivating their policy by the lower cost and increased volume of attracted funds, the stronger competition in the sector and the absence of gainful investment alternatives. At the same time, the lending standards for the maximum amount of the loan and the premium for riskier loans in corporate lending were slightly tightened, with banks reporting credit risk, collateral risk and the uncertainties in the macroeconomic environment as factors for that.

The increased liquidity in the banking system, the weak lending activities and the interest rates on the interbank money market in the Euro area and in Bulgaria contributed to a continuing downward trend of interest rates on deposits in 2015. As of January 2016, the weighted average interest rate on new[13] fixed-term deposits[14], presented as a weighted average on a 12-month basis, declined to 1.2% compared to 2.4% a year earlier. The decline in the cost of attracted funds and the increased liquidity of the banking system in the context of low demand for bank loans contributed to lower interest rates on loans. As of January 2016, the weighted average interest rate on newly contracted loans[15], presented as a weighted average on a 12-month basis, declined by 0.8 pp against the same month of the previous year, to 6.9%. Over the same period, the average interest rates on newly contracted loans to households and enterprises decreased respectively by 1.0 pp and 0.9 pp to 8.5% и 6.3%.

In 2015, the Bulgarian banking sector continued reporting stable financial indicators, with growth in balance sheet assets and deposits and enhanced liquidity and capital position. In the context of

[13] The terms "new" deposit agreements and "new" loan agreements refer to the statistics category "new business".

[14] Weighted average interest rate on term deposits for the household and non-financial corporations sectors, weighted in terms of currency and term.

[15] Weighted average interest rate on loans for the household and non-financial corporations sectors, weighted in terms of currency and term.

unstable international environment and deteriorated economic and financial situation in Greece, the liquidity of the banking system was enhanced further. Maintaining liquidity at high levels and keeping the capital buffers remained in the focus of the additional measures applied by BNB to all lending institutions in the country with a view to counteracting external risks to the Bulgarian banking sector. Additional precautionary limitations were introduced for the banks in Bulgaria with Greek shareholding, which made those banks completely independent of their parent companies with regard to their activities on the territory of Bulgaria.

As of end-December 2015, the liquid assets ratio of the banking system, calculated according to Ordinance No. 11 of BNB, increased to 36.71% (30.12% as of December 2014). In January 2016, the liquidity position of the banking system continued to strengthen and at the end of the month the liquid asset ratio reached 36.83%.[16]

As of 31 December 2015, the profit of the banking sector amounted to BGN 854 million. This financial result ensured a return on assets of 0.98% (0.85% at end-2014).[17] The total capital adequacy of the banking system remained high at a level of 22.18% as of December 2015, including the Tier 1 capital adequacy ratio of 20.46%. At end-2015, the capital in excess of the minimum required capital adequacy of 8% (including the capital conservation buffer (2.5%) and the systemic risk buffer (3%)) fully covered the net amount of non-performing loans (after impairment)[18].

A number of important legislative changes related to the operation of the banking system and banking supervision were made in 2015[19]. The Law on the Recovery and Resolution of Credit Institutions and Investment Firms (LRRCIIF) and a new Law on Bank Deposit Guarantee were adopted on the 30th of July 2015. The two laws took effect on the 14th of August 2015.

According to the provisions of LRRCIIF, BNB is the bank resolution authority. In early November 2015, the Governing Council of BNB designated an independent structural unit to support the council in the discharge of its functions of a bank resolution authority.

In addition, a Bank Resolution Fund (BRF) was established for financing the application of the resolution tools and powers by BNB. At the end of November 2015, the Governing Council of BNB set the total amount of the banking system's 2015 contribution to BRF at BGN 82.2 million.

According to LRRCIIF, in order to ensure the effective functioning of the financial system and given the need to ensure greater transparency of financial market operations in the Republic of Bulgaria in accordance with the National Reform Programme Europe 2020, adopted with Decision No. 28 / 2015 of the Council of Ministers, the BNB shall conduct an asset quality review (AQR) of the banking system within 12 months from the entry into force of the Law. After reporting the outcomes of the AQR, the BNB shall conduct stress test of the banking system in order to determine the ability of banks to absorb unexpected losses in extreme stress situations. The AQR process was launched at end-July 2015 and its preparatory phase was completed on 12 February 2016. The asset quality review and the stress test of the banking system are scheduled for completion in mid-August 2016. These measures also implement Country Specific Recommendation 2 of the Council of 14 July 2015 on Bulgaria's National Reform Programme.

The new Law on Bank Deposit Guarantee implements in national legislation the requirements of Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes. On 21 January 2016, the Governing Council of BNB approved Ordinance No. 30 for calculating the amount of banks' due premiums under the Law on Bank Deposit Guarantee.

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16 The amount of liquid assets in the banking system was not significantly affected by the changes announced in the new Ordinance No. 21 of BNB on the Minimum Required Reserves Maintained with BNB by Banks.

17 Preliminary data as of 18.03.2016.

18 Net amount of gross non-performing loans (after impairment) represents the residual credit risk in bank balances.

19 The 2015 changes related to the operation of the banking system and banking supervision are presented in greater detail in the 2016 National Reform Programme.

The other important legislative changes in the field of banking system and banking supervision operation, promulgated in 2015, included amendments to the Law on Credit Institutions and to the Law on Bank Bankruptcy.

On 5 October 2015, the Governing Council of BNB approved the Plan on Reforms and Development of Banking Supervision which contains priority actions and implementation deadlines till the end of 2016. The reform and development of banking supervision aim to bring Bulgarian supervision practices in compliance with the current international standard – the 2012 *Basel core principles for effective banking supervision*. The Banking Supervision Department was reorganised as of 1 November 2015.

As mandated, the BNB provides macro-prudential oversight of banks in order to maintain the stability of the banking system. Examination and development work was carried out in 2015 in order to calibrate a countercyclical capital buffer to protect the banking system against potential losses from cyclical systemic risk accumulated during periods of excessive credit growth. In December 2015, the Governing Council of the BNB set the countercyclical buffer rate applicable to credit risk exposures in Bulgaria from early 2016 to 0%.[20]

According to the MF's forecast, the annual growth rate of money supply is expected to reach 8% in 2016 and to accelerate slightly to 8.3% in 2017. The gradual acceleration trend of broad money growth will be maintained till 2019 when this growth will reach 9%. Banking system deposits will increase at rates close to those of money supply throughout the forecast period. In 2016 and 2017 the main contributors to this growth will be overnight deposits but in 2018 and 2019 their growth will slow down while the growth of less liquid deposits (with agreed maturity and redeemable at notice) will accelerate.

Credit growth to the private sector will gradually strengthen in the 2016–2019 period. At the end of 2016, its growth on an annual basis will remain slightly negative (-0.4%), continuing to reflect mainly the reluctance of companies and households to take on new liabilities, as well as the optimisation of banks' balances. Growth in credit to the private sector will accelerate more visibly in 2017, to 2.4%, and at the end of 2018 and 2019 it will reach 4.2 и 5.5% respectively. It will be driven mainly by the growth in corporate loans which in 2016 and 2017 will cover mainly working capital needs while in the last two years of the review period the role of investment loans will increase. Loans to households will also accelerate owing to consumer loans and housing loans, driven by the projected acceleration of growth in private consumption, the positive labour market dynamics in respect to employment and income, and the ongoing recovery of the real estate market.

[20] Together wiht the capital conservation buffer and the systemic risk buffer introduced in 2014, this is the third buffer which all banks should maintain above the minimum regulatory requirement of 8%.

3 Government Balance and Debt

3.1 Policy strategy

Maintaining the sustainability of public finances is a major priority of fiscal policy in the medium term. It is to be achieved by creating a reliable basis for the stability of the budgetary framework through adherence to the determined gradual fiscal consolidation steps within the annual range of 1.1%-0.4% for the General Government deficit under ESA 2010 and 0.5% annual improvement of the structural deficit for the 2016-2019 period. This is essential for complying with the reference value for the General Government budget deficit under the Stability and Growth Pact requirements.

Major changes to the basic taxes and tax rates are not envisaged in the medium term and the government priority in the area of tax policy, namely preserving the tax system and keeping low the share of the government-reallocated GDP, is maintained. The forecast of revenue takes into account the favourable trends for the stabilisation of the national economy confirmed by the current spring macroeconomic forecast. Additional positive fiscal effects are expected from the discretionary revenue measures.

With regard to expenditure, the main objective is to limit its annual growth to the potential GDP growth. Efforts to limit expenditure by optimising the expenditures of budget organisations and by improving the efficiency of public expenditure in the individual sectors continue.

Continuing the policy of gradual consolidation is a prerequisite for minimising the potential negative effect of fiscal policy on economic growth and for achieving progress in implementing the Council's 2015 Country Specific Recommendation addressed to Bulgaria's fiscal policy.

The Government Debt management policy, implemented by the Ministry of Finance, is crucial for the dynamics and structure of the consolidated debt of the General Government sector due to the fact that central government debt accounts comprise around 99% of the latter.

The main goal of the borrowing policy will be oriented to secure the resources needed to finance the state budget and to refinance debt outstanding as a direct consequence of the need to cover maturing debt, budget deficit and to ensure the stability of the fiscal reserve. Government debt management will be implemented taking into account the situation and development outlook of different economic sectors, in relation to the 3-year macroeconomic forecasts, and proposing different options for action depending on the drivers on the domestic and international markets and in the fiscal sector. New government debt will be issued within the debt limitations envisaged in the respective annual State Budget Act and taking into account the effects of the adopted borrowing strategy on the government debt's risk parameters and servicing cost.

Efforts will be focused on securing government's access to financial resources by means of free market-based funding, both on the domestic and international market, mainly through the existing Global Medium term Note Programme of the Republic of Bulgaria for issuing government securities on international capital markets, following an analysis and assessment of the various sources of debt financing (internal and external) and of the specifics and conditions on debt markets. The planning and implementation of an issue policy for offering market-based debt instruments will be tailored to the financing needs and the investor demand, including maintaining a well-functioning and diversified debt market by offering highly liquid debt instruments with appropriate yield to risk ratio, positioned in all maturity segments.

3.1.1 Medium term objectives

The fiscal consolidation process will continue in the medium term. The targets for the General Government deficit for the 2016–2019 period are as follows: 1.9% of GDP for 2016, 0.8% of GDP for 2017, 0.4% of GDP for 2018 and 0.2% of GDP for 2019.

The adjusted deficit target of the General Government sector will be achieved mainly by measures in the revenue side of the budget aimed at improving the revenue collection rate and combating shadow economy whereas measures of a horizontal nature will be applied to limit expenditure.

In the medium term, high reliance is placed on increasing government revenue in nominal terms and limiting government expenditure. Fiscal consolidation, supported by tax measures, is expected to lower deficit to 0.8% of GDP on an accrual basis in 2017 and by 2019 the budget balance will improve to -0.2% of GDP. In 2017, consolidation will be driven mainly by cyclical factors, in particular through the slightly increased inflow of funds from the European Union in the early phases of the projects from the 2014–2020 programming period, which corresponds to the lower real expenditure. According to the current forecasts, the expenditure of the General Government sector, measured as a percentage of GDP, will decrease by 1.0 pp in 2017 compared to 2016 and will be accompanied by an increase in revenue (by 0.2 pp in 2017 compared to 2016), with the consolidation strategy remaining valid in the medium term.

As regards revenues, the government increases the excise duty rates applied to tobacco products and continues the implementation of its programme for changing the parameters of the pensions and social security policy. In the medium term, the government intends to preserve taxation (as a percentage of GDP) below its 2017 level and at the same time it plans to increase the social security burden in 2017 and 2018.

The budgetary forecast envisages reaching a close to balanced budgetary position by the end of the forecast period (deficit under ESA'2010 at 0.2% of GDP in 2019), supported by positive outlooks for a sustainable economic growth in the medium term which generates sufficient tax revenue and creates prerequisites to decrease certain government expenditures.

3.2 Actual balances and updated budgetary plans for the current year

In 2015, the fiscal parameters developed positively compared to the assumptions in the previous Convergence Programme. Greater than the planned consolidation effort was achieved in respect of the 2015 deficit targets for the General Government sector. With a deficit target of not more than 2.8 per cent of GDP, assessments show that the deficit for the year will come up at about 2.1 per cent of GDP. Thus the one-off deficit deterioration in 2014 as a result of the sector reclassification of the Bank Deposit Insurance Fund[21] was immediately adjusted in 2015 and the government continued to pursue the strategy of gradual fiscal consolidation in the medium term.

[21] Estimates in the April EDP notification tables show that in 2014 the deficit of the General Government sector came up at 2.8 % of GDP. Pursuant to Council Regulation No. 479/2009 on the application of the Protocol on the excessive deficit procedure, Eurostat expressed reservations on the sector classification of the Bank Deposit Insurance Fund (BDIF) and the effect of the insured deposits paid in Corporate Commercial Bank AD on the deficit of the General Government sector. On 21 October 2015, Eurostat withdrew the reservations exressed on the sector classification of the BGIF, after NSI revised the data in the October EDP notification tables for the 2014 deficit and debt and included the unit in the General Government sector. Thus the assessment of the 2014 deficit of the General Government sector was revised to deficit at 5.8% of GDP. The 3 pp difference between the estimates and the assessment is mainly due to the reclassification of the BDGF in the General Government sector. Till 2013 BDIF was classified in the financial institutions sector and its balance-sheet transactions did not affect the deficit of the General Government sector. Eurostat conducted a horizontal analysis of the sector classification of such units in all Member States, in the context of the methodological requirements of ESA2010. This has led to the reclassification of a couple of such units into the General Government sector in other Member States. Despite the revision to Bulgaria's 2014 deficit, EC has decided not to launch an excessive deficit procedure against Bulgaria because BDIF's 2014 commitments are of a provisional nature and will not affect the deficit for the following years.

A number of internal and external factors contributed to the positive development of the budgetary position in 2015. On the revenue side, positive developments were observed mainly in tax revenues and proceeds from social and health insurance contributions. Stronger border and inland fiscal control, the enforcement measures with regard to overdue liabilities, the continuing operation of the VAT reverse charge mechanism for grains and industrial plants, the combat against tax and social and health insurance contributions fraud and evasion and a number of other measures of the revenue administrations, on one part, as well as the improvements in the main macroeconomic aggregates, on the other part, were among the main contributors to the positive development on the revenue side. Last but not least, 2015 was the last year for finalising the projects under the operational programmes of the 2007–2013 programming period and, on one side, this required a wider pool of resources by the national budget to prefinance expenditure while on the other side it resulted in growth in EU grants for reimbursement of certified expenditure under finalised projects.

Improvement against estimates is reported for most of the main macroeconomic indicators. Real GDP growth reached 3 percent, compared to the 1.4 growth set in the previous Convergence Programme. Accelerated economic growth, driven mainly by export, had a positive effect on tax revenue. The economic activity intensified over the year, which was reflected in higher production capacity utilisation, increased employment, growth in foreign investment etc. The completion of projects co-financed from European programs and funds in the 2007-2013 programming period was a major contributor to the increased dynamism of the economy. The favourable external environment also had a positive effect. The economies of Bulgaria's major trading partners registered growth, pushing up Bulgarian export. The prices of imported energy carriers were on a downward trend which was in support of Bulgarian users and consumers. After the initial negative effects of the Russian market closure, producers and traders gradually adjusted to the new conditions and refocused their economic interest to new areas.

The measures taken by the revenue administrations to increase the collection rate of public claims, to fight tax and social security contributions fraud and evasion, the efforts to fight smuggling, etc., began to yield results and this is also a major contributor to increased tax revenue. Growth in revenues from excise duties is particularly significant in this respect. The YoY growth of the revenues from excise duties (on cash basis) amounted to almost BGN 0.5 billion or 12.1 per cent and revenues considerably exceeded the annual projections. Notable increase was registered also in revenues from social and health insurance contributions, as well as in the case of most main taxes.

Successful completion of the projects from the 2007-2013 programming period was the main priority on the expenditure side. The managing authorities and the beneficiaries of the different programmes put tremendous efforts into implementing the contracted projects within the deadlines set for that purpose and into minimising the loss of European financing. The data show that the gross fixed capital formation of the General Government sector increased by 23.8 compared to the previous year, driven mainly by the accelerated absorption of the finances on EU programmes and funds. Another challenge emerged in the course of budget implementation: the envisaged decrease in personnel costs could not be realised in full in some sectors, including the unforeseen compensation costs, etc. Efforts were made also to settle arrears in the budgets of ministries and agencies. Given the revised revenue forecasts and the need to secure additional funds on a cash basis to finalise the projects under the EU programmes and funds for the 2007–2013 programming period, the parameters on a cash basis in the 2015 SBA had to be amended. It should be noted, however, that notwithstanding the changes in the framework on a cash basis, the forecast of the deficit target for the General Government sector remained unchanged compared to the value set in the previous Convergence Programme, as estimates were more conservative due to the higher level of uncertainty in the assessments on the actual implementation of a large portion of the projects under European programmes in the last quarter of the year.

In line with the positive developments on the revenue side the reported improvement in the 2015 deficit in ESA 2010 terms is greater than the one forecast in the updated annual estimates.

3.2.1 Budgetary development in 2015

In 2015, the total general government revenues as a ratio of GDP reached 38.2%, going up by 1.9 pp compared to the 2014 level. The revenues of the General Government sector were by 2.2 pp higher than the projections in the previous Convergence Programme. The external and internal factors described above are the main contributors to the better performance against the forecast in the last year's Convergence Programme.

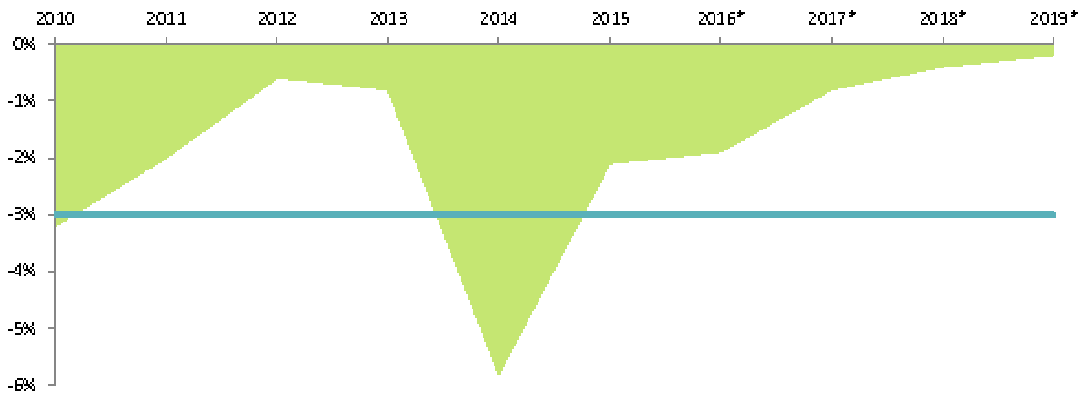
Increase was registered in almost all revenue parameters. Compared to the previous year, the ratio of taxes on production and import to GDP increased by 0.8 pp. Revenues from VAT and excise duty are the main contributors and their increase is a result of improvements in internal consumption, intensified activity of economic agents and of the measures taken by the revenue administrations to improve the collection rate and to fight smuggling.

Compared to 2014, the ratio of taxes on income and wealth to GDP improved by 0.2 pp. For the tax on personal income the main contributors are the upward trend in employment and the increase, though negligible, in income. For corporate taxes the increase is due to the increased positive financial result of companies which, in turn, reflects the economic recovery.

Social and health insurance revenues as a ratio to GDP increased by 0.4 pp against the previous year, driven by the aforementioned factors with effect on the personal income tax and by the increase in the maximum insurance income, the increase in the minimum thresholds for social security contributions, the increase in employment/decrease in unemployment rates, etc. Contributors to higher revenues from health insurance contributions are also the payments by persons who in 2015 availed themselves of the option to re-establish their health insurance rights.

The share of capital transfers received increased by 1.5 pp against the level of previous year, to a peak value for the past few years. This amount includes the main portion of the grants effectively transferred to Bulgaria by the EC and the accrued claims on the EC for reimbursement of certified expenditure under the EU programmes and funds. The growth registered in this indicator in 2015 is a result of the efforts endeavoured in finalising the projects from the 2007–2013 programming period and of the maximum absorption of the funds from the European programmes.

Figure 3-1: Budget balance (ESA'2010, % of GDP)



*Forecast

Source: Eurostat, MF

Total expenditure for 2015 amounted to 40.2 % of GDP, going down by 1.9 pp compared to the level in 2014. Over the year, expenditure policies were focused on accelerating public investment, strengthening the social commitment of the State to the most vulnerable groups of the population and securing funds for the normal functioning of the budgetary systems. Particularly significant is the change in the structure of expenditure. The ratio of expenditure for gross fixed capital formation to

GDP increased by 1 pp against the previous year. The investment and infrastructure projects implemented and paid in 2015 under the EU programmes and funds for the 2007–2013 programming period are strong contributors to the growth reported in this indicator. The end of 2015 deadline for payments on projects led to concentration of substantial expenditure in the last quarter of the year, with efforts made to accelerate work on major infrastructure projects and complete them on time. Amendments to the 2015 SBA were proposed and passed by the National Assembly for the purpose of realising this priority. They secured additional funds on a cash basis from the national budget for pre-financing of expenditure and for additional national co-financing. Transport infrastructure projects, environmental infrastructure projects and projects for other regional development aspects account for the highest share of financing from the European funds. Sizeable was also the amount of payments on projects in support of economic competitiveness and human resources development in 2015.

Relative to GDP, the expenditure on compensation of employees reported decrease by 0.2 pp against the previous year as a result of the personnel optimization in some administrative structures. Expenditure on subsidies also decreased, by 0.1 pp compared to 2014.

The amount of social transfers increased, by more than BGN 200 million in nominal terms compared to 2014. Social transfers increase as a share of GDP with the exception of those in kind. However, it is important that a distinction between the different types of social payments be undertaken. Expenditure on Pension fund increased, due mainly to the indexing of pensions by 1.9% under the "Swiss Rule" and to the increase in the amount of the maximum pension from July 2015, as laid down in the programme for the year.

The relative share of interest expenditure in GDP registered slight increase in 2015 (by 0.1 pp) compared to the previous year. Concerning the share in GDP of the capital transfers (paid) there is not significant change against the level for the previous year, which is due to a base effect in 2014 from the classification of the Bank Deposit Insurance Fund in the General Government sector. Expenditure of one-off nature was reported in 2014 in relation to payment of the guaranteed deposits to the eligible depositors in Corporate Commercial Bank AD (in insolvency). Therefore, the analysis of the indicator should take into account the base effect of the expenditure related to this transaction.

3.2.2 2016 Budgetary focus

In the forecasts of the updated medium term budgetary framework for the 2016–2018 period and the framework of the 2016 budget, the deficit of the General Government sector is set at 1.9 per cent of GDP in 2016. This target takes into account the current economic situation. Measures have been laid down in 2016 to ensure fiscal consolidation and shrink of the deficit from 2.9 % of GDP in 2015 to 2.0 % of GDP in 2016 on a cash basis under the national legislation, which is in line with the national fiscal rules requirements and corresponds to the deficit target set pursuant to ESA'2010 at 1.9 % of GDP in 2016.

The **revenue** policy is geared towards supporting economic growth, improving the business environment, fight against the shadow economy, and enhancing fiscal sustainability in the long term. The programme for the year provides for maintaining the tax burden of basic taxes, with the exception of certain increase in excise duties, and the revenue framework is planned conservatively, attaching importance to measure for improving the tax collection rate.

The **public expenditure** policy is geared towards ensuring the normal functioning of the budgetary systems and, at the same time, restructuring of expenditure in order to secure funding for the priority policies of the government and limit inefficient expenditures and structures. Measures concerning expenditures are aimed at their restricting by optimising ineffective spending, and a balance is sought between the need to reduce costs and the risk of unsecured liabilities rise in the different budgetary systems.

– **Measures on the revenue side:**

The main priorities of the tax policy are aimed at increasing budget revenues and continuing fight against smuggling; decreasing costs for businesses and citizens; promoting the investment activity and employment; continuing the measures for collecting overdue liabilities; measures for lowering the administrative burden, improving the conditions for doing business and attracting investors. The main regulatory characteristics and changes regarding taxes include:

- Keeping corporate tax rates at low levels, the personal income tax and VAT, as an important incentive for investment, economic growth and employment.
- Measures to improve the collection of tax, social and health insurance contributions by different mechanisms such as: enforcement measures for overdue liabilities, stricter control on high fiscal risk goods, preventing tax evasion, scheduled telephone campaigns, measures against the shadow economy and against smuggling. The positive overall effect of the measure on revenues is projected at BGN 84.0 million in 2016 (0.09 % of the projected GDP).
- Organising a national lottery game with receipts, as a measure to improve the tax collection rate and to address the shadow economy by promoting voluntary tax compliance. The positive overall effect of the measure on revenues is estimated at BGN 12.1 million in 2016 (0.01 % of the projected GDP).
- Increasing the excise duty rates for tobacco products. This is a step laid down in the scheduled increase of the excise duty rates to the minimum EU levels and this step-by-step process will continue in the years to come. The positive overall effect on tax revenues is estimated at BGN 92.3 million (0.1 % of the projected GDP).
- Increasing the excise duty rates for energy products used as heating fuel. The positive effect on revenues from the increased excise duty rates for energy products used as heating fuel is estimated at BGN 85.3 million (0.1 % of the projected GDP).
- The positive effect of the increased minimum wage on tax revenues is estimated at about BGN 1.6 million (0.002 % of the projected GDP).
- Decreasing the percentage deducted from the profits of companies with majority state ownership as a dividend for the State to 50 % in 2016. This is aimed at stabilising the financial condition of State-owned companies and enterprises and increasing the disposable resources to be used for maintenance and investment.

The social security policy has the following parameters on the revenue side:

- The amounts and ratios of the social security contributions to the Public Social Security (PSS) funds and the health insurance contributions in 2016 remain unchanged.
- A separate fund is set up for the employees in the Public order and safety sector as of 1 January 2016 –the Pensions for Persons under Article 69 of PSS Fund.
- The differentiated minimum insurance income of self-insured persons based on their taxable income remains unchanged in 2016, respectively at BGN 420, BGN 450, BGN 500 and BGN 550. The minimum monthly amount of the insurance income for registered farmers and tobacco producers remains unchanged, at BGN 300.
- The maximum insurance income for all insured persons remains unchanged, at BGN 2600 in 2016.
- Increasing the minimum thresholds for social security contributions for the main economic activities and occupational groups on average by 8.6 % in 2016 against 2015, with estimated positive effect on revenue for PSS at about BGN 81.0 million (0.09 % of the projected GDP).
- A multiple choice option is envisaged for the individuals born after 31 December 1959, provided that they are not granted a pension for old age and length of service, to migrate

from the Universal Pension Fund to the Pensions Fund of PSS or the Pensions for Persons under Article 69 Fund of PSS and vice versa. The positive effect on revenues is estimated at BGN 5 million (0.01 % of the projected GDP).

- An option for recalculating the pensions with reduced individual coefficient granted before 31 December 2015 is introduced for persons who by 31 December 2016 choose to transfer the funds on their individual account in a Universal Pension Fund to the Pensions Fund of PSS. The positive effect on revenues is estimated at BGN 116 million (0.13 % of the projected GDP).

– **Measures on the expenditure side**

The implementation of expenditure policies is linked to carrying out structural reforms in individual sectors. Measures to improve the efficiency of public expenditure are envisaged in the different fields, including by enhancing the role of market-based mechanisms and compliance with budget ceilings and limits.

- The national minimum wage have been increased from BGN 380 to BGN 420 as of 1 January 2016. The net effect of the measure on the budget balance is minimal because the expected higher expenditure resulting from the increased minimum wage of the budget sector employees will be offset to a large extent by the expected revenues from taxes and social and health insurance contributions on the increased pay to all employees in the other sectors of the economy whose remuneration is equal to the minimum wage. The increased amount of the minimum wage is aimed at achieving increase in nominal terms in the incomes of the lowest income groups in the labour market. Pursuing such income policy will contribute to social cohesion and equal opportunities for all groups of the population to have a fulfilling social and productive life, which is fully in line with the established practices in the EU Member State for protecting the income and living standard of the low-paid workers and the "working poor" and for applying minimum standards to ensure acceptable standard of living.
- In the school education system for 2016, an increase of the standards for the funding of educational activities is ensured, which guarantees the realized in the end of 2015 growth of the pedagogical and non-pedagogical staff in the system. Increasing the remunerations in the sector is a key prerequisite for attracting young people to the teaching profession and for enhancing the quality of education in the longer term. The additional funds in the amount of BGN 95.2 million used for increasing the unified funding standards per child and per student compensate the growth of the minimum teacher salary by 5.7% on average and of the other remunerations in the system. The effect on expenditure is estimated at 0.11 % of the projected GDP.
- With a view to maintaining the administrative capacity and the normal functioning of the three biggest agencies under the minister of labour and social policy (Social Assistance Agency, Employment Agency, General Labour Inspectorate Executive Agency), personnel funds will be increased in 2016. The effect on expenditure is estimated at 0.01 % of the projected GDP.
- Additional funds estimated at BGN 10 million (0.01 % of the projected GDP) are envisaged for increasing the personnel costs for the employees in museums, art galleries and libraries on national territory.

– **Measures regarding pensions, social and family assistance:**

- In 2016, the application of the so-called "Swiss rule" will continue, i.e. all pensions will be subject to indexation as of the 1st of July of the corresponding year by a percentage, equal to the sum total of 50 per-cent of the increase in the insurance income and 50 per cent of the consumer price index during the previous calendar year. The planned increase for 2016 is 2.5%. The increase in pensions as of 1 July, the year-round payment of the higher pensions increased as of 1 July 2015, the legislative changes related to the option of choosing between UPF/OPF and PSS and transferring the pension respectively, among other things, will result in net increase in expenditure by BGN 244.3 million (0.27% of the projected GDP).

- The maximum amount of the one or several pensions granted is maintained at BGN 910 in 2016.
- The age and the insurance length of service for entitlement to pension were increased for all categories of labour as of 1 January 2016 and minimum age for entitlement to pension was introduced for the employees in the Security sector. This resulted in decrease in pension costs by BGN 23.6 million. (0.03 % of the projected GDP).
- An option for retiring with entitlement to less than the full amount of the pension was introduced for people who have not reached the retirement age by 12 months but have the required insurance length of service. The increase in expenditure as a result of this measure is estimated at BGN 32.0 million (0.04 % of the projected GDP);
- The option of granting PSS pensions to first and second category workers who are not eligible to retire with entitlement to pension from an occupational pension fund is maintained. The increase in expenditure as a result of this measure is estimated at BGN 20.8 million (0.02 % of the projected GDP);
- To support the pensioners with the lowest pensions, in April 2016 an additional payment will be granted to all pensioners with pensions below the poverty line – BGN 300 inclusive. The total amount of these payments which is BGN 50.5 million will increase expenditure by 0.06% of the projected GDP.
- The parameters of the existing legislation in the field of social and family benefits and compensations will not change in 2016: the period of payment of cash benefits for pregnancy and maternity and the amount of compensation for raising a child aged from one to two years will remain unchanged; the arrangements for granting compensation for temporary disability remains unchanged; the period based on which short-term benefits for temporary disability and unemployment and for pregnancy and maternity are calculated remains unchanged; the size of the lump-sum benefit in case of death remains unchanged; the maximum amount of the guaranteed claims of workers and employees from the Guaranteed Claims of Workers and Employees Fund for unpaid wages in the event of bankruptcy of the enterprise remains unchanged; the minimum and maximum amount of unemployment benefits also remains unchanged.

The priority of the policy in support of families with children is to improve the effectiveness and focus of family assistance for raising children in a family environment. The amendments to the Family Child Benefits Act, effective as of 01.01.2016, aim to improve the effectiveness and focus of family assistance. They relate mainly to: increasing the amount of the average monthly income per family member, which serves as a threshold for the entitlement to family child benefits, to BGN 400 as of 01.07.2016; the lump-sum childbirth allowance was increased from BGN 200 to BGN 300 for the third child; a lump-sum adoption allowance of BGN 250 was introduced; the monthly benefit for raising children till they complete their secondary education was increased and set as a total amount for the family depending on the number of children; the monthly benefit for raising a child with permanent disabilities or twins was also increased.

– Measures concerning healthcare

The new Law amending and supplementing the HIL includes changes which create effective rules for improving the quality of health services, the control of medical activities and for more effective utilisation of the NHIF resources. The law introduces scheduled increase of the portion of the minimum insurance income used to determine the health insurance contributions for the persons insured from the state budget, from 50 per cent in 2015 to 55 per cent of the minimum insurance income for self-insured persons as of 1 January 2016. The percentage will be increased yoy till the minimum insurance income for self-insured persons is reached. The effect on revenue and expenditure is neutral.

– **Measures concerning education**

The 2016 priorities in the field of education are focused on addressing the major challenges and on supporting the implementation of the key policies in the sector. Integrated measures and actions for ensuring equal access to quality education and vocational training and for growth based on knowledge and science and on the development of young people will be implemented with a view to delivering these priorities.

The main challenge to the system of pre-school and school education in the long term is the recruitment of good teachers in it. The planned increase of pedagogical staff salaries described above is the main tool to achieve this. Another major priority is the ensured funding of full-day organisation of the school day in the focal point schools and for the sixth grade pupils in the other schools throughout 2016. The full-day organisation of the school day is one of the major activities for improving educational outcomes and reducing early school drop-out rates. Planned funds coming from the state budget are in the amount of BGN 128.4 million, or BGN 38.9 million more compared to the planned funds in 2015. With the entry into force of the new Law on Pre-School and School Education (from the beginning of the 2016/2017 school year) out-of-school units will be transformed into Centres for personal development support and at the same time additional functions will be delegated to them. For ensuring the activities of the out-of-school units resp. Centres for personal development support, in 2016 BGN 5.4 million are planned and additional BGN 6.0 million are provided for printing new textbooks and teaching aids for the fifth grade with a view to implementing the new curricula as of the 2016/2017 school year.

The resources from the state budget for the implementation of the policy in the field of higher education remain unchanged compared to the 2015 levels. At the same time, the structure of financing was changed with the aim to diversify the portfolio of strategies for quality development, specialisation of higher education institutions and consolidation of the network. The portion of the maintenance subsidy, granted on the basis of a comprehensive evaluation of the quality of education and its correspondence to labour market needs, was increased. The modified conditions imply that higher education institutions should concentrate on those of their areas of specialisation in which they score high on quality of education and on career options of graduates, and should enhance their research activity. Another important change in the system of financing, in addition to promoting education in the priority areas of specialisation, is the assistance for support of protected courses. Funds for 2016 scholarships for students and post-graduate persons were increased by BGN 1.1 million.

– **Measures concerning defence**

Defence policy involves supporting modern and combat-ready armed forces (AF). Effective and efficient defence planning, aimed at building, developing and using the necessary AF capabilities to fulfil national defence tasks, Bulgaria's commitments within the collective security and defence system and to contribute to national security in peacetime, is maintained and developed with a view to implementing the defence policy in line with the NATO Defence Planning Process and the EU defence capability development process. Additional expenditure at BGN 160 million (0.18 % of the projected GDP) are foreseen to maintain the existing and develop new defence capabilities in 2016.

3.3 Medium term perspectives, including description and quantification of the strategic policy effects

The medium term government strategy is detailed in the medium term budgetary framework, the National Reform Programme and the three-year action plan for implementing the National Development Programme: Bulgaria 2020 during the period 2016–2018. The action plan provides for the implementation of a number of measures, grouped in several key priority areas, which are expected to lead to more balanced regional development, enhanced quality of human capital, promotion of innovation, higher quality of infrastructure and, generally, to enhanced economic competitiveness, higher employment rates and higher income. Funding will come mainly from the EU funds, which will complement the expenditures from the national budget.

3.3.1 Improved access to and enhanced quality of education and training and quality of the workforce – allocations in the amount of BGN 4.8 billion

The policy is focused on forming and enhancing the quality of human capital in all its dimensions. It foresees actions for: modernising the national education system, managing the quality of education, including young people in training and/or employment, as well as upgrading of existing facilities and equipment, and improving creativity and personality-driven innovation. The policy aimed at enhancing the quality of the workforce will be implemented by adapting lifelong learning and mobility to labour market needs, strengthening the links between the educational institutions and the labour market, acquisition of competencies in accordance with the requirements of the labour market, promoting the introduction of modern forms of work organisation, introducing a dual system of education and increasing the quality of education. Measures aimed at increasing the financial culture of the population will also be implemented.

Increasing the social role and relevance of research, development of scientific potential through integration into the European Research Area, as well as development of research through programme and competitive funding are envisaged. Innovations for sustainable and effective health system, as well as enhancing the quality of health services and ensuring access to health care and services for all citizens are planned in order to improve the quality of healthcare.

3.3.2 Reducing poverty and promoting social inclusion – allocations in the amount of BGN 3.5 billion.

The emphasis is laid on guarantees for the adequate participation of vulnerable groups of the population in all spheres of public life through a set of measures covering areas such as possibilities for employment and own business, better quality of social services, deinstitutionalisation of care for children and elderly and disabled people, and a number of legislative amendments. The activities planned include improving the qualification of the unemployed, enhancing the quality of intermediary services in order to better address workforce's needs, as well as measures for more flexible employment so as to improve the possibilities for reconciling personal and professional life. Measures for tackling the shadow economy on the labour market through better protection of labour rights and reduction of undeclared employment are also envisaged.

3.3.3 Achieving sustainable integrated regional development and use of local potential – allocations in the amount of BGN 8.5 billion

The country's regional development is focused on developing the potential of the Bulgarian regions, decreasing interregional disparities and turning all regions into an attractive place for living and doing business. The key areas of government intervention will be: strategic planning and regional governance through enhanced capacity of local authorities; encouraging city development and better integration of the Bulgarian regions through integrated sustainable urban development and strengthening of the polycentric network of cities, improving urban labour mobility, development of and improving the access to cultural services and sports in the regions and building broadband infrastructure, support for effective and sustainable utilisation of the regions' tourist potential through development of the infrastructure for specialised forms of tourism and through marketing of the tourist regions and development of regional tourist products, support for the development of regions that lag behind and for improving the quality of life in rural areas, creating conditions for environmental protection and better environment in the regions through enhancing the quality and effectiveness of water supply services for the businesses and the population and building and modernising the sewerage systems and waste water treatment for sustainable water resource management, as well as enhancing territorial cohesion through the development of cross-border, interregional and transnational cooperation.

3.3.4 Supporting innovation and investment activities to enhance the competitiveness of the economy – allocations in the amount of BGN 0.7 billion

The key priority areas in the three-year period will be building of innovation and scientific infrastructure to improve the connections between business, science and education, and implementation of measures under the Investment Promotion Law. There will be comprehensive measures for promoting investment in industry and in high-tech manufacturing and services, such as support for building infrastructure, education, job creation and financing of innovation products. The National Reindustrialisation Programme will promote the development of sectors and sub-sectors of the Bulgarian industry that are competitive or have a development potential. A pro-active marketing will help support the attraction of targeted investment in the economy and the promotion of the country as a tourist destination. SMEs will be supported through activities for improving the conditions for starting up business and implementation of good practices, including wider use of ICT and support for R&D projects. EU funds will be used to finance the building and completion of a different type of innovation and science infrastructure across the country, while national budget funds will ensure the participation of Bulgarian enterprises in EU programmes such as Horizon 2020 and Eureka.

3.3.5 Strengthening the institutional environment for greater effectiveness of public services for citizens and businesses – allocations in the amount of BGN 0.3 billion

In the period till 2018 government work will be targeted at introduction and consolidation of integrated administrative services and at implementation of the Third Action Plan to reduce the administrative burden. Some of the measures are aimed at improving the investment environment. Regular reviews of existing legislation are envisaged in order to reduce and prevent increased administrative burden and to ensure better coordination between the territorial units of the central administration which provide services. The main focus of the government policy will be on developing electronic government and ensuring the interconnectivity and interoperability of the information systems in the administration. The insolvency procedures will be facilitated and the use of the tacit consent principle will be increased. Improved cooperation between the individual structures and the wider implementation of ICT are expected to improve the quality of the judicial system. Measures to enhance law enforcement and limit the room for unregulated and corrupt practices will be implemented. To make the administration more effective, the system of assessing and planning the need for experts will be improved and a wider choice of upskilling options will be offered. Measures to upgrade selection methods and improve mobility options are also envisaged. Work to enhance the dialogue with the society on formulating and monitoring government policies will continue by developing private sector's capacity in the field and improving the access to information.

3.3.6 Energy security and improving resource efficiency – allocations in the amount of BGN 0.4 billion

Government efforts will be targeted at enhancing energy security and the independence and effectiveness of the economy, as well as at improving the environment. In order to guarantee the country's energy security, conditions will be provided for diversification of the sources and the routes for natural gas supply through the building of gas interconnections with the neighbouring countries and supporting the construction of gas pipelines along the main European gas corridors, as well as by promoting the maintenance of reasonable balance between the energy resources available in the country and the EU clean energy objectives. Reducing electricity consumption in everyday life by replacing it with natural gas will result in a more effective use of resources, lower costs and healthier environment of better quality. As regards the effective use of resources, actions will be taken to promote the introduction of low-carbon, energy-efficient and low-waste technologies, as well as to increase the share of recycled and utilised waste.

3.3.7 Improving transport connectivity and access to markets – allocations in the amount of BGN 6.9 billion

In the period up to 2018, the key focus of the policies aimed at creating optimal conditions for development of the economy, improving the access to markets and limiting environmental pollution will be on the effective maintenance, modernisation and development of transport infrastructure, sustainable development of public transport and reform in the railway transport system. A number of projects along the trans-European corridors crossing the country are planned. Major projects include the completion of Struma motorway, Hemus motorway, modernisation of the Sofia-Plovdiv railway, modernisation of the Sofia-Pernik-Radomir railway, modernisation of the Vidin-Sofia railway. With a view to ensuring the sustainable development of public transport, efforts are focused with priority on the construction and development of smart public transport networks and services. The extension of the subway in Sofia is of paramount importance in this respect. As regards the reform in the railway transport system, the efforts will be focused on the better management of the railway sector, as well as on the restructuring of BDZ Holding EAD and National Railway Infrastructure Company.

3.3.8 Ex-ante impact assessment

The table below presents the anticipated effects from the implementation of the measures planned. The SIBILA (Simulation model of Bulgaria's Investment in Long-term Advance) model has been used to this effect. Effect[22] defined as changes in the levels of key macroeconomic indicators have been assessed.

The interventions planned are expected to result in positive change in employment (an increase by more than 10% against the baseline scenario) and in the unemployment rate (a decrease by 6 pp) by the end of 2018, driven by direct effects from the inflow of funds in the economy (opening of new jobs) and indirect effects (resulting in improved quality of employed persons and of the workforce in general).

Table 3-1: Effects from the implementation of the measures planned

Macroeconomic indicator	Effect as of 2018
GDP	11.8%
Export of goods and services	3.6%
Current account balance(% of GDP)	-11.8 pp
Employment (15-64 years), thousands	10.9%
Unemployment rate(15-64 years)	-6 pp
HICP inflation	1.9 pp
Budget balance(% of GDP)	-4.1 pp

Source: MF, SIBILA

According to the analysis, the country's fiscal stance will deteriorate in the short term and as of the end of 2018 the net effect of the measures planned on the budget balance will reach -4.1 pp of GDP, given the high amount of expected government expenditure. As a whole, the overall effect is a combination of several opposite influences – increasing government expenditure, higher income and better economic conditions leading to an increase in budget revenues. In the medium term the interventions will contribute positively to the budget balance as a result of the better economic conditions and increased production and consumption.

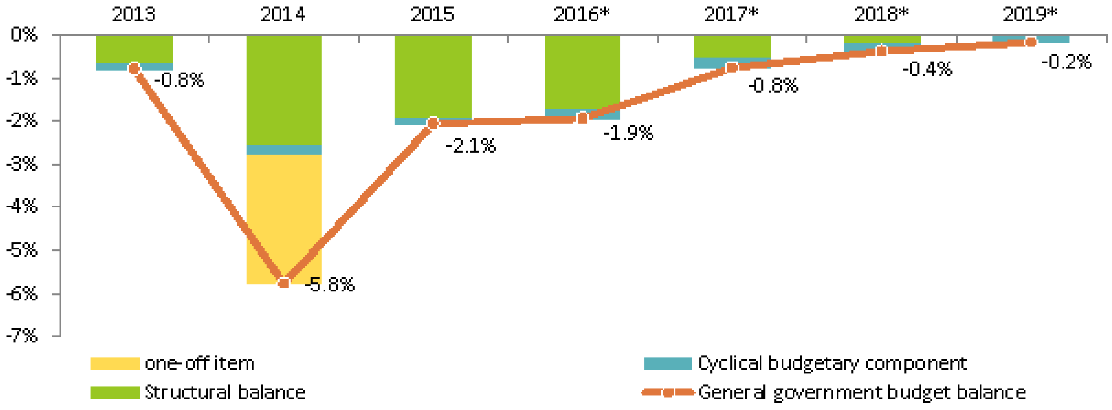
[22] The overall effects from the implementation of measures for the economy are the difference between two scenarios – a baseline scenario (scenario 0) which simulates economic development without the action plan interventions, and a hypothetical alternative scenario (scenario 1) which takes account of the implementation of measures in the deadlines set in the action plan and with the resources planned for this purpose.

The country's production output and GDP will increase smoothly in the review period, thus allowing gradual convergence with the EU. The implementation of the measures planned will be a major contributor in this respect, with simulations showing that, as of 2018, their effect on GDP would be by 11.8% higher than the baseline scenario. The inflation rate will remain at relatively low levels but will nevertheless accelerate by 1.9 pp compared to the baseline scenario. The export of goods and services will also increase faster compared to the baseline scenario (3.6%) as a result of the interventions planned.

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

The structural budget balance is estimated at -1.9% of GDP in 2015, thus complying with the latest country specific recommendation to avoid structural deterioration in public finances for this particular year. Measures to improve tax collection have been taken during the year, while the control of budgetary expenditure has been further strengthened. As a result, the indicator improved by 0.6 pp compared to 2014, performing in advance the required structural effort for 2016. Further adjustment of the structural deficit by 0.2 pp is going to be achieved during 2016, expecting it to reach -1.7% of GDP at the end of the year. The budgetary plans set 2017 as the target year for the achievement of the MTO. An improvement of the deficit by approximately 1.2 pp of GDP in structural terms is envisaged for 2017, expecting the structural balance to reach -0.5% of GDP. The consolidation is planned to continue in the next years of the forecast period, although by a lower reduction rate, aiming at reaching a neutral budget balance in the medium term. The structural balance is estimated respectively at -0.2% and 0.0% of GDP for 2018 and 2019, contributing to macroeconomic stability and long-term sustainability of public finance.

Figure 3-2: General Government balance, % of GDP



Source: Eurostat, MF

The assessment of the compliance with the expenditure benchmark pillar is done by comparing the estimated real growth rate of the corrected expenditure aggregate net of discretionary revenue measures with the updated reference values provided by EC in April 2015. For 2016, when the country has not yet reached its medium term budgetary objective (MTO), a reference rate from the estimates of the average potential GDP growth is used, namely 1% and a margin of 1.26, based on Commission's winter 2015 forecast. For the next two years, when the structural deficit is planned to remain below the MTO, a limit of maximum 1% growth in expenditure in real terms is applied.

Based on the above mentioned assumptions, with the exception of 2016, the increase in the corrected expenditure aggregate, net of the discretionary revenue measures, is expected to be lower than the maximum reference rate.

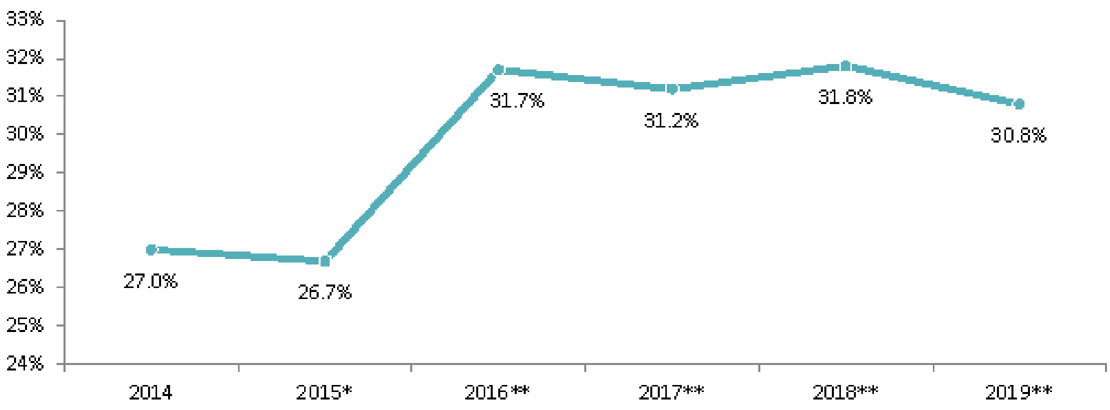
3.5 Debt levels and developments, analysis of below-the-line operations and stock-flow adjustments

The government debt management policy pursued in 2015 continued to follow the main guidelines of the fiscal policy, while complying with the debt reference values laid down in the State budget act and taking into account the need to secure financial resource to refinance the outstanding debt, to cover the budget deficit and to ensure the stability of the fiscal reserve. When issuing new government debt, it has remained a priority to take account of the current size, structure and parameters of the debt and of the forecast levels and rates of change.

According to preliminary MF data, the consolidated general government debt-to-GDP indicator is expected to reach 26.7% as of end-2015, against 27.0% in 2014 and its levels will remain far below the maximum reference value of the Maastricht convergence criterion of 60%.

The budget policy pursued, the forecasts for moderate GDP growth and the need for maintaining adequate liquid buffers in the budget, as well as the needs for refinancing of the outstanding government debt in the period 2016–2019 are expected to result in a consolidated general government debt at around 30% – 32% of GDP. The projected amount of the consolidated general government debt for the review period will be influenced by the debt-related operations undertaken and by the classification of the Bulgaria Deposit Insurance in the sector as required by Eurostat.

Figure 3-3: Consolidated general government debt/GDP ratio



* Calculated; ** Forecast

Source: Eurostat, MF

The dominant source of debt financing in 2015 (around 95%) is secured through GS issues, most of which on the international capital markets. The remaining 5% are disbursements on loans from international financial institutions, including for the financing of investment projects and under the Financial Contract between the Republic of Bulgaria and the EIB on the project "Bulgaria EU Funds Co-financing 2014–2020 (SPL) in an amount of up to 500 million EUR. In 2015, the share of external financing in total new debt borrowing is about 83 % and the share of internal financing is about 18% respectively.

The operations that had the most considerable influence on the size and the structure of the government debt as of the end of 2015 were the successful placement of external government debt of the triple tranche type (7-year, 12-year and 20-year GS) under the Global Medium term Note Programme of the Republic of Bulgaria, the disbursement on the Financial Contract between the Republic of Bulgaria and the EIB on the project "Bulgaria EU Funds Co-financing 2014-2020" (SPL), and the repayment of the global bonds denominated in US Dollars, maturing in 2015, and the short-term Bridge to bond loan assumed during December 2014.

The *Global Medium term Note Programme of the Republic of Bulgaria (GMTN)* established in 2015 provides the issuer with an opportunity to apply a flexible approach in the offering of securities, in terms of access speed, scale and combination of appropriate financial parameters, and to issue multiple tranches with different parameters, to place on the European and on the US market, to use different alternatives when choosing the appropriate borrowing strategy, including currencies, maturities, public or private placement and the right time to enter the market. The amount of debt issued under the Programme is determined annually with the State Budget Act of the Republic of Bulgaria and is limited to the statutory debt ceilings. The effectiveness of the GMTN programme was strongly confirmed by the second transaction realized in March 2016, with which the Republic of Bulgaria confirmed its position of a low-risk issuer in the region.

On 14 March 2016 the Republic of Bulgaria successfully issued a EUR 1.994 billion dual-tranche Eurobond transaction. It is comprised of 7-year bonds amounting to EUR 1.144 billion and 12-year bonds amounting to EUR 850 million with coupons at 1.875 % and 3.0 % respectively. The adopted intraday strategy enabled the issuer to take full advantage of the favourable market conditions after the quantitative easing measures announced by the Executive Board of the European Central Bank. Thus for a second consecutive year the Republic of Bulgaria made an extremely successful issuing of Eurobonds and this is the largest EUR denominated transaction out of the Central and Eastern Europe, Middle East and Africa (CEEMEA) region in the first quarter of 2016 and the first Euro-denominated Sovereign issuance since the announcement of the ECBs new stimulus package.

The two transactions executed under the programme contributed to enlarging the investor base and supplementing the country's Euro benchmark curve which represents an impartial market assessment of the country risk. The registered high demand confirms investor confidence in the Republic of Bulgaria as a sovereign debt issuer. In addition to covering maturing debt payments and budget financing the net proceeds of the transaction will also be used for maintaining certain liquidity buffers.

The following debt ceilings have been regulated in the 2016 State Budget Act in support of the efforts to control the government debt level and maintaining it at low risk levels:

- The maximum amount of the government debt as of the end of 2016 shall not exceed BGN 26.6 billion (EUR 13.6 billion);
- The maximum amount of the new government debt that could be assumed in accordance with the procedure set out in the Government Debt Act is BGN 5.3 billion (EUR 2.7 billion)

The approach of setting debt limits annually with the State Budget Act, applied so far, contributes to controlled increase of the debt and to maintaining its sustainability. In addition, in circumstances that could lead to a risk of breaching the 60% threshold of the consolidated general government debt-to-GDP ratio, there is a statutory possibility to plan additional limitations for the assumption of municipal and social security funds debt in the State Budget Act for the respective year. Such a restriction makes it possible to prevent significant negative effects from the excessive increase in the amount of the debt.

Local Government debt which forms around 1% of the Consolidated General Government debt is not expected to change notably in the review period. As a major factor appears the limit set in the Public Finance Act, which envisages that the annual amount of municipal debt payments for each municipality may not exceed 15 per cent of the annual average amount of own revenue and the total balancing subsidy for the past three years calculated on the basis of information from the annual reports on the municipal budget implementation.

The debt of the Social Security Funds subsector will be fully repaid in 2016. The financial assets accumulated in the form of GS issued by the Central Government sub-sector amounted to BGN 668.4 million in 2015 and determine the influence of the sub-sector on the General Government debt in the 2016–2019 period.

The debt estimates for the Local Government and the Social Security Funds sub-sectors indicate lower contribution of these sub-sectors to the State's indebtedness.

3.6 Budgetary implications of "major structural reforms"

3.6.1 Implications for the expenditure side of the budget

The measures taken to implement Country Specific Recommendation 1 and aimed at improving the cost effectiveness of the health care system, in particular, by reviewing the pricing of health care and strengthening non-hospital and primary care, are detailed in the 2016 National Reform Programme.

The pension reform, adopted during the recent years aims at ensuring stable revenues in the pension system, as well as to make pensions more adequate in view of the demographic challenges ahead for the country. The further increase in the retirement age will serve as a way for enhancing the stability of the pension system in the long run, maintaining solidarity among generations and reducing the poverty risk for elderly pensioners.

The pension expenditure forecast for the 2017–2019 period takes into account the provisions of the Social Security Code and the assumptions in Government's medium term fiscal framework, as follows:

1. Changing the retirement conditions for third category workers and introducing minimum age for retirement for military personnel, namely:

   – The retirement age for third category workers shall be increased by 2 months every year for women as of 1 January 2016 and by 2 months every year for men as of 1 January 2016 and 2017 and by 1 month every year as of 1 January 2018. As of 1 January 2016, the required insurance length of service for entitlement to pension shall be increased by 2 months every year for both genders. The retirement conditions to for the 2016–2019 period are given in the table below:

Table 3-2: Retirement conditions under Article 68 (1), (2) of SSC, 2016–2019

	WOMEN		MEN	
Year	**Age**	**Length of service**	**Age**	**Length of service**
2016	60 years10 months	35 years2 months	63 years10 months	38 years2 months
2017	61 years	35 years4 months	64 years	38 years4 months
2018	61 years2 months	35 years6 months	64 years1 months	38 years6 months
2019	61 years4 months	35 years8 months	64 years2 months	38 years8 months

   – Minimum retirement age of 52 years and 10 months is introduced as of 1 January 2016 for the Public order and safety sector employees. It shall be increased by 2 months every year as of 1 January 2017.

The estimated effect on the budget from the described changes is a decrease in expenditure by BGN 23.6 million in 2016, by BGN 20.5 million in 2017, by BGN 17 million in 2018 and by BGN 15 million in 2019.

The increased retirement age and insurance length of service will make pension payments more adequate and at the same time it will decrease expenditure for newly granted pensions. Insured persons will stay longer on the labour market and at the same time the number of new pensioners will decrease. By 2037, the retirement age in the most prevalence third category of labour will become the same for women and men - 65 years, and by 2027 the insurance length of service for women will become 37 years and for men – 40 years. After 2037 the retirement age is envisaged to follow the changes in the average life expectancy.

- An option for retiring with less than the full amount of the pension was introduced as of January 2016 for third category workers who have the required length of service under Article 68 (2) but have not reached the retirement age by less than 12 months. Their pensions will be lowered for life by 0.4 per cent for each missing month.

The estimated increase in the expenditure for new pensions in 2016 is about BGN 32 million.

The early retirement option introduced for third category workers enables some long-term unemployed people to take advantage of this option.

- The option of granting PSS pensions to certain categories of workers and smoothly increasing their retirement age until it reaches 55 years for first category workers and 60 years for second category workers is maintained as of 1 January 2016. The estimated effect from the continuation of this option is an increase in the pension expenditure by about BGN 20.8 million in 2016, by BGN 40 million each in 2017 and 2018 and by BGN 30 million in 2019.

This option enables certain categories of workers to choose between receiving an early pension from an Occupational Pension Fund or from the PSS Pensions Fund. Those who have made early pension payments to an OPF but have chosen to receive pension from PSS shall transfer their individual account/savings to the Pensions Fund of PSS.

- As of 2017, the percentage for each year of insurance length of service in the pension formula shall be increased by a percentage equal to or higher than the percentage under Article 100, until it reaches 1.5. The new percentages will be applied both for newly and for already granted pensions. In the 2017–2019 period work-based pensions granted until 31 December of the previous year shall be recalculated as of 1 July of the respective year applying the new percentage for each year of insurance length of service set for the respective calendar year. The recalculation, applying the new weight per year of insurance length of service in the pension formula, will replace the adjustment under Article 100 of SSC.

The estimated effect on pension expenditures is as follows:

- For 2017 – with a percentage per year of insurance length of service at 1.119, the required funds amount to BGN 77.9 million, including for newly and already granted pensions;
- For 2018 – with a percentage per year of insurance length of service at 1.150, the required funds amount to BGN 104.7 million, including for newly and already granted pensions;
- For 2019 – with a percentage per year of insurance length of service at 1.183, the required funds amount to BGN 165.6 million, including for newly and already granted pensions.

This measure will have significant effect on the adequacy of pensions.

- As of 1 July 2019, the maximum amount of one or several pensions received shall be increased from 35 to 40 percent of the maximum insurance income for already granted pensions. The ceiling of newly granted pensions shall be eliminated as of the beginning of 2019.

The estimated increase in pension expenditures is about BGN 20 million in 2019

This measure will have effect on the adequacy of pensions.

Expenditures on pensions and allowances in the reference medium term programme are maintained at levels between 9.6 % and 9.8% of GDP.

Table 3-3: Estimated pension expenditure[23]

Year	Pension expenditure	
	BGN million	**% of GDP**
2016	8700.0	9.8
2017	8928.5	9.7
2018	9159.2	9.6
2019	9500.0	9.6

Source: NSSI

3.6.2 Implications for the revenue side of the budget

– **I. Legislative amendments in the tax policy**

Table 3-4: Estimated effects on the budget from discretionary revenue measures

Discretionary measures in Million BGN	**2016**	**2017**
Positive effect on VAT revenue from increased excise duty rates for energy products used as heating fuel, as set in the Law amending and supplementing the Excise Duties and Tax Warehouses Law, in the 2015 –2018 period.	14.2	
Positive effect on VAT revenues in accordance with the scheduled increase of excise duty rates for cigarettes	15.4	23.8
Excise duty rates for energy products used as heating fuel – 2015–2018 – gas oil – from 50 to 645 (BGN /1000 litres); – heavy fuel oils – from 50 to 400 (BGN/kg);	71.1	
Scheduled increase of the excise duty rates for cigarettes until the maximum excise duty rate of BGN 177 per 1000 cigarettes is achieved as of 1.1.2018.	76.9	119.2
The effect of the fuel vouchers granted to agricultural producers under Article 45 a-d of EDTWL, effective 2013	-84.0	
Exercising border and inland fiscal control of the points of receiving/unloading of goods of high fiscal risk (GHFR).	30.0	20.0
Ongoing monitoring of debtors with overdue liabilities of over BGN 100 thousand (BGN 200 thousand for Sofia City Territorial Office) for taxes and social security contributions and implementing an approved plan for scheduled telephone campaigns	54.0	43.1
Organising a national lottery game with receipts – launch in November 2015	12.1	
Effect on PIT revenues from the annual increase of the minimum wage – by BGN 40 from the beginning of 2016 and from the beginning of 2017	1.6	1.4
Revenue for Pensions Fund and Pensions under Article 69 Fund of PSS (pursuant to paragraph 51 of the Law amending and supplementing SSC) – for the pensioners who have transferred their accounts/savings from UPF to PSS and want to have a recalculation of their pension	116	
Increase by 1 pp each from the beginning of 2017 and 2018 – effect on Social Security Contributions		187
Increase by 1 pp from the beginning of 2017 and 2018 – effect on Personal Income Tax		-7.5
Cumulative effect on the amount of health insurance transfers from increasing the share of the insurance income on which the State will make health insurance payments for persons insured from the State budget (55 per cent as of 2016 and 5 per cent each year thereafter – Article 40, paragraph 4a of HIL) and from increasing the minimum insurance income from BGN 420 to BGN 460 as of 2017	40.0	72.9
Changing the minimum insurance thresholds (income) under the Law on the Budget of Public Social Security for the respective year		15.0
Increasing the minimum insurance income for the main economic activities and other occupational groups by 8.6 % on average in 2016 compared to 2015[24]	81.0	

[23] Data up to 2019 are based on the forecast of revenue and expenditure of the consolidated PSS budget for 2017-2019, dated March 2016.

[24] The estimated effect from the implementation of this measure is not included in the estimates in Table 2a of Annex A.

Discretionary measures in Million BGN	2016	2017
Multiple choice option for the individuals born after the 31st of December 1959, who have not been granted a pension for old age and length of service, to migrate from the Universal Pension Fund to the Pensions Fund or the Pensions for Persons under Article 69 Fund and vice versa[25]	5.0	
Decreasing the percentage deducted from the profits of companies with majority state ownership in favour of the State from 60 to 50 % in 2016 and maintaining its level in 2017 and 2018. The range of companies making deductions for dividends to the State has been changed – the Water Supply and Sewerage sector and Bulgarian Development Bank AD were included in addition to health care institutions. The method of determining the financial result for the purposes of the deduction (on consolidated basis, if applicable) is preserved. The estimated annual financial results of the companies are used as a basis for the above estimates.	-12.6	
Total	**420.7**	**474.9**

➢ *Corporate Tax*

The forecast for corporate tax revenue (including taxes on dividends, liquidation quotas and income of resident and non-resident legal persons) is based on retaining the basic tax rate of 10 per cent, the forecast development of macroeconomic indicators, the data about losses from previous years that are subject to deduction in subsequent accounting periods, declared by taxable persons in their annual tax returns, the amount of the tax prepayments made by taxable persons who have realised taxable profit in the previous year and the respective amount of the adjustment payment under the annual tax return (ATR) for certain legal entities, the reimbursable tax amount, and on the changes in the regulatory basis.

According to the amendments to CITL which align the Bulgarian taxation system with the European legislation on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (Council Directive 2014/86/EU of 8 July 2014 amending Directive 2011/96/EU), as of the beginning of 2016 the Member State of the parent company should not allow that company to benefit from the tax exemption applied to received distributed profits, to the extent that such profits are deductible by the subsidiary of the parent company, established in another Member State.

CITL contains an express provision implementing the European legislation on applying the common minimum anti-abuse rule to the distribution of profits. The Bulgarian tax legislation contains a general provision on tax evasion which is of a wider scope than the one included in the directive, therefore specific additions to the texts of the CITL have not been made.

After the expiry of the state aid scheme in the form of tax relief in accordance with Article 184, in relation to Article 189 of CITL, which entered into force on 31 December 2013, a notification procedure was initiated for a new state aid scheme to be applied in the new programming period. As a result of the implemented notification procedure the European Commission issued positive Decision No. C (2015) 6174 of 14.09.2015 on State Aid SA.39869 (2014/N) – Bulgaria, Corporate Tax Exemption Scheme in accordance with Article 184 of the Corporate Income Tax Act, declaring the measure compatible with the internal market pursuant to Article 107(3)(a) TFEU.

In reference to the alignment of the national legislation with the conditions of the regional development state aid scheme approved by the Commission and with the provisions of Commission's Regional Aid Guidelines for the period 2014–2020 (the Guidelines), with regard to tax relief constituting regional development state aid, amendments have been enacted, waving the automaticity of the state aid scheme and introducing four new requirements which every taxable person wanting to make use of tax relief constituting state aid should comply with. The four types of requirements include most of the requirements applied under the state aid scheme which existed till 2013 plus a number of new requirements.

[25] See Note 24.

In connection with Bulgaria's accession to the international initiatives for transparency and exchange of information for tax purposes of the Organisation for Economic Cooperation and Development (OECD) – the Convention on Mutual Administrative Assistance in Tax Matters, the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information and the Global Forum on Transparency and Exchange of Information, amendments to CITL have been enacted, effective 1 January 2016, regarding the criteria based on which the countries/territories will be defined as jurisdictions offering preferential tax regimes and regarding the list approval procedure. The EU Member States and the countries which exchange information pursuant to Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation, as subsequently amended, are expressly excluded from the scope of jurisdictions offering preferential tax regimes.

- ***Personal Income Tax***

The forecast of the revenue under the Personal Income Tax Law (PITL) for 2015-2019 has been made while preserving the single tax rate of 10% (with no tax-free threshold) for all taxpayers, except for the income from economic activities of sole traders for which the tax rate is 15%. It also takes into account forecast growth of compensations for employed persons, the projected number of employed persons, the statutory tax relief, the expected better collection rate of PITL taxes, as well as some legislative amendments. The effect of the planned changes to the minimum wage and the contribution to the Pensions Fund has also been taken into consideration. Personal income tax revenues also include patent tax proceeds in the municipal budgets.

Legislative amendments relating to tax relief include adding the funds paid under EU's Erasmus+ Programme in the field of education, training, youth and sport, to the scope of non-taxable income. The definition of "disposal of financial instruments" has been expanded to include transactions with government securities on a regulated market within the meaning of Article 73 of the Markets in Financial Instruments Law. In this context, to the extent that the law exempts from tax the income from disposal of financial instruments, the scope of non-taxable income is affected.

The new legislative amendments, effective 1 January 2016, create an opportunity for the mandatory health insurance contributions, which individuals are obliged to pay in respect of themselves pursuant to Article 40(5) of the Health Insurance Law, to be deducted from the taxable income originating from other business activities (Article 29 of PITL), the income originating from rent or any other granting of the use of rights or property for consideration (Article 31 of PITL), the income originating from the transfer of rights or property (Article 33 of PITL) and the income originating from other sources (Article 35 of PITL) received in the tax year when such taxable income is included in the annual adjustment of the insurance income.

Legislative amendment has been passed as a measure to lessen the possibility of undeclared and untaxed income, whereby income originating from other sources of an occasional or non-regular nature (compensation for loss of profit and indemnities, pecuniary and non-pecuniary awards in games and competitions which are not provided by an employer or an assignor, interest which is not subject to a final tax, etc.), which were only taxed on an annual basis with the payable tax determined by the natural person in the annual tax return, shall be subject to advance withholding of tax as of 1 January 2016, where the payer of the income is an undertaking or a self-insured person. The payer of the income shall determine and withhold the tax upon paying the income.

- ***Value Added Tax (VAT)***

The forecast of VAT revenues includes an assumption for preserving the relative share of VAT proceeds in consumption. It takes account of the macroeconomic indicators forecast and the positive impact of introduced in 2014 measures, concerning the fiscal control of the circulation of goods of high fiscal risk on the territory of the Republic of Bulgaria and the VAT reverse charge mechanism for the supplies of cereals and technical crops. The effectiveness of fiscal control was enhanced in 2015 by opening additional fiscal points inland and expanding the scope of goods subject to fiscal control. The period for the application of the VAT reverse charge mechanism for the supplies of cereals and technical crops was extended till 31 December 2018, pursuant to Article 199a(1) of Directive 2006/112/EC. The forecast also takes into account the amendments to the tax law.

VATL has been amended in respect of the supplies and sales of liquid fuels. The scheme under Article 118(7) applicable to petrol bases has been repealed and the persons making use of it have been granted a transitional period of six months to bring their activity in conformity with of Article 118 of VATL, i.e. to apply the general scheme of registration and reporting of supplies/sales of liquid fuels at a commercial outlet by means of fiscal devices and transfer of data via the remote connection to the National Revenue Agency (NRA).

Another group of amendments concerns the administrative penalties on taxable persons. In cases when the tax is charged after the statutory period within which it should have been charged, the time interval in which the lowest rate of pecuniary penalty or fine applies has been extended to 6 months as of the end of the month, during which the tax should have been charged. Another low-rate pecuniary penalty or fine has been provided in case a registered person has charged the tax after the above six-month period but not later than 18 months after the end of the month, which the tax should have been charged.

Some of the VATL provisions have been elaborated to in order to address problems occurring with the practical application of the law. Persons effecting distance selling of goods from a place of transaction within the territory of another Member State shall issue invoices for such supplies pursuant to the legislation of such other Member State. The conditions for determining the place of transaction for the purpose of distance selling of goods have been elaborated in respect of the dispatching or transportation of the goods and the completion thereof.

The amendments effected in line with Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services relate to the opportunity for the suppliers of telecommunications services, radio and television broadcasting services and electronically supplied services, established in the Republic of Bulgaria, who register for an intra-Union scheme, to declare in addition to the bank account denominated in EUR also a bank account in BGN which, however must be opened with a Bulgarian bank or with a branch of a foreign bank in Bulgaria.

VATL has been amended in order to align national legislation with a provision of Council Regulation (EU) No. 904/2010 of 7 October 2010 on administrative cooperation and combating fraud in the field of value added tax. According to the amendment the scope of proportional refund of overpaid tax until 31 December 2018 to a person who has registered for the "mini-One-Stop-Shop" service shall only apply to intra-Union schemes.

Amendments to VATL have been passed in relation to European Commission's Letter EU Pilot 7122/14/ TAXU regarding the non-compliance of provisions of the law with Directive 2006/112/EC. Pursuant to Directive 2006/112/EC, where a person uses goods or services for the purposes of both supplies conferring right to deduct credit for input tax and supplies not conferring right to deduct credit for input tax, only the portion of the VAT charged for the goods or services attributable to the first supplies shall be deductible. The deductible portion is a fraction expressed as a factor. As a result of the amendment, the factor shall be rounded to the second decimal place, to the next bigger number, and not according to the common mathematical rounding rules.

VATL has been amended in several aspects, based on identified non-conformities with the acquis and a need to align national with EU law, with a view to uniform application and taking into account the case-law of the Court of Justice.

The first one is the legislative amendment to achieve compliance with Directive 2006/112/EC. It introduces an express provision regulating that the supply of a service for provision of medical care in the exercise of the medical professions under the Health Act shall be exempt from VAT. An express provision for exemption from VAT of manufacturing services concerning currency, bank notes and coins used as a legal tender is also included.

The time of occurrence of the chargeable event in the case of provision of services for the private use of the taxable person, the owner, the factory and office workers or for purposes other than the independent economic activity of the taxable person, the performance of which involves use of goods for which credit for input tax has been deducted, has been determined, namely the last day of the month in which the service has been provided.

It has been specified that the provision, free of charge, of services for the private use of the taxable person, the owner, the factory and office workers or for purposes other than the independent economic activity of the taxable person in case of dire need or force majeure shall not be equivalent to supplies effected for consideration.

In relation to decisions of the Court of Justice it has been provided that the wear and tear costs shall be taken into account in determining the taxable amount of the supply, free of charge, of services for the private use of the taxable person, the owner, the factory and office workers or, generally, for purposes other than the independent economic activity of the taxable person, which services the law has made equivalent to services provided for consideration and for which goods with deducted credit for input tax or goods which would have been a fixed asset within the meaning of the Corporate Income Tax Law if used in the activity of the taxable person, have been used.

The forecast of the 2016 VAT revenues takes into account the estimated positive budgetary implication at BGN 15.4 million as a result of the scheduled increase, pursuant to the Excise Duties and Tax Warehouses Law (EDTWL), of the excise duty rates for cigarettes. *The 2017 positive budgetary implication is estimated at BGN 23.8 million.*

- ***Excise Duties***

The forecast of excise duty revenue takes into account, in addition to the macroeconomic indicators, also the positive impact of the enhanced control over trading in excisable goods. The legislative changes as of January 2016 which include increased excise duty rates for cigarettes and for energy products used as heating fuels have also been taken into account.

Article 39 of EDTWL was amended to change the ration of the specific to the proportional excise duty for cigarettes. The amended ratio of the specific to the proportional excise duty strikes a balance between the revenues to the state budget and a minimum increase in the prices of the cigarettes in the lowest price brackets. The specific excise duty for cigarettes is changed from BGN 101 per 1000 cigarettes in 2015 to BGN 70 per 1000 cigarettes in the 2016–2018 period, and the proportional excise duty is changed, as follows: a) 38 per cent as of 1 January 2016; b) 40 per cent as of 1 January 2017; c) 42 per cent as of 1 January 2018. Pursuant to the schedule set out in the law, the excise duty for cigarettes is increased gradually to the minimum rate of EUR 90 for 1000 cigarettes established in the Directive (BGN 177 per 1000 cigarettes) as of 01.01.2018. *The positive effect on budget revenues from the increase of the excise duty rates for cigarettes as the change in the ratio of the two components of the excise duty is estimated at BGN 76.9 million for 2016 and at BGN 119.2 million for 2017 in increased revenues from* excise duties.

With a view to preventing excise duty abuse and evasion as a result of unlawful use of heavy and marked fuels not for their intended purpose as heating fuel but as automotive fuel, it has been provided that the excise duty rates for energy products used as heating fuel shall be increased, as has been the case in many EU Member States. *The positive budgetary implication of the change for 2016 is estimated at BGN 71.1 million.*

Article 22(2) of the tax law has been amended towards direct exemption from excise duty of ethyl alcohol which is expressly denatured and is not intended for human consumption. The amendment aims, on one part, to lower the administrative burden and costs for the persons and, on the other part, to improve the competitiveness of Bulgarian producers and the liquidity of economic operators, as is the case in other EU Member States.

➢ ***Tax and Social Security Procedure Code***

A new Section IIIa has been inserted in Title Two, Chapter Sixteen of TSIPC. It regulates the administrative cooperation through automatic exchange of financial information in the field of taxation with the participating jurisdictions, the obligations of the reporting financial institutions to collect information, the performance of the reporting and due diligence rules.

The new section of the Code implements in the national legislation the provisions of Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation (Directive 2014/107/EU), as well as provisions for implementation of the Agreement between the Government of the United States of America and the Government of the Republic of Bulgaria to Improve International Tax Compliance and to Implement FATCA (Foreign Account Tax Compliance Act), signed on 5 December 2014 in Sofia (promulgated, SG, No. 47 / 2015).

The amendments implementing the provisions of the directive regulate a special type of administrative cooperation between the Republic of Bulgaria, the EU Member States, third countries, and the European Commission through automatic exchange of financial information.

– **II. Measures for improving the revenue collection rate**

The measures taken by the NRA to improve the revenue collection rate are detailed in item 6.3 of the Convergence Programme (2016–2019)

➢ ***Bulgarian Customs Agency***

In 2015, the Bulgarian Customs Agency implemented a number of projects for design and development of the integrated information systems. New components were added to the systems and existing components were upgraded. As a result, the quality of the services provided to citizens and businesses was enhanced through the new e-services, processes for migration to electronic customs, legislative amendments and/or new functional obligations for the administration, stricter control, increased horizontal interaction and provision of automated inter-institutional exchange of data and information.

The following information systems, components and functionalities were developed in 2015:

- Bulgarian Integrated Customs Information System (BICIS);
- Bulgarian Excise Centralised Information System (BECIS);
- Subsequent/Previous Document Component (SPDC);
- Customs Information System for Exports (CISE/BG-ECS);
- Bulgarian Transit Management System (BTMS);
- Imports Control System (BG-ICS);
- Road Charges and Authorisation Mechanism Module (RCAMM/PTRR);
- System for provision of information for management purposes from customs documents (SPIMPCD/MIS3A);
- Register of Liabilities towards the Customs Administration (RLCA/REZMA);
- ITMS-BG – Upgrading the functionality of the Calculation Module of ITMS (Integrated Tariff Management System);
- Surveillance-BG – Surveillance of transferred data;
- Reference Data Management System RDMS;

- Risk Analysis Module (RAM);
- System for Exchange of Risky Information (SERI).

The implementation of the Microsoft Active Directory Service was started in 2015. It facilitates the centralised administration of users and their workstations and thus enhances security. The National Service Desk system was put into actual operation. The procurement was implemented in the part providing the integration of the call management centre (CMC) with the Service Desk function automation system in the Bulgarian Customs Agency.

The following are pending development in 2016:

- Bulgarian Integrated Customs Information System (BICIS);
- Road Charges and Authorisation Mechanism Module (RCAMM/PTRR);
- Bulgarian Excise Centralised Information System (BECIS);
- eCustoms.bg – Bulgarian Customs Agency e-Portal;
- System for provision of information for management purposes from customs documents (SPIMPCD/MIS3A);

New components and functionalities will be added to the information systems:

- Developing the information systems of BCA by implementing a uniform digital signature and time stamp component (DS&TS);
- Analysis and implementation of the necessary changes resulting from Commission Delegated Regulation (EU) 2016/341 of 17.12.2015 supplementing regulation (EU) No. 952/2013 of the European Parliament and of the Council as regards transitional rules for certain provisions of the Union Customs Code where the relevant electronic systems are not yet operational and amending Delegated Regulation (EU) 2015/2446.

Three OPAC-financed projects were successfully completed in the Bulgarian Customs Agency in 2015:

- Project: "Development and implementation of architecture and information technology services, processes and infrastructure of the Bulgarian Customs Agency (Enterprise Architecture) under Grant Contact No. A13-31-2 / 11.04.2014 within OPAC, co-financed by the EU through the ESF" – the Institution/Enterprise Architecture of the Bulgarian Customs Agency and the new Customs Information System for Exports (CISE) have been implemented as a result of the project. CISE is developed on the SOA principle and offers new e-services to citizens and businesses;
- Project: "Improving administration by designing new electronic administrative services provided by the Bulgarian Customs Agency, Contract No. 13-32-6 / 22.01.2014". Thirteen new electronic administrative services for citizens and business have been developed and are now available in the Bulgarian Customs Agency e-Portal – the functionality of the single access point for provision of administrative services was upgraded as a result of the project. The document flow of the Bulgarian Customs Agency is fully electronic and is effected through the upgraded Automated Information System for Document Management and Administrative Activities (AIDA);
- Project: "Building an interoperability IC platform for data exchange and implementation of goods control measures between the Bulgarian Customs Agency and the Bulgarian Food Safety Agency, Contract No. 13-32-7 / 10.02.2014".

The Bulgarian Customs Agency prepared the sector strategy "E-Customs 2020" and a Road Map for implementation of the automation measures and of the National E-Governance Strategy 2014 – 2020. In 2016, the measures concerning the customs legislation will be financed from the new Operational Programme "Good Governance".

The System for Exchange of Risky Information SERI 2.0. was commissioned on 10.12.2015. It was developed to automate the process of collection and processing of the risk information available and coming from different sources.

The development of Road Charges and Authorisation Mechanism Module (RCAM) of BICIS continued in 2015 by adding new functionalities aiming to improve the collection rate of fees and vignette tolls and to optimise control. Operational are: functionality for payment of such fees and tolls with fuel cards and for collecting the balance of fees under Article 6 and Article 7 of Ordinance No. 11 / 2001 on the movement of overweight and/or oversize vehicles; functionality for automated import of data about identified registration numbers of vehicles from video surveillance systems (the functionality is piloted at Kapitan Andreevo Customs Point which currently has 24 video cameras installed); functionalities for checking the validity of TIR-carnets, required permits, container numbers and nomenclature types, electronic administrative documents and prior notifications under Article 76c of the Excise Duties and Tax Warehouses Law (EDTWL) in case of carriage of excisable goods with tank trucks – by integration of module RCAM and BECIS.

The tendency of enhanced interaction between the Bulgarian Customs Agency, the bodies of the National Revenue Agency (NRA) and the Ministry of Interior, registered in the previous period, persists. In the beginning of 2015 NRA was actively supported in conducting checks on depositors in tax warehouses for storage of energy products. As a result of the findings of these checks, public enforcement agents from NRA imposed anticipatory security measures and pre-trial procedures were initiated under the supervision of the Specialised Prosecutor's Office of the Republic of Bulgaria.

The Bulgarian Customs Agency participates jointly with MoI, SANS, the State Agency for Metrological and Technical Surveillance and NRA in control actions in respect of persons trading in automotive fuels. The institutional cooperation has notably driven up the share of legitimate fuel trade.

In 2015, the Bulgarian Customs Agency was highly efficient in implementing measures to increase budget revenues and fight smuggling as a result of the improved control exercised by customs authorities under EDTWL and the Customs Law (CL).

Prevention of excise tax fraud and excise tax evasion and the fight against the illegal production, distribution and smuggling of tobacco products were major priorities of the customs administration in 2015. At different times during the year, the customs authorities exercised enhanced control on the major licensed warehouse keepers managing tax warehouses for the production and storage of energy products, tobacco products, ethyl alcohol and alcoholic beverages. Control consisted in 24-h presence of the customs authorities in certain tax warehouses and documentary control of the excisable goods brought in and out, resulting in notable increase in the legitimate use of excisable goods and in the expected increase in the collection rate of excise duty and VAT.

The control at the external borders was enhances through continuous presence of mobile customs groups in the course of several months in support of the work of border customs offices. The stricter control of the passenger and cargo traffic from third countries and of the tax warehouses resulted in a notable decrease in the volumes of tobacco products sold at the illegal market.

4 SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS UPDATE

4.1 Alternative scenario: deterioration of the external environment

The European economic development outlook remains uncertain. The slowdown of the developing economies, mostly China, poses a major risk to the growth of EU's GDP. The rebalancing of GDP growth in China, from export and investment towards consumption, geared down global trade in the past year. The faster than expected slowdown of the Chinese economy in the medium term will result in worse than anticipated performance of EU exports and lower GDP growth. Insecurity in the region remains high, given the stronger geopolitical tension. Stricter border control between some Member States could further restrict trade in the region. While according to Commission's estimates the migration wave is expected to have a positive effect on the European economy in the short term, because of the increased government spending some Member States intend to pursue a policy of reducing budget deficits. The deployment of significant funds from the EU budget, for addressing the migration flow could limit investment resources.

As a result of the existing risks to the development of the European economy, an alternative scenario assuming lower GDP growth in the EU has been prepared.

Table 4-1: Comparison between the baseline and the alternative assumptions

	2016		2017		2018		2019	
	Alternative scenario	Difference compared to the baseline scenario (pp)	Alternative scenario	Difference compared to the baseline scenario (pp)	Alternative scenario	Difference compared to the baseline scenario (pp)	Alternative scenario	Difference compared to the baseline scenario (pp)
EU GDP, (real growth, %)	1.5	-0.5	1.7	-0.3	1.8	-0.1	1.9	0.0

Source: MF

This underlying economic slowdown in the EU is expected to weaken external demand, the main deviation from the baseline scenario occurring in 2016 and subsiding towards the end of the forecast period. Consequently, more limited increase in Bulgaria's exports to the EU Member States compared with the baseline scenario is expected. Less favourable external environment and slower increase in export receipts will also keep down domestic demand by limiting consumption growth and weakening the investment activity.

Lower demand for raw materials from export-oriented sectors and weaker domestic demand will contribute to slower growth in imports. This is expected to partly offset weak exports and limit the adverse effect of net exports on GDP and of the balance of goods and services on the current account. Overall, Bulgarian economic growth is expected to slow down compared with the baseline scenario.

The unfavourable external developments will have minimum effect on the balance of *Primary* and *Secondary income* and will affect mainly trade in *Goods* and *Services*. The *Current account* is expected to deteriorate, with surplus (as a ratio to GDP) going down by 0.3-0.6 pp against the baseline scenario in the 2016–2019 period.

Table 4-2: Effects on the main macroeconomic indicators

Real growth rates	2016		2017		2018		2019	
	Alternative scenario (%)	Difference from the baseline scenario (pp)	Alternative scenario (%)	Difference from the baseline scenario (pp)	Alternative scenario (%)	Difference from the baseline scenario (pp)	Alternative scenario (%)	Difference from the baseline scenario (pp)
GDP	1.4	-0.7	2.1	-0.4	2.5	-0.2	2.6	-0.1
Final consumption	1.3	-0.3	2.1	-0.2	2.3	-0.2	2.3	-0.2
Investment	-2.5	-0.7	-0.6	-0.5	2.6	-0.1	3.5	0.0
Export of goods and services	3.7	-0.8	4.2	-0.5	4.7	-0.1	5.1	0.0
Import of goods and services	2.3	-0.3	3.4	-0.2	4.6	-0.1	5.1	-0.1
Current account balance (% of GDP)	1.5	-0.3	1.5	-0.5	1.2	-0.6	1.3	-0.5
Annual average inflation (HICP), %	-0.9	-0.13	1.1	-0.07	1.1	-0.05	1.3	-0.05
Employed persons, %	0.3	-0.2	0.5	-0.1	0.6	0.0	0.6	0.0

Source: MF

The forecasted lower external demand is expected to limit the contribution of industry sector to the growth in total employment in the country, driven by both decreased production activity of export-oriented activities in industry and weaker investment. The contribution of employment in services will remain positive but lower than the baseline scenario, determining the more limited effect of final consumer expenditure. Less favourable employment developments compared to the baseline are expected in 2016 and 2017.

Weaker domestic demand, on its turn, will result in a lower inflation rate, with a more tangible impact expected in 2016.

4.2 Sensitivity of budgetary projections to different scenarios

4.2.1 Sensitivity of the budgetary projections to the alternative scenario

The alternative scenario reveals some risks to the budgetary projections associated with the change in the structure and the level of economic recovery. The dynamics of domestic demand, and particularly of final consumption, has a significant impact on the revenue side of the budget as indirect taxes make up a relatively high share of total tax revenues. The negative effects of the implementation of the alternative scenario on employment growth and, generally, on the labour market, where recovery from the crisis goes relatively smoothly and at a slower pace, limit the amount of additional revenue from the projected increase of social security contributions by 1 pp in 2017 and in 2018. The decrease in total budget revenue compared to the baseline scenario triggers a need to take additional compensatory measures in order to limit the negative impact on the medium term fiscal targets set for the balance of the General Government sector.

Despite the fact that in the alternative scenario of slower recovery of the European economy the negative impact comes mainly from the export dynamics, the growth rate of almost all GDP components is lower than in the baseline scenario. As a result, the collection rate of revenues to the state budget in each year of the forecast period 2016-2019 is lower compared to the baseline scenario. Tax and insurance revenues are influenced by direct taxes, due to the lower profits of affected export-oriented industries and the weaker increase in total employment in the country, as well as by indirect taxes, due to the lower levels of final consumption and of imports of goods and services compared to the baseline scenario. The negative impact of the latter two factors on indirect taxes is partly offset by a significant decrease in nominal exports in 2016 and 2017 compared to the baseline scenario, leading to a reduction in the estimates of the VAT claimed for refund in these years.

The lower budget revenue compared to the baseline scenario will cause a deterioration of the General Government balance in the 2016–2019 period. With total expenditure maintained at the baseline scenario level, the budget deficit is expected to go down to 2.1% of GDP in 2016, 1.0% of GDP in 2017 and 0.7% of GDP in 2018.

4.2.2 Sensitivity of debt upon any changes in the levels of exchange rates and interest rates on international markets

The current composition of the consolidated general government debt with regard to market indicator levels (exchange and interest rates) does not imply any significant influence on both its nominal value and the amount of funds required for debt service. The share of debt denominated in currencies other than EUR and BGN is estimated within 1% over the 2016-2019 period. The share of debt with floating interest rates is also estimated at comparatively low levels in the reviewed period, varying between 6-8.7%, which, in turn, results in a minimum interest rate risk in case interest rates are increased.

4.3 Comparison with the previous programme

The growth of the Bulgarian economy in 2015 was higher than the one projected in the previous Convergence Programme, driven mainly by higher growth in exports. Strong export growth and weaker consumption resulted in a positive contribution of net exports of 2.1 pp, against a projected negative contribution of 0.6 pp.

The more favourable development of the Bulgarian and of the European economy in 2015, the revised forecasts of international financial institutions for EU and US GDP growth, as well as the modified assumptions for international prices and exchange rate development necessitated a revision of the medium term economic forecast of the Ministry of Finance.

This Convergence Programme projects higher GDP growth throughout the forecast period as well as changes in the structure of growth, which will be driven to a greater account by net exports whereas the contribution of domestic demand will show more gradual increase compared to the previous Convergence Programme. Lower than expected growth in consumption reported in 2015 resulted in more moderate assumptions in the medium term. Investment estimates were also lowered due to an anticipated decline of public investment in 2016 and 2017 attributable to the time necessary to launch the projects with EU funding under the new financial programme. At the same time, weaker domestic demand will limit the increase in the import of goods and services and keep it below the growth rates projected in CP2015. Growth in exports is projected at higher levels compared to last year's CP. It will be higher than the growth in imports till 2018 and thus the positive contribution of net exports to the GDP dynamics observed in 2015 will be maintained.

Table 4-3: Main macroeconomic indicators

Real growth rates	2015			2016			2017		
	CP 2016	CP 2015	Difference, pp	CP 2016	CP 2015	Difference, pp	CP 2016	CP 2015	Difference, pp
GDP	3.0%	1.4%	1.6	2.1%	1.7%	0.4	2.5%	2.3%	0.2
Final consumption	0.7%	2.0%	-1.3	1.5%	2.6%	-1.1	2.2%	3.0%	-0.8
Gross fixed capital formation	2.5%	1.8%	0.6	-1.8%	1.5%	-3.3	-0.1%	2.9%	-3.0
Export of goods and services	7.6%	2.8%	4.8	4.5%	3.1%	1.4	4.7%	3.4%	1.2
Import of goods and services	4.4%	3.6%	0.8	2.6%	4.0%	-1.4	3.6%	4.4%	-0.7
Annual average inflation (HICP)	-1.1%	-0.6%	-0.4	-0.8%	1.8%	-2.6	1.1%	1.9%	-0.7

Source: MF

All main commodity price indices are expected to decline in 2016, in contrast to the increase expected in the previous CP update. Changes in external assumptions and the negative inflation throughout the entire 2015, on their turn, resulted in different expectations about inflation dynamics in the country. Projections for the end-of-period inflation rate in 2016 have been revised downwards due to the assumed higher negative contribution of transport fuels and the larger decline in prices of non-energy industrial goods. The annual average inflation rate will also remain negative. Furthermore, the acceleration of HICP inflation after 2017 under this CP update is expected to be lower throughout the entire forecast period.

Unemployment rates are underestimated compared to the previous forecast because of the more pronounced downward dynamics of the workforce in 2015 and the more favourable developments in employment. As a result, unemployment rates are driven down not only in 2015 but also in the medium term. Estimated compensation per employee and labour productivity also imply a revision downward of unit labour costs because the higher estimates of economic growth in the forecast period suggest accelerated real growth of labour productivity.

5 Sustainability of Public Finance

5.1 Policy Strategy

This chapter is analysing the fiscal position by evaluating the current status of public finance by taking into account the future increase in age-related public expenditures. The sustainability indicators S1 and S2, calculated under the methodology elaborated by the Commission, are used for this purpose[26]. The medium term fiscal sustainability indicator (S1) shows the necessary adjustment to the primary structural budget balance ensuring a level of government debt of up to 60% of GDP in 2030. The long-term fiscal sustainability indicator (S2) shows the necessary adjustment to the current primary balance required to fulfil the inter-temporal budget constraint (the discounted value of the future primary structural balances should cover the current debt level) over infinite horizon including additional age-related costs. The positive value of the indicators means a need for fiscal consolidation or structural reforms to reduce the burden of the ageing population on public finance.

Table 5-1: Comparison between sustainability indicators under the old and the new Programme scenario

	Programme scenario 2015		Programme scenario 2016[27]	
	S1	S2	S1	S2
Value,	-1.0	3.1	-2.9	2.0
of which:				
Initial budgetary position	1.6	2.3	0.1	1.3
Debt requirement	-2.0		-2.1	
Cost of aging	-0.6	0.8	-0.9	0.7

Source: MoF

The estimates of the Ministry of Finance show that the value of the S1 indicator for 2016 is negative, which according to the Commission's reference values[28] means low fiscal sustainability risk in the medium term. The only component with negative impact on the indicator is the initial budgetary position but government policies are aimed at a reduction in the negative budget balance which will ensure public finance sustainability and debt level below 60%. As far as the S2 indicator is concerned, its value of 2.0% corresponds to a medium fiscal sustainability risk and shows that a policy of budget surpluses in the long run is needed. An adjustment to both the initial budgetary position (1.3 pp) and to the ageing expenditure component (0.7 pp) is required.

The demographic changes related to a decrease in the working-age population represent a main

[26] Annex 2 of Fiscal Sustainability Report 2015.

[27] The assessment of fiscal sustainability is strongly dependent on the prospects for long-term development of the economy. The basic parameters used in this scenario are shown on Table 7 of Annex A. They have been developed by the Ministry of Finance on the basis of the long-term assumptions and methodology set in the 2015 Ageing Report. The differences between the long-term macroeconomic scenario released in the Report and in the present Convergence Programme is justified by the different medium term forecasts used to start calculations. The MoF scenario is based on the forecast in this Convergence Programme (2016-2019), while the one in the Report is based on the Commission's 2014 Spring Forecast.

[28] Reference values set in the Fiscal Sustainability Report 2015 that show the level of risk for public finance sustainability:

S1<0 - low risk; 0<S1<2.5 – medium risk; S1>2.5 – high risk;

S2<2 – low risk; 2<S2<6 – medium risk; S2>6 – high risk.

challenge for public finance in the long run due to an increase in the budget expenditure for pensions and healthcare. The aging effect will have implications on the revenue –expenditure balance under the Public Social Security budget. Ageing of population will translate into a decrease of the workforce, the number of total persons employed and therefrom in the number of insured persons, paying social security contributions. Nevertheless, the conducted pension reform will limit these negative effects. The healthcare expenditures are also expected to grow as a result of the increasing share of people in the 65+ age group, because treatment expenditure per person from this group is the highest. The other expenditures related to the demographic developments, such as education and social care expenses are not expected to have any serious negative impact on the budgetary expenditure.

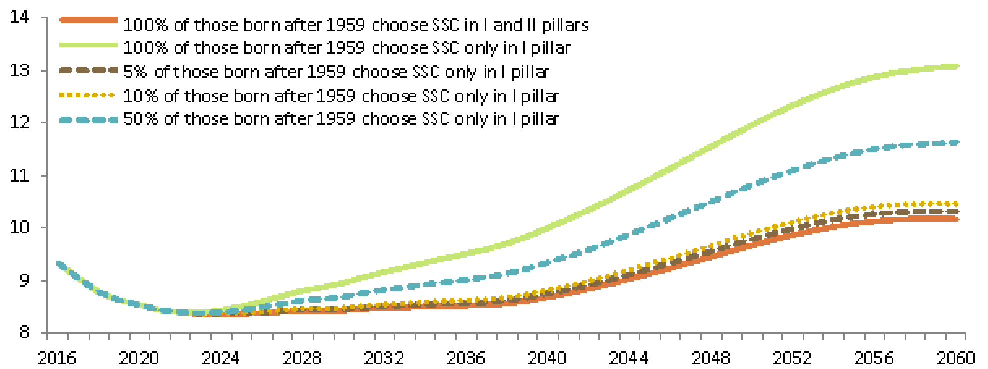
The conclusions of the European Commission's conclusions given in the Fiscal Sustainability Report that was published in January 2016 coincide with the stated analysis. According to the European Commission, regardless of the deficit of the primary structural balance and the increasing debt to GDP ratio, the risks to sustainability in the midterm appear to be low, due to the current low level of debt to GDP. In the long term Bulgaria is exposed to medium risk due to the unfavourable initial budgetary position and the age-related expenditures.

5.2 Long-term budgetary prospects, including the implications of ageing populations

The long-term budgetary forecast for the development of the pension system is based on the current (2016) pension legislation and on the provisions of the Social Security Code. For the preparation of the pension expenditure forecast, the latest Eurostat demographic projections EUROPOP 2013 and the macroeconomic forecast developed by the Ageing Working Group (AWG) to the Economic Policy Committee of the European Commission in connection with the 2015 Ageing Report were used. The NSSI Actuarial model for long-term forecasting of PSS funds was used as a tool. The forecast does not take into account the link between the retirement age and the changes in the average life expectancy after 2037. In regards to the 2016 provided opportunity to transfers social security rights only in PSS, there are different proposals on the percentage of persons, born after 1959 who chose to be insured only in pillar I.

The figure below shows the estimated results in terms of the public pension expenditures as a share of GDP in the period 2016–2060.

Figure 5-1: Pension expenditures as % of GDP, 2016–2060



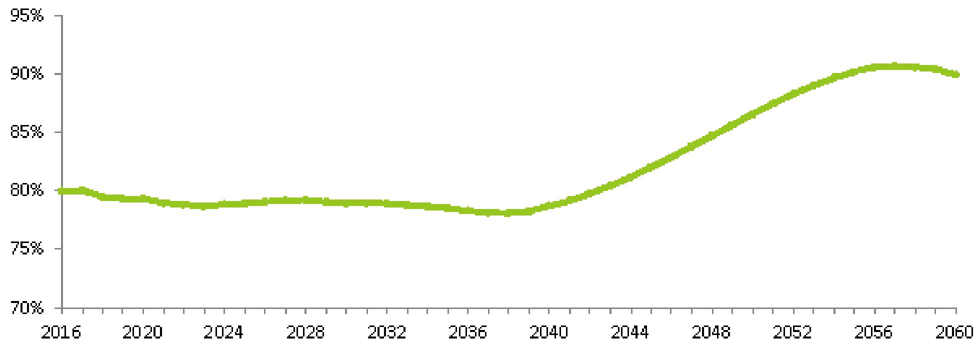
Source: NSSI

The results on the basis of the latest amendments to pension legislation, show a certain reduction of pension expenditure as a share of GDP in the beginning of the forecasting period, reaching its lowest levels in the period 2021–2023.

As a result of the ageing population and the increasing average life expectancy in Bulgaria, the fiscal pressure on the pension system will increase considerably in the long run. Assuming that 100% of those born after 1959 choosing insurance in both pillars, pension expenditure as a share of GDP is expected to exceed 10% in 2060. This is the variant with the lowest expenditures because PSS pensions of all persons born after 1959 will be reduced proportionally to the social security contribution, which is transferred to pillar **II**. The reduction applies to the person's social insurance income upon calculation of the pension for the periods with social contributions in pillar **II** and by 2060 the reduction reaches 25%. In case that 100% of those born after 1959 choose to be insured in pillar **I** only, the pension expenditure would grow considerably due to the fact that all persons will receive pensions in full amount, reaching 13.1% of GDP in 2060. Thus, at the end of the period for each 10% of those who transferred to pillar I, there will be an increase in pension expenditure of approximately 0.3% of GDP. The possibility to transfer social security rights fully to the first pillar will also lead to an increase in the PSS incomes, which translates into an increase of PSS revenue of around 0.13% of GDP for every 10 % of persons born after 1959, transferring to the I pillar.

The main factors having an impact on pension expenditures are the dependency ratio[29] and the replacement rate[30]. 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. In 2015 a hundred social insured individuals corresponded to 80 pensioners. In the period until 2037, when the retirement age for women and men will become equal at the level of 65 years of age, the dependency ratio remains at levels close to 80% due to the increase in the retirement age and in the insurance 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 2037 due to the ageing population, the increasing average life expectancy and the decreasing number of employed persons, with 90 pensioners expected to correspond to 100 insured persons in 2060.

Figure 5-2: Number of pensioners to number of socially insured individuals (dependency ratio) 2016–2060



Source: NSSI

The upward trend of the dependency ratio is accompanied by an upward trend of the replacement rate, mainly due to the higher values of the pensions, as a result from the gradual increase in the percentage for each year insured length of service in the pension formula from 1.1 to 1.5 in the period 2017–2026. The recent amendments in the pension legislation stipulate that from 2017 the percentage for one year of length of insurance service, referred to also as weight of one year insured length of service, will increase by a percentage larger than or equal to the one calculated from the

[29] The ratio between the number of pensioners and the number of social insured persons

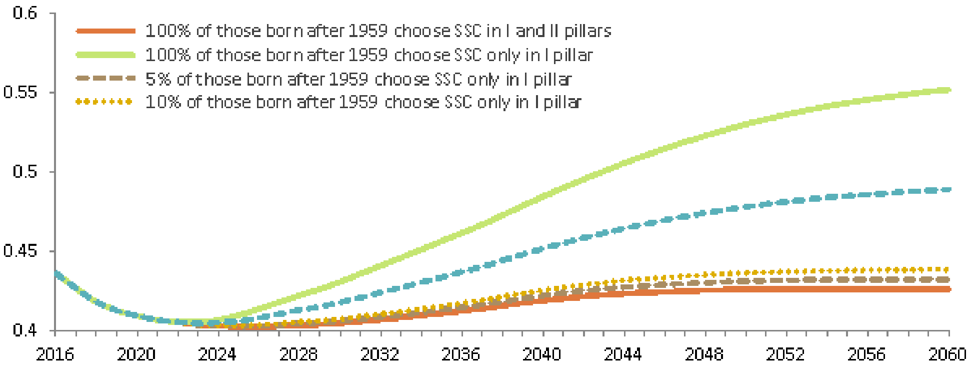
[30] The ratio between the average pension and the average contributory income for the country

sum of 50% of the increase of the insurance income and 50% of the consumer price index in the preceding year. For new pensioners the new percentage will apply upon determination of the amount of their pensions, and as regards already granted pensions there will be a recalculation of the amounts performed from 1 July of the respective year, which will replace the annual indexation in the period of achievement of a weight of 1.5%. The increase of the percentage for each year of length of service will have a considerable positive effect on the adequacy of pensions, fully making up for the decrease of the PSS pension for persons who have been insured in the second pillar too. The amount of this decrease depends on the insurance length of service in the two pillars and on the amount of the social security contributions, which is redirected from the first to the second pillar.

Considerable impact on the replacement rate from the first pillar will have the possibility, provided in the legislature, to transfer social security rights from the first and second pillars to the first pillar only.

The next figure shows the values of the average gross replacement ratio from the first pillar of the pension system depending on the percentage of insured persons born after 1959 who will choose to be insured in PSS only. The possibility to transfer SSC entirely to PSS has a favourable influence on the replacement rate from the first pillar in the long run, as in the case when 100% of the insured persons born after 1959 choose to pay contributions in pillar I only, the average gross replacement ratio exceeds 55% in 2060, compared to values of about 43% in case when 100% of the persons born after 1959 are insured in both pillars.

Figure 5-3: Average pension to average social insurance income (replacement rate), 2016–2060



Source: NSSI

5.3 Contingent Liabilities

The government guaranteed debt of the general government sector as of end-2015 was 0.5% of GDP. The sector of "Energy" has a dominating share of 87.9% in the government guarantees' structure by sectors.

As regards to the currency composition of the government guaranteed debt, the share of BGN- and EUR-denominated loans is 63.1%, of YEN-denominated ones – 35.8%, and of USD-denominated debts – 1.1%.

A possibility was set forth in 2016 for the issuing government guarantees for funding the "Gas Interconnection Greece-Bulgaria" project, for the benefit of the Bulgarian Development Bank, under the Student and Doctoral-Candidate Law, as well as in the form of guarantee deposits for covering the financial shortage of beneficiaries from the public sector of projects under Operational Programmes "Transport and Transport Infrastructure", "Environment" and "Regions in Growth". When making assumptions about the listing of the mentioned government guarantees, resp. when the funds are utilised it is expected to have a considerable impact both on the nominal amount of the government guaranteed debt, and on its ratio to GDP.

The approach in the issuance of new government guarantees for debt financing and within the forthcoming medium term will remain restrictive, while maintain a consistent and strict observance of the legally determined procedure and conditions, as well as outlining the priority areas for funding, in accordance with the degree of readiness for implementation of the projects and the future impact of funding on the state budget.

6 Quality of Public Finances

6.1 Policy Strategy

The policy strategy in the area of the quality of public finances is related, on the one hand, to strengthening the management of public finances through the establishment of practices of implementation of the Public Finance Law (PFL), and on the other hand – to the quality of budgetary documents and the procedures for their preparation, and last but not least – to the effective mechanisms for maintaining fiscal stability.

The objectives to increase the quality of public finance by executing the budgetary process in accordance with the Public Finance Law, adhering to the fiscal rules and limitations, exercising constant monitoring of the impact of the budgetary legislation and its improvement, as well as implementing good budgetary practices are preserved. In this connection a review and an analysis of the implementation of the Public Finance Law from its entry into force was made, both with respect to the compliance with the rules and procedures and with respect to legal gaps and discrepancies identified in the course of implementation of the budgetary process. As a result, the main trends were outlined for improvement of the structure and contents of the budgetary documents and acts of the respective bodies related to the implementation of specific provisions of the Public Finance Law, as well as the need of improvement of the budgetary legislation, incl. through an amendment to the Public Finance Law.

The increased efficiency of public expenditures in individual sectors remains among the priorities of the government, as the measures are not limited to the implementation of structural reform programmes, only but are also focused on the nature and orientation of expenditures in the relevant sector in order to strengthen their contribution to the increase of the economic growth, mostly through investments.

An important element in this aspect is also the process of implementation of programme and result-oriented budgeting on the part of the budget organizations responsible for the conduction and execution of policies in the public sphere. The achievement of a maximum degree of connection between the targets and the priorities set by budget organizations, the activities performed for their implementation and the products/services provided within this process to the achieved results (measured through objectively defined performance indicators) and the ensuring of an adequate level of funding in accordance with the degree of achievement of the target values set, is a major tool for improvement of the public sector expenditure quality.

In order to improve the processes of strategic planning and development of the national policies in line with the government priorities and the possibilities for their funding, a legal requirement was set for establishment of a sustainable classification of expenditures by policy areas and budget programmes. The first-level spending units that apply programme budgeting shall prepare their budgetary forecasts for the period 2017-2019 on the basis of the adopted by a Council of Ministers' Decision classifier of expenditures by policy areas and budget programmes within the competence and under the responsibility of the relevant first-level spending unit, thus ensuring continuity and consistency of the policies and budget programmes implemented by them.

6.2 Composition, efficiency and effectiveness of expenditure – COFOG

Table 6-1: Budget expenditure by function

	% of GDP		% of the total budget expenditure	
	2014	**2019**	**2014**	**2019**
1. General public services	6.3	4.2	14.9	11.5
2. Defence	1.4	1.2	3.3	3.4
3. Public order and safety	2.8	2.2	6.5	6.0
4. Economic affairs	4.9	5.2	11.7	14.1
5. Environmental protection	0.7	1.3	1.6	3.4
6. Housing and community amenities	1.6	1.2	3.9	3.3
7. Health care	5.5	4.8	13.0	13.0
8. Recreation, culture and religion	1.5	0.6	3.5	1.7
9. Education	4.1	3.2	9.7	8.7
10. Social protection	13.4	12.8	31.9	34.9
11. Total expenditure	42.1	36.7	100.0	100.0

The decrease of the expenditure for the "**General public services**" function from 6.3% of GDP in 2014 to 4.2% of GDP in 2019 reflects the measures taken for structural and functional reforms in the public sector.

The expenditures for the **"Healthcare"** function decrease from 5.5% of GDP in 2014 to 4.8% of GDP in 2019. The expenditures for the function include the measures for optimization of the activities and improvement of the control over expenditures in the healthcare system, aimed at stabilising the health insurance model and increasing the financial independence of the health sector as a whole.

The expenditures for the **"Economic activities"** function increase from 4,9% of GDP in 2014 to 5.2% of GDP in 2019. Their dynamics corresponds to the planned increase under the function according to the medium term budget framework. The function includes the state-owned enterprises which form part of the general government sector and excludes the expenditures covered by EU funds which, according to ESA 2010 methodology, do not have any impact on revenues and expenditures in the general government sector. The expenditures under the EU operational programmes and funds are also relevant to the increase of this function, as this position increases at the end of the new programme period.

The expenditures for the **"Environmental Protection"** function increase from 0.7% of GDP in 2014 to 1.3% of GDP in 2019. The expenditures for the function include measures for continuing the accelerated construction of an ecological infrastructure in the country and the Natura 2000 ecological network, which will support the improvement of the life quality of the population and the protection of the ecosystems, as well as the meeting of the country's commitments to the EU.

The expenditures for the **"Education"** function will decrease from 4.1% of GDP in 2014 to 3.2% of GDP in 2019 as a result from the measures directed towards the achievement of higher transparency and efficiency of the spending of public funds in the educational system, optimization of the structures in the school network system and more comprehensive covering of students within the system.

The reduction of the expenditures for the **"Social protection" function** from 13.4% of GDP in 2014 to 12.8% of GDP in 2019 reflects the decrease of the social security and social assistance benefits due to the expected improvement of the economic environment and the lower level of unemployment. The pension reform continues in the medium term, as an increase is envisaged both of the insurance contributions and of the age and length of insurance service required to obtain an entitlement to pension. This brings about a decrease of the pension expenditures as a share of GDP as at the end of the period.

6.3 Structure and Efficiency of Revenue Systems

6.3.1 Institutional Changes and Legislative Amendments Related to Public Finances and Improving the Collection Rate of Tax Revenues, Tackling the Shadow Economy, Reducing the Compliance Costs, which Address Specific Recommendation 1 in the Part Concerning Tax Revenues

– **Tax Policy and Legislation**

The tax and social security policy pursued by the Ministry of Finance is oriented towards supporting the economic growth, improving the business environment, as well as towards restricting the tax frauds and increasing the fiscal sustainability in the long run. It is intended to preserve the low rates of corporate taxes and personal income tax, as an important incentive for investments, economic growth and employment. The priorities for the period 2016–2018 include, inter alia, achievement of the minimum levels of excise duty rates in the EU, in accordance with the agreed transitional period.

The amendments to the tax legislation for 2015 are related to the implementation of measures on the tax policy priorities, and namely:

- measures for increasing budget revenue through prevention of the possibilities to hide and not pay taxes and evade taxation, as well as through measures in the field of collection of obligations overdue;
- measures for reducing the administrative burden and costs for doing business and costs for the citizens;
- measures for stimulating the economic development, investments and employment.
- introduction in the national legislation of European Directives in the field of taxes, as well as for setting of the national legal framework in conformity with the case-law of the EU Court of Justice.

In view to increasing budget revenues and tackling the shadow economy amendments were made to the Excise Duties and Tax Warehouses Law, to the Value Added Tax Law, to the Income Taxes of Natural Persons Law and to the Tax and Social Insurance Procedure Code.

➢ ***Amendments to the Excise Duties and Tax Warehouses Law (EDTWL)***

The amendments to the Excise Duties and Tax Warehouses Law (EDTWL) adopted in 2015 are aimed at optimizing the monitoring of the movement of energy products in tax warehouses, part of which are oil pipelines and oil product pipelines, optimizing the control over the activity of the tax warehouse and the control over excise goods and the accrual of the excise duty due. In this relation the legal framework of the excise-duty suspension arrangement is supplemented. According to the amendments made the licensed warehouse keeper is bound to use measuring and control devices at the points of inflow or outflow of energy products from and to the oil pipeline or oil product pipeline, part of the tax warehouse, to and from the points of production and/or warehousing, when the tax warehouse is located on the territory of more than one customs institution. One measuring and control device may be used in cases of a common point of inflow or outflow of energy products from and to the oil pipeline or oil product pipeline, which is a part of the tax warehouse. The amendments make possible also the use of a single measuring and control device from the points of production and/or warehousing, part of the tax warehouse or to and from another tax warehouse, production and/or warehousing, part of the tax warehouse, or to another tax warehouse. The Law amending and supplementing the Excise Duties and Tax Warehouses Law fixes a two-month term from its entry into force, in which licensed warehouse keepers must set their activity in conformity with the new provisions.

The regulation of lubricants was relieved, as they were exempted from excise duties for packages of up to 5 litres. According to the current framework, the exemption from excise duties applied to packages of up to 3 litres.

In order to improve the control over the supplies and sales of liquid fuels the special regime with respect to oil bases was repealed, as a six-month transitional period was set forth for the persons enjoying the regime to set their activity in conformity with the requirements of Article 118 of the Value Added Tax Law, i.e. to apply the general arrangements for registration and reporting of supplies/ sales of liquid fuels in the trade outlet through fiscal devices and to deliver data through the distant connection of the National Revenues Agency.

As a result from the joint inspections of the bodies of the National Revenue Agency and the Bulgarian Customs Agency regarding the distribution of motor oils by depositors in tax warehouses, provisions were created in EDTWL entitling the revenue authorities to online access to the automated report system of the licensed warehouse keepers, as well as a number of conditions with respect to the transfer of ownership in excise goods under the "excise-duty suspension" arrangement on the territory of the tax warehouses.

In order to prevent evasion of excise duties through the transfer of a company – debtor to persons having no property, a requirement was introduced with respect to the issuance of licenses and certificates to a person whose owners, managers, procurators, majority shareholders are or were at the time of arising of the obligations owners, procurators, majority shareholders, members of management or supervisory bodies of persons having unsettled public obligations subject to collected by the customs authorities.

In view to decreasing the possibilities of improper sale of tobacco products a requirement was introduced that the right to trade in tobacco products shall be vested in a person who did not perform trade in and/or storage of tobacco products without authorization in the last 24 months, unless the administrative-and-penal procedure ended up with the conclusion of a settlement agreement. Likewise, it is prohibited to hold, carry and transport hand-rolled cigarettes or cigarettes produced from work pieces with a filter, in a quantity exceeding 40 sticks, as well as the holding, carriage, transportation, offering and sale of tobacco waste that does not represent smoking tobacco (for pipe cigarettes), except in the cases provided for in the EDTWL.

Amendments to the EDTWL were adopted, whereby the ratio between the specific and proportional excise duty was changed in view to achieving a balance between the revenues for the state budget and the minimum increase of the prices of cigarettes from the lowest price categories. The time-table for a gradual increase of the excise duty rate for cigarettes until the minimum levels of taxation determined by the European legislation is reached is fixed, as follows: as regards specific excise duty – BGN 70 per 1000 sticks; as regards proportional excise duty: 38 per cent of the sale price – from 1 January 2016; 40 per cent of the sale price – from 1 January 2017; 42 per cent of the sale price – from 1 January 2018.

Considering the larger number of abuses of marked oils for heating the amount of the excise duty rate for gas oil and kerosene was changed, as the said rates were made equal to the ones of motor oils (BGN 646 per 1000 l.). The rate for heavy fuel oils for heating was also increased to BGN 400, in view of the possible risks in the consumption thereof, as it is provided for that they will be transported on the territory of the country by the use of transportation vessels, on which a GPS is installed. Similarly to the transportation of marked energy products, the GPS data should be delivered in real time to the Bulgarian Customs Agency.

As regards taxable persons who use in their activities ethyl alcohol denatured under a special method for the production of goods that are not intended for humane use, direct exemption from excise duty was provided for rather than exemption trough refund of the excise duty. The aim is to decrease the administrative burden and the costs of persons, and on the other hand – to increase the competitive power of the Bulgarian manufacturers and to improve the liquidity of the economic operators, such as the practice of other EU member states is.

It is provided for that the movement from a tax warehouse to another one when both belong to the same licensed warehouse keeper on the territory of the country of excise goods, on which an excise duty label is stuck, will not be considered release for consumption, and they will be under an excise-duty suspension arrangement after a received authorization from the director of the Bulgarian Customs Agency.

In view to putting an end to the evasion by bad-faith persons having obligations to the Bulgarian Customs Agency of the payment of the public receivables due, a requirement was introduced not to issue licenses and certificates to a person whose owners, managers, procurators, majority shareholders are or were at the time of arising of the obligations owners, procurators, majority shareholders, members of management or control bodies or persons with public liabilities subject to collection by the customs authorities, unless a security is provided.

There is no more limitation in the movement of excise goods between tax warehouses of the same licensed warehouse keeper on the territory of the country. Excise duties, on which an excise duty label is stuck, will be under an excise-duty suspension arrangement, after the receipt of an authorization.

For the purpose of reducing the administrative burden, the government reduced the term for issuing a decision for refund of the excise duty paid for electricity from 3 months to 2 months, and removed the requirement licensed warehouse keepers to file the report on excise-duty labels. There was also a reduction of the term for the factual refund of the excise duty under an issued refund decision.

- ***Amendments to the VAT Law***

In accordance with article 199a(1) of Directive 2006/112/EC the deadline for implementation of the VAT reverse charge mechanism upon supplies of grain and technical cultures was extended to 31 December 2018. The aim of the measure is to decrease the VAT frauds, to restrict unfair competition in the branch and to provide considerable additional financial resource to the traders and processors in the industry.

The rules regulating the tax treatment for VAT purposes of gratuitous supplies of a commodity or service for the personal needs of the tax liable person, of the owner, of the workers and employees or for purposes other than the independent business activity of the person were made more precise. It was specified that a supply performed in case of dire need or force majeure is not treated as a supplied carried out for consideration.

- ***Amendments to the Income Taxes of Natural Persons Law***

Advance taxation of incomes of individuals from the so called other sources (occasional and irregular incomes), when they are in cash and the income payer is an enterprise or a self-insured person was introduced in order to prevent evading taxation. It was provided for that the income payer would determine and deduct the tax upon the payment of the income.

- ***Amendments to the Tax and Social Security Procedure Code***

Amendments were adopted to the Tax and Social Security Procedure Code intended to optimize the process of ascertainment of taxes and to improve the regime of forcible collection of public receivables, as well as to facilitate the inter-institutional interaction and for regulation of implementation of administrative cooperation in relation to the provision and exchange of financial information.

For the achievement of results with respect to the second priority – reduction of the administrative burden and costs for doing business and costs for the citizens and considering the introduction of complex administrative servicing, an additional possibility was created to have the information from the tax and social security account of the person, respectively the certificate of presence of liabilities obtained by a person other than the tax liable person when the liable person has explicitly stated the recipient before a revenue authority. A possibility was also created for the competent administrative authorities from the various departments to request and obtain, for the purposes of administrative servicing, from the revenue authorities certificates of the presence or absence of liabilities of the person.

In reply to the country specific recommendations in the field of tax policy from 2014 and 2015 a ***Uniform national strategy for strengthening the tax collection, tackling the shadow economy and reducing the compliance costs 2015-2017 (UNS) and an Action Plan to It*** *was developed and adopted (Decision No. 806 of 15 October 2015 of the Council of Ministers)*

The strategy identifies the key problems resulting in failure to collect receivables for taxes and the main reasons for them. The definition of the specified problems is based on a risk analysis made by the revenue agencies. The key actions needed to achieve the targets set are determined on the basis of the analysis. The evaluation of the implemented measures is carried out both upon their implementation and in advance, for cases when the given measure requires legislative amendments. The revenue agencies analyse on an on-going basis the effects from the measures taken to combat tax frauds. This activity is basic for some of the structures in the agency and is important both upon the taking of control related government decisions and in the resolution of problems in the field of tax policy, including upon the update or outlining of new measures. In this relation, in view to achieving and implementing the objectives, measures and activities set, a system of monitoring and evaluation indicators is developed in the national strategy, with specific responsible institutions and terms for performance. The UNS includes part 4, which is entirely dedicated to the coordination, monitoring and evaluation of the implementation of the strategy, and measures 1.14 and 2.11 of the Action Plan are connected to the analysis and evaluation of specific implications. The effects from the implementation of a part of the measures are also included in Appendix No. 1 of the National Reform Programme, which specifies also the values of the performance indicators under the specific measures. The evaluation of the effects will continue in the future too, as the aim is to constantly improve the quality and its complexity.

A report to the Minister of Finance containing an evaluation of the performance in the first year of implementation of the strategy is being prepared, and will be moved for hearing before the Council of Ministers.

– **Bulgarian Customs Agency (CA)**

➢ ***Amendments to Law Amending and Supplementing the Customs Law (CL)***

The amendments of 2015 in the Customs Law settled the control over the border check-points with respect to the compliance with the obligation to pay fees and vignette tolls and to the observance of the permit system for cargo and passenger transportations.

It is envisaged that in case of appointment and promotion in the Customs Agency persons must have a positive result from an examination of professional competence and psychological suitability. The EU Customs Competency framework developed by the European Commission in cooperation with the member states, the trade sector and the World Customs Organisation (WCO), is one of the three main directions of the so called Dublin Strategy – a strategic performance framework for the customs profession, 2012-2015. The framework applies to all levels of positions in the customs administration and includes the functional fields related to the main customs activities and competencies, classified in several groups, the main values in the customs profession ranking first.

According to the amendments to the law, the decisions issued by the customs authorities whereby the debtor and the amount of the public state receivable is determined serves as an enforcement order for forcible collection of the ascertained receivables. The decisions are subject to provisional enforcement and an appeal will not stop their enforcement. The conditions and procedure for suspension of the enforcement at the request of a concerned party and if a security is provided in the amount of the principal and interests were set forth. The issue of a writ of forcible collection of public state receivables was repealed.

The new texts are compliant with the provisions of Article 7 and Article 244 of Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code.

The provision of Article 233 (4) and (5) of the Customs Law introduced a graver sanction in case of a repeated violation because the analysis on the committed violations of the customs legislation showed that the perpetrators committing contraband of goods are engaged in such activity on a systematic basis.

Part of the administrative penal provisions related to confiscation in favour of the state of goods subject of customs violation were fine-tuned thus reducing to the minimum extent the possibility to impose a sanction in the amounts set out in Article 39(2) of the Administrative Violations and Sanctions Law (fine by slip), examining the extent of public danger. The term "serious violation" was introduced, with the aim to bring clarity and definition, both for customs authorities and for economic operators, in the implementation of a number of customs provisions related to the identifying or verifying the presence or absence of serious violations depending on the severity of public danger of the specific violation.

Extended powers of the customs authorities were introduced with respect to:

- the exchange of information between the Bulgarian Customs Agency and the Ministry of Interior through regulation of access to automated information systems;
- introduction of Article 255 of the Criminal Code (CC) as a part of the crimes, for which the investigating customs inspectors have substantive competence to carry out investigations, which is aimed at higher speed and efficiency in the revealing of crimes related to evasion and non-payment of excise duties and VAT in large amounts;
- assignment of the customs bodies to carry out operative, investigative and convoying activity in the exercising of their powers related to prevention, detection and neutralization of crimes under Articles 234, 242, 242a, 251 and 255 of the Criminal Code.

The new European Union Customs Code – Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code will be applicable from 1st of May 2016. In this relation a draft Law Amending and Supplementing the Customs Law was drawn up with the aim of setting the national legislation in conformity with the customs legislation of the Union and making the provisions more precise for the purpose of facilitating their practical application. The proposals made for amending and supplementing the Customs Law are dictated by and are in full compliance with Regulation (EU) No 952/2013, Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015 supplementing Regulation (EU) No 952/2013 of the European Parliament and of the Council as regards detailed rules concerning certain provisions of the Union Customs Code and Commission Implementing Regulation (EU) 2015/2447 of 24 November 2015 laying down detailed rules for implementing certain provisions of Regulation (EU) No 952/2013 of the European Parliament and of the Council laying down the Union Customs Code. The Union customs legislation is directly applicable in the Republic of Bulgaria. In this relation the draft Law Amending and Supplementing the Customs Law proposes repealing of provisions that settle matter and public relations, which are already primarily regulated at the level of the European customs legislation.

➢ ***Amendments to the Excise Duties and Tax Warehouses Law (EDTWL)***

In addition to the abovementioned amendments to the Excise Duties and Tax Warehouses Law, in view to improving the control over excise goods, specific powers were set forth for the customs authorities – the right to perform field tests and to stop road vehicles for checking driving and transportation documents.

The procedure for making of control purchases by the customs authorities was regulated, which is a prerequisite for improving the quality of proving in control activity.

- ***Amendments to the Agricultural Producers Support Law***

In 2015 a new provision of Article 35(4) was added to the Agricultural Producers Support Law, according to which the National Revenue Agency and the Bulgarian Customs Agency must exchange information with State Fund Agriculture, as necessary for the performance of administrative checks, under such conditions and procedure as determined in jointly issued interaction instructions.

- ***Amendments to the Carriage by Road Law***

In 2015 a new provision was introduced in Article 91a(13) of the Carriage by Road Law, which regulates the right of customs authorities to carry out control checks on the road in order to ascertain the daily periods of driving, interruptions and the periods of daily and weekly rest of motor vehicles carrying out carriage of cargo.

- ***The Rules Implementing the Excise Duties and Tax Warehouses Law (RIEDTWL)***

Amendments was approved to the Rules Implementing the Excise Duties and Tax Warehouses Law, whereby it was provided for that when excise goods released for consumption, on which excise duty label is stuck, will be exported or sent to another member state, the excise duty labels stuck on the unit packets must be scrapped after their authenticity is proven. A new procedure for excise duty label scrapping by the customs authorities was introduced.

- ***Ordinance Supplementing Ordinance No.H-1 of 2014 on the Specific Requirements the and Control***

Ordinance Supplementing Ordinance No.H-1 of 2014 on the Specific Requirements and the Control Exercised by the Customs Authorities on the Devices for Measurement and Control of Excisable Goods was published and the regulatory framework in this field was thus harmonized. The aim of the legal instrument is protection of the fiscal position and increase of the budget revenues through the exerting of a more effective preventive and follow-up control by the customs authorities over the introduction, production, warehousing and taking out of excise goods from a tax warehouse or from another facility. In view to decreasing the possibility to evade the determined control points, there was an expansion of the general requirements to persons that are supposed to set their activity in conformity with the Ordinance within up to 3 months from its entry into force.

In line with the most recent amendments to the EDTWL, a proposal was made to make more precise the regulatory framework. In case a request for refund of excise duty is submitted, the customs authorities are proposed to make a check of the persons for the presence of payable public liaiblities subject to collection by the Customs Agency, rather than – as previously – only of excise duty obligations. In cases of refund of an excise duty paid, the deadline for refund of the amounts or the set-off against payable public liabilities of the person subject to collected by the Customs Agency was decrease from 14 days to 7 days. The licensed warehouse keepers automated reporting systems must also report data for the depositors in the tax warehouse, which are to be identified by a uniform identification code. The requisites of the *Log of Warehouse Availability* register kept by licensed warehouse keepers were supplemented. The requirements to the information contained in the material accounting of end consumers exempted from excise duty were expanded in relation to the control of the used excise goods. The contents of the register of the authorizations issued for trade in tobacco products, which is kept in the Customs Agency was also regulated.

- ***Amendments to the Organic Rules of the Bulgarian Customs Agency***

In 2015 and in the beginning of 2016 considerable reorganizations were carried out in the structure of the Customs Agency, which were regulated by amendments to the Organic Rules of the Customs Agency. In view of the changes in the legislation, the activity, structure and functional competence of the customs and directorates in the Central Customs Directorate were optimized.

Considering the securing of legal services for the general and specialized administration, it was provided for that the procedural representation before the judiciary bodies under proceedings related to competence based decisions, a party to which is the Customs Agency, including before the EU Court of Justice will be secured by the use of legal advisors in several directorates.

The aim of the changes is to strengthen the expert analytical assessment in forming concepts on the agency's activity and elaborating documents with a plan, programme and reporting nature within the framework of drafting analyses and forecasts for the agency's activity.

For the sake of higher efficiency a number of specialized trainings of the customs officers were conducted within the new and/or improved components of the information systems. The Customs Agency is in active partnership with the trade sector with respect to the use of the electronic systems and services in the sphere of customs and excised duty legislation.

– **National Revenue Agency (NRA)**

In order to decrease the shadow economy, to improve the collection of tax and social security liabilities and to reduce the administrative burden the National Revenue Agency, in most cases jointly with the Customs Agency, continues implementing the following measures:

- Offer new electronic services and improve the existing ones provided by the National Revenue Agency;
- Management of the risk from failure to comply with the tax and social security legislation through the preparation and implementation of a biennial Programme for compliance and reduction of the risk levels, incl. legal, control, communication, educational, and other measures;
- Uniform counteraction to customs, foreign exchange and tax violations, the subject of which is excise goods, as well as to tax frauds involving excise duty and VAT via:
  - Joint risk assessment by the Customs Agency and the National Revenue Agency with respect to persons dealing with excise goods.
  - Performance of joint inspections by the Customs Agency and the National Revenue Agency aimed at preventing and detecting tax violations and crimes.
  - Joint inspections by the Customs Agency and the National Revenue Agency at energy product/fuel storage and sale facilities.
- Strengthened coordination between the bodies of the National Revenue Agency, the Customs Agency and bodies of pre-trial proceedings if tax frauds are detected in the course of audit proceedings and inspections by:
  - Implementing exchange of information between the National Revenue Agency, the Ministry of Interior, the State Agency for National Security and the Prosecutor's Office, related to specific cases of avoiding the ascertainment and payment of tax liabilities.
  - Improvingthe functioning in the Specialized Prosecutor's Office of a Specialized Unit for Investigation of Tax Crimes Related to Organized Criminal Groups.
  - Strengthening the work of a joint interdepartmental centre between the National Revenue Agency, the Ministry of Interior, the State Agency for National Security, the Prosecutor's Office, the Customs Agency and Automobile Administration
- Optimization and development of the business processes and an information system in the control activity of the National Revenue Agency via:

- Constant monitoring and communication with obligated persons forming a significant share of the economy in the country.
- Expanding the use of database analysis electronic software in the so called e-audits carried out by the National Revenue Agency.
- Forming specialized teams for computer investigations and provision of instruments for securing of evidence in an electronic form.
- Implementing a project for the construction building of administrative capacity of the National Revenue Agency for the performance of systematic and effective control over liable persons performing trade activity on the internet.

- Improvement and acceleration of the collection of public receivables through:
  - Constant monitoring of the collection of receivables overdue having a high fiscal effect.
  - Target campaigns for collection of public receivables overdue.
  - Increase of the electronic volume of documents and data with public execution creditors, as well as with institutions maintaining information for the property/ assets of the detained persons.
  - Implementation of a comprehensive specialized software product covering all activities of collection of public receivables.
  - Enforcement against the receivables of debtors by spending units (Decision No.788/ 28 November 2014 of the Council of Ministers).
  - Development and implementation of functionality for automated identification of a debtor's profile in view to determining adequate debt collection measures.

In addition to the above, in order to decrease the grey economy and improve the collection of the tax and social security obligations, a proposal will be made to create the so called "tax police" – i.e. vesting in the bodies of the National Revenue Agency of police investigative functions, as they will be proposed to pursue together with the prosecutor's office the police investigation against tax crimes.

As regards the efficiency of the implemented measures for reduction of the administrative burden and costs for doing business and costs for the citizens, it should be pointed out that more than 97% of the accounting registers under the VAT Law, which are subject to submission together with the tax return for the respective period, were submitted electronically, by the use of a qualified electronic signature (QES). Electronic filing is the only possibility provided for in the law to file the tax return and the accounting registers with respect to these tax liable persons that carry out intra-community supplies of goods or services and are bound to file also VIES-returns. The preparation of the ledgers of account also takes place mostly electronically. On the one had, the person have at their disposal a software product for drawing-up of the reports, which is made available by the National Revenue Agency completely free of charge. On the other hand – a large part of the companies generate their returns automatically from the accounting – by its own software or by the use of external (accounting) services. For the fulfilment of the legal obligation there is no need of information that is to be collected additionally, other than the information available in the accounting of the liable persons.

- The annual corporate income tax returns – under Article 92 of the Corporate Income Tax Law (CITL) filed electronically, are 61 % (for tax year 2014, including the advance instalments in 2015). It could be said that the relative share of the returns filed electronically is higher that the stated one when separating the indicators for the medium-size enterprises – 85.7 % in companies having incomes ranging from BGN 5 million to BGN 25 million. The advance corporate tax instalments in Bulgaria are monthly (for undertakings having annual incomes in excess of BGN 3 million) or quarterly. Enterprises having annual incomes from sales of up to BGN 300 thousand are exempted from the obligation to pay advance instalments for the tax. The amount of the advance instalments is determined by the forecast tax profit for the current year, which is declared in the annual tax return for the previous year. Hence, as a general rule, there is no obligation to file a separate return in relation to advance taxation.

It must be noted that according to the National Revenue Agency the use of the electronic services provided by the agency saves businesses and citizens about BGN 300 million per year.

- In addition, the payment of corporate tax, VAT and taxes on the received remunerations for performed labour, incl. taxes on salaries and social security contributions (the three taxes, on the basis of which the "Doing business" study determines the time indicator), in Bulgaria may only be made by bank, i.e. it is not possible to generate time from waiting in an office of the National Revenue Agency. All banks provide online banking options and it is thus not necessary to visit an office of the National Revenue Agency. The National Revenue Agency enables all types of electronic payments of taxes and social security contributions. A possibility was also created to file a part of the social security returns electronically, by a qualified electronic signature. Self-insured persons are also provided with the option to file these returns by the use of a Personal Identification Code (PIC). In the meantime, PIC provides also access to statements concerning data under mandatory additional pension insurance (for individuals), insurance income (for individuals), the current status of labour contracts (for legal entities).
- The improvement of the "tax payment time" indicator used in the World Bank's "Doing business" study is on the focus of the government of the Republic of Bulgaria. The above data is a part of a comprehensive analysis of the condition performed by an interdepartmental workgroup created in pursuance of Decision No.617 of the Council of Ministers of 12 August 2015 for the adoption of an analysis of the problems obstructing the growth of investments and for the approval of a list of key problem areas and proposals for measures on them.

7 INSTITUTIONAL FEATURES OF PUBLIC FINANCES

7.1 National budgetary rules

By the adoption of the Public Finance Law (PFL) and the Law on Fiscal Council and Automatic Correction Mechanisms Bulgaria has introduced in its national legislation the requirements of the European Union's economic governance framework. The presence of a legal framework that determines budgetary rules, restrictions and procedures for action upon any deviations from the targets set for a certain indicator, is a precondition for increasing the predictability of the fiscal policy and compliance with the budgetary and financial discipline, and ensuring public finance sustainability.

The fiscal rules set in the Public Finance Law aim at defining clear and transparent restrictions on the fiscal policy in the long run, expressed in the imposition of numerical restrictions on main budgetary aggregates. The rules were developed in accordance with the internationally adopted definitions and criteria, as well as with the requirements for coordination of the national fiscal planning with the preventive and corrective arm of the Stability and Growth Pact.

The concentration of fiscal rules and their permanent regulation within the Public Finance Law have a positive effect as they guarantee long-term sustainability, link the elaboration of the fiscal policy to the making of a complex evaluation for their application and create preconditions for preserving budgetary discipline at all levels of governance of public finance.

The fiscal rules and restrictions comprise indicators under the national methodology – for the budget balance and the expenditures under the consolidated fiscal programme (on a cash basis) and for the state debt, as well as indicators of the General Government sector (for some rules as well as for the relevant subsectors) - for the medium term budgetary objective for the structural deficit, the budget balance and the consolidated debt of the General Government sector. The construction of three groups of fiscal rules – balance, debt and expenditure ones helps reflect the impact of the policies on the parameters of key budget indicators relevant to the General Government sector and to its relevant subsectors, as well as to the consolidated fiscal programme, incl. to a local level (municipalities/municipal budgets). The rules are further developed with the inclusion of specific provisions for cases of deviation from the target/restriction and the respective correction mechanisms and measures for returning to the target or the determined by the rule limit.

The introduction of fiscal rules and restrictions that indicate the state of public finances is a mechanism for prevention from adverse fiscal trends and for taking prompt and adequate decisions, based also on the opinions and recommendations of the Fiscal Council, which after being constituted in the end of 2015 has started performing in practice its functions in accordance with the Law on Fiscal Council and Automatic Correction Mechanisms.

7.1.1 Draft Law on Amendments of the Public Finance Law

In 2015 the Ministry of Finance reviewed the implementation of the Public Finance Law, and on that basis amendments were proposed for overcoming the identified problems and discrepancies. On 3 February 2016 the Council of Ministers approved a draft Law on Amendments of the Public Finance Law, which was adopted at first reading by the National Assembly on 11 March 2016.

The proposed amendments are related to the need of taking actions for setting the budgetary position of the municipalities in conformity with the requirements of the national fiscal rules applicable to municipalities and stipulated by the Public Finance Law. The draft law provides for a comprehensive procedure for financial rehabilitation of municipalities, which includes: identification of municipalities suffering financial difficulties; opening of a procedure for their rehabilitation; implementation of a financial rehabilitation plan.

The draft law proposes other changes too, which clarify and answer questions raised in the period of implementation of the Public Finance Law with respect to the application of certain provisions.

Following the adoption of the Law on Fiscal Council and Automatic Correction Mechanisms an amendment to the respective provisions related to references to the Public Finance Law was proposed.

The Draft Law regulates the possibility to limit the debt accumulation by institutional units classified in the General Government sector, in case of exceed of the 60% debt threshold, taking in mind the fact that their debt could have a considerable impact on the level of state indebtedness. Additional requirement regulates the submission of data for the state of play and movement of the debt of institutional units, which participate in the formation of the indicators for the General Government sector, which will considerably facilitate the systematization and preparation of quality statistical information for the debt of the sector. Sanctions are envisaged in case of failure to fulfil the obligation to submit debt information.

The proposed amendments expand the scope of the monthly published official information for the government and government guaranteed debt as a requirement is introduced for publication on a monthly basis official information for the debt and guarantees of the Central government subsector. A provision is also included to ensure consistency and to overcome any discrepancy/difference between the time scope of the government debt management strategy, the documents developed in the course of the budgetary procedure (incl. the medium term budgetary framework and the draft state budget act) and the Convergence Programme of the Republic of Bulgaria. The draft law provides for the necessary amendments to the Government Debt Law related on the one hand to the need of making certain texts more precise, and on the other – corresponding to the proposed amendments to the Public Finance Law related to the monthly publication of the official debt information and the guarantees of the Central government subsector.

The draft law proposes permanent regulation of certain aspects connected to the implementation of the budgets related to the making of changes in the indicators under the respective budgets, as well as the making of provisions more precise in view of achieving higher clarity in their application. Analogical regulation of the said aspects is contained in the annual state budget acts and the decrees on their implementation.

The draft law proposes also permanent regulation of the relations connected to the determination of the elements of the structure of the programme budgets through regulation of a classification in the policy areas/ functional areas and budget programmes, the aim being to create preconditions for a sustainable framework of the conducted policies and budget programmes for their budgeting, as well as their closer linking to the functions and activities of budget organizations.

7.2 Budgetary procedures

The process of planning and drawing up budgetary documents, as well as the adequacy and quality of the information therein contained are a precondition both for the quality of the public finances and for their good governance. The overall success of the budgetary procedure depends on the active participation of all engaged institutions – both budget organizations and legal entities that though not being a part of the consolidated fiscal programme are within the scope of the General Government sector.

The budgetary procedure for 2016 was a continuation of the practice established in the last years, which guarantees sustainability of the budgetary process. It was organized and carried out in accordance with PFL rules and requirements and started with the adoption of Council of Minister's Decision No.62 of 30 January 2015. In the process of its preparation the requirements set for the structure and contents of key budgetary documents and time limits for their adoption in two main stages were reflected.

The procedure created a good organization and ensured the necessary coordination during the preparation of the medium term budgetary framework, its update and development of the state budget draft act, account being taken of the main participants in the budgetary process, stages, deadlines and requirements for the structure of the budgetary documents defined by the Public Finance Law. The 2016 budgetary procedure complied with the deadlines related to the application of the mechanisms and measures laid down in the main stages of the European Semester, thus ensuring the coordination required by the Semester among the key budgetary documents of the government and the commitments related to Council's opinion and recommendations on the implementation of the measures laid down in the National Reform Programme in the framework of "Europe 2020" Strategy as well as in the Convergence Programme.

The first stage of the budgetary procedure for 2016 ended up with the adoption of Decision No.267 of the Council of Ministers of 23 April 2015 for the approval of the medium term budgetary framework for the period 2016–2018, which was developed on the basis of the medium term fiscal strategy of the government for elimination of the budget imbalances and recovery of the budgetary position through the implementation of consistent, moderate and balanced steps towards fiscal consolidation.

The second stage of the procedure covered the preparation, consideration and approval of Budget 2016 by the Council of Ministers and the subsequent steps for reflection of the final budget parameters approved by the National Assembly. The successful implementation of the second stage implies achievement of coordination of the fiscal policy with the sectorial policies of the government being conducted in the period 2016–2018 subject both to the fiscal rules of the Public Finance Law and to the latest values of macroeconomic parameters and the expectations for the development of the national and world economy.

In the second stage of the budgetary procedure the government approved Decision No.847 on the updated medium term budgetary forecast for the period 2016–2018, which was submitted to the parliament as part of the documents accompanying the 2016 Draft Budget . Decision No.1025 of the Council of Ministers of 2015 made changes to the forecast in accordance with the parameters of the 2016 State Budget of the Republic of Bulgaria (promulgated in State Gazette, No.96 of 2015). In the end of the year the Council of Ministers adopted Decree No.380 for the execution of the State Budget of the Republic of Bulgaria for 2016.

Within his powers and in accordance with the deadlines defined in the procedure the Minister of Finance issued instructions and guidelines for the respective stages in order to support the processes of planning and preparation of the budgetary forecasts and the draft budgets of the budget organizations, including those that apply programme budgeting. The guidelines to the spending units concern not only the budgetary parameters of their forecast but also the increase of the quality of the budgetary documents prepared by them.

For the purpose of improving the process of strategic planning and formulation of national policies in accordance with the government's priorities and the possibilities for their financing, a classification of the expenditures by areas of policies and budget programmes within the competence of the respective first-level spending unit under the budgets of the Council of Ministers, of the ministries, of the state agencies and of State Fund Agriculture for 2016 – 2018 was approved by Council of Ministers' Decision No. 468 of 25 June 2015. In the second stage of the 2016 budgetary procedure the Council of Ministers approved by Decision No.961 of 7 December 2015 changes in the classification that correspond to legally effective amendments (e.g. the adopted Pre-school and

School Education Act and the amendments to the Public Procurement Act) and they lead to a need of redefinition/deletion of areas of policies/ budget programmes under the budgets. In compliance with the approved classification, in the course of the 2016 budgetary procedure the budget organizations that apply programme budgeting developed their draft budgets for 2016 and their updated budgetary forecasts for 2017 and 2018.

Preconditions for sustainability of the approved classification have been created, thus corresponding to the objectives and priorities set in the government programme. Changes to the classification can be made, resulting from organizational, structural or normative changes, which affect the activity of budget organizations. They are to be prepared and submitted to the Council of Ministers by the Minister of Finance on the basis of a proposal of the respective first-level spending unit.

On 28 January 2016, the preparation of Budget 2017 started with the adoption of a Council Decision on 2017 budgetary procedure. This procedure is fully in line with the Public Finance Law. The 2017 budgetary procedure continues the practice laid down in the last years, thus ensuring sustainability of the budgetary process.

7.3 Other institutional developments in relation to public finances

In view of maintaining sustainable public finances, increasing the quality of the official macroeconomic and budgetary forecasts, and strengthening the public awareness with respect to the fiscal governance of the country, a Fiscal Council was set up in 2015. It performs the functions of an independent fiscal monitoring body within the meaning of Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States. The establishment of the Fiscal Council is provided for by the Law on Fiscal Council and Automatic Correction Mechanisms adopted by the National Assembly on 8 April 2015 and promulgated in State Gazette on 21 April 2015.

The main function of the Council is to monitor the compliance with the numerical fiscal rules provided for by the Public Finance Law and relevant to the General Government sector and the consolidated fiscal programme. The Council prepares opinions regarding the spring and autumn macroeconomic forecasts of the Minister of Finance, the based on them draft medium term budgetary framework, Draft State Budget Act and the draft laws amending the latter, and the draft laws on the Public Social Security budget and the National Health Insurance Fund budget. In addition, the Fiscal Council shall also monitor the implementation of the automatic correction mechanisms provided for in Article 3, paragraph 1, letter "e" of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

On 25 November 2015 the National Assembly elected the five members of the Council. The organizational-and-technical work required for the functioning of the council has been done so far. The Fiscal Council is expected to present its first opinions on the spring macroeconomic forecast of the Minister of Finance and the medium term budgetary framework within the first stage of the 2017 budgetary procedure. A Memorandum of Cooperation between the Fiscal Council and the Ministry of Finance was signed in April 2016. ▼

8 ANNEX A

Table 1a: Macroeconomic prospects

	ESA code	2015	2015	2016	2017	2018	2019
		Level MBGN	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
Real GDP (at previous year prices)	B1*g	86 094	3.0	2.1	2.5	2.7	2.7
Nominal GDP	B1*g	86 373	3.3	3.3	3.6	3.8	3.9
Components of real GDP							
Private consumption expenditure	P.3	53 031	0.8	2.1	2.6	2.8	2.8
Government consumption expenditure	P.3	13 814	0.3	-0.7	0.7	1.1	1.1
Gross fixed capital formation	P.51	18 086	2.5	-1.8	-0.1	2.7	3.5
Change in inventories and net acquisition of valuables (% of GDP)	P.52+ P.53	165	0.2	0.2	0.2	0.2	0.2
Export of goods and services	P.6	58 599	7.6	4.5	4.7	4.9	5.1
Import of goods and services	P.7	57 601	4.4	2.6	3.6	4.7	5.2
Contributions to real GDP growth (In percentage points)							
Final domestic demand		-	1.0	0.8	1.7	2.4	2.6
Change in inventories and net acquisition of valuables	P.52+P. 53	-	-0.1	0.0	0.0	0.0	0.0
External balance of goods and services	B.11	-	2.1	1.3	0.8	0.3	0.1

Table 1b: Price developments

	ESA code	2015	2015	2016	2017	2018	2019
		Level	Rate of change [31]	Rate of change	Rate of change	Rate of change	Rate of change
GDP deflator		100	0.3	1.2	1.1	1.1	1.2
Private consumption deflator		100	-0.8	0.5	1.1	1.2	1.3
HICP[32]		100	-1.1	-0.8	1.1	1.2	1.4
Public consumption deflator		100	1.8	0.1	0.9	0.9	1.1
Investments deflator		100	1.0	0.3	2.1	2.2	1.8
Export price deflator (goods and services)		100	-2.0	-0.9	0.2	1.1	1.3
Import price deflator (goods and services)		100	-2.5	-2.1	0.5	1.5	1.6

[31] Percentage change as compared to the previous year.

[32] Optional for Stability Programmes.

Table 1c: Labour market developments

	ESA code	2015	2015	2016	2017	2018	2019
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
Employment (thousand persons)[33]		3446.2	0.4	0.5	0.6	0.6	0.6
Employment (millions of hours worked)[34]		5691.4	0.3	0.4	0.5	0.6	0.6
Unemployment rate (%)[35]		9.1	-2.3	-0.6	-0.6	-0.5	-0.3
Labour productivity (BGN per person employed)[36]		24347.2	2.6	1.6	1.9	2.0	2.0
Labour Productivity (BGN per hour worked)[37]		14.8	2.6	1.7	1.9	2.1	2.1
Compensation of employees (MBGN)[38]	D.1	34282.4	2.8	3.2	3.8	4.5	4.7
Compensation per employee		13678.9	1.8	2.7	3.4	3.8	4.0

Table 1d: Sectoral balances

% of GDP	ESA code	2015	2016	2017	2018	2019
Net lending/borrowing vis-à-vis the rest of the world	B.9	4.6	3.3	3.9	3.7	4.1
of which: –balance of goods and services		1.8	3.4	3.8	3.6	3.3
–balance of primary incomes and transfers		-0.4	-1.6	-1.7	-1.9	-1.5
–capital account		3.2	1.5	1.9	2.0	2.3
Net lending/borrowing of the private sector	B.9	6.7	5.2	4.7	4.1	4.3
Net lending/borrowing of the general government	EDP B.9	-2.1	-1.9	-0.8	-0.4	-0.2
Statistical discrepancy						

33 Occupied population, national accounts definition.

34 National accounts definition.

35 Harmonised definition, Eurostat; levels.

36 Real GDP per one person employed.

37 Real GDP per one hour worked.

38 In MBGN.

Table 2a: General government budgetary prospects

	ESA 95	2015	2015	2016	2017	2018	2019
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-1 774.3	-2.1	-1.9	-0.8	-0.4	-0.2
2. Central government	S.1311	-831.2	-1.0	-2.2	-0.9	-0.5	-0.4
3. State government	S.1312	0.0	0.0	0.0	0.0	0.0	0.0
4. Local government	S.1313	-888.3	-1.0	0.1	0.1	0.1	0.2
5. Social security funds	S.1314	-54.8	-0.1	0.1	0.0	0.0	0.0
General government (S13)							
6. Total revenue	TR	32 970.1	38.2	36.5	36.8	36.7	36.5
7. Total expenditure	TE	34 744.4	40.2	38.5	37.5	37.1	36.7
8. Net lending / borrowing	EDP B.9	-1 774.3	-2.1	-1.9	-0.8	-0.4	-0.2
9. Interest expenditure	EDP D.41	823.1	1.0	1.0	1.0	1.0	1.0
10. Primary balance		-951.2	-1.1	-0.9	0.3	0.6	0.8
11. One-off and other temporary measures							
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		18 393.2	21.3	21.3	21.4	21.5	21.5
12a. Taxes on production and import	D.2	13 405.1	15.5	15.5	15.6	15.6	15.7
12b. Current taxes on income wealth, etc.	D.5	4 764.3	5.5	5.5	5.6	5.6	5.6
12c. Capital taxes	D.91	223.9	0.3	0.2	0.3	0.2	0.2
13. Social contributions	D.61	6 965.7	8.1	8.0	8.2	8.3	8.2
14. Property income	D.4	541.2	0.6	0.4	0.4	0.4	0.4
15. Other		7 070.0	8.2	6.8	6.7	6.5	6.4
16=6. Total revenue	TR	32 970.1	38.2	36.5	36.8	36.7	36.5
Tax burden (D.2+D.5+D.61+D.91-D.995)		25 359.0	29.4	29.3	29.6	29.8	29.7
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	13 048.2	15.1	14.5	14.3	13.9	13.4
17a. Compensation of employees	D.1	8 033.1	9.3	9.3	9.2	8.9	8.7
17b. Intermediate consumption	P.2	5 015.1	5.8	5.3	5.1	5.0	4.8
18. Social payments (18=18a+18b)		12 319.6	14.3	14.6	14.6	14.4	14.4
of which Unemployment benefits	D.621, D.624	339.0	0.4	0.4	0.3	0.3	0.3
18a. Social transfers in kind	D.6311. D.63121. D.63131	1 705.3	2.0	2.4	2.5	2.5	2.5
18b. Social transfers other than in kind	D.62	10 614.3	12.3	12.2	12.1	11.9	11.8
19=9. Interest expenditure	EDP D.41	823.1	1.0	1.0	1.0	1.0	1.0
20. Subsidies	D.3	1 079.3	1.2	1.3	1.3	1.2	1.2
21. Gross fixed capital formation	P.51	5 396.4	6.2	5.0	4.1	4.4	4.6

	ESA 95	2015	2015	2016	2017	2018	2019
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
22. Capital transfers	D.9	636.9	0.7	0.6	0.6	0.6	0.6
23. Other		1 440.9	1.7	1.4	1.5	1.5	1.6
24=7. Total expenditure	TE1	34 744.4	40.2	38.5	37.5	37.1	36.7
Government consumption (nominal)	P.3	14 060.2	16.3	15.7	15.4	15.1	14.9

Table 2b: No-policy change projections

	2015	2015	2016	2017	2018	2019
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	32 970.1	37.97	36.16	36.25	36.20	36.49
2. Total expenditure at unchanged policies	34 744.4	40.07	38.07	37.26	36.84	36.34

Table 2c: Amounts to be excluded from the expenditure benchmark

	2015	2015	2016	2017	2018	2019
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	3 788.4	4.4	1.9	1.8	2.0	2.0
2. Cyclical unemployment benefit expenditure	-28.6	-0.03	-0.01	0.0	0.0	0.01
3. Effect of discretionary revenue measures	152.5	0.2	0.5	0.5	0.5	0.1
4. Revenue increases mandated by law	0.0	0.0	0.0	0.0	0.0	0.0

Table 3: General government expenditure by function

% of GDP	COFOG code	2014	2019
1. General public services	1	6.3	4.2
2. Defence	2	1.4	1.2
3. Public order and safety	3	2.8	2.2
4. Economic affairs	4	4.9	5.2
5. Environmental protection	5	0.7	1.3
6. Housing and community amenities	6	1.6	1.2
7. Health	7	5.5	4.8
8. Recreation, culture and religion	8	1.5	0.6
9. Education	9	4.1	3.2
10. Social protection	10	13.4	12.8
11. Total expenditure (=item 7=24 in Table 2)	TE1	**42.1**	**36.7**

Table 4: General government debt developments

% of GDP	ESA code	2015	2016	2017	2018	2019
1. Gross debt[39]		26.7	31.7	31.2	31.8	30.8
2. Change in gross debt ratio		-0.3	5.0	-0.5	0.6	-1.1
Contributions to changes in the gross debt to GDP ratio						
3. Primary balance[40]						
4. Interest expenditure[41]	EDP D.41	1.0	1.0	1.0	1.0	1.0
5. Stock-flow adjustment						
of which:						
Differences between cash and accruals[42]						
Net accumulation of financial assets[43]						
of which: privatisation proceeds		0.00	0.03	0.01	0.06	0.02
Valuation effects and other[44]						
Implicit interest rate on debt[45]		2.9	3.4	2.7	2.7	2.6
Other relevant variables						
6. Liquid financial assets[46]						
7. Net financial debt (7=1-6)						
8. Debt amortization (existing bonds) since the end of the previous year		8.5	1.7	3.8	1.7	1.4
9. Percentage of debt denominated in foreign currency		77.0	80.2	81.5	82.0	80.7
10. Average maturity		8.3	7.9	8.2	7.8	7.2

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

40 Cf. item 10 in Table 2.

41 Cf. item 9 in Table 2.

42 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.

43 Including liquid assets, government securities, assets in 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.

44 Changes due to 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.

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

46 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	2015	2016	2017	2018	2019
1. GDP growth (%)		3.0	2.1	2.5	2.7	2.7
2. Net lending of general government	EDP B.9	-2.1	-1.9	-0.8	-0.4	-0.2
3. Interest expenditure	EDP D.41	1.0	1.0	1.0	1.0	1.0
4. One-off and other temporary measures						
5. Potential GDP growth (%)		2.7	2.4	2.5	2.5	2.6
Contributions:						
labour		0.5	0.4	0.4	0.4	0.4
Capital		1.3	1.1	1.0	1.0	1.1
total factor productivity		0.9	1.0	1.1	1.1	1.2
6. Output gap		-0.4	-0.7	-0.7	-0.5	-0.5
7. Cyclical budgetary component		-0.1	-0.2	-0.2	-0.2	-0.1
8. Cyclically-adjusted balance (2-7)		-1.9	-1.7	-0.5	-0.2	0.0
9. Cyclically-adjusted primary balance (8+3)		-1.0	-0.7	0.5	0.8	0.9
10. Structural balance (8-4)		-1.9	-1.7	-0.5	-0.2	0.0

Table 6: Divergence from previous update

	ESA code	2015	2016	2017	2018	2019
Real GDP growth (%)						
Previous update		1.4	1.7	2.3	2.1	
Current update		3.0	2.1	2.5	2.7	2.7
Difference(pp.)		1.6	0.4	0.2	0.6	
General government net lending (% of GDP)	EDP B.9					
Previous update		-2.8	-2.4	-1.8	-1.3	
Current update		-2.1	-1.9	-0.8	-0.4	-0.2
Difference(pp.)		0.7	0.5	1.1	1.0	
General government gross debt (% of GDP)						
Previous update		29.8	30.1	30.4	30.9	
Current update		26.7	31.7	31.2	31.8	30.8
Difference(pp.)		-3.1	1.6	0.8	0.9	

Table 7: Long-term sustainability of public finances

% of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure	37.3	36.4	36.0	36.6	37.7	39.6	40.4
Of which: age-related expenditures	14.9	18.0	17.2	17.8	18.9	20.8	21.6
Pension expenditures	7.3	9.5	8.9	8.9	9.5	10.7	11.3
Social security pension	7.1	9.2	8.5	8.6	9.0	10.3	10.8
Old-age and early pensions	5.6	7.6	6.7	6.4	6.4	7.8	8.6
Other pensions (disability, survivors)	1.5	1.6	1.9	2.3	2.6	2.5	2.3
Occupational pensions (if in general government)							
Health care	3.9	4.5	4.5	4.9	5.3	5.7	5.7
Long-term care							
Education expenditure	3.6	3.6	3.5	3.7	3.7	4.0	4.3
Other age-related expenditures	0.1	0.4	0.3	0.3	0.3	0.3	0.3
Interest expenditure	1.1	0.7	1.1	1.2	1.5	2.2	3.3
Total revenue	38.4	33.3	36.5	36.5	36.5	36.5	36.5
Of which: property income	1.3	1.2					
Of which: from pensions contributions (or social contributions if appropriate)	5.6	7.1					
Pension reserve fund assets							
Of which: consolidated public pension fund assets (assets other than government liabilities)							
Social contributions diverted to mandatory private pension scheme47	0.7	1.0					
Pension expenditure paid by mandatory private pension scheme48	0.0	0.0					
Labour productivity growth	3.0	6.6	3.1	2.2	2.3	2.0	1.5
Real GDP growth	7.7	0.1	2.8	1.1	1.2	0.9	1.3
Participation rate males (aged 20-64)	78.3	77.3	79.8	79.9	79.1	79.3	80.6
Participation rate females (aged 20-64)	68.3	68.0	70.7	70.1	68.2	68.1	70.1
Total participation rates (aged 20-64)	73.3	72.6	75.3	75.1	73.7	73.8	75.4
Unemployment rate (%. 15-64)	6.9	10.2	7.1	7.2	7.3	7.3	7.3
Population aged 65+ over total population	17.3	17.5	21.6	24.3	27.1	30.2	31.9

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

[48] Pension expenditure or other social benefits paid by the mandatory additional pension insurance.

Table 7a: Contingent Liabilities

% of GDP	2015	2016
Government guaranteed debt	0.5	0.9
Of which: linked to the financial sector	0.1	0.1

Table 8: Basic assumptions

	2015	2016	2017	2018	2019
Short-term interest rate (annual average) 6-month LIBOR in EUR, %	-0.02	-0.32	-0.37	-0.24	-0.03
Short-term interest rate (annual average) 6-month LIBOR in USD, %	0.48	0.88	1.52	2.47	3.25
Long-term interest rate (annual average), %	2.49	2.42	2.51	2.70	2.87
USD/EUR exchange rate (annual average)	1.11	1.09	1.09	1.09	1.09
Nominal effective exchange rate. percentage change. previous year = 100[49]					
EUR/BGN exchange rate (annual average)	1.95583	1.95583	1.95583	1.95583	1.95583
World economy (excluding EU). GDP growth, %	3.1	3.2	3.6	3.7	3.9
EU GDP growth, %	1.9	2.0	2.0	1.9	1.9
Growth of relevant foreign markets. %					
World import volumes, excluding EU, %					
Oil Brent (USD/barrel)	52.4	39.7	45.3	49.2	52.6
International prices of non-energy goods, %	-15.1	-9.5	-0.7	0.1	0.6
International prices of food products, %	-15.5	-5.6	-0.9	-0.5	0.0
International prices of agricultural raw materials, %	-9.4	-10.3	0.4	0.4	0.0
International prices of metals, %	-21.1	-14.1	-1.5	0.4	2.2

[49] The positive values reflect appreciation, the negative – depreciation.