



REPUBLIC OF BULGARIA  
Ministry of Finance

# CONVERGENCE PROGRAMME

(2021–2023)

2021  
Sofia, Bulgaria

# CONVERGENCE PROGRAMME

OF THE REPUBLIC OF BULGARIA  
2021–2023

Sofia, 2021  
Ministry of Finance

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## List of Abbreviations

AF	Armed Forces
AQR	Asset Quality Review
ATR	Annual Tax Return
BNB	Bulgarian National Bank
CEB	Council of Europe Development Bank
CITA	Corporate Income Tax Act
CP	Convergence Programme
EC	European Commission
EC	European Union
ECB	European Central Bank
EIB	European Investment Bank
ESA 2010	European System of Accounts 2010
EUR	Euro
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GS	Government Securities
GVA	Gross Value Added
HIA	Health Insurance Act
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
ITC	International Trade Centre
LFS	Labour Force Survey
LIBOR	London Interbank Offered Rate
LRRCIIF	Law on Recovery and Resolution of Credit Institutions and Investment Firms
MMR	Minimum reserve requirements
MoF	Ministry of Finance
MoI	Ministry of Interior
MTO	Medium-Term Objective
NHIF	National Health Insurance Funds
NRA	National Revenue Agency
NRIC	National Railway Infrastructure Company
NSI	National Statistical Institute
NSSI	National Social Security Institute
OPAC	Operational Programme Administrative Capacity
OSSI	Other Systemically Significant Institution
p.p.	percentage point
PFA	Public Finance Act
PIC	Personal Identification Code
PITA	Personal Income Tax Act
R&D	Research and Development
RA	Registry agency
REER	Real Effective Exchange Rate
SBARB	State Budget Act of Republic of Bulgaria
SGP	Stability and Growth Pact
SSC	Social Security Code
SSI	State Social Insurance
ULC	Unit Labour Costs
USD	U.S. dollar
VAT	Value Added Tax
WB	World Bank
WTO	World Trade Organization

# 1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

**B**ulgaria's Convergence Programme (2021-2023) outlines the main policies aimed at providing support to businesses and citizens to overcome the consequences of the COVID-19 pandemic, stimulating economic activity in the country and at the same time preserving macroeconomic and fiscal sustainability in the medium term in order to create conditions for economic growth.

The program is prepared annually in April, based on the rules of the Stability and Growth Pact (SGP) - the regulatory framework for the coordination of national fiscal policies of EU member states. Unlike last year, when the format of the program followed the European Commission's (EC) Guidelines for refocusing and simplifying the content of the program as a result of the pandemic, this year's Convergence Program has been prepared in accordance with the Code of Conduct<sup>1</sup>, containing Specifications on the implementation of the SGP and Guidelines on the format and content of Stability and Convergence Programmes.

Given the coincidence of the preparation of the Convergence Program with the political cycle (parliamentary elections and the forthcoming formation of a new government), the fiscal parameters are based on no-policy-change scenario and information on fiscal policy is set out on the basis of the Medium-Term Budget Forecast adopted by the Council of Ministers in autumn 2020. Expenditure policies for the period 2022-2023 are limited to nominal values from the last budget framework. Only the impact of current macroeconomic assumptions and forecasts is reflected.

In this context, it is important to note that the assumptions for the development of horizontal and sectoral policies may be subject to revision in the second phase of the 2022 budget procedure in accordance with the programme of the new government and the priorities for the mandate of its governance, most of which falls within the time frame of the current program.

Despite the ongoing health crisis and economic uncertainty caused by the global pandemic of COVID-19 and within the context of the general escape clause, which will be in force for the duration of 2021 and possibly 2022, the main priority of fiscal policy in the current and subsequent years continues to be maintaining the stability of public finances, combined with the provision of the necessary measures to stimulate economic activity in the country.

The implementation of a policy for sustainable and transparent public finances in the period 2021-2023 is expected to lead to a consolidation of the deficit in the following years, and in 2021 the budget balance is expected to be negative at 5.6% of GDP. In the medium term, a deficit of 2.7% of GDP for 2022, and 3.1% for 2023 is expected.

Based on projected debt financing and GDP forecast, the General Government debt is expected to increase over the next years, both in nominal value and as a ratio of the consolidated sector's debt to GDP, but remain far below the maximum reference value of the Maastricht criterion of 60%.

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<sup>1</sup> <http://data.consilium.europa.eu/doc/document/ST-9344-2017-INIT/en/pdf>

In the context of maintaining macroeconomic stability and its participation in ERM II, Bulgaria guarantees that it will keep the Currency Board Arrangement at the current level of the fixed exchange rate of BGN 1.95583 per 1 Euro until the country's entry into the EMU.

This Convergence Program covers the period 2021-2023 and consists of seven parts.

The current first part contains the general framework of government economic policies and objectives.

The second part analyzes the economic development of the country in terms of key macroeconomic indicators, and presents a forecast for their development in the medium term.

The third part is a description of the strategic objectives of fiscal policy in terms of budget balance and government debt. This part contains the current state of the budget and the expected development during the reference period, with an emphasis on the structural balance. The main guidelines for the development of the debt position during the programming period are outlined. The main highlights of the policies and the specific measures for their implementation are also presented, as well as an assessment of the expected quantitative effect of their implementation.

In the fourth part, an analysis of the sensitivity of the forecast parameters is made, and an alternative scenario for economic development of the country in the medium term is developed. The effect of implementing the alternative scenarios on the budgetary parameters is discussed. The effects on government debt of changes in assumptions under the baseline macroeconomic scenario are presented as well.

Part five is dedicated to the sustainability of public finances. The main focus is on the long-term budgetary perspective in view of the effects of population aging.

The sixth part deals with the quality of public finances. Here are presented the strategy of government policy in this area, the composition of expenditures, as well as the structure and efficiency of revenue systems.

The seventh part reviews the institutional characteristics of public finances in Bulgaria - budget procedures and national fiscal rules. This part of the program also focuses on key legislative changes related to public finances.

This Convergence Program takes into account measures and developments under part of the first of the four Council Recommendations of 9 July 2019 on the 2019 National Reform Program of Bulgaria, containing a Council opinion on the 2019 Convergence Program of Bulgaria<sup>2</sup>, namely :

**Specific recommendation 1:** Improve tax collection through targeted measures in areas such as fuel and labour taxes.

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<sup>2</sup>[https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019H0905\(02\)&from=EN](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019H0905(02)&from=EN)

## 2. ECONOMIC OUTLOOK

### 2.1 Assumptions concerning the development of the world economy

This Convergence Program is based on the macroeconomic framework for the period 2021-2024 and has been developed using the medium-term macroeconomic model of the Ministry of Finance of the Republic of Bulgaria with the assumptions about key indicators of the external environment provided by the International Monetary Fund and the Ministry of Finance, as of mid-March 2021.

**Table 2-1: Assumptions about key macroeconomic indicators**

	2021	2022	2023	2024
Global economy (real growth)	5.5%	4.2%	3.9%	3.6%
EU GDP (real growth)	3.9%	3.9%	3.1%	2.3%
Exchange rate USD/EUR - average	1.20	1.19	1.19	1.19
International commodity prices:				
Crude oil Brent (USD/barrel)	59.3	55.7	53.7	52.6
Non-energy goods (change in dollar terms)	14.8%	-1.6%	-1.4%	-1.4%
Food	14.6%	-2.4%	-1.1%	-1.1%
Beverages	3.3%	-0.1%	-0.7%	-0.7%
Agricultural raw materials	7.7%	-1.2%	-0.8%	-0.8%
Metals	22.0%	-2.6%	-2.4%	-2.4%
3-month EURIBOR	-0.5	-0.5	-0.3	-0.1

*Source: IMF, Eurostat, ECB, WB, MoF*

The presented macroeconomic forecast is based on the assumption that measures against the spread of COVID-19 will be most stringent in the first quarter of the year in both the EU and Bulgaria, after which the acceleration of the vaccination process will allow a gradual easing of restrictions and a smooth return to normal economic activity. Fiscal stimulus will also play a significant role in reigniting growth in the world's leading economies. Global GDP is expected to increase by 5.5% in 2021, with the USA and developing countries, especially China, helping world economy to rebound to pre-crisis levels as early as 2021. The European economy will grow by 3.9% in the current year, and the recovery to 2019 levels is expected in 2022. From 2023, growth rates in both the EU and the world will slow down, reflecting the normalization of economic activity. Assumptions about the development of the external environment suggest an accelerated increase in demand for Bulgarian goods and services in 2021 and 2022, followed by a slowdown at the end of the forecast horizon.

### 2.2 Economic Outlook and Cyclical Developments

#### 2.2.1 Economic Growth

In 2020, Bulgaria's gross domestic product decreased by 4.2% in real terms. On the demand side, most affected by the crisis caused by COVID-19 were investments and exports of goods and services.

Final consumption grew by 1.8% in real terms. Increased government spending led to a 7.5% rise in public consumption. At the same time, private consumption increased by 0.2%. Restrictive measures against COVID-19, reduced employment and higher uncertainty have led to a sharp growth slowdown but not a decline. Consumption was supported by growth in household disposable income driven by increasing compensation in the industrial and General Government sectors, social transfers and pensions.

Investment in the economy decreased by 11%, mostly due to changes in inventories. Fixed capital investment decreased by 5.1% due to weak private investment<sup>3</sup> activity, which was partially offset by an increase in public capital expenditures.

Foreign trade made a major contribution to the decline in GDP in 2020. The decline in external demand and the significant restrictions on international travel were reflected in a decline in exports of goods and services by 11.3% in real terms. At the same time, the decrease in imports was weaker and reached 6.6%.

On the supply side, gross value added decreased by 4.3%. The sectors most affected by the crisis were trade; transport; accommodation and food service activities, as well as arts, entertainment and recreation. Industrial production was also affected, mainly through export-oriented industries such as manufacture of machinery and equipment.

### 2.2.2 Cyclical Developments<sup>4</sup>

According to MoF estimates, the growth of potential GDP in 2020 reached 1.7%, and the output gap is negative at 3.1%. The main reason for the weaker growth of potential output during the year was the negative contribution of labour. The expected recovery in employment in the coming years will lead to accelerated potential growth and it will reach 2.3% in 2023. The increase in investment will also lead to a more serious contribution of capital to growth in 2023. Total factor productivity (TFP) will contribute 1.2-1.3 p. p. for potential growth during the period considered. In 2024, a slight slowdown in growth to 2.2% is expected, which will come both in terms of capital and labour. Further increase in employment will be limited by the negative demographic trends in the country.

The output gap will shrink to -2.3% in 2021 and -0.8% in 2022. In 2023, the negative gap is expected to close.

## 2.3 Medium-term Scenario

In 2021, GDP growth is projected to reach 2.7%. Restrictive measures against the spread of COVID-19 will have a negative effect on household consumption in the first quarter of the year, after which it will increase, supported by increased employment. In total, its growth will be about 2% for the year. As in 2020, government consumption will contribute to economic growth by nearly 1 percentage point. The decline in investment will continue in 2021, but at a slower pace. Private investment is the component that will recover the slowest from the crisis caused by COVID-19 due to the still uncertain economic environment. In line with the increase in external demand in 2021, exports of goods are expected to grow by 4.1% and almost reach pre-crisis levels. The recovery of services will be more gradual, predetermined by the much slower

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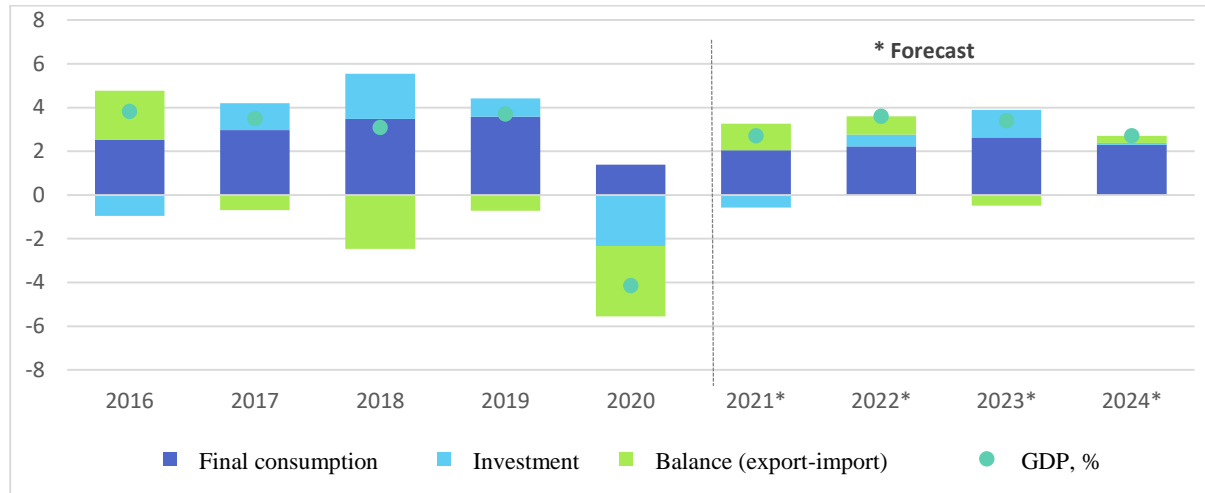
<sup>3</sup> Private investment is defined as the difference between fixed capital investment for the whole economy and that of the General Government sector.

<sup>4</sup> The cyclical development of the economy is measured by the indicator output gap. It is calculated as the difference between actual and potential GDP in relation to potential. The potential GDP for the Bulgarian economy is calculated using a production function according to a methodology developed by the EC: Havik, K., & Kieran Mc Morrow, K., & Fabrice Orlandi, F., Christophe Planas, C., Rafal Raciborski, R., Werner Roeger, W., Alessandro Rossi, A., Anna Thum-Thysen, A. & Valerie Vandermeulen, V., "The Production Function Methodology for Calculating Potential Growth Rates & Output Gaps," European Economy – Economic Papers 535, 2014.



resumption of international travel. The contribution of net exports to GDP growth will be positive (1.2 p. p.).

**Chart 2-1: Contributions to GDP growth, by component (in p.p.)**



Source: NSI, MoF

GDP growth will reach 3.6% in 2022. The acceleration will be driven by household consumption and investment. Increased consumer confidence and increasing incomes will lead to private consumption growth of 3.8%. Private investment activity is also expected to begin to recover and investment in the economy to increase by 3%. At the same time, due to consolidation measures, public consumption is not expected to contribute to GDP growth. Overall export growth will accelerate. The services will make a major contribution due to the expected increase in foreign tourists. Exports of goods will maintain their pace of growth, supported by the ongoing recovery in the EU and major trading partners. The contribution of net exports to GDP will again be positive.

In 2023 and 2024, economic growth will slow to 3.4 and 2.7%, respectively. Exports will have a lower contribution in both years due to the slowdown in external demand. In 2023, a one-off factor will significantly increase both public investment and imports.

## 2.4 Sector Balances

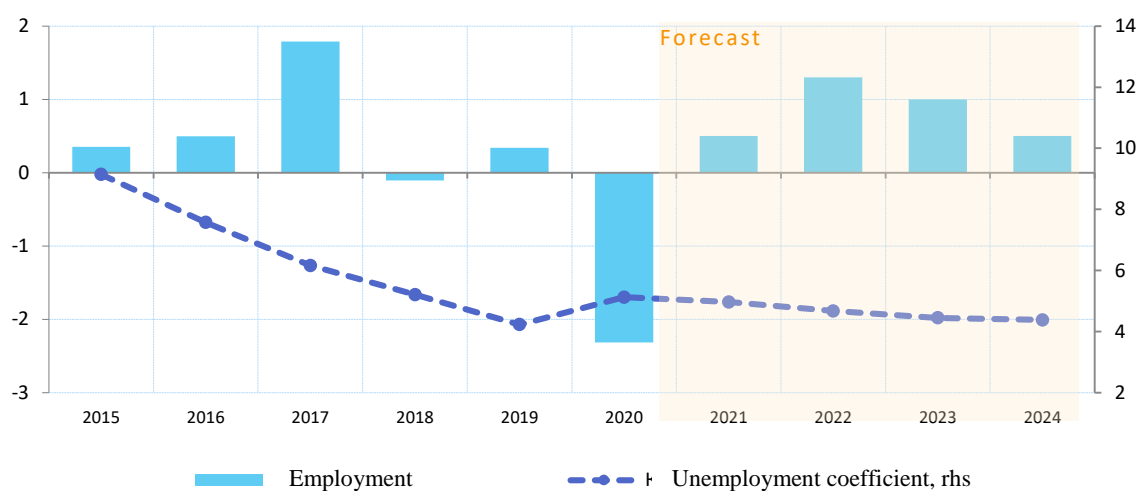
### 2.4.1 Labour Market, Income Levels and Productivity

The containment measures against the spread of COVID-19 had a negative impact on the dynamics of the labour market in the country. There was a decrease in the employment rates and economic activity of the population (age group 15-64 years) to 68.5% and 72.2%, respectively. Employment in the economic activities of hotels and restaurants, culture, sports and entertainment, as well as in some industries such as textiles, clothing and footwear and the production of wood, paper, cardboard and articles thereof was most affected. The total employment<sup>5</sup> in the country amounted to 3,451.7 thousand and decreased compared to 2019 by 2.3%. The sectors in which there was an increase in employment in 2020 were the creation and dissemination of information and creative products; telecommunications (6.0%) General Government; education; human health and social work activities (1.2%) and financial and insurance activities (0.4%). Despite the COVID crisis, labour demand in the first sector remained extremely high and employers chose to retain the hired employees even if they experienced temporary difficulties in their current activities.

<sup>5</sup> By definition of ESA 2010

The decline in employment also affected the dynamics of unemployment in the country. In 2020, the unemployment rate in the country (age group 15-64) reached 5.2%, which is an increase of 0.9 p. p. (yoy). The government has taken a number of short-term measures to preserve existing employment and limit job losses, including the "60/40", "Zapazi me", "Zaetost za teb" measures, etc. These programs have softened the rise in unemployment, and according to MoF estimation the largest of these measures, the 60/40 program, has protected about 260,000 jobs by the end of 2020.

**Chart 2-2: Employment dynamics and unemployment rate, %**



Source: NSI, MoF

In 2021, the number of employees (ESS 2010) is expected to increase by 0.5%. The assumption is that in the second half of the year the vaccination campaign will cover a large enough share of the population and the restrictive measures will be gradually mitigated. This will contribute to the beginning of the process of gradual economic recovery, which in turn will contribute to the recovery of some of the lost jobs in 2020. At the same time, measures to maintain existing employment will continue to operate at least until the end of May 2021, which will be among the factors influencing employment and unemployment in the first half of the year. The unemployment rate is expected to decrease to 5.0%, which will be accompanied by an increase in the participation of the working population in the labour force (15-64 years) to 73.4%.

In the coming years (2022-2023), employment growth is expected to accelerate due to the relatively high rates of economic growth. In 2023, the activity rate is expected to reach 76.5%, which will be over 3 p.p. higher than the pre-crisis level of the indicator in 2019. In 2024, employment growth will slow to about 0.5%, due to the slowdown of the growth of the economy, as well as due to the exhaustion of the opportunity to attract new employees from the contingent of unemployed and inactive people. Throughout the period, the unemployment rate is expected to decrease and reach 4.4% in 2024.

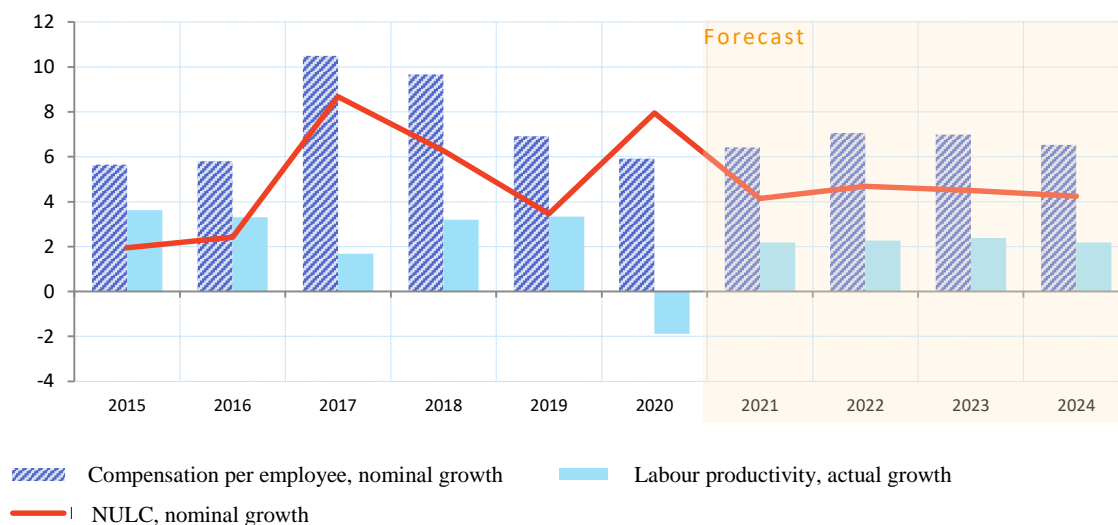
In the conditions of reduced economic activity and limitation of dismissal of employees due to the measures adopted by the government to preserve employment, the real productivity per employee decreased by 1.9% in 2020. However, labour productivity per hour worked was characterized by a positive dynamic (0.6%), indicating that companies have managed to adequately adapt to the reduced activity through hours worked, while at the same time they have managed to retain a large part of their staff by using job retention schemes.

Due to the COVID crisis, the compensations slowed down their growth but it remained positive, and the process of optimizing labour costs was carried out primarily by reducing the number of employees. In 2020, the nominal growth of compensation per employee amounted to 5.9% and remained high mainly in the industry sector, where the indicator increased at a double-digit rate

(11.5%). The public sector also had a high contribution to the growth of total compensations, but in general the services reported significantly lower growth of 4%, with some activities even declining (real estate transactions; creation and dissemination of information and creative products; trade, hotels and restaurants, and transport; culture, sports and entertainment). The increase in the compensation of one employee was also influenced by the acceleration of the growth of the employers' expenditures for social insurance. The dismissal of lower-skilled employees also had an impact, while the process of hiring highly skilled labour observed in recent years has continued, which, other things being equal, is also reflected in an increase in average incomes.

As a result of the positive dynamics of compensation per employee and the decline in labour productivity per employee, the increase in nominal unit labour costs (ULC) accelerated to 7.9% in 2020. Manufacturing is the main contributor to this upward trend of ULC.

**Chart 2-3: Dynamics in nominal ULC and its components (%)**



Source: MoF

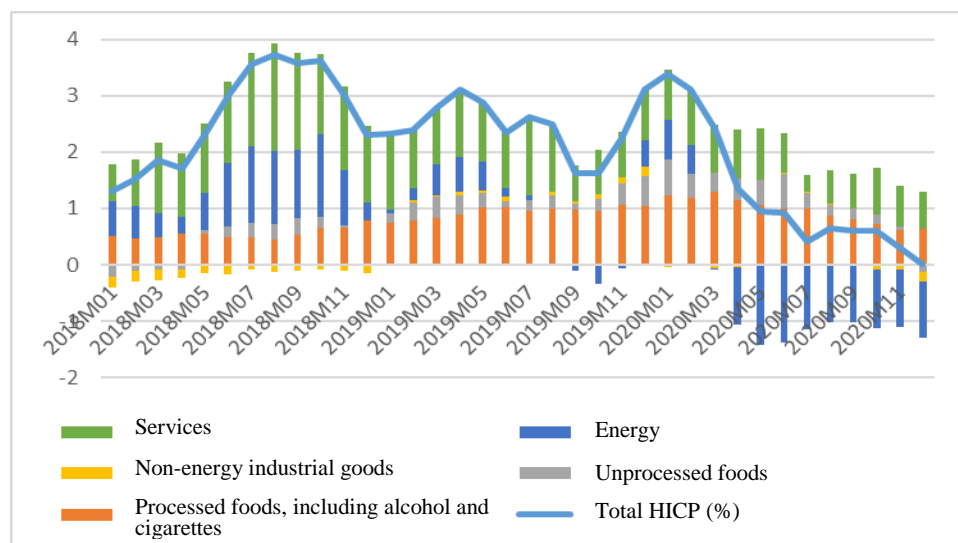
The increase in economic activity and labour demand in the country in 2021 will contribute to accelerating the nominal growth of compensation per employee to 6.4%. A more significant acceleration of the indicator will be observed in the services, as a result of the expected resumption of activity and employment in the second half of the year. Other factors which will contribute for the income growth are the wage increases, particularly in sectors with high labor demand, as well as the wage increase in the structures that are in charge of pandemic control activities, the minimum wage increase, etc. In 2022, in line with the expectations for the Bulgarian economy to reach its full recovery and the upward dynamics of employees, the compensation per employee will continue to accelerate to 7.1%. In the period 2023-2024, the growth rate will remain high, but at the end of the forecast period it will begin to slow down.

Within the forecast period, labour productivity will be characterized by positive dynamics and in 2021 the level of GDP per employee (at constant prices) will exceed its pre-crisis value from 2019. Expectations for the development of the indicator in the medium term are associated with a gradual acceleration of the pace, and in 2023 it will be close to 2.5%. With the recovery of the positive dynamics of productivity, the nominal growth of ULC will begin to slow down compared to the high rate observed in 2020. Within the forecast period, the indicator is estimated to grow by about 4% on average per year.

## 2.4.2 Inflation

Inflation, as measured by the Harmonized Index of Consumer Prices (HICP), followed a clear downward trend throughout 2020, slowing from 3.4% yoy in January to 0% at the end of the period. Annual average inflation in 2020 also narrowed to 1.2%, from 2.5% a year earlier. The measures imposed to control the COVID-19 pandemic worldwide led to a significant reduction in oil prices on international markets, which in turn determined price dynamics of energy products in the country. They also had the highest negative contribution to inflation at the end of the year, as the prices of transport fuels decreased by 17.3% yoy in December.

Chart 2-4: Annual inflation rate (%) and contributions by key components (p. p.)



Source: Eurostat

Food prices also contributed to the slowdown in the annual inflation rate, shrinking from 7.5% in January to 2% at the end of the year. This delay came on the back of the unprocessed foods subcomponent. As the effect of African swine fever in 2019 faded out, the price increase in meat and meat products gradually slowed down from 18.9% yoy in January and their prices decreased by 1% at the end of the year. The rate of increase in prices of processed foods remained almost stable throughout the year. Prices of alcohol and tobacco reported a slowdown in their rate increase, up 0.8% yoy in December.

The spread of COVID-19 and the introduction of anti-epidemic measures also affected inflation of the core HICP components. Inflation of services slowed down, due to both lower domestic demand and shrinking external demand for tourism services in the state of pandemic. A lower VAT rate of 9% was temporarily introduced for restaurant and catering services for the period from 1 July 2020 until the end of 2021. Despite this measure, the increase in prices of catering was 3.8% yoy in December, and this sub-component also had a relatively high contribution to the inflation in services (0.21 p. p.). After a temporary brake in the previous year, in 2020 prices of non-energy industrial goods again reported a decline by 0.6% yoy in December. This came largely on the back of lower prices of durable goods, and second-hand cars in particular, while prices of non-durable goods increased at the end of the year.

Administrative prices increased by 1.4% yoy at the end of 2020. Due to lower international prices of energy goods and especially crude oil, the decrease in the price of natural gas and heating energy as of December was 21.3% and 12.8% yoy, respectively. However, their negative contribution was offset by an increase in almost all other items with regulated prices, i.e. in electricity by 2.8%, medicines and other pharmaceuticals by 1.8%, higher education by 5.1%.

In January 2021, the annual inflation rate briefly moved to negative territory, after which it reported a positive value of 0.2% in February. The headline inflation rate will continue to accelerate and will reach 2.8% at the end of the period. The expected increase in international oil prices will lead to higher domestic energy prices, with transport fuels expected to increase by nearly 17% by the end of 2021. Inflation in services will accelerate to 2.6% by the year-end, supported by the strengthening of domestic demand. On the other hand, the expected higher food prices in the country will be reflected in higher prices for catering services. Non-energy industrial goods will report an increase and, given the increase in prices for services, the contribution of core inflation to the total index at the end of the year is expected to increase. The annual average annual inflation in 2021 is projected to be 1.8%.

**Table 2-2: Forecast of the HICP dynamics in the period 2021-2024**

	2021	2022	2023	2024
Average annual inflation (in %)	1.8	2.0	2.0	2.1
Tear-end inflation (in %)	2.8	1.8	2.1	2.2

Source: MoF

The annual average HICP increase in 2022 is projected to be 2%, and the end-of-period inflation will slow to 1.8%. This will be largely due to the expected decline in the international oil prices which will lead to cheaper automotive fuels and therefore negative contribution of the latter. By the end of the forecast period, the annual inflation and that at the end of the year are expected to accelerate slightly, to 2.1 and 2.2% in 2024, respectively. Core inflation will continue to accelerate under the influence of stronger domestic demand.

### 2.4.3 External sector<sup>6</sup>

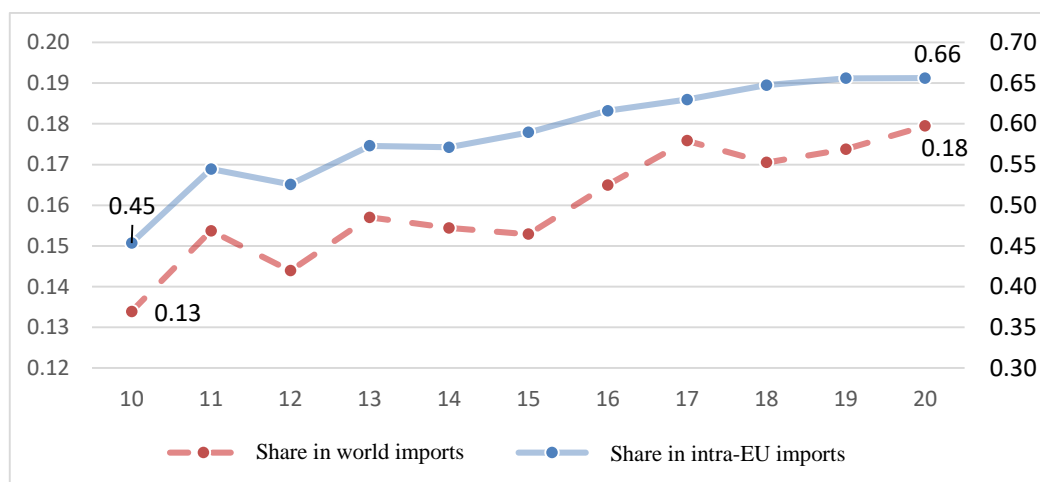
The COVID-19 pandemic and related containment measures led to a significant decline in the overall current and capital account surplus to EUR 547.5 million or 0.9% of GDP in 2020. In particular, the current account balance shifted from a surplus in 2019 to a deficit of EUR 400 million or 0.7% of GDP.

The unprecedented measures to limit the spread of COVID-19 had a significant negative effect on international tourism and related services. The impact was much stronger on exports of services, which decreased by 30.4%, while imports shrank by 22.2%. As a result, the total surplus on services decreased by 3.1 p. p. to 4.9% of GDP in 2020. Surplus on secondary income also deteriorated, driven by the decline in remittances. At the same time, due to preference for higher liquidity, the investment income paid to non-residents also shrank, which resulted in better primary income balance.

The trade balance improved by 1.7 p. p. up to 3.1% of GDP as a result of the weaker nominal decline in exports of goods (by 6.5%) compared to the decline in imports (9.1%). The difference was largely due to lower prices of petroleum products in the first half of the year, which also constitute a higher share in imports. As regards regional structure, exports to the EU-27 declined by 3.4% and was formed mainly by lower trade with the old Member States. Export to third countries decreased by 11.7% as the increase in trade with China failed to offset the decline in export to most Balkan countries, including Turkey, as well as to Russia and Ukraine. Despite the unfavourable external environment, in 2020 the market shares of Bulgaria's exports within world and EU imports continued to increase.

<sup>6</sup> The analysis of the External sector is based on the statistical data for the Balance of payments (analytical presentation), except for charts and data where another source is explicitly stated.

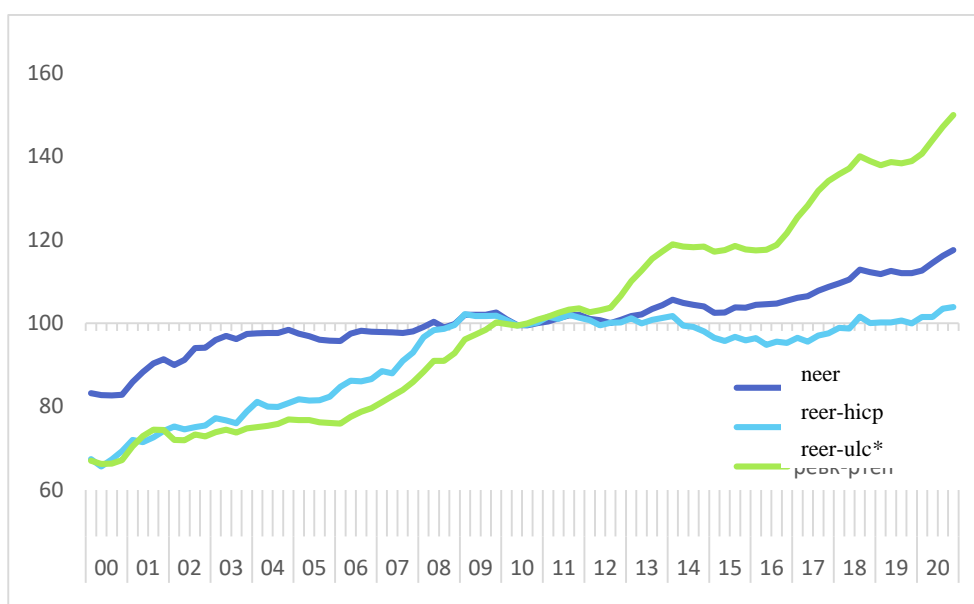
**Chart 2-5: Bulgaria’s share in international trade (%)**



Source: MoF calculations based on WTO and BNB data

**Chart 2-6: REER of Bulgaria compared to 36 industrial countries, 2010 = 100**

(quarterly data until the fourth quarter of 2020, inclusive)



\* Nominal unit labour costs total for the total economy

Source: Eurostat

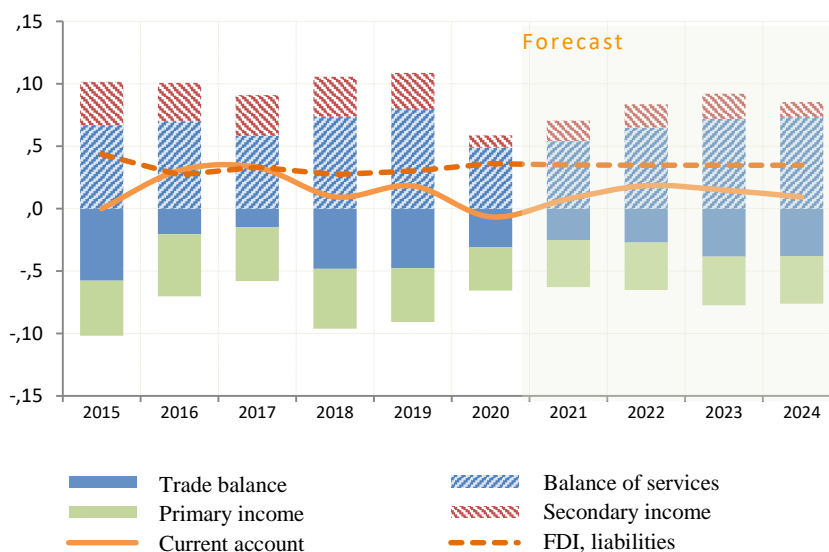
After a slowdown in the period 2018-2019, the dynamics of the real effective exchange rate (REER), calculated with different deflators, again showed some acceleration in 2020. This was partly due to the appreciation of the Euro against the US dollar during the year, shown by the nominal effective exchange rate (NEER) dynamics, but in the unit labour costs based REER there was also a contribution from the deflator. In 2020, the nominal growth of unit labour costs (ULC) accelerated, which was a result of continuous upward dynamics of compensation per employee, while economic activity and labour productivity per employee declined. These processes reflected the measures undertaken to preserve jobs, aimed at limiting the negative effects of the crisis on the labour market and disposable income of households.

During the forecast period, current account is expected to return to positive balances. The increase in external demand, combined with higher international commodity prices, will be reflected in stronger nominal growth in export of goods (9.4%) than in imports (7.9%) in 2021 and therefore lower trade deficit. In the coming years, the impact of prices will be limited and nominal growth will be determined by changes in quantities. Due to stable domestic demand, which will lead to stronger import growth and the expected more moderate increase in export growth, trade deficit is forecast to slightly increase up to 2024.

The expected gradual easing of the containment measures in the country and in our main partners will be an important stimulus for the recovery of international tourism. Globally, tourism dynamics will depend on people's willingness to travel away from home, as well as on the speed of recovery in air transport and appropriate provision of all travel-related services. Travel receipts from foreigners in Bulgaria and exports of related transport services are expected to grow at double-digit rates in 2021-2022, but both total exports of services and the balance of services will remain below pre-crisis levels until 2023.

In line with the improved economic activity, there will be an increase in remittances from abroad. With the accelerated disbursement of funds from the European social and investment funds at the end of the programming period, higher incoming transfers to the General Government sector are expected. They will have a more significant contribution to the current account surplus in 2021-2023, while in 2024 they will be traditionally lower due to the gradual absorption of funds at the beginning of a new programming period.

**Chart 2-7: Current account**



Source: BNB, NSI, MoF

Annual Foreign Direct Investment inflows increased by 18.2% in 2020 and reached 3.6% of GDP. FDI was mainly in the form of debt instruments and reinvested earnings to non-financial private sector enterprises. FDI is expected to amount to about 3.5% of GDP over the forecast horizon. The general dynamics of the balance of payments suggests preserving a sustainable external position and a stable level of international reserves.

#### 2.4.4 Monetary and Financial Sector

The main objective of the monetary policy in Bulgaria is to maintain price stability by ensuring the stability of the national currency. This objective is achieved by means of the currency board arrangement and a fixed exchange rate of the national currency to the euro.

At the end of December 2020, the market value of Bulgaria's international foreign exchange reserves - the assets on the balance sheet of the Issue Department<sup>7</sup> of the Bulgarian National Bank (BNB), amounted to EUR 30.8 billion (50.9% of GDP), increasing by EUR 6.0 billion on an annual basis. According to the principles of operation of the currency board, the dynamics of international foreign exchange reserves corresponded to the increase in the amount of the liabilities of the Issue Department balance sheet. The main contribution to the higher amount of BNB Issue Department liabilities was the significant increase in the excess reserves of banks with the BNB, as a result of the measures taken by the BNB on March 12, 2020, aimed at further strengthening the capital and liquidity of banks in order to limit the adverse effects on the banking system and economic activity resulting from the COVID-19 pandemic. At the end of December 2020, the international reserves provided coverage of 11.1 months of imports of goods and non-factor services, and their ratio to the short-term external debt of the country amounted to 336.4%. At the end of February 2021, international foreign exchange reserves amounted to EUR 27.6 billion, indicating an increase of EUR 2.8 billion compared to February 2020. The annual increase in the amount of international foreign exchange reserves was partially limited by the shrinking of government deposits in BNB for the same period.

Since the beginning of 2020, there has been a trend towards a gradual acceleration of the annual growth of deposits of the non-government sector, which was mainly due to the strengthening of the growth rate of household deposits, which reached 9.7% in December. The main factors that determined the dynamics of household deposits were the forced savings formed due to the limited ability to make certain expenditures during the state of emergency and subsequent maintenance of precautionary savings in an uncertain macroeconomic environment caused by the pandemic and postponement of consumption of some goods and services by households. In 2020, deposits of non-financial enterprises in the banking system continued to grow at a relatively high rate, mainly due to the limited investment activity of enterprises, and at the end of 2020 their annual growth rate amounted to 10.5%.

As of December 2020, the broad monetary aggregate M3 recorded annual growth of 10.9% (9.9% at the end of 2019). In the context of uncertainty about the development of the macroeconomic environment due to the pandemic and at near zero interest rates on deposits, economic agents continued to keep their savings in high liquidity overnight deposits, which had a major contribution to M3 growth. As of February 2021, the annual growth rate of deposits of the non-government sector accelerated to 12.0%, and that of broad money to 13.3%, respectively.

The annual growth of credit to non-financial corporations and households followed a trend of slowdown from March 2020 under the simultaneous influence of factors on the demand and on the supply side. The increased uncertainty in the macroeconomic environment as a result of the pandemic was crucial for the weakening of credit demand. The tightening of credit standards and conditions by banks had an additional impact on the weakening of lending activity during the year as a result of the increased credit risk assessment against the background of the deterioration of the financial situation of some households and companies. At the same time, low interest rates on new loans to companies and households continued to support credit demand. The use by companies and households of the opportunity to defer due liabilities to banks approved by the BNB at the request of the Association of Banks in Bulgaria in April 2020 private moratoria was a potential factor with a supporting impact on credit growth during the year. An additional factor that contributed to the growth of credit, but to a relatively lesser extent, were the loans extended by commercial banks, guaranteed by the Bulgarian Development Bank under the introduced government measure in support of vulnerable companies and households. At the end of 2020, the annual growth of credit to non-financial corporations decreased to 3.0% (5.9% in December 2019), and credit to households decelerated to 6.6% (9.5% in December

<sup>7</sup> The market value of international foreign exchange reserves includes changes in transactions, exchange rate differences and price revaluations.



2019). By individual types of loans for house purchases, a relatively stronger slowdown was reported in consumer loans, while the deceleration in housing loans growth was relatively weaker. As of February 2021, the growth rate of credit to non-financial corporations decreased to 2.6% yoy, while loans to households slowed down to 6.3% yoy.

In 2020, the significant liquidity in the banking system and the high inflow of funds attracted from residents were the main factors for the lowering of interest rates on new time deposits from the historically low levels reached. The interest rate on the new<sup>8</sup> time deposits of the household sector amounted to 0.13%, decreasing by 6 basis points compared to 2019. The interest rate on the newly contracted time deposits for non-financial corporations decreased more significantly, reflecting mainly the relatively more the volatile dynamics of deposits in US dollars, and amounted to 0.12%. At the same time, the interest rate on new deposits of companies in BGN reached a negative level on average for the year (-0.04%), and as of February 2021 these interest rates remained negative. In 2020, interest rates on newly contracted loans to companies and on newly contracted loans for house purchases continued to decline. Interest rates on new consumer loans increased somewhat in April and December, but on average for the year their levels were only slightly higher than in 2019. As of February 2021, the interest rate on new loans to companies amounted to 2.52%, and the interest rates on newly extended housing and consumer loans amounted to 2.83% and 7.56%, respectively.

The high levels of liquidity and capital adequacy of the banking system created good initial conditions for the banking system in Bulgaria immediately before the sharp contraction of economic activity as a result of the unprecedented restrictive measures imposed to curb the spread of the COVID-19 pandemic. Both the policy of building buffers in the system in recent years and the measures taken on March 12, 2020 by the Governing Council (GC) of the BNB aimed at further strengthening the capital and liquidity of banks have contributed to the resilience and flexibility of the banking sector. These measures included capitalizing the profits of credit institutions and imposing individual and aggregate limits on banks' foreign exposures in order to limit credit risk and the risk of concentration in their balance sheets. On March 19, 2020, the BNB Governing Council also decided to cancel the planned increases in the level of the countercyclical capital buffer.

On April 9, 2020, the BNB Governing Council approved the draft of the "Procedure for deferral and settlement of liabilities payable to banks and their subsidiaries - financial institutions in connection with the state of emergency introduced on March 13, 2020 by the National Assembly, related to the COVID 19 pandemic", proposed by the Association of Banks in Bulgaria, representing a private moratoria within the meaning of the Guidelines of the European Banking Authority (EBA) on legislative and non-legislative moratoria on credit payments applied in the light of the COVID-19 crisis. These EBA Guidelines introduce temporary relief in the form of an exemption from the obligation to reclassify exposures in forbearance or default in the event of a moratorium on bank loan payments, subject to strict conditions. Taking into account the continuation of the anti-epidemic measures and in accordance with the updated EBA guidelines and requests of the Association of Banks in Bulgaria, the term of the duration of the moratoria on loan payments was extended two additional times - in July and December.

In 2020, the share of non-performing loans in the banking system decreased, which was mainly due to the effect of the moratorium on bank loan payments and the operations of banks related to sales and write-offs of non-performing loans<sup>9</sup>. Gross non-performing loans and advances in the banking system decreased by 6.3% and amounted to BGN 5.7 billion at the end of the year.

<sup>8</sup> The terms "new" deposits and "new" loans refer to the statistical category "new business".

<sup>9</sup> The assessment of the state of the banking system is based on data from the supervisory reports on an individual basis as of the end of December 2020, received by February 22, 2021 and as of the end of December 2019, updated by March 8, 2021.

The gross amount of all non-performing exposures<sup>10</sup> was BGN 5.7 billion and its share was 4.8% (against BGN 6.1 billion, 5.6% as of December 31, 2019). As of June 2020, Regulation (EU) 2020/429<sup>11</sup> changed the scope of reporting on gross loans and advances. According to the new "narrow scope", the amount of gross loans and advances in the banking system at the end of 2020 amounted to BGN 76.7 billion, and the ratio of non-performing loans calculated on this basis was 7.5% (7.8% at the end of 2019). According to the so-called "broad scope" (including "cash balances with central banks and other demand deposits"), the total amount of gross loans and advances at the end of 2020 amounted to BGN 101.1 billion. The calculated share of non-performing loans based on the "broad scope" decreased to 5.7% at the end of 2020 (6.5% at the end of December 2019). The net amount of non-performing loans and advances<sup>12</sup> at the end of December 2020 amounted to BGN 3.1 billion. This amount reflects the potential residual credit risk in the balance sheet of the banking system, which remained fully covered by the excess of capital above capital requirements and applicable capital buffers. Compared to the end of 2019, the net amount of non-performing loans and advances decreased by 2.9%, and its share in net loans and advances at the end of December 2020 amounted to 3.1% according to the "broad scope" of calculation (3.5% at the end of December 2019 d.). Based on the "narrow scope", the share of net non-performing loans and advances at the end of 2020 remained at 4.2%.

The capital position of banks improved in 2020, as capital indicators increased compared to the previous year. The increase in the equity of the banking system was of decisive importance for the improvement of the capital indicators, which was mainly due to the capitalization of banks' profits as a result of the BNB measures and the increase in the paid-in capital. Regulatory easing was also introduced during the year in response to the COVID-19 pandemic, which led to a reduction in the amount of risk exposures. Under Regulation (EU) 2020/873<sup>13</sup> adopted at the end of June 2020, preferential risk weights apply to banks' exposures to central governments and central banks, which are denominated in the currency of another Member State. Changes in risk weights contributed to the improvement of banks' capital position. As of 31 December 2020, as a result of the decrease in risk exposures and the increase in banks' equity compared to the end of 2019, the ratios of Common Equity Tier 1 capital, Tier 1 capital and total capital adequacy were 21.69%, 22.10%, and 22.74%, respectively (compared to 19.25%, 19.71% and 20.37% at the end of 2019, respectively). The profit of the banking system as of December 31, 2020 amounted to BGN 815 million (BGN 1.7 billion for 2019). The main factors for its decline were the decline in all major components of income and the increase in impairment costs of financial assets. The lower amount of realized profit, as well as the increase in assets and capital during the year determined the decrease in the indicators return on assets (ROA) and return on equity (ROE). At the end of 2020, the return on assets (ROA) amounted to 0.66% (1.45% as of December 31, 2019), and the return on equity (ROE) - 5.31% (11.50% as of December 31, 2019).

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<sup>10</sup> The exposures are determined on the basis of the broadest definition in the EBA methodology, which includes both gross loans and advances, together with cash balances with central banks and other demand deposits, and debt securities other than 'held for trading'.

<sup>11</sup> The changes are in line with Commission Implementing Regulation (EU) 2020/429 of 14 February 2020 amending Implementing Regulation (EU) № 680/2014 on the provision of information by institutions to supervisory bodies. According to the amendments, in contrast to the period June 2015 - March 2020, "cash balances with central banks and other demand deposits" should not be included in the scope of gross loans and advances, but should be reported separately.

<sup>12</sup> The net value of non-performing loans and advances is calculated according to the EBA methodology, and their gross amount is reduced by the accumulated impairment. When calculating the share of net non-performing loans and advances, both their net value and that of total loans and advances are used.

<sup>13</sup> Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards certain adjustments in response to the COVID-19 pandemic (the so-called CRR – Capital Requirements Regulation – "quick fix").

The liquidity of the banking system improved as the liquidity coverage ratio (LCR<sup>14</sup>) of the banking system increased to 279.0% (269.9% at the end of 2019). For all credit institutions, the liquidity coverage ratio exceeded the minimum regulatory requirements of 100%.

In 2020, BNB supervised the activities of credit institutions within two different legal frameworks. A change in a large part of the functions, responsibilities and tasks of BNB as a supervisory body for the activities of credit institutions in Bulgaria occurred as a result of Decision (EU) 2020/1015 of 24 June 2020 of the European Central Bank (ECB/2020/30), which established close cooperation between the ECB and the BNB as of 1 October 2020. As a result, the Republic of Bulgaria joined the Single Supervisory Mechanism (SSM). Under the framework for close cooperation from 1 October 2020, the ECB assumed responsibility for the direct supervision of the institutions it identified as significant<sup>15</sup>. From that date, the ECB is responsible for supervising the less significant institutions and for the common procedures for all credit institutions. The direct supervision of the less significant institutions continues to be carried out by the BNB, but with full harmonization of the supervisory process with that of the ECB.

In 2020, BNB's macroprudential policy was implemented in the conditions of a significant deterioration of the economic environment in Bulgaria, caused by the emergency measures to limit the spread of COVID-19. Based on the assessments of the deteriorating economic conditions internationally and in Bulgaria, in March 2020 BNB canceled the announced in 2019 increases<sup>16</sup> in the level of the countercyclical capital buffer and retained the applicable buffer level of 0.5%. Maintaining the current level of the countercyclical capital buffer would contribute to maintaining the resilience of the banking system in the event of continued deterioration of the economic environment and negative development in the quality of the loan portfolio - increasing credit risk provisions and potential pressure on profitability and capital position of credit institutions. The countercyclical capital buffer continues to be part of the overall consistently applied conservative BNB supervisory policy to strengthen the banking sector's capital position against systemic shocks, which is based on a combined buffer requirement, including capital conservation, systemic risk capital buffer and capital conservation buffer for other systemically important institutions, as well as additional capital requirements under Pillar 2<sup>17</sup>. The decision to maintain the level of the countercyclical capital buffer at 0.5% in March 2020 was confirmed in the following quarters of the year.

In 2020, an annual review of the identified as other systemically important institutions (OSII) and the set for them capital buffer levels for OSII was performed. The annual review in accordance with the requirements of Ordinance № 8 of the BNB and the pan-European methodology of EBA identified eight systemically important institutions with a total market share that covers over 80% of the assets of the banking system. The set capital buffer level was between 0.5% and 1.0% and came into force on January 1, 2021.

In 2020, the BNB's activities in the field of the regulatory framework focused on the implementation of the EBA Guidelines on Legislative and Non-legislative Moratoria, the reporting and disclosure of exposures subject to measures implemented in response to the COVID-19 crisis,

<sup>14</sup> The liquidity coverage ratio for the banking system is calculated as the ratio between the liquidity buffer and the net cash outflows.

<sup>15</sup> The identified as significant credit institutions include Unicredit Bulbank AD, DSK Bank AD, United Bulgarian Bank AD, Eurobank AD and Raiffeisen Bank (Bulgaria) EAD.

<sup>16</sup> The increases in the level of the countercyclical capital buffer envisaged for 2020 and for the first quarter of 2021, up to 1.0% and 1.5%, respectively, applicable to local credit risk exposures

<sup>17</sup> More information on capital buffers is available on the BNB website: <http://www.bnb.bg/BankSupervision/BSCapitalBuffers/index.htm>

as well as supervisory reporting and disclosure requirements in accordance with the "quick fix" response to the COVID-19 pandemic.

During the year new legislative texts were prepared to amend BNB Ordinance № 7 on the organization and management of risks in banks, which aim to bring the ordinance in line with the requirements arising from the accession to the SSM by establishing close cooperation between the BNB and the ECB.

According to the forecast of the Ministry of Finance in the period 2021-2024, credit to the private sector will grow at a moderate pace in line with the restoration of consumer and investment confidence. The credit demand<sup>18</sup> from the private sector will remain subdued in 2021, with the slowdown continuing until the end of the year. Factors from the supply side will also have an impact in this direction, such as the tendency of banks to take less risk and a possible increase in interest rates. The expected lower credit growth in 2021 will be due to weaker demand and the negative effects on investment activity resulting from the situation with COVID-19, as well as due to the effect of the gradual expiration of the moratorium on deferral of liabilities payable to banks. In 2021, the annual increase in claims on corporates<sup>19</sup> is projected to be around 2.8%, and claims on households - 4.3%. In total, the growth of claims on the private sector in 2021 is expected to be around 3.4%.

In 2022, the demand for credit will be higher, in line with expectations of accelerating growth in income and consumer confidence, as well as investment. Higher credit growth for households will be in line with the acceleration in growth in compensation of employees and will support the expected recovery in consumption. Claims on corporates at the end of 2022 will slightly accelerate their growth to 3.9%, and those on households - to 4.9%. In total, the growth of private sector receivables in 2022 is expected to be around 4.3%.

It is projected that in the period 2023–2024, the acceleration in credit growth for the private sector will continue smoothly, along with the recovery of domestic demand. The growth of credit to non-financial enterprises will have a gradual upward trend, with the expected recovery of private investment. The total growth of corporate claims will accelerate to 5.6% in 2024. Household credit will also accelerate gradually, with a steady increase in employee compensations and a lower unemployment rate. The annual growth rate of receivables on this institutional sector will reach 6.4% at the end of the forecast period. The total annual growth of claims on the private sector at the end of 2024 will be 5.9%.

## 2.5. Macroeconomic effects from the National Recovery and Resilience Plan

Bulgaria is expected to be one of the main beneficiaries of the EC Recovery Resilience Facility. The national Recovery and Resilience Plans should include both investment components, as well as structural reforms, identified in the context of the European Semester. Given the amount of funds allocated to the country, significant positive impact on the country's economy can be expected. An assessment of the possible macroeconomic effects from the absorption of the funds under the National Recovery and Resilience Plan has been prepared, assuming that the budgetary effect will be neutral for each of the years. **The current estimations are based on the draft version of the National Recovery and Resilience Plan as of April 2021<sup>20</sup>.**

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<sup>18</sup> The forecast for the development of private credit is made taking into account the current implementation and expectations for the measures implemented by the government under the two anti-crisis programs guaranteed by the Bulgarian Development Bank (BDB) to support individuals and companies, affected by the pandemic.

<sup>19</sup> The data refer to non-financial and financial enterprises from the BNB monetary statistics.

<sup>20</sup> Version 1.2. - <https://www.nextgeneration.bg/14>

An estimate has been made for the distribution of funds in the amount of BGN 12.6 billion by components of demand and by years for the period 2021-2026. According to the preliminary estimates of the implementation of the Plan, the absorbed funds will be lower in the first three years, when about 26.2% of them are expected to be allocated. After that, the transfers are expected to increase rapidly, reaching a peak in 2025, before declining slightly at the end of the period. The distribution of funds by components is made after a review of the individual projects and assumption on the part of funds for public consumption and for investment. The main share of financing is expected to be realized in the form of public investments, and 13.7% - as public consumption. Part of the funds under the program are distributed as private investment. The absorption of the individual components of demand will follow similar dynamics in the period 2021-2026.

The positive effect of the funds is expected to increase GDP at constant prices by 3.8%, compared to the baseline scenario at the end of the period. Real GDP growth is expected to accelerate. The significantly larger government investments, which will be realized as a result of the Plan, will stimulate the overall investment activity in the country. A positive effect will also be observed on private investments. This will affect the demand for labour, and is expected to increase the number of employees by 2.3% by 2026, compared to the scenario without the funds under the Plan. The unemployment rate is estimated to be lower by 1.1 p. p. at the end of the period. Increased employment and further increases in income will contribute to higher household consumption. Higher domestic demand will be reflected in higher levels of imports, while a more significant positive effect on exports will be observed after 2022. Increased economic activity in the country is not expected to significantly affect the price level expressed by the deflator of GDP or inflation (HICP). The effect on the current account will be determined by the growing domestic demand, which will lead to its deterioration compared to the baseline scenario.

**Table 2-3: Main macroeconomic indicators (deviation from the scenario without funds under the Mechanism for Recovery and Resilience)**

	2021	2022	2023	2024	2025	2026
<b>Gross Domestic Product</b>						
GDP, constant price level [%]	0.3	0.9	1.9	2.8	4.1	3.8
Consumption	0.2	0.7	1.6	2.9	4.4	5.3
Gross fixed capital formation	1.1	4.1	8.5	12.7	19.0	18.1
Export of goods and services	0.0	0.0	0.2	0.6	1.0	1.5
Import of goods and services	0.1	0.7	1.8	3.5	5.6	7.4
<b>Labour market and prices</b>						
Employment (SNA) [%]	0.2	0.6	1.1	1.6	2.4	2.3
Unemployment rate (LFS) [p.p.]	-0.1	-0.3	-0.6	-0.8	-1.2	-1.1
Compensation of employees [p.p.]	0.1	0.2	0.4	0.6	0.8	0.7
GDP deflator [p.p.]	0.0	0.1	0.1	0.1	0.2	0.2
Annual average inflation (HICP) [p.p.]	0.0	0.1	0.1	0.2	0.2	0.1
<b>Balance of payment</b>						
Current account, % GDP [p.p.]	-0.1	-0.5	-1.1	-1.9	-2.9	-3.4
<b>Sector budget</b>						
Budget balance, % of GDP [p.p.]	0.0	0.0	0.0	0.1	0.1	0.1
Government debt, % of GDP [p.p.]	-0.1	-0.2	-0.4	-0.7	-1.2	-1.2
<b>POTENTIAL GDP</b>						

Potential GDP level at constant prices [%]	0.6	1.1	1.8	2.6	3.4	4.3
Potential GDP [growth, p.p.]	0.4	0.5	0.7	0.8	0.8	0.8

Source: MoF

The expected higher investment in the economy will increase the physical capital. Labour will be positively affected as well. As a result, it is estimated that the potential growth will average about 0.7 p. p. higher than in the scenario without the resources under the Recovery and Resilience Facility.

The implementation of the plan will lead to additional expansion of the tax base and higher tax revenue in comparison to the baseline scenario. Corporate tax and VAT revenues will be the most significantly affected. At the same time, in view of the more favourable economic environment, some increase in current expenditure may be expected. As a result, the implementation of the plan will have almost a neutral effect on the budgetary balance as a % of GDP. Government debt to GDP ratio will be lower by 0.1-1.2 p.p. in the period 2021-2026 which will result from the expected higher nominal GDP.

# 3. GOVERNMENT BALANCE AND DEBT

## 3.1 Policy Strategy

The main priority of fiscal policy in the current and in the coming years continues to be maintaining the sustainability of public finances, while providing for the relevant measures to stimulate economic activity in Bulgaria.

Despite the ongoing health crisis and economic uncertainty caused by the global COVID-19 pandemic, pursuing a coherent and predictable fiscal policy is a priority in defining key fiscal parameters and indicators of the budgetary framework in the medium term and in implementing budget measures.

The expectations are that the good starting point of the pre-crisis fiscal situation (low deficit and debt) will be a mitigating factor and a buffer against potential risks in the implementation of the budgetary framework in the medium-term.

The starting point in the preparation of the forecast parameters of the budget framework is the last approved forecast (Updated Medium-Term Budget Forecast for the period 2021-2023), against which the objectives of fiscal policy remain unchanged.

Given the concurrence of the preparation of the Convergence Program with the parliamentary elections and the forthcoming election of a new government, the fiscal parameters are calculated under no-policy-change scenario, reflecting only the impact of current macroeconomic assumptions and forecasts, and updating the nominal amounts of some budget indicators as a result of reassessing the effect of current policies. This ensures that there is a baseline, no-policy-change scenario, which will be further developed in the elaboration of the 2022 Budget.

The measures aimed to maintain a sustainable debt level far below the maximum threshold of 60% of GDP of the Maastricht convergence debt criterion in order to ensure its long-term implementation remain a priority. The change in the General Government consolidated debt depends mainly on the dynamics of the Central Government subsector debt, due to its predominance in the sector's debt (with a share of about 98% as of 31.12.2020). The component with the most significant share of 95% at the end of 2020 in the subsector is government debt. This factor determines the government debt management policy as dominant in defining the current position and the consolidated liabilities development outlook.

In the medium term, debt management corresponds with the main fiscal objectives of improving the budgetary position and restoring the budget balance in an emergency caused by the global pandemic of COVID-19 and the associated economic uncertainty.

Pursuing a consistent and predictable fiscal policy enables the management of sovereign liabilities to be in line with the specific market conditions and to minimize liquidity risks in the implementation of the budget. The strategic goal of the government debt management policy remains unchanged and is aimed at providing the necessary resources for refinancing the debt outstanding, financing the planned State Budget's deficit and ensuring the legally regulated levels of the fiscal reserve, including ensuring the best possible price for financing and reducing the expenditures of debt service in the medium term. Efforts will be focused on providing opportunities for market-oriented financing, while complying with statutory debt ceilings and maintaining the sustainability of key debt parameters. The specific characteristics of the newly issued debt will be determined in accordance with the current Government Securities (GS) market conditions and the debt outstanding profile, taking into account the possibilities for reducing

the refinancing risk and smoothing its maturity structure. It is planned to secure the debt financing of the budget by providing highly liquid debt instruments, with an appropriate yield / risk ratio, positioned in different maturity segments.

### **3.2 Medium-Term Objectives**

In the medium term, consolidation of the General Government deficit is expected, with the negative budget balance for 2021 gradually decreasing. In 2021, the budget balance is expected to be negative at the level of 5.6% of GDP, and the forecast deficit of the sector for the coming years is amounting to 2.7% of GDP for 2022, and 3.1% for 2023 respectively. An effect on the balance have one-off expenditures - after their deduction, the negative balance on an accrual basis decreases to 2.4% in 2022 and to 2.3% in 2023, accordingly.

The reduction of the budget deficit in the medium term is mainly attributed to the expenditures. In terms of revenue, the ratio of total revenues to GDP remains around the level planned for 2021.

The nominal growth of revenues on an annual basis is due to an increase in earnings from all major revenue elements, with tax and social security revenues having the largest increase in direct taxes and social security contributions, which is a result of rising household incomes and the possibility to choose an insurance under I and II pillar and the increase of the insurance length of service upon retirement. In the case of non-tax revenues, a more significant increase is observed in the capital transfers received due to the higher revenues from the EU under the Recovery and Sustainability Plan.

The largest contributors to the increase in General Government expenditures are capital expenditures and social transfers other than social transfers in kind, which cover pension expenditure as well as social security benefits. As a share of GDP, gross fixed capital formation expenses increased by almost 1 p.p. The change in the indicator is mainly due to the construction of the Hemus highway and other priority road infrastructure projects, the supply of military equipment, as well as the acceleration of the rate of use of European funds and the Recovery and Sustainability Plan. Most important for the increase in social transfers are the measures and policies taken in previous years, which continue to have a fiscal impact during the forecast period, such as the increase in the hourly rate of personal assistants, as well as the recalculation of the pensions with additional length of service acquired after retirement and those with a reduced individual coefficient.

### **3.3 Actual Balances and Updated Budgetary Plans for the Current Year**

#### **3.3.1 Update of the budget framework for the year**

On the eve of the outbreak of the COVID-19 pandemic, Bulgaria had the necessary fiscal space to respond, expressed in the reported budget surplus and fiscal reserve at the end of the first quarter of 2020. These buffers allowed the fiscal shock of the COVID-19 crisis to be curtailed in the short term and provided flexibility in the expected revenue slowdown. However, the changed macroeconomic perspectives regarding the external and internal environment, the worsened revenue forecasts and the need to provide additional resources in implementation of the Law on Measures and Actions during the State of Emergency, declared by a decision of the National Assembly of March 13, 2020 outlined the immediate need to update the fiscal framework for the year.

Shortly after the declaration of a state of emergency, the government prepared and submitted for approval an urgent draft law to amend the State Budget Act of the Republic of Bulgaria (SBARB) for 2020, which aimed to meet and reflect the most urgent and direct negative effects



of the crisis. The draft law contained assumptions regarding the development of the main macroeconomic indicators, and the forecasts were prepared with a very high degree of uncertainty regarding the scale and duration of the crisis. The urgency of the proposed expenditure changes has made it possible to provide a resource to finance only the first most urgent socio-economic package and to mobilize direct resources related to front-line systems in combating the pandemic. The measures were planned to be implemented both through the revenue and expenditure part of the budget and through the development of financial instruments for financing through the Bulgarian Development Bank. In addition, an analysis was made of the possibilities for redirecting resources under the Operational Programs and EU funds to support and complement national policies and measures to overcome the consequences of the pandemic. The draft law approved by the National Assembly in early April envisaged a deterioration of the balance of the General Government sector to a deficit of 3.1 percent of the projected GDP.

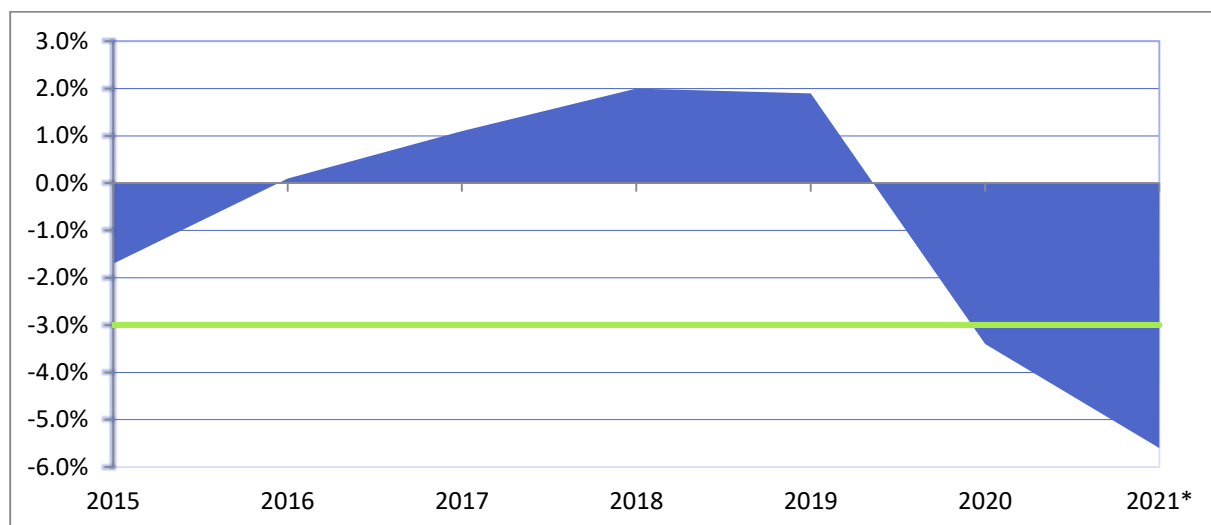
Despite the use of unprecedented resources, the development of the economic environment during the crisis highlighted the urgent need for further action in a number of sectors of the economy and measures to support the most affected groups of the population. In July, the government approved a second package of socio-economic measures, including a 30 per cent increase in the remunerations of staff in the front-line and prevention of the spread of COVID-19, the payment of BGN 50 supplements to the pensions of all pensioners for the months of August to October (subsequently it was decided to extend the measure until the end of 2020 and for the first five months of 2021), redirecting NHIF's expenditures to activities related to the prevention and treatment of the consequences of COVID-19, measures to encourage investment, to support tourism, for infrastructure sites, etc. An important priority together with these measures was investment in public infrastructure, which aimed, on the one hand, to reduce to some extent the decline in investment in other sectors of the economy and, on the other, to preserve jobs. The increase in public investment has a positive effect on growth through final consumption, which is further reinforced by multipliers, through the chain of contractors, material suppliers and employees, who are mainly local economic entities.

The significant resources aimed at overcoming the negative consequences of the pandemic have exhausted the available opportunities for restructuring and securing priority expenditures within the approved expenditure ceilings with the updated estimates to the State Budget Act for 2020 from spring 2020. This necessitated a change in the fiscal framework for 2020 again at the end of the year, with estimates forecasting further deterioration in the General Government sector deficit to 5.2% of the projected GDP.

### 3.3.2 Budget developments in 2020

After a period of budget surpluses and sustainable economic growth in past years, the sudden shock of the pandemic in 2020 led to a significant deterioration of Bulgaria's budgetary position. In the period 2016-2019, the budget balance of the General Government sector was positive, with an average surplus of 1.4% of GDP for the period. This made it possible to accumulate buffers in the fiscal reserve and create fiscal space. The autumn 2019 target for 2020 followed this strategy and envisaged a close to neutral balance of the sector, but the sharp change in the external and internal environment caused by the pandemic outbreak required a change in the fiscal framework, which changed the parameters for the budget balance for the year. The target set for 2020 in the previous Convergence Program was for a deficit of 3.1% of GDP, but the data from the April Notification Tables for the Deficit and Debt of Bulgaria from April 2021 report a minimal deterioration of the budget balance of the General Government sector compared to this target to a deficit of at 3.4% of GDP. It should be noted that compared to the updated estimates under the Amendment and Supplement Act of the State Budget Act of the Republic of Bulgaria for 2020 from the end of the year (deficit of 5.2% of GDP) there is an improvement by 1.8 percentage points, which is due to better revenue performance and lower cost absorption compared to the estimate.

Chart 3-1: Budget Balance (ESS 2010, % of GDP)



\*Forecast

Source: Eurostat, MoF

The reported negative budget balance of the General Government sector for 2020 amounting at 3.4% of GDP is 0.3 percentage points higher than projected in last year's Convergence Program. The main reasons for this deterioration are the increases in some expenditure groups due to the additional funds to combat the COVID-19 pandemic, aimed both at addressing the challenges facing the health system and preserving human life and health, and at supporting the suffered businesses and the most affected/vulnerable groups.

Revenues as a ratio to GDP reached 39.5% in 2020, an increase of 1.4 percentage points compared to the level in 2019. On the one hand, this increase is due to the nominal growth compared to the previous year in current taxes on income, wealth, etc., social and health insurance contributions and in some other current revenues, and, on the other - the nominally lower GDP leading to an increase in the relative share of GDP in 2020.

Revenues from taxes on production and imports, current taxes on income, wealth, etc. and taxes on capital increase both in nominal and as a share of GDP - by 0.3 percentage points compared to 2019.

Taxes on production and imports remain at their nominal level almost unchanged compared to 2019, and due to the decline in GDP, their share increased by 0.1 percentage points. The slight reductions in the main taxes in the group (VAT and excises), despite initial expectations for a significant decline, are a result of the overall retention and even a minimal increase in private consumption due to the registered increase in employees' incomes (both in the budget and in the private sector), disbursed additional funds to pensioners and the funds provided by the government to pay part of the remuneration of the persons affected by the restrictive measures.

In the current taxes on income, wealth, etc. there is an increase in proceeds - by 0.2 percentage points which in nominal terms is nearly BGN 0.2 billion. The main reasons for this increase in personal income tax are the registered growth of remunerations in the public sector (next step of the planned increase in remunerations in the school education sector and the overall wage increase of those employed in the public sector, including more significant increase for those on the front-line in the fight against the coronavirus) and in many areas of the private sector, as well as government measures that have helped to preserve the remuneration of some of those working in the sectors most severely affected by the crisis and limited growth of unemployment rate. Taxes on capital retain their share of GDP - 0.3%, unchanged compared to 2019, and nominally increase by BGN 24.1 million.

Revenues from social and health insurance contributions, as a per cent of GDP, increased by 0.4 percentage points compared to 2019 and this increase is nearly BGN 0.4 billion. Factors contributing to this are: the growth of income, which also affects the revenues from personal income taxes (PIT), contribute to this development; the successful implementation of measures to support people with limited employment opportunities from the pandemic, which have kept unemployment at appropriate levels and certain administrative measures such as the increase of the minimum wage and the minimum insurance thresholds.

The capital transfers received increased by 0.4 percentage points of GDP, which is nominally over BGN 470 million. This reflects the increased amount of funds disbursed and respectively reimbursed by the EC in 2020 under EU programs and funds.

The total expenditures of the General Government sector in 2020 amounted to 42.9% of GDP, which is 7.0 percentage points higher than the level reported in 2019. An increase as a share of GDP compared to the level in 2019 is reported for almost all expenditure elements. The most significant increases in values are reported in social transfers, the gross fixed capital formation, the expenditures of subsidies and others.

Expenditures for compensation of employees increased by 0.9 percentage points as a share of GDP compared to 2019. The main reason for this is the indexation of public sector wages, including the increase in the funds for the staff in the budget sector by 10 percent, the next step of the increase (as of January 1, 2020) of the remunerations of the pedagogical staff in the secondary schools, increase of the medical specialists and the others, who are involved in the front line in the fight against the COVID-19 pandemic, etc.

The maintenance expenditures increased both nominally - by over BGN 1 billion, and as a share of GDP - by 1.0 percentage points, the main reason being the additional funds to prevent the spread of coronavirus for the purchase of medicines, vaccines, disinfectants, personal protective equipment, consumables, medical devices, etc.

The amount of social transfers as a share of GDP increased by 2.1 percentage points, in nominal terms over BGN 2.4 billion on annual basis. In social transfers in kind, where payments to health care providers are reported, the increase is a result of increased expenditures in the healthcare system, including the increase of the funds and creation of new funds on existing clinical pathways for treatment of patients with coronavirus and concomitant complications, expenditures for medicines, consumables and other medical devices for the hospitals, etc. As a share of GDP, this increase of social transfers is by 0.6 percentage points. The other category of social benefits, other than social transfers in kind, reflects the social payments made for pensions and benefits to households and their share in GDP increased by 1.5 percentage points compared to 2019. This includes the raise in pension expenditures due to the indexation of all pensions by 6.7% as of July 1, 2020, an additional increase in the minimum pension from BGN 219.43 to BGN 250, additional funds for pensioners with the lowest pensions (the so-called "Easter" supplements) in the amount of about BGN 50 million provided in April 2020 and the payment of a monthly supplement of BGN 50 to all pensions in the period August - December 2020. In the group of expenditures on social transfers and benefits for households, there is an increase in the amounts of unemployment benefits and temporary incapacity for work, as well as social benefits for people with disabilities and various instruments for social assistance to the most deprived, including the various forms of support for those affected by quarantine measures in the country.

Subsidies increased by 0.9 percentage points compared to the previous year, as the main reason for this are the funds for maintaining employment under the so-called measure "60/40" and its variants in the amount of over BGN 0.9 billion, which are reported as subsidy expenditures.

Capital expenditures increased both in gross fixed capital formation - by 1.2 percentage points, and in other elements of capital expenditures - by 0.1 percentage points. The nominal increase

in capital expenditures is over BGN 1.5 billion. The increase in gross fixed capital formation is due to the ongoing work on infrastructure projects, the implementation of which was not terminated despite the crisis, assessing their importance for the economy and preservation of existing jobs. Most of these projects are implemented with the resources from European programs and funds, which at the end of the programming period reported an increase in the amounts paid.

In 2020, interest expenditures remained unchanged compared to their share in 2019 of GDP - 0.6%.

### 3.3.3 Measures to combat the COVID-19 pandemic in 2020

The main categories of revenue and expenditure measures taken to limit the negative socio-economic consequences of the pandemic and to combat the spread and for treatment of COVID-19 patients in 2020 are as follows:

- Measures to support and strengthen the public authorities in charge of pandemic management and the consequences of COVID-19:
  - providing personal protective equipment and disinfectants for the needs of the state administration; providing personal protective equipment, disinfectants, consumables, reagents, medicines, tests for infection, etc. for the needs of the medical institutions; providing protective equipment and disinfectants in educational institutions;
  - support for frontline staff directly involved in activities to prevent the spread of COVID-19;
  - providing additional funding from the NHIF to the providers of medical care, dental care and medical diagnostic activities for work in unfavorable conditions in connection with the declared epidemic situation and to prevent the spread of COVID-19;
  - additional subsidies for medical institutions for hospital care; capital transfers and expenditures to medical institutions;
  - providing the necessary equipment and organization for conducting remote learning in the education system; providing conditions for remote work in the event of a declared emergency epidemic situation;
  - purchase of necessary types and quantities of state reserves for overcoming the crisis situation;
  - providing financial assistance to farmers;
  - exemption from VAT and duties tax on the import of some medical goods necessary to combat the consequences of the COVID-19 pandemic in accordance with Commission Decision (EU) 2020/491 of April 3, 2020.
- Measures to support business:
  - maintaining employment in the country with the help of the so-called measure "60/40", "80/20", etc.;
  - financial support to Bulgarian artists and performers directly affected by the suspension of mass events on the territory of the country, including arts and entertainment;
  - state subsidy to tour operators who use air carriers with a valid operating license to operate charter flights to the Republic of Bulgaria for tourism in the amount of 35 euros per each seat of the maximum passenger capacity of the aircraft for each flight;
  - additional expenditures to support farmers affected by the negative effects of the pandemic;

- state subsidy to tour operators and travel agents, amounting to 4 percent of their turnover excluding VAT in 2019 to compensate for losses arising from customers who have given up vouchers, as well as amounts withheld by service providers;
  - additional expenditures under the budget of the State Fund "Agriculture" to support farmers affected by the negative effects of the pandemic;
  - additional capitalization of BDB with BGN 700 million for the provision of financial instruments to support the affected individuals and companies from the COVID-19 pandemic;
  - direct assistance to bus service operators;
  - decreased tax rate from 20% to 9% for the delivery of food by restaurant and catering services, books, food suitable for babies or small children and baby diapers and similar hygienic articles, as well as for the consumption of beer and wine in drinking establishments, for providing services related to the use of sport facilities and for providing general tourist services under Article 136 of the VAT Act;
  - postponing the date for declaration and payment of the annual taxes for legal entities in accordance with the Corporate Income Tax Act.
- Measures to help households and socially vulnerable groups:
    - one-off payment of additional amounts to the pensions in the amount of BGN 50 for the period August-December 2020;
    - support for families with children up to 14 years of age, where parents cannot work remotely from home and do not have the opportunity to use paid leave;
    - implementation of employment programs and training measures to support the unemployed persons and employers;
    - provision of vaccines and medicinal products in the fight against the COVID-19 pandemic;
    - support for children and families under the Family Benefits for Children Act;
    - one-off benefits for families whose children are enrolled in the eighth grade in the state or municipal schools;
    - one-off social assistance;
    - targeted programme "Warm lunch at home in a State of Emergency -2020";
    - payment of unemployment benefits, as well as benefits in case of temporary incapacity to work for persons infected with COVID-19 virus.

Based on the preliminary reporting data on the magnitude of the effects of the cost measures related to the efforts to limit and control the COVID-19 pandemic, as well as the social and economic measures to reduce the consequences for the population and business, it can be summarized that unprecedented resources have been mobilized from the national budget. The 2020 data shows that after the introduction of the state of emergency in Bulgaria and the ensuing epidemic emergency situation, expenditure measures and fiscal incentives which have been approved to control the pandemic of COVID-19 and its consequences, amounting to BGN 3,811 million ( 3.2% of GDP), including the financial instruments developed by the Bulgarian Development Bank. In addition to this resource, under the EU funds Operational Programs resources were redirected to finance measures to combat the pandemic and to overcome the negative effects on the economy including:

- Measures for the state authorities engaged with the management of the pandemic and the consequences of COVID-19:
  - Increasing the capabilities of medical institutions for the treatment of patients infected with COVID-19 through the supply of goods and services including the purchase of hospital equipment, ventilators, special equipment for infectious hospital wards and other medical equipment and consumables;
  - Provision of additional remuneration to medical and non-medical staff directly engaged in the implementation of activities related to the measures for prevention and control of COVID-19 pandemic;
- Business support measures:
  - Providing working capital to Bulgarian micro and small enterprises to combat the consequences of the COVID-19 pandemic;
  - Providing working capital to Bulgarian medium-sized enterprises to combat the consequences of the COVID-19 pandemic;
  - Providing working capital to Bulgarian micro, small and medium-sized enterprises engaged in bus transportation to combat the consequences of the COVID-19 pandemic;
  - Providing working capital to Bulgarian micro, small and medium enterprises, registered under the Tourism Act as tour operators or travel agents, to combat the consequences of the COVID-19 pandemic;
  - Providing support to Bulgarian micro, small and medium enterprises affected by the temporary anti-epidemic measures introduced in the country by implementing a support scheme by the National Revenue Agency (NRA);
  - Temporary Framework for State aid measures in the form of equity and quasi-equity investments in support of small and medium-sized enterprises implemented by the Fund Manager of Financial Instruments in Bulgaria;
  - Support for employers and self-insured persons through compensations.
- Measures to support households and socially vulnerable groups:
  - Patronage care for the elderly and people with disabilities;
  - Support to employers for hiring unemployed people;
  - Support for maintaining the employment of employees in enterprises that have ceased economic activity as a direct result of anti-epidemic measures against the spread of COVID -19.

### 3.3.4 2021 Budget Highlights

In 2021, the General Escape Clause of the Stability and Growth Pact, activated by the Council, is continuing, allowing Member States to undertake measures to deal with the spread of COVID-19 by temporarily deviating from their Medium-term Objective. This gives national governments flexibility to take action in the event of an epidemiological emergency situation, excluding expenditures directly related to coping with the effects of the pandemic when assessing compliance with fiscal rules and constraints.

The sudden shift in the focus of fiscal policy in 2020, caused by the COVID-19 pandemic, has led to a redefinition of the priorities in the 2021 Programme. Budgetary challenges for the continuation in the first half of 2021 of the main part of the government's socio-economic measures

to overcome the negative effects of the pandemic, as well as lower than the projected recovery in the last quarter of 2020, are the main reasons on the need to expand the horizon of fiscal incentives in 2021. The opportunities to address the medical aspect of the crisis require the provision of adequate resources for the health care system, including the implementation of the program of mass vaccination of the population as soon as possible. At the same time, support for the most affected sectors of the economy and vulnerable groups must continue in the first half of the year, which also mobilizes significant resources and increases spending accordingly. Taking into account the current state of the economy and the development of the crisis, additional measures have been proposed and are expected to be implemented if necessary, which again poses a challenge to the budget to secure the appropriate funding for their implementation. On the other hand, the projected positive effects on revenues from the expected economic recovery are still weak. Lower income in terms of revenues and the need to mobilize more resources for expenditures predetermine a deterioration of the budget balance. This is reflected in the set goals of the fiscal policy regarding the budget balance for the current year.

**Revenue policy** continues to adhere to the established principles and guidelines in recent years, and its main focus is again to create favorable conditions for economic growth and stimulate labour supply and demand, improve the business environment, combat tax abuse and increase fiscal sustainability in the long run. The main priorities related to improving revenue collection, tackling the shadow economy and reducing administrative burdens and expenditures for businesses and citizens remain.

**Measures in the revenue part:**

- maintaining low corporate and personal income tax rates, as well as the basic VAT rate, as an important incentive for investment, consumption, economic growth and employment.
- the amounts and ratios of insurer/insured person of the insurance contributions for the state social insurance funds and of the health insurance contribution remain unchanged in 2021 compared to 2020.
- the increase of the minimum salary by BGN 40 from BGN 610 to BGN 650 as of January 1, 2021, as well as the improvement of the minimum insurance income for self-insured persons and of the minimum insurance income for the main economic activities and qualification groups of occupations for employees with the minimum salary will generate a positive effect on PIT revenues of BGN 29.3 million (0.02% of the projected GDP) and on insurance contributions amounting to BGN 93.0 million (0.07% of the projected GDP) .
- the increase of the funds for staff in the budget sphere by 10% from the beginning of 2021, including a 15% increase in staff expenditures in the Ministry of Interior, an increase in the salaries of the lowest academic positions in higher education institutions, as well as the implementation of the last step of the increase in pedagogic staff remunerations, which achieved the planned doubling of the remuneration funds compared to 2017, as well as the year-round provision of funds for the increase by 30% as of 01.08.2020 of the staff expenditures of the systems of bodies and administrations, which are charged with pandemic management activities and the consequences of COVID-19 pandemic, including for front-line employees and the administrations with delayed remunerations and others are expected to have a positive effect on PIT revenues in the amount of BGN 110.4 million (0.09% of the projected GDP) and on revenues from insurance contributions by BGN 353.5 million (0.3% of the projected GDP).
- the expected additional social insurance contributions from a change in the insurance type (from a universal pension fund to a State Social Insurance Fund) and from a change

in the parameters of the pension policy (required length of service and age) amount to BGN 48 million (0.04% of the projected GDP).

- reduction of the VAT tax rate from 20% to 9% for the period 01.07.2020 - 31.12.2021 for supplies of certain goods and services - restaurant and catering services, which consist in the supply of prepared or unprepared food, including the supply of catering, books, food suitable for babies or young children and baby diapers and similar hygiene articles, and the consumption of beer and wine in drinking establishments, for the supply of services for use of sports facilities and for delivery of general tourist service in the cases under Art. 136 of the VAT Act, in order to minimize losses in these sectors and to help their recovery. The effect of this measure is a decrease in tax revenues by BGN 198.0 million (0.16% of the projected GDP).
- reduction of the VAT rate from 20% to 0% for the period 1 January 2021 – 31 December 2022 for delivery and intra-Community acquisition of vaccines against COVID-19 and services directly related to these vaccines, as well as of delivery of in-vitro diagnostic medical devices intended for the diagnosis of COVID-19 and the services directly related to these devices, as well as an exemption by 30.04.2021 from customs duties and VAT on imports of medical goods needed to combat the effects of the COVID-19 pandemic. The negative effect on tax revenues is by BGN 66.7 million (0.05% of the projected GDP).
- increase in the amount of tax relief for children for the income acquired in 2021. According to the provisions of the Personal Income Tax Act, the following amounts are deducted from the amount of the annual tax bases: BGN 4,500 (instead of BGN 200) - for one minor child, BGN 9,000 (instead of BGN 400)- for two minor children and BGN 13,500 (instead of BGN 600) - for three or more minor children. The amount of the tax relief for children with disabilities has also been increased, as the amount of the annual tax bases under Art. 17 of the Personal Income Tax Act shall be cut back by BGN 9,000 (instead of BGN 2,000) for raising a child with 50 and over 50 per cent type and degree of disability, determined by an effective decision of a competent authority. This measure is expected to have a negative effect on PIT revenues in the amount of BGN 230.0 million on accrual basis (0.18% of the projected GDP).
- an increase in the total amount to be reimbursed to farmers for excise duty on gas oil used in primary agricultural production. The negative effect on excise revenues is by BGN 16.0 million (0.01% of the projected GDP).
- the effect of the tax relief for the improvement and/or repair of property is estimated at BGN 20.0 million decline of tax revenues (0.02% of the projected GDP).
- the estimated revenues for 2021 include the initial concession payment of BGN 660.0 million (0.5% of the estimated GDP) under the signed Concession Agreement of Sofia Civil Airport for Public Use. The impact of this transaction on the revenues of the General Government sector for 2021 is limited, as the amount of the initial Concession Fee for the state will be distributed proportionally for each of the years for the Concession Period (35 years).

The parameters of the **expenditure policy** for 2021 are in line with the possibilities of the budget for financing the state activities and the perspectives for development of the public policy areas, as well as with the COVID-19 pandemic and its economic consequences. In the State Budget Act of the Republic of Bulgaria for 2021 a limit is set in the form of a buffer amounting to 5% reduction of expenditures, the maximum amounts of new expenditure commitments, the transfers and subsidies provided to some of the first level spending units, as well as subsidies and capital transfers from the central budget. The purpose of the restriction is to provide a reserve for the health system, provided that in 2021 the situation with the COVID-19 pandemic



deteriorated significantly and led to the need for emergency provision of resources related to the protection of life and health and the treatment of sick Bulgarian citizens. The planned limit of funds in the amount of 5 percent is not applicable on the expenditures for the delegated budgets in the system of preschool and school education and the National Institute of Meteorology and Hydrology, and the provided transfers for state universities, the Bulgarian Academy of Sciences and the Agricultural Academy.

### **Income policy**

As of 1 January 2021, the minimum wage (MW) for the country is increased from BGN 610 to BGN 650, and the amount of BGN 650 will be maintained in 2022 and 2023. The effect for 2021 amounts to BGN 33.9 million (excluding municipalities). Funds are planned for the year to pay for the 30% increase in 2020 in staff expenditures of the systems of institutions and administrations, which are charged with controlling the pandemic and the consequences of COVID-19, including for front-line employees who were included in the socio-economic package of the government, as the funds provided for this purpose for 2021 amounted to BGN 220.4 million (excluding municipalities), as well as a 15% increase in staff expenditures of the Ministry of Interior for 2021. The budget estimates for 2021 envisage a 10% increase in the funds for staff wages for employees under labour and official legal relations, including the funds for social security contributions, for all structures that do not fall within the scope of the package of socio-economic measures of the government, as the resources amounted to BGN 455.8 million (excluding municipalities). The cumulative effect of all those measures amounted to BGN 1,015.3 million (0.82% of the projected GDP), including BGN 280.3 million (0.23% of the projected GDP) are funds for payment of the 30% increase in 2020 in staff expenditures of the systems of bodies and administrations, which are in charge of activities to control the pandemic and the consequences from COVID-19 and BGN 735 million for remuneration since the beginning of 2021 (0.59% of the projected GDP).

For 2021, a BGN 84 million increase in the funds for the staff costs for the elected positions and for the employees in the judiciary system is planned, for which a mechanism for formation of the remunerations is legally regulated.

In 2021, the planned doubling of the funds for remuneration of pedagogical specialists compared to 2017 was achieved, and for this purpose BGN 360.0 million were estimated for supporting the activities for education and training of children and students in the school system. The amount represents 0.29% of the projected GDP.

### **Measures concerning pensions, social benefits and compensations, and social assistance:**

The objectives of the pension policy are to ensure both the adequacy and sustainability of the pension system in accordance with the demographic and socio-economic characteristics of the country, and with the need for sustainable growth of pension income, according to the rate of economic growth. In the area of pension policy, expenditure is affected by the following measures:

- increase of the minimum amount of the pension for length of service and age from BGN 219.43 to BGN 250 from July 1, 2020 and from BGN 250 to BGN 300 from January 1, 2021. The expected effect of the measure is an increase in costs by BGN 543,1 million (0.49% of the projected GDP), including BGN 69,1 million for the payment of the indexed pensions since July 1, 2020.
- also since January 1, 2021 the maximum amount of received one or more pensions increased from BGN 1,200 to BGN 1,440, which leads to increase in expenses by BGN 94.0 million (0.08% of the projected GDP).
- To index all pensions disbursed by the end of 2020 as of July 1, 2021 by 5 percent (as the minimum amount of the pension for insurance length of service and age and the

maximum amount of received one or more pensions are kept at the level from January 1, 2021) and for the year-round payment of the indexed amounts of pensions as of July 1, 2020, the total necessary funds are BGN 688.2 million (0.55% of the projected GDP), including BGN 383.2 million for payment of the pensions indexed as of July 1, 2020.

- the payment of supplements amounting to BGN 50 per month to all pensioners for the first five months of 2021 raise the expenditures for pensions by BGN 527.4 million or 0,42% of the projected GDP.
- recalculation of pensions with reduced individual coefficient has an effect of BGN 43.2 million or 0.03% of the projected GDP.
- increase in the funds for pensions due to other reasons (possibility to choose a methodology for determining the individual coefficient, automatic recalculation of the pensions with additional acquired length of service after retirement, natural growth of the pension expenses, etc.) – BGN 95.6 million or 0.08% of the projected GDP.
- the change in the requirements for retirement, including increase of the required retirement age and length of service for those working under the conditions of the third labor category and the minimum retirement age for the persons working in the security area and those working in the conditions of the first and second labor category who do not meet the conditions for retirement from an occupational pension fund; maintaining the percentage for each year of insurance length of service in the pension formula is maintained at the level reached in 2019 of 1.2 percent, etc. The financial effect of the change in the retirement requirements is estimated at about BGN 12.0 million reduction in pension expenditures (0.01% of the projected GDP).

The main features of the policy in the field of social benefits and compensations paid by the state social insurance in 2021 are sustainability of the assistance/support, predictability for the affected persons and steps towards expanding the coverage of social risks. This is expressed in maintaining the deadlines, income and other criteria for granting the main types of benefits and compensations. The increase of the minimum amount of the unemployment benefit from BGN 9 to BGN 12 from October 1, 2020 will have an effect of BGN 15.6 million (0.01% of the projected GDP). Improvement in the maximum amount of the guaranteed receivables of the employees in case of insolvency of the employer is from BGN 1,525 to BGN 1,625.

The measures for preservation of employment, through which the state takes up 60 per cent, and in certain cases 80 per cent, of the amount of the insurance income and the insurance contributions due at the expense of the insurer of the employees in the enterprises whose business has suffered the most of the introduced emergency measures to control the spread of COVID-19 infection (the so-called measure "60/40" and its modifications) has an effect of BGN 300.0 million for 2021 (0.24% of the forecast GDP).

### **Social assistance policy**

The social policy priorities are mainly aimed at overcoming the socio-economic consequences of the COVID-19 pandemic, related to maintaining employment, increasing the employability of the workforce and reducing unemployment, especially among young people, as well as improving the adequacy and sustainability of social protection and social inclusion with a focus on the most vulnerable groups in society.

Among the main priorities of the national policy in the field of labour market, free movement of workers and labour migration, first of all is raising the qualification of the labour force according to the needs of the economy and increasing the employment of disadvantaged groups in the labour market. Secondly, but also essential, is the increase of labour supply. This implies activating the inactive persons, reducing the unemployment rate and maintaining the work habits of the most vulnerable groups in the labour market. For 2021, the additionally estimated

funds for increasing the digital literacy and digital skills of a larger number of unemployed amounted to BGN 10.0 million (0.01% of the projected GDP).

Social assistance policy is aimed at ensuring that the basic needs of persons in a critical situation are met by applying a clear, precise and objectively justified mechanism. Ensuring adequate social payments is an important element of support for vulnerable groups in society. For 2021, the government plans to provide a one-off financial support in the amount of BGN 120 to pensioners whose pension or the sum of pensions together with the supplements and compensations to them is from BGN 300.01 to BGN 369. The funds provided for this aim are at the amount of BGN 47.0 million (0.04% of the projected GDP) are for the support of part of the most vulnerable group of pensioners in the conditions of the COVID-19 emergency epidemic situation. In connection with the amended criteria for granting targeted heating aid, the funds for this type of support have been increased by BGN 10 million (0.01% of the projected GDP).

The main focus of the policy for people with disabilities is on creating conditions and opportunities for social inclusion and providing targeted support measures to vulnerable groups of people with disabilities, having a positive impact on their quality of life and prevention of social exclusion. Financial support for people with disabilities is intended to compensate for the expenditures associated with overcoming the difficulties caused by the type and degree of disability. Due to an increase in the hourly wage of personal assistants and an increase in the poverty line, the amount of financial support for people with disabilities increased by BGN 82.1 million (0.07% of the projected GDP).

Social inclusion policy is about more focused measures and implementing an integrated approach to preventing poverty and promoting social inclusion. An essential part of the social inclusion policy is the provision of material support for families with children and families caring for children at risk. For the implementation of this policy in 2021 the funds increase by BGN 41.7 million (0.03% of the projected GDP). This raise is related to the following measures taken in connection with limiting the negative impact of the emerging epidemic situation and the reduced income of families: increasing the income criterion for one-off pregnancy benefits and monthly childcare allowances up to one year from BGN 450 to BGN 510; increasing the amount of the monthly allowances for raising a child up to the age of one year - from BGN 100 to BGN 200; dropping the income criterion for receiving one-off assistance for students enrolled in first grade and increasing the amount of the assistance itself from BGN 250 to BGN 300. Amendments to the Family Allowances for Children Act regulate the new one-off allowance for students enrolled in the eighth grade in the amount of BGN 300, to be granted without an income criterion. The measure is of a one-off nature and is in connection with the Law on Measures and Actions during the State of Emergency, declared by a decision of the National Assembly of March 13, 2020, and for overcoming the consequences and amounts to BGN 18.7 million (0.01% of projected GDP).

For 2021, BGN 73.0 million (0.06% of the projected GDP) have been provided for targeted assistance for families with children under 14 years of age, where parents cannot perform remote work from home and do not have the opportunity to use paid leave in case of a declared State of Emergency or an emergency epidemic situation.

The provision of social services by the municipalities under the new Social Services Act is envisaged to BGN 79.7 million (0.06% of the projected GDP).

### 3.3.5 Measures in the field of healthcare

The identified priorities in healthcare policy area in 2021 are the following:

- controlling the pandemic and the consequences of COVID-19;
- strengthening the role of prevention as an opportunity for better health and quality of life. Expanding the scope of preventive examinations with additional screening tests.

Early diagnosis and detection of pre-chronic and chronic conditions by introducing annual prevention examinations of all Bulgarian citizens - blood, urine and cardiac tests, in order to monitor outpatient care prevention. Introducing an integrated approach to reducing drug use and tackling the growing percentage of drug-addicted adolescents;

- ensuring financial stability and security of the health system. Stabilization of the health insurance model;
- development of e-health;
- overcoming regional imbalances and ensuring functional interaction between the different levels of medical care.

The budget of the National Health Insurance Fund for 2021 envisages additional expenditures for health payments amounting to BGN 583.0 million (0.47% of the projected GDP). Additional funds are provided from the budget of the Ministry of Health - BGN 114.3 million (0.09% of the projected GDP), including BGN 50.0 million for the building of a National Pediatric Hospital through the acquisition of shares and stocks of the company. The approved funds are targeted at several main priority areas in the healthcare system:

- policy in the field of promotion, prevention and control of public health, which aims to ensure quality and effective response to the health needs of citizens through the implementation of primary prevention, health promotion and integrated prevention of infectious diseases, including monitoring of infectious diseases and effective state health control over environmental factors. The policy includes: implementation of national programs to reduce morbidity and mortality from infectious diseases; central supply of vaccines for mandatory and targeted immunizations and vaccines and drugs for the treatment of COVID-19, etc.
- policy in the field of diagnosis and treatment, which is aimed at improving the health well-being and quality of life of Bulgarian citizens and reducing health inequalities through activities in the field of diagnosis and treatment of diseases and the organization of medical care. The priority investment projects envisaged for implementation in the field of diagnostics and treatment are related to the development of e-health and the improvement of the material base and access to health services for all citizens.
- the main scope of the policy in the field of medicinal products and medical devices is the provision of medicinal products that meet the standards of quality, safety and efficacy to meet the needs of the population.

The provisions of the Health Insurance Act are still in force, as they introduce a gradual increase in the part of the minimum insurance income, on which the health insurance contributions for the persons who are insured at the expense of the State Budget are determined - from 55 percent in 2016 to 80 percent of the minimum insurance income for self-insured persons as of January 1, 2021, as each subsequent year the ratio increases by 5 percentage points until reaching the minimum insurance income for self-insured persons. Together with the increase of the minimum wage, the minimum insurance income on which the state makes the contributions also increases. The total amount transferred as a result of the changes will increase by BGN 117.1 million. The effect on the balance on a consolidated basis is neutral, as revenues and expenditures will raise by the same amount.

### **3.3.6 Measures in the field of education**

The total estimated expenditure for education in 2021 is BGN 5 643,0 million which is 4,5% of the GDP. The education priorities for 2021 are aimed at meeting the key challenges and supporting the implementation of key sector policies.

Strategic and operational goals in the field of pre-school and school education are aimed at increasing the scope and quality of pre-school education, given its basic importance for achieving higher educational results in school and for successful realization on the labour market; successful inclusion of children and students in the system of pre-school and school education and reduction of the share of early school leavers; increasing the share of secondary school graduates and encouraging the participation of young people in formal and non-formal education and training. In 2021, the last step of the annual increase in the salaries of pedagogical specialists, which began in 2017, is being implemented. With the provided BGN 360 million, the remuneration doubled compared to 2017.

In 2021, additional funding is provided for the following priority measures and activities in the field of preschool and school education:

- construction and modernization of the material base of kindergartens and schools. Additional BGN 70.0 million has been allocated for this purpose.
- additional BGN 61.0 million have been provided for expanding the access and coverage of 4-year-old children in compulsory pre-school education and for supporting the payment of fees due by parents for feeding children in compulsory pre-school education.
- additional BGN 46.0 million have been provided for the provision of transport for children and students, including the maintenance of buses in connection with the optimization of the network of kindergartens and schools for 2021.
- BGN 20.0 million have been planned for the continuation of the modernization of school classrooms in the secondary education system.

The total effect of the abovementioned measures in the field of pre-school and school education is an increase in expenditures by BGN 197.0 million (0.16% of the projected GDP).

The policy in the field of higher education is aimed at sustainable development, improving the quality of education through its financial promotion and its orientation to the practical needs of the labour market and optimization. In 2021, the reforms aimed at restructuring the admission to professional fields with expected higher future demand on the labour market will continue to be implemented; improving the rating system of higher education institutions; providing public guarantees for student loans; removal of restrictions on the admission of students from Bulgarian communities abroad, etc. In order to continue the reforms and ensure the policies for sustainable development and expansion of the access to higher education for 2021, additional funds in the amount of BGN 17.7 million (0.01% of the projected GDP) have been provided for: increase of the funds for student scholarships - BGN 6.0 million; for providing support to education - BGN 11.7 million.

### **Policy in the field of science**

Increasing the size and efficiency of public spending on research and development (R&D) aims to increase the quality, use and commercialization of research results; raising the level of research institutions and modernization of R&D equipment; developing regional and local technology testing laboratories, promoting entrepreneurship in research organizations, supporting successful clusters, addressing gaps in research infrastructure and the optimal use of shared infrastructure capacity; capacity building and human resources development in the R&D system; closer integration of the Bulgarian research community in the international and promoting research in the country, in the context of global trends in research; stimulating the cooperation between the universities, the scientific institutes and the businesses in order to effectively direct scientific developments to the needs of the market and the society. BGN 534 million (0.43% of the projected GDP) is allocated for science in the 2021 Budget.

### **3.3.7 Policy in the field of defence**

Defense policy is about maintaining a modern, combat-ready and interoperable armed forces. To implement it, the government will uphold and develop effective and efficient capability-based defence planning, in line with NATO's defense planning process, the EU Coordinated Annual Defense Review and in the context of the EU's Ongoing Structured Defense Cooperation. The Republic of Bulgaria will continue its participation in the decision-making process, as well as in the process of building the defence capabilities of NATO and the EU. Funds are provided for supporting and developing the national defense capabilities and the capabilities related to the collective defence, including funds for the implementation of the investment projects for modernization of the Bulgarian Army approved by the National Assembly namely: the acquisition of a multifunctional modular patrol ship for the Navy and basic combat equipment for the formation of battalion battle groups within a mechanized brigade. Furthermore, funds are provided for the construction of an integrated system and infrastructure for the development, operation and provision of the new type of fighter aircraft.

The additional expenditures envisaged in 2021 for investment projects for the development of the defense capabilities of the Armed Forces of the Republic of Bulgaria amount to a total of BGN 350 million.

### **3.3.8 Measures in the field of justice**

The government planned an improvement of administrative services in the field of justice by expanding the technical possibilities for communication between the various judicial authorities, including the provision of automated access to public court registers, as well as the gradual replacement of depreciated computer equipment as part of e-justice. The additional funds for material and technical provision for 2021 amount to BGN 26.0 million, incl. BGN 17.0 million for the process of introduction of e-justice and the gradual introduction of the Unified Information System for Courts as part of the Unified e-Justice Portal.

### **3.3.9 Measures in the field of transport and communications**

The policy in the field of transport focuses on developing the basic transport infrastructure, which is an important condition for maintaining sustainable economic growth. The main priority of transport policy is the improvement of the quality of the offered transport services and the sustainable development of transport. The transport sector is key for the Bulgarian economy both because of its connecting role in relation to other sectors and because of its own contribution to gross value added and employment.

The main strategic infrastructure projects in the field of road transport, for which financial resources are provided are: completion of the Struma highway Lot 3.1, 3.2 and 3.3; completion of the Hemus highway with an approximate length of 250 km; construction of a "Bypass of the town of Gabrovo", including a tunnel under Shipka; construction of Kalotina - Sofia highway; preparation for construction of Vidin – Botevgrad highway; preparation of "Ruse - Veliko Tarnovo" highway; development, construction and rehabilitation of the national road network; construction, reconstruction and rehabilitation of first-class, second-class and third-class roads, etc.

The state participation in the financing of the activities for the construction, maintenance, development and operation of the railway infrastructure is carried out through the granting of subsidies and capital transfers for the National Railway Infrastructure Company (NRIC). For current maintenance and operation of the railway infrastructure for 2021 an increase of the subsidy by BGN 50 million (0.04% of the projected GDP) is envisaged. The overall investment program of NRIC, related to the construction, rehabilitation and development of railway infrastructure, is implemented with funds from the Operational Program "Transport and Transport Infrastructure" 2014-2020, Operational Program "Transport Connectivity" 2021-2027, the Connecting Europe Facility and with funds provided in the central budget in the form of capital

transfers. For 2021 the capital transfer has increased by BGN 20 million (0.02% of the projected GDP) compared to the previous year.

The capital transfer for the State Enterprise “Port Infrastructure” is envisaged to be directed both for repair, rehabilitation and strengthening of the port infrastructure, as well as for modernization of the port facilities and activities related to their possibility. For 2021, compared to 2020, the capital transfer has increased by BGN 37.5 million (0.03% of the projected GDP) to BGN 148.5 million, of which BGN 120 million, are for the development of the port infrastructure in the region of the city of Varna.

Bulgarian Posts EAD is subsidized with funds to fulfil its obligations to provide universal postal service and the service of general economic interest for distribution of periodicals (newspapers and magazines). In 2021, the amount of the subsidy was increased by BGN 27.1 million (0.02% of the projected GDP) mainly due to the assigned performance of the new type of service - the distribution of periodicals.

### **3.3.10 Measures in the field of tourism**

Tourism policy is in line with the challenges of the COVID-19 pandemic, which have changed the image of the sector not only nationally but also globally. It requires the undertaking and implementation of measures that will lay a good foundation, both to ensure the life and health of every tourist and the sustainable development of tourism. The policy is aimed at tackling the unprecedented pressure on the tourism ecosystem with an increasing emphasis on retaining jobs and skillful use of mechanisms to support tourism enterprises. At the same time, a policy priority remains ensuring increased competitiveness of the sector in the new realities to create the right and realistic positioning of the Bulgarian tourist product on the international markets and hence to promote the tourist visits of foreigners in Bulgaria, in compliance with all necessary sanitary requirements.

The government’s package of socio-economic measures for overcoming the consequences of COVID-19 to support the tourism sector in 2021 includes an additional BGN 40.0 million under a scheme for providing state aid to tour operators who provide tourist packages to consumers with final point of arrival on the territory of the Republic of Bulgaria. The support is provided in the form of a state subsidy for tour operators who use air carriers with a valid operating license to operate charter flights to the Republic of Bulgaria for tourism and BGN 10.0 million for one-off assistance for the use of tourist services for domestic tourism at a unit value of BGN 210 for the persons who have directly carried out or are carrying out activities related to the treatment, prevention of the spread and/or overcoming the consequences of COVID-19.

### **3.3.11 Central Election Commission**

According to the Electoral Code, BGN 155.0 million (0.12% of the projected GDP) were planned for specialized devices for machine voting in connection with the implementation of the legal requirement for machine electronic voting in the Republic of Bulgaria.

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

### **Structural budget balance**

In 2020, the negative economic effects of the global pandemic led the Bulgarian economy to operate below its potential, as the negative output gap is estimated at 3.1%. The actual balance of the General Government shifted to a negative territory (-3.4% of GDP) as a result of the crisis and the fiscal measures taken to support businesses, households and public authorities responsible for combating the COVID-19 pandemic. In 2020, the cyclical component of the

fiscal balance was negative (-0.9%), and the cyclically adjusted budget balance was a deficit of 2.5% of GDP. The estimate for the structural budget balance for the past year is a surplus of 0.8% of GDP, as one-off and temporary measures related to the COVID-19 pandemic are taken into account.

In 2021, the output gap will shrink, due to which the cyclical component will slightly decrease to -0.7%. The actual deficit is planned to increase to 5.6% of projected GDP, with 2.5% of GDP one-off and temporary measures, and the structural deficit for 2021 is estimated at 2.4% of projected GDP. Next year, the structural deficit will fall to 2.1% of projected GDP, as a result of the halving of the actual deficit and lower one-off measures. In the last two years of the forecast period, the output gap is expected to move to a positive territory and gradually increase, due to which the cyclical component will be slightly positive. The structural deficit will amount to 2.4% in 2023.

### **Expenditure Benchmark**

The assessment of compliance with the requirements of the Stability and Growth Pact and the Public Finance Act regarding the growth of budget expenditures is based on the general methodology for the so-called expenditure benchmark, taking into account the division between national and EU-funded public investments. In 2019 and until the outbreak of the COVID-19 pandemic in 2020, Bulgaria strictly complied with the rules of the Stability and Growth Pact, and in particular its preventive part.

Based on calculations made by the Ministry of Finance, the change in real terms of the expenditure indicator used for the purposes of fiscal management in the EU is estimated respectively at 3.8% for 2021, -2.8% for 2022, and 2.5% for 2023.

The activation in 2020 of the General Escape Clause of the Stability and Growth Pact has allowed Member States to temporarily deviate from the adjustment path toward the Medium-Term Objective, provided that this does not jeopardize their fiscal sustainability in the medium term<sup>21</sup>. In addition, the European Commission proposed the SGP General Escape Clause to remain in force in 2021 and 2022. It should be borne in mind that the expenditure benchmark is part of the indicators monitored in assessing compliance with the rules in the preventive part of the SGP and as such it falls within the scope of the General Escape Clause.

### **3.5 Debt levels and developments, below-the-line operations**

Based on preliminary annual data, by the end of 2020 the General Government debt increased compared to the level registered at the end of the previous year, both in nominal value and as a share of GDP.

The General Government debt to GDP ratio reaches up to 29.3% in 2023, which is significantly below the maximum reference threshold of the Maastricht Convergence Criterion of 60% and among the lowest levels in the EU. The increase in the consolidated liabilities in 2020 is objectively justified as a result of the outbreak and rapid spread of the COVID-19 pandemic and the changed in this regard fiscal targets amendment of the 2020 State Budget Act for the budget balance in the context of deteriorating assumptions for the external and domestic economic environment.

The major share of about 98.0% at the end of 2020 and the component with the most significant contribution to the sector's debt continues to be occupied by Central Government sub-sector debt, and it retains its largest share in the medium term. In its structure the government debt

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<sup>21</sup> Communication from the EC on the activation of the general escape clause - <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020DC0123>



predominates with a share of about 95% which is a prerequisite government debt management policy to play an important role in defining the current position and assumptions for the development of consolidated liabilities. The debt indebtedness of the units included in the sub-sector has a relatively low share and minimal impact on the total sector's debt. The other two sub-sectors: the Local Government sub-sector and the Social Security Funds sub-sector Also have neutral impact of the General Government sector's debt.

Comparing the projections for 2020 with those set in the previous Convergence Programme of the Republic of Bulgaria, there is a positive adjustment in the debt to GDP ratio, which results from smaller than planned amount of new issued debt during the year.

The new debt financing of the Central Government sub-sector received in 2020 amounts to a total of BGN 7.1 billion, of which BGN 6.0 billion for financing the budget in the form of government securities placed in both domestic and on the foreign capital markets and BGN 1.1 billion of loan disbursements, including government loans and loans of institutional units within the scope of the sub-sector (state hospitals, FLAG EAD, State consolidation company, etc.). Within the ceiling for the maximum amount of the new government debt which can be assumed of up to BGN 10.0 billion set in the 2020 State Budget Act, the new issued nominal debt in 2020 amounts to BGN 7.1 billion in nominal value, including BGN 4.9 billion (EUR 2.5 billion) under the Global Medium-Term Note Programme on International Capital Markets (GMTN programme), BGN 1.2 billion from government securities issued on the domestic market and BGN 1.0 billion (EUR 511.0 million) in relation with the loan agreement ratified by the National Assembly on December 22<sup>nd</sup>, 2020, promulgated, SG No. 109 / December 22<sup>nd</sup>, 2020 under the European Temporary Support Instrument for the purpose of mitigation of the risks of unemployment in exceptional circumstances following the outbreak of COVID-19 (SURE) (OB L 159/1 from May 20<sup>th</sup>, 2020), as expected disbursements of the loan funds will be in 2021.

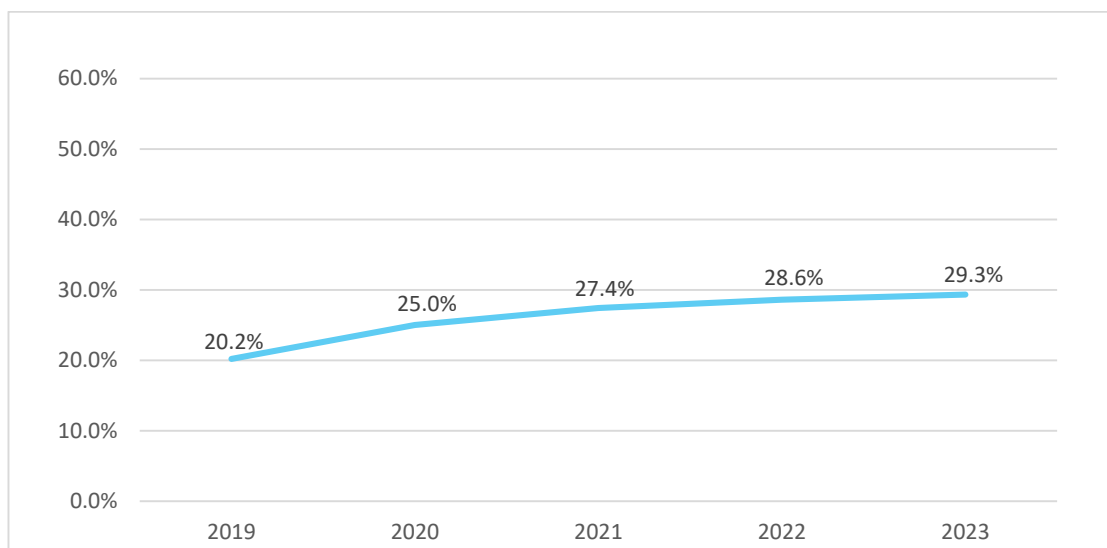
The share of the external financing of the sub-sector reaches a share of 67.8% of the total amount of the realized new borrowing, and domestic - about 32.2%.

The currency and interest rate structure of the General Government debt at the end of 2020 is characterized by a clear predominance of the relative share of debt denominated in euro - 81.7% and in BGN - 18.0%, as well as liabilities with fixed interest rates - 97.7%. The share of debt in other currencies remains negligible - 0.3% and with floating interest rates - 2.3% as of December 21<sup>st</sup>, 2020. In the next three-year period the debt structure of the sector is expected to remain stable in terms of the impact of market risks.

Interest payments on an accrual basis for 2020 relative to GDP are expected to amount to 0.6%, and to remain below 1% of projected GDP.

The average residual maturity of the General Government debt as of December 31<sup>st</sup>, 2020 is 8.4 years, and by the end of 2023 it is projected to be gradually extended to almost 10 years.

Given the dynamic environment caused by the spread of COVID-19 and economic uncertainty, the debt to GDP ratio is expected to range between 27.4% - 29.3%. The projections for the dynamics of the parameter depend mainly on the development of the epidemic situation both in the country and globally, but remain far below the maximum reference threshold of 60%, keeping the sustainable levels of government indebtedness.

**Chart 3-2: Consolidated General Government debt/ GDP ratio**

Source: MoF, NSI/Eurostat

The projected amount of the General Government debt for the period under review could be further affected by a possible extension of the scope of the sector through reclassifying of its institutional units in line with Eurostat requirements and the implementation of the European System of Accounts 2010.

The debt ceilings set in the annual state budget acts contribute to the controlled increase of the debt and keep its sustainability. According to the provisions of the 2021 State Budget of the Republic of Bulgaria Act, the maximum amount of the government debt at the end of the year shall not exceed BGN 31.9 billion, and the maximum amount of the new government debt that can be issued under the Government Debt Act during the year is BGN 4.5 billion.

Debt financing of the budget in the form of government securities is planned in the range around BGN 6.2 - 6.7 billion per year, with the maturing debt of 3.0 - 3.5 billion BGN per year. The projected amounts of new debt more than the debt repayments are aimed at accumulating funds in the fiscal reserve and providing resources for the upcoming repayments of maturing Eurobonds. In the period, first level spending units whose budgets are included in the consolidated fiscal programme and are not part of the government budget may not assume new government debt through government loans, and financial leasing the other forms of debt.

In the period, the debt level of the Local Government sub-sector is not expected to have significant deviations from its level at about BGN 1.4 billion reported at the end of 2020. The main factors for this development are the restrictions set in the Public Finance Act and the Municipal Debt Act. They stipulate that the annual amount of municipal debt payments for each municipality in the respective year shall not exceed 15 percent of the average annual amount of own revenues and the total equalization subsidy for the last three years, calculated on the basis of data from the annual reports on the implementation of the budget of the municipality, as well as that within the current budget year the municipalities can issue new debt for realization of long-term contracts with guaranteed result (ESCO contracts) in the amount of up to 15 percent of annual average amount of the reported capital expenditures in the past four years in the respective municipal budget. The estimates show that the regulated statutory restrictions as well as the expected flexible municipal financing schemes in the new programming period will retain its share within about 1% of GDP.

The Social Security Funds sub-sector does not have any debt obligations and it is not expected to take any new ones in the coming years. The sub-sector will continue to exert its influence in

reducing the General Government debt through the accumulation of financial assets in the form of Government Securities issued by the Central Government sub-sector. For 2020, they amounted to about BGN 443 million.

Taking into account the forecasts for the amount of debt of the subsectors "Local Government" and "Social Security Funds" in the period, no negative impact of these subsectors is expected when measuring the debt burden of the "General Government" sector.

**Table 3-1: Revenues from privatisation**

(BGN million)

	Report 2020	State Budget Act of the Republic of Bulgaria for 2021	Forecast 2022	Forecast 2023
Revenues from privatisation and post-privatisation control in the central budget	3,1	2,0	1,0	0,8

Source: MoF

The values set in the table above are based on a forecast of revenues from privatisation and post-privatisation control for the period 2022-2023, prepared by the Agency for Public Enterprises and Control.

The main revenues by years are anticipated from the sale of:

- 2022 - properties-private state property (BGN 0.8 million), separate parts (BGN 0.2 million);
- 2023 - properties-private state property (BGN 0.6 million), separate parts (BGN 0.2 million).

Proceeds from the implementation of post-privatisation control under signed privatisation contracts are also expected.

### 3.6 Budgetary Implications of Major Structural Reforms

#### 3.6.1 Implications on the Expenditure Side of the Budget

- **Changes in the Pension System**

Continuing the pension reform in the next years aims to ensure revenue stability in the pension and social security system, and to improve the adequacy of pensions in view to the demographic challenges the country is facing. The further increase in the retirement age will be geared towards increased stability in the pension system in the long term, maintaining solidarity among generations and reducing poverty risk for elderly persons .

The State Social Security Budget Act (SSSBA) for 2021 provides for BGN 1,770.1 million or 16.7% more funds for pensions compared to the SSSBA for 2020. An additional BGN 209.4 million have been approved by an act of the Council of Ministers for continuing the support of the pensioners with one-off payment of additional amounts in the amount of BGN 50 also for April 2021 (CMD No. 84 from March 11<sup>th</sup>, 2021) and May 2021 (CMD No. 168 from April 22, 2021). Thus, the planned additional funds for pensions for 2021 amounted to a total of BGN 1,875.1 million compared to the Social Insurance Act for 2020. The difference is mainly due to funds provided for:

- BGN 884.1 million - the year-round payment of the increased as of July 1<sup>st</sup>, 2020 by 6.7% the amounts of the pensions for insurance length of service and age, the social old-age pension, as well as the related amounts of pensions and supplements; indexation of pensions from July 1<sup>st</sup>, 2021 by 5%; official automatic recalculation of the pensions with

the additionally acquired by the pensioner insurance length of service after retirement; recalculation of pensions with reduced individual coefficient, as the individual coefficient will be calculated according to the new rules of art. 70, para. 10, 11 and 19 of the SSC (in force from September 1<sup>st</sup>, 2021) and if it is more favorable for the person; possibility to choose a methodology for determining the individual coefficient; natural increase in pension costs; effect of the change in the requirements for retirement .

- BGN 474.0 million - the increase of the minimum amount of the pension for insurance length of service and age from BGN 250.00 to BGN 300.00 as of January 1<sup>st</sup>, 2021;
- BGN 94.0 million - the increase of the maximum amount of the received one or more pensions from BGN 1,200.00 to BGN 1,440.00 as of January 1<sup>st</sup>, 2021;
- BGN 527.4 million - payment of an additional amount of BGN 50.00 to the pension of each pensioner in the months of January, February, March, April and May 2021.

In elaborating the pension expenditure forecast, the parameters of the current legislation in the Social Security Code and the Social Security Budget Act for 2021 are taken into account and the forecasts set out in the Government's Medium-Term Budget Forecast have been taken into account, including:

The age for acquiring the right to a pension for insured persons under the conditions of the third labor category continues to increase by 2 months for women and 1 month for men, respectively. The required length of service for acquiring the right of a pension for both sexes continues to grow by 2 months until reaching 36 years and 6 months for women and 39 years and 6 months for men in 2024.

The necessary requirements for retirement in the period 2021 - 2023 are listed in the table below:

**Table 3-2: Requirements for retirement under Art. 68, para. 1-2 of SSC, for the 2021–2023 period**

year	WOMEN		MEN	
	age	Length of service	age	Length of service
2021	61 yrs. and 8 mo.	36 years	64 yrs.and4 mo.	39 years
2022	61 yrs.and10mo	36 yrs. and 2 mo.	64 yrs.and5 mo.	39 yrs. and 2 mo.
2023	62 years	36 yrs. and 4 mo.	64 yrs.and6 mo.	39 yrs. and 4 mo.

Source: NSSI

The minimum retirement age in the event of incomplete length of service for a third labour category continues to increase by 2 months until reaching the age of 67 in 2023.

The minimum retirement age for persons employed in the Defence and Security sector continues to grow by 2 months until reaching the age of 54 years and 2 months in 2024.

The minimum retirement age for persons who have been employed under Labour Categories 1 and 2 and do not meet the retirement requirements for an occupational pension fund stipulated in Article 168 of the Social Security Code or have opted for a switch in their social security scheme under Article 4c of the Social Security Code continues to rise by 4 months for women and 2 months for men until it reaches in 2024 50 years and 8 months for women and 54 years and 2 months for men for Category 1, and 55 years and 8 months for women and 59 years and 2 months for men for Labour Category 2, respectively.

Over the period, the value of for every year under Article 70 (1) of the Social Security Code of insurance service in the pension formula is preserved at the level reached in 2019 amounting to 1.2.

The pensions for labour awarded until December 31 of the previous year will be indexed as of 1 July of the next year in accordance with the so called “Swiss rule” (Article 100 of the Social Security Code) with a percentage equal to the sum of 50 per cent of the increase of the social security income and 50 per cent of the index of consumer prices in the previous calendar year. The amounts of the minimum pension for insurance length of service and age and of the social old-age pension, as well as the pensions and benefits related thereto, will also increase by the same percentages as of July 1 of the relevant year.

The maximum amount of one or more pensions received is kept at the amount of BGN 1 440, as it applies to all pensions, regardless of the initial date of granting.

In the reference medium-term programme, the cash expenditure for pensions and supplementing allowances remains in the range between 9.7% - 10.0% of GDP.

**Table 3-3: Pension and allowances expenditure estimates, for the 2021–2023 period** <sup>22</sup>

year	Pension expenditures	
	BGN million	% of GDP
2021 (Budget of the State Social Security Budget Act)	12 346.7	9.9
2022	12 748.3	9.7
2023	13 591.5	9.8

Source: NSSI

### 3.6.2 Implications on the Revenue Side of the Budget

Estimates of the amount of tax revenues for the period are based on the forecasts of the Ministry of Finance for the main macroeconomic indicators, the impact of the measures applied by the revenue agencies to improve collection and compliance with the legislation, and the assumptions regarding the duration of the restrictive measures to control the COVID-19 pandemic. The factors taken into account are the priorities in the tax policy in the medium term, the effects of the changes in the tax legislation related to the implementation of measures for improving the collection, the overcoming of the consequences of the pandemic and stimulating the economic recovery and development, the reduction of the administrative burden and the introduction in the national legislation of provisions of European tax law.

#### Corporate taxes

The forecast for corporate tax revenue is based on retaining the basic tax rate of 10%. The corporate tax revenues are influenced most of all by the reported financial results (taxable profit/loss) of the persons obligated under the Corporate Income Tax Act (CITA).

In 2020, the provisions of CITA were changed regarding the deadline for declaring advance payments for the current calendar year (according to Art. 87a, para 1 of CITA from March 1<sup>st</sup>, to April 15<sup>th</sup>, of the same year) and for submitting the declaration for changes of the advance payments for corporate tax under Art. 88 of CITA. The deadlines for the monthly and quarterly payments do not change, except the one for advance corporate tax for the month of December

<sup>22</sup> The data up to 2024 are based on the revenue and expenditure forecast of the consolidated budget of the PSS for 2022-2024 as of March 2021.

and for the third quarter of the current year, which was changed from of December 15<sup>th</sup> to December 1<sup>st</sup> of the year.

The date for filing the annual tax returns under CITA and the date for filing the corporate tax have been postponed from March 1<sup>st</sup> to June 30<sup>th</sup> of the respective year.

In connection with the introduction of a legal opportunity to organize a growth market within the meaning of Art. 122, para. 1 of the Markets in Financial Instruments Act, which provides an opportunity for small and medium enterprises to raise capital under more lenient conditions regarding the scope and periodicity of the information disclosed by them and on the basis of the publication of a simplified prospectus, the regime of tax treatment of the income from disposal of financial instruments and of the income from interest on bonds and other debt securities traded on a regulated market has been equalized with those traded on a growth market.

### **Personal Income Tax (PIT)**

The income tax revenues for 2021 and the forecast for the period 2022–2023 have been made while preserving the flat tax rate of 10% (with No. tax-exempt minimum amount) for all tax-payers' incomes, with the exception of income from economic activities of sole traders, carrying out economic activity as traders within the meaning of the Commercial Law, including sole traders or natural persons registered as farmers, who have chosen to tax the income from their economic activity with tax on such annual tax base, for which the rate remains at 15%. The revenues from these taxes also includes revenues to local budgets from patent tax and tax on taxi transport of passengers.

The amount of tax revenues from personal income tax is mainly influenced by the development of labour market parameters and the legislative and administrative measures taken in the field of labour, social and tax legislation. The amount of the average salary, the level of unemployment in the country, the results declared with the ATR of individuals, the size of paid amounts for dividends and liquidation shares, the level of interest rates on deposits of individuals and the volume of deposits have an impact.

In order to increase the revenues from the Personal Income Tax, the measures taken to reduce undeclared labour, the measures to increase the collection of liabilities for previous periods and the information campaigns conducted by the NRA, as well as the legal changes made have an impact.

In 2020, in connection with the postponement of the date for declaring and paying the annual taxes of legal entities under the CITA, the PIT Act has shifted the deadline for declaring and paying annual taxes for persons engaged in economic activity as traders within the meaning of the Commercial Law, including sole traders or natural persons registered as farmers who have chosen to tax their business income on such an annual tax base. To reduce the administrative burden, changes have been made, reducing the cases in which the issuance of a primary accounting document with data on the payer of the income is required for documenting the income.

The regime of tax treatment of income from disposal of financial instruments and income from interest on bonds and other debt securities traded on a regulated market has been equalized with those traded on the growth market (non-taxable income until December 31<sup>st</sup>, 2025).

A new type of tax relief has been introduced in the Personal Income Tax Act when using services for improvements and / or repairs of real estate. The amount of tax relief for children under the Personal Income Tax Act for the income acquired in 2021 has been increased.

In forecasting PIT revenues, the expected negative budgetary effect of BGN 230 million from the application of the increased amount of tax reliefs for children for the incomes acquired in 2021 was taken into account.

## Value Added Tax

When forecasting VAT revenues for the period 2021-2023, the Ministry of Finance took into account the assumptions about the duration and spread of COVID-19, the changes in economic activity in the country, the dynamics of consumption, imports, exports, the impact of adopted legislative changes and the impact of factors due to changes in the external environment. Both the forecasts for the macroeconomic indicators and the effects of the changes in the legislation have been taken into account.

In 2020, the tax rate has been reduced from 20% to 9% for the supply of restaurant and catering services, books, food suitable for babies or young children and baby diapers and similar hygienic articles, as well as for the consumption of beer and wine in drinking establishments, for the services of sports facilities and general tourist service in the cases under Art. 136 of the VAT Act will be implemented until 31 December 2021.

Exemption from VAT and customs duties on imports of certain medical devices necessary to combat the effects of the COVID-19 pandemic has been adopted, in accordance with Decision 2020/491 from April 3<sup>rd</sup>, 2020 of the European Commission. The term for application of the measure has been extended until April 30<sup>th</sup>, 2021.

The VAT Act establishes norms for exemption with the right to deduct a tax credit (i.e. by applying a zero tax rate) to the following supplies taxable on the territory of the country: 1. The supply of vaccines against COVID-19 and the services directly associated with these vaccines; 2. The supply of medical devices for in vitro diagnostics of COVID-19 and the services directly related to these devices. The measure is also temporary and will apply until December 31<sup>st</sup>, 2022.

Since the beginning of 2020, the list of goods to which the VAT refund mechanism applies for supplies of goods and services listed in Annex No. 2 to Chapter Nineteen (a) of the VAT Act has been extended to include supplies on transfer of quotas for greenhouse gas emissions (SG, issue 18 of 2020, in force until June 30<sup>th</sup>, 2022). The VAT refund mechanism introduced on January 1<sup>st</sup>, 2014 in national legislation is an effective tool for counteracting and combating VAT tax fraud for certain categories of goods and currently the deadline for its application has been extended to June 30<sup>th</sup>, 2022.

The forecast for VAT revenues took into account the expected negative budget effect of BGN 264.4 million for 2021 and BGN 65 million for 2022 from the temporary measures taken in response to COVID-19.

### *Excise duties*

The forecast for excise duty revenues takes into account, in addition to the macroeconomic indicators, also the positive effect from the measures for improving the control of trade in excise goods, as well as the legislative amendments. It is assumed that the excise rates for taxation of the different groups of excise goods will be maintained throughout the period and that the structure of the consumption of excise products within the different groups of excise goods will be relatively stable.

A number of changes have been made within the Excise Duties and Tax Warehouses Act (EDTWA) not only in order to eliminate problems arising from the application of the act, but also to continue the harmonization of Bulgarian tax legislation with the requirements of European directives and decisions of the Court of Justice of the European Union, as well as with a view to reducing the administrative burden in compliance with the provisions of the act.

For 2021, a negative effect on excise revenues is included - BGN 16 million from the increase of the amount under the state aid scheme "Aid in the form of a discount on the value of excise duty on gas oil used in primary agricultural production" of BGN 84 million to BGN 100 million.

**Table 3-4: Anticipated effects on the budget from the discretionary measures in the field of revenues, BGN million**

Discretionary measures	2021	2022
Increase of the amount of tax relief for children	-230,0	
Exemption from VAT (0% rate) for the supply of vaccines and medical devices related to COVID-19	-65,0	-65,0
Tax relief for improvements and / or repairs of real estate	-20,0	
Change in the parameters of the dividend policy	6,0	
Reduction of the tax rate from 20% to 9% of VAT for certain deliveries	-198,0	
Exemption from customs duties and VAT on imports of medical goods	-1,7	
Change in the amount under the State aid scheme Special procedure for refund of excise duty on purchased gas oil used in primary agricultural production	-16,0	
Revenues from the introduction of TOLL fee	112,7	50,0
Revenues from insurance choice	47,5	56,7
Income from insurance contributions from the increase in the required age and length of service for retirement	0,5	0,5
<b>Total</b>	<b>-364,0</b>	<b>42,2</b>

Source: MoF



## 4. SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS UPDATE

### 4.1 Sensitivity of Budgetary Projections to Various Scenarios

The sensitivity analysis presents the change in key budgetary parameters that would occur in the materialisation of the alternative macroeconomic scenario.

In the alternative scenario, GDP at current prices is lower throughout the forecast period, which has a negative impact on tax revenues and total budgetary revenues. The most affected will be the revenues from corporate tax and taxes on products, including VAT. The decrease in total revenues compared to the baseline scenario in 2021 is estimated at 0.9%, and in the period 2022-2023 it is in the range of 2.1-2.8%. Lower revenues also imply a reduction of the expenditure part of the budget, which is estimated at 0.6% for 2021 and 1.5-1.6% in the period 2022-2023. As a result of these developments and the lower level of GDP level at current prices, the budget balance would deteriorate by 0.1 percentage points in 2021 and by between 0.3-0.6 percentage points during the rest of the period.

The effect on government debt, as a percentage of GDP, is an increase throughout the forecast period due to higher budget deficits and lower GDP at current prices in the alternative scenario. The increase evolves from 0.4 p. p. to 2 p. p.

### 4.2 Comparison with the Previous Programme

The Convergence Programme 2020-2023 presented forecasts only for 2020. The expectations at that time were for a decline in real GDP of 3%. In fact, GDP shrank by 4.2%. The larger decrease was mainly due to investments and in particular to changes in inventories. The change in inventories had a negative contribution to economic growth in 2020 of 1.4 percentage points, while expectations were for a neutral contribution. Lower production and temporary difficulties in supply chains led to a contraction in inventories in the first and especially in the second quarter. Gross fixed capital formation also shrank more than expected due to high uncertainty and weak private investment activity. The larger decline in investment was partially offset by better performance of consumption, in particular private consumption, where growth was recorded instead of the expected decline. However, higher consumption led to a less pronounced decline in imports compared to exports. As a result, net exports contributed more to the decline in GDP.

**Table 4-1: Key macroeconomic indicators**

	2020		
	CP 2021	CP 2020	Difference, pp
GDP, real growth, including:	-4.2%	-3.0%	-1.2
Final consumption	1.8%	0.2%	1.7
Investments	-11.0%	-2.5%	-8.5
Export of goods and services	-11.3%	-16.3%	5.0
Import of goods and services	-6.6%	-12.9%	6.2
Annual average inflation (HICP)	1.2%	0.1%	1.1
Employed	-2.3%	-2.1%	-0.2

Unemployment rate	5.1%	6.2%	-1.1
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Source: MoF, NSI

The change in the number of employees projected in the previous Convergence Programme was very close to the one realized in 2020. A year ago, the spread of COVID-19 was expected to be controlled at the beginning of the summer months at the latest and the gradual process of economic recovery to start in the last quarter of 2020. In reality, in November and December, Bulgaria entered a second wave of the virus. However, short-term employment retention measures were continued and lasted not only until the end of the second quarter, but until the end of 2020, and were extended in the first months of 2021 (at least until the end of May). In addition, additional programmes have been developed and implemented targeting the most affected economic activities of the restrictive measures (such as hotels and restaurants) to the self-employed in the field of culture, as well as to parents whose children have not been able to attend school or kindergartens. All these measures helped curb the decline in employment (-2.1%), which remained very close to the previous forecast (-2.3%).

At the same time, the unemployment rate (5.1%) is significantly lower than projected for 2020 (6.2%). This is largely due to the fact that a relatively large proportion of those who lost their employment status in 2020 became inactive (they left the workforce) instead of becoming unemployed. In the second quarter of the year, when the country underwent its strongest employment shock, about 77% of the unemployed during the period under review left the workforce and about 23% joined the unemployed contingent, while the preliminary expectations were this flow to be divided approximately in half between the inactive and the unemployed.

In line with the expectations in the previous Convergence Program, the negative impact of the pandemic on labour incomes on average in the economy was less pronounced and the optimization of expenditures was achieved to a greater extent by reducing the hired labour force. The reported nominal growth of compensation of employees of 3% in 2020 remained close, slightly exceeding the estimate for the development of the indicator a year ago (2.6%).

Uncertainty regarding global economic development at the beginning of the COVID-19 pandemic in the spring of 2020 also led to a discrepancy between the actual reported annual average inflation for 2020 and the forecast according to the previous Convergence Program. This, above all, is related to the assumptions made regarding the dynamics of international prices, which differ significantly from those actually reported. Internal factors include not only lower domestic demand, but also the observed change in the structure of consumption during the year due to the effects of the pandemic.

### 4.3 Alternative scenario: slower recovery of the external environment

The presented alternative macroeconomic scenario presents a less favourable external environment than expected in the baseline scenario. This includes protracted recovery of the EU and world economy, reflected in slower growth in 2021 and 2022. In the rest of the period the growth rates of Bulgaria's main trading partners are slightly higher than in the baseline scenario, yet GDP levels remain lower. Under this alternative scenario, a full recovery of both EU and global GDP to 2019 levels is expected to be achieved in 2023. There is also a slower rise in international prices in 2021 and a slight increase in the period after that, due to a slower recovery of the world economy in connection with the COVID-19 pandemic. This mainly affects the prices of energy goods and metals, which are more dependent on global economic activity, and to a lesser extent the prices of food, which are mainly affected by weather conditions in the producing countries. The expected of a slower recovery of the global and EU economies will increase the demand for US dollars as a safe-haven currency, which will lead to appreciation of the dollar against the baseline scenario.

**Table 4-1: Assumptions used in the alternative scenario, difference from the baseline scenario**

<b>INTERNATIONAL ENVIRONMENT</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>
World economy [real growth, percentage points]	-3.3	-2.7	2.3	0.2
European Economy – EU [real growth, percentage points]	-2.4	-1.6	1.6	0.5
USD / EUR exchange rate [%]	-2.5	-2.0	-1.5	-1.0
Brent oil price, USD / barrel [%]	-14.3	-7.9	-2.4	3.2
Prices of metals, [in USD,%]	-9.1	-5.5	-1.8	2.1
Prices of agricultural raw materials, [in USD,%]	-4.0	-1.8	0.1	1.9
Food prices, [in USD,%]	-3.9	-1.0	0.7	2.4
Prices of non-energy raw materials, USD [%]	-5.4	-2.6	-0.3	2.1

Source: MoF

The assumptions for deteriorating development of the external environment will be reflected in more unfavorable dynamics of the country's GDP, as its real growth is expected to be by 1.5 percentage points lower in 2021 and by 1.7 percentage points in 2022. Although growth is expected to accelerate for the rest of the period, the level of GDP in the alternative scenario will remain permanently below that in the baseline scenario. The changed external conjuncture will be reflected in lower growth rates of exports of goods and services in the first two years, which will be followed by a year of faster recovery. A slower recovery in external demand will suppress the recovery in labour demand and income, which in turn will slow the growth rate of household consumption. The uncertain external environment will further limit investment activity, but the effect will be somewhat slower than other components of demand. In the first two years, a slower rise in the price level in the country is expected, expressed both through the GDP deflator and through inflation (HICP). This will have a negative impact on the level of GDP at current prices and despite the subsequent accelerated rise in price levels, it will remain lower than in the baseline scenario. The current account balance will follow the trends in foreign trade and will deteriorate compared to the baseline scenario.

A summary of the anticipated changes in key macroeconomic indicators as a result of the changes made in the assumptions are presented in the following table.

**Table 4-3: Effects on key macroeconomic indicators**

<b>Key macroeconomic indicators</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>
<b>GROSS DOMESTIC PRODUCT (GDP)</b>				
GDP level at current prices [%]	-2.5	-5.4	-4.8	-4.5
GDP real growth, [percentage points]	-1.5	-1.7	0.2	0.1
Consumption	-0.5	-1.0	-1.4	-0.6
Gross fixed capital formation	-0.1	-1.7	-5.2	1.6
Export of goods and services	-4.3	-3.3	3.5	-0.3
Import of goods and services	-2.4	-2.3	-0.2	-0.6
<b>LABOUR MARKET AND PRICES</b>				
Employment (SNA) [percentage point]	-0.9	-1.0	0.1	0.0
Unemployment Rate (Unemployment Rate) [percentage point]	0.5	0.7	0.5	0.3
Compensation of employees [percentage point]	-0.3	-0.9	-0.7	-0.5
GDP deflator [percentage point]	-0.9	-1.3	0.4	0.2

Average annual inflation (HICP) [percentage point]	-0.8	-0.4	0.2	0.6
<b>BALANCE OF PAYMENT</b>				
Current account% of GDP [percentage point]	-1.5	-2.8	-0.5	-0.5

Source: MoF

## 5. SUSTAINABILITY OF PUBLIC FINANCE

### 5.1 Policy Strategy

This chapter deals with the sustainability of the fiscal position by evaluating the current status of public finance in view of the future increase in age-related public expenditures. For this purpose, the sustainability indicators S1 and S2 are used, calculated under the methodology elaborated by the European Commission<sup>23</sup>.

The medium-term fiscal sustainability indicator (S1) shows the necessary adjustment to the primary structural budgetary balance within five years from the end of the forecast period, which is needed to guarantee that the government debt in the period t+15 (2036) does not exceed the reference value of 60%.

The long-term fiscal sustainability indicator (S2) shows the adjustment to the primary balance required to fulfil the inter-temporal budgetary 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, while the negative value indicates the presence of fiscal space.

**Table 3-1: Sustainability indicators**

	MoF		EC	
	S1	S2	S1	S2
Value from which:	-1.6	4	-3.1	2.5
Initial budgetary position	0.9	2	-1.2	-0.1
Debt requirement	-2.9		-2.5	
Ageing costs	0.4	2.1	0.7	2.5

Source: MoF, Debt Sustainability Monitor 2020

The table represents the MoF's assessments of sustainability indicators and those of the European Commission from the Debt Sustainability Monitor<sup>24</sup>, published in February 2021. The existence of differences in the values of indicators S1 and S2 between the two institutions is largely due to different expectations for economic growth, debt and the budgetary balance in the medium term. The Commission's estimates are based on forecasts from the autumn of 2020. In addition, the assessment of the sustainability of fiscal policy is highly dependent on the long-term prospects for economic development. The existence of differences in the values of indicators S1 and S2 between the two institutions is also due to differences in projections for future changes in the budgetary position, which are related to the expenditures for pensions, health care and education. In preparing its long-term macroeconomic forecast and the corresponding estimates of age-related expenditures, the MoF uses updated assumptions<sup>25</sup>, which will be included in the 2021 Ageing Report, a forecast of pension expenditures submitted by the National Social Security Institute and forecasts for health and education expenditures derived from the

<sup>23</sup> Annex 2 of Fiscal Sustainability Report 2018.

<sup>24</sup> [https://ec.europa.eu/info/sites/info/files/economy-finance/ip143\\_en.pdf](https://ec.europa.eu/info/sites/info/files/economy-finance/ip143_en.pdf)

<sup>25</sup> "2021 Ageing Report: Underlying forecasts and projection methodologies", European Commission, European Economy, Institutional papers, No. 142, November 2020.

MoF's long-term model. At the same time, the EC forecast for Ageing costs is based on the 2018 Ageing Report.

Estimates show that despite expectations of debt growth over the forecast period, the country's fiscal sustainability is not threatened. The indicator S1 is negative, which according to the EC reference value<sup>26</sup> means a low risk for fiscal sustainability in the medium term and implies maintaining the debt level below 60% of GDP. The value of indicator S2 indicates medium risk and the need to adjust the primary balance to maintain fiscal sustainability.

The presented results overlap with the conclusions of the Commission's report, according to which the country has fiscal space and even in the event of a negative shock on nominal GDP growth or the budgetary balance, debt risks remain low in the medium term. According to the Commission, the risk is moderate in the long run.

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

### 5.2.1. Social security

The Bulgarian pension system faces serious demographic challenges. Eurostat forecasts show that the country's population will decline and at the same time its age structure will deteriorate. As a result, the age dependency ratio will increase significantly - if in 2019 per 100 persons between 20 and 64 correspond to 36 persons over the age of 65, then in 2070 their number will increase to 60 per 100 persons. As a result of the ageing population and shrinking labour force, the number of employees will decrease by about 34%. For its part, the share of the elderly population (65+) within the total population will increase from about 21% in 2019 to 31% in 2070.

In recent years, a number of actions have been taken to stabilize the financial condition of the pension system and improve the adequacy of pensions. The 2015 reform created conditions both for increasing the revenues from social security contributions, as well as for limiting the growth of pension expenditures by introducing stricter requirements for acquiring the right to a pension for length of service and age. The income policies pursued in recent years, including increases in the minimum wage, the minimum insurance income for self-insured persons and the maximum insurance income, have also led to an increase in revenues in the system. They, among other decisions, led to an increase in the average insurance income for the country and therefore assisted, through the mechanism for updating pensions, to improve their adequacy. But on the other hand, in the medium and long term, this inevitably affects pension costs. The medium- and long-term effects on expenditure have been reinforced by other decisions, notably the minimum size of employment pensions and the maximum amount of pensions.

The long-term budget forecast for the development of the pension system has been developed under the parameters of the current (2021) legislation in the field of pensions and the provisions of the Social Security Code. In preparing the forecast for pension expenditure in the period 2021 - 2070, the latest demographic forecast of Eurostat and macroeconomic forecast provided by the Ministry of Finance was used.

In 2021, pension expenditures are expected to reach 9.9% of GDP. This is mainly due to the higher amounts of pensions as a result of the increase of the minimum amount of the pension for length of service and age from BGN 250 to BGN 300 and to the maximum amount of the

<sup>26</sup> Reference values set in the Fiscal Sustainability Report 2018, indicating the degree of risk to the sustainability of public finances:

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.

received one or more pensions from January 1<sup>st</sup>, 2021 on, as well as the lump sums to the pensions paid in the period January-May 2021. There will be a slight decrease to 9.7% in 2022 due to the fact that funds for lump sums are not provided. In 2023, pension expenditures will grow at a faster rate than Gross Domestic Product and their share will reach 10.0%.

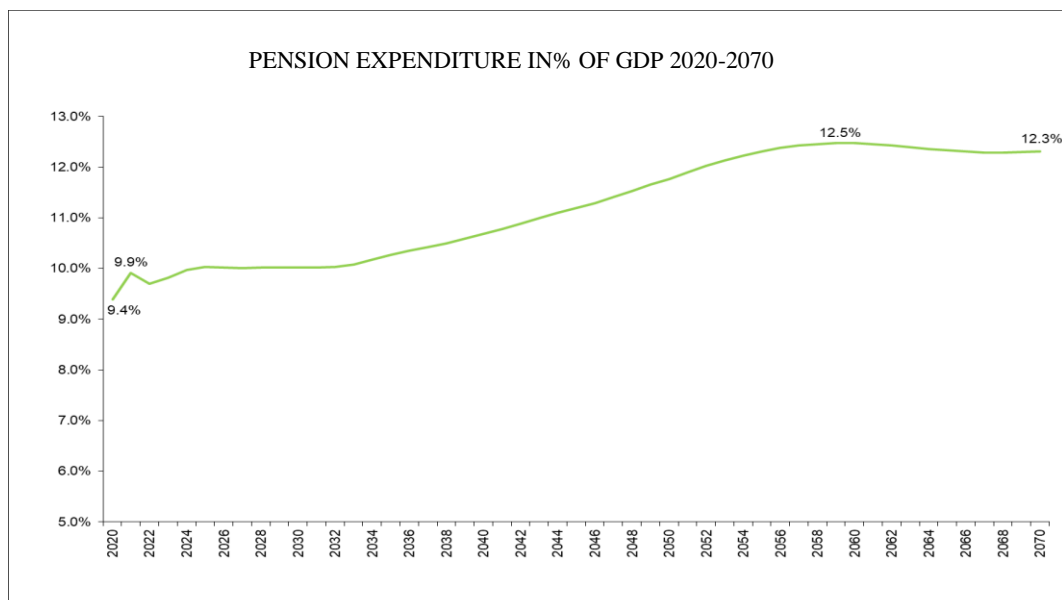
Between 2025 and 2034, the share of pension expenditure in GDP is expected to remain at a relatively constant level of around 10.0% and will be affected by the declining number of newly granted pensions due to the gradual increase in the retirement age and the required insurance length of service. In the period from 2035 to 2060, as a result of the ageing process and the expected higher life expectancy, the fiscal pressure on the state pension system will increase and pension expenditures as a share of GDP will start to increase reaching its highest value of 12.5% in 2060.

In the last decade of the forecast period, a certain decrease in the share of pension expenditures to about 12.3% of GDP can be expected, which is due to the higher birth rates projected by Eurostat and a certain increase in the share of the working age population to end of period.

The dynamics of long-term pension expenditures will also be affected by the opportunity provided to insured persons born after 1959, who until August 2015 were compulsorily insured in the state social insurance (Pillar I) and in the universal pension fund (Pillar II.), to change their insurance and to switch to insurance only in the first pillar with increased insurance contribution. Due to the fact that the currently available data do not allow a specific assumption to be made for the percentage of persons born after 1959 who would in the long run switch to social security only, the forecast was developed assuming that the share of insured persons, born after December 31<sup>st</sup>, 1959, which will continue to be insured in both the state social insurance and universal pension funds, remains unchanged compared to 2021.<sup>27</sup>

The following chart shows the expenditure on pensions paid by the state social insurance as a share of GDP for the period 2020-2070.

**Chart 5-1: Pension expenditure 2020-2070**



Source: NSSI

The following factors will have the greatest impact on the financial condition of the pension system in Bulgaria in the long run:

<sup>27</sup> By the end of March 2021, 63,660 insured persons had applied to the National Revenue Agency for the transfer of their insurance from a universal pension fund to the state social insurance, which is 2.8% of the insured persons born after 1959.

***Increasing the ratio between the number of pensioners and the number of insured persons.***

The COVID-19 pandemic and the associated negative processes in the development of the labour market had a particularly pronounced effect on the dynamics of the number of insured persons. After a nearly 10-year period of annual growth, in 2020 the average number of persons for whom social security contributions were paid decreased by more than 100.0 thousand. In the long run, the number of insured persons will follow the trend in the number of employed, and is expected to increase until 2024, and then until 2070 the trend will be declining, which will be a result of the decrease in the working age population, which will lead to shrinking the workforce and reducing the number of employees.

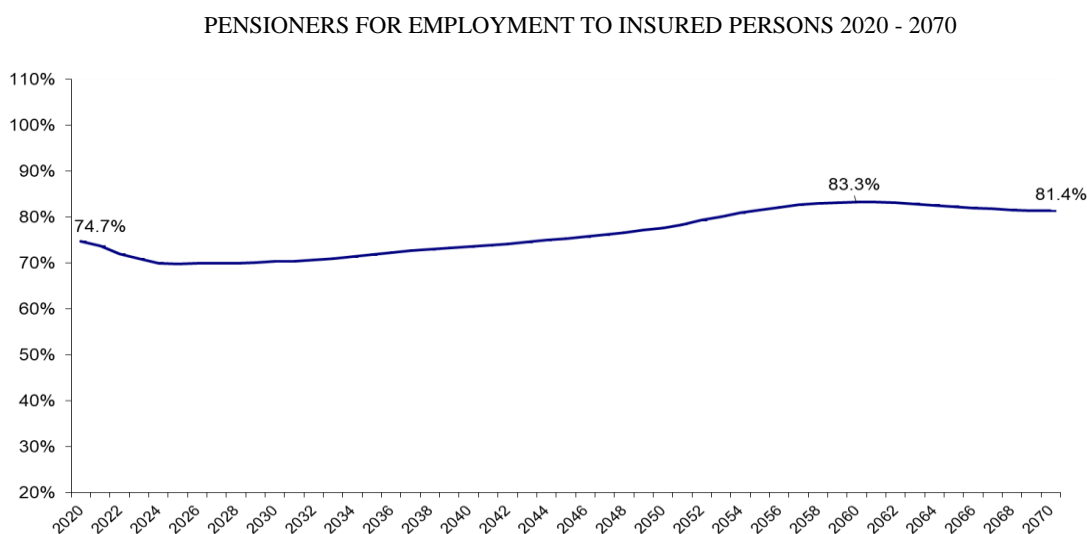
The total number of pensioners with employment pensions paid by the Social Security will decrease in the long run. This result will be a consequence of the increase in the legal requirements for access to pensions and the negative demographic trends in the country. However, the relative share of pensioners in the total population of the country will increase from about 30% in 2019 to 36% in 2070.

The ratio between the number of pensioners and the number of insured persons, also called the (systemic) dependency ratio, is a key indicator of the financial condition of cost-benefit pension schemes. The ageing of the population and the increase in life expectancy on the one hand, and the decrease in the working age population on the other, will have a significant impact on the state social security system in the long run.

In 2020, 75 pensioners with employment pensions corresponded to 100 insured persons, and in 2021 73 pensioners are expected to correspond to 100 insured persons. In the coming years, the reduction of the dependency ratio will continue, and by 2037, when the retirement age for women and men will be equal to 65, the ratio between the number of pensioners and the number of insured persons will remain below 73%. This decrease is a result of the projected lower number of newly granted pensions during these years, due to the increase of the retirement age and the required length of service, the restriction of early retirement, as well as due to incentives for older workers to stay in the labour market longer. After 2037, under the influence of factors such as population ageing, increasing life expectancy and declining employment, the dependency ratio will be growing significantly, and according to the projected results for 2060, 83 pensioners for employment will correspond to 100 insured persons. Between 2060 and 2070, there will be a slight improvement in the dependency ratio as a result of the gradual increase in the total fertility rate projected by Eurostat from 1.5 to 1.7, leading to an increase in the share of the working age population towards the end of the period when 81 pensioners are expected to correspond to 100 insured persons.



Chart 5-2: Pensioners for employment to insured persons 2020-2070



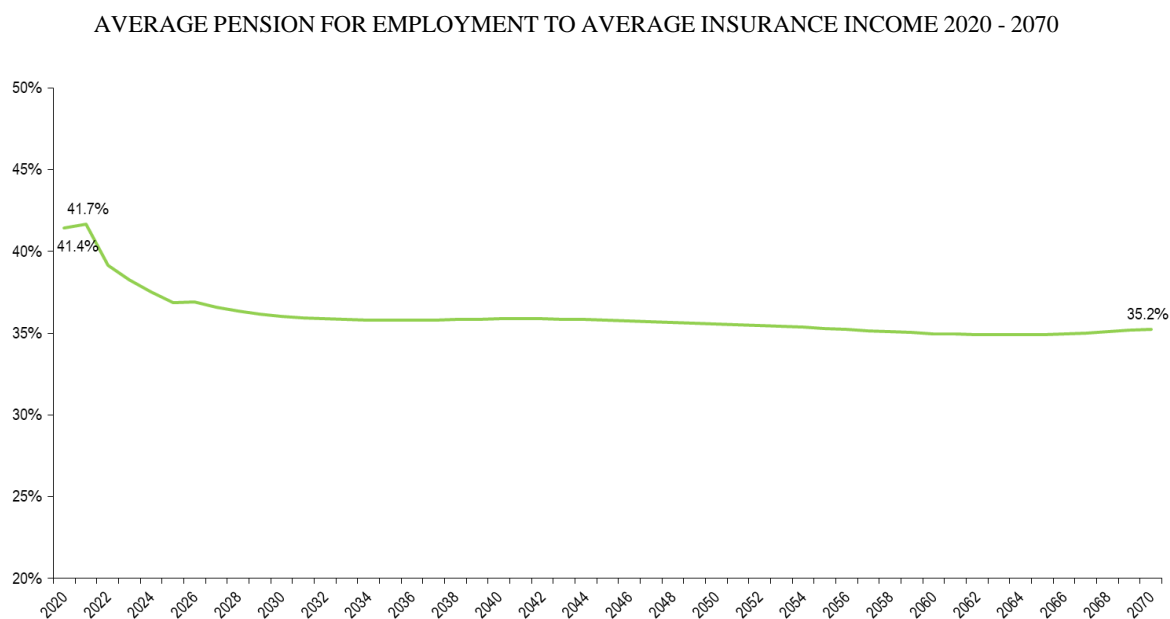
Source: NSSI

**Reduction of the income replacement ratio.** The income replacement coefficient is the ratio of the average pension for employment to the average insurance income of the insured persons for the respective calendar year. The annual updates on the amount of pensions from July 1<sup>st</sup> have an impact on the amount of pensions already granted. The size of the newly granted pensions is influenced by the increase of the average insurance income and the value of the percentage for each year of insurance service in the pension formula, which as of 2019 is 1.2. Other factors impacting the income replacement ratio are the minimum and maximum amounts of pensions, as well as the recalculation of some pensions from lower to higher.

At 41.4% in 2020, the income replacement ratio for 2021 is expected to increase to 41.7%, which is a result of the increase in the minimum pension for length of service and age of BGN 250.00 per BGN 300.00 and the maximum amount of the received one or more pensions from BGN 1200.00 to BGN 1440.00 as of January 1<sup>st</sup>, 2021. The replacement coefficient for 2021 is also influenced by the payment of supplements of BGN 50, 00 for each pensioner for the months from January to April. In the long run, the income replacement rate will decrease to about 35% in 2070. This process is most significantly influenced by the legislative requirement for reduction of the individual coefficient of pensioners who will be granted a pension by both the Social Security and the universal pension fund.

The replacement rate will be lower for retirees who are insured in both pillars. Their pensions will be reduced, according to the percentage of the insurance contribution that has been transferred to the second pillar, taking into account the number of months during which the person was insured in a universal pension fund compared to the total length of his insurance period, but they will receive a second pension from a universal pension fund. The reduction in the amount of pensions granted in the last quarter of 2021, when women born in the early 1960s will acquire the right to a pension for length of service and age, will be about 9 percent, and this percentage will increase until about 25 percent for pensions granted after 2050. This is because the entire insurance record of the persons who will retire then will cover periods after 2001 with insurance in a universal pension fund. It is important to note that the value of the reduction is different for each individual pensioner and depends on the specific period that covers his/her insurance period.

**Chart 5-3: Average pension for employment to average insurance income 2020-2070**



Source: NSSI

### 5.2.2. Healthcare

In recent years, there has been a steady increase in health care spending, as its level reached 5% of GDP (according to COFOG) in 2019. The increase in costs is mainly determined by factors such as the demographic structure of the population, related to the progressively increasing share of the elderly population, the introduction of new treatments, the dynamically changing medical technologies and equipment, as well as the rising expectations and requirements of people for protection from health risks and access to high quality medical care.

In the long run, population ageing will have an impact on health and long-term care expenditures. Although healthcare is targeted at different age groups in society, per capita spending, as a percentage of GDP, is expected to increase with age. The combination of a sharp decline in the working age population and the expected increase in the demand for health care from the elderly population determines the growing financial burden for workers, as well as an increase in the total cost of health care.

**Table 3-2: Health expenditures<sup>28</sup> in % of GDP**

	2019	2030	2040	2050	2060	2070
MoF	5.0	5.2	5.4	5.5	5.4	5.3
2021 Ageing Report	4.9	5.1	5.3	5.5	5.4	5.4
2018 Ageing Report	5.5	5.7	6.0	6.1	6.0	5.8
Population share 65+	21.3	24.3	27.3	30.7	32.6	31.0

Source: MoF, The 2018 Ageing Report, The 2021 Ageing Report(forthcoming)

As shown in Table 5-2, the expected increase in health care expenditures is due to a deterioration in the demographic structure of the population. The share of persons over the age of 65 will be growing significantly, by more than 10 percentage points by 2060. Given that in most

<sup>28</sup> The values in the aging reports represent the sum of health care costs and long-term care costs. The forecasts from the Report are based on data from the System of Health Accounts, while the forecasts of the Ministry of Finance are based on data from the General Government expenditure by function (COFOG)

cases the basic healthcare expenditures of an individual are incurred in the years immediately before death, the aging of the population logically leads to an increase in the health care expenditures of the elderly population compared to the total expenditures. The share of total health expenditure is expected to increase from 5% of GDP in 2019 to 5.5% in 2050 and then slightly decrease to 5.3% in 2070. Similar dynamics is expected in the Population Ageing Report. The forecast for long-term healthcare expenditures is based solely on the population forecast. Such a scenario is very restrictive. It does not imply a change in public health spending policy in the context of expanding budget-funded health services. Also, according to many econometric studies, technical progress and other non-demographic factors are among the main reasons for rising healthcare expenditures in developed countries. For this reason, in addition to the basic one, the Population Ageing Report examines 11 other scenarios for the development of healthcare expenditures related to different demographic and economic dynamics. According to them the expenditures in Bulgaria in the period 2019-2070 will increase by 0.2 percentage points to 2.2 percentage points, with the largest increase in a scenario involving factors other than demographic as innovations in medical technology.

### 5.2.3. Education

**Table 3-3: Education expenditures in % of GDP**

	2019	2030	2040	2050	2060	2070
MoF <sup>29</sup>	3.9	4.3	4.2	4.5	4.7	4.6
2021 Ageing Report	2.9	3.1	3.0	3.2	3.4	3.3
2018 Ageing Report	3.0	3.3	3.3	3.5	3.8	3.7

Source: MoF, The 2018 Ageing Report, The 2021 Ageing Report (forthcoming)

The MoF's forecast of public spending on education is based on the long-term demographic forecast and the assumption that spending will be indexed to an increase in nominal labour productivity. In the period after 2040, the stabilization of the demographic dynamics of the population up to 18 years is expected to lead to a gradual increase in total education expenditures.

## 5.3 Contingent Liabilities

The guaranteed debt of the General Government sector at the end of 2020 amounted to BGN 253.8 million or 0.2% of GDP, recorded an increase compared to the level reported at the end of 2019 (BGN 143.7 million or 0.1% of GDP). The dominant share in the sectoral structure of the guarantees is occupied by the guarantees issued in the “Other” category - 44.0% (of which 32.7% or BGN 83.0 million are guarantees under the European Instrument for Temporary Support in order to mitigate the risks from unemployment in extraordinary circumstances following the outbreak of COVID-19 (SURE), followed by domestic guarantees under the Student and Doctoral Candidate Loans Act - 28.5% and guarantees for the energy sector with a share of 27.4%.

In the period, the nominal amount of the guaranteed debt of the General Government sector is expected to continue to increase and at the end of the period to reach up to about 0.4% of GDP. The projected increase in debt is due to planned disbursements on the government-guaranteed loan from the European Investment Bank for the implementation of the project Gas Interconnector Greece-Bulgaria (project IGB), provision of guarantees under the SURE instrument and the EIB Pan-European Guarantee Fund, as well as forecast assumptions on the provided state financial support in lending to students and doctoral candidates.

<sup>29</sup> General Government expenditure by function (COFOG)

The guaranteed debt of the General Government sector is formed mainly by the guarantees issued by the Central Government sub-sector with a share of 99.4%. The Local Government sub-sector accounts for around 0.6% and the Social Security Funds sub-sector cannot issue guarantees.

In 2020, following the outbreak of the pandemic caused by COVID-19 at European Union (EU) level, the European Temporary Support Instrument to mitigate the risks of unemployment in exceptional circumstances (SURE) and the Pan-European Guarantee Fund were established. The country's participation in them was ensured through an amendment to the State budget Act for 2020, providing for the possibility for the National Assembly to ratify the relevant guarantee agreements during the year.

In September 2020, the National Assembly ratified the Voluntary Guarantee Agreement according to Art. 11 of Council Regulation (EU) 2020/672 SURE - European instrument for temporary support to mitigate the risks of unemployment in an Epidemic Emergency situation following the outbreak of COVID-19, between the European Commission and the Republic of Bulgaria in the amount of EUR 107,466,500 (BGN 210,186,204.70).

In October 2020, the National Assembly also ratified the Agreement on Contribution between the Republic of Bulgaria and the EIB with regard to the Pan-European Guarantee Fund in response to COVID-19 I Agreement on Guarantee at First Request between the original guarantors and the subsequent guarantors and the EIB. The amount of the guarantee is EUR 51,251,027.24 (BGN 100,238,296.60), which corresponds to the participation of the Republic of Bulgaria in the EIB capital by 0.21%.

In accordance with item 1.11 of Decision No. 64 of the Council of Ministers from January 22<sup>nd</sup>, 2021 for the budgetary procedure for 2022 and in connection with Art. 73, item 8 of the Public Finance Act, the object of monitoring are all state and municipal enterprises with a total amount of liabilities as of December 31<sup>st</sup>, 2019 over 0.1% of the Gross Domestic Product of the country, which are not part of the Consolidated Fiscal Programme and do not fall within the scope of the General Government sector. They should provide information and an estimate of the revenue and expenditure forecasts and the assets and liabilities with reporting data for 2019 and 2020, an estimate for 2021 and a forecast for the period 2022-2024.

The enterprises falling within the scope of this criterion are included in the Guidelines BU No. 1 / February 10<sup>th</sup>, 2021, according to a list provided by the NSI.

Based on the received information, for the four-year period 2021 - 2024 a decrease in the liabilities of the state-owned companies from the non-financial sector, subject to monitoring, by 34.6% is forecasted. The amount of the long-term and short-term liabilities of these companies reported as of December 31<sup>st</sup>, 2020 is a total of BGN 8.4 billion, and as of December 31<sup>st</sup>, 2024 the forecasts are the same to amount to BGN 5.5 billion.

The total debt ratio decreased from 0.77 as of December 31<sup>st</sup>, 2020 to 0.46 at the end of the period. The total debt-to-assets ratio of these companies decreased by 0.12 over the forecast period to 0.31. The liquidity ratio remains stable at a level of over 1.50 throughout the period 2020 - 2024.

## 6. QUALITY OF PUBLIC FINANCES

### 6.1 Policy Strategy

The policy strategy in the area of the quality of public finances retains its focus on the institutional, legal and methodological changes aimed at the improvement of the public finance management.

Achieving a sustainable medium-term fiscal framework and its execution are related to the implementation of a number of measures aimed at improving the quality of public finances, including improving the budgetary process, improving budgetary documents, promoting the implementation of good budgetary practices and monitoring the effects of sectoral policies.

Despite the challenges posed by the pandemic and the struggle to overcome its consequences, the efforts to achieve a better link between the financing of policies and the results achieved by their implementation are continuing.

In recent years, the practice of including in the Medium-Term Budget Forecast information on the key indicators for measuring the degree of achievement of policy objectives pursued by the executive authorities has been established. In the medium-term, the accumulation of information on the defined key performance indicators is expected to contribute to the creation of a sustainable basis for monitoring and tracking trends, as well as to assessing the relationship between the strategic goals of budgetary organisations and their policies / budgetary programmes.

In connection with the decision to extend the scope of programme budgeting in 2019, the classification of policy areas / functional areas and budgetary programmes was also expanded, defining functional areas and budgetary programmes of the newly appointed first level budgetary spending units. In 2020, with the inclusion of the National Audit Office, practically all budgetary organisations included in the state budget were covered, with the exception of the institutions and structures of the judiciary.

Notwithstanding the permanent regulation of the budgetary framework established by the Public Finance Act, efforts to improve the regulatory framework in the budget area continue, accompanied by monitoring and analysis of the implementation of budget legislation and budgetary practices, as well as compliance with the fiscal rules.

The quality of public finances is based on the developed macroeconomic and budgetary forecasts in support of the prudent fiscal policy pursued by the government, and for this purpose a corrective is needed - an independent authority with its own functions to promote the sustainability of the budgetary framework, including not only the monitoring for compliance with fiscal rules, but also the existence of corrective mechanisms in case of deviations from the targets set. The strengthened framework for fiscal governance within the EU has expanded the role and formalized the tasks of national independent fiscal institutions which has found a place in national legislation.

The effective interaction of the Ministry of Finance with the Fiscal Council in the preparation of the main budgetary documents contributes to the improvement of the quality and reliability of information and data based on the analyses, assessments and recommendations of the Fiscal Council. The Fiscal Council also contributes to the increase of accountability and improvement of fiscal transparency by monitoring compliance with numerical fiscal rules and indicating potential budgetary risks.

The accession of the Republic of Bulgaria to the Organisation for Economic Cooperation and Development (OECD) is a top priority for the country because the activity of this organisation covers almost all aspects of the socio-economic life. The government of the Republic of Bulgaria has clearly declared its intentions for enhanced cooperation with OECD, and in 2017 a permanent Interdepartmental Coordination Mechanism was established on the candidacy of the Republic of Bulgaria for membership in the organisation.

Based on an Agreement between the Ministry of Finance of the Republic of Bulgaria and the Organisation for Economic Cooperation and Development to conduct a budget review of Bulgaria, the Republic of Bulgaria was given the opportunity to be assessed for compliance with the OECD Council Recommendation on Budget Governance (2015), which provides a possibility for comparison with established international standards and best practices in the budgeting and fiscal management process.

Preliminary OECD assessments point to the stable economic growth in recent years, as well as the sound state of public finances - low government debt and budgetary balance. The main strengths are the Medium-Term Budget Forecast and budgetary forecasting in line with the European System of Accounts, fiscal rules, the good development of programme budgeting, and the increase in budget transparency and accountability in recent years. Regarding the quality of public finances, the initiatives for prioritization of key indicators, for conducting expenditure reviews, as well as the developed methodology for conducting expenditure reviews are noted. The importance of the independent fiscal institution - the Fiscal Council, and the National Audit Office which has important functions in terms of financial reporting, was noted. Capital budgeting is noted to be integrated into the government's overall fiscal policy, and the Council of Ministers has adopted a framework for approving capital investments. The final report was completed in 2020 and is expected to be published in the OECD Journal on Budgeting in 2021.

At the end of April 2020, the results of the seventh study of the International Budget Partnership (Walnut Budget Survey) for 2019 were published. It should be noted that the assessment of Bulgaria's budget transparency by the survey increased from 66 points in 2017 to 71 points which is the average for OECD member countries. Thus, the country remains in the second group of countries in the index with a score between 60 and 80 (out of a maximum of 100) - these countries are considered to provide "significant information" regarding the budget.

The Open Budget Index is the only internationally independent comparative study of budget transparency that assesses the extent to which the governments of 117 countries around the world provide the public with timely and detailed budget information. The index covers the procedures for drawing up, adopting, implementing and reporting the budget and the responsibilities of other institutions such as the National Audit Offices and the legislature in the budget process.

Bulgaria has been participating in the Open Budget Survey since 2006, when it achieved 47 points, and over time our country has significantly improved its score to 71 points in the latest edition of the 2019 index.

Overall, the Government in Bulgaria provides a significant amount of information through the eight types of key budget documents that are subject to evaluation. Undoubtedly, the preparation and publication of a "Citizens Budget" at various stages of the budget process has been essential to the progress made in recent years.

In terms of public participation, our country achieves a score of 26 points (out of a maximum of 100), as this indicator assesses the formal opportunities provided to the public to participate in various budget initiatives.

The assessment for budget oversight is 63 points (out of a maximum of 100), as the indicator assesses the functions of the legislative and supreme audit institutions to ensure budget monitoring.

## 6.2 Composition, efficiency and effectiveness of expenditure – COFOG

The expenditures under the **General public services** function increase their share from 2.8% of GDP in 2019 to 3.3% in 2023. The increase of its share is due to the increase of the expenditure for science and for executive and legislative authorities.

The expenditures under the **Defence** function increase as a share of GDP from 1.2% to 2.3% due to the action taken for modernization of the Bulgarian Army. Provisions of aviation equipment and basic combat equipment for the construction of battalion battle groups are envisaged, as the requirement for reaching defence expenditures up to 2% of GDP is met, in accordance with the National Plan for increasing defence expenditures of the Republic of Bulgaria until 2024.

The expenditures under the **Public order and safety** function decrease from 2.8% of GDP in 2019 to 2.6% of GDP in 2023.

The expenditures under the **Economic affairs** function decrease from 6.5% of GDP in 2019 to 6.2% of GDP in 2023. This decline is mainly due to lower capital expenditures in the transport and communications sector. The function includes state-owned enterprises that are part of the General Government sector and eliminates the costs related to European funds, which according to the ESA 2010 methodology do not have an impact on the revenues and expenditures of the General Government sector.

The expenditures under the **Environmental Protection** function increase their level from 0.7% of GDP in 2019 to 0.8% of GDP at the end of period under review. The costs of the function include measures in the field of protection and use of environmental components; for the national environmental monitoring system; to address climate and environmental challenges; for the maintenance, modernization and construction of the technical infrastructure related to the improvement of the transport accessibility and the integrated management of the water resources and geoprotection, and for the financing of programs for elimination of the caused damages on the environment.

Under the **Housing and Community Amenities** function in 2019 the expenditures accounted for 1.2% of GDP. In 2023 a minimal decrease to 1.1% of forecast GDP is envisaged.

The expenditures under the **Health** function increase from 5.0% of GDP in 2019 to 5.6% of GDP in 2023. Expenditures under the function include measures to strengthen the role of prevention as an opportunity for better health and quality of life; ensuring financial stability and security of the healthcare system; development of e-health and overcoming regional imbalances, as well as ensuring functional interaction between the different levels of medical care.

The expenditures under the **Recreation, Culture and Religion** function remain at the same level of 0.7% of GDP in the period under review.

The expenditures under the **Education** function increase their level from 3.9% of GDP in 2019 to 4.2% in 2023, including measures aimed at reducing inequalities and promoting social inclusion, motivating children and students to education and learning key competences. In the perspective until 2030, for the provision of quality education for all lifelong learning, the policies in the field of education and training are envisaged to cover each of the stages of personality development, following the principles of lifelong learning, to be oriented towards increasing the scope and quality of education and training.

The significant increase in expenditures under the **Social Protection** function from 11.5% of GDP in 2019 to 13.1% of GDP in 2023 reflects the increase in social transfers due to the measures and policies taken in previous years, which continue to have a fiscal impact in the forecast period, such as the increase in the hourly rate for the work of personal assistants, the increase in the poverty line, a new calculation of the individual coefficient for employment pensions, recalculation of pensions with a reduced individual coefficient and recalculation of pensions with acquired after retirement additional length of service.

**Table 6-1: Budget expenditure by function**

	% of GDP	
	2019	2023
1. General public services	2.8	3.3
2. Defence	1.2	2.3
3. Public order and safety	2.8	2.6
4. Economic affairs	6.5	6.2
5. Environmental protection	0.7	0.8
6. Housing and community amenities	1.2	1.1
7. Health	5.0	5.6
8. Recreation, culture and religion	0.7	0.7
9. Education	3.9	4.2
10. Social protection	11.5	13.1
<b>11. Total expenditure</b>	<b>36.3</b>	<b>39.9</b>

Source: MoF, NSI

## 6.3 Structure and Efficiency of Revenue Systems

### Tax Policy and Legislation

The tax policy of the Republic of Bulgaria is oriented towards ensuring macroeconomic and budget stability in the medium and long term, as well as the necessary financial resources for the implementation of the fiscal policy of the government. At the international level, tax policy is aimed at supporting the functioning of the European Union's single market and meeting the challenges of globalization and the digitalization of the economy.

Adhering to the principles of fairness and efficiency, the tax system develops in a way that is conducive to growth and ensures an increase in budget revenues. In this regard, the goals and measures of the tax policy to increase revenue collection, to reduce tax fraud, to prevent tax evasion, to deal with the shadow economy and to reduce the administrative burden and costs for businesses and citizens play an important role.

Continuing is the work related to the participation of the Republic of Bulgaria in the activities for the implementation of the already agreed by the Organisation for Economic Cooperation and Development (OECD) four minimum standards and other elements of the package of measures under the Project "Base Erosion and Profit Shifting" (BEPS), in connection with the accession of the Republic of Bulgaria to the OECD Inclusive Framework for the implementation of the project measures for the shrinking of the tax base and the transfer of profits (Minutes No. 13.37 of the meeting of the Council of Ministers on March 30<sup>th</sup>, 2016). The introduction of the minimum standards is also related to the fulfilment of Bulgaria's obligations as an EU member state.

During this period, the participation of Bulgarian experts in the activities related to the discussion, analysis and impact assessment of the measures planned by the OECD to address the tax challenges posed by the digitalization of the economy and the unresolved issues related to the transfer of profits will continue: Pillar 1 (redistribution of tax rights) and Pillar 2 (minimum



taxation of profits of multinational enterprises). The reform is expected to increase corporate tax revenues, significantly reduce profit transfers and increase tax security.

The European Commission's top priority for action to address climate and environmental challenges involves Bulgaria's commitment to taking steps in tax legislation to achieve the European Union's goals in areas such as energy taxation and promoting the use of environmentally friendly vehicles.

The main objective remains pursuing a policy aimed at increasing revenue collection and achieving the set budget objectives while maintaining the burden of taxation. The measures envisaged in the revenue policy are aimed at ensuring the necessary financial resources for the implementation of the government's expenditure policies. Improving revenue collection is the leading line in the specific recommendations made to Bulgaria by the Council of the EU in recent years. Many of the measures in the field of tax policy are of a permanent nature and are included in the strategic documents that each of the responsible institutions develops and implements, and they will continue to be implemented in the period under review. The main tools for minimizing the losses from uncollected tax revenues in the budget are the ongoing interaction of institutions and the exchange of information on a national and international level, as well as the reduction of administrative burdens and costs for businesses and citizens.

The main permanent measures include: Mechanism for VAT reverse charge for supplies of goods and services; Implementation of fiscal control over the movement of goods with high fiscal risk (HFRG); Mechanism for repayment of public liabilities of persons with receivables from municipalities, other departments or state enterprises under public procurement contracts and those awarded in implementation of EU operational programmes; Continuous monitoring of debtors with overdue debts above a certain amount; Promoting voluntary compliance with legislation; Control over the supply and movement of liquid fuels; Reduction of the administrative burden.

### **Legislative amendments in 2020**

#### **To increase budget revenues and combat tax fraud - measures to improve compliance with legislation, prevention and counteraction to tax fraud and tax evasion.**

In order to optimize the preparation of annual tax returns under Art. 92 of the Corporate Income Tax Act (CITA) of companies and improving the process of annual accounting closing, the Act adopted an amendment that shifts the date of filing annual tax returns under CITA, replacing March 31<sup>st</sup> with the period from March 1<sup>st</sup> to June 30<sup>th</sup> of the respective year. The date for payment of the corporate tax is changed, as the deadline on March 31<sup>st</sup> is replaced by the deadline on June 30<sup>th</sup>. In connection with the postponement of the end-date for declaring and paying the annual taxes of legal entities under CITA, the deadline for declaring and paying the annual taxes for persons engaged in economic activity as traders within the meaning of the Commercial Law, including sole traders or natural persons registered as farmers who have chosen to tax the income from their economic activity with tax on the annual tax base in the Personal Income Tax Act (PITA) has been postponed as well. In connection with the change of the end-date for filing annual tax returns under CITA, the deadline in Art. 38 of the Accounting Act for publication of the annual financial statements, the consolidated financial statements and the annual reports under Chapter Seven, has been extended. For the enterprises that did not carry out activity during the reporting period, the deadline for declaring this circumstance has been extended until June 30<sup>th</sup> of the following year (once for the first reporting period without activity). Respectively, the deadline during which the Registry Agency provides the NRA with a list of enterprises that have applied for declaration in the commercial register and the register of non-profit legal entities declaration under Art. 38, para. 9, item 2 of the Accounting Act, has been extended until July 31<sup>st</sup>.

Amendments have been adopted with regards to the deadline and the manner of declaring advance payments for the current calendar year (according to Art. 87a, para 1 of CITA in the period from March 1<sup>st</sup> to April 15<sup>th</sup> of the same year). The deadline for submitting the declaration for changes in the advance payments for corporate tax under Art. 88 of CITA has been changed. The aim is to ensure greater predictability of tax revenues in the budget, to obtain timely information on revenues to the State Budget for December which will allow more accurate planning and implementation of expenditures by budget spending units at the end of the financial year.

The VAT reverse charge mechanism applies to supplies of goods and services listed in Annex No. 2 to Chapter Nineteen (a) of the Value Added Tax Act (VATA) and is an effective tool for counteracting and combating VAT fraud. In this regard, an extension of the deadline for implementation of the measure until June 30<sup>th</sup>, 2022 has been accepted.

In 2020, the provisions of Directive 2017/2455 and Directive 2019/1995 were introduced in the VAT Act. They aim to improve the functioning of the VAT regime applied throughout the European Union in the context of the supply of services and distance selling of goods, and import of low value shipments. The new provisions cover: intra-Community remote sales of goods; remote sales of goods imported from third countries or territories; internal remote sales and deliveries facilitated by a person operating an electronic interface. The amendments aim to improve and simplify certain rules in the VAT system, in the context of the supply of services and remote selling of goods and certain domestic supplies of goods, in order to improve the collection of tax revenues and alleviate administrative burdens.

An amendment has been made to the Excise Duties and Tax Warehouses Act (EDTWA), related to the harmonization of national legislation with the case law of the Court of Justice (Decision C-306/2014) regarding the conditions under which the paid excise duty on ethyl alcohol that has been invested in the production of medicinal products within the meaning of the Law on Medicinal Products in Human Medicine and veterinary medicinal products within the meaning of the Law on Veterinary Medical Activity is refunded.

The legislative changes undertaken in Art. 47, para. 7-11 of EDTWA (promulgated, SG, issue 44 of 2020) aim to create a normative possibility for keeping separate records of the oil pipeline and of the bases for storage and / or production, thus facilitating control and allowing for the inventorization of each of the tax warehouses, as well as creating an opportunity to establish the quantities in the oil pipeline and bases at any time. After the changes, the competence (the competent territorial directorate) for carrying out the customs control and for establishing the arisen obligations for excise duty, as well as for the observation of the requirements of EDTWA, respectively of possible established violations, is more clearly defined.

The State Reserves and Wartime Stocks law (promulgated, SG No. 65/2020) establishes the normative establishment of a state enterprise “State Oil Company” under the Minister of Economy, which will perform all the functions of the state reserve for storage and renewal of reserves of petroleum energy products. The change is related to the optimization of the activities for creation and management of all reserves and stocks of oil and oil products in order to ensure their sustainable maintenance. The aim is to improve competition in the internal market through state participation in the fuel market, which will benefit end-users and contribute to increasing the number of tax warehouses in the fuel sector. A positive budgetary impact and an increase in excise revenues are expected.

The mechanism for repayment of public debts of persons with receivables from municipalities, other departments or state-owned enterprises under public procurement contracts and those assigned to the implementation of EU operational programs by directing enforcement against third party debtors, such as specified, has been improved. This is one of the main measures for collecting public debts from debtors who are contractors under contracts with persons - authorizing officer. The measure is of a permanent nature and has been introduced and improved with

DCM No. 788/2014, DCM No. 593/2016, DCM No. 592 from 2018 and DCM No. 681 from 2020.

**To improve the business environment and reduce the administrative burden and costs for businesses and citizens**

The deadline for application for the tax relief for carrying out production activity in municipalities with unemployment, higher than the average for the country, has been extended in the cases of minimum aid under Art. 188 of CITA until December 31<sup>st</sup>, 2023 and in the cases of regional development aid under Art. 189 of CITA until December 31<sup>st</sup>, 2021.

The CITA and the Personal Income Tax Act have equalized the regime of tax treatment of income from disposal of financial instruments and income from interest on bonds and other debt securities traded on a regulated market with those traded on a growth market (until December 31<sup>st</sup>, 2025). The amendment is in relation to the introduction of a legal opportunity to organize a growth market within the meaning of Art. 122, para. 1 of the Markets in Financial Instruments Act, which provides an opportunity for small and medium enterprises to raise capital under more lenient conditions regarding the scope and periodicity of the information disclosed by them and on the basis of the publication of a simplified prospectus.

A change has been made in the Personal Income Tax Act to synchronize the provisions of the Personal Income Tax Act with those of the Personal Data Protection Act and in parallel to create clearer rules concerning the obligation of individuals to issue documents when doing business or receiving rental income. With the amendment, when the payer is a natural person, it will not be necessary to issue a document when the payment is by bank transfer. In the case of cash payment, a document that does not contain data on the person who pays the income, when the same is a natural person, will be issued. The requirement to issue a primary accounting document with data on the person paying the income is retained only for the cases when the person paying the income from another economic activity is an enterprise or a self-insured person who keeps accounting records and does not issue an invoice for paid amounts.

A new type of tax relief has been introduced in the Personal Income Tax Act for persons using services for repair activities. The purpose of the tax relief is for individuals who have made improvements and / or repairs in their own homes during the year, when the conditions specified in the law are met, to be able to reduce the total amount of their annual tax base with the actual labour costs paid by them to the natural or legal persons who have performed the repairs or improvements, in a total amount of up to BGN 2,000.

With an addition made in Article 130a of the Tax and Social Insurance Procedure Code (TSIPC), a procedure has been created for the use of the overpaid amounts under a submitted tax return so that they can be used for subsequent payments. This possibility will be exercised only at the expressed request of the taxpayers.

In view of the established problems hindering the activity of the economic entities, when introducing the requirements of Ordinance No. H-18, which should be met by the software for sales management at commercial sites (SSMCS), changes have been made in Art. 118 of the VAT Act for cancellation of the obligation to implementation. In order to promote voluntary compliance with tax and social security legislation, the use of SSMCS is maintained but as a voluntary measure and option for choice by the merchant. In order to stimulate its use and to guarantee the investments already made by the merchants for the introduction of SSMCS, some reliefs are provided for the persons - possibility for accelerated refund of the VAT tax credit, non-imposition of a compulsory administrative measure “sealing of a commercial site” in case of first violation for non-issuance of a fiscal receipt, as well as accelerated depreciation under CITA of the software and hardware on which it is installed.

It has been decided that the requirement provided for in the Local Taxes and Fees Act (LTFA) for the purposes of the real estate tax, that the completion of a building or parts thereof to be established not only with a certificate of commissioning or a permit for use issued by under the Spatial Planning Act (SDA) but also with the presentation of a certificate issued by the Agency for Geodesy, Cartography and Cadastre (AGCC), is to be repealed. The envisaged change is related to the amendment to the Law on Cadastre and Property Register, according to which AGCC allows the bodies that put the works into operation to access the information system of the cadastre and perform an official check on whether a construction has been registered in the cadastral map and the cadastral registers. The amendment is aimed at reducing the administrative burden for taxpayers and the administration and at improving the quality of services and activities provided in the process of administrative services.

With an amendment to the Agricultural Producers Support Act (APSA), promulgated in the State Gazette, issue 103 from December 4<sup>th</sup>, 2020, the term for application of the scheme for "State aid in the form of a discount on the value of excise duty on gas oil used in primary agricultural production" has been extended until December 31<sup>st</sup>, 2023. The legal framework for the implementation of the assistance is regulated in the provisions of Art. 47a and the following from APSA. From the point of view of the state aid regimen, the measure was assessed for compliance with the block exemption rules under Regulation (EU) No. 651/2014 (Art. 44) in 2016. Its extension is permissible under Regulation (EU) No. 972/2020, and amendments to the relevant legal basis are subject to coordination in the general order of the State Aid Act and its Implementing Regulations. The total amount of the provided state aid is approved annually by the State Budget Act of the Republic of Bulgaria for the respective year.

In relation to the activities for the preparation of the Customs Agency for transition to a single account for payments of excise duties, changes have been made in Art. 44 of the Excise Duties and Tax Warehouses Act (EDTWA). It is envisaged that each taxable person will have an open virtual account which will reflect the received payments for receivables under the excise legislation, and it is envisaged that these changes will come into force on January 1<sup>st</sup>, 2022.

Amendments have been made to Art. 75b of Excise Duties and Tax Warehouses Act (EDTWA), which aim to optimize the administrative activity in terms of the amount of established liabilities in a particular tax period, as well as the conditioned need to avoid difficulties in issuing acts for which the relevant excise duty is paid in the country.

Specified is the provision of Art. 43, para. 5 of the Excise Duties and Tax Warehouses Act (EDTWA) in order to avoid difficulties in determining the last tax period in the cases of a decision for termination of license / registration where the preliminary implementation has been suspended and subsequently entered into force after a court appeal.

When issuing a certificate for an excise-exempt end-user, it is regulated that in the course of the procedure for issuing the certificate for establishing the quantity of excise goods invested in the final product and for determining the Combined Nomenclature (CN) code, the competent customs authorities have an obligation to take samples for laboratory analysis at each stage of the production process.

A legal framework has been established which will regulate the cases when, if necessary for the licensed warehouse keepers and, under certain conditions, they can exceed the required and provided for the tax warehouse security, thus reducing the administrative burden compared to licensed warehouse holders who do not have delayed excise payments but in certain cases need to exceed the security provided.

Indicated are the cases where traders within the meaning of the legislation of another Member State of the European Union or of another state-party to the Agreement on the European Economic Area may carry out activities which are subject to mandatory registration under the Excise Duties and Tax Warehouses Act (EDTWA), and through a local legal entity-accredited

representative under the Value Added Tax Act, as the local legal entity-accredited representative is registered.

Clarified are the provisions which aim to prevent the transfer of property and other actions by the inspected persons where the customs authorities have found violations of the EDTWA and have taken actions to secure evidence representing excise goods.

A legal framework is created for these persons who wish to use the provided legal opportunity to use a certain part of the storage capacity of the licensed warehouse keepers.

In order to avoid the misuse of goods used for the production of so-called "designer fuels", provisions have been introduced regulating that the goods included in CN code 3814 are energy products within the meaning of the EDTWA, and an excise rate is determined. An excise rate was also introduced for lubricant materials with CN code 3403. Detailed are the regulations related to the requirements for the construction of the video surveillance system, as well as the procedure for its coordination with the customs administration.

Amendments and additions have been made in connection with the requirement introduced in Article 24a of the EDTWA (in force since 1 January 2020), excise-exempt end-users receiving energy products with CN code from 2710 12 to 2710 20 to use automated reporting systems and control means, as a corresponding sub-normative regulation has been introduced in Ordinance H-1 of 22 January 2014 on the specific requirements and control carried out by the customs authorities on the means for measuring and control of excise goods.

In order to limit the administrative regulation and the administrative control over the economic activity, as well as to reduce the administrative burden for the economic operators, an opportunity is provided for persons to indicate the individualising data of the respective document, on the basis of which to establish the information ex officio, by reference in the medium for inter-register exchange. In this regard, additions have been made to the relevant provisions. A new Article 101c of EDTWA has been added which is related to the documentary substantiation in the movement of excisable goods released for consumption from a tax warehouse or from sites registered under Art. 56, para. 1, or from a site of persons under Art. 57a, para. 1, item 1 of EDTWA. This change is a consequence of the lapse of the obligation for persons to fill in on paper Annex № 14b of the Regulations for Implementation of the Excise Duties and Tax Warehouses Act (RIEDTWA) which certified the exact address of the place of unloading of motor fuels. Thus, the legal norm will be applied when inspecting persons, recipients or suppliers of excisable goods released for consumption for which the submitted excise tax documents and / or invoices do not certify unambiguously that they are relevant to the excise goods, respectively that their excise duty was charged or paid. After the amendment, the bodies of the NRA and the customs authorities have the opportunity to trace the movement of fuel from the tax warehouse to the end user, respectively to certify its origin and whether indirect taxes have been paid for it.

The creation of Art. 101c of EDTWA led to changes in the administrative penal provisions, in particular in Art. 126 of ETDWA. According to the new wording of Art. 126, para. 2 of ETDWA (in force since 01 January 2021), the penalties under Art. 126, para. 1 shall also be imposed on the persons who hold liquid fuels released for consumption, for receipt, respectively for the subsequent delivery of which they have not submitted the required data to the NRA, while the submitted documents under Art. 126, para. 1 do not indisputably certify the accrual or payment of the excise duty.

## **Customs Agency**

### **Performed audits in connection with excise legislation for 2020**

Of the audits performed under the Tax and Social Security Procedure Code in connection with the excise legislation for 2020, 22 are with established liabilities and 14 are without established liabilities. The relative share of audits without established liabilities is 38.9%.

Out of a total of 36 audits performed (including - planned 18 and unscheduled 18), established liabilities for excise duty and default interest with an audit act (AA) are a total of BGN 11,465,905.46 (including for excise BGN 10 075 925, 61, for interest BGN 1 389 979, 85). Overpaid excise duty in the amount of BGN 1,887,769.28 was established with the AA. Excise and interest liabilities in the amount of BGN 42,425.45 were established from planned audits. Of unscheduled audits, liabilities for excise duty and interest in the amount of BGN 11,423,480.11 have been established. Of the total established liabilities for excise duties and interest in the amount of BGN 11,465,905.46 - the relative share of planned audits is 0.37%, and the relative share of unscheduled audits is 99.63%.

Compared to the same period last year, established excise duties increased by 57.3%.

### **Customs legislation.**

With the abolition of the threshold of EUR 10/22 for exemption from VAT on imports, starting on July 1<sup>st</sup>, 2021, all goods imported into the European Union (EU) will be subject to value added tax (VAT), regardless of their value. The implementation of the VAT package in the field of e-commerce also necessitated amendments to the customs legislation.

In order to ensure the collection of VAT on all goods imported from a third country into the EU, a customs declaration for release for free circulation must be submitted even for consignments with an intrinsic value not exceeding EUR 150. The processing of customs declarations for consignments with an intrinsic value not exceeding EUR 150 which are not subject to prohibitions or restrictions shall be effected by submitting a customs declaration for release for free circulation containing the specific data set out in Annex B to the Delegated Regulation (EU) 2015/2446 from July 28<sup>th</sup>, 2015 supplementing Regulation (EU) No. 952/2013 of the European Parliament and of the Council laying down detailed rules for certain provisions of the Union Customs Code, column H7 “Customs declaration of admission to free circulation of a consignment exempt from import duty in accordance with Article 23 (1) or Article 25 (1) of Regulation (EC) (1186/2009)”.

### **Projects related to the development and improvement of the integrated information systems of the Customs Agency.**

In 2021, the Customs Agency continues to implement a number of projects in accordance with the Roadmap for the implementation of the Sectoral Strategy "e-Customs" (2016-2025) which aims to improve the quality of administrative services to citizens and businesses by the improvement of existing electronic administrative services and the inclusion of new electronic services, reduction of the administrative burden, timely reflection of changes in regulations, improvement of the processes of transition to a paperless environment and others.

In 2020, within the framework of a project financed under contract No. BG05SFOP001-1.007-0001 for granting financial aid under the Operational Programme "Good Governance", the following priority activities have been implemented:

- The AM Identity and Access Management (AMS) system has been upgraded and brought in line with the Union functional requirements arising from UUM & DS Release 2;
- Conformance tests for acceptance of the developed functionalities of the module "National application of the Import Control System 2 (ICS2, Release1- postal and express consignments)" have been finalized. A Universal CCN 1/2 gateway has been implemented for the integration of the national domain of the Trans-European Systems of the

Customs Agency with the Common Domain and Red Hat AMQ Broker and the applications that use them. ICS2 Release 1 and the Universal CCN ½ gateway are expected to be the first applications running on it (Cloud Architecture);

- The activities for development and introduction of the Institutional Architecture of the AM regarding the module “Risk Analysis”, module “Risk Information Processing”, module “Administrative and Criminal Proceedings”, module “Declaration of Cash” and module “Register of obligations to the customs administration, automatic collection of debts and building an interface for connection to RegiX” have been initiated;
- The activities for development and introduction of the Institutional Architecture of the Customs Union for customs processes related to the expansion of the data warehouse (Data Warehouse) regarding the reference and analytical requirements of the target area "Development of the Customs Information System - BIMIS 2020" and more have been completed, in particular with regard to the Customs Information System for imports, Customs obligations, Customs information system for transit and Customs information system for exports.

Functionalities of the national import system have been changed in relation to the implementation of project 1.17 of MASP: use of the direct consultation service at the central IOSS-DR, use of the consultation service at the National IOSS register for validation of VAT numbers and processing of customs declarations. The need to implement the project stems from the amendments to the VAT legislation on VAT on e-commerce (VAT package), and the amendments to the customs legislation of the Union - Commission Delegated Regulation (EU) 2019/1143 from March 14<sup>th</sup>, 2019 amending the Delegated Regulation (EU) 2015/2446 as regards the declaration of certain low-value consignments and Commission Implementing Regulation (EU) 2019/1394 from September 10<sup>th</sup>, 2019 amending and correcting Implementing Regulation (EU) 2015/2447 as regards the declaration of certain rules for monitoring the release for free circulation and for leaving the customs territory of the Union.

Versions of modules of the Bulgarian Excise Centralized Information System (BECIS) have been put into operation with implemented changes, according to the European specifications for implementation of planned activities for EMCS phase 3.4 and SEED 1.20.

The project "Changes in the Module Road Tolls and License Regime (PTRR) module - transitional project" has been completed. Integration has been implemented between the ATUF module and the information system of the National Toll Management in the Road Infrastructure Agency for checking the regularity of a vehicle in the information system of the National Toll Management, payment of a compensatory and maximum fee and issuance of an Act for establishment of an administrative violation. The effect of the project is the faster processing of border traffic.

In order to prepare for the accession of the Republic of Bulgaria to the euro area, with regard to the payment of public receivables and fulfilment of the requirements of the Union legislation aimed at eliminating the differences between national and cross-border payments within the single euro area, the implementation of project "Upgrading the Customs Agency's information systems to close the gap between national and cross-border payments within the Single Euro Payments Area (SEPA)" continues.

Foreseen in 2021 is the implementation of the following projects for the Customs Agency:

Project 3.3.1.39 of PG-2021 for implementation of changes in the Module Road Tolls and License Regime (PTRR) for bringing to the current regulatory framework of the automatic calculation of due tolls for freight vehicles on a particular route, in the case of Art. 6, para. 1, item 3 letters (c) and (d) of Ordinance No. 11 from July 3<sup>rd</sup>, 2001 for movement of oversized and / or heavy road vehicles;

Project 3.3.1.41 for changes in the Customs Importing Information System (CIIS) regarding the processing of the certificate of completion, changes in the Customs Debt and Guarantee Management Module (CDGMM) for bringing the functionality of manual entry of documents in compliance with the requirements of Art. 66, para 3 of the Customs Act for oral declaration of goods, changes in the module "Follow-up control" of the Bulgarian Integrated Customs Information System (BIMIS PC) regarding the integration with the System for identification and registration of economic operators (EORI2) and CIIS.



## 7. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

### 7.1 National fiscal rules

The legal regulation of the budget framework also includes the definition of fiscal rules and restrictions. The international criteria about the rules and restrictions require that the action procedures be regulated on a statutory level in the presence of deviations from the targets set for an indicator, thereby ensuring predictability in the conduction of the fiscal policy and guaranteeing the sustainability of public finance.

With the adoption of the Public Finance Act and the Law on Fiscal Council and Automatic Correction Mechanisms, as well as their subsequent amendments related to achieving full compliance with European legislation, Bulgaria has fully met the requirements for strengthening and reinforcing economic governance in the EU. The rules meet internationally accepted definitions and criteria, and the requirements for aligning national fiscal planning with the preventive and corrective part of the SGP.

The legal framework of the Public Finance Act has a positive impact, as it guarantees that their long-term sustainability and universal criteria are introduced for the evaluation of the fiscal policy.

The fiscal rules in general impose restrictions on the fiscal policy on a national level but some of them impose numerical restrictions also on budgetary indicators of individual budgets, like these of the municipalities.

As regards the scope, there are rules for indicators both under the national methodology – for the budgetary balance and the expenditures under the Consolidated Fiscal Programme (on a cash basis) and for the state debt, as well as indicators in accordance with the European methodology – for the General Government (for some rules as well as for its relevant subsectors) – for the Medium-Term Objective for the structural deficit, the budget balance and the Consolidated General Government debt.

The evaluation of the fiscal policy is built on the combination of three types of fiscal rules – balance, debt and expenditure rules. All the three groups of rules are applicable to the parameters of key budget indicators both under the national and under the European methodology. The rules are further developed, as statutory requirements and procedures are introduced for the putting in place of corrective mechanisms and measures for returning to the objective or to the rule-determined restriction and the cases of deviation from the objective/restriction.

The legal framework regulating the fiscal rules and restrictions, as well as the results from their application, is subject to periodical review both on the part of the Government and of the authorities of the European Union and international financial institutions. In case of non-compliance of the rules governing the budget framework with the internationally adopted rules and practices in this field, as well as non-regulated public relations in the management of public finances which give rise to risks for the budget and for the adherence to the fiscal rules, the government takes the relevant regulatory measures. Since the adoption of the Public Finance Act in 2013 until the present three material amendments and supplementations have been adopted to the Public Finance Act, two of which were related to making more precise and further developing the regulation in view of improving the processes of public finance management and achieving full compliance with the requirements of Council Directive 2011/85/EU of November 8<sup>th</sup>, 2011 on requirements for budget frameworks of the Member States, as well as

creating conditions for the implementation of the relevant regulations adopted in the end of 2011. The third was adopted in order to provide greater flexibility in the event of extraordinary circumstances caused by unusual events. Managing and overcoming the consequences of the COVID-19 pandemic has led both to the activation of the General Escape Clause within the European Union and to the need to revise national numerical fiscal rules and their flexibility against the background of global economic and budget challenges.

As early as the adoption in 2016 of the Amending and Supplementing Act of the Public Finance Act, were resolved a number of issues relating to the need of taking action to set the budget position of municipalities in accordance with the requirements of the national fiscal rules applicable to municipalities pursuant to the PFA. Provided for were issues concerning the identification of municipalities in financial difficulty, the introduction of procedures for their recovery and the implementation of a financial recovery plan.

The financial recovery plans include measures in an annual and medium-term perspective for prioritization and optimization of the expenditures, for increasing the revenue collection rate, for decreasing and liquidating of obligations overdue, for decreasing the municipal budget deficit, as well as management and organizational acts towards the implementation of the plan for the purpose of achieving financial sustainability and stability of the municipal finances.

In line with the implementation of the amendments to the PFA, methodical guidelines were drawn up and criteria were approved for determination of municipalities with financial difficulties. Quarterly analyses are performed and the data for the financial condition of municipalities and for municipalities in a financial recovery procedure is published, while an evaluation is made of indicators for financial independence; financial sustainability and efficiency indicators; other indicators, such as the compliance with the fiscal rules; the presence as at the end of the year of obligations for expenditures under the budget of the municipality which exceed by 15 per cent the average annual amount of the reported expenditure for the past 4 years; the presence as of the end of the year of commitments undertaken of expenditure under the budget of the municipality exceeding by 50 per cent the average annual amount of the reported expenditure for the last four years; the presence as of the end of the year of municipal budget obligations overdue, which exceed by 5 per cent the expenditure of the municipality reported for the past year; the presence of a negative budget balance on the budget of the municipality for each of the last three years; the presence of an average collection rate for the real estate tax and the vehicle tax, which is under the average collection rate of the two taxes for all municipalities, as reported for the past year.

At the level of individual budgets, the legal commitments of the first level spending units' managers require within the framework of the managerial responsibility that budget discipline be observed, including the rules applicable to them. This also applies to stand-alone budgets, which are not part of the State Budget, as they affect the parameters of the budget framework at the national level.

In addition to the basic principles, rules and procedures relevant to all budget managers, the accumulated budget imbalances of local authorities and the inability to comply with the rules for municipalities are the reason for legal regulation of procedures for identifying municipalities in financial difficulties and creating financial recovery mechanisms.

For the relatively short period of application of the amendments to the PFA with respect to the created mechanism for financial recovery of municipalities, the number of municipalities defined as municipalities in financial difficulty decreases.

In 2021, for the municipalities where the term of the financial recovery procedure expires in 2019 or 2020, in order to fulfill their commitments for repayment of interest-free loans, the practice of approval by the Minister of Finance of their draft budgets continues. Three of these

municipalities in 2021 are defined as municipalities with financial difficulties, and it is mandatory for them in the preparation of their new financial recovery plans to include measures to optimize costs in the activity "Municipal Councils" and that the plans do not include the use of an interest-free loan for financial recovery.

In 2021, the procedure for municipalities with financial difficulties in the implementation of projects funded by the European Union was maintained, and for these municipalities the introduction of a resolution procedure and the implementation of a financial recovery plan is envisaged.

The existence of national fiscal rules and their simultaneous compliance with the rules and restrictions imposed by European legislation can be both an advantage and a challenge.

The adoption of the amendments to the Public Finance Act in 2020 was an adequate response to the emerging economic and financial emergency as a result of the COVID-19 pandemic, which would allow measures to be taken in strict compliance with the requirements of European legislation regarding fiscal rules and to free up the necessary fiscal space within national constraints and in compliance with financial discipline and fiscal sustainability.

The extremely dynamic situation and the need for swift budget decisions, including a reassessment of the parameters of the budget framework in the medium-term plan according to the provisions of the PFA, necessitated urgent consideration of changes in the rules and constraints underlying fiscal policy development, with regards to the preparation of the estimates on key budget indicators and are a guarantee for the long-term sustainability of public finances.

The main reasons for the amendments to the Public Finance Act are related to the introduction of norms for temporary deviation from the restrictions of the national fiscal rules in emergency situations in order to limit their procyclical impact.

With the adoption of the Law for Amendment and Supplementation of the PFA:

- opportunities are created for greater flexibility with regard to national fiscal rules in the event of exceptional circumstances;
- a clearer definition of limits and tolerances is achieved;
- the implementation of measures for limiting and overcoming the consequences of emergencies is ensured.

In addition, it should be noted that at European level, as an adequate and rapid response to the challenges posed by the COVID-19 pandemic, the legal possibilities to apply exceptions to the assessment of compliance with fiscal rules and restrictions by Member States have been activated. This was the main reason for the accelerated adoption of changes in the PFA in order to achieve synchronization of the legal norms of the European and national legislation regarding the admissible possibilities for deviations.

The changes concern both the indicators of the General Government sector (on an accrual basis) and the possible deviations in exceptional circumstances that are allowed in the applicable European legislation and the rules of the Stability and Growth Pact, as well as the indicators of the Consolidated Fiscal Programme (on a cash basis) for possible deviations in exceptional circumstances.

The created new para. 3 in Art. 25 allows the General Government deficit to exceed 3 percent of GDP on an annual basis in extraordinary circumstances (unusual events) outside the control of the Council of Ministers that have a serious impact on the financial position of the General Government sector.

The amendments in art. 26, para. 2 expand the possibility that in the presence of extraordinary circumstances beyond the control of the Council of Ministers which have a serious impact on

the financial position of the General Government sector the annual growth of expenditures to exceed the reference growth of the potential Gross Domestic Product, thus achieving consistency with Art. 24, para. 1. Furthermore, para. 3 shall ensure compliance of the terms for undertaking additional measures for return to the admissible restriction. The situation related to the outbreak of the COVID-19 pandemic has clearly shown that unusual events can lead both to the non-fulfillment of the Medium-Term Objective for the structural deficit on an annual basis and to the expenditure growth exceeding the reference GDP growth target, which is permissible as an exception under the rules of the Stability and Growth Pact.

With the amendments in art. 27 (para. 4 and 5), the regulation regarding the limit for the annual budget deficit under the CFP is changed and admissible possibilities for deviation from the limit are determined. The link between the possibility to exceed the 3% limit of the deficit on a cash basis in exceptional circumstances with the condition that the limit for the deficit of the General Government sector is not violated has also been abolished. This is aimed at greater flexibility in the presence of extraordinary circumstances, as the amount of the limit on the CFP deficit has been changed from 2 percent to 3 percent.

In order not to limit the absorption of funds from European funds and programs, an amendment has been made in Art. 28, para. 1, which excludes from the scope of the maximum amount of the expenditures under the consolidated fiscal program that shall not exceed 40 per cent of the Gross Domestic Product, the expenditures made from accounts for funds from the European Union, including other international programmes and contracts that have a regime of European Union funds' accounts, as well as the related national co-financing. The changes in the Public Finance Act regarding the fiscal rules provide an opportunity for the restrictions to be in line with the dynamic challenges in compliance with the requirements of the European legislation.

The Fiscal Council contributes to improving the quality of the budget framework and is a guideline for the government's fiscal policy, given its functions of monitoring compliance with numerical fiscal rules and indicating potential risks to the budget. With the 2019 amendments in the Law on Fiscal Council and Automatic Correction Mechanisms, the powers of the Council have been further strengthened by introducing an obligation to perform periodic and ex post evaluation of the macroeconomic and budget forecasts of the Ministry of Finance. In this way, full transposition into Bulgarian legislation of Directive 2011/85 / EU on the budget frameworks of the Member States has been achieved, and the role of the Fiscal Council as an independent observer of fiscal rules has been further strengthened.

## 7.2 Budget procedures

### **Budget procedure for 2022**

Budgeting is a constant process but the stages and steps for the implementation thereof are subject to many factors – organisational, economic, political, statutory and others, which pre-determine the need for the development of a timetable for the organisation of the process of planning and composition of the budget documents.

The Public Finance Act states that the budget procedure includes the stages, deadlines, distribution of responsibilities and requirements for compiling both the Medium-term Budgetary Forecast and the draft State Budget. The constant strive to improve the quality of the budgetary documents as a form of expression of the good management of the public finance requires that the budget procedure takes into account both the varying requirements to all responsible institutions, and the requirements to Bulgaria as a Member State within the so-called European Semester – the timetable, through which consistency of the national economic and budget policies is implemented within the European Union.

The budget procedure for 2022 was drawn up in accordance with the rules and requirements of the Public Finance Act, as its preparation reflected the requirements set for the structure and

contents of the key budget documents, deadlines and the responsible budget organisations, as well as the deadlines and responsibilities of the executive branch in relation to functions of the Fiscal Council within the budget process. The procedure was approved with Decision No. 64 of the Council of Ministers of January 22<sup>nd</sup>, 2021.

It should be noted that the 2022 budget procedure provides a return to the standard stages in the budget preparation and adoption process after the 2021 budget procedure was carried out in a State of Emergency and extraordinary circumstances, which inevitably affected the structure, form and content of the budget documents prepared. This was the case with regard to the requirements of the European Semester, in particular concerning the optimization of the form and content of the Stability / Convergence Programmes and the activation of the General Escape Clause allowing for a temporary deviation from compliance with fiscal rules and constraints, taking into account the impact of measures to address the effects of the pandemic when assessing benchmarks.

Due to the above reasons, in the first stage of the budget procedure for 2021 the Medium-Term Budget Forecast for the period 2021-2023 was not prepared as a separate budget document, and the macroeconomic and budget forecasts adopted with the Convergence Programme performed this function. Thus, the medium-term planning horizon was temporarily limited but with the Updated Medium-Term Budget Forecast for the period 2021-2023, approved as a reason for the draft State Budget for 2021, a forecast for the main macroeconomic and budget parameters and assumptions in the Medium-Term was presented

The budget procedure for 2022 created the necessary organisation and coordination between the individual authorizing officers in the process of budget planning and compilation of the main budget documents. From the point of view of scope and participants within the budget process, it defines the responsibilities of all institutions (budget organisations) whose budgets are part of the Consolidated Fiscal Programme, but also of other legal entities that fall within the scope of the General Government sector.

With the budget procedure for 2022, the Council of Ministers determined for 2022, in addition to the Prosecutor's Office of Republic of Bulgaria (PORB), that the budgets of the Council of Ministers, ministries and state agencies, the other FLSUs, whose budgets are included in the State Budget under the Public Finance Act, except for the budgets of the National Assembly and the judiciary power, shall apply a programme format of the policy areas/ functional areas and budget programmes approved by the government (CMD No. 891 from 2020). It is an instrument of the government for improving the quality of public finance management, improving the processes of planning and drafting of budget organisations, increasing the transparency and accountability of the budget systems.

Within the budget procedure for 2022 and in accordance with the Public Finance Act, spring and autumn macroeconomic forecasts are prepared and standards for financing the activities delegated by the State through municipal budgets are adopted. In the course of the budget procedure, procedures for approval by the Council of Ministers of the projects that will be financed by state and / or state-guaranteed loans in 2022 have been integrated.

The procedure for 2022 is split into two main stages.

**At the first stage** of the procedure, in April 2021 the Council of Ministers will consider and approve the Medium-Term Budget Forecast for the period 2022-2024, the annual update of the Convergence Programme and adopt the standards for the state-delegated activities with natural and value indicators in 2022, will approve a hourly rate for programme preparation, creation and dissemination of national and regional programmes of BNR and BNT in 2022, as well as the motives prepared by the Minister of Finance upon rejection of the reasoned opinion and the recommendations of the Fiscal Council about the Spring macroeconomic forecast and/or the

Medium-Term Budget Forecast for the period 2022-2024. In June 2021, the Council of Ministers will consider and approve the draft resolution drawn up by the Minister of Education and Science for approving the maximum amount of the new State guarantees that may be issued in 2022 under the Students and Doctoral Students Crediting Act, as well as the draft resolution drawn up by the Minister of Finance for approving the projects that will be financed with state and/or state-guaranteed loans in 2022. The stage will end in July with the harmonization of the FLSUs with their budget forecasts for the period 2022-2024 with the decisions adopted by the Council of Ministers and with the publication of its budget forecasts in programme format on its websites in compliance with the requirements of the Protection of Classified Information Act.

Given the political situation following the parliamentary elections held on 4 April 2021, this stage of the budgetary procedure has been extended so as to enable the newly formed majority in the National Assembly to reflect and budget its priorities in accordance with its programming documents for the management of the country within the mandate of the current parliament.

**At the second stage** of the procedure, the Ministry of Finance will prepare the draft State Budget Act of the Republic of Bulgaria for 2022 and the draft acts amending and supplementing the tax laws. The coordination with the National Association of Municipalities in the Republic of Bulgaria of the mechanism for distribution of the total equalization subsidy and the targeted subsidy for capital expenditures by municipalities and the holding of consultations on the proposals of the association for the total budget relations of municipal budgets with the central budget and others. proposals on the draft State Budget for 2022 in its part for the municipalities is also part of the second stage. By the end October 2021, the Council of Ministers will consider and approve the reports drawn up by the Minister of Finance of the State Budget Act of the Republic of Bulgaria for 2022 and of an updated Medium-Term Budget Forecast for the period 2022-2024, which is reasoning to the draft act, as well as of reasoning in case of rejection of the reasoned opinion and the recommendations of the Fiscal Council about the Autumn macro-economic forecast and/or draft State Budget Act of the Republic of Bulgaria for 2022 and the updated Medium-Term Budget Forecast for the period 2022-2024. If necessary, the Council of Ministers will approve an amendment to the Decision on the adoption of standards for the state-delegated activities with natural and value indicators in 2022 and the Decision to approve the hourly rate for programme preparation, creation and dissemination of national and regional programmes of BNR and BNT in 2022. At the same time, the Council of Ministers will consider and approve the drafts prepared by the Head of the National Health Insurance Fund and submitted through the Minister of Health to the Council of Ministers of the Law on the Budget of the National Health Insurance Fund for 2022 and of reasoning in case of rejection of the reasoned opinion and the recommendations of the Fiscal Council about the draft act, as well as the drafts prepared by the Head of the National Social Security Institute and submitted through the Minister of Labour and Social Policy to the Council of Ministers of the Law on the Budget of the Public Social Security for 2020 and of reasoning in case of rejection of the reasoned opinion and the recommendations of the Fiscal Council about this draft.

Within one month from the promulgation in State Gazette of the State Budget Act of the Republic of Bulgaria for 2022, the Council of Ministers shall adopt on a proposal of the Minister of Finance a Decree for the Implementation of the State Budget of the Republic of Bulgaria for 2022.

If necessary, within one month from the promulgation of the State Budget Act of the Republic of Bulgaria for 2022, the Budget of the Public Social Security for 2022 Act, the Budget of the National Health Insurance Fund for 2022 Act and of the tax laws, the Council of Ministers will hold a session where it will consider and approve amendments in the updated Medium-Term Budget Forecast for the period 2022-2024 in accordance with the parameters of the adopted laws.

If necessary, within one week from the approval of the amendments in the updated Medium-Term Budget Forecast for the period 2022-2024, the first-level spending units under the budgets of the budget organisations which are ordered to apply programme budgeting will update the programme formats of their budgets, send them to the Ministry of Finance, the National Audit Office and the National Assembly and publish them on their webpages upon observance of the requirements of the Protection of Classified Information Act, and the budget procedure for 2022 thereby ends. The final budgets in the programme format of the FLSUs should correspond to the indicators under the State Budget Act of the Republic of Bulgaria for 2022 adopted by the National Assembly and to the changes in the updated Medium-Term Budget Forecast for the period 2022-2024 approved by the Council of Ministers.

In view of supporting the processes of planning, development and updating of the Medium-Term Budget Forecast and the planning and drawing-up of the draft-budgets of the authorizing officers, including in case of programme budgeting, the Minister of Finance must issue detailed instructions at both stages of the budget procedure, as for the first stage of the budget procedure for 2022 this was done with BU No. 1 from February 10<sup>th</sup>, 2021. The guidelines also set the deadlines and the responsible budget organisations, which should publish on their websites the relevant documents related to the budget procedure for 2022, in compliance with the requirements of the Protection of Classified Information Act.

The compliance with the budget procedure creates conditions for transparency and is an element of the good governance of public finance in the country. The voluntary participation in the budget process by all budget organisations is a condition for the overall success of the procedure and a premise for the achievement of the desired final outcomes from the conduction thereof, and namely sustainable Medium-Term Budget Forecast and Annual State Budget.

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

#### **Process of accession of the Republic of Bulgaria to the euro area**

Following the accession of the Bulgarian lev to Monetary Mechanism II and the Banking Union through the establishment of close cooperation with the ECB on July 10<sup>th</sup>, 2020, the process of Bulgaria's membership in the euro area has entered its final phase. In this regard, by Decree of the Council of Ministers No. 103 from March 2021, Decree No. 168 of the Council of Ministers from July 2015 on the establishment of a Coordination Council for the preparation of the Republic of Bulgaria for membership in the euro area was amended and supplemented.

The amendments to the Decree of the Council of Ministers No. 168 are aimed at refining and supplementing the provisions in order to ensure quality management and coordination of the preparatory process and the expert implementation of the activities necessary for the successful introduction of the euro. An important change is the assumption of the post of Co-Chair of the Coordination Council by the Governor of the Bulgarian National Bank, given the key role of the BNB in the process of preparation for euro area membership. The changes also envisage the development of a National Euro Changeover Plan of the Republic of Bulgaria by June 30<sup>th</sup>, 2021, with an indicative date for membership in the euro area as of January 1<sup>st</sup>, 2024.





# 8. ANNEX A

## Table 1a: Macroeconomic prospects

	ESA 2010 code	2020	2020	2021	2022	2023	2024
		Level (MBGN)	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
Real GDP (2015 prices)	B1*g	98 389	-4.2	2.7	3.6	3.4	2.7
Nominal GDP	B1*g	118 605	-1.0	5.0	5.5	5.4	4.6
<b>Components of real GDP</b>							
Private consumption expenditure	P.3	65 549	0.2	2.0	3.8	3.6	3.6
Government consumption expenditure	P.3	17 734	7.5	4.4	-0.2	2.7	0.8
Gross fixed capital formation	P.51	18 834	-5.1	-3.4	3.0	7.2	0.4
Change in inventories and net acquisition of valuables (% of GDP)	P.52+P.53	801	1.1	1.1	1.1	1.1	1.1
Export of goods and services	P.6	61 526	-11.3	5.8	6.8	4.8	3.5
Import of goods and services	P.7	66 061	-6.6	3.7	5.7	6.0	3.2
<b>Contributions to real GDP growth (In percentage points)</b>							
Final domestic demand		-	0.4	1.5	2.7	3.8	2.4
Change in inventories and net acquisition of valuables	P.52+P.53	-	-1.4	0.0	0.0	0.0	0.0
External balance of goods and services	B.11	-	-3.2	1.2	0.8	-0.5	0.3

## Table 1b: Price developments

	ESA 2010 code	2020	2020	2021	2022	2023	2024
		Level	Rate of Change <sup>30</sup>	Rate of Change	Rate of Change	Rate of Change	Rate of Change
GDP deflator		100	3.3	2.2	1.9	1.9	1.9
Private consumption deflator		100	0.5	1.2	1.7	1.7	1.8
HICP <sup>31</sup>		100	1.2	1.8	2.0	2.0	2.1
Public consumption deflator		100	6.7	5.9	0.1	0.6	0.3
Investments deflator		100	0.0	1.1	3.2	3.1	3.3
Export price deflator (goods and services)		100	-2.3	4.8	0.0	0.3	0.5
Import price deflator (goods and services)		100	-5.3	4.8	-0.4	-0.1	0.2

<sup>30</sup> Percentage change as compared to the previous year.

<sup>31</sup> Optional for Stability Programmes.

**Table 1c: Labour market developments**

	ESA 2010 code	2020	2020	2021	2022	2023	2024
		Level	Rate of Change	Rate of Change	Rate of Change	Rate of Change	Rate of Change
Employment (thousand persons) <sup>32</sup>		3 452	-2.3	0.5	1.3	1.0	0.5
Employment (millions of hours worked) <sup>33</sup>		5 539	-4.7	1.8	2.1	1.5	0.5
Unemployment rate <sup>34</sup>		5	5.1	5.0	4.7	4.4	4.4
Labour productivity (BGN per person employed) <sup>35</sup>		28 504	-1.9	2.2	2.3	2.4	2.2
Labour Productivity (BGN per hour worked) <sup>36</sup>		18	0.6	0.9	1.5	1.9	2.2
Compensation of employees (MBGN) <sup>37</sup>	D.1	53 942	3.0	7.5	8.6	8.2	7.1
Compensation per employee		20 962	5.9	6.4	7.1	7.0	6.5

**Table 1d: Sectorial balances**

% of GDP	ESA 2010 code	2020	2021	2022	2023
Net lending/borrowing vis-à-vis the rest of the world	B.9	0.9	2.6	3.5	3.3
of which:		1.8	2.9	3.8	3.4
–balance of goods and services		-2.5	-2.1	-2.0	-1.9
–balance of primary income and transfers		1.6	1.8	1.6	1.8
–capital account		4.3	8.2	6.2	6.4
Net lending/borrowing of the private sector	B.9	-3.4	-5.6	-2.7	-3.1
Net lending/borrowing of the general government	EDP B.9	-	-	-	-
Statistical discrepancy		-	-	-	-

<sup>32</sup> Occupied population, national accounts definition.

<sup>33</sup> National accounts definition.

<sup>34</sup> Harmonised definition, Eurostat; levels.

<sup>35</sup> Real GDP per one person employed.

<sup>36</sup> Real GDP per one hour worked.

<sup>37</sup> In MBGN.

**Table 2a: General government budget prospects**

	ESS 2010	2020	2020	2021	2022	2023
		Level	% of GDP	% of GDP	% of GDP	% of GDP
<b>Net lending (EDP B.9) by sub-sector</b>						
1. General government	S.13	-4 055.5	-3.4%	-5.6%	-2.7%	-3.1%
2. Central government	S.1311	-4 550.6	-3.8%	-5.6%	-2.8%	-3.2%
3. State government	S.1312					
4. Local government	S.1313	329.8	0.3%	0.0%	0.1%	0.1%
5. Social security funds	S.1314	165.3	0.1%	0.0%	0.0%	0.0%
6. Total revenue	TR	46 798.2	39.5%	36.5%	37.2%	37.4%
7. Total expenditure	TE	50 853.7	42.9%	42.1%	39.9%	40.5%
8. Net lending / borrowing	EDP B.9	-4 055.5	-3.4%	-5.6%	-2.7%	-3.1%
9. Interest expenditure	EDP D.41	673.3	0.6%	0.6%	0.6%	0.7%
10. Primary balance		-3 382.3	-2.9%	-5.1%	-2.1%	-2.4%
11. One-off and other temporary measures		-3 896.8	-3.3%	-2.5%	-0.3%	-0.8%
12. Total taxes (12=12a+12b+12c)		25 860.4	21.8%	21.2%	21.5%	21.5%
12a. Taxes on production and import	D.2	18 420.9	15.5%	15.0%	15.2%	15.1%
12b. Current taxes on income, wealth, etc.	D.5	7 102.2	6.0%	5.9%	6.1%	6.1%
12c. Capital taxes	D.91	337.3	0.3%	0.3%	0.3%	0.3%
13. Social contributions	D.61	11 001.2	9.3%	9.4%	9.5%	9.6%
14. Property income	D.4	589.4	0.5%	0.5%	0.5%	0.5%
15. Other		9 347.1	7.9%	5.4%	5.7%	5.8%
16=6. Total revenue	TR	46 798.2	39.5%	36.5%	37.2%	37.4%
Tax burden (D.2+D.5+D.61+D.91-D.995)		36 861.6	31.1%	30.6%	31.1%	31.2%
17. Compensation of employees + intermediate consumption	D.1+P.2	19 537.1	16.5%	16.9%	15.8%	15.2%
17a. Compensation of employees	D.1	12 983.3	10.9%	11.7%	10.9%	10.4%
17b. Intermediate consumption	P.2	6 553.7	5.5%	5.2%	4.9%	4.8%
18. Total social transfers (18=18a+18b)		17 731.4	14.9%	15.8%	15.2%	15.3%
<i>of which Unemployment benefits</i>	D.621, D.624	658.6	0.6%	0.6%	0.5%	0.4%
18a. Social transfers in kind	D.6311, D.63121, D.63131	3 335.4	2.8%	2.9%	2.8%	2.9%
18b. Social transfers other than in kind	D.62	14 396.0	12.1%	12.9%	12.4%	12.4%
19=9. Interest expenditure	EDP D.41	673.3	0.6%	0.6%	0.6%	0.7%
20. Subsidies	D.3	3 998.1	3.4%	2.3%	1.7%	1.9%
21. Gross fixed capital formation	P.51	5 390.6	4.5%	4.1%	4.4%	5.4%
22. Capital transfers	D.9	1 601.5	1.4%	0.6%	0.5%	0.5%
23. Other		1 921.8	1.6%	1.8%	1.7%	1.6%
24=7. Total expenditure	TE1	50 853.7	42.9%	42.1%	39.9%	40.5%
Government consumption (nominal))	P.3	23 057.6	19.4%	20.5%	19.4%	19.0%

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

	2020	2020	2021	2022	2023
	Level	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	46 798.2	39.46	36.32	37.21	37.37
2. Total expenditure at unchanged policies	50 853.7	42.88	39.25	39.46	39.67

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

	2020	2020	2021	2022	2023
	Level	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	1 854.9	1.6%	1.2%	1.9%	2.5%
1a. Investments fully matched by EU funds revenue	1 190.3	1.0%	0.7%	1.3%	1.9%
2. Cyclical unemployment benefit expenditure	658.6	0.6%	0.6%	0.5%	0.4%
3. Effect of discretionary revenue measures	29.2	0.0%	-0.3%	0.0%	0.1%
4. Revenue increases mandated by law	0.0	0.0%	0.0%	0.0%	0.0%

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

% of GDP	ESA 2010 code	2019	2023
1. General public services	1	2.8	3.3
2. Defence	2	1.2	2.3
3. Public order and safety	3	2.8	2.6
4. Economic affairs	4	6.5	6.2
5. Environmental protection	5	0.7	0.8
6. Housing and community amenities	6	1.2	1.1
7. Healthcare	7	5.0	5.6
8. Recreation, culture and religion	8	0.7	0.7
9. Education	9	3.9	4.2
10. Social protection	10	11.5	13.1
<b>11. Total expenditure (= item 7 = 24 of Table 2)</b>	<b>TE1</b>	<b>36.3</b>	<b>39.9</b>

**Table 4: General government debt developments**

<b>% of GDP</b>	<b>ESA code</b>	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>
1. Gross debt <sup>38</sup>		25.0	27.4	28.6	29.3
2. Change in gross debt level		4.8	2.4	1.2	0.7
3. Primary balance <sup>39</sup>					
4. Interest expenditure <sup>40</sup>	EDP D.41	0.6	0.6	0.6	0.7
5. Stock-flow adjustment					
of which:					
Differences between cash and accruals <sup>41</sup>					
Net accumulation of financial assets <sup>42</sup>					
of which: privatisation proceeds					
Valuation effects and other <sup>43</sup>					
Implicit interest rate on debt <sup>44</sup>		2.5	2.1	1.9	1.7
6. Liquid financial assets <sup>45</sup>					
7. Net financial debt (7=1-6)					
8. Debt amortization since the end of the previous year		7.1	4.1	9.1	8.7
9. Percentage of debt denominated in foreign currency		82.0	80.0	74.5	69.9
10. Average maturity		8.8	8.4	8.9	9.5

<sup>38</sup> As defined in Regulation 479/2009 (not an ESA concept).

<sup>39</sup> Cf. item 10 in Table 2.

<sup>40</sup> Cf. item 9 in Table.

<sup>41</sup> 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.

<sup>42</sup> 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.

<sup>43</sup> 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.

<sup>44</sup> Approximately calculated as interest expenditure divided by the debt level of the previous year.

<sup>45</sup> AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

**Table 5: Cyclical developments**

% of GDP	ESA 2010 code	2020	2021	2022	2023
1. GDP growth (%)		-4.2	2.7	3.6	3.4
2. Net lending of general government	EDP B.9	-3.4	-5.6	-2.7	-3.1
3. Interest expenditure	EDP D.41	0.6	0.6	0.6	0.7
4. One-off and other temporary measures		-3.3	-2.5	-0.3	-0.8
5. Potential GDP growth (%)		1.7	1.9	2.1	2.3
Contributions:					
labour		-0.3	0.0	0.2	0.2
capital		0.8	0.6	0.6	0.8
total factor productivity		1.2	1.2	1.3	1.3
6. Output gap		-3.1	-2.3	-0.8	0.2
7. Cyclical budget component		-0.9	-0.7	-0.3	0.1
8. Cyclically-adjusted balance (2-7)		-2.5	-5.0	-2.4	-3.1
9. Cyclically-adjusted primary balance (8+3)		-1.9	-4.4	-1.8	-2.4
10. Structural balance (8-4)		0.8	-2.4	-2.1	-2.4

**Table 6: Divergence from previous update**

	ESA 2010 code	2020	2021	2022	2023
Real GDP growth (%)		-3.0	n.a.	n.a.	n.a.
Previous update		-4.2	2.7	3.6	3.4
Current update		-1.2	n.a.	n.a.	n.a.
Difference (p.p.)					
General government net lending (% of GDP)	EDP B.9				
Previous update		-3.1	n.a.	n.a.	n.a.
Current update		-3.4	-5.6	-2.7	-3.1
Difference (p.p.)		-0.3	n.a.	n.a.	n.a.
General government gross debt (% of GDP)					
Previous update		28.5	n.a.	n.a.	n.a.
Current update		25.0	27.4	28.6	29.3
Difference (p.p.)		-3.5	n.a.	n.a.	n.a.

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

<b>% of GDP</b>	<b>2007</b>	<b>2010</b>	<b>2020</b>	<b>2030</b>	<b>2040</b>	<b>2050</b>	<b>2060</b>	<b>2070</b>
Total expenditure	37.7	36.3						
Of which: age-related expenditures	7.6	8.0	19.7	19.6	20.3	21.8	22.6	22.2
Pension expenditures			9.4	10.1	10.7	11.8	12.5	12.3
Social security pension			9.3	9.9	10.6	11.6	12.3	12.1
Old-age and early pensions			7.3	8.1	8.8	9.9	10.7	10.6
Other pensions (disability, survivors)			1.9	1.9	1.8	1.7	1.6	1.5
Occupational pensions (if in general government)								
Healthcare	4.0	4.4	6.1	5.2	5.4	5.5	5.4	5.3
Long-term care								
Education expenditure	3.6	3.6	4.2	4.3	4.2	4.5	4.7	4.6
Other age-related expenditures								
Interest expenditure								
Total revenue	38.8	33.2						
Of which: property income								
Of which: from pensions contributions (or social contributions if appropriate)								
Pension reserve fund assets								
Of which: consolidated public pension fund assets (assets other than government bonds)								
Social contributions diverted to manda- tory additional pension scheme <sup>46</sup>								
Pension expenditure paid by mandatory additional pension scheme <sup>47</sup>								
Labour productivity growth	1.9	7.2	-0.7	2.6	2.3	2.2	1.8	1.5
Real GDP growth	6.6	0.6	-4.2	1.5	1.1	0.9	1.3	1.2
Participation rate males (aged 20-64)	78.3	76.8	82.2	87.7	86.9	87.5	88.7	88.1
Participation rate females (aged 20-64)	68.3	67.0	72.4	76.9	76.6	76.9	78.4	77.8
Participation rate total (aged 20-64)	73.3	71.9	77.3	82.4	81.8	82.3	83.7	83.1
Unemployment (%. 15-64)	6.9	10.2	5.1	5.3	5.3	5.3	5.3	5.3
Population aged 65+ over total popula- tion	17.8	18.2	21.6	24.3	27.3	30.7	32.6	31.0

<sup>46</sup> Revenue from social security contributions or other revenue for the mandatory additional pension insurance, with which the accounts payable can be covered.

<sup>47</sup> Pension expenditure or other social benefits paid by the mandatory additional pension insurance.

**Table 8: Basic assumptions**

	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>
Short-term interest rate (annual average) 3-month EULIBOR, %	-0.42	-0.54	-0.53	-0.33	-0.13
Short-term interest rate (annual average) 6-month LIBOR in USD, %	0.69	0.27	0.42	0.80	1.18
Long-term interest rate (annual average), %	-	-	-	-	-
USD/EUR exchange rate (annual average)	1.14	1.20	1.19	1.19	1.19
<b>Nominal effective exchange rate. percentage change. previous year = 100<sup>48</sup></b>					
EUR/BGN exchange rate (annual average)	1.95583	1.95583	1.95583	1.95583	1.95583
World economy, GDP growth, %	-3.4	5.5	4.2	3.9	3.6
EU GDP growth, %	-6.2	3.9	3.9	3.1	2.3
<b>Growth of relevant foreign markets. %</b>					
World import volumes, excluding EU, %					
Oil Brent (USD/barrel)	42.3	59.3	55.7	53.7	52.6
International prices of non-energy goods, %	3.0	14.8	-1.6	-1.4	-1.4
International prices of food products, %	6.3	14.6	-2.4	-1.1	-1.1
International prices of agricultural raw materials, %	-0.6	7.7	-1.2	-0.8	-0.8
International prices of metals, %	1.0	22.0	-2.6	-2.4	-2.4

<sup>48</sup> The positive values reflect appreciation, the negative – depreciation.



## 9. ANNEX B

**Table 1: Stock of guarantees adopted/announced at 31.12.2020 according to the Programme**

	Measures	Date of adoption	Maximum amount of contingent liabilities <sup>1</sup> (% of GDP)	Estimated take-up (% of GDP)
In response to COVID-19	1. European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) as a result of the COVID-19 outbreak, between the Republic of Bulgaria and the European Commission.	18.09.2020	0.07%	0.07%
	2. Contribution agreement between the Republic of Bulgaria and EIB in relation to the Pan-European Guarantee Fund.	09.10.2020	0.00%	0.00%
	Subtotal		0.07%	0.07%
Others	1. Guarantee for financing of a project for the construction of a cross-border pipeline between the Greek and Bulgarian gas transmission systems.	12.2019	0.05%	0.05%
	2. COTONOU II Guarantee agreement.	03.2009	0.00%	0.00%
	3. Guarantee agreement for the reconstruction of "KCM EAD – Plovdiv" with the aim of reducing industrial pollution.	11.1995	0.02%	0.00%
	4. Guarantee agreement for the modernization and improvement of the Kozloduy EAD Nuclear Power Plant.	12.1999	0.01%	0.00%
	5. Guarantee in accordance with the Students and Doctoral Candidate Loans Act	08.2009	0.06%	0.01%
	6. Municipal guarantee for "Municipal passenger transport EOOD", Gabrovo	2020	0.00%	0.00%
	7. Municipal guarantee for "Diagnostic and consulting centre II", Dobrich	08.2019	0.00%	0.00%
	Subtotal		0.14%	0.06%
	Total		0.21%	0.13%

<sup>1</sup>Any possible budget impact related to the call of those guarantees should be provided in the table on the discretionary measures in the SCP.

**Table 2: Discretionary measures adopted/announced according to the Programme<sup>1</sup>**

Measures		ESA Code (Expenditure / Revenue component)	Date of adoption	Budget impact (% of GDP - change from previous year)			
				2020	2021	2022	2023
<i>Temporary measures<sup>2</sup></i>	Increasing the amount of tax relief for children	D.5, revenue	2020		-0.18%		
	Tax relief for the supply of vaccines and medical devices related to COVID-19	D.2, revenue	2020		-0.05%	-0.05%	
	Tax relief for improvements and/or repair of real estate	D.5, revenue	2020		-0.02%		
	Change in the parameters of the dividend policy	D.42, revenue	2018	0.00%	0.00%		
	Reduction of the VAT rate from 20% to 9%	D.2, revenue	2020	-0.08%	-0.16%		
	Exemption from VAT and customs duties on imports of medical goods	D.2, revenue	2020	0.00%	0.00%		
	Change in the amount under the State aid scheme Special procedure for refund of excise duty on purchased gas oil used in primary agricultural production	D.2, revenue	2020		-0.01%		
	State subsidy for tour operators for charter flights	P.2, revenue	2020	0.00%	0.03%		
	One-off payment of additional amounts in the amount of BGN 50 to the pensions of all pensioners	D.62, expenditure	2020	0.45%	0.34%		
	One-off assistance for the use of tourist services for domestic tourism at a unit value of BGN 210	D.62, expenditure	2020	0.00%	0.01%		
	One-off assistance for students enrolled in the 8 grade	D.62, expenditure	2020	0.00%			
	One-off financial support in the amount of BGN 120 per year for food products of pensioners whose pension or the sum of pensions together with the supplements and compensations to them is from BGN 300.01 to BGN 369 inclusive	D.62, expenditure	2020		0.04%		
	Cumulative effect of dropping the income criterion for access to monthly allowances for raising a child up to one year and targeted allowances for students	D.62, expenditure	2020		0.03%		
	Machine electronic voting	P.51, expenditure	2020		0.03%		
	Monthly targeted assistance in case of a declared state of emergency or declared	D.62, expenditure	2020	0.02%	0.06%		

	state of emergency for families with children up to 14 years						
	Measure for maintaining employment, the so-called "60/40"	D.3, expenditure	2020	0.84%	0.24%		
	Supporting the payment of fees due by parents for feeding children in compulsory pre-school education	P.2, expenditure	2020		0.02%		
	Recalculation of pensions with reduced individual coefficient	D.62, expenditure	2021		0.03%	0.02%	
	Increasing the period for payment of unemployment benefits	D.62, expenditure	2020	0.00%	0.00%		
	Expenditures related to the application of the law on recognition, enforcement and sending of judicial acts for imposition of imprisonment	P.2, expenditure	2019	0.00%	0.00%		
	Expanding access and coverage in compulsory pre-school education	P.2, expenditure	2020	0.00%	0.03%		
	Change in the average monthly income of a family member and the monthly allowances for raising a child under the Family Allowances for Children Act	D.62, expenditure	2018	0.00%	0.00%		
	Increasing the salaries of the pedagogic staff	D.1, expenditure	2018	0.30%	0.29%		
	Increasing the salaries of the staff from the budgets of the municipalities in functions "Health care" and "Social security, assistance and care"	D.1, expenditure	2020	0.02%	0.05%		
	Increase of the maximum pension	D.62, expenditure	2019	0.06%	0.08%		
	Increase of the minimal pension	D.62, expenditure	2020	0.06%	0.44%		
	Increase in staff costs by 30% for authorities and administrations responsible for management of the pandemic and the consequences of COVID-19	D.1, expenditure	2020	0.07%	0.18%		
	Targeted assistance for a free translation service for the deaf and blind	D.62, expenditure	2021		0.00%	0.00%	
	Income policy - increase in staff costs in the budget sphere and increase in the minimum wage	D.1, expenditure	2019	0.50%	0.59%		
	<b>Subtotal</b>			<b>2.26%</b>	<b>2.07%</b>	<b>-0.02%</b>	<b>0.00%</b>
<i>Non-temporary measures<sup>2</sup></i>	Revenue from the introduction of TOLL fee	P.131, revenue	2019	0.07%	0.09%	0.04%	0.03%
	Revenue from insurance selection	D.61, revenue	2017	0.04%	0.04%	0.04%	0.04%
	Revenue from social security contributions resulting from an increase in the	D.61, revenue	2019	0.00%	0.00%	0.00%	0.00%

	length of service at retirement						
	Expenditure for the introduction of TOLL fee	D.1, P.2, P.51, expenditure	2019	0.07%	0.09%	0.04%	0.03%
	Investment expenditure "Acquisition of basic combat equipment for the construction of battalion battle groups from the mechanized brigade"	P.51, expenditure	2018			0.10%	0.14%
	Increase of the hourly rate for work of the personal assistants under the Personal Assistance Act and increase of the poverty line	D.62, expenditure	2020	0.05%	0.07%	0.02%	0.01%
	Calculation in a new way of the individual coefficient for pensions for employment	D.62, expenditure	2021		0.00%	0.02%	0.03%
	Recalculation of pensions with additional length of service acquired after retirement	D.62, expenditure	2020	0.01%	0.01%	0.01%	0.01%
	Increasing the minimum amount of unemployment benefits	D.62, expenditure	2020	0.00%	0.01%	0.00%	0.00%
	Increasing the part of the insurance income on which the state pays health contributions for the persons insured at the expense of the state budget	D.62, expenditure	2016	0.08%	0.09%	0.04%	0.04%
	Increase in the required age and length of service for retirement	D.62, expenditure	2016	-0.01%	-0.01%	-0.01%	-0.01%
	Investment cost "Acquisition of a new type of fighter aircraft"	P.51, expenditure	2018		0.13%	0.23%	0.59%
	Subtotal			<b>0.30%</b>	<b>0.52%</b>	<b>0.53%</b>	<b>0.91%</b>
	<b>Total</b>			<b>2.56%</b>	<b>2.59%</b>	<b>0.50%</b>	<b>0.91%</b>
<sup>1</sup> Excluding those measures that are planned to be financed by grants under the RRF.							
<sup>2</sup> For the purpose of this table, temporary measures refer to those discretionary measures that have no budget impact beyond 2022, which corresponds to the end of the Commission spring 2021 forecast horizon. By contrast, those measures adopted or announced for 2020, 2021 or 2022 that continue to have a fiscal effect of 0.1% of GDP or greater until at least 2023 are considered as 'non-temporary' for the purpose of this table.							

**Table 3: RRF's impact on programme's projections - Grants**

<b>Revenue from RRF grants (% of GDP)</b>							
	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>
RRF GRANTS as included in the revenue projections	0.02%	0.28%	0.81%	1.36%	1.74%	2.64%	1.77%
Cash disbursements of RRF GRANTS from EU	0.00%	0.94%	0.63%	1.34%	1.69%	1.93%	2.17%
<b>Expenditure financed by RRF grants (% of GDP)</b>							
	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>
Compensation of employees D.1							
Intermediate consumption P.2			0.01%	0.01%	0.00%		
Social payments D.62+D.632							
Interest expenditure D.41							
Subsidies, payable D.3							
Current transfers D.7		0.00%	0.05%	0.11%	0.10%		
<b>TOTAL CURRENT EXPENDITURE</b>		<b>0.00%</b>	<b>0.06%</b>	<b>0.12%</b>	<b>0.11%</b>		
Gross fixed capital formation P.51g		0.00%	0.56%	0.89%	0.99%		
Capital transfers D.9	0.02%	0.28%	0.19%	0.35%	0.64%		
<b>TOTAL CAPITAL EXPENDITURE</b>	<b>0.02%</b>	<b>0.28%</b>	<b>0.75%</b>	<b>1.25%</b>	<b>1.63%</b>		
<b>Other costs financed by RRF grants (% of GDP)<sup>1</sup></b>							
	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>
Reduction in tax revenue							
Other costs with impact on revenue							
Financial transactions							
<sup>1</sup> 1 This covers costs that are not recorded as expenditure in national accounts							
Bold: required information							

**Table 4: RRF's impact on programme's projections - Loans**

**(In the draft version from April 2021 of the National Recovery and Resilience Plan there is no envisaged usage of the loan part of the instrument.)**

<b>Cash flow from RRF loans projected in the programme (% of GDP)</b>							
	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>
Disbursements of RRF LOANS from EU	0	0					
Repayments of RRF LOANS to EU							
<b>Expenditure financed by RRF loans (% of GDP)</b>							
	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>
Compensation of employees D.1							
Intermediate consumption P.2							
Social payments D.62+D.632							
Interest expenditure D.41							
Subsidies, payable D.3							
Current transfers D.7							
<b>TOTAL CURRENT EXPENDITURE</b>							
Gross fixed capital formation P.51g							
Capital transfers D.9							
<b>TOTAL CAPITAL EXPENDITURE</b>							
<b>Other costs financed by RRF loans (% of GDP)<sup>1</sup></b>							
	<b>2020</b>	<b>2021</b>	<b>2022</b>	<b>2023</b>	<b>2024</b>	<b>2025</b>	<b>2026</b>
Reduction in tax revenue							
Other costs with impact on revenue							
Financial transactions							
<sup>1</sup> This covers costs that are not recorded as expenditure in national accounts <b>Bold: required information</b>							