REPUBLIC OF BULGARIA
Ministry of Finance

CONVERGENCE PROGRAMME

(2014–2017)

April 2014
Sofia, Bulgaria

CONVERGENCE PROGRAMME

OF THE REPUBLIC OF BULGARIA 2014–2017

April 2014
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List of abbreviations

BGN	Bulgarian lev
BNB	Bulgarian National Bank
CB	Central Budget
CFP	Consolidated Fiscal Programme
CP	Convergence Programme
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
EDP	Excessive Deficit Procedure
EIB	European Investment Bank
ESA'95	European System of Accounts'95
EU	European Union
EUR	Euro
FDI	Foreign Direct Investments
GDMS	Government Debt Management Strategy
GDP	Gross Domestic Product
GS	Government Securities
GVA	Gross Value Added
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
LA	Law Amending
LIBOR	London Interbank Offered Rate
LSB	Law on the State Budget
LSBRB	Law on State Budget of the Republic of Bulgaria
MF	Ministry of Finance
MSTI	Medium-sized Taxpayers and Insurers
MTO	Medium-term budgetary objective
NAWRU	Non-accelerating wage rate of unemployment
NHIF	National Health Insurance Fund
NRA	National Revenue Agency
NRP	National Reform Programme
NSI	National Statistical Institute
NSSI	National Social Security Institute
PFL	Public Finances Law
pps	percentage points
PSS	Public Social Security
RIEDTWA	Rules for Implementation of the Excise Duties and Tax Warehouses Act
SGP	Stability and Growth Pact
SSC	Social Security Code
SSF	Social Security Funds
TFP	Transitional and Final Provisions
ULC	Unit Labour Costs
USD	US dollar
VAT	Value Added Tax

1. Overall Policy Framework and Objectives

The Convergence Programme of the Republic of Bulgaria (2014–2017) outlines the main policies to maintain the country's economic and financial stability with the aim to create conditions for economic growth.

The Government's policy is focused on more effective and competitive allocation of public resources with the aim to encourage investment and employment and thus accelerate economic growth. This will help to reduce the imbalances accumulated in the Bulgarian economy, particular attention being paid to reducing regional and social imbalances.

Key priorities of the Government are: enhancing the implementation of structural reforms, increasing the effectiveness and efficiency of the institutions, development of e-governance, improving the business climate, fostering the development of small and medium-sized enterprises through effective absorption of EU funds. In this regard the Government is also committed to strengthen the role of the Bulgarian Development Bank as an effective tool for implementing economic policy.

An important aspect of the strategic policies is also to increase productivity and competitiveness of the economy in order to achieve a balanced growth, sustainable convergence and enhancement of the welfare in the long term. In this regard improving priority policies are the education and in particular its connection with the labour market, reducing the administrative burden, enhancing competitiveness in different sectors of the economy, investment in infrastructure.

The medium term fiscal objectives remain oriented at maintaining the sustainable budgetary framework in the context of Bulgaria's commitments both under the Stability and Growth Pact and as a party to the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union[1]. Medium and long term sustainability of the key fiscal parameters remains a priority in terms of enhancing confidence and creating a predictable investment and business environment. Given the three-year cycle of updating the medium-term budgetary objective provided for in Article 23(4) of the Law on Public Finances, the current update of Bulgaria's Convergence Programme defines a medium-term budgetary objective for a structural deficit of 1%.

[1] On 28 November 2013, the National Assembly adopted the Law on the Ratification of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, promulgated in the State Gazette, No. 106 of 10.12.2013. The Law includes a Declaration whereby Bulgaria commits to apply Title III ("Fiscal Compact") of the Treaty as from 1 January 2014.

The Government's tax and social security policy is oriented towards supporting economic growth and strengthening fiscal sustainability in the long term. The improvement of the effectiveness of revenue administrations' work and tackling the shadow economy are also a main priority. All these measures contribute to fiscal stability that provides a good basis for the implementation of the Government's policies.

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

This Convergence Programme (CP) has been approved by the government and has been discussed by the National Assembly. It comprises of seven chapters.

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

The third chapter provides an overview of strategic fiscal policy objectives with regard to the budget balance and government debt. This chapter outlines the current budgetary position and the expected developments in the reference period, with emphasis on the structural and cyclically-adjusted balance. Major trends in the debt development position over the programme period are also presented here, as well as the main elements of the policies provided for in the medium-term strategy of the Government and their quantitative effects.

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

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

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

The seventh chapter provides an overview of the institutional characteristics of public finances in Bulgaria – budgetary procedures and national fiscal rules. This chapter of the Programme also presents the key legislative changes in the area of public finances and in particular the setting up of an independent fiscal institution and correction mechanisms.

The current Convergence Programme takes into account measures and developments under the first of the seven Council Recommendations of 9 July 2013 on the National Reform Programme 2013 of Bulgaria and containing the Council Opinion on the Convergence Programme of Bulgaria for the period 2012–2016[2], namely:

[2] OJ C 217, 30.07.2013

Specific recommendation 1: Preserve a sound fiscal position by ensuring compliance with the medium-term objective and pursue a growth-friendly fiscal policy as envisaged in the Convergence Programme. Implement a comprehensive tax strategy to strengthen all aspects of the tax law and collection procedures with a view to increase revenue, in particular by improving tax collection, tackling the shadow economy and reducing compliance costs. Establish an independent institution to monitor fiscal policy and provide analysis and advice. ▼

2. Economic Outlook

2.1 World economy/technical assumptions

The current Convergence Programme is based on the macroeconomic framework for the period 2014–2017, developed using the medium-term macroeconomic model of the Ministry of Finance with some key assumptions about the external environment of the International Monetary Fund, the European Commission and the Ministry of Finance as of the middle of March 2014. The effects from policy changes, envisaged in the National Reform Programme of the Republic of Bulgaria (2013–2020), were not taken into account.

Table 2-1: Assumptions on Key Macroeconomic Indicators

	2014	2015	2016	2017
World economy (real growth, %)	3.7	3.9	4.0	4.0
EU GDP (real growth, %)	1.4	1.7	1.8	1.9
USD/EUR Exchange rate, annual average	1.34	1.36	1.36	1.36
International commodity prices (dollar-denominated, %)				
Oil Brent (USD/barrel)	-2.8	-5.8	-4.5	-3.7
Non-energy goods	-3.6	-2.2	-0.8	-0.8
Food	-6.4	-2.6	-1.0	-0.8
Beverages	-2.7	-0.2	-1.0	-1.6
Agricultural raw materials	3.5	-0.1	-2.7	-3.1
Metals	-4.6	-3.5	0.9	0.8
Six-month LIBOR on USD-denominated deposits	0.42	0.82	1.86	2.93
Six-month LIBOR on EUR-denominated deposits	0.33	0.53	1.02	1.47

Source: IMF, EC, MF

2.2 Cyclical developments and current prospects

– Economic growth

Bulgarian GDP growth accelerated to 0.9% in 2013, while being 0.6% in 2012. The gradual recovery of economic activity in the EU resulted in strong increase of Bulgarian exports. Net exports were the main positive contributor to GDP dynamics during the year. After registering a 3.1% growth in the previous year domestic demand dropped by 1.1% in 2013.

Final consumption decreased by 1.4%, having risen by 2.9% in 2012. The deterioration came from a drop in household expenditure by 2.3%, while public consumption rose by 2.5%. Notwithstanding the real disposable income growth, households have been cautious regarding their expenditure due to the existing uncertainty on the labour market related to the continuing, although with considerably lower pace, drop in employment and increase in unemployment. During the third and fourth quarters of 2013 the drop in households' consumption slowed down compared to the same quarters of the previous year. The January consumer survey reported considerable improvement of the consumer confidence indicator. The reason therefore was the more optimistic expectations of the interviewed about both the economic situation in the country and the financial situation of households.

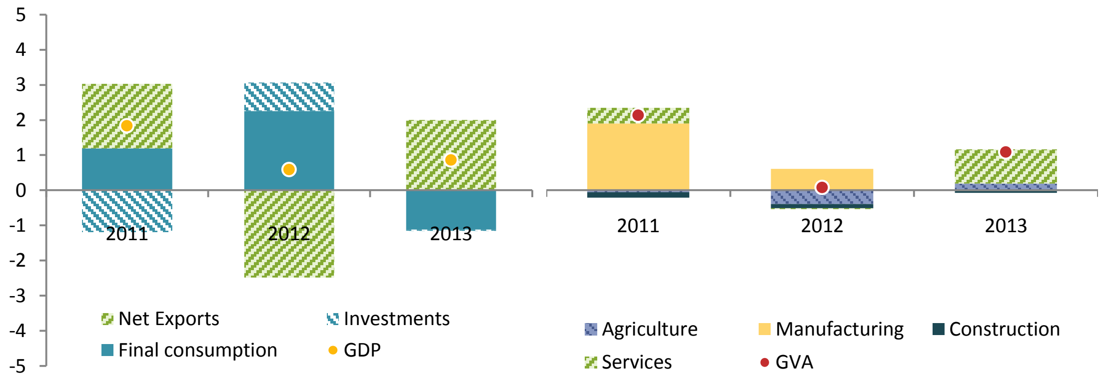
Low demand limited the investment activity of the enterprises. That resulted in a drop of private investment during the year. At the same time, government capital expenditure has risen thus compensating to some extent the lower private investment. Gross fixed capital formation dropped by 0.3%.

Due to the improved external demand the export of goods and services in 2013 increased by 8.9% in real terms. Low private consumption restricted imports growth to 5.7%, which to a large extent was influenced by increased demand of export oriented sectors. That dynamics resulted in positive contribution of net exports to GDP growth of 2 pps.

The economic activity in the country accelerated also on the supply side, as the gross value added growth reached 1.1% in real terms with positive contribution by services and agriculture.

The value added in the services' sector increased by 1.5%. General government and financial and insurance activities were the main positive contributors. Low consumer demand resulted in a drop in wholesale and retail trade; repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities.

Figure 2-1: Contributions to the GDP and GVA annual growth, by components (pps)



Source: NSI

The lower domestic demand influenced also the manufacturing whose value added dropped by 0.1%. According to industrial turnover data, sales on the international market increased by 3.8%, while domestic sales dropped by 3.9%.

The slump of value added in construction decelerated to 1%. The dynamics in the sector was determined by lower output both of the building construction and the civil engineering.

The good harvest during the year and the increased production of cereals and industrial crops resulted in value added growth in agriculture of 3.4%.

– Cyclical position

According to the Ministry of Finance estimates, the potential GDP growth in 2013 was 1.1% and is expected to reach 1.9% in 2014. The total factor productivity will remain a key factor for the moderate acceleration of growth over the whole forecast period until 2017. Positive contribution will come also from the gradual increase in capital affected by the increase in investment activity. The sluggish labour market recovery will keep high the NAWRU in 2014, which is expected to start decreasing in 2015. The negative contribution of labour as a factor for potential growth over the forecast period will be low due to the negative demographic characteristics.

In 2014 the output gap will reach 1.3%. Over the following years the economy will move towards the potential, thus the gap is expected to close around 2017.

2.3 Medium-term scenario

In 2014 the Bulgarian economy is expected to register real growth of 2.1%. As in 2013 net exports will have positive contribution to growth, but considerably lower due to stronger imports growth. Domestic demand is expected to be the main driver of economic activity. In the medium term consumption and investment will contribute to economic growth acceleration, while the contribution of net exports will become negative.

Increase of consumer confidence, stabilisation of labour market and real household income growth will support the rise of private consumption in 2014 to 1.3%. A gradual acceleration in consumer expenditure growth is expected in the coming years, which is projected to reach 4% in 2017.

The gradual consumption recovery and increase of external demand will have a stimulating effect on investment activity of enterprises in the period under consideration. A positive contribution of government capital expenditure is also expected. As a result gross fixed capital formation will increase by 4.5% on average in real terms for the period 2014–2017.

The improvement of the prospects for the European and global economies in 2014 will result in growth of Bulgarian exports of 6.9%. However, net exports will have minor positive contribution of 0.3 pps due to the increasing pressure on imports by domestic demand. Until 2017, imports and exports are expected to increase gradually, and the negative contribution of net exports to GDP will reach 1.1 pps.

2.4 Sectoral balances

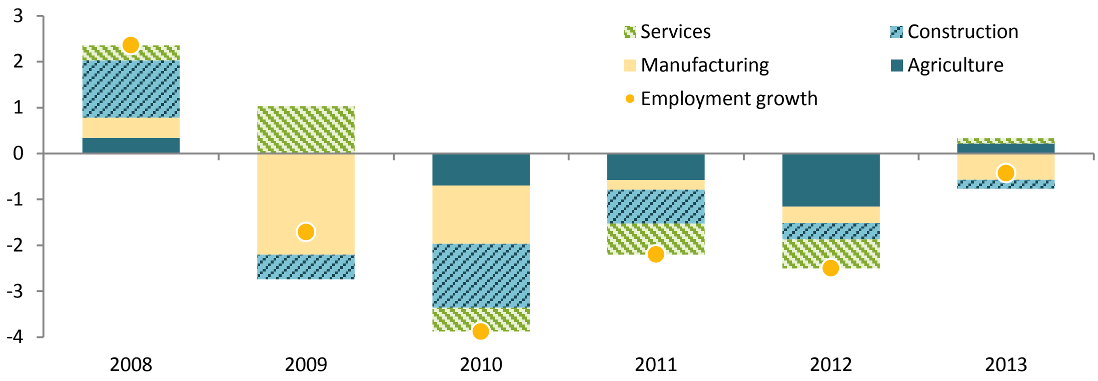
– Labour market, incomes and labour productivity

In 2013, the labour market was characterised with employment stabilisation and continuing increase in the number of unemployed and unemployment rate. The average annual number of employed persons continued to decrease but the negative dynamics was reduced to 0.4%, compared to the drop of 2.5% for the previous year[3]. Agriculture, and to a lesser extent, services, contributed the most to that improvement. The considerable increase of the number of employed in agriculture in the second and third quarter of 2013 determined the positive annual dynamics of 1.2%, and the stabilisation of the number of employed in the services sector

[3] Based on the definition in the System of National Accounts (SNA).

around its 2012 level was supported mostly by increased employment registered in the professional, scientific and technical activities; and administrative and support service activities sector. At the same time industry continued with dismissals. In construction the drop in employment slowed down to 3.5%, but still remained high, while in industry it accelerated to 2.8%, with sectors producing mainly for the domestic market, such as manufacture of food products, beverages and tobacco products, and other manufacturing, contributing the most therefore[4].

Figure 2-2: Contributions to employment dynamics



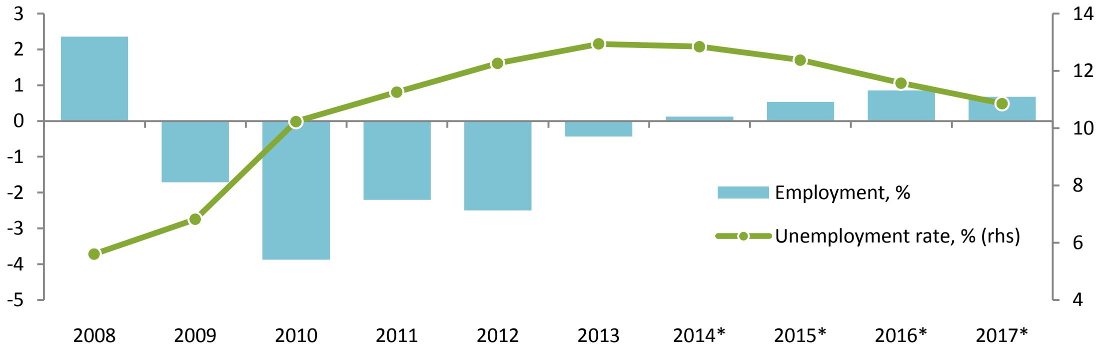
Source: NSI (SNA), MF

The number of unemployed persons continued to increase for a fifth consecutive year and reached an average annual value of 436.3 thousand[5], which in an environment of employment stabilisation showed higher labour force participation. Participation rate (aged 15+) reached 53.9%, up by 0.8 pps compared to its previous year level. However, due to the limited employment possibilities the higher participation rate was also a factor for retaining the high levels of unemployment during the year, the annual average level of the indicator being 12.9%[6].

The labour market is expected to register slight improvement in 2014. The number of employed persons is expected to stabilise and to increase slightly with a rate of 0.1%[7] compared to the previous year. Employment recovery is expected to be supported mostly by the services sector given the expected improvement in the domestic demand. Contrary to 2013 when employment stabilisation was accompanied by an increase of unemployment level, in 2014 its recovery is expected to put an end to the upward trend in unemployment and its value is expected to register a slight decrease to 12.8%[8].

[4] The breakdown of manufacturing activities is based on the annual enterprises' survey.
[5] Based on Labour Force Survey data.
[6] As defined in the Labour Force Survey.
[7] As defined in the SNA.
[8] As defined in the Labour Force Survey.

Figure 2-3: Employment growth and unemployment rate, %



* Forecast

Source: NSI (SNA, LFS), MF

Employment recovery is expected to gradually strengthen in the next years supported by higher labour demand and economic activity growth of the population, while at the end of the forecast horizon a slow-down in employment growth is expected as a result of the effect of the demographic processes on the labour force. Unemployment rate is expected to follow a downward trend to reach 10.9% in 2017.

Increased economic activity and the favourable employment development observed in the country determined the upward dynamics of labour costs in 2013. For the economy as a whole, the share of the compensation of employees in gross value added has increased from 45.0% to 47.4%, the highest level being registered in services' sector (51.3%), followed by industry (42.9%) and agriculture (24.3%). The increase of the indicator under consideration was a result of the increased compensation of employees by 5.3% in nominal terms, while current price value added did not report any increase. Only financial and insurance activities registered a drop in the share of the labour costs determined by a drop in the compensation of employees (20.5%) while the value added increased considerably (7.3%). All other activities registered an increase in the share of the labour costs. Industry also reported a nominal value added growth of 0.9%, but it remained lower than that of compensation of employees (4.8%). In some economic activities (construction, wholesale and retail trade; repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities and agriculture) even a drop in the value added was observed, and in the agricultural sector and wholesale and retail trade; repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities the compensation of employees dynamics remained close to the reported in the previous year levels of 12.8% and 4.4% respectively, while the increase of the indicator in construction accelerated substantially to 8.7%.

The evaluation of labour costs as share of GVA in Bulgaria shows a comparative advantage compared to the EU28 average level in the context of the cost competitiveness of the economy. In 2013 the share of the compensation of employees in gross value added in Bulgaria (47.4%) remained lower that the reported value in EU28 (55.3%), this trend being valid also by economic activity.

Table 2-2: Share of the compensation of employees (CE) in gross value added (GVA)

Economic activities	CE/GVA (%) EU 28	CE/GVA (%) Bulgaria		Change of CE (%)	Change of GVA (%)
	2013	2013	2012	2013/2012	2013/2012
Total	**55.3**	**47.4**	**45.0**	**5.3**	**0.0**
Agriculture	**27.8**	**24.3**	**19.6**	**12.8**	**-9.0**
Industry	**56.7**	**42.9**	**40.2**	**5.5**	**-1.1**
Industry	63.0	43.0	41.4	4.8	0.9
Construction	55.3	42.1	35.3	8.7	-8.9
Services	**55.6**	**51.3**	**49.5**	**5.1**	**1.3**
Wholesale and retail trade; repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities	58.8	56.9	50.4	4.4	-7.5
Information and communication	58.3	52.1	48.7	6.2	-0.7
Financial and insurance activities	54.0	32.2	43.5	-20.5	7.3
Professional, scientific and technical activities; administrative and support service activities	58.7	64.0	57.1	9.1	-2.6

Source: NSI (SNA), MF

The improved employment dynamics observed in 2013 resulted in a slow-down of labour productivity growth rate to 1.3% in real terms[9] compared to 3.2% in 2012. The trend was strongest in industry, but productivity growth there remained higher than the average for the economy (2.8%), followed by agriculture (2.2%) and services (1.4%). In 2013 the real unit labour costs[10] (RULC) increased by 6.1% as a result of the accelerated growth of the compensation per employee (6.6%) compared to that of labour productivity (0.5%), measured in current prices. The upward development of the indicator was mostly influenced by activities such as agriculture, construction and wholesale and retail trade; repair of motor vehicles and motorcycles, transportation and storage, accommodation and food service activities. Industry, which is largely exposed to external market competition, was also characterised by a 3.8% RULC growth as a result of the accelerated growth of the compensation per employee (7.7%) compared to the value added growth (3.8%). The unfavourable development of value added in the activity under consideration reflected in the lower industrial turnover on the domestic market reported in the first half of 2013. In the second half a successful adaptation of the RULC was observed.

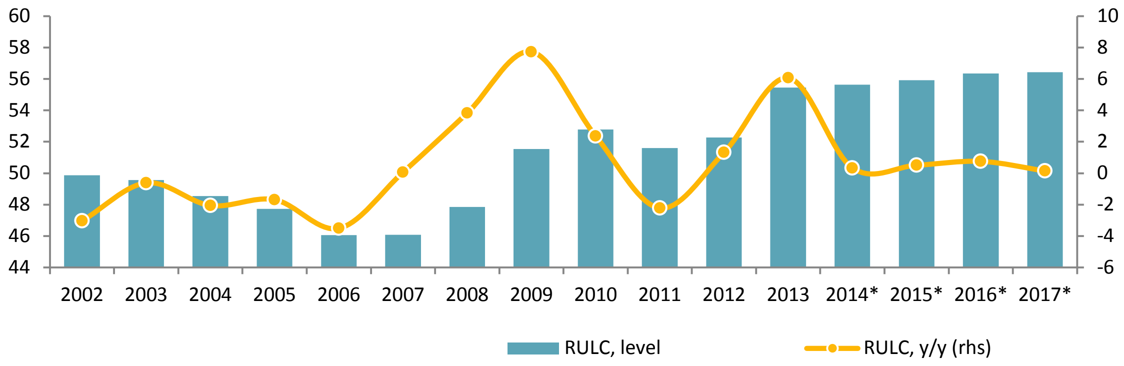
The expected high levels of unemployment will continue to act as a deterrent for the growth in labour income, which is expected to increase at moderate rates of about 3.5–5.5% in nominal terms within the programming period (2014–2017). The expectations for increased economic activity in the period under consideration will reflect also in accelerated productivity rate and

[9] Real labour productivity growth is calculated as a ratio between GDP at 2005 prices and the number of employed persons as per SNA definition.

[10] Real unit labour costs (RULC) is the ratio between compensation per person employed and GDP per person employed in current prices.

the gradual increase of labour demand will result in gradual increase in the share of compensation of employees in GDP. The RULC developments in the next three years are not expected to have a negative impact on the cost competitiveness of the economy.

Figure 2-4: Real Unit labour costs (RULC) developments



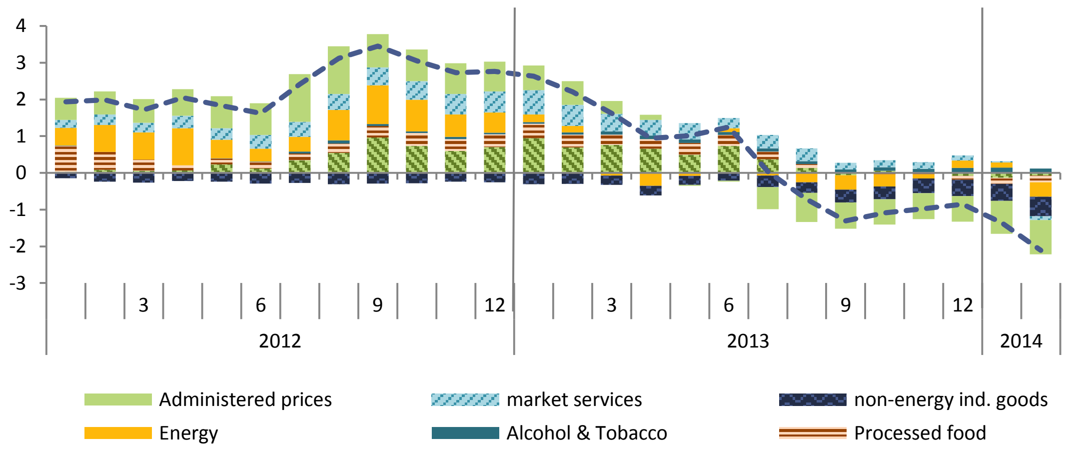
* Forecast

Source: NSI (SNA), MF

— Inflation

Headline inflation slowed significantly in 2013. Total HICP even moved to negative territory in August and the deflation rate at the end of the year reached 0.9%. These developments were largely driven by adjustments in administered prices and the downward trend in international prices of food and energy commodities, as well as the week domestic demand. The average annual inflation also slowed down to 0.4%.

Figure 2-5: Inflation rate (%) and contributions (pps) by main HICP components (compared to the corresponding month of the previous year)



Source: NSI, MF

The drop in international food and energy prices and the strengthening of the Euro vis-à-vis the US Dollar in the second half of the year had a deflationary effect on producer and consumer prices in the country. Food prices inflation decelerated significantly and reported an annual drop of 0.8% at the end of the year compared to an increase of 4.6% in December 2012. The latter came mostly on the account of the slowdown in unprocessed food prices, particularly in the second half of the year. Domestic fuel prices also followed the price dynamics of international crude oil, being characterised with certain fluctuations during the year. The slump in energy prices (excluding regulated prices) narrowed during the second half of 2013 and even reported a 2.2% yoy increase in December, compared to the 6.3% growth a year earlier.

The reduction in administered prices was among domestic factors which contributed the most to the reported slowdown in the headline rate. It stood at 3.9% at end-2013 with a negative contribution of 0.7 pps. Most of it was attributable to the corrections in the energy price for households, in March and August respectively, its accumulated reduction as of December reaching 11.1%. Prices of central heating, gas supply and medicines also decreased during the year.

Weak household consumption also had substantial impact on consumer prices developments in the country. It favoured the deepening of the downward trend in core inflation which reached -0.7% in December. Considered by main components, the annual inflation of market services slowed considerably to 0.6% in December. Price developments in that group and the reported slow-down in the increase of catering and transport services prices in particular, were also influenced by lower fuel and food prices. The slump in non-energy industrial goods prices accelerated to 2.3% in December mostly as a result of the continuing decrease in prices of consumer durables.

The negative change of consumer prices in the country accelerated to 2.1% in February 2014. Reductions in administered prices largely accounted for these developments, though the widening deflation in food price as well as the registered decrease in prices of market services compared to a year earlier also had a contribution.

Inflation in 2014 will remain comparatively low under the influence of the expected favourable juncture on the international commodity markets. Due to the expected increase in domestic demand the negative change of total HICP will slow down and will turn slightly positive in the second half of the year, thus it will accelerate to 1.4% at the end of the year. The average annual inflation will remain slightly negative at 0.2% due to the negative readings at the end of 2013 and the beginning of this year. The still weak labour market and the limited consumer demand for durables and services will continue to keep core inflation at a relatively low level.

The average annual inflation is expected to accelerate to 2.4% in 2015 due to the lower base during the previous year, and then it will slow down to 1.7-1.8% in 2016–2017. Assuming a slight drop in international prices in the coming years, inflation is not expected to accelerate under the influence of external factors. With domestic demand recovery, expectations are for higher relative consumer prices of services in comparison with those of foods and non-food goods. During this period the core inflation is estimated at around 2% and is expected to be slightly above the overall inflation.

Table 2-3: HICP forecast for the 2014-2017 period

	2014	2015	2016	2017
End-of-period inflation (%)	1.4	1.6	1.8	1.8
Annual average inflation (%)	-0.2	2.4	1.7	1.8

The contribution of administered prices to the overall inflation during the period 2014–2017 is expected to be low. The influence of tax policy changes on the dynamics of consumer prices will also be low as the harmonisation of excise duties on liquid fuels has been finalised at the beginning of 2013. The planned increase of the excise duty on cigarettes in 2015 and 2016 is expected to result to an average increase of their prices by 3.9% at the end of each respective year and their contribution to the increase of the total index is estimated at around 0.15 pps for each one of them.

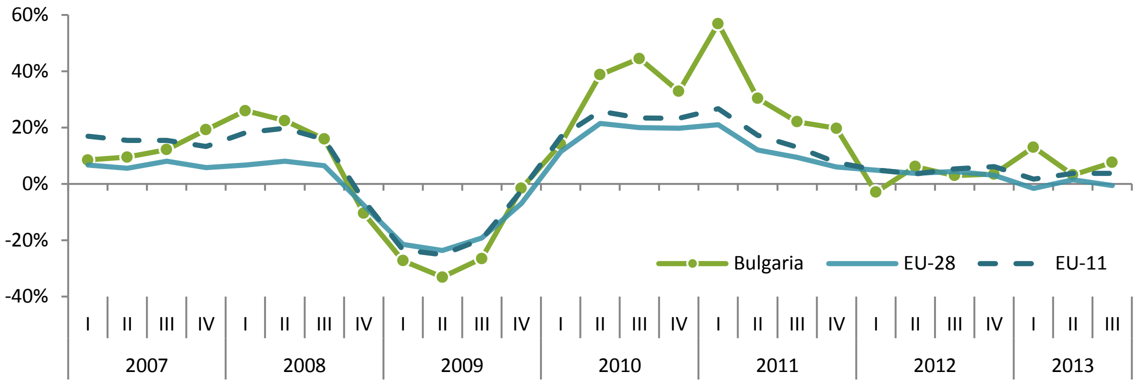
The main risks to the inflation forecast relate mainly to developments in international prices and the rate and structure of economic growth in Bulgaria. International prices of crude oil may increase more substantially as a result of political crises or increased demand. The limited supply of some agricultural goods, especially cereals, on a global scale as a result of adverse weather conditions, could further trigger higher inflation in Bulgaria.

– External Sector

In 2013 the overall balance of the current and the capital accounts reached a surplus of EUR 1.2 billion (3% of GDP) compared to EUR 207 million (0.5% of GDP) in 2012.

Strong exports growth was decisive for that positive development. Improved economic activity in our main EU trade partners had favourable impact on Bulgarian exports. The decrease in international prices, reflected in a drop of producer prices, led to negative export price deflator. As a result, the nominal growth of 7% was mainly driven by increased volumes while prices had a negative contribution.

Figure 2-6: Dynamics of nominal exports

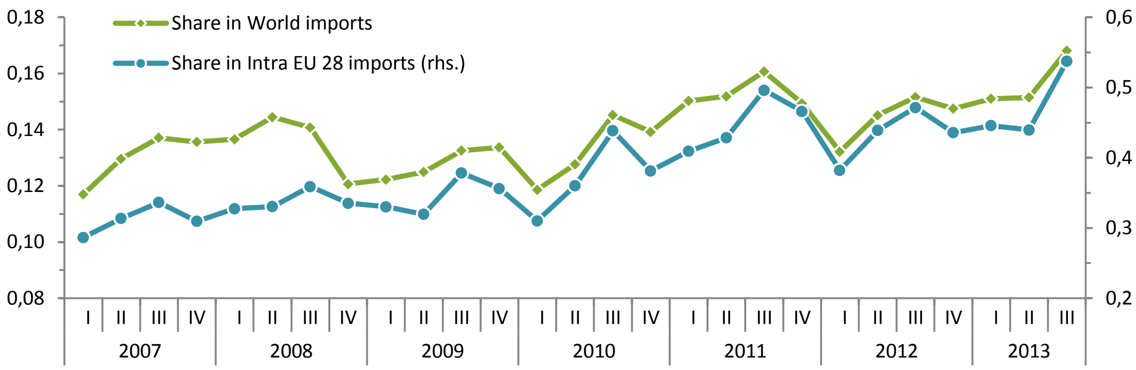


Source: Eurostat

Weak domestic demand, reflecting drop in consumption and investment, has acted as deterrent for imports growth. The downward dynamics of international prices also had a negative contribution to imports nominal change. Growth slowed down to 1.4% compared to 8.1% in 2012.

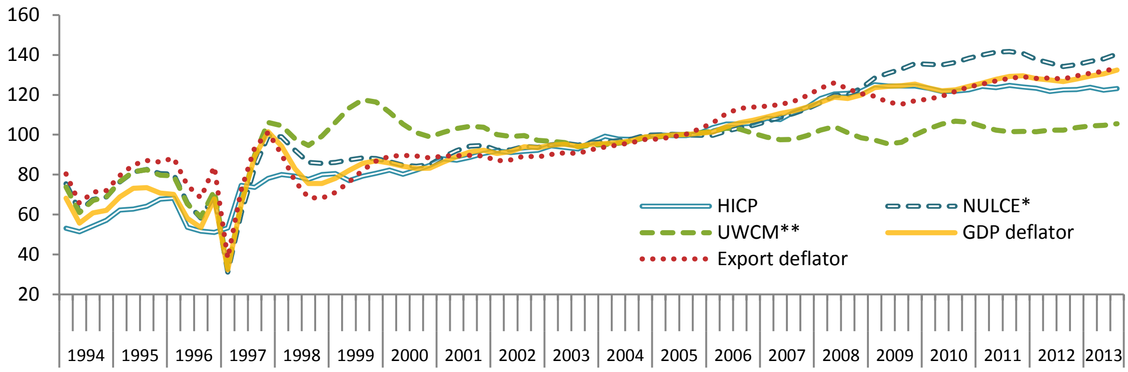
Exports growth acceleration in 2013 reflected in an increase of the country's market shares in international trade and imports within the EU, underlining improved export competitiveness.

Figure 2-7: Bulgaria's share in international trade



Source: MF staff estimates based on WTO and Eurostat data

Figure 2-8: Real effective exchange rate, Bulgaria vis-a-vis 36 industrial countries, 2005=100



* Nominal unit labour costs for the total economy

** Share of labour costs in manufacturing (EC methodology)

Source: EC, MF

Developments of the real effective exchange rate (REER) in the past years showed an improvement of cost and price competitiveness. The REER based on different deflators showed a considerable slowdown in the post-crisis period and in 2012 it has even registered a period of declines compared to the same quarter a year earlier.[11]

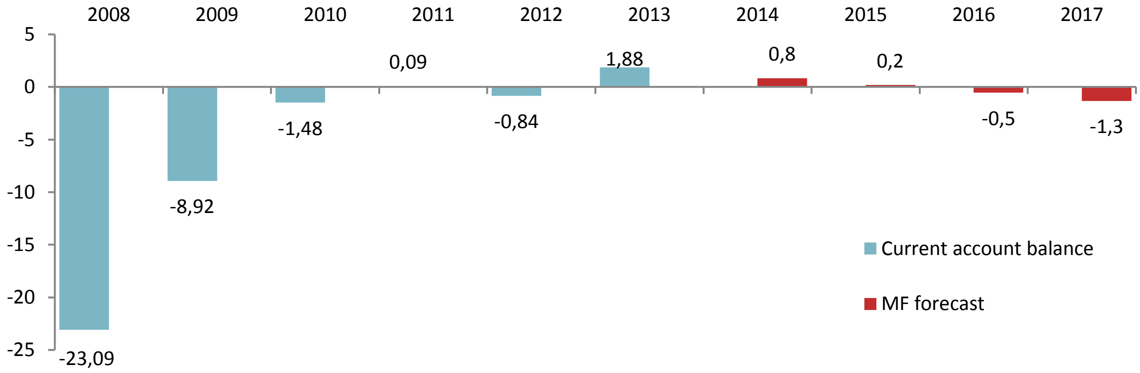
In the medium term REER of the Bulgarian lev is expected to continue appreciating as a result of the positive differential of labour productivity growth and the economic convergence towards the more advanced EU Member States.

Weak domestic demand recovery in 2014 will reflect in slight acceleration of imports growth. The continuing stabilisation of the European economies will have a positive impact on exports while third countries' contribution will be limited. As a result, the exports growth rate will be more moderate, but it will still outpace the increase in imports growth in 2014. With consump-

[11] REER based on the share of labour costs in manufacturing is deemed to measure more reliably the competitiveness of Bulgarian economy since it compares the increase of labour costs in the tradable sector of the economy with that in Bulgaria's main trade partners. Namely there we observe the weakest accumulated increase compared to the base year 2005.

tion and investment activity acceleration from 2015 we expect a gradual widening of the trade deficit. Current account deficit will, from a balanced position, become slightly negative and the deficit will moderately grow in the medium term, reaching 1.3% of GDP at the end of the forecast period. The negative trade balance will be almost entirely compensated by the surplus on transfers, mainly from the EU, and the positive balance of services, which throughout the forecast period will amount to around 5% of GDP. The expectations are for growth in travel receipts, while the acceleration in the merchandise import, which will also support the growth of transportation services import, will act as a deterrent to the net change in the services balance. The capital account will remain practically unchanged as relative share of GDP.

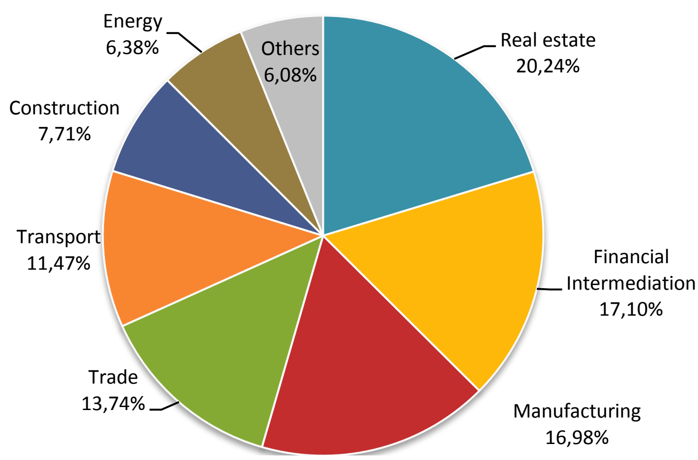
Figure 2-9: Current account balance, % of GDP



Source: BNB, MF

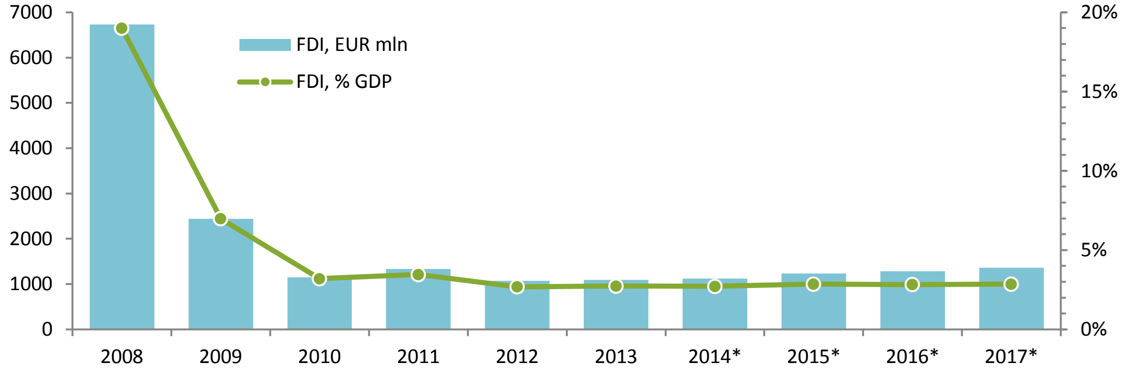
The financial account in 2013 was negative to the amount of EUR 1.5 billion compared to a surplus of EUR 2.2 billion in 2012. The outflows were mainly the result of increase in the assets kept by Bulgarian banks abroad in the form of currency and deposits. Portfolio investment dynamics was determined by one-off transactions – repayment of government debt at the beginning of the year and the placement of corporate bonds in November. Foreign direct investments (FDI) represented the main inflows in the financial account. The latter amounted to EUR 1.1 billion or 2.7% of GDP in 2013, registering an increase of 2.1%. Investments were mainly in *trade, transport, storage and communication,* and *manufacturing*.

Figure 2-10: FDI stock by economic sector (relative share, %)



Source: BNB

Figure 2-11: FDI dynamics



Source: BNB, MF

FDI are expected to stabilise at levels slightly below 3% of GDP in the period 2014–2017, ensuring full coverage of the current account deficit. As a result of the comparatively high liquidity maintained by banks, in the medium term no financial inflows in the sector will be observed. The contribution of the net portfolio investments to the financial account will be determined by the repayment of principal under the government debt in global bonds maturing in 2015 and 2017.

– Monetary Sector

The primary objective of the monetary policy in Bulgaria is to maintain price stability through ensuring the stability of the national currency. This objective is achieved within the framework of the Currency Board Arrangements with a fixed exchange rate of the national currency to the euro.

As of the end of March 2014 the international reserves of the country reached EUR 14.0 billion (recording a drop by 3.7% compared to the same month of the previous year). The main contribution to the decrease in the balance sheet value of the Issue Department on an annual basis as of March 2014 had the changes on the liabilities side (BNB monetary liabilities)[12] , including reduction of liabilities to banks mainly due to reduced banks' funds in the TARGET2-BNB payment system[13]and reduction of their excess reserves in the minimum reserve requirements accounts. The drop in the price of gold resulted in a substantial reduction of the Banking Department deposit. At the end of January 2014 the gross international reserves covered 5.9 months of imports of goods and non-factor services, and the reserves to short-term external debt ratio amounted to 144.3%.

In 2013 the uncertainty in the expectations for external and internal environment developments continued to have an impact for preserving high household savings rate and for the increase of attracted funds in the banking system. At the same time in 2013 the observed changes in the structure of household deposits were due to the introduction of a 10% tax on

[12] Under Article 28 (1) of the Law of the Bulgarian National Bank "The aggregate amount of monetary liabilities of the Bulgarian National Bank shall not exceed the lev equivalent of the international foreign exchange reserves" and the lev equivalent shall be determined on the basis of the fixed exchange rate.

[13] The national component of the Trans-European Automated Real-time Gross settlement Express Transfer system in euro, TARGET2.

income from interest on time deposits at the beginning of the year. Overnight deposits and deposits redeemable at notice up to 3 months which are not covered by the tax reported high growth rates while deposits with agreed maturity dropped. As of December 2013 broad money reported an annual growth of 8.9% compared to 8.4% at the end of 2012, the main contribution thereto having deposits redeemable at notice up to 3 months (6.9 pps) and overnight deposits (5.6 pps), while agreed maturity deposits had a negative contribution of -4.4 pps. The M1 monetary aggregate followed a clearly pronounced upward trend throughout 2013, reporting an annual growth of 17.5% at the end of the year compared to 9.5% in December 2012. As of February 2014 broad money growth accelerated slightly to 9.2% due to the higher growth of the narrow monetary aggregate M1.

Growing household deposits and comparatively low demand for loans determined banks' ample liquidity. A substantial part of their liquidity was used for purchasing foreign assets and for reducing foreign liabilities. These developments resulted in a positive balance of net foreign assets of banks since August 2013 that as of February 2014 reached BGN 2.82 billion.

Low demand for loans in the context of still weak economic activity and the sustained high household savings rate were the key factors determining the trends in lending. Throughout 2013 the annual growth of claims on the non-government sector followed a downward trend, which was sustained in January 2014, when a decrease of 0.3% was reported (2.8% in December 2012). The dynamics of credit to the private sector was mainly influenced by the deceleration of loan growth to non-financial corporations. By sector of economic activity, major negative contribution to the annual growth of claims on non-financial corporations since the second quarter of 2013 had lending in the energy sector[14]. As of February 2014 the slowdown in the annual growth of claims on non-financial corporations ceased and reached 1.3%. Banks' claims on households continued to record a decline on an annual basis throughout 2013 but at a decelerating pace and reported a 0% growth as of February 2014 (-1% at the end of 2012) mainly due to low annual growth of consumer loans.

According to the data of the quarterly bank lending survey conducted by the BNB, banks eased their lending policy in respect to loans to non-financial corporations, whereas easing of credit standards was observed in respect to short-term as well as long-term loans. At the same time banks eased their lending standards for consumer and housing loans to households in the first three quarters of the year and slightly tightened them in the fourth quarter. Banks pointed the following factors which contributed to the easing of their lending policy: the increased volume and decreased cost of attracted funds, competition from other banks and the decreased return on alternative investments.

Interest rates on deposits in Bulgaria continued declining as a result of the sustained increase in funds attracted from residents and the low lending activity. As of February 2014 the weighted average interest rate on new[15] time deposits[16], presented as weighted average on a 12-month basis, declined to 3.2% and was by 0.8 pp lower compared to the same month of

[14] Sector: Production and distribution of electricity, heating and gaseous fuels.

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

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

2013. The weighted average interest rate on new loans[17] decreased by 0.1 pp for the same period to 8.4%, whereas average interest rates on bank loans to households and non-financial corporations decreased by 0.1 pp each — to 9.7% and 8.1% respectively.

In 2013 the Bulgarian banking sector remained stable, continued to maintain considerable buffers and to report relatively good financial performance. The reported unaudited profit of the banking system as of 31 December came to BGN 585 million, which was BGN 18 million higher than the previous year and ensured the preserving of the return on assets. The continued increase in attracted funds in the banking system was accompanied by growth in liquid assets. As a result, the liquidity ratio reached 27.07% as of December 2013, posting an increase by 1.1 pp compared to the same period of 2012. The capital adequacy of the banking system remained high at 16.85% as of the end of 2013, including the Tier 1 capital adequacy ratio of 16.04%, and the accumulated capital surplus increased to BGN 2.7 billion (BGN 2.6 billion at the end of 2012.)

In 2013 the Bulgarian National Bank continued applying the best practices in regulating banks' activities. In October the BNB Governing Council adopted changes to Ordinance No. 5 of the Ministry of Finance and the BNB on the Terms and Procedure for Acquisition, Registration, Redemption and Trade in Government Securities, to the BNB Ordinance No.31 of 2007 on Government Securities Settlement and to the Tariff on the Fees and Commissions Charged on Government Securities Transactions. These amendments are associated with the implementation of a project for participation of the Government Securities registration and settlement system at the BNB as an ancillary system in TARGET2-BNB. By that system the GSs market participants will be able to settle in euro the primary and secondary market transactions in government securities denominated and payable in euro whereby credit and liquidity risks for investors will be minimised. An option is also provided Bulgarian banks to execute cross-border transfers of GS, issued on the domestic market, to central depositories of other EU Member States. On the one hand, this will facilitate their access to credit lines from international financial institutions, and, on the other hand, it will encourage foreign investors to trade in Bulgarian debt instruments. The major changes in the Tariff on the Fees and Commissions Charged on Government Securities Transactions ensue from the requirements of the European Code of Conduct on Clearing and Settlement regarding price transparency and compatibility of prices and services across the depositories in the EU.

According to the MF forecast, the annual growth rate of broad money in 2014 will register slight acceleration compared to the previous year and will reach at the end of the year 9.2%. In the period up to 2016 broad money will grow with relatively stable rates between 8.4% and 9.0%. The net foreign assets of banks will continue their upward trend until 2016. Banks will increase their foreign assets as the amount of attracted funds by residents is expected to exceed the change of loans granted. In 2017 both flows will get close; therefore banks will reduce their foreign assets.

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

The growth of credit to the private sector will slowly accelerate in the next years. At the end of 2014 its growth rate on an annual basis will be 2.9% to reach 5.2% by 2017. During the whole period a trend of gradual increase of the contribution of loans to households, in particular consumer loans, will be observed, which trend will follow the recovery of domestic demand. ▼

3. General Government Balance and Debt

The sound basis on which fiscal policy is being built is a prerequisite for achieving the medium-term objective regarding the budget balance and government debt management. Continuing a consistent and balanced fiscal policy and maintaining the trend of the key fiscal parameters are prerequisites for following the targets set in the updated 2014-2016 medium-term budgetary framework and the 2014 Budget without any need for their revision.

The gradual reduction of the budget deficit in the medium term will continue also in 2017 by a step relevant to those for the rest of the years in the period provided for the last medium-term budgetary framework.

In 2014 fiscal policy is focused on maintaining the budget deficit within the limits set in the Law on Public Finances while ensuring its positive influence on economic activity and growth through more effective and competitive allocation of public resources with the aim to encourage investment, employment and sustainable development of the regions.

Some changes in the macroeconomic assumptions and the fiscal policy were included in the revised 2013 budget whereby some models of the fiscal policy had been corrected were reflected in the updated 2014-2016 medium-term budgetary framework and in the 2014 Budget.

The main objectives of the fiscal policy and public finance management for the period 2014-2016 are focused on realistic budget planning, implementation of consistent fiscal policy to avoid pro-cyclical impact of the budget on the economy, ensuring the Government's priority policies and limitation of ineffective expenditure and structures.

3.1 Policy strategy

The fiscal policy implemented in the past years remains unchanged in terms of the effort to maintain public finance stability. The budgetary framework key fiscal parameters show maintaining the tendency of implementing prudent fiscal policy through fiscal consolidation measures expressed in balanced steps to limit the budget deficit.

Regarding government debt management Bulgaria remains committed to the implementation of consistent policy in line with the objectives and measures set in the Government Debt Management Strategy for the period 2012–2014 (GDMS). Due to the fact that approximately 95% of the General Government sector debt falls within the scope of the Strategy, it is essential in defining the debt policy objectives for the sector. The main objective of the government debt management policy implemented by the Ministry of Finance, set out in the GDMS, is ensuring the necessary resources to finance the budget and to refinance the outstanding debt, as well as ensuring the fiscal reserve level, at an optimal cost and level of risk. The efforts to achieve the main objective of the existing Government Debt Management Strategy will be combined, in favourable conditions, with the entire set of available instruments for optimising the servicing of government debt, reducing the refinancing risk and settling the maturity structure of debt. The drafting of a new GDMS for the period 2015–2017 is pending and therein the main objective followed so far is expected to remain unchanged.

3.2 Medium-term objectives

The medium-term objective for the period 2015–2017 reflects the policy development since the last update of the medium-term budgetary framework. Notwithstanding the changes in the macroeconomic assumptions for the period, expenditure under the CFP are within the limits set by the fiscal rules in the LPF, and on the revenue side the estimates for the funds absorption by the end of the current and the beginning of the new programming period have been taken into account. The fiscal consolidation process continues; the deficit targets set are achieved in downward trends of revenues and expenditure in percentage of GDP and the steps follow the ones provided for in the last medium-term budgetary framework. The deficit target under the CFP as a percentage of GDP for the period 2015–2017 is, as follows: 1.5% of GDP for 2015, 1.1% of GDP for 2016 and 0.9% of GDP for 2017.

3.3 Actual balances and updated budgetary plans for the current year

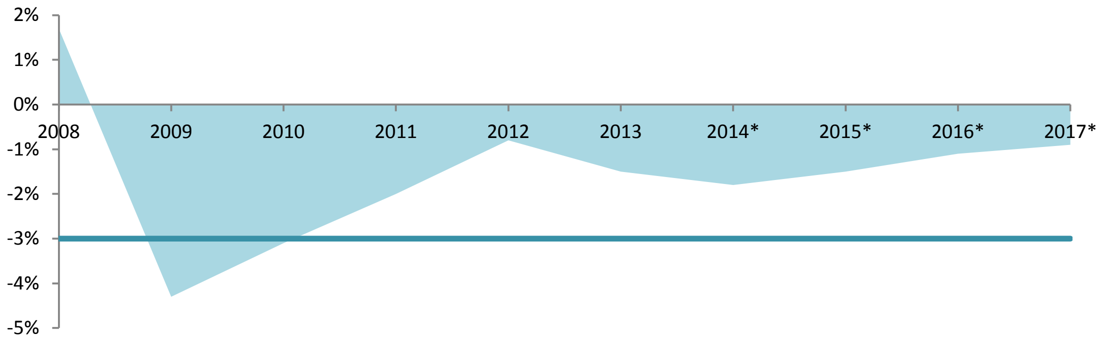
After several consecutive years of rigorous fiscal consolidation, in 2013 the fiscal policy guidelines were changed and in addition to maintaining a disciplined and sustainable fiscal position, supporting the economy and accelerating economic growth had also become leading priorities. The 2013 Law on the State Budget was revised in the middle of the year to reflect the changes in the current economic situation in the country and to ensure the necessary resources for the priority policies in the newly elected Government's programme until the end of the year. In consistency with the principles of the European and national fiscal rules, the fiscal policy envisaged moderately expansive fiscal position. The fiscal target for the year was changed and the deficit for 2013 was foreseen not to exceed 2% of the projected GDP, which was a change compared to the parameters provided for in the previous Convergence Programme.

– Budgetary developments in 2013 for the general government sector

The preliminary estimates for the general government sector deficit show that the deficit for 2013 is 1.5% of GDP which is an improvement by 0.5 pps compared to the fiscal target after the August revision. The main contribution to the improvement compared to the updated programme for the year was the increased EU funds absorption in the second half of the year which was accompanied by measures in the national budget expenditure.

In 2013 the revenues as a ratio of GDP reached 37.2%, 2.2 pps higher than in 2012. The main factors for improved revenues compared to the previous year are the continuing economic recovery, the measures of the revenue administrations to improve collection, the increased EU funds absorption, etc.

Figure 3-1: Budget balance (ESA'95, % of GDP)



* Forecast

Source: Eurostat, MF

In order to improve the business environment and the liquidity of taxable persons, on 1 July 2013 a strict accounting with regard to VAT refund was introduced, including strict adherence to the statutory deadlines for VAT refunds and also introduction of a principle of VAT refunds by priority rating of the VAT returns for refunding filed. In the period July-December 2013 the VAT refunded amounted to BGN 3,279 million or by BGN 200 million more compared to the same period of 2012. In December 2013 the whole amount of VAT declared by the companies was refunded except the amounts that were under tax audits. Data shows that in December 2013 the VAT refunded is BGN 541 million, which is by BGN 302 million more compared to December 2012.

The tax refund under strict rules consistent with normal economic logic and the reliability of the State in its payments to the private sector resulted in reliability of the private sector in paying its tax and social security liabilities.

The effects on revenues of the changes in the GDP components compared to the initial forecasts should also be noted. Exports continued to be the main driver of growth, while the recovery of domestic consumption was weaker than projected. Therefore the projected effects of the expected higher domestic consumption growth on taxes on products and imports did not materialise in full.

The active measures taken by the revenue administrations for improving collection of government receivables supported the revenue side of the budget. In the last months of 2013 more proceeds from taxes on income and wealth were reported, due to the legislative changes introduced at the beginning of the year. This is most valid for the corporate tax whose performance exceeded preliminary estimates. Despite the initial expectations, domestic consumption remained weak and did not report any growth, affecting mostly the taxes on production and imports, whose level as share of GDP remained unchanged compared to the previous year. Social security and health insurance contributions revenues increased by 0.6 pps of GDP compared to the previous year, the main reason was the materialisation of the expected positive effects of the increase of maximum contributory income from BGN 2,000 to BGN 2,200, the increase of the social security contribution to the Public Pension Fund by 20 pps for employees in specialised institutions (military officials, Ministry of Interior employees, investigators and those working in penitentiary establishments), etc. The other current revenues, where part of the EU grants are included, exceeds both the plans and last year's figures, which demonstrates the improved absorption of EU funds from projects that enter completion phase at the end of the 2007-2013 programming period.

Total expenditure for 2013 amounts to 38.7% of GDP, representing an increase by 2.9 pps compared to the previous year. Expenditure policies were focused on measures encouraging economic growth, improving the quality of life and enhancing human resource quality, mitigating the negative impact of demographic changes and trends related to the ageing population and work force on the stability of public finances and social systems, as well as strengthening social protection of the most vulnerable groups of the population while maintaining fiscal stability. After freezing the pensions for three years, in 2013 they had been indexed and Christmas allowances were paid to pensioners with the lowest pensions. Changes were also made in the policies supporting children and households. The amount of childcare cash benefits, the monthly allowances for a child until graduation from high school, the monthly allowance for permanently disabled children were increased. Additional resources were also provided to the healthcare system. The 0.9 pps of GDP increase of expenditures for compensation of employees was a result of the increase of the social security contribution for employees in specialised institutions, paid by the state budget (the aim is to cover the expenditure for the pensions of this category of employees and has equal effect both on revenue and expenditure side), of the increase of the absorption of EU funds being compensation of employees expenditure (incl. technical assistance) and rise in the remuneration in the systems of some autonomous budgets (mainly municipalities) which have autonomy over their budgets. In addition to these policies, a main priority on the expenditure side was the expenditure for gross fixed capital formation (increase by 0.8 pps of GDP compared to 2012) supported considerably by the increased payment under EU funded projects. Funds for the construction of transport and environmental infrastructure and other regional development aspects have a considerable share. In 2013 the amount of payments under projects supporting competitiveness of the economy and human resource development was also considerable. Interest expenditure level – 0.8% of GDP, shrunk by 0.1 pps compared to 2012.

– 2014 Budgetary Plans

The 2014 fiscal strategy envisages general government deficit of 1.8% of the projected GDP. The target set fully meets the existing fiscal rules and is also consistent with the current economic conditions and reflects the measures to improve the business environment, to restore confidence and to limit the possible negative effects on the economy.

The revenue policy aims to improve taxation conditions, by reducing the administrative burden and the costs for businesses and citizens; efforts are also made to improve collection of liabilities and encourage investment activity and employment. Expenditure policies are focused on using the state budget as effective instrument for bringing the economy on the path of sustainable growth, encouraging investment and employment and ensuring the necessary social protection to the vulnerable groups of society.

Main characteristics of the policy on the revenue side for 2014 are as follows:

- Keeping unchanged indirect tax rates and VAT rates;
- Increase in some of the excise duty rates in consistence with the transition periods agreed with the European Commission and the commitments made to achieve the

minimum levels of excise duties in the EU. The excise rates for natural gas used for heating and heavy fuel oils for ship have been increased. The positive effect is expected to be 0.04% of the projected GDP;

- Introduction of a tax benefit for a reduced excise duty on gas oil used in primary agricultural production by using a system of fuel vouchers. The negative effect on revenue is expected to be 0.1% of the projected GDP;
- Introduction of a cash accounting scheme for VAT and a reverse charge mechanism for VAT for supplies of cereals and industrial crops, the aim of the measure being reduction of tax fraud with VAT, limitation of unfair competition and provision of additional financial resources to traders and processors in the sector. The positive effect on revenue is expected to be 0.5% of the projected GDP;
- Legislative introduction of fiscal control over the movement of goods with high fiscal risk on the territory of the Republic of Bulgaria, with the aim to protect the fiscal position, to prevent tax evasion and to limit unfair competition. The positive effect of the measure is expected to be 0.3% of the projected GDP;
- Expansion of the corporate tax benefit "remission of corporate income tax" for enterprises performing activities in municipalities with high unemployment, the aim being to encourage investment and to reduce unemployment in these municipalities. The expected effect of the measure is negative for total revenues and amounts to 0.01% of the projected GDP;
- The rate of the final tax on the gross amount from interest incomes on deposits accounts of individuals within commercial banks has been lowered from 10% in 2013 to 8% in 2014. This change is expected to have a negative effect on revenues of 0.02% of GDP;
- Keeping unchanged the social security contributions for all categories of workers, as well as concerning the Teachers' Pension Fund and the contributions to the additional mandatory retirement insurance;
- The maximum monthly contribution income will be increased from BGN 2 200 to BGN 2 400; the effect on revenue is estimated at around 0.05% of the projected GDP;
- The minimum social insurance thresholds for the main economic activities and occupational groups will be increased by 2.6% on average in 2014 yoy, with estimated positive effect on revenue at around 0.03 % of the projected GDP;
- Introduction of a fee of 20% for the production of electricity from wind and solar energy, the expected revenues being in the amount of 0.2% of the projected GDP.

The priorities on the expenditure side for 2014 are: the investment programme for economic growth and sustainable development of the regions, the programmes for development of education, healthcare and social needs of the population, etc. It should be noted that the Law on the State Budget of the Republic of Bulgaria for 2014 envisages an expenditure buffer to minimise possible risks with negative impact on the budget balance. An option for limitation of some non-interest expenditure and some state budget transfers of up to 95 per cent of the approved annual amounts has been provided, with the possible effects of this measure expected to be about 0.3 % of the planned GDP.

The 2014 budget provides for the implementation of a new public investment programme for growth and sustainable development of the regions. The programme's financial resources have been allocated to finance approved projects as follows:

- for the construction of water sewerage infrastructure and waste management – 0.1 % of projected GDP;
- repair, rehabilitation and maintenance of transport infrastructure – 0.12 % of projected GDP;
- for social infrastructure sites – 0.24 % of projected GDP;
- for other sectors – 0.15 % of projected GDP.

Box 3-1: Public Investment Programme for Development of the Regions and Enhancing Economic Growth:

The **Growth and Sustainable Development of the Regions** Public Investment Programme is an example of a completely new strategically focused policy aimed at economic development and bridging the gap among the different regions of the country. It will help reduce regional demographic disparities and have a more even territorial distribution of the population. The Programme has been launched together with the 2014 State Budget Law and aims to generate possibilities for income and employment and to enhance the competitiveness of the economy. It amounts to BGN 500 million (EUR 255 million), or 0.6 % of GDP. The technical and financial aspects of the calls for proposals are evaluated on the basis of 11 criteria. The projects are selected by an inter-ministerial council chaired by the Minister of Finance. The Government plans to finance the Programme in the years to come as well.

All calls for proposals should be of regional or municipal importance. In 2014, around BGN 350 million (EUR 178 million) will be allocated for the financing of municipal projects while the remaining BGN 150 million (EUR 76 million) will be spent on regionally-oriented projects by the central administration. The main task of the programme is to achieve synergy between the central and local authorities for sustainable regional development and bridging the gap between them will thus start to be implemented. The projects of the ministries that have been approved for financing are targeted at sites located in different towns. Thus, for instance, BGN 20 million (EUR 10.2 million) will be granted to the Ministry of Regional Development to cope with the lack of water in some municipalities. The Ministry of Health will receive BGN 12 million (EUR 6.1 million) for the development of a National Health Information System. The funds granted to the Ministry of Education and Science will be used to improve the infrastructure of four universities and colleges.

Project funds are allotted per sector: for water sewerage and waste management – BGN 78.3 million (EUR 40 million), for transport infrastructure – BGN 104.8 million (EUR 53 million), for social infrastructure – BGN 192.5 million (EUR 98 million), including BGN 25.9 million (EUR 13.2 million) for schools and kindergartens and BGN 15.7 million (EUR 8 million) for higher institutions, BGN 28 million (EUR 14.3 million) for healthcare, BGN 63.2 million (EUR 32.3 million) for sports facilities and BGN 123.7 million (EUR 63 million) for other sectors supporting social and economic development, including BGN 118.8 million (EUR 60 million) for public works sites.

The projects submitted by the municipalities for financing under the Growth and Sustainable Development of the Regions Public Investment Programme which have not been granted financing are not rejected by the Inter-Ministerial Council but remain non-financed for the time being. There will be another possibility for financing these projects later in the year when the Inter-Ministerial Council will process the information about the procedures held under the Public Procurement Law concerning the approved municipal budgets approved. The projects for which no public procurement procedures have been held and for which there is no contracting will be terminated and the resources allotted to them will be transferred to projects that are ready to be implemented. The projects under this programme will continue being implemented in 2015 as well.

In addition to the above, the creation of such a programme is expected to be effective in several other directions[18]:

– **Better focus of public expenditure on growth-oriented projects** while at the same time enhancing competition, which in turn results in a higher quality of budget proposals. All this will contribute to **enhancing allocative efficiency**, i.e. better direction and allocation of resources and goods in the economy.

– **Enhanced technical efficiency** of spending units, i.e. increasing the operational capacity of beneficiaries for preparation, management and accountability of result-oriented projects on the basis of better effectiveness and efficiency of the managerial systems.

– **Better approach to public expenditure management** at macro level with regard to any commitments taken, transparency, predictability of the rules and procedures for selection and evaluation of proposals, which will, last but not least, contribute to achieving greater political and institutional accountability.

Policies in the field of education and science are key for 2014. Additional financing of up to BGN 100 million (0.1 % of projected GDP) is planned for structural measures and programmes for education development including up to BGN 22 million for increasing the maintenance subsidy for universities determined in accordance with the overall assessment of the quality of education and its correspondence to the labour market needs as well as for increasing the differentiated education maintenance standards in priority vocational directions, the aim being to increase the qualification and the quality of human resources and to support the labour market. Concerning secondary education, the main focus is on: reforming vocational training by improving its quality, attractiveness and binding it to business; improving the quality of education by introducing e-learning and improving the facilities; measures aimed at development and incentives for pedagogical staff, etc. The additional resources for higher education will increase the subsidy for state universities depending on the quality of education and its correspondence to labour market needs. Funds of up to BGN 20 million are envisaged for innovation development programmes in 2014.

[18] For more information: World Bank (1998) Public Expenditure Management Handbook (http://www1.worldbank.org/publicsector/pe/handbook/pem98.pdf)

Another priority is the social policy and the measures for meeting the demographic challenges related to ageing of the population, support to families and children, support for an active and independent life of the elderly and of the groups at risk, reduction of poverty and promotion of social inclusion.

- The pension indexation under the so-called Swiss rule (an increase by a percentage equal to 50 per cent of the consumer price index and 50 per cent of the rise of the average insurable income in the previous calendar year) will be resumed in 2014. All pensions are planned to be increased by 3 % as from 1 July 2014, with the overall effect of this increase for pension expenditure expected to be 0.15 % of projected GDP.
- The maximum amount of the pensions received will also increase from BGN 770 to BGN 840 as from 1 July 2014. The expenditure implications will be around 0.02 % of projected GDP.
- The retirement age and social security length of service will be preserved in 2014 at the levels of 2013, which will account for 0.06 % of projected GDP. This measure will result in an increase in the number of new pensioners but will ensure jobs on the labour market and will allow some time to reconsider the problems and the policies in the pension system in the context of specific recommendation No. 2 of the European Commission to reduce early retirement and equalise the retirement age for men and women.
- Payment of one-off allowance of BGN 57.7 million to the pensions in April 2014, the implications for the expenditure side being around 0.07 % of projected GDP.

In the area of social and family allowance and benefits, some changes have been made in 2014 and some actions are being taken to improve the social protection and provide allowance to a wider range of persons in need: the allowance for small children until turning the age of 2 is increased; the social insurance period on the basis of which the pregnancy and maternity leave allowance is calculated is reduced from 24 to 18 months; the monthly allowance for disabled children is increased; introduction of differentiated monthly allowance for children until finishing secondary school and one-off supplementary heating allowance paid in April 2014. The expected effect from these measures on the expenditure side of the 2014 budget is about 0.11 % of projected GDP.

The increase in the minimum wage from BGN 310 to BGN 340 as from 1 January 2014 is another measure aimed at addressing poverty, the implications for the budget being 0.01 % of projected GDP.

The conducting of reforms in the healthcare sector is also among the priorities in the programme for 2014. As to health insurance, the legal framework will be refined so as to optimise the health insurance payments and enhance the control of their allocation and spending. An emergency reform is planned in order to improve the system's structure, to change the equipment and to increase the remuneration of staff. The financing of activities such as assisted reproduction and obligatory immunisations and re-immunisations is transferred from the NHIF budget to the budget of the Ministry of Health.

The 2014 budget plans targeted funds for investment and programmes in the energy sector of up to 0.2 % of projected GDP upon observing the state aid legislation.

3.4 Medium-term outlook, including description and quantification of the effects of strategic policies

In the medium term until 2017, the budget deficit on accrual basis is envisaged to decrease gradually from 1.8% of GDP in 2014 to 0.9% of GDP in 2017. The primary balance at the end of the period will be slightly positive (0.1% of GDP). Given the significant reforms for better revenue collection launched at the end of 2013 and taking effect in 2014, we expect that tax revenue will increase substantially in 2014, continuing to grow at moderate rates over the rest of the period. With expenditures reaching the statutory ceiling of 40% of GDP this year, in the next three years they will be dropping in terms of a relative share of GDP. Capital expenditures and capital transfers will shrink in 2015 by the end of the period due to the beginning of the next programming period and the related lower absorption of EU funds as part of the programme cycle. National capital expenditures remain relatively constant at levels of around 3% of GDP.

The medium-term government strategy has been laid down in detail in the medium-term budgetary framework and in the three-year action plan implementing the National Development Programme: Bulgaria 2020 in the period 2014-2016. It envisages the conducting of a number of measures grouped in several key priority areas that are expected to lead to a more balanced demographic development, improvement in the quality of human capital, promotion of innovation, improvement in the quality of infrastructure and enhancement of the competitiveness of the economy, employment and income as a whole.

- ***Improving the access to and enhancing the quality of education and training and qualitative features of the labour force – envisaged funds of BGN 4.4 billion***

The policy is focused on forming and enhancing the quality of human capital in all its dimensions. It envisages activities for modernisation of the system of education across the country, management of the quality of education and of youth activities, including improvement of the existing facilities, as well as enhancement of creativity and personality-oriented innovation. The policy aimed at improving the qualitative features of the labour force will be ensured by adapting life-long learning and mobility to personal and labour market needs, strengthening the connections between the educational institutions and the labour market, gaining competences in accordance with the requirements of the labour market, promoting the introduction of modern forms of labour arrangement, as well as introducing a dual system of education. In addition, there will be measures for raising the financial culture and education.

The plans also include increasing the social role and the importance of scientific research, development of the scientific potential through integration into the European research area, as well as research and development through programme and competitive financing. As to enhancing the quality of healthcare, innovation for a sustainable and effective health system and enhancing the quality of health services and ensuring access of all citizens to health care and services are envisaged.

- ***Reducing poverty and promoting social inclusion – envisaged funds of BGN 3.7 billion***

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

- ***Achieving sustainable integrated regional development and use of local potential – envisaged funds of BGN 4.9 billion***

The country's regional development is targeted at development of the potential of the Bulgarian regions, decrease of inter-regional disparities and turning all regions into an attractive place for living and doing business. The key areas of government intervention will be: strategic planning and regional management through strengthening the capacity of local authorities, urging town development and better integration of the Bulgarian regions through integrated sustainable urban development and strengthening of the polycentric network of towns, improving urban labour mobility, development of and improving the access to cultural services and sports in the regions and building broadband infrastructure, support for effective and sustainable absorption of the regions' tourist potential through development of the infrastructure for specialised forms of tourism and marketing of the tourist regions and forming regional tourist products, creating conditions for environmental protection and better environment in the regions through enhancing the quality and effectiveness of water supply services for the businesses and the population and building and modernising the sewerage systems and waste water treatment for sustainable water resource management.

- ***Supporting innovation and investment activities to enhance the competitiveness of the economy – envisaged funds of BGN 0.7 billion***

The key priority directions in the three-year period will be building of innovation and scientific infrastructure to improve the connections between business, science and education, and implementation of measures under the Investment Promotion Law. The Innovation Strategy for Smart Specialisation outlining the country's innovation policy priorities will be finalised in 2014. EU funds will be used to finance the building and the further construction of a different type of innovation and scientific infrastructure across the country, while national budget funds will ensure the participation of Bulgarian enterprises in EU programmes such as Eureka, Eurostars 2 and the Enterprise Europe Network. There will be comprehensive measures for promoting the investment in industry and high-tech manufacturing and services, such as support for building infrastructure, education, job creation and financing of innovation products. The National Reindustrialisation Programme will promote the development of sectors and sub-sectors of the Bulgarian industry that are competitive or have a development potential. A pro-active marketing will help support the attraction of targeted investment in the economy, as well as promotion of the country as a tourist destination. SMEs will be supported through activities for improving the conditions for starting up business, as well as introduction of good practices, including wider use of ICT and support for R&D projects.

- ***Strengthening the institutional environment for greater effectiveness of public services for citizens and businesses – envisaged funds of BGN 140 million***

There are plans for a reduction in the administrative burden for businesses, regular review of laws with a view to avoiding its increase, as well as better coordination between the territorial units of the central administration that deliver services. The impact assessment will be institutionalised, the insolvency procedures will be alleviated and the application of the tacit consent principle will be expanded. The quality of the judiciary is expected to be improved through better interaction among the individual units within the structure and extensive application of ICT. Some pilot initiatives will also be launched that will lead to strengthening of the control of law enforcement and limitation of any non-regulated and corruption practices. With a view to a more effective administration, a mechanism for assessment and planning of the need for experts will be devised, the methods of selection will be updated, the internship programmes will be used more actively and the mobility options will be improved. The work related to improving the dialogue with the society when formulating and monitoring state policies will continue.

- ***Energy security and enhancing resource efficiency – envisaged funds of BGN 0.7 billion***

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

- ***Improving transport connectivity and access to market – envisaged funds of BGN 6.4 billion***

In the period up to 2016, the key focus of the policies aimed at creating optimal conditions for development of the economy, improving the access to markets and limiting environmental pollution will be on the effective maintenance, modernisation and development of transport infrastructure, sustainable development of public transport and reform in the railway transport system. A number of projects along the European corridors crossing the country are planned. The most large-scale ones are the further construction of the Struma motorway, finalisation of the Plovdiv-Svilengrad railway, finalisation of the Plovdiv-Burgas railway, modernisation of the Vidin-Sofia railway and recovery of the project parameters of the Ruse-Varna railway. In order to have a sustainable development of the public transport, efforts are mainly focused on the construction and development of smart networks and public transport services. The extension of the subway in Sofia is of paramount importance here. Concerning the reform in the railway transport system, the efforts will be focused on the better management of the railway sector, as well as on the restructuring of BDZ Holding EAD and National Railway Infrastructure Company.

– Ex-ante impact assessment

The table below presents the anticipated effects from the implementation of the measures planned. The SIBILA model has been used to this end. Effects[19] defined as changes in the levels of key macroeconomic indicators have been assessed.

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

Macroeconomic indicator	Effect as of 2016
GDP	8.5%
Exports of goods and services	2.7%
Current account balance (% of GDP)	-3.8 pps
Employment (15-64 years), thousands	6.4%
Unemployment rate (15-64 years)	-2.8 pps
HICP inflation	2.5 pps
Budget balance (% of GDP)	2.3 pps

Source: MF, SIBILA

Resulting from the interventions planned, as of end-2016 there will be a positive change concerning the employment (an increase by 6.4% over the baseline scenario) and the unemployment rate (a drop by 2.8 pps). This is mostly due to the direct effects of investing funds in the economy (opening new jobs) and to indirect effects (reflecting in enhancement of the quality of the employed and the labour force as a whole).

According to the analysis, the country's fiscal stance will improve by 2.3 pps as a result of the implementation of the measures planned. As a whole, the overall effect is a combination of several opposite influences – increasing government expenditure and higher income and better economic conditions leading to an increase in budget revenue.

The country's production output and GDP will grow smoothly in the period under consideration, thus allowing gradual convergence with the EU. The implementation of the planned measures will play a significant role in this regard, with simulations showing that their effect for GDP would be 8.5% higher than the baseline scenario as of 2016. The inflation rate will remain at relatively low levels but will yet accelerate by 2.5 pps compared to the baseline scenario. The exports of goods and non-factor services will also grow more quickly than the baseline scenario (2.7%) as a result of the interventions planned.

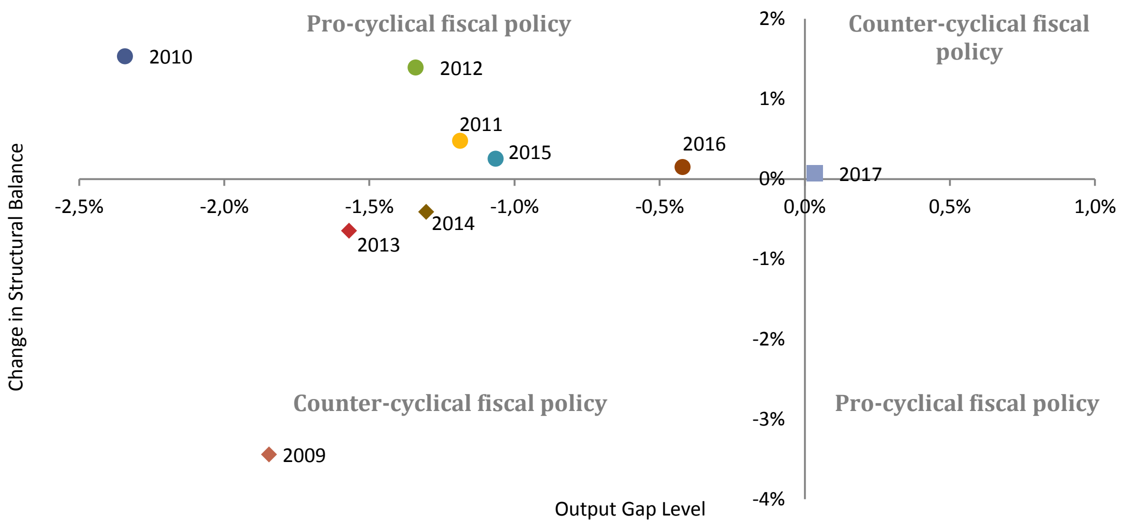
[19] The overall effects from the implementation of measures for the economy are the difference between two scenarios – a baseline scenario (scenario 0), which simulates economic development without action plan interventions, and a hypothetical alternative scenario (scenario 1), which takes account of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

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

In 2013 the budget balance, adjusted for the stage in the economic cycle, reached a deficit of 1% of GDP. The deterioration of the fiscal stance in structural terms by 0.6 pps has been mostly due to higher social payments, capital expenditures and wage and social security contribution expenses for budget sector staff. The fiscal policy in the past year has been assessed as counter-cyclical, having in mind the increase in the output gap from -1.3% in 2012 to -1.6% in 2013. The structural deficit is expected to reach 1.4% of GDP in 2014.This year target for the overall deficit is set to 1.8% of GDP and the cyclical component is estimated at 0.4%. From 2015 to the end of the forecasting period the process of fiscal consolidation will be resumed by an annual average improvement of 0.2 pps. The negative budget balance in structural terms will drop to 1.2%, 1% and 0.9% of GDP in 2015, 2016 and 2017 respectively.

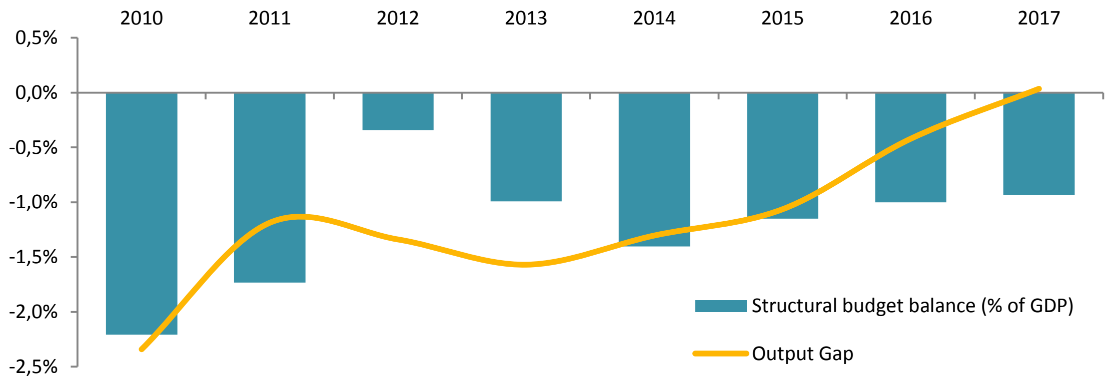
In accordance with the provisions of Article 5, paragraph 1 and Article 9, paragraph 1 of the Preventive Arm of the Stability and Growth Pact (Regulation No 1466/97), the member states are allowed to apply the so-called "investment clause" which allows temporary deviation from the medium-term budget objective concerning the structural deficit in order to take account of national co-financing under the EU Structural Funds, the Trans-European Networks and the Connecting Europe Facility. On 15 October 2013 Bulgaria sent its request to the European Commission for the application of the clause in the period 2013-2014 and received prior approval. The application of this clause will allow for a temporary deviation from the required gradual reduction in the structural deficit until reaching the medium-term budget objective by taking into account the government's investment expenditure. The projected levels of the structural deficit deviate insignificantly from the medium-term objectives in the period 2013-2015. In 2016 Bulgaria is expected to meet its medium-term budgetary objective for the structural deficit of 1%, while in 2017 it is expected to overachieve it by 0.1 pps.

Figure 3-2: Cyclicality of the fiscal position



Source: MF

Figure 3-3: Structural deficit and output gap



Source: MF

According to MF estimates, the growth of modified government expenditure should not exceed 2% in 2013, 2014 and 2017 and 1.5% in 2015 and 2016. The calculations for 2013 show that the reference growth is exceeded, while modified expenditures for 2014 drop in real terms. In the last two years the modified expenditures have grown more than the reference levels of the potential GDP growth. The nominal year-on-year change of modified government expenditure for 2017 corresponds to the rule, being 0.8 pps lower than the relevant reference growth of the potential GDP.

In accordance with the Stability and Growth Pact, the deviation may be considered as the average for two contiguous years, whereby an average growth of modified expenditure of up to 0.25% of GDP would be considered as insignificant. Bulgaria meets this requirement in the period 2013-2015 due to the real drop of modified expenditure in 2014 but exceeds it in the period 2016-2017.

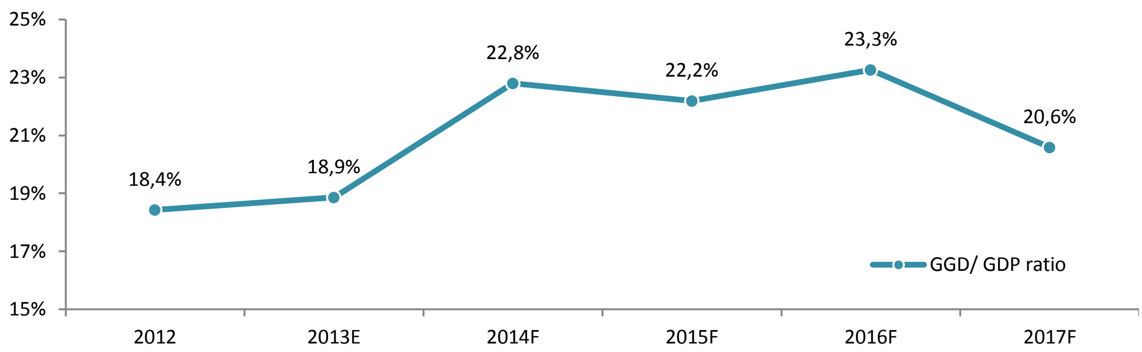
3.6 Debt levels and developments, analysis of below-the-line operations and stock-flow adjustments

The debt policy pursued in 2013 has ensured the required debt financing, including the budget deficit as revised in the amended Law on the State Budget of the Republic of Bulgaria for 2013. In 2013 the Republic of Bulgaria is expected to preserve its second place among the 28 EU members concerning the lowest share of consolidated debt of the general government sector in GDP. The preliminary data for the notification in April show that on the basis of the nominal consolidated debt of the general government amount of BGN 14.7 billion, the general government debt/GDP ratio will be around 18.9%, or far below the reference 60%. Compared to the forecasts in the Convergence Programme 2013–2016, the ratio reported is higher by 0.9 pps The reasons for this difference originate from the reported lower economic growth and the change in the country's fiscal stance in 2013.

The combination of an update to the forecasts of the main macroeconomic indicators finding expression in a lower amount of nominal GDP for 2013 and the need for a revision of the planned budget deficit, and the depleted limit of newly assumed debt after the extraordinary offering of BGN 800 million (EUR 410 million) in the form of short-term bonds for farmer payments have resulted in an increase in the limit of newly assumed government debt in the amended Law on the State Budget of the Republic of Bulgaria for 2013. This provision has ensured the assumption of additional debt financing by using an optimal combination of debt instruments of an amount up to BGN 1.0 billion (EUR 511 million), which increases the limit of newly assumed government debt for 2013 from BGN 2.0 billion (EUR 1.023 million) to BGN 3.0 billion (EUR 1.534 million). The revision remained neutral, however, and did not result in an increase in the regulated limit of the maximum amount of government debt of BGN 14.7 billion (EUR 7.465 million) as of end-2013. Despite the short remaining period, additional debt financing of up to BGN 1.0 billion was timely secured for 2013 by the appropriate combination of domestic issues of government securities and private offering of assignable *Schuldschein* loans under the legislation of the Federal Republic of Germany. This transaction, which is innovative for Bulgaria, has contributed to securing needs for state budget financing and avoiding the concentration of payments in the peak 2015 and 2017, and supported the fiscal reserve level at the end of the year.

The budget policy carried out by the Government combined with the assumptions for moderate GDP growth and the need for maintaining adequate liquid buffers in the budget, as well as the needs for refinancing of the outstanding government debt in the period 2014–2017 will result in a general government debt of around 22–23%. As already mentioned, the forecast takes account of the need to secure financial resources in connection to some specific characteristics of the repayment government debt profile mostly finding expression in the concentration of debt payments at the beginning of 2015 and in the middle of 2017.

Figure 3-4: General government debt/GDP ratio



(F) – forecast

Source: MF

The central government sub-sector has the major contribution to the change in the consolidated debt of the general government sector due to its prevalence of 95% in the overall sectoral debt which is expected to be preserved in each of the years to come. The reclassified financial liabilities of state-owned enterprises in the form of loans, the servicing of which is a responsibility and obligation of the enterprises themselves, have a relatively low share in and influence on the overall debt amount. The underlying debt dynamics factors within the general government sector are therefore the planned budget deficits, the amortisation government debt structure and the need for funds to maintain an adequate level of fiscal reserve at the end of each of the years in the period under consideration.

The basic debt instruments highlighted in the debt management policy to be used as a source of budget financing and refinancing of the debt maturing in the period under consideration are the issues of government bonds on the domestic and international markets. When carrying out this policy, the priority emphasis will be put on the targeted maintenance of a stable debt structure, controlled changes in the rates of the basic government debt parameters and the conducting of an active, predictable and balanced issuing policy through an optimal use of the various options which market-oriented financing provides. The recovery of the European economy that has started and the stable macroeconomic environment in the country combined with the low levels of government debt and deficit and the wide public support to the functioning of the currency board arrangement are prerequisites for considerable investor interest in Bulgarian government bonds – an explicit trend witnessed in the last couple of years.

Maintaining maximum flexibility in the selection of the financing structure in terms of markets, instruments and currencies will be of priority importance in the period 2015-2017. The selection of an appropriate financing option will be the result of the current market conditions, the demand level, the expected interest rates and exchange rates and, last but not last, the resource cost. In order to review net budget inflows and resulting from the serious investor interest, the Ministry of Finance plans to issue in the period under consideration short-term treasury bills in the standard maturities of 3, 6, 9 and 12 months focusing on the first half the relevant year in order to accommodate the timing of inflows and outflows to the single account.

Maximum expansion and diversification of the investor base in Bulgarian sovereign debt is planned by attracting a wider range of foreign and institutional investors. All possible mechanisms that secure the required debt financing will be applied, i.e. including loans and securities from both domestic and foreign sources and in different forms such as auctions, public issues, private offering, etc. Given the dominant share of market-oriented financing, volatility and possible insecurity, even though episodic, that accompany the development dynamics of international capital markets are identified as the key risks.

Along with the measures taken to avoid any future sizeable delayed payments to businesses and to fulfil the social commitments taken to citizens and achieve an accelerated economic growth, debt financing is planned to be used for productive public expenditure of investment character after analysing and evaluating the effects and the benefits thereof upon adhering to the existing legislation. The potential sources of financing from international financial institutions in the period 2015–2017 include EIB loans under the Structured Programming Loan Agreement of EUR 700 million and the forthcoming contracting of a new agreement of EUR 500 million for the co-financing of projects under EU funds in the next programming period 2014–2020.

In order to secure the financing needed to conduct budget policies, preserving the country's financial stability and guaranteeing Bulgaria's position as a country preserving budget discipline, the State Budget of the Republic of Bulgaria for 2014 sets the following government debt limits:

- The maximum amount of the government debt as of the end of 2014 may not exceed BGN 18.0 billion (EUR 9.2 billion);
- The maximum amount of the new government debt that may be issued under the Government Debt Law is BGN 4.4 billion (EUR 2.2 billion);

Local government debt accounts for 5 % of the consolidated debt of the general government sector. Resulting from the consolidation measures taken in the sub-sector, for the first time in

2013 there is a negative growth of the reported nominal amount of municipal debt. The preliminary data for 2013, the restrictions set by the Public Finance Law for the debt of municipalities in Bulgaria and the flexible FLAG financing schemes presuppose a relatively weak increase in the local government debt and preserving it within 5% for the entire period under consideration from 2014 to 2017.

The FLAG fund has consolidated itself as the financial instrument preferred by municipalities for the implementation of EU projects mostly in the field of municipal infrastructure. The Fund thus appears to be an important financial source for conducting government policies aimed at supporting Bulgarian municipalities in the absorption of EU funds. The signing of a new loan agreement with EBRD for EUR 35 million in 2013 will further strengthen the Fund's position as a secure source of financing and a reliable partner of Bulgarian municipalities.

The social security funds sector has continued its influence on the reduction of the consolidated debt of the general government sector by adhering to the principle of consolidation. Taking account of the existence of only one loan (maturing in June 2016) and the accumulated financial assets in the form of GS issued by the central government sub-sector, the social security funds sector practically appears to have an extremely small contribution to gross debt. Another argument in this direction is the forecasts for an increase in the sub-sector's assets in the form of GS by an average of around BGN 70 million (EUR 36 million) yoy in the period under consideration.

The forecast of a slight yet comparatively sustainable increase in the general government debt is accompanied by a further improvement in the currency, interest and maturity structure, thus contributing to the minimisation of the market risks with regard to the debt portfolio. After the payment of the liabilities under the USD-denominated global bonds at the beginning of 2015, the debt denominated in currencies other than EUR and BGN is expected to drop down to 1.5% of the overall debt at the end of 2015, while as to the interest structure, the share of the debt with floating interest rates is expected to continue dropping sustainably, reaching to around 7% at end-2017.

Efforts are constantly made to avoid the concentration of sizeable maturities of government debt. Measures are planned to be taken in the period of consideration to expand the maturity of the outstanding debt and to build a balanced maturity structure of the debt portfolio along with extension of the benchmark curve.

The interest expenditure-to-GDP ratio is forecast to remain within 1% both on cash and accrual basis. Despite the fact that nominal debt increases, when reporting the country's sustainable macroeconomic and fiscal stance, the new financing is expected to be at considerably lower interest rate levels compared to the maturing issues of previous years.

The thus established combination of prudent and transparent debt policy, well balanced debt portfolio and sustainable macroeconomic indicators is a prerequisite for the successful accomplishment of the goals set in the Government Debt Management Strategy and in the debt policy as a whole.

3.7 Budgetary implications of major structural reforms

This item describes the implications for public finance of the measures taken when implementing strategic government policies.

– Implications for the Expenditure Side of the Budget

The comparative analysis of long-term public expenditure for pensions in EU members[20] shows that pension expenditures in Bulgaria are relatively low, with the forecasts of the European Commission for the same period showing a downward trend and reaching a level of around 9.2% of GDP (against 11.3% for EU-27 and 12.3% for the euro area).

The pension reform undertaken recently aims at ensuring stable revenue in the pension system, as well as at making pensions more adequate in view of the demographic challenges for the country finding expression in a reduction in and ageing of the population and of the labour force. The further increase in the retirement age will be subordinate to enhancing the stability of the pension system in the long run, solidarity among generations and reducing the poverty risk for elderly pensioners. Furthermore, the reform will have a positive impact on the public finance in view of the reduction in the public expenditure related to pension scheme financing.

The pension expenditure forecast for the period 2015–2017 takes account of the provisions of the Social Insurance Code and the assumptions in the Government's medium-term fiscal framework.

A decision is to be taken by end-2014 on the possibilities and conditions for early retirement.

The maximum amount of the pensions received by one person will be increased from BGN 770 to BGN 840 for all pensions as from 1 July 2014, from BGN 840 to BGN 910 as from 1 July 2015, from BGN 910 to BGN 980 as from 1 July 2016 and from BGN 980 to BGN 1,050 as from 1 July 2017.

The weight of each year of length of service in the pension formula will increase from 1.1% to 1.2% as from 1 January 2017 for newly granted pensions.

Table 3-2: Estimated pension expenditures[21]

Year	BGN M	% of GDP
2014	8,103.4	10.0
2015	8,371.6	9.9
2016	8,630.3	9.7
2017	8,941.3	9.6

Source: NSSI

The pension forecast plans a pension increase as from 1 July every year by a percentage equal to the sum of 50 per cent of the insurable income increase and 50 per cent of the consumer

[20] Data from the latest "AgeingReport" 2012 of the European Commission.

[21] Data up to 2017 are based on forecast of revenue and expenditure of the consolidated PSS budget for 2015-2017 dated 4 March 2014.

price index for the previous calendar year. As displayed in the table below, pension scheme expenditure and supplement in the medium-term reference programme drop from 10% in 2014 to 9.6% of GDP in 2017.

– Implications for the Revenue Side of the Budget

I. Legislative Amendments in the Tax Policy

Table 3-3: Revenue implications of the amendments to tax and social security legislation[22]

Amendments to tax legislation	2014	2015
Budgetary implications of the legislative amendments to CITL (revenue carried forward from the 2013 financial year).	BGN 90 million	
Implications of the improved corporate tax remissions granted to enterprises with production activities in municipalities with high level of unemployment.	BGN -4 million	BGN -4 million
Implications of the introduction of tax relief for contractual labour remuneration not exceeding 12 minimum monthly wages for the relevant year;		BGN -150 million
Implications of the gradual reduction in the final deposit earnings tax rate for physical persons;	BGN -16.5 million	BGN -16.5 million
Implications of any amendments affecting VAT revenue (VAT reverse charge mechanism for the supplies of corn and technical crops, fiscal control of the circulation of goods of high fiscal risk on the territory of the Republic of Bulgaria).	BGN 620 million	BGN 620 million
Revenue implications of the reduction of the administrative burden in the area of excise duty legislation.	BGN 80 million	BGN 80 million
Revenue implications of the increase in excise duty rates of tobacco products in line with the agreed transition period to reach to the minimum Community levels of excise duties.		BGN 80 million
Revenue implications of the increase of VAT rates of tobacco products.		BGN 16 million
Implications of the reduced excise duty rate for gas oil used in primary agricultural production through the fuel voucher system.	BGN -54 million	BGN -30 million
Customs duties implications of the liberalisation of trade on the basis of the bilateral agreements between EU and third countries.	BGN -5 million	
Budgetary implications of the changes to the maximum contributory income.	BGN 37.8 million	BGN 30.8 million
Budgetary implications of the changed minimum thresholds for social security contributions for the main economic activities and groups of professions.	BGN 27 million	
Total net revenue implications	**BGN 775.3 million**	**BGN 626.3 million**

Source: MF

[22] The amendments to tax legislation for 2015 aim to improve the business environment and reduce the administrative burden, as well as to improve the collection of revenue from certain taxes. The effect of these amendments will be calculated at a later stage after evaluating and deciding the specific parameters.

Corporate Taxes

The estimate for corporate tax revenue (including taxes on dividends, liquidation quotas and income of resident and non-resident legal persons) is based on retaining the basic tax rate of 10 per cent, the forecast macroeconomic indicators, the data about losses from previous years declared by taxable persons that are subject to deduction in subsequent accounting periods, as well as on some legislative amendments.

As from the beginning of 2013, the base for determining monthly and quarterly corporate tax prepayments is the estimated tax profit for the current year as declared by the taxable persons. Alternative CITL taxes, such as tax on expenses, tax on the public financed enterprises' income and tax on vessels operation activity, have become annual rather than monthly taxes.

The changes to the regime of declaration and payment of alternative CITL taxes have led to an one-off effect of BGN 90 million resulting from the transfer of revenue from these taxes from 2013 to 2014.

Tax preference for withholding tax exemption of the income from interest on bonds or other debt securities issued by resident companies and eligible for trading on a regulated market in the country or in an EU member, or in another EEA state has been introduced as from 1 January 2014.

Following a positive decision of the European Commission, tax relief in the form of state regional development aid will also apply in 2014 by expanding the scope of the municipalities where corporate tax may be remitted. The negative implications of expanding the tax preference for enterprises with production activities in municipalities with high level of unemployment amount to BGN 4 million.

Personal Income Taxes

The estimate for the revenue under the Personal Income Tax Law (PITL) for 2014–2017 has been made upon preserving the single tax rate of 10% (with no income-tax-free threshold) for all taxpayers, except for the income from economic activities of sole owners for which the tax rate is 15%. It takes account of the expected average wage growth, legislative amendments, as well as the expected better collection of PITL taxes.

It also takes account of the budgetary implications of the introduction of tax relief for contractual labour remuneration not exceeding 12 minimum monthly wages for the relevant year which are negative and amount to BGN 150 million for 2015.

As from 1 January 2013, the deposit interest earnings with commercial banks are subject to a final tax of 10 per cent. The amendments to PITL envisage a gradual reduction in the tax rate until becoming zero in 2017 and afterwards. The budgetary implications are negative for the entire period, being BGN 16.5 million for 2014 and 2015, BGN 16 million for 2016 and BGN 33 million for 2017.

Value Added Tax (VAT) Law

When estimating VAT revenue, the following implications of the legislative amendments have been taken into account in addition to the macroeconomic indicator forecasts:

- positive effect of up to BGN 400 million from the introduction of the VAT reverse charge mechanism for the supplies of corn and technical crops applied by end-2015 in accordance with Council Directive 2013/43/EU of 22 July 2013;
- positive effect of BGN 220 million per annum from the introduction of fiscal control of the circulation of goods of high fiscal risk on the territory of the Republic of Bulgaria;
- positive effect of BGN 16 million in 2015 from the increase in the excise duty rates for cigarettes;
- positive effect of BGN 60 million per annum from the strengthening of customs supervision and control and establishing a uniform practice in the admission of goods in free circulation with regard to the elements of taxation, and better cooperation with law enforcement authorities in view of achieving more effective results in the counteraction to violations and crimes.

The VAT revenue forecast takes account of the assumption for preserving the trend of increasing the relative share of VAT proceeds in consumption from 13% in 2014 to 13.7% in 2017.

Excise duties

Excise duty revenue is mostly formed by two groups of goods – fuels with a relative share of 47.8% and tobacco products with a relative share of 44.5%. The rest of the excise goods (alcoholic beverages, beer, electricity, etc.) account for a relative share of 7.7%. The excise duty revenue forecasts take account of the planned increase in some excise duty rates in line with the agreed transition period for achievement of the minimum levels of Community excise duty rates for the period 2014-2017.

An increase in the excise duty rates for cigarettes is planned in line with the agreed transition period for achievement of the minimum levels of Community excise duty rates for the period 2015-2017.

Excise duties		**2014**	**2015**	**2016**	**2017**
Excise duty on cigarettes	BGN/1,000 pieces	154.45	160.00	165.00	170.00

When estimating excise duty revenue, the following implications have been taken into account in addition to the macroeconomic assumptions:

- positive effect of BGN 80 million per annum from the increase in the excise duty rates for cigarettes;
- positive effect of BGN 100 million per annum from the strengthening of control over trading in excisable goods.

A new Excise Duties and Tax Warehouses Law is being drafted and is planned to become effective as from 1 January 2015. Its elaboration is aimed at improving the business environment and reducing the administrative burden through the elaboration of clear provisions and simplified procedures for implementation by the economic operators (shortening the periods for reimbursement of excise duties, introduction of possibilities for direct exemption from excise duties, alleviation of the collaterals regime, etc.) and increasing budget revenue through the introduction of effective legislative measures for fighting tax fraud, tax evasion and smuggling of excisable goods.

II. Measures for Improving Collection and Tackling the Shadow Economy

Implementing the government's policies aimed at enhancing the effectiveness and efficiency of the activity of the revenue agencies and increasing budget revenue through effective measures for prevention and addressing tax fraud and smuggling of excisable goods, as well as implementing Specific Recommendation 1 of the European Commission, the following legislative and administrative measures have been taken:

National Customs Agency

The National Customs Agency has made an analysis and has taken specific measures to improve the Bulgarian Excise Centralized Information System (BECIS). In order to enhance control, increase collection of excise duties and VAT and guarantee equal treatment of economic operators, the BECIS system was launched on 1 April 2013. It will ensure automaticity of the process of submission and processing excise documents, exchange of information and control of the overall chain of sale of excisable goods.

An obligation has been introduced for individuals to submit electronically the excise tax documents, debit/credit statements and documents of certification of purpose of the excisable goods to which reduced excise duty rates apply. It is provided for to validate a paper document, in case of extraordinary circumstances, when the information system of the National Customs Agency is unavailable. A certain time limit is set in which individuals are to submit electronically the documents issued within that period.

In addition to the above, some activities have been carried out with regard to the refinement and upgrading of the Bulgarian Integrated Customs Information System (BICIS). The existing risk module analysis has been upgraded by creating a centralised version of this module and upgrading its functionality. A possibility has been created to define a wide set of risk criteria, recommend actions in connection to the specific risk profiles, which allows to select shipments of high risk as of the time of their customs clearance.

Table 3-4: Measures aimed at effective collection of budget revenue and counteraction to any violations of customs, currency and excise legislation[23]

2014, mln BGN

№	Short description of the measure	Fiscal implications for the revenue (amount) / Estimate of prevented damages			
		Customs duties	VAT from imports	Excise duties	Total revenue
TOTAL		**12**	**261**	**283.4**	**556.4**
1	Strengthening of customs supervision and control and establishing a uniform practice in the admission of goods in free circulation with regard to the elements of taxation (tariff rating, origin of goods and customs value) and customs clearance	2	20		22
2	Improving the organisation of activities related to the control on closing the transit regime		5		5
3	Laying down the priority areas of control for each customs office depending on geographical location, seasonality, specific economic operators and identification of local risks	2	20	20	42
4	Enhancing the cooperation with the law enforcement authorities in view of achieving more effective results in the counteraction to violations and crimes	1	15	40	56
5	Strengthening the control on the territory of the border points or in the areas of the border points concerning the illegal transportation and carriage of tobacco products through the external EU borders and the state border of the Republic of Bulgaria			40	40
6	Determining and implementing a national priority control area for the railway transport			8	8
7	Inspections under international cooperation		5		5
8	Targeted inspections and audits of economic operators, on-going analysis of the results thereof	1	7	20	28
9	Reducing the administrative burden in the area of excise duty legislation			80	80
10	Creating an adequate business environment for the correct economic operators, including the attraction of new economic operators on national level through establishment and consolidation of good practices	6	189	75.4	270.4

The process of setting up an *Ex-post Control* module started in 2013 as part of a project for upgrading BICIS which was implemented on 24.10.2013. The overall objective of the project is to improve the services for citizens and businesses and to enhance their trust in the customs authorities. The module will contribute to improving the process of risk analysis and assessment when selecting economic operators subject to inspection, setting up and maintaining a

[23] The measures set forth in the table below are related to administrative and organisational actions (with the exception of measure No 9) due to which the estimated implications are not included in Table 3-6 "Revenue implications of the amendments to tax and social security legislation".

register, setting up a mechanism for improved communication and exchange of data among the ex-post control units.

Furthermore, new internal documents have been drafted aiming to optimise the activities related to customs intelligence and ex-post control. The existing Risk Management Handbook has been updated within the implementation an OLAF project under the Hercule II programme. A Methodical Guide to Customs Inspections within the Ex-post Control was approved in 2013. It optimises the process of planning, analysis, evaluation and selection of economic operators and expands the scope of the control areas when making inspections.

A joint analytical and information centre is being set up for exchanging information and performing analytical activities and interaction among the National Revenue Agency, the National Customs Agency, the General National Police Directorate, the General Border Police Directorate and the National Security Agency. A System for Exchange of Risky Information is to be introduced which is an instrument for collection, storage and exchange of information for the purposes of risk analysis, for facilitation of control activities and documentation of the results from the control actions taken.

National Revenue Agency (NRA)

The following legislative measures have been taken to fight tax fraud and evasion:

A VAT reverse charge mechanism for supplies of cereals and industrial crops has been introduced from 1 January 2014. The measure has been implemented with the purpose to limit unfair competition in the sector of production and trade of cereals and industrial crops, to secure additional working capital to traders and processors of cereals and industrial crops and to raise budget revenues from VAT by means of reducing tax frauds. The reverse charge mechanism is one of the most effective measures to combat tax fraud and the expected positive effect on the budget amounts to up to BGN 400 million.

From 1 January 2014 fiscal control has been introduced on the movement of goods with high fiscal risk on the territory of the Republic of Bulgaria with the purpose to protect the fiscal position and to prevent evasion of VAT, corporate taxes and personal income taxes, as well as to limit unfair competition. The expected positive effect on the budget amounts to BGN 220 million.

From 1 January 2014 there is a new arrangement of the process of collecting public receivables, one of its purposes being to streamline legal proceedings in relation to the examination and selection of debtor's assets.

A legal possibility has been created of rescheduling and deferral of liabilities for taxes and mandatory insurance contributions under relieved conditions for a longer period and in a larger amount. The aim is the liable persons in temporary financial distress to be able to serve both their current liabilities for taxes and insurance contributions, and the arrears covered by the authorization for deferral or rescheduling.

Each year there are targeted campaigns for collection of overdue public receivables. For 2014, 17 phone information campaigns have been planned, which will be aimed at encouraging voluntary payment of arrears under PITL, health insurance contributions and fines and fees imposed by various institutions, to selected liable persons by all NRA regional offices.

In view of optimizing the process of collecting public receivables the electronic exchange of documents and data with public creditors as well as with institutions keeping information about debtors' property/assets is envisaged to be enhanced. In this connection the NRA has developed an e-service whereby public creditors will be able to directly enter data on the executive grounds subject to enforced collection. With this purpose the existing agreements and instructions are being reviewed and updated with texts related to the electronic exchange of data and documents.

The development of comprehensive specialized software started in the beginning of 2014, covering all the activities of collecting public receivables. It is being developed with the own resources of the NRA and it should be completed by 2015. The expected positive effect on the budget of the above measures in the area of enforced collection is up to BGN 150 million per year.

A Compliance and Risk Minimisation Programme has been prepared, which contains the specific measures (control, communication, proposed legislative measures) that will be taken by the NRA in 2014 for addressing already analysed risks of non-compliance with the law in the following three priority areas: shadow economy and concealed turnovers, failure to pay insurance liabilities, as well as newly analysed risks that have not been addressed so far. The Programme includes a total of 13 risks, 11 of which will be addressed with control measures – audits, surveillance and operational checks. A legislative change related to concealing income in businesses related to taxi services has been envisaged, as well as in the area of phone calls, sending invitations and communication campaigns. The expected effect of the Programme is a reduction of the total residual damages under these 13 risks to the amount of BGN 226 million in 2014, the annual average amount being about BGN 40 million. The exchange of information between the Customs Agency and the NRA as regards the executed intra-Community supplies and acquisitions as well as the joint analysis for identification of sites carrying out illegal production, storage and sale of motor fuels and for selection of persons at risk for the purpose of making inspections should be completed by June 2014. ▼

4. Sensitivity Analysis and Comparison with the Previous Update

4.1 Alternative scenario and risks – macroeconomic effects on Bulgaria's economy from a deterioration in the external environment

The alternative scenario has been prepared on the assumption of a complicated situation with Ukraine, while not assuming any interruption of imports from the crisis region to Bulgaria, but just a rise in the prices of key raw materials. Thus there will be no cessation of production in the country and the only impact on the industry will be related to the more expensive resources.

According to this scenario we expect an increase in the international price of crude oil by 20% on average for the year. The price of natural gas that Bulgaria imports is expected to remain unchanged as it is determined by long-term contracts and, moreover, the country has no alternative for supplies from other countries.

Thus the external factors of inflation will strengthen, leading to higher inflation in 2014 compared to the baseline scenario both in terms of the higher energy prices and as a result of second round effects on the other HICP components and the higher producer prices, which will have an impact on inflation in 2015, too. Thus the annual average inflation is expected to increase compared to the baseline scenario by 0.6 pps in 2014 and by 0.9 pps in 2015.

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

	2014		2015	
	Alternative scenario (%) change	Difference compared to the baseline scenario, pps	Alternative scenario (%) change	Difference compared to the baseline scenario, pps
Price of Brent oil, USD/barrel	20	22.8	-5.8	0.0
Inflation (HICP) – average for the year	0.3	0.6	3.2	0.9

Source: MF

At the same time there is an assumption of limited Bulgarian exports for the nine months until the end of 2014. About 2.6% of the annual exports of goods are targeted to Russia. The main products are *medical products and pharmaceuticals, machinery and equipment for general purpose* and *electrical equipment*. The assumption is for a complete embargo on exports to

Russia after the first quarter of 2014. In addition, the scenario also envisages a decline in the number of visits of Russian citizens to the country. In 2013 Russia was the leading country in tourism visits (with a share of 11.5 %), taking the fifth place in the total number of visits to Bulgaria (7.6% of all visits). In the alternative scenario, the total share for 2014 is reduced to 5%. The two constraints will lead to a total negative effect on the real growth of exports of goods and services of 4.8 pps in 2014. On the other hand, the more expensive raw materials will be reflected in a rise in goods export deflators. The total effect will be a reduction in the nominal exports of goods and services by about BGN 1.2 billion.

The deteriorated environment associated with the decreased production of exporting enterprises will affect the investment plans of enterprises and the consumption of households. As a result, domestic demand growth will slow down compared to the baseline scenario. Weaker domestic demand, together with the limited exports growth, will lead to a slowdown of the real imports of goods by about 3.9 pps. At the same time, import prices will increase significantly compared to the baseline scenario. The nominal drop in total imports will be about BGN 290 million.

The above mentioned effects will be reflected in a reduction in real GDP growth compared to the baseline scenario by about 1.1 pps in 2014. Both the deteriorated external environment and the domestic demand will contribute to this slowdown. The expected lower growth of the Bulgarian economy by 0.5 pps in 2015 will be primarily due to weaker domestic demand, as the higher inflation is expected to be reflected in lower growth of private consumption, while the recovery of investment activity in the country will be slower.

Table 4-2: Effects on the main macroeconomic indicators

Real growth rates	2014		2015	
	Alternative scenario	Difference compared to the baseline scenario, pps	Alternative scenario	Difference compared to the baseline scenario, pps
GDP	1.0%	-1.1	2.1%	-0.5
Households' consumption	0.7%	-0.6	2.3%	-0.7
Gross fixed capital formation	1.7%	-0.4	4.1%	-0.2
Exports of goods and services	2.1%	-4.8	5.3%	-0.5
Imports of goods and services, %	2.5%	-3.9	5.8%	-0.8
Employed	-0.4%	0.5	0.1%	-0.4
Unemployment rate	13.2%	0.4	13.1%	0.7

Source: MF

The lower dynamics in foreign trade and the negative impact on the contribution of net exports are expected to similarly affect the development of the labour market. The most significant impact is expected to be on industry, which in times of crisis has shown a rapid adjustment to changing economic conditions by shrinking labour costs. Thus the increase in producer prices in the sector will make end products more expensive and the need to increase competitiveness on external markets will result in a further drop in the number of employed persons. In contrast to the baseline scenario, in the alternative scenario the recovery of the labour market will not take place. The total number of employed persons is expected to decline by 0.4%, at an expected slight increase in employment of 0.1% in the baseline scenario. The unemployment rate will continue to rise reaching 13.2%, in contrast to the expected, albeit insignificant, decrease in the baseline scenario. The slowdown of the economic activity in 2015 in the alternative scenario as compared to the baseline one is not expected to be related to continuing dismissals of employed persons due to a significant weakening of the negative impact of the external environment. During the period under review employment will stabilize at its level from the previous year, while the slower recovery of the labour market laid down in the alternative scenario will precondition the high level of unemployment in 2015, too, which is expected to remain close to the estimated percentage for 2014.

4.2 Sensitivity of budgetary projections to different scenarios

– **Sensitivity of budgetary projections to the alternative scenario (macroeconomic effects on the economy of Bulgaria from deterioration of the external environment)**

The changes in the structure and pace of economic recovery significantly affect the fulfilment of the planned medium-term fiscal objectives and parameters. The alternative scenario assumes negative impact on most components of GDP, which in turn will lead to collecting less budget revenues in 2014 and 2015 compared to the baseline scenario.

Tax and social insurance revenues will be influenced both on the side of direct taxes as a result of the lower profits of the sectors affected by trade restrictions and the negative effects on the labour market, and indirect taxes as well due to the lower levels compared to the baseline scenario of final consumption and imports of goods and services. The rise in inflation leads to the opposite effect, which, together with the significant reduction in the nominal value of exports in 2014 and 2015, offsets the negative effects on indirect taxes resulting from the lower domestic demand and imports.

The lower budget revenues compared to the baseline scenario will lead to deterioration of the General Government balance in 2014 and 2015. If total expenditures stay at the level of the baseline scenario, the budget deficit will reach 2.1% of GDP in 2014 and 1.6% in 2015, respectively.

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

The current structure of the consolidated government debt in terms of its currency and interest composition does not imply significant dependence of the nominal value of government debt as well as of the amount of funds for debt service on any changes in the levels of exchange rates and interest rates on international markets in the period 2014–2017 (with slight variations until the beginning of 2015, when the USD-denominated global bonds of the Republic of Bulgaria, with a nominal value of USD 1086.35 million, are maturing).

The level of influence of market risks was established by analysis of the sensitivity of the debt portfolio for the period 2014–2017, while using a highly negative forecast for the change in the exchange rates of the US dollar and the Japanese yen (the currencies other than EUR and BGN that had the most significant share – 12.6%, in the debt portfolio at the end of 2013) towards an increase of 20% and an increase of the 6-M LIBOR for EUR and USD as well as the 6-M EURIBOR by 300 b.p (the interest rates that had the most significant share – 14.6%, in the debt portfolio at the end of 2013) compared to the values of these parameters used in the preparation of the estimates for the medium-term budgetary framework for the period 2014–2017.

The results from the analysis confirmed the expected relatively moderate sensitivity of debt obligations to any changes in the key market indicators. It was found that for the period under review a 20% change in the EUR/ USD ratio would cause an upward fluctuation in the nominal level of government debt in 2014 by about BGN 467 million (EUR 240 million) or an increase of 2.6%, which is 0.6% of forecasted GDP. For the subsequent years that influence is negligible.

A similar change in the exchange rate of the Japanese yen will have far weaker influence on the nominal amount of debt within an increase of about BGN 50 million (EUR 26 million) in 2014, the trend being the same change to reach around BGN 27 million in 2017. The reported differences in the exchange rates of the abovementioned size, albeit unlikely, would contribute to government debt growth at the end of 2014, although in view of the forthcoming significant repayment in USD in January 2015 that effect will be minimized.

In this sensitivity analysis the interest rates' fluctuation is the second risk factor considered in the context of its impact on debt service costs. During the period under review the trend of continuous reduction in the proportion of debt with floating interest rates will be preserved and at the end of 2014 it is expected to be about 10%, dropping to 6.5% at the end of 2017. Based on these basic characteristics of the interest structure of the debt, even according to the highly pessimistic assumptions of an increase in the interest rates, the amount of the budgeted funds for interest payments during the period 2014–2017 will undergo a relatively slight change, with an additional amount of about BGN 66 million (EUR 33.8 million) needed for the whole period 2014–2017 on cumulative basis.

The dynamics of the main characteristics of the debt portfolio leads to gradual minimization of these market risk factors, and the main approach used to limit currency and interest risk comprises the strategy of taking new debt as a priority denominated in BGN and EUR and at fixed interest rates.

In addition, the legislative framework of government debt management gives the Minister of Finance an opportunity to execute debt transactions related to the optimisation of the sovereign debt servicing costs, such as to issue government securities for redemption of external and internal debts of the country, to conclude agreements for reducing the refinancing risk and settling the maturity structure of the debt.

4.3 Comparison with the previous programme

Although the expected growth of the Bulgarian economy in the previous Convergence Programme has not deviated significantly from the reported growth in 2013, the differences by components are considerable. Domestic demand was weaker than expected in 2013, but was offset by strong growth in exports. As a result, net exports had a positive contribution to GDP growth by 2 pps, at an expected negative contribution of 0.5 pps in the previous Convergence Programme. The good performance of exports in 2013 and the improved prospects for the development of the European and world economy in 2014 are reflected in an increase in the forecast for export growth. On the other hand, the negative development of domestic demand in 2013 has led to more moderate expectations for growth in 2014. As in the previous Convergence Programme, domestic demand will be the main engine of growth, but according to the present forecast, net exports will preserve their positive contribution to GDP growth in 2014, while in 2015 their contribution is expected to turn negative. For comparison, in the previous

Convergence Programme net exports had a negative contribution throughout the forecast period.

Table 4-3: Main macroeconomic indicators

Real growth rates	2013			2014			2015		
	CP 2014	CP 2013	Difference, pps	CP 2014	CP 2013	Difference, pps	CP 2014	CP 2013	Difference, pps
GDP	0.9%	1.0%	-0.1	2.1%	1.8%	0.3	2.6%	2.9%	-0.3
Private consumption	-2.3%	1.7%	-3.9	1.3%	2.7%	-1.4	3.0%	3.9%	-0.8
Gross fixed capital formation	-0.3%	0.9%	-1.2	2.1%	2.4%	-0.3	4.3%	5.4%	-1.0
Exports of goods and services	8.9%	2.0%	6.9	6.9%	3.9%	3.0	5.9%	4.0%	1.9
Imports of goods and services	5.7%	2.6%	3.1	6.3%	4.4%	1.9	6.6%	5.1%	1.5

Source: MF

5. Sustainability of Public Finances

5.1 Policy strategy

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

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

	Programme scenario 2013		Programme scenario 2014	
	S1	**S2**	**S1**	**S2**
Value	-2.52	-0.26	-1.97%	0.99
of which:				
Initial budgetary position	-0.30	0.06	--0.5	-0.01
Debt ceiling in 2060	-0.92	-	-0.83	-
Future changes in the budgetary position	-1.31	-0.32	-0.62%	1.00

Source: MF

Both indicators, S1 and S2, reflect the difference between the Programme fiscal position in the long run and this position which ensures the sustainability of public finance.

The primary balance levels in this analysis are adjusted to the phase of the economic cycle. The negative value of S1 is due to the favourable fiscal position in terms of budget deficit and debt in the medium term.

The positive value of the S2 indicator is below the reference value set by the European Commission (2% of GDP) and shows a low risk in the long run. The deterioration of the values of the two indicators is mainly due to the expenditures associated with the ageing of the population, including the recovery of the Swiss rule on indexation of pension payments and the increase in expenditures on healthcare, as well as to the increase in the consolidated government debt in 2013.

In view of the more optimum sustainability of public finances in the long run, consistent and constructive measures need to be taken in the areas of pension insurance, healthcare and education, which are to address the risks of population ageing.

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

The long-term budgetary forecast for the development of the pension system is based on the following assumptions and policies in the area of pensions:

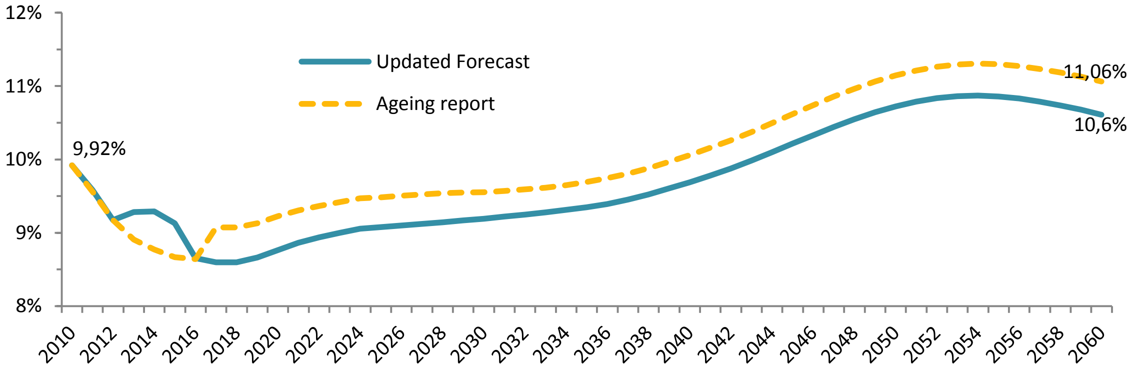
- From 2014 the so-called "Swiss rule" on pensions' indexation is recovered, according to which from 1 July each year pensions will be indexed with a percentage equal to the sum of 50% of the CPI and 50% of the growth of the average contributory income for the previous calendar year.
- In 2014 the requirements for retirement age and minimum years of service will be kept at the levels reached in 2013.
- By the end of 2014 final decision is to be taken on the further increase of the retirement age.
- Since the beginning of 2014 the introduced in 2013 minimum retirement age of military personnel from the Ministry of Defence has been dropped out and the latter will again retire if they meet the condition for 27 insured years of service.
- From 1 January 2015 pensions from the public social security will not be granted to workers in first and second category of work before they reach the statutory retirement age. From that date on the early retirement pensions of such persons will be granted only from the occupational pension funds, while the early pensions already granted to workers in those categories of work will continue to be paid. By the end of 2014 a decision is to be taken on the possibilities and conditions for early retirement.
- From 1 January 2017 the insurance contribution for the second pillar of the pension system (universal pension funds) will be increased from 5% to 7%.

When preparing the pension expenditure projections, both the latest Eurostat demographic projections of EUROPOP 2010 and the macroeconomic forecast, developed by the Ageing Working Group (AWG) to the Economic Policy Committee of the European Commission in connection with drafting of the 2012 Ageing Report, have been used. The forecast on pensions included in the Ageing Report, was updated in 2013 in line with the measures to accelerate the pension reform. The present results are consistent with the latest policies on pensions and are agreed with representatives of the European Commission and the Ageing Working Group. The tool used is an actuarial model of the National Insurance Institute for long-term forecasting of the public social security funds.

As a result of population ageing in Bulgaria and the increase in the average life expectancy at birth, if the current level of insurance contributions is maintained the pension system will face increasing fiscal pressure to keep an adequate level of pensions, which to some extent will be mitigated by the tightening of the criteria for access to pensions, that started in 2012.

The figure below shows the estimated results in terms of the public pension expenditures as a share of GDP in the period 2010–2060.

Figure 5-1: Estimated pension expenditures (relative share of GDP)



Source: NSSI

The estimated results included in the 2012 Ageing Report[24] have shown an accelerated rate of increasing public pension expenditures which grow from 9.9% of GDP in 2010 to 11.1% of GDP in 2060. The new estimated results on the basis of the latest amendments to pension legislation show a constraint of pension expenditure as a share of GDP. Thus, at the end of the forecasting period, the value of this indicator will be 10.6% or 0.5 pps less than the figures specified in the above report. The greatest contribution to this reduction is made by the increase in the statutory retirement age (which started in 2012 instead of 2021).

The ageing population and the increasing life expectancy, on the one hand, and the decreasing number of working age population, on the other hand, significantly affect the public social security system in the long term. 100 socially insured individuals corresponded to 78 pensioners in 2010. There is an improvement in the dependency ratio[25] in the next couple of years, because of the projected lower number of newly granted pensions in those years due to the increase in the retirement age and in the length of service, the limitation of early retirement, as well as due to the existence of incentives for longer presence of older workers on the labour market. There is an upward trend of the dependency ratio after 2020 due to the ageing population, the growing average life expectancy and the decreasing number of employed persons, while it will reach 98.6% in 2060.

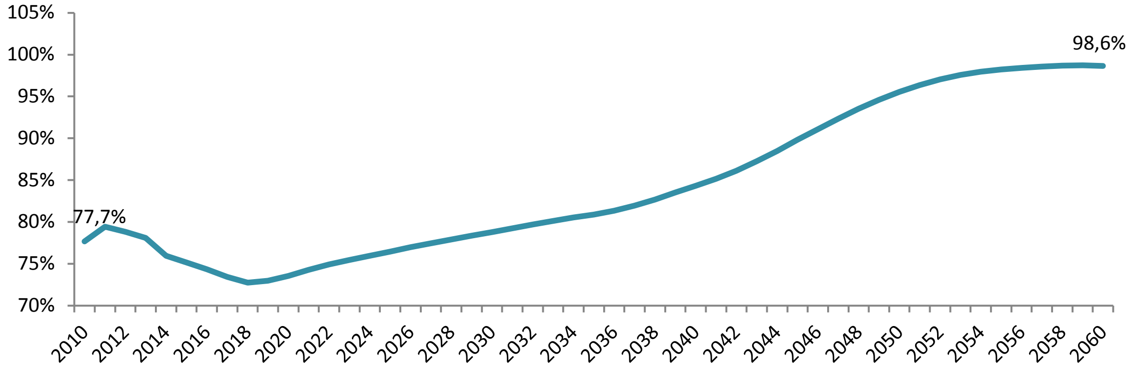
The upward trend of the dependency ratio is accompanied by a long-term downward trend of the replacement rate.[26] The replacement rates for the first pillar are expected to decline due to the gradual linking of the amount of the pension with the personal social security contribution over the whole working life, not only in the last years. Another reason for the lower replacement rate for the first pillar in the long term is the decrease in the amount of the first-pillar pension for the individuals insured in the second pillar as well. The amount of this decrease depends on the insurance period in both pillars and the amount of the social security contribution, which is transferred from the first to the second pillar.

[24] "The 2012 Ageing Report"

[25] The ratio between the number of pensioners and the number of socially insured people, also known as dependency ratio, is a key indicator for the financial status of the pay-as-you-go pension schemes.

[26] The ratio between the average pension and the average contributory income.

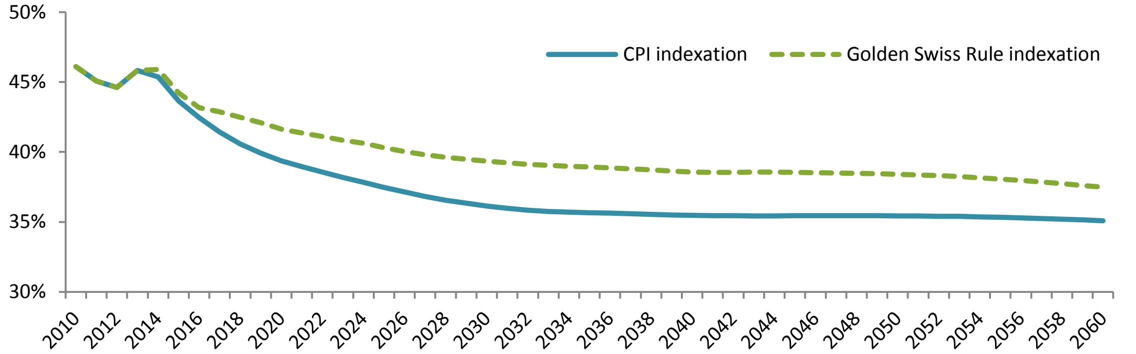
Figure 5-2: Number of pensioners to number of socially insured individuals (dependency ratio) 2010–2060



Source: NSSI

The recovery of the so-called "Swiss rule" on pensions' indexation from 2014 has a favourable effect on the replacement rate – in the long run it increases the latter by about 2.5 pps compared to an indexation only with inflation. However, the gross replacement rate decreases from 45% in 2014 to 37.5% in 2060.

Figure 5-3: Average pension to average contributory income (replacement rate), 2010–2060



Source: NSSI

As in Bulgaria pensions are not subject to taxation, a clearer idea of how much income they replace is given by the net replacement rate (the ratio between the average pension and the average net contributory income), which is higher by about 13 pps – 57.9% is the expected net replacement rate for 2014 and until 2060 the value of this indicator decreases to about 50%.

In the long term, factors such as an increased average life expectancy, ageing population and a reduced number of employed persons would exert an increasingly stronger impact on the public pension system and put a challenge on the financial stability of the Bulgarian social security system. At the same time, the above factors lead to a significant decrease in the replacement rate under the first pillar. The three-pillar pension model favours the improvement in the substitution rate. The future adequacy of pensions, in this sense, would largely depend on the extent to which the second and the third pillar would be able to improve the income of the future pensioners.

5.3 Contingent liabilities

The relative amount of government guarantees in 2013, too, remained within 1% of GDP. The beneficiaries of government guaranteed loans are concentrated mainly in the sectors of "Energy" (64.5%) and "Transport" (22.6%). During the past year funds were utilized only under the domestic government guarantees issued according to the procedure of the Student and Doctoral-Candidate Loans Law.

In line with the government policy for accelerated economic growth and promotion of key socially important economic sectors and the related need to secure their funding, government guarantees are an important tool in this respect. In this connection, the 2014 State Budget of the Republic of Bulgaria Law provides for the possibility of issuing guarantees under loan agreements with EIB for financing the activity of Bulgarian Development Bank AD with the purpose to facilitate the access to cheap financial resources for small and medium size businesses, as well as to ensure the independence of gas supplies to the country by means of supporting the Gas Interconnection Greece-Bulgaria project. The maximum amount of the government guarantees, which may be issued under the Government Debt Law, other specific laws and in the form of guarantee deposits, is totalling BGN 0.6 billion (EUR 0.3 billion).

As a result of the policy in this area the share of government guaranteed debt is planned to rise to 1.4% by the end of 2014 and 1.6% of GDP in 2015, while at the end of 2017 it is expected, however, to fall again to its current levels of about 1%.

As regards the undertaking of new government guarantees, the period under review will again witness the pursuance of a consistent analytical approach and consideration of the level of their effectiveness while both the servicing of government guaranteed loans, and the financial condition of borrowers are constantly being monitored. ▼

6. Quality of Public Finances

6.1 Policy strategy

The improvement of the budgetary process, the extension of the scope and indicators for monitoring and management of public finances and the introduction of new fiscal and budgetary rules and restrictions were at the heart of the reform and appeared a prerequisite for the development of a new legislative framework for the budget.

The medium-term budgetary framework for the period 2015-2017 has been developed in the presence of two new aspects. On the one hand it covers a time period from the term of office of the government which creates prerequisites for pursuance of a predictable fiscal policy and for provision of funding for priority sectors. This will allow for greater sustainability and at the same time for a greater flexibility in taking budgetary decisions.

The second important aspect is connected to the base on which the budgetary framework is developed. According to the budgetary procedure for the preparation of the 2014 budget, as envisaged in the Public Finance Law, the 2014-2016 medium-term budgetary framework for has been updated twice – during the preparation of the 2014 budget (as arguments to the draft law) in the autumn of 2013, and after the adoption of the main budgetary laws with the purpose to maintain an up-to-date base of fiscal parameters and basic assumptions. The 2015-2017 medium-term budgetary framework has been developed in the framework of the budgetary procedure for 2015, fully complying with the requirements of the Public Finance Law, which came into force on 1 January 2014.

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

In the area of public finance management there were a number of initiatives – the procedure for the preparation of the 2013 budget introduced a requirement for making assessments and estimates of CFP parameters and an estimate of the expected amount of the budget organizations' liabilities, as well as assessment of the effect on the balance of the general government sector based on forecasts for the activity of non-financial enterprises and non-profit legal entities controlled by the state and/ or municipalities, in accordance with the requirements of the European system of national and regional accounts in the Community.

The efforts to link more closely the budget expenditures on a cash basis with the maximum size of the expenditure commitments and the maximum size of the new obligations for expenditures that could be incurred during the year by the first-level spending units, are continuing.

6.2 Composition, efficiency and effectiveness of expenditure – COFOG

Table 6-1: Budget expenditure by function

	% of GDP			% of the total budget expenditure		
	2012	2017	EU27 2012	2012	2017	EU27 2012
1. General public services	3.7	4.7	6.7	10.3	13.0	13.5
2. Defence	1.1	1.1	1.5	3.1	3.0	2.9
3. Public order and safety	2.3	2.2	1.9	6.6	6.0	3.8
4. Economic affairs	5.1	4.9	4.1	14.4	13.6	8.4
5. Environmental protection	0.7	0.9	0.8	2.0	2.5	1.7
6. Housing and community amenities	1.0	0.9	0.8	2.8	2.6	1.7
7. Healthcare	4.6	4.6	7.3	12.9	12.7	14.9
8. Recreation, culture and religion	0.8	0.6	1.1	2.2	1.7	2.3
9. Education	3.5	3.4	5.3	9.8	9.3	10.7
10. Social protection	12.8	12.9	19.9	35.9	35.8	40.3
11. Total expenditure	35.7	36.2	49.4	100	100.0	100

Source: Eurostat, MF

In the period 2009-2012 Bulgarian budget expenditures report a drop by 5.7 pps of GDP, which is among the three biggest drops in the EU. The average drop of budget expenditures for the same period in the EU-27 amounts to 1.6 pps, while in the Euro area it is 1.3 pps. Bulgarian expenditures in 2012 were therefore the lowest in the EU (35.7% of GDP) and are expected to grow by 0.5 pps in 2017.

- The expenditures for the "General public services" function are one of the largest expenditure items. It includes the maintenance expenditure of the judiciary and of other government institutions, the R&D expenditure, etc. There is a sizeable drop here from 2009 to 2012 – from over 7.4% down to 3.7% of GDP. This drop is mostly due to the reduction in the maintenance expenditure of government institutions from 5.9% of GDP to 2.5% of GDP. R&D expenditure also decreases from 0.3% to 0.2% of GDP. The expenditure for general government departments are expected to grow by around 1 pps in the medium term.
- In 2009 the defence expenditure of Bulgaria reached 1.3% of GDP and in 2012 it dropped to its lowest value thus far – 1.1%. In 2012 the defence expenditure of EU Member States amounted to 1.5% of GDP. This trend will be preserved until 2017 when the defence expenditure in Bulgaria will remain at 1.1% of GDP, or 3% of all budget expenditure.
- The security expenditure also reports a drop down to 2.3% of GDP in 2012. This level remains comparatively high, though, as EU Member States allocated an average of 1.9% of GDP for security in 2012 against 2.3% of GDP in Bulgaria. In the medium term these expenditures will continue to decrease, but will remain relatively high as a share of GDP and of the total budget expenditure.

- The expenditure for economic activities such as agriculture, transport, communications and energy are higher than the EU average (Bulgaria as at 2012 – 5.1%, and in the EU – 4.1%), but are similar to the levels in the states with close income levels. Bulgarian expenditures in this area are mostly allocated for transport (3.2% of GDP in 2012). 0.9% of GDP is allocated for agriculture. These expenditures will continue having a significant share in the Bulgarian budget until 2017, which will be mostly due to the growing significance of EU funds and the related national co-financing.
- Bulgarian public expenditure for healthcare as a share of GDP is relatively lower compared to the EU average. At the end of 2012 healthcare expenditures as a share of GDP are 4.6%, while for the EU Member States these are 7.3%. Healthcare expenditures in Bulgaria in the medium run will stay at the same level thanks to the implementation of a series of measures aimed at optimisation of costs and greater efficiency.
- The education expenditures in Bulgaria have registered a slight drop in recent years, remaining far below the EU average (in Bulgaria for 2012 – 3.5% of GDP and in the EU – 5.3%). There is a substantial difference in the funds for pre-school and school education for which 0.7% of GDP are allocated and they remain relatively constant over the years. Education expenditure in Bulgaria as a share of the total budget expenditure is currently relevant to the EU average level.
- Environmental protection expenditure in Bulgaria account for 0.7% of GDP and this is close to the EU average.
- Social expenditure account for the greatest share of expenditures by function – 12.8%. As a share of GDP it is far lower than the EU average which was 19.9% of GDP for 2012. Bulgaria allocated 35.9% of its budget expenditure for this area, and this is relatively close to the EU average of 40.3% in 2012. There are differences in the structure of these expenditures. 9.6% of GDP are allocated for pensions in Bulgaria, which is among the highest shares in the EU. The share of expenditures supporting families and children is 2.3% of GDP and is relatively similar to that in other EU Member States.

6.3 Structure and efficiency of revenue systems

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

This part of the Programme outlines measures and policies largely addressing measures and policies for increasing revenue collection, fight against smuggling, tax crimes, informal economy, etc.

Tax Policy and Legislation

Tax policy is aimed at creating an effective tax system providing macroeconomic and budgetary stability in the medium and long term. The tax and social insurance policy and the effective actions of the revenue administrations aim to ensure the resources needed for implementation of the government's fiscal policy, to improve the business climate, to limit tax fraud and to stimulate the economic activity. The changes in the tax legislation for 2014 are driven by the tax policy for the period and are structured by priority. In line with the 2013 recommendations to Bulgaria, these priorities include:

- Increase of budget revenues and fight against smuggling;
- Reduction of the administrative burden and costs for businesses and citizens.

In relation to the first of the above priorities, an amendment to the Value Added Tax Law (VAT Law) has introduced a VAT reverse charge mechanism for supplies of cereals and industrial crops. The VAT reverse charge mechanism is a powerful tool to reduce VAT frauds with the potential at the same time to limit unfair competition in the sector of production and trade of cereals and industrial crops and to provide significant additional financial resources to traders and processors of cereals and industrial crops.

At the same time, the amendments to the Tax and Social Insurance Procedure Code (TSIPC) introduce a new form of effective preventive monitoring and control on the movement of goods with high fiscal risk on the territory of the Republic of Bulgaria. The aim is to protect the fiscal stance by preventing evasion of VAT, corporate taxes and personal income tax, as well as to limit unfair competition.

In regard to the delivery of results on the second priority – reduction of the administrative burden and costs for businesses and citizens, the amendments to TSIPC have improved the single account for payment of taxes and mandatory insurance contributions. There is a legal possibility of rescheduling and deferral of liabilities for taxes and mandatory insurance contributions under relieved conditions – for a longer period and in a larger size. The aim of the amendments is the liable persons with temporary financial constraints to be able to serve both their current liabilities for taxes and insurance contributions, and their arrears covered by the authorization for deferral or rescheduling.

In order to support small and medium-size enterprises that encounter difficulties in paying VAT to the budget before they have received payment for their supplies of goods and services from their customers, a special regime "Cash flow scheme of VAT" is applicable. The expected benefits of these amendments to the VAT Law are as follows:

1. Reduction of intercompany indebtedness;
2. Improvement of the liquidity of small and medium-size enterprises;
3. Reduction of tax frauds which use fictitious suppliers and/ or fictitious transactions for illegal VAT refunds or for reduction of the amount of the payable tax.

Customs Agency

Since 2013 there has been a series of legislative amendments aimed at aligning Bulgarian legislation with the Community one. In this connection there are proposals for amendments to the *Customs Law*. One of the proposals is to repeal the provision for enforced collection of public state receivables, as the case law shows that within the proceedings for appeal of the *Rulings for enforced collection of public state receivables* debtors make objections for groundlessness of the customs administration's receivable itself and in many cases this leads to a second ruling by the court regarding the payability of the receivable. According to the now effective Customs Law, a Ruling for enforced collection of public state receivables should be issued on the basis of a final decision. Both the decision and the ruling are individual administrative acts and are subject to separate appeal through both administrative and judicial channels. It is unjustified in the presence of definitively established liability and debtor the collection of state receivables to be deferred in time, opening up a possibility of challenging the second individual administrative act – the Ruling for enforced collection of public state receivables, which essentially provides for enforced collection of the outstanding liability not paid voluntarily.

The Ruling for enforced collection of public state receivables had been provided for in the national customs legislation in the period before the accession of the Republic of Bulgaria to the European Union. With the purpose of attaining procedural economy and increasing efficiency by shortening the periods for collection of payable public state receivables, the draft law contains a proposal for repeal of Section III of Chapter Twenty-Six of the law, while the decision of the customs authority establishing the debtor and the amount of the public state receivable will also determine the receivable. The draft law expressly envisages the decisions of the customs authorities to be subject to provisional enforcement. It also envisages the appeals against the decisions not to suspend their enforcement. The conditions are indicated, in the presence of which the enforcement of the decision may be suspended at the request of the person concerned by the authority that has issued it.

The proposals are in accordance with the provisions of Article 7 and Article 244 of Council Regulation (EEC) No 2913/92 of 12 October 1992 establishing the Community Customs Code. In connection with the above, there is a proposal for amendment to Article 209, paragraph 2, item 4 of TSIPC according to which instead of the Ruling for enforced collection of public state receivables the grounds for enforced collection will be the decision of the relevant customs authority, establishing the due customs receipts and other public receivables.

An amendment to Article 211 of the Customs Law has been proposed with a view to defining more precisely and determining the starting point from which the customs authorities charge interest for late payment of the public state receivables administered by them. It is provided that the customs authorities charge and collect the legal interest on the amount of the due customs receipts and other public state receivables from the day following the date of occurrence of the liability when the latter has occurred on the grounds of Article 199, paragraph 1, items 3-9 and Article 200, paragraph 1, item 3 or when the liability has been established during a subsequent inspection or an ex-post control carried out by the customs authorities.

The amendment to Article 233, paragraph 3 of the Customs Law provides for higher penalty in cases of smuggling of tobacco products – cigarettes without banderol and/ or labelled “duty-free” and tobacco, performed by persons that regularly engage in such activity and that attempt to carry without the knowledge and permission of the customs authorities small amounts – from 10 to 50-60 boxes of cigarettes and from 2 to 5 kg of tobacco. With respect to the base which serves to determine the percentage of the penalty the current situation has been preserved, namely a percentage of the purchase price of the goods. It is expected the prescribed minimum amount of the imposed fine – not less than BGN 1,000, to be preventive and dissuasive. For a second violation there is a more severe penalty, as the conclusion of the analysis of the infringements of the customs legislation is that the perpetrators of goods’ smuggling engage systematically in such activity.

Article 234, paragraph 4 of the existing Customs Law defines the cases where the goods subject to infringement under Article 234, paragraph 1, items 1 and 2 are seized in favour of the state. The provision of Article 234, paragraph 4 was amended by the Law Amending the Customs Law (SG, No 15 of 2013), the purpose of the amendment being to relieve the regime and to limit the seizure in favour of the state to the cases of full evasion of the payment or security of customs receipts or other public state receivables.

Amendments have been made to the Excise Duties and Tax Warehouses Law (EDTWL) and the Rules for Implementation of the Excise Duties and Tax Warehouses Law (RIEDTWL) in order to alleviate economic operators.

The new provisions of EDTWL have increased excise duty rates on heavy fuel oil and natural gas used as fuel for heating. The changes are aimed to meet the requirements of Council Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity and the commitments taken under the Treaty of Accession to the European Union to increase excise duty rates in order to reach the minimum levels of the Community. Preserved is the excise duty rate on natural gas used as motor fuel, which will be increased in the event that the European Commission passes an act for non-compliance with the rules on state aid.

The amendments to Article 12 of EDTWL complement the characteristics of the term "tobacco refuse" (remnants of tobacco leaves) as refuse of tobacco leaves does not fall within the scope of EDTWL until it is established that they are marketed for retail sale. In view of this and in order to prevent fraud and evasion of excise duties, a procedure is provided for the persons dealing with those goods.

In view of the equality of tax liable persons the provision of Article 20, paragraph 2, item 1a of EDTWL has been complemented, enabling small wine producers when sending excisable goods to a licensed warehouse keeper in the country or to a temporarily registered recipient in another EU Member State as well as when exporting such goods also to apply the regime of deferred payment of excise duty and the goods not to be accompanied by an electronic administrative document. The goods may be accompanied by the accompanying document referred to in Council Regulation № 436 of 26 May 2009 as regards the vineyard register, the mandatory declarations and the gathering of information with the purpose to monitor the market, the documents accompanying the consignments of products and the records that are to be kept in the vineyard and wine sector.

A new section "IIa" "Licensing in special cases" (Article 55b – Article 55h of EDTWL) has been introduced, according to which the State Agency "State Reserve and Wartime Stocks" is provided with the opportunity to obtain a license under EDTWL to implement the specific activities of management of state reserves and wartime stocks, their creation, storage, preservation, renewal, maintenance, release, use, recording, financing and controlling. In this way, the Agency will be able to store in the warehouses, provided to it for management, excisable goods under the regime of deferred payment of excise duty.

In order to facilitate the activity of licensed warehouse keepers amendments have been made, related to collateral under a regime of deferred payment of excise duty, and Article 77 of EDTWL envisages the amount of collateral to be determined in such a way that it covers at any time the amount of excise duty which has been incurred or may be incurred, or has been established in the application of a regime of deferred payment of excise duty. Reduced is also the amount of collateral under Article 78 of EDTWL, with the amount used as a basis to determine the amount of the collateral being reduced from 30 to 20 percent of the amount of excise duty on the monthly average quantity of goods stored, from 10 to 0 percent of the amount of excise duty on the monthly average quantity of goods stored as regards the quantities of stored distillate or the statutory quantities under the Statutory Reserves of Petroleum and Petroleum Products Law, stored in a licensed warehouse, and from 150 to 100 percent of the amount of excise duty on the monthly average quantity of the excisable goods released for consumption.

Commission Decision C (2011) 9152 of 5 December 2011 approved the state aid scheme proposed by the Republic of Bulgaria "Reduced excise duty on gas oil used in primary agricultural production by using a system of fuel vouchers". The scheme was in force until 31 December 2013 but has not been implemented and for this reason the Ministry of Agriculture and Food has sent a request to the European Commission for an extension of the scheme to 31 December 2014.

In connection with the implementation of the state aid scheme in 2014, amendments have been made to the national legislation – the Excise Duties and Tax Warehouses Law and the Support to Farmers Law. The measure constitutes a scheme to support farmers registered under the Support to Farmers Law and aims to create relieved conditions for the fuel used by them in the production of primary agricultural products through the application of a reduced excise duty rate for gas oil through fuel vouchers. The aid will be provided in the form of fuel vouchers with pre-determined quantity of fuel and nominal value to farmers for cultivated agricultural land, used meadows and bred animals.

New Ordinance № H-1 of 22 January 2014 on the specific requirements and the control exercised by the customs authorities on the devices for measurement and control of excisable goods has been developed and entered into force in pursuance of Article 103a, paragraph 2 of the Excise Duties and Tax Warehouses Law, repealing Ordinance № 3 of 19.02.2010 on the specific requirements and control exercised by the customs authorities on the devices for measurement of excisable goods.

The aim is on the one hand to reduce the administrative burden and costs for businesses, and on the other hand – the customs authorities to exercise effective control on the placement, production, storage and removal of excisable goods from a tax warehouse or other site.

Clear rules have been created as regards both the devices for measurement and control to be used in the sites for placement, production, storage and removal of excisable goods, and the control to be exercised by customs authorities. To this end, it is envisaged that the points of control shall be only in the places where excisable goods are placed, produced, stored and removed and the devices for measurement and control of excisable goods shall be mounted at these points. It is envisaged the data from the devices for measurement and control to be transmitted electronically to the automated accounting systems of the persons and to the information system of the Customs Agency.

The general part of the Ordinance regulates the general requirements to the devices for measurement and control as well as the general requirements to the economic operators. The specific part regulates the specific requirements to the persons and the devices for measurement and control by types of excisable goods: alcohol and alcoholic beverages, tobacco products, energy products and electricity. Regulated is the order and manner of exercising control over the devices for measurement and control used in the placement, production, storage and removal of excisable goods by the customs authorities.

National Revenue Agency (NRA)

NRA policies and measures are aimed at reducing the administrative burden, including development of the e-government, reduction of the shadow economy and improvement of the collection of tax and insurance liabilities. In this regard, in 2013 and 2014 the NRA introduced 13 additional e-services:

1) Submission of the declaration under Article 55 of PITL/ Article 201 of CITL for 2013;
2) Information for payments;
3) Submission of the declarations under Articles 224, 231, 239(1), 239(2) of CITL in relation to gambling activities;
4) Submission of the declaration under Article 88 of CITL;
5) Notification by e-mail of any payment received to NRA's account for taxes and insurance contributions;
6) Information for liabilities and payments;
7) Submission of a Request for authorization for a "Cash flow scheme of VAT"
8) Submission of a Request for termination of a Cash Accounting regime
9) Public register of the persons having authorization for a Cash Accounting regime under VAT Law
10) Submission of the declaration under Article 246 of CITL
11) Submission of the declaration under Article 252 of CITL
12) Submission of the declaration under Article 14, paragraph 1 of IPTL;
13) Submission of the declaration under Article 14, paragraph 2 of IPTL

As a result, service has been improved, administrative burden has been reduced and more detailed and timely information is provided to citizens and businesses.

A legal possibility has been established for rescheduling and deferral of liabilities for taxes and mandatory insurance contributions under relieved conditions and a more flexible mechanism for the authorities competent to issue authorizations. The aim is the liable persons in temporary financial constrains to be able to serve their current liabilities for taxes and insurance contributions after obtaining authorization for deferral or rescheduling of liabilities for taxes and insurance contributions whose payment deadlines have expired.

The efficiency of the process of refunding and set-off of overpaid or refundable taxes and insurance contributions to the NRA has been improved The level of the VAT not refunded within the deadlines decreased by BGN 117 million in 2013. During this period, corporate tax to the amount of BGN 173.7 million was also refunded. This on the one hand returned financial resource back into circulation to the economy, and on the other – saved the state expenditures on the interest due for any delay to refund taxes within the deadlines.

In view to reducing the number of tax frauds, an amendment has been made, on proposal by the NRA, to the VAT Law in line with Council Directive 2013/43/EU of 22 July 2013 amending

Directive 2006/112/EC on the common system of value added tax, as regards an optional and temporary application of the reverse charge mechanism in relation to supplies of certain goods and services susceptible to fraud. The reverse charge mechanism applies only to a specific category of goods (cereals and industrial crops), which are among the most frequently used in complex VAT fraud schemes.

From the beginning of 2014 there is a legislative change which introduces a relieved regime of the so-called “cash accounting” of persons registered under the VAT Law. The measure allows the persons that meet certain conditions to benefit from a relieved regime of charging and paying the VAT due on supplies, namely before receiving payment for the supplies of goods and services by their customers. The expected effects of it include reduction of the administrative and financial burden, decrease of the intercompany indebtedness, improvement of the liquidity of small and medium-size enterprises and drop in tax frauds.

From the beginning of 2014 revenue authorities authorized by the Executive Director of the NRA exercise fiscal control on the movement of goods with high fiscal risk throughout the country. The introduction of fiscal control is designed to protect the fiscal stance and to prevent evasion of VAT, corporate taxes and personal income taxes. Fiscal control does not apply in respect of goods under a customs regime. For each individual case there is a specific regime for fiscal control. The list of goods with high fiscal risk is public and is approved by the Minister of Finance on a proposal by the Executive Director of the NRA.

From 01.12.2013 there is a possibility of firstly paying the principal for taxes and insurance contributions whose deadline for payment has expired; its purpose is to support the liable persons in temporary financial constrains to pay taxes and mandatory insurance contributions. Thus the charging of interest is stopped and the accumulation of new liabilities is prevented. There is a possibility within the enforced execution proceedings under TSIPC an authorization to be granted to the debtor to make urgent payments for all types of public liabilities. The application of the procedure under Article 169, paragraph 4 of TSIPC for payment of public liabilities whose payment deadline had expired before 1 January 2008, is postponed with one year.

From 01.01.2014, in view of counteracting more effectively the aggressive international tax planning and tax evasion in the field of direct taxation, there is a possibility the hitherto existing mechanism regarding the hidden distribution of profits and related sanctions to be also applied with respect to transactions with companies registered in jurisdictions with preferential tax regime. The hitherto existing mechanism was inapplicable to companies and individuals registered in jurisdictions with preferential tax regime (offshore zones) due to the inability to identify the actual owners of the capital of these companies. As far as regarding the taxation of the local legal entity until the end of 2013 there was a protection introducing the presumption that the local person and the company from a jurisdiction with preferential tax regime are related persons, in order to complete the protective mechanism in a comprehensive and neutral in terms of taxation way, the amendments to TSIPC introduced a presumption of connection between the owners of the capital of the local person and the company from the jurisdiction with preferential tax regime. This will allow a smooth application of the mechanism of taxation of the hidden distribution of profit in regard to the other party in the relationship, leading to evasion, while covering all cases of evasion and preserving and maintaining the neutrality of taxation. The application of this improved mechanism would lead, all other conditions being equal, to the following taxation:

- Corporate tax on the expenses not recognized to the local person – 10 %
- Tax on the dividends of the foreign person from the jurisdiction with preferential tax regime – 5 %
- Sanction for the undeclared hidden profit distribution – 20 % of the hidden profit distribution.

The protection against the use of companies registered in jurisdictions with preferential tax regime is complemented by a rule stating that a person from a jurisdiction with preferential tax regime is also considered any legal person, whether local or foreign, which is controlled by a company registered in a jurisdiction with preferential tax regime.

Another measure in the field of direct taxation is the introduced requirement for reporting of transactions with related parties and/ or persons from jurisdictions with preferential tax regime, as well as for reporting of any hidden profit distribution. The samples of the annual tax return for the corporate income taxation and the annual tax return submitted by sole proprietors in 2013 provide for reporting of information by the tax liable persons that in 2013:

- performed transactions with related parties or persons from jurisdictions with preferential tax regime or are party to commercial and financial relationships with such persons – regardless of the type, form and timing of achievement of the relevant agreement (conclusion of the transaction), if there was any execution under the latter in 2013 and at the time of execution the persons were related or any of the parties was a person from a jurisdiction with preferential tax regime, they shall declare the volume (value) of the execution;
- made hidden distribution of profit – the persons shall declare the total amount of the hidden distribution of profit made in 2013. Failure to declare this information is sanctioned with an administrative penalty of 20 percent of the amount of the hidden profit distribution.

The requirement for the above information aims at improving the selection of tax liable persons in relation to whom the undertaking of control actions by the revenue administration would result in collection of additional revenue to the state budget. ▼

7. Institutional Features of Public Finances

7.1 National budgetary rules

The government has at its disposal a legal framework which includes a set of fiscal rules and restrictions, the compliance wherewith ensures the sustainability of public finances.

The entry into force of the Public Finance Law from the beginning of 2014 has led to actual extension of the scope of the existing fiscal rules that are consistent with the internationally accepted definitions and criteria. The Law defines both the restrictions on maximum admissible limits and parameters of certain indicators, and mechanisms that are triggered in the case of negative fiscal trends and/ or established significant deviations from the set fiscal targets.

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

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

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

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

The inclusion of restrictions on the undertaking of debt by the social security subsector in the scope of the fiscal rules of the Public Finance Law aims at achieving full coverage of the subsectors of the general government sector. Those limit the possibilities of the social insurance funds to undertake debt and forbid the issuance of guarantees, while keeping the possibility of undertaking debt under international programmes and contracts ratified by the National Assembly, financial leasing and other forms of debt other than monetary loans and securities' issues. Similar restrictions are also set for state universities, Bulgarian Academy of Sciences, Bulgarian National Television, Bulgarian National Radio and Bulgarian News Agency, as well as for the entities whose budgets are not part of the state budget but are included in the consolidated fiscal programme.

The Public Finance Law has preserved the requirement the annual law on the state budget to determine the minimum level of the fiscal reserve as at the end of the relevant year. The annual budget law also envisages reliable cushions, including limitations of expenditures, which are to counteract potential budgetary imbalances.

7.2 Budgetary procedures

The organization and conduct of the budgetary procedure for 2014 was consistent with the rules of the PFL. It was carried out during the term of office of three governments, which proved the soundness and efficiency of the processes of budgetary planning. The entry into force from the beginning of 2014 of the provisions of PFL has set a new framework for the implementation of the 2014 Budget, too.

The beginning of the preparations for the 2015 Budget was marked by the adoption on 4 February 2014 of the Council of Ministers' Decision on the 2015 budgetary procedure. This procedure is based entirely on the Public Finance Law, while adhering to its requirements to the structure and content of key budgetary documents and deadlines for their adoption. The 2015 budgetary procedure continues the practice from recent years, thus ensuring the sustainability of the budgetary process.

The procedure creates a good organization and ensures the necessary coordination among the individual spending units in the process of budgetary planning and preparation of the 2015-2017 medium-term budgetary framework and the draft 2015 state budget. The 2015 budgetary procedure covers all budget organizations as well as all legal entities controlled by the state and/ or municipalities that are not part of the consolidated fiscal programme but fall within the scope of the general government sector.

For a second consecutive year the budgetary procedure for the preparation of the budgets and the estimates of the accounts for the EU funds in 2015 will be held under the rules of the Public Finance Law; it defines the basic requirements that should be met within the budgetary process. The required assessments, estimates and the basis for development of the 2015-2017 medium-term budgetary framework and the draft 2015 State Budget of the Republic of Bulgaria Law have been determined.

A spring and autumn macroeconomic forecast is prepared and standards for the state mandates with the cost and natural indicators are adopted within the budgetary procedure and in accordance with the Public Finance Law.

The 2015 budgetary procedure integrates procedures for approval by the Council of Ministers of the projects to be funded with government and/ or government-guaranteed loans in 2015 as well as for approval of the Operational Plan with included projects for state public-private partnerships or public-private partnerships of state public organizations.

The 2015 procedure is divided into two main stages. The first stage concludes in April 2014 with the approval by the Council of Ministers of a decision for approval of the 2015-2017 medium-term budgetary framework and for the approval of an update of the Government Debt Management Strategy. The second stage of the procedure concludes at the end of October 2014 with the approval by the Council of Ministers of the draft 2015 State Budget of the Republic of Bulgaria Law and the 2015-2017 updated medium-term budgetary framework, which constitutes arguments to the draft Law.

Compliance with the budgetary procedure creates conditions for transparency and constitutes an element of the sound management of public finances. The diligent participation in the budgetary process of all budget organizations is a prerequisite for the overall success of the procedure and a precondition for achieving the desired outcomes of its implementation, namely sustainable medium-term budgetary framework and annual state budget. To support medium-term budgetary framework planning, development and updating, as well as the planning and preparation of draft budgets of spending units, including in programme format, the Minister of Finance gives detailed instructions.

7.3 Other institutional developments in relation to public finances

On 3 April 2014, the Budget Committee of the National Assembly adopted on second reading the draft ***Law on Fiscal Council and Correction Mechanisms***. The draft Law has been prepared in compliance with the requirement for establishment of an independent institution for fiscal surveillance laid down in Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States as well as in line with the commitments of the Republic of Bulgaria under the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

The adoption of the draft Law will also fulfil the Council Recommendation of 9 July 2013 on the National Reform Programme 2013 of Bulgaria and delivering a Council opinion on the Convergence Programme of Bulgaria, 2012–2016, where Bulgaria was recommended during the period 2013–2014 to *"establish an independent institution to monitor fiscal policy and provide analysis and advice*".

The draft Law on Fiscal Council and Correction Mechanisms sets up an independent advisory body on fiscal management issues called Fiscal Council.

The objectives of the Fiscal Council are to independently monitor and analyse the budgetary framework with a view to preserving sustainable public finances, as well as to increase the quality of the official macroeconomic forecasts and budgetary frameworks. Together with these objectives, the Fiscal Council should also constitute a mechanism for improving transparency and public awareness of the fiscal governance of the country.

The main function of the Council is to monitor the compliance with the numerical fiscal rules provided for in the Public Finance Law relevant to the general government sector and the consolidated fiscal programme. The Council will prepare reasoned opinions regarding the spring and autumn macroeconomic forecasts of the Minister of Finance and the based on them draft medium-term budgetary framework, the Draft State Budget Law and the draft laws amending the latter, and the draft laws on the public social insurance budget and the National Health Insurance Fund budget. The Council will also prepare a reasoned opinion on the reports on the implementation of the state budget, the budgets of the public social insurance and the other social insurance funds administered by the National Social Security Institute, and the National Health Insurance Fund budget. In addition, the Fiscal Council will, on detecting significant bias affecting macroeconomic forecasts from the reported data within a period of at least four consecutive years, recommend to the Minister of Finance to take necessary measures to correct the bias. The Council will also monitor the implementation of the automatic correction mechanisms under Article 3, paragraph 1, letter "e" of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

The Fiscal Council will comprise 5 members, including a Chairperson, to be elected by the National Assembly on the basis of a preliminary public discussion, with a term of office of 6 years. The members shall be persons of high morals with at least a Master's degree in Economics and not less than 10 years of professional experience in the field of macroeconomic analysis and/or public finance management. The members of the Council may also have foreign citizenship.

The Law envisages the reasoned opinions and recommendations of the Council to be public and published on its website, thus ensuring the transparency of its activity. The reasoned opinions and recommendations are not binding, but where the government disagrees therewith it should provide the reasons therefor in writing. The reasons for the non-agreement shall be published on the websites of the Council of Ministers and of the Ministry of Finance.

The resources needed for the functioning of the Council will be planned in the budget of the National Assembly, specified in a separate expenditure heading.

The draft Law on Fiscal Council and Correction Mechanisms also regulates the establishment and application of automatic correction mechanisms aimed at correcting significant deviations from the medium-term budgetary objective for the structural deficit or the adjustment path towards it according to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.

The draft Law envisages that in case of identifying any significant deviation from the medium-term budgetary objective in structural terms the Minister of Finance shall prepare a correction plan with the main purpose of bringing the fiscal position back to the medium-term budgetary objective or the adjustment path towards it within a maximum of two years after the year of occurrence of the deviation. There is a requirement the average annual improvement of the structural balance to be in the amount of at least 0.5% of the gross domestic product for the timeline of correction. The existence of significant deviation from the medium-term budgetary objective or the adjustment path towards it can be identified by the European Commission, the Minister of Finance and/ or the Fiscal Council.

The draft Law envisages that the implementation plan may be temporary suspended in case of exceptional circumstances within the meaning of Article 9 of Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies. When the exceptional circumstances cease to exist the Minister of Finance, if necessary, shall prepare a revised correction plan. ▼

Annex A

Table 1a: Macroeconomic prospects

	ESA code	2013	2013	2014	2015	2016	2017
		Level MBGN	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
Real GDP (at previous year prices)	B1*g	78 762	0.9	2.1	2.6	3.4	3.4
Nominal GDP	B1*g	78 115	0.0	3.3	4.4	5.2	5.2
Components of real GDP							
Private consumption	P.3	50 209	-2.3	1.3	3.0	4.3	4.4
Government consumption expenditure	P.3	12 416	2.5	2.4	2.2	2.4	2.3
Gross fixed capital formation	P.51	16 648	-0.3	2.1	4.3	5.4	6.0
Change in inventories and net acquisition of valuables (% of GDP)	P.52+ P.53	309	0.4	0.4	0.5	0.5	0.5
Exports of goods and services	P.6	56 701	8.9	6.9	5.9	6.1	6.2
Imports of goods and services	P.7	57 521	5.7	6.3	6.6	7.1	7.4
Contributions to real GDP growth (In percentage points)							
Final domestic demand		-	-1.2	1.7	3.2	4.3	4.5
Change in inventories and net acquisition of valuables	P.52+ P.53	-	0.0	0.2	0.0	0.0	0.0
External balance of goods and services	B.11	-	2.0	0.3	-0.6	-0.9	-1.1

Table 1b: Price developments

	ESA code	2013	2013	2014	2015	2016	2017
		Level	Rate of change[27]	Rate of change	Rate of change	Rate of change	Rate of change
GDP deflator		100	-0.8	1.1	1.8	1.7	1.8
Private consumption deflator		100	-1.9	0.5	1.1	1.3	1.3
HICP[28]		100	0.4	-0.2	2.4	1.7	1.8
Public consumption deflator		100	6.6	1.6	1.8	1.7	1.5
Investments deflator		100	-3.5	3.4	3.3	2.5	2.3
Export price deflator (goods and services)		100	-3.3	0.3	1.2	1.4	1.4
Import price deflator (goods and services)		100	-3.4	0.6	1.1	1.3	1.2

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

[28] Optional for Stability Programmes.

Table 1c: Labour market developments

	ESA code	2013	2013	2014	2015	2016	2017
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
Employment (thousand persons)[29]		3 422	-0.4	0.1	0.5	0.9	0.7
Employment (millions of hours worked)[30]		5 628	-0.4	0.2	0.4	0.7	0.7
Unemployment rate[31]		12.9	0.6[32]	-0.1	-0.5	-0.8	-0.7
Labour productivity (BGN per person employed)[33]		22 830	1.3	2.0	2.1	2.5	2.7
Labour Productivity (BGN per hour worked)[34]		14.0	1.3	2.0	2.1	2.6	2.7
Compensation of employees (MBGN)	D.1	31 790	5.3	3.6	5.1	6.1	5.5
Compensation per employee		12 690	6.6	3.5	4.4	5.1	4.7

Table 1d: Sectoral balances

% of GDP	ESA code	2013	2014	2015	2016	2017
Net lending/borrowing vis-à-vis the rest of the world	B.9	3.0	2.1	1.3	0.6	-0.2
of which: – Balance of goods and services		-0.6	-0.6	-1.2	-2.0	-2.9
– Balance of primary incomes and transfers		2.5	1.4	1.4	1.5	1.5
– Capital account		1.2	1.2	1.2	1.1	1.1
Net lending/borrowing of the private sector	B.9	4.5	3.9	2.8	1.7	0.7
Net lending/borrowing of the general government	EDP B.9	-1.5	-1.8	-1.5	-1.1	-0.9
Statistical discrepancy						

29 Occupied population, national accounts definition.
30 National accounts definition.
31 Harmonised definition, Eurostat; levels.
32 The unemployment rate change is in pps.
33 Real GDP per person employed.
34 Real GDP per one hour worked.

Table 2a: General government budgetary prospects

	ESA 95	2013	2013	2014	2015	2016	2017
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-1 177.6	-1.5	-1.8	-1.5	-1.1	-0.9
2. Central government	S.1311	-1 423.7	-1.8	-1.8	-1.7	-1.3	-1.1
3. State government	S.1312						
4. Local government	S.1313	327.0	0.4	0.0	0.1	0.1	0.2
5. Social security funds	S.1314	-80.9	-0.1	0.0	0.1	0.0	0.0
General government (S13)							
6. Total revenue	TR	29 062.4	37.2	38.0	37.1	35.7	35.3
7. Total expenditure	TE	30 239.9	38.7	39.9	38.6	36.9	36.2
8. Net lending / borrowing	EDP B.9	-1 177.6	-1.5	-1.8	-1.5	-1.1	-0.9
9. Interest expenditure	EDP D.41	611.6	0.8	0.8	0.9	0.9	1.0
10. Primary balance		-556.6	-0.7	-1.1	-0.6	-0.2	0.1
11. One-off and other temporary measures							
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		16 054.1	20.6	22.2	22.5	22.6	22.8
12a. Taxes on production and imports	D.2	11 795.0	15.1	16.4	16.7	16.8	17.0
12b. Current taxes on income, wealth, etc.	D.5	4 059.4	5.2	5.5	5.5	5.5	5.5
12c. Capital taxes	D.91	199.7	0.3	0.3	0.2	0.2	0.2
13. Social contributions	D.61	6 060.2	7.8	7.8	7.5	7.4	7.2
14. Property income	D.4	821.3	1.1	0.4	0.5	0.4	0.4
15. Other		6 126.8	7.8	7.6	6.6	5.3	4.9
16=6. Total revenue	TR	29 062.4	37.2	38.0	37.1	35.7	35.3
Tax burden (D.2+D.5+D.61+D.91-D.995)		22 114.2	28.3	30.0	30.0	30.0	30.0
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	12 343.6	15.8	15.3	15.1	14.6	14.1
17a. Compensation of employees	D.1	7 704.2	9.9	9.6	9.3	9.0	8.7
17b. Intermediate consumption	P.2	4 639.4	5.9	5.7	5.7	5.5	5.4
18. Social payments (18=18a+18b)		11 275.3	14.4	14.7	14.4	14.1	13.7
of which Unemployment benefits							
18a. Social transfers in kind	D.6311. D.63121. D.63131	1 539.8	2.0	2.0	2.0	2.0	1.9
18b. Social transfers other than in kind	D.62	9 735.5	12.5	12.6	12.4	12.1	11.8
19=9. Interest expenditure	EDP D.41	611.6	0.8	0.8	0.9	0.9	1.0
20. Subsidies	D.3	971.4	1.2	1.0	0.9	0.9	0.9
21. Gross fixed capital formation	P.51	3 219.0	4.1	5.7	5.1	4.4	4.3
22. Capital transfers	D.9	392.2	0.5	0.4	0.6	0.6	0.7
23. Other		1 426.9	1.8	2.1	1.5	1.5	1.5
24=7. Total expenditure	TE1	30 239.9	38.7	39.9	38.6	36.9	36.2
Government consumption (nominal)	P.3	13 347.7	17.1	17.1	17.0	16.8	16.6

Table 2b: No-policy change projections

	2013	2013	2014	2015	2016	2017
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	29 062.4	37.2	38.0	37.0	35.7	35.3
2. Total expenditure at unchanged policies	30 239.9	38.7	39.2	38.1	36.5	35.8

Table 2c: Amounts to be excluded from the expenditure bench-mark

	2013	2013	2014	2015	2016	2017
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	2141.6	2.7	3.3	3.0	2.6	2.6
2. Unemployment benefit expenditure at unchanged policies	10.1	0.01	0.008	0.003	-0.005	-0.007
3. Effect of discretionary revenue measures	103.8	0.1	1.0	0.7	0.01	-0.01
4. Revenue increases mandated by law	0	0	0	0	0	0

Table 3: General government expenditure by function

% of GDP	ESA code	2012	2017
1. General public services	1	3.7	4.7
2. Defence	2	1.1	1.1
3. Public order and safety	3	2.3	2.2
4. Economic affairs	4	5.1	4.9
5. Environmental protection	5	0.7	0.9
6. Housing and community amenities	6	1.0	0.9
7. Health	7	4.6	4.6
8. Recreation, culture and religion	8	0.8	0.6
9. Education	9	3.5	3.4
10. Social protection	10	12.8	12.9
11. Total expenditure (=item 7=24 in Table 2)	TE1	35.7	36.2

Table 4: General government debt

% of GDP	ESA code	2013	2014	2015	2016	2017
1. Gross debt[35]		18.9	22.8	22.2	23.3	20.6
2. Change in gross debt ratio		0.5	3.9	-0.6	1.1	-2.7
Contributions to changes in gross debt						
3. Primary balance[36]		-0.7	-1.1	-0.6	-0.2	0.1
4. Interest expenditure[37]	EDP D.41	0.8	0.8	0.9	0.9	1.0
5. Stock-flow adjustment						
of which:						
Differences between cash and accruals[38]						
Net accumulation of financial assets[39]						
of which: privatisation proceeds		0.02	0.16	0.07	0.02	0.04
Valuation effects and other[40]		-0.2	0.1	0.1	0.1	0.1
Implicit interest rate on debt[41]		4.3	5.1	4.3	4.2	3.4
Other relevant variables						
6. Liquid financial assets[42]						
7. Net financial debt (7=1-6)						
8. Debt amortization since the end of the previous year		3.7	3.3	4.5	3.3	4.0
9. Percentage of debt denominated in foreign currency		68.9	74.5	70.9	71	67.8
10. Average maturity		6.2	6.7	6.3	5.8	5.7

[35] As defined in Regulation 3605/93 (not an ESA concept).
[36] Cf. item 10 in Table 2.
[37] Cf. item 9 in Table 2.
[38] 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.
[39] Including liquid assets, government securities, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.
[40] 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.
[41] Proxied by interest expenditure divided by the debt level of the previous year.
[42] AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5: Cyclical developments

% of GDP	ESA code	2013	2014	2015	2016	2017
1. Real GDP growth (%)		0.9	2.1	2.6	3.4	3.4
2. Net lending of general government	EDP B.9	-1.5	-1.8	-1.5	-1.1	-0.9
3. Interest expenditure	EDP D.41	0.8	0.8	0.9	0.9	1.0
4. One-off and other temporary measures						
5. Potential GDP growth (%)		1.1	1.9	2.4	2.7	2.9
contributions:						
labour		-0.8	-0.2	0.1	0.3	0.4
capital		0.9	0.8	0.9	1.0	1.1
total factor productivity		1.1	1.2	1.3	1.4	1.5
6. Output gap		-1.6	-1.3	-1.1	-0.4	0.0
7. Cyclical budgetary component		-0.5	-0.4	-0.3	-0.1	0.0
8. Cyclically-adjusted balance (2 – 7)		-1.0	-1.4	-1.2	-1.0	-0.9
9. Cyclically-adjusted primary balance (8 + 3)		-0.2	-0.6	-0.2	-0.1	-0.1
10. Structural balance (8 – 4)		-1.0	-1.4	-1.2	-1.0	-0.9

Table 6: Divergence from previous update

	ESA code	2013	2014	2015	2016	2017
Real GDP growth (%)						
Previous update		1.0	1.8	2.9	3.4	
Current update		0.9	2.1	2.6	3.4	3.4
Difference (pps)		-0.1	0.3	-0.3	0.0	
General government net lending (% of GDP)	EDP B.9					
Previous update		-1.3	-1.3	-1.0	-0.8	
Current update		-1.5	-1.8	-1.5	-1.1	-0.9
Difference (pps)		-0.2	-0.5	-0.5	-0.3	
General government gross debt (% of GDP)						
Previous update		17.9	20.4	18.6	19.9	
Current update		18.9	22.8	22.2	23.3	20.6
Difference(pps)		1	2.4	3.6	3.4	

Table 7: Long-term sustainability of public finances

% of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure	**39.2**	**37.4**	**36.3**	**37.3**	**38.4**	**40.0**	**40.4**
Of which: age-related expenditures	15.5	18.2	17.1	18.1	19.1	20.8	21.2
Pension expenditure	7.8	9.9	8.8	9.2	9.7	10.7	10.6
Social security pension	7.5	9.6	8.4	8.9	9.4	10.4	10.3
Old-age and early pensions	5.9	8.0	6.7	6.9	7.4	8.5	8.4
Other pensions (disability, survivors)	1.6	1.6	1.8	1.9	2.0	2.0	2.0
Occupational pensions (if in general government)	-	-	-	-	-	-	-
Health care	4.1	4.8	4.4	4.8	5.4	5.8	6.1
Long-term care	-	-	-	-	-	-	-
Education expenditure	3.8	3.8	3.6	3.8	3.8	4.0	4.3
Other age-related expenditures	0.1	0.4	0.3	0.2	0.2	0.2	0.2
Interest expenditure	1.2	0.6	0.9	1.3	1.9	3.1	4.6
Total revenue	**40.4**	**34.3**	**34.9**	**34.2**	**34.2**	**34.2**	**34.2**
Of which: property income	1.3	1.1	1.0	0.3	0.3	0.3	0.3
Of which: from pensions contributions (or social contributions if appropriate)	6.0	7.4	8.1	8.1	8.1	8.1	8.1
Pension reserve fund assets	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Of which: consolidated public pension fund assets (assets other than government liabilities)	-	-	-	-	-	-	-
Systemic pension reforms[43]							
Social contributions diverted to mandatory private scheme[44]	0.8	1.0	-	-	-	-	-
Pension expenditure paid by mandatory private scheme[45]	0.0	0.0	-	-	-	-	-
Assumptions							
Labour productivity growth	3.1	5.3	2.8	2.5	2.3	1.6	1.5
Real GDP growth	6.4	0.4	2.0	1.4	0.9	0.5	0.4
Participation rate males (aged 20-64)	78.3	77.3	78.1	77.1	76.1	76.8	78.3
Participation rates females (aged 20-64)	68.4	68.0	69.7	67.9	66.1	67.1	69.2
Total participation rates (aged 20-64)	73.3	72.6	75.0	73.0	72.1	72.9	74.8
Unemployment rate (people aged 15-64)	6.9	10.3	9.0	7.3	7.3	7.3	7.3
Population aged 65+ over total population	17.3	17.7	21.0	24.3	27.6	31.2	32.6

43 Pension reforms, including mandatory additional pension insurance.

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

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

Table 7a: Contingent liabilities

% of GDP	2013	2014
Government guaranteed debt	1.0	1.4
Of which: linked to the financial sector	0.1	0.5

Table 8: Basic assumptions

	2013	2014	2015	2016	2017
Short-term interest rate (annual average) 6-month LIBOR in EUR, %	0.22	0.33	0.53	1.02	1.47
Short-term interest rate (annual average) 6-month LIBOR in USD, %	0.41	0.42	0.82	1.86	2.93
Long-term interest rate (annual average), %	3.47	3.67	3.80	4.07	4.35
USD/EUR exchange rate (annual average)	1.33	1.34	1.36	1.36	1.36
Nominal effective exchange rate, percentage change, previous year = 100[46]					
EUR/BGN exchange rate (annual average)	1.95583	1.95583	1.95583	1.95583	1.95583
World economy, GDP growth, %	3.0	3.7	3.9	4.0	4.0
EU GDP growth, %	0.1	1.4	1.7	1.8	1.9
Growth of relevant foreign markets. %					
World import volumes, excluding EU, %					
Oil Brent (USD/barrel)	108.9	105.8	99.7	95.18	91.69
International prices of non-energy goods, %	-7.2	-3.6	-2.2	-0.8	-0.8
International prices of food products, %	-7.1	-6.4	-2.6	-1.0	-0.8
International prices of agricultural raw materials, %	-5.9	3.5	-0.1	-2.7	-3.1
International prices of metals, %	-7.8	-4.6	-3.5	0.9	0.8

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