REPUBLIC OF BULGARIA
Ministry of Finance

2019-2022 CONVERGENCE PROGRAMME

April 2019, Bulgaria

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List of Abbreviations

ATR	Annual tax return
BNB	Bulgarian National Bank
CITA	Corporate Income Tax Act
CP	Convergence Programme
EC	European Commission
ECB	European Central Bank
EDTWA	Excise Duties and Tax Warehouses Act
ESA 2010	European System of Accounts 2010
EU	European Union
EUR	euro
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GS	Government securities
GVA	Gross Value Added
HIA	Health Insurance Act
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
ITC	International Trade Centre
LFS	Labour Force Survey
LIBOR	London Inter-Bank Offered Rate
MF	Ministry of Finance
MoI	Ministry of Interior
MRR	Minimum reserve requirements
NCA	National Customs Agency
NHIF	National Health Insurance Fund
NRA	National Revenue Agency
NSI	National Statistical Institute
NSSI	National Social Security Institute
OSIIs	Other Systematically Important Institutions
OECD	Organisation for Economic Cooperation and Development
OPAC	Operational Programme Administrative Capacity
OPIC	Operational Programme Innovation and Competitiveness
p.p.	Percentage points
PFA	Public Finance Act
PITA	Personal Income Tax Act
PSS	Public Social Security scheme
R&D	Research and Development
SBA	Republic of Bulgaria's State Budget Act
SGP	Stability and Growth Pact
SSC	Social Security Code
ULC	Unit Labour Costs
USD	U.S. dollar
VAT	Value Added Tax
WTO	World Trade Organisation

OVERALL POLICY FRAMEWORK AND OBJECTIVES

Bulgaria's Convergence Programme (2019–2022) outlines the key policies for maintaining the macroeconomic and fiscal stability of the country in order to create conditions for economic growth.

Key objectives in public finance management are maintaining fiscal sustainability, overcoming macroeconomic imbalances and the pursuit of a coherent, transparent and predictable fiscal policy to improve the business environment, promote investment and stimulate labour market developments.

Policies aimed at increasing productivity and competitiveness of the economy will have a positive impact on economic growth by creating a favourable environment for Bulgaria's development as a hub of high-value-added knowledge-intensive production and service delivery, ensuring a better match between supply and demand on the labour market, improving the quality of public goods and services, investment in infrastructure and increasing funding in areas such as education, healthcare and social protection. To achieve a balanced growth, sustainable convergence and higher living standards, the Bulgarian authorities will persist in their efforts to improve the efficiency and effectiveness of public administration, ensure transparent absorption of EU funds, and eliminate barriers to private sector investment. In addition the government implements measures and activities for simultaneously joining the Exchange Rate Mechanism II (ERM II) and the Banking Union and, in the longer term, the Eurozone, and those efforts are expected to have a positive impact on the economic environment and on public finance sustainability.

In the medium-term, fiscal policy is fully geared towards maintaining the sustainability of the budgetary framework in the context of Bulgaria's commitments both under the Stability and Growth Pact (SGP) and its status of a Contracting Party under Title III of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. In this respect, fiscal policy clearly sets strict adherence to budget discipline as the main commitment of the government, including by retaining Bulgaria's leading position among EU member states in terms of the low level of debt burden.

The medium and long-term sustainability of public finances remains a policy priority, including in terms of strengthening credibility and creating a predictable investment and business environment. In this update of its Convergence Programme, Bulgaria maintains its medium-term budgetary objective of -1% of GDP for the structural balance on an annual basis.

The tax policy of the Republic of Bulgaria remains predictable while at the same time oriented towards promoting business development and investment activity, by retaining its low tax rates for direct taxes, a broad tax base and a limited number of tax preferences. The government will continue its policies to improve the tax collection and the fight against shadow economy and undeclared work.

Improving the effectiveness of public spending in the implementation of expenditure policies will continue, by implementing sectoral structural reforms, streamlining budget organization spending and improving public expenditure effectiveness in the various sectors, and by increasing their contribution to higher economic growth.

In the context of preserving its macroeconomic stability, Bulgaria guarantees that it will maintain the currency board arrangement, with a fixed exchange rate to the euro at its current level of 1.95583 BGN, until the country joins the euro area.

This Convergence Programme covers the period 2019–2022 and comprises seven chapters.

The first chapter contains the overall framework of the government's economic policies and objectives.

The second chapter analyses the economic development of the country in terms of the key macroeconomic indicators, as well as a forecast for their development in the medium-term.

The third chapter makes an overview of the strategic fiscal policy objectives in terms of budget balance and government debt. It details the current budgetary position and the expected developments over the reference period, with an emphasis on the structural balance. It outlines the main directions for the development of the debt position during the programming period. The main policy focus and concrete implementation measures, as well as an assessment of the quantitative effect of the policies' implementation, are also presented.

Chapter Four analyses the sensitivity of the forecast parameters by developing an alternative scenario for the country's economic development in the medium-term. It also assesses the effect of implementing alternative scenarios on the budgetary parameters. It presents the effects from changes in assumptions under the main macroeconomic scenario on government debt as well.

Chapter Five is dedicated to the sustainability of public finances. The main focus is on the long-term budgetary outlook in view of the effects of the ageing population.

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

Chapter Seven reviews the institutional features of public finances in Bulgaria: budgetary procedures and national fiscal rules.

This Convergence Programme takes into account measures and developments under the first of the three Council Recommendations of 13 July 2018 on the 2018 National Reform Programme of Bulgaria and delivering a Council opinion on the 2018 Convergence Programme of Bulgaria[1] , namely:

Country-Specific Recommendation 1: *Improve tax collection and the efficiency of public spending, including by stepping up enforcement of measures to reduce the extent of the informal economy. Upgrade the State-owned enterprise corporate governance framework in line with international good practices.*

[1] OJ C 320/02, 10.09.2018

CHAPTER 1
ECONOMIC OUTLOOK

1.1 Assumptions concerning the development of the world economy

This Convergence Programme is based on the macroeconomic framework for the period 2019–2022 and has been developed using the medium-term macroeconomic model of the Ministry of Finance with the assumptions about key indicators of the external environment provided by the International Monetary Fund, the European Commission and the Ministry of Finance of the Republic of Bulgaria, as of mid-March 2019.

Table 1: **Assumptions on key macroeconomic indicators**

	2019	2020	2021	2022
Global economy (real growth, %)	3.5	3.6	3.6	3.6
EU GDP (real growth, %)	1.5	1.7	1.6	1.5
Exchange rate USD/EUR, annual average	1.13	1.13	1.13	1.13
International commodity prices (in USD, %)				
Crude oil Brent (per barrel)	-13.4	-0.2	-1.5	-0.9
Non-energy goods	-0.2	1.1	0.7	0.6
Food	-2.9	2.1	0.1	0.1
Beverages	-2.1	6.8	3.2	0.0
Agricultural raw materials	-3.7	-0.2	-0.4	0.0
Metals	2.4	-2.2	0.5	0.6
6-month LIBOR on USD denominated deposits	3.22	3.81	3.48	3.19
6-month LIBOR on EUR denominated deposits	-0.28	-0.17	0.01	0.24

Source: EC, IMF, MF

Global, economic activity remained stable in 2018. The global economic growth is expected to slow down in 2019, as a result of a slower economic activity both in the developing and in the developed countries. Protectionist trade measures adopted, primarily by the U.S., will continue to restrict global trade. Forecasts point to a persisting downturn in the economic situation in Turkey and a drop in its GDP. The growth rates of the European and the U.S. economies will also slow down in 2019.

In 2020, economic activity in the EU will pick up, powered by growth in euro area countries. A stronger increase is expected for the global economy as well, as a result of increased economic activity in developing countries (including Turkey). Until the end of the forecast horizon, the EU economy will grow at a declining rate, while the growth rate of the global economy will plateau.

1.2 Economic Outlook and Cyclical Developments

1.2.1 Economic Growth

In 2018 Bulgaria's gross domestic product (GDP) grew by 3.1% in real terms, compared to 3.8% in 2017. The slower growth of the economy was due to the dynamics of exports, while the positive contribution of domestic demand increased.

Final consumption increased by 6%, versus 4.3% in 2017. Private consumption grew by 6.4%, on the back of the continuing increase in income levels, higher credit activity and growing consumer confidence. At the same time, the increase in personnel and maintenance costs led to a government consumption increase of 4.7%.

Fixed capital investments rose by 6.5%, against 3.2% in 2017. Growth was supported by both public and private investment activity[2]. Government capital expenditure went up in terms of EU funding and national budget funding. The increase in private investment in the economy was associated with the improvement of the business climate in the country and the increase of credit to non-financial enterprises. During the year, growth was registered in investments in construction and in machinery and equipment.

In 2018, the increase in exports of goods and services decreased by 0.8%. The dynamics was due to temporary effects, impacting firm trade with metals and petrol products, as well as due to the slowdown of foreign demand growth during the year. Imports of goods and services registered an increase of 3.7%.

Gross value added in 2018 rose by 3%, compared to 4.2% in 2017. The increase in value added in services reached 4%. In manufacturing, growth slowed down to 0.8%, from 4% in 2017. The lower growth rate was due to developments in export-oriented sectors. The growth recorded in construction was 4% and was determined by building construction.

1.2.2 Cyclical Developments[3]

According to MF estimates, the potential GDP growth in 2018 reached 3.3%. This represents an acceleration compared to 2017, due to a higher contribution from total factor productivity (TFP) and capital. In 2019, potential growth is expected to go up, reaching 3.4%. This is linked to an increase in the share of capital stocks, due to the forecasted growth in investment, mostly in terms of public capital expenditure. For the period 2020–2022, potential GDP growth is expected to decelerate, in the range of 3.3% to 3.1%. Productivity will continue to be a growth driver, with a contribution of 2 p.p. The increase in investment activity will contribute to a gradual increase in the contribution of capital stocks to potential growth. At the same time, the positive contribution of labour as a factor for potential growth will decrease and become a negative value over the 2021-2022 period. Despite the increase in the economic activity rate and the decrease in unemployment, the employment rate

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

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

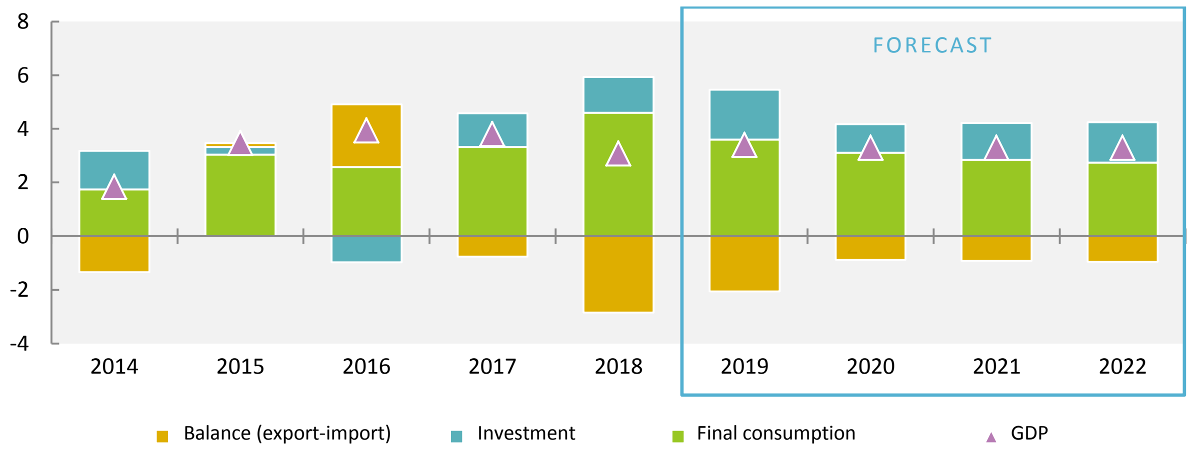
in the economy will start to decline, due to the negative effects caused by the demographic processes.

The output gap closed in 2018. Within the projection period until 2022, the gap will be positive but will remain below 1%.

1.3 Medium-term Scenario

According to the Spring forecast of the MF, GDP will grow by 3.4% in 2019. The planned increase in public investment and in exports will have a major contribution to the higher growth rate compared to 2018. Private consumption will continue to develop in a sustainable manner, yet its rate of increase will show a deceleration, compared to the previous year. This lower increase will be due both to a technical effect caused by the high baseline in 2018 and to a deterioration in consumer confidence which was observed in the second half of 2018. The growing uncertainty associated with the unstable external environment will also translate into a weaker private investment performance. In 2019, as the one-off negative effects from 2018 wear off, the export is expected to return to growth. External demand from EU countries will continue to support the growth of Bulgarian's export, but the contribution will be limited by the expected slowdown in economic activity in most of the Member States. Bulgaria's export to Turkey will remain negatively affected by the decrease in the country's economic activity. Demand for export-oriented sectors and the upward trend in investment will be reflected in an acceleration of import. International trade will have a more favourable impact on GDP growth, as the contribution of net export to growth will remaining negative but will shrink to 2.1 p.p.

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



Source: NSI, MF

GDP growth will slow down slightly to 3.3% in 2020 as a result of lower government spending for consumption and investment. While private investment is expected to improve, the increase in the growth of private consumption will be limited by the weaker rise in income levels and in the employment rate. The expected improvement in external demand, both in the EU and in some third countries, will translate into an acceleration of export growth in 2020 г. At the same time, the growth in import of goods and services will decelerate as a result of weaker domestic demand, limiting the negative influence of the external sector on GDP growth to 0.9 p.p.

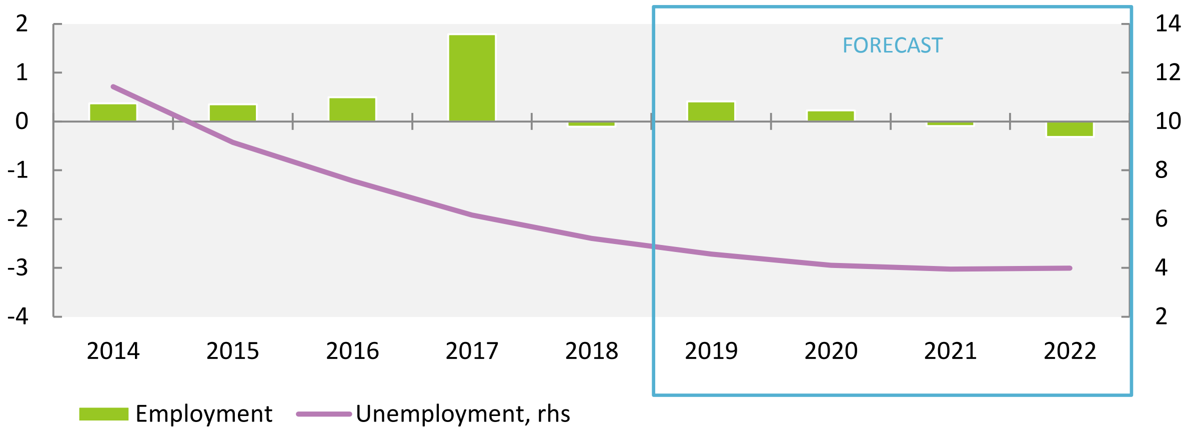
GDP will continue to grow at the rate of 3.3% over the 2021-2022 period. Domestic demand will remain the driving force behind the increase, both in terms of consumption and investment. While investment activity is expected to rise moderately, private consumption dynamics will be subdued by labour market developments associated with the exhaustion of the growth capacity of the employment rate. The growth in imports will continue to outpace the increase in exports, translating into a negative external sector contribution to GDP growth throughout the rest of the forecast period.

1.4 Sector Balances

1.4.1 Labour Market, Income Levels and Productivity

The sustainable economic growth and job creation in the economy in 2018 contributed to the increase in the employment and economic activity rates of population (aged 15-64), bringing them to their all-time historical highs of 67.7% and 71.5%, respectively. That occurred in the context of negative demographic developments which had a limiting effect on the labour supply in Bulgaria. The increase in economic activity among the working-age population last year was entirely due to persons in the age groups of the 45-54 year-olds and the 55-64 year-olds, which reflected the aging of the labour force but also the targeted policy in support of vulnerable groups in the labour market, as well as the pension scheme reform, aiming to assist the longer stay on the labour market among which has as one of its goals to assist them in remaining on the labour market for longer. The two highest age groups had the strongest impact towards thefor the overall increase in the employment rate (within the 15-64 age bracket), although a slight increase was registered for also persons in the 25-34 and 35-44 age groups as well but on the account of the more significant drop in the number of population compared to the decrease in the number of employed.

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



Source: NSI, MF

In 2018, the total employment number[4] in Bulgaria remained close to its level from the previous year, with a slight dip of 0.1% from its 2017 figure, entirely as a result of the negative dynamics of employment in agriculture. Also, that was the only sector evidencing a drop in real GVA, and the strong linkage between the dynamics of economic activity and that of the employment in agriculture is due to the high labour in the production process. At the same time, although the demand for labour in manufacturing and services weakened in the second half of the year, the employment growth in both sectors accelerated over 2018 as a whole. In manufacturing, that was due to construction, which registered one of the fastest rates of increase in the number of employed, at 5.2%, while in the manufacturing sector the increase in the employment slowed down to 0.6%, due to the influence of the weakened economic activity in some of the export-oriented industries. In the context of a high domestic demand, the number of employed in the service industries rose by 1.2% compared to 2017, supported both by sectors generating a higher value added and employing people with higher skills,

[4] As defined in ESA 2010.

such as information and communicaton, and by sectors employing mostly people with medium and lower levels of qualification, such as wholesale and retail trade, transport and storage, and accomodation and food service activites.

The favourable developments in the labour market in 2018 were reconfirmed by the continuing decrease in the unemployment rate. Its level reached 5.2%, falling below its pre-crisis low of 5.6% from 2008 and registering a new historical low level[5]. The structural features of unemployment also improved, as manifested by the further decrease in the long-term unemployment rate, down to 3.1%, and in the unemployment rate of people with lower secondary or lower education, down to 15.5%.

In 2019, the number of employed (ESA 2010) is expected to rise by 0.4%, and its acceleration in comparison to 2018 manifests the expectation for a significantly smaller decrease in the number of employed in agriculture, compared to the previous year. At the same time, the momentum caused by the weaker labour demand in manufacturing and the service industries in the second half of 2018 is expected to carry over well into the first six months of 2019. Thus, despite of the expected revival in the labour market in the second half of the year, for 2019 as a whole, the number of employed in manufacturing and services will grow at a more subdued rate than in 2018. The unemployment rate is expected to go down to 4.6%, which will be accompanied by an increase in the activity rate of the working-age population (15-64-year-olds) up to 72.3%, following the slowdown in the rise of that indicator in the previous year.

Over the 2020-2022 horizon, the employment growth is expected to weaken and gradually convert into a decrease of 0.1% in 2021 and 0.3% in 2022. This will be affected by the limitations coming from labour supply which are driven by the negative demographic trends and the shrinking labour force, and by the rapid depletion of the available labour force resource of unemployed and persons outside the labour force (discouraged) that could have been capable of satisfying the labour demand most quickly. The unemployment rate will retain its downward trend which will occur at an increasingly slower pace, to reach 4% in 2021-2022. In the context of a decreasing population and labour force, the economic activity rate (15-64-year-olds) will continue to climb, reaching 74.5% at the end of the forecast period.

Increased labour demand in manufacturing and services[6] affected differently the dynamics of wages and salaries[7] in those sectors. In terms of the total economy, the nominal growth of compensation per employee slowed down to 5.6% in 2018 from 10.5% in the previous year, and that development was driven by the service sector activities. They exhibited an accelerated growth in the number of employees, but that was paired with a significant slowdown in the compensation per employee, down to 3.1% in 2018. That trend reflected the decrease of the indicator in a large portion of the activities in the sector, including the aggregated industry of wholesale and retail trade, transport and storage, and accomodation and food service activites, information activities, financial and insurance activities, and real estate. In the context of an increased labour demand and productivity in services, the lower growth in wages was affected also by the change in the qualification profile of persons employed. Unlike in 2017, the demand for labour in 2018 was characterized by hiring primarily persons with low and medium-level of qualification, which, *ceteris paribus*, led to a lower average level of pay. In the service sector, only budget-oriented activities (public administration, education and healthcare) showed an accelerated rates of increase in labour incomes, which came as a result of changes due to the raising of salaries in certain priority areas within the budget sector. In industry, compensation per employee continued to grow at a double-digit rate (12.7%). In construction, the value for the indicator reached 17.6%, and the dynamics of labour demand in the sector was the

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5 Based on Labour Force Survey (LFS) data.

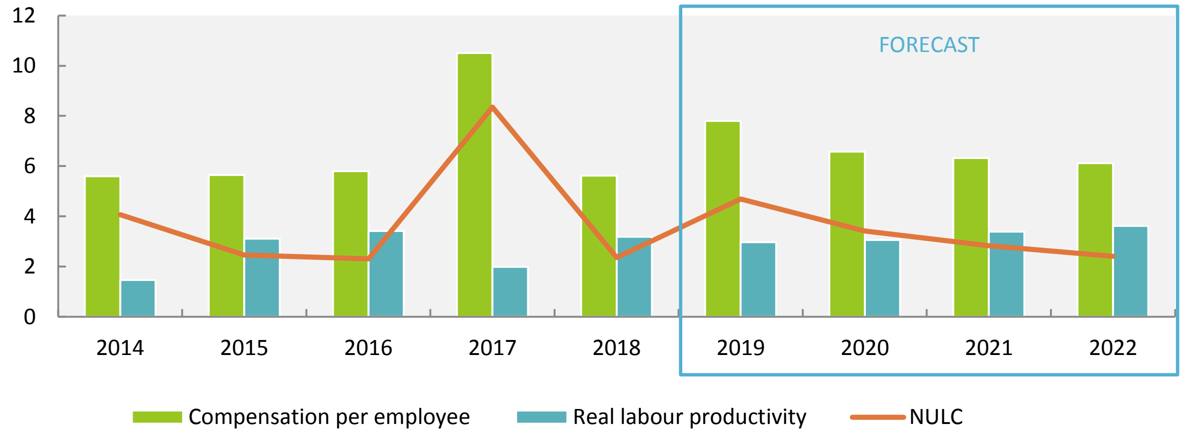
6 As defined in ESA 2010. The impact of agriculture on compensation of employees is limited, due to the large number of self-employed in the sector whose wages and salaries are not included in the scope of compensations. The dynamics of labour demand in the agricultural sector mostly influences labour productivity.

7 As defined in ESA 2010.

highest throughout the post-2008 period. In manufacturing, the nominal growth of compensation per employee also accelerated, reaching 11.8%, but the dynamics in the number of persons employed slowed down, and even went negative in the second half of 2018.

The income dynamics was supported by the increase in value added in the services and manufacturing. Real growth of labour productivity[8] in the total economy accelerated to 3.2% in 2018, mainly contributed by services (2.8%) and agriculture (5.3%). The growth of the indicator in industry excluding construction remained lower (0.2%), yet it should be noted that in manufacturing, which is most exposed to influences from the external environment, the rate of increase of the indicator (3.9%) was considerably higher than the average for the economy. From the viewpoint of estimating cost competitiveness, the current development of income levels and labour productivity determined the slowdown in the growth of unit labour costs[9] (ULC), down to 2.4% in nominal terms against 8.4% in the previous year. That growth remained lower, compared to the dynamics of the indicator in the new member states and close to the EU-28 average and supported cost competitiveness.

Chart 3: **Dynamics of nominal ULC and its components (%)**



Source: NSI, MF

After slowing down significantly in 2018, the nominal growth in compensation per employee is expected to accelerate at a rate of up to 7.8% in 2019, in the conditions of a positive development of labour productivity, prices, labour market, and the annual indexation of the minimum wage, at the rate of 9.8% year-on-year. Similarly, to 2018, the increase in labour costs in priority areas in the budget sector will also provide a high contribution. In the post-2019 period, however, the influence of the latter two factors will gradually weaken and along with the expectations for a lower growth rate for the number of employees, and even a decline at the end of the forecast period, the nominal rate of growth of the compensation per employee will begin to decelerate and will reach about 6.1% in 2022. During the forecast period, the dynamics of compensation of employees will support that of consumption expenditure. The latter will exhibit lower rates of growth in comparison with those reported in 2018 but will remain high over the subsequent years.

Real growth in labour productivity over the 2019–2022 period is estimated 3.3% on an annual average. The expectations that the dynamics of compensation per emploees will precede that of productivity also remain in place. The assumption for a more substantial increase in unit labour costs in 2019 will be offset by their lower rate of increase at the end of the forecast period. Thus, the annual average growth for the discussed indicator will reach 3.3% in 2019–2022.

8 Calculated as a ratio between GDP in 2010 prices and the number of employees in accordance with ESA 2010.

9 The indicator was calculated as a ratio between compensation per employee (in current prices) and GDP per employee(in 2010 prices) using data from ESA 2010.

1.4.2 Inflation

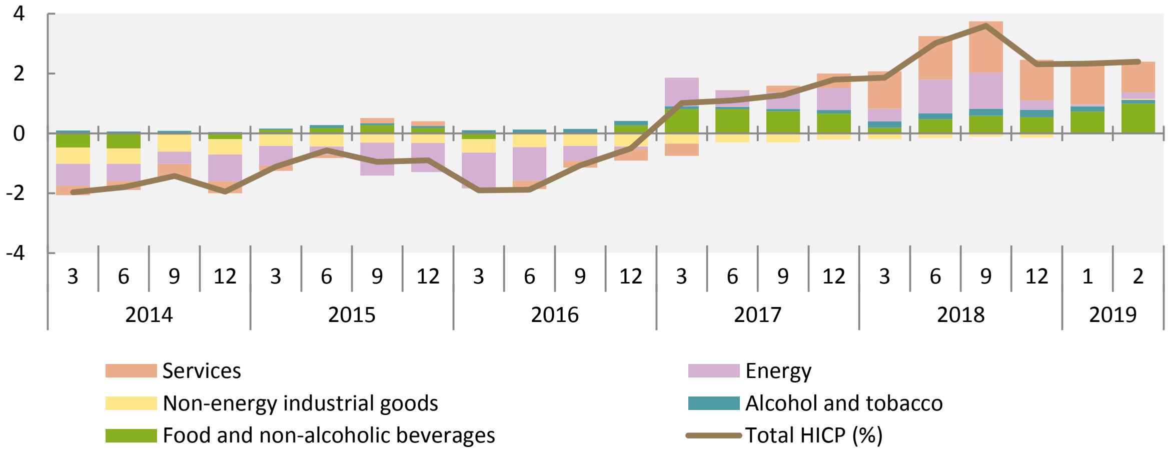
End-year inflation stood at 2.3% in 2018. Over the year, the inflation rates accelerated year-on-year until August, reaching 3.7%. In November and December, inflation decelerated considerably primarily due to prices of liquid fuels which were affected by the drop in international prices of crude oil (by 30% for the two months). The annual average inflation in 2018 was 2.6%.

Increases in the prices of services (4.4%) and food products (2.4%) had the highest contributions to annual inflation at the end of the year, by 1.4 and 0.5 p.p., respectively. In food products, the rise in prices followed a strong acceleration trend over the past year. That was influenced by several factors, such as the rise in international commodity prices of grains and oil, the weaker domestic supply as manifested in the drop of GVA in the agriculture sector, and the increase in salaries. The increase in the prices of processed food was 3.2%, while the prices of non-processed foods remained at almost the same level as in early 2018. The increase in the prices of services was driven by second round effects of the higher international oil prices which pushed up the prices of transport services and to higher hotel and catering services, influenced by the increased domestic demand. Driven by the upward trend in prices of services, core inflation[10] stood at 2.1% at the end of the year.

The increase in the prices of goods and services with administered[11] prices reached 2.4% at the end of 2018 and contributed 0.4 p.p. to the increase in headline inflation. Over the year, there were price increases in electricity, district heating and natural gas rates, as well as in water supply and sewage service charges.

Inflation in February 2019 reached 2.4% yoy, which constituted an acceleration of 0.1 p.p. vis-à-vis January 2019 and December 2018. Food prices increased by 4.5%, incl. the increase in unprocessed and processed foods by 6.3 and 4%, respectively. During the month the domestic prices of liquid fuels increased by 3.3% month on month, affected by the higher prices of crude oil. Core inflation decreased to 1.8%.

Chart 4: **Inflation and contributions by key components (p.p.)**



Source: Eurostat, MF

Considering the assumptions on international commodity prices dynamics in 2019, the upward pressure on production costs and consumer prices is much lower compared to the autumn of 2018. On the other hand, there are still domestic drivers of inflation, manifested in relatively strong household

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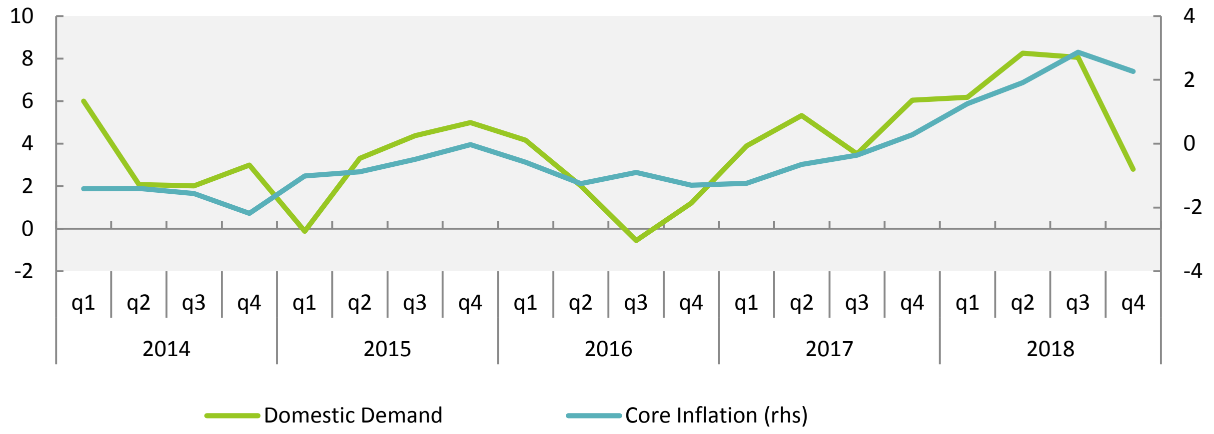
10 The price changes in energy goods, food products, alcoholic beverages and cigarettes have been excluded from the headline HICP.

11 The index of administered prices is calculated as a weighted average of the relevant elementary aggregates in the consumer basket.

consumption, supported by the rise in incomes, the low unemployment rate and a continuing improvement in the employment rate. The limited effect expected on the side of international commodity prices indicates that the year would end with a price pressure that is feasibly lower for the consumer prices of goods than for services. The forecast for the 2019 end-of-year inflation is 2.4%, a bit higher than at the end of 2018. In terms of annual average inflation, this is expected to reflect as 1.8%, which is technically due the monthly rates reported in 2018. As a result of strong domestic demand, and a price level of services that is lower than that of goods, the relative price for services is expected to grow at a higher rate than the rate of the total price increase. Core inflation at the end of the year is expected to climb higher, reaching 2.5%, compared to the 2.1% at the end of 2018.

Chart 5: **Core inflation and domestic demand**

(%, quarterly, year-on-year rates)



Source: Eurostat, MF

In 2020-2022, the end-of-year inflation rates are expected to slow down slightly, due to the expected lower international crude oil prices, relatively stable prices in the rest of the commodities, and decelerating rates of increase in domestic demand.

In the forecast period some increase in certain administered prices of goods and services is possible. However such adjustments were not accounted for in the forecast as no official projections were available.

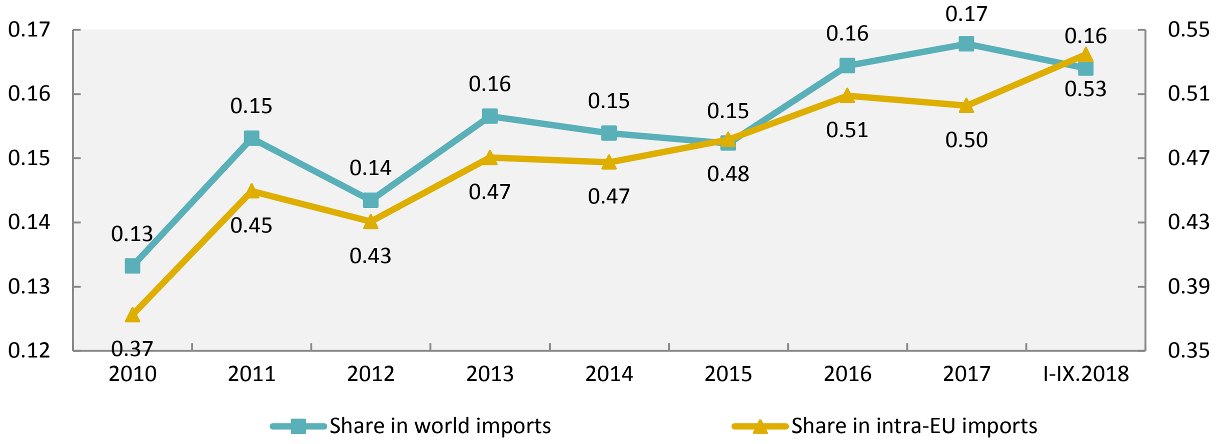
1.4.3 External sector

In 2018, the current and the capital accounts reported a considerable surplus in the amount of EUR 3.3 billion (6% of GDP).

The balance went down from 2017, determined by the increase in the trade deficit, up by 2.6 p.p., to 4.1% of GDP. The reported deterioration was due to the more rapid real growth in import of goods versus export, in the context of similar price increases in both import and export. The accelerated increase in consumption and fixed capital investment determined the growth in import, while the slowdown in external demand, along with some one-off effects, had a negative effect on the export of goods. In nominal terms, a drop in export was registered in export to non-EU countries (including Turkey and Russia)[12], while trade with EU Member States continued to grow. As a result, in 2018 was again observed an upward dynamics in the market shares of Bulgaria's export within the EU, while the share in global import went down to its 2016 level.

[12] The decrease of export to Turkey reflects the unstable economic environment in the country, as well as the reduced export of oil products. The primary reason for the deacrease in trade to Russia, was a basic effect following reexport of unused equipment in 2017.

Chart 6: **Bulgaria's share in international trade (%)**

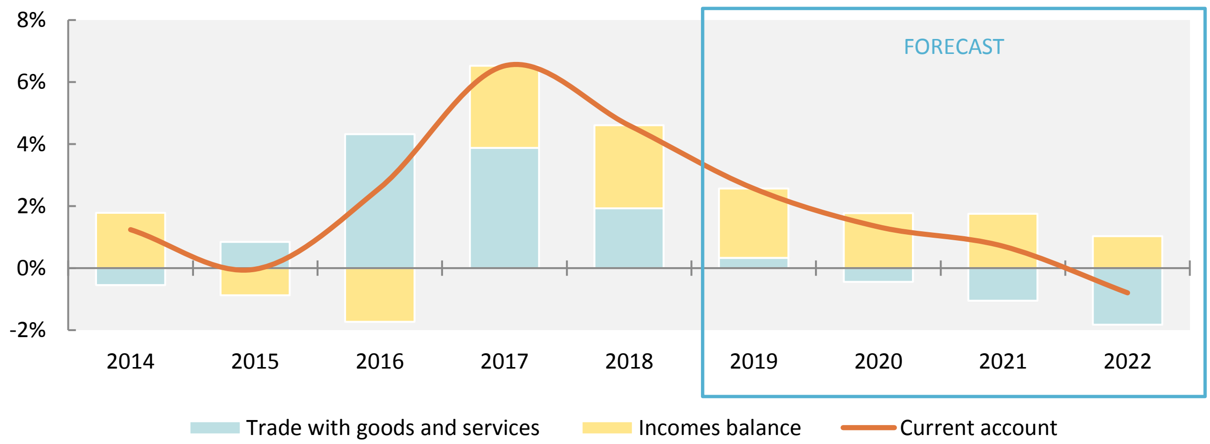


Source: MF calculations based on WTO and Eurostat data

The balance on services went up to 6% of GDP, supported by higher income generated from travels in Bulgaria by non-residents and export of other services (including business services and telecommunications, computer and information services). The Primary and Secondary income balances remained close to those reported for the previous year, and thus the total balance on Incomes remained positive, 2.7% of GDP.

Assumptions concerning the dynamics on international prices dynamics used in this forecast show an improvement in the terms of trade in 2019 (the change in export prices will outpace that in the import prices). The positive price effect, along with the rebound in the real growth in export, will translate into an accelerated nominal increase in exports of goods compared to 2018. Its rate of growth (4.1%) will get sloser to that of imports (7.2%), yet remain below it, and the trade deficit will continue to widen, reaching 5.5% of GDP. The surplus in trade on services will remain broadly unchanged (5.9% of GDP). The expected rise in the net operating surplus, which is a proxy for corporate profits, will translate into an increase in investment payments to non-residents and thereof a decrease in the positive balance on Incomes. As a result, the current account balance is expected to slower compared with 2018 but remain positive, at 2.6% of GDP.

Chart 7: **Current account (% of GDP)**

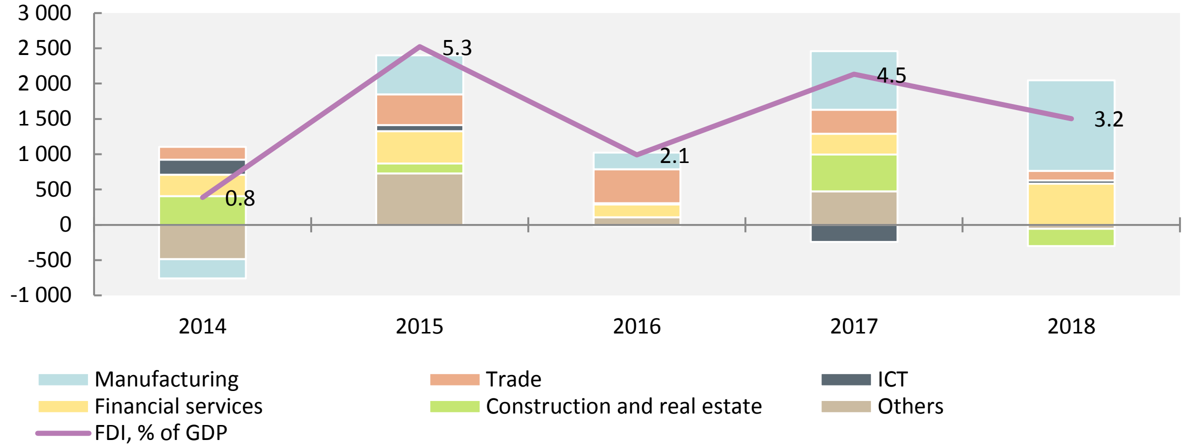


Source: BNB, NSI, MF

During the 2020-2022 period, the nominal growth in export of goods and services will be more modest, as a result of lower price deflators and a slowdown in the growth of EU economies at the end of the forecast horizon. The trend of a more rapid increase in import compared to that in export will continue, which will push up the deficit in the trade in goods and services. The positive balance in secondary income will remain sizeable, supported by higher payments under the operational programmes as the programming period comes to a close. Primary income deficit will go slightly up as a ratio to GDP. As a result the current account surplus will decline gradually and turn into a deficit towards the end of the forecast period. Despite the deterioration, the balance will be sufficient to support a sustainable external account position.

Annual foreign direct investments inflows continued to grow and in 2018 they reached 3.5% of GDP, or EUR 1.9 billion. FDI came mainly in the form of debt instruments to non-financial corporations from the private sector.

Chart 8: **FDI inflows by sector[13] (in EUR million)**



Source: BNB, NSI

The MF expects the positive dynamics of FDIs in Bulgaria to continue, and the rate of increase will be close to the nominal growth rate of GDP. As a result, FDI inflows will amount to around 3.5% of GDP per annum throughout the forecast period.

1.4.4 Monetary sector and financial sector

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

As of December 2018, the market value of Bulgaria's international foreign exchange reserves – the assets on the balance sheet of the Issue Department[14] of the Bulgarian National Bank (BNB) amounted to EUR 25.1 billion, up by EUR 1.4 billion year-on-year. Foreign exchange reserves provided a coverage of 8.7 months of imports of goods and services, while their ratio to the country's short-term foreign debt was 318.0%.

As of February 2019, international foreign exchange reserves amounted to EUR 24.8 billion, which was an increase of EUR 2.6 billion from the same period of 2018. Under the currency board operating principles, the increase in international foreign exchange reserves corresponded to the increase in the liabilities of the Issue Department balance sheet. A major contribution to the dynamics in liabilities was due to the increases in liabilities to banks and in money in circulation.

[13] FDI data are in line with the directional principle of the initial direction of investment.

[14] The market value of international foreign exchange reserves includes adjustments from transactions, exchange rate differences and price revaluations.

Following a one-off decrease in the excess reserves of banks in October 2017 which was influenced by changes in the methodology for setting interest rates on accounts held with the BNB[15], a stabilization in the excess reserves has been observed from the beginning of 2018, with a tendency of gradual decline in the second half of the year. As of December 2018, the excess in banks' funds held with the BNB above the required minimum reserve assets under Ordinance No.21 of the BNB[16] amounted to a daily average of 33.1% of the minimum required reserves (against 44.9% in December 2017). The decrease in the excess reserves of banks in the second half of the year was fully offset by the increase in the minimum required reserves (MRR) due to the growing deposit base and by the increase in the resources of banks in the TARGET2 system. As a result, in December 2018, the total amount of bank reserves went up by BGN 0.9 billion as a year-on-year change of the monthly average. As of February 2019, the amount of banks' funds held with the BNB in excess of the required minimum reserve assets went down to 30.7% of the MRR, and the total amount of bank reserves registered an increase of BGN 1.1 billion as a monthly average compared to February 2018.

In 2018, broad money continued to increase at a relatively high pace and as of December their annual growth amounted to 8.8% (7.7% at the end of 2017). The dynamics was determined by the retention of a high saving rate in the economy, in the context of a continuing improvement in economic activity and an increase in wages and salaries. A major positive contribution to the growth in broad money continued to come from overnight deposits, while the contribution of money outside the monetary financial institutions remained stable throughout the year. As from April, a positive contribution from quasi-money to the overall growth of M3 was also observed, largely determined by time deposits with agreed maturity up to 2 years. In the context of low interest rates, overnight deposits remained the preferred form of savings for both enterprises and households due to the flexibility of withdrawals of savings that it provides. From the viewpoint of the currency structure, both enterprises and households continued to prefer to keep their savings mostly in the national currency.

As of the end of 2018, the total growth in deposits held by the non-government sector amounted to 7.3% on an annual basis (6.2% at the end of 2017). A key contribution to that growth came from household deposits, which increased at an accelerating rate over the year and reached BGN 51.5 billion as of December (an annual growth of 7.7%). In deposits held by non-financial corporations, a certain acceleration in the rate of growth was observed as from the end of the second quarter of the year, which was largely due to one-off factors the effects of which wore off in November. At the end of 2018, the amount of deposits held by non-financial corporations reached BGN 23.2 billion, and their growth slowed down to 5.2%. In January 2019, the annual growth rate of broad money accelerated to 10.0%, while the growth rate of deposits held by the non-government sector reached 8.6%.

Loans to non-financial corporations and households exhibited an acceleration trend in the annual growth rate in 2018, which amounted to 7.7% at the end of the year (3.3% at the end of 2017). This dynamic was helped by the favourable macroeconomic environment, the increasing domestic demand and the low lending rates. As of December 2018, the annual growth rate of loans to non-financial corporations amounted to 5.4% (1.6% at the end of 2017), with positive contributions from both non-overdraft loans and overdrafts. The trend in loans to households also showed an upward dynamics and, over the year, the annual rate of growth in consumer loans and in housing loans tended to accelerate. At the same time, the contribution by other loans was negative. As at the end of 2018, the overall growth in loans to households reached 11.2% year-on-year (6.0% at the end of December 2017). The considerable acceleration in the growth of consumer loans (up to 17.7% in December 2018) was significantly supported by the inclusion of a new reporting entity in the scope of

[15] In force as from 4 October 2017, there are amendments in the methodology for setting interest rates on accounts held with the BNB. According to the amendments, an interest rate applies to excess reserves of banks, at a rate equal either to 0% or to the interest rate on the ECB deposit facility less 20 basis points, whichever is smaller. That change brought down the interest rate applicable to excess reserves of banks held with the BNB to -0.60%.

[16] Ordinance No. 21 of the BNB on the minimum required reserves maintained with the Bulgarian National Bank by banks (in force as from 4 January 2016).

monetary statistics as from April 2018.[17] At the same time, the negative contribution of other loans to households was largely determined by repayments made by the government towards loans issued under the National Programme for Energy Efficiency in Multifamily Residential Buildings, which exceeded the volume of new loans under this programme. As of January 2019, the annual growth rate of loans to non-financial corporations and households rose to 7.8%.

In 2018, the interest rates on time deposits retained their levels, which are low in terms of historical values, which was influenced by the sustained high inflow of deposits by residents and the high liquidity in the banking system. As of January 2019, the weighted average interest rate on new[18] time deposits[19], presented as a 12-month weighted average, amounted to 0.3%, remaining unchanged from the same period in the previous year. In the context of a favourable macroeconomic environment, improved assessment by banks as to the creditworthiness of their borrowers and strong competition in the banking sector, interest rates on newly issued loans to enterprises and new housing loans retained their downward trend. As of January 2019, the weighted average interest rates on new loans[20] to non-financial corporations and on new housing loans, presented as a 12-month weighted average, went down by 0.6 percentage points and by 0.5 percentage points, respectively, compared to the same period in 2018 and stood at 3.4% for both categories of loans. At the same time, interest rates on consumer loans exhibited a certain increase from April 2018.

In 2018, the banking sector operated in an environment of a continuing process of asset quality improvement and observance of adequate levels of the liquidity and capital positions of credit institutions.[21]

Capital ratio levels in the banking system at the end of 2018 were down, compared to the end of 2017, but remained considerably above the minimum requirements. Credit institutions complied with the capital buffer requirements (a capital conservation buffer of 2.5%, a systemic risk buffer of 3.0%, a countercyclical capital buffer of 0% and a buffer for other systemically important institutions). With the increase in the amount of Common Equity Tier 1 capital during the year, both Tier 1 capital and banking system equity increased. At the end of 2018, regulatory own funds amounted to BGN 11.6 billion, which constituted an increase of BGN 142 million (1.2%) compared to the end of 2017. The total amount of risk exposures increased during the year under the influence of the growth in credit and as a result of regulatory changes.[22] The total capital adequacy of the banking system remained high at 20.38% as of December 2018 (22.08% at the end of 2017), including Tier 1 capital adequacy ratio of 19.41% (20.86% at the end of 2017). The amount of capital exceeding the minimum regulatory requirement of 8% decreased by 3.5% and at the end of the year amounted to BGN 7.1 billion. At the end of 2018, the banking system reported a profit in the amount of BGN 1.7 billion, which exceeded the 2017 profit by 44.7%.[23] The return on assets (ROA) and return on equity (ROE)

[17] As from April 2018, BNP Paribas Personal Finance S.A., Bulgaria branch has been included in the sector of "Other monetary financial institutions", with outstanding amounts reclassified from the sector of „Other financial intermediaries". The reclassification was the result of the merger into this new credit institution of the company engaged with the lending operations, BNP Paribas Personal Finance EAD, which, until March 2018, was reported, for the purposes of monetary statistics, within the sector of „Other financial intermediaries ".

[18] The terms "new" deposits and "new" loans refer to the statistical category of New business.

[19] Weighted average interest rates on time deposits for the sectors of households and non-financial corporations, weighted in terms of currency denomination and term of deposit.

[20] `Weighted average interest rates on loans to the sectors of households and non-financial corporations, weighted in terms of currency denomination and term of credit.

[21] The assessment of the state of the banking system is made on the basis of data from the supervision reports for the individual banks as of the end of December 2018 received by 7 March 2019.

[22] As from 1 January 2018, it is no longer allowed to apply preferential treatment to certain types of exposures which, until the end of 2017, were reported by banks as having a 0% risk weighting and a 0% capital requirement with respect to combining the BGN/EUR currency pair.

[23] Certain evens with a one-off effect also contributed for the increase in bank profits.

ratios went up from their 2017 values and at the end of 2018 stood at 1.58% (1.18% in December 2017) and 11.97% (9.15% in December 2017).

In 2018, the trend of bank asset quality improvement continued. At the end of December, the gross amount of non-performing exposures[24] amounted to BGN 6.8 billion, and their share in the total gross amount of all exposures in the banking system went down to 6.7% (from 8.9% at the end of 2017). On an annual basis, the gross amount of non-performing loans and advances fell by BGN 1.5 billion. (18.1%). At the same time, the total gross loans and advances grew by 9.2% (BGN 7.5 billion). As a result, the share of gross non-performing loans and advances in the total stock of gross loans and advances went down by 2.6 p.p. to 7.6% at the end of 2018. The coverage of gross non-performing loans and advances with their inherent impairment at the end of 2018 г. rose to 51.4% (from 49.4% at the end of 2017). The net amount of non-performing loans and advances[25], which represents the potential credit risk in bank balance sheets, went down by 21.4% to BGN 3.3 billion, and their share in total net loans and advances fell to 3.9% at the end of 2018 (5.4% at the end of 2017). At the end of the period, the amount of the residual credit risk was more than two times less than the excess of capital above the minimum regulatory requirement of 8%.

The liquidity position of the banking sector remained stable, and the liquidity coverage ratio in the banking system significantly exceeded the minimum requirement. The liquidity coverage ratio (LCR)[26] at the end of December 2018 amounted to 294.1% (344.7% at the end of 2017) and remained above the average for the European banking system.

In line with its mandate, the BNB supervises banks in order to maintain the stability of the banking system. In order to cover risks to the stability of the banking system, macro prudential stress tests were carried out in 2018 to assess the resilience of the capital position and the liquidity against unfavourable conditions. In addition, in-depth analyses of key components of the development of systemic risks to the banking system were conducted, such as the dynamics of non-performing loans, credit standards applied to mortgage loans, dynamics of sovereign debt exposures on bank balance sheets and rating profiles of foreign government debt securities held in portfolios. There was also a review of the current implementation of International Financial Reporting Standard 9 (IFRS 9).

Based on the favourable trends in the economic environment and the relatively strong credit activity observed in 2018 and based on the analysis of indicators for the cyclical systemic risk in the banking system, the assessment concluded that Bulgaria is in the upward phase of the economic and financial cycle. Taking account of these factors, on 25 September 2018, the BNB Governing Council raised the level of the countercyclical capital buffer rate applicable to credit risk exposures in Bulgaria from 0% to 0.5%, effective as from 1 October 2019. The increase in the countercyclical capital buffer rate aims to take advatange of the favourable economic conditions in order to preserve and further strengthen the capital position of the banking system, thus increasing the resilience of credit institutions vis-à-vis future realization of credit risk.[27] In December 2018, the BNB Governing Council set the level of the countercyclical capital buffer rate at 0.5%, applicable in the first quarter of 2020 as well.

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[24] Non-performing exposures are determined on the basis of the broadest definition in accordance with the EBBA definition which includes both gross loans and advances and debt securities other than those held for trading.

[25] The net value of non-performing loans and advances is calculated using the EBBA methodology, where their gross amount is reduced by the accumulated impairment for that classification category. The calculation of the share of net non-performing loans and advances uses the net value of both non-performing loans and advances, and that of total loans and advances.

[26] The liquidity coverage ratio for the banking system is calculated as a ratio between the liquidity buffer and the net liquidity outflows. For further information concerning the new requirements for reporting liquidity, effective as from the beginning of 2018, see the BNB Quarterly Publication, Banks in Bulgaria, October – December 2017.

[27] The countercyclical capital buffer is envisaged as a macroprudential instrument in Ordinance No. 8 of the BNB from 24 April 2014 on capital buffers in banks, and according to the requirements set out in this Ordinance, when the buffer is set for the first time at a level other than 0%, or whenever its level is increased, the requirement must be announced 12 months before it takes effect.

In 2018, an annual review of the institutions identified as Other Systemically Important Institutions (O-SIIs) and the O-SII capital buffer levels set for them was also conducted. In compliance with the adopted methodology, those levels are being implemented step by step, until the full implementation of the set levels is reached in the banks as from 1 January 2020.[28] During the annual review performed in line with the methodology, ten systemically important institutions were identified, with a total market share of 83.8% of the banking system assets.

In 2018, the BNB continued to work actively on identifying areas of fine-tuning and improvement of the legislative framework of banking supervision. To that end, the BNB offered to the MF a draft amendment to Article 45 of the Law on Credit Institutions. The amendments expand the range of exposures constituting exposures to related parties. Ordinance No.37 adopted by the BNB in July 2018 concerning internal exposures of banks regulates how banks should calculate internal exposures, and the reporting and notification obligations of credit institutions to the BNB. In addition, it sets the requirements for in-house rules and procedures to establish, monitor and report on internal exposures, which banks should adopt to ensure that they have identified all of their internal exposures and that they adequately take into account the risks involved.

Through amendments to BNB Ordinance No.11 from March 2017 on bank liquidity management and supervision, the arrangements concerning the management and supervision of bank liquidity were modified and supplemented. The amendments have to do with implementing Regulation (EU) No.575/2013 and Commission Implementing Regulation[29] (EU) 2017/2114, which necessitated the deletion of certain texts from the earlier version of Ordinance No.11 of the BNB relating to a table of the maturity structure of assets, liabilities and off-balance items; the liquid assets ratio and liquidity ratio by maturity intervals. In compliance with Delegated Regulation[30] (EU) 2015/61, it introduced requirements concerning the treatment of the minimum required reserves for the purposes of liquidity were introduced. A large part of the provisions in the BNB Ordinance No. 11 are retained, since they transpose Directive 2013/36/EU[31] into Bulgarian law.

The BNB adopted an Ordinance amending Ordinance No. 30 on the calculation of the amount and collection of premium contributions due by banks under the Law on Bank Deposit Guarantees (LBDG). Changes to the Ordinance include shortening the process of determining and collection of extraordinary contributions from banks from 45 to 7 days, which will ensure synchronisation with the time periods specified in the LBDG (7 business days) to pay out bank deposits when the legal requirements to do so have been met. In addition, the inclusion of a new chapter to the ordinance further develops the legal framework concerning actions by the BNB and the Bulgarian Deposit Insurance Fund, in case a credit institution should fail to pay the premium contribution due within the time limits specified in the LBDG and in BNB Ordinance No. 30.

In 2018, the BNB also continued its efforts towards the convergence of supervision practices in order to ensure harmonized implementation of prudential rules across the EU. To that end, the *Guidelines on Internal Governance* issued by the European Banking Authority (EBA) were adopted. The objective is to harmonise the internal governance rules, processes and mechanisms in institutions so as to comply with the requirements of the Law on Credit Institutions.

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[28] Further information on capital buffers is available on the BNB website at: http://www.bnb.bg/BankSupervision/BSCapitalBuffers/index.htm .

[29] Commission Implementing Regulation (EU) 2017/2114 of 9 November 2017 amending Implementing Regulation (EU) No 680/2014 as regards templates and instructions, OJ L 321 from 06.12.2017.

[30] Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions.

[31] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

In 2018, the BNB started preparations to amend the legislative framework, in connection with the request made by Bulgaria on 18 July 2018 to establish close cooperation between the European Central Bank (ECB) and the BNB and to join the Single Supervisory Mechanism (SSM) when the Bulgarian lev joins the Exchange Rate Mechanism II (ERM II). In connection with the procedure for the establishment of close cooperation with the ECB and joining the SSM, the Law on Credit Institutions and the Law on the Bulgarian National Bank were amended. The legislative changes refer mostly to the requirements for the establishment of close cooperation between the ECB and the BNB, including the delegation of powers to the ECB, and expanding the powers of the BNB relating to the exercise of macro prudential supervision of credit institutions.

According to the MF forecast, over the period 2019-2022, lending to the private sector will continue to increase, against the background of positive expectations for the economic activity, rising disposable income and a growing household consumption.

In 2019, the growth rate of credit to households will slow down. On the one hand, that will be associated with the wearing off of one-off effects from 2018 and due to effects related to remaining government repayments on loans extended under the National Programme for Energy Efficiency of Multi-family Residential Buildings. On the other hand, it will reflect the expectations for a slowdown in consumer loans growth, in line with lower household consumption growth compared to 2018.

The annual rate of increase in loans for house purchases will also slow down, in line with the downward trend in the growth of house prices from 2018 which is expected to continue in 2019 as well. Those effects will affect credit to the private sector and in 2019 its annual growth will slow down, compared to 2018.

According to the MF forecast, at the end of 2019, the annual growth in private sector total claims will be 7.5%, against 9% at the end of 2018. Additional factors in that respect could include the new macroprudential toolbox of measures concerning bank lending, the higher rate of the countercyclical capital buffer, which will be applicable as from October 2019, and possible actions by the banks to improve the quality of their balance sheet assets. Factors that will influence households credit in upward direction include higher growth in the compensation per employee in 2019 and expectations that relatively high demand for borrowed funds will remain. The growth rate of loans to households will slow down slightly over the rest of the forecast period, in line with the expectations for a slowdown in household consumption growth.

Loans to non-financial corporations will continue to increase over the forecast period, and their growth will also reflect the dynamics in private investment. The annual increase in total claims on enterprises is projected to reach 8.6% at the end of 2022.

Claims on the private sector will also follow an upward trend over the period 2020 – 2022 (with an increasing contribution from non-financial corporations), and their growth will be around 8% at the end of the forecast period.

CHAPTER 2
GOVERNMENT BALANCE AND DEBT

2.1 Policy Strategy

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

Over the period 2019-2022, the rate of change in consolidated debt in the General Government sector will continue to depend mainly on the change in the debt of the Central Government sub-sector, due to its dominance in the total debt of the sector (with a share of about 97% as of 31.12.2018). This factor also determines the dominant significance of the government debt management policy in defining the current position and the prospects for the development of consolidated liabilities.

The management of sovereign liabilities in the medium-term corresponds to the main fiscal policy objectives aimed at maintaining a near-balanced position of the budget balance. The strategic objective of debt management is to provide the necessary resources for refinancing the debt outstanding, to finance the budget where necessary, and to ensure the stability of the fiscal reserve at an optimal possible price and an acceptable level of risk.

The larger amount of fiscal reserves reported at the end of 2018 and the continuing fiscal consolidation in the upcoming three-year period provide an opportunity for implementing a debt policy tailored to both the specific market conditions and the need for debt financing while preserving the sustainability of key debt indicators. Efforts will focus on securing possibilities to obtain market-oriented financing, in compliance with the statutory annual debt ceilings. Defining the specific characteristics of the newly assumed debt will be in line with the current situation on the domestic market for government securities and the amortization profile of debt outstanding, taking into account the possibilities for reducing the refinancing risk and smoothing the maturity structure of the debt. It is planned to secure the debt financing of the budget by providing high-liquidity debt instruments, at an appropriate risk/return ratio, positioned in various maturity segments, and through disbursements from contracted government loans with the special purpose at co-financing projects implemented with EU funds.

2.2 Medium-Term Objectives

The budget framework parameters pursue the set fiscal policy objectives and take into account the effects of the policies implemented in both the revenue and expenditure side of the budget, in compliance with the priorities, targets and measures laid out in the Governance Programme of the Bulgarian government for the period 2017–2021. Since the forecast horizon also covers a period beyond the end of the government's mandate, horizontal and sectoral policies and assumptions concerning the final year have been kept at their 2021 level, and projections take into account the macroeconomic forecast for the period 2019-2022.

From the viewpoint of public finance sustainability over the forecast period, the tendency to determine realistic objectives for the key budget parameters in compliance with the established fiscal rules and restrictions as laid out in the Public Finance Act and based on the requirements of Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States (OJ L 306/41 of 23 November 2011) and Council Regulation (EC) No.1466/1997 from 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies will continue.

The key objectives of maintaining fiscal sustainability and implementing a consistent, transparent and foreseeable fiscal policy that contributes to improvements in the business environment, investment promotion and encouragement of the development of the labour market in order to achieve economic growth and create employment, in compliance with the common EU rules continue to apply. In that context, the medium-term perspective remains, in terms of the set objectives of continuing the fiscal consolidation and the achievement and maintaining of a balanced budget. They remain unchanged over several consecutive budgeting cycles.

The fiscal framework as expressed in the parameters of the General Government sector aims to achieve a near-balanced budget for 2019 and maintain accrual-based surpluses over the 2020-2022 period. The 2019 budget balance is expected to be negative, in the amount of 0.3% of GDP. In the medium-term, the expectations are for a surplus of 0.4%, 0.2% and 0.1% of GDP in 2020, 2021 and 2022, respectively. A major contributor to the increase in the budget deficit in 2019 is expenditure, which is expected to go up by 2 p.p. (to 37.9%). In the medium-term, revenues and expenditure are expected to shrink, compared to their 2019 levels.

The planned budget balance amount for the period 2020-2022 will be achieved in the context of an emerging trend towards a slight decline in both revenue as a percentage of GDP, and in expenditure. As a percentage of GDP, 2019 expenditure is projected at 37.9%, and in 2020, 2021 and 2022 it will go down to 36.9%, 36.7% and 36.0%, respectively. In the revenue part, the ratio of total revenue to GDP will decrease to 37.7% in 2019, to be followed by a further downward trend to 36.1% in 2022.

Nominal revenue growth in the individual years will be due to an increase in revenues from all major types of taxes: VAT, excise duties, personal income tax and corporate tax. Growth is also expected in social security contributions, most significantly in 2019, as a result of the measures to increase income levels, and in connection with the increase in the maximum insurable income for social security purposes. In 2020, total revenues will go up by 5.3%, and their growth will slow down to 3.8% at the end of the period.

For General Government expenditure, the highest nominal growth in the medium-term will be observed in personnel payments, social security payments and capital expenditure. At the same time, as a percentage of GDP, social security payments will decline to a level of about 10.7% of GDP at the end of the period. A positive influence towards restricting the increase in this expenditure item as a percentage of GDP will come from the continuing effect of the pension scheme reform, in connection with the increase in the pensionable age and length of service.

The realistic projections for the budget framework parameters make it possible to manage external and internal risks.

2.3 Actual Balances and Updated Budgetary Plans for the Current Year

The trend of positive budget balances in the General Government sector registered in 2016 and 2017 continued in 2018 as well. The target set in the previous Convergence Programme was to achieve a balanced budget, and reporting data indicate an overachievement of the set target. Based on data from the April Notification Tables on Bulgaria's deficit and debt, the General Government balance for 2018 is a surplus in the amount of 2.0 % of GDP, which is an improvement by 2.0 p.p. compared to the projection in the previous Convergence Programme.

Both the revenue and the expenditure side of the budget have contributed to the improvement in the budget balance in 2018 compared to the forecast. The positive revenue trend in recent years continued in 2018 as well, with an increase in all key elements of tax and social security revenues and in the capital transfers from the European Union, while expenditure remained below the projections for the year. Higher tax and social contribution proceeds are mainly the result of the positive development in the macroeconomic indicators and, at the same time, the positive results from the implementation of the Single National Strategy for improving the tax collection, tackling the shadow economy and reducing the compliance costs and other steps in this regard.

On the expenditure side, the actual execution is below the outcome projected for 2018, largely due to the capital expenditure, which remained lower than the projection amount for the year. Compared to the forecast in the previous Convergence Programme, total expenditure in the General Government sector represented as a relative share of GDP was 1.5 p.p. lower. The expenditure items, on an accrual basis, for certain large infrastructure and investment projects, including several lots of the Hemus highway, certain projects for military equipment repair and maintenance, and other capital projects are programmed to be accomplished in the period 2019-2023. Under capital spending, too, some of the planned investment projects dealing with the purchase of new armaments for the Bulgarian army have been postponed for the following years due to objective reasons. The implementation of those projects and the increase in expenditure in the accounts for EU funds will translate into an increase in expenditure for gross fixed capital formation over the next several years, which is reflected in the Ministry of Finance projections in this Convergence Programme.

– **Budget developments in 2018**

In 2018, Bulgaria reported a positive budget balance in the General Government sector in the amount of 2.0 % of GDP.

The General Government revenues reached 36.8% in GDP terms, an increase of 0.6 p.p. compared to the 2017 level. Compared to the forecast in the previous Convergence Programme, General Government revenues are higher by 0.5 p.p.

Revenues from taxes on production and import, current taxes on income, wealth, etc. and taxes on capital increased in nominal terms by more than BGN 1.3 billion, while their relative share in GDP remained almost unchanged (a 0.1 p.p. decrease) vis-à-vis 2017.

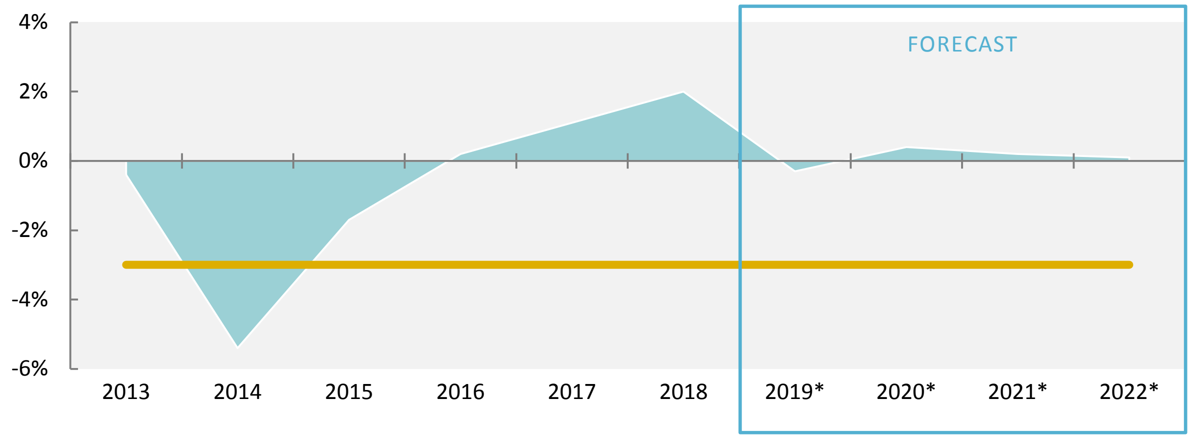
Revenues from current taxes on income, wealth, etc. showed an increase by 0.1 p.p., which in nominal terms is over BGN 0.5 billion. The main factors behind the increase of income tax revenue are the all-times high employment rate in 2018 and the registered sustainable growth in wages and salaries, both in the private sector and in certain areas of the public sector (mostly in the sector of primary and secondary school education). Capital tax revenue retained its share of GDP at 0.3%, unchanged from 2017, with a nominal increase of BGN 18.5 million.

Despite registering a decrease of 0.2 p.p. in GDP terms, taxes on production and import grew nominally by over BGN 800 million. It should be noted that the VAT revenue performed quite well, and its growth was due to an increase in domestic demand and imports, the stronger activity of the economic agents and the positive effect of the efforts made by the revenue administration to increase revenue collection and in combating the informal economy and tax evasion, while growth was weaker in revenues from excise duties.

In GDP terms, revenues from social security and health insurance contributions grew by 0.4 p.p. compared to 2017, which is close to BGN 1.1 billion. This is due to the favourable development in macroeconomic indicators, the labour market and the income levels, which also affected revenue from personal income tax, and to certain administrative measures such as the increase in the minimum insurable thresholds, the increase in the social security contribution due to the Pension Fund by 1 p.p. and the increase in the portion of the minimum insurable income for the purposes of assessing the health insurance contributions for those group of people whose health insurance are covered for the account of the government budget.

Capital transfers received grew by 0.1 p.p. in GDP terms, which, in nominal terms, is approximately BGN 200 million. This reflects the higher amount of payments made in 2018 under EU programmes and funds.

Chart 9: **Budget balance (ESA 2010, % of GDP)**



Source: Eurostat, MF

Total expenditure in the General Government sector in 2018 amounted to 34.8% of GDP, which is 0.3 p.p. less than the level reported in 2017. At the same time, the expenditure figure is 1.5 p.p. lower than the projection in the previous Convergence Programme. Under the individual expenditure items, an increase, in GDP terms, compared to the 2017 levels, was recorded mostly for capital expenditure, while current expenditure showed a decrease of 0.4 p.p. Within capital expenditure, growth was registered mainly in gross fixed capital formation, by 0.7 p.p., the main reason being the higher spending on projects financed under EU programmes and funds, including also the corresponding national co-financing. The rest of the capital expenditure items showed a decrease.

Spending on compensation of employees grew by 0.2 p.p. in GDP terms. Several factors accounted for the reported increase. The most significant contributor to the growth in the compensation of employees in the budget sector was the second raise (as from 1 January 2018) in the compensation of teaching staff of secondary schools, which came as the next step in implementing the policy of increasing the appropriations for education and making education a major priority for Bulgaria and a future engine for its development. The appropriations for compensation of employees in the Security and Defence sector and others were also increased. Budget spending on social security contributions also grew due to the increase by 1 p.p., effective as from 1 January 2018, in contributions to the Pension Fund and the increase in the portion of the minimum insurable income for the purposes of assessing the health insurance contributions for those group of people whose health insurance are covered for the account of the government budget. Maintenance expenditure also went up by 0.2 p.p., and there was an increase in the expenditure items for regular repairs, external services and others.

The amount of social transfers as a share of GDP was down by 0.3 p.p. but in nominal terms those amounts grew by approximately BGN 600 million. The largest increase occurred in social transfers other than in-kind, which includes also pension expenditures, where all pensions were updated by 3.8% , effective as from 1 July 2018, and additional appropriations were made twice over the year, earmarked for pensioners receiving the lowest pensions (the so-called Easter and Christmas top-ups), in the total amount of about BGN 100 million.

A decrease in GDP terms compared to the previous year was recorded also for interest expenditure, down by 0.1 p.p., while subsidy expenditure went up by 0.2 p.p.

– **2019 Budget Highlights**

According to the updated medium-term budget forecast, the General Government sector target is to maintain a close to balanced position, and the minimum negative value in 2019 is planned at 0.3 % of GDP, while in the subsequent years of the three-year period it is expected to return to a positive budget balance again. This target is in line with the current economic conditions and in compliance with the requirements in the national fiscal rules.

The revenue policy has retained the trends and directions from recent years and is geared towards sustaining macroeconomic and budget stability, and in particular, increasing economic growth and promoting labour demand and supply, and securing the financial resources necessary to implement the government's fiscal policy, including providing the relevant fiscal possibilities to finance priority sectors. The main policy objectives include improvement of revenue collection, tackling the informal economy and reducing the administrative burden and cost for business and the citizens. The achievement of higher amounts of budget proceeds involves a predictable tax environment, and also curbing tax fraud, eliminating any opportunities for tax evasion and avoidance. Tax policy is aimed at promoting business and investment activity by keeping the tax burden unchanged, a broad tax base and a limited number of tax preferences. A more significant increase is expected in production and import taxation (mainly VAT), mainly related to the growth of the tax base (domestic consumption). A more feasible increase is planned in regard to proceeds from social security and health insurance contributions, which is largely the result of the continuing increase in income levels of employees, including those employed in the budget sector, and the increase in the maximum insurable income in 2019. The revenue framework has been designed realistically, taking into account the measures to improve tax collection.

Public expenditure policy is aimed at making provisions for the implementation of the government's priority policies in the area of education, social work and healthcare, income policy, implementation of capital expenditure, including in the area of defence, that have been postponed from previous years, while setting as a permanent priority the improvement of the efficiency of expenditure in the various sectors, so as to strengthen their contribution to increased economic growth.

Priorities on the revenue side:

The main regulatory amendments in the area of taxation and social security policies that have an impact on budget revenues are as follows:

- maintaining low rates of corporate taxes, personal income tax and VAT as an important incentive for investment, economic growth and employment.
- maintaining unchanged the insurer/insured rates and ratios of the social security contributions to the state social security funds and the health insurance contribution in 2019 compared to 2018.
- increasing the minimum salary by BGN 50 to become BGN 560 from 1 January 2019, increasing the minimum insurable income for the main economic activities and qualification groups of professions for the persons employed and the minimum insurable income for self-insured persons, and increasing the minimum insurable income for farmers and tobacco growers from BGN 350 to BGN 400 will generate a positive effect on the revenues from the personal income tax amounting to BGN 33.2 million (0.03% of the projected GDP) and on the insurance contributions amounting to BGN 68.3 million (0.06% of the projected GDP).
- increasing the maximum insurable income from BGN 2,600 to BGN 3,000 is expected to have a negative effect on the revenues from the Personal Income Taxes amounting to BGN 19 million (0.02% of the projected GDP), while increasing the resources for compensation of employees in the budgetary sphere, incl. of the pedagogical staff in secondary education, will

have a reverse effect – a positive effect on the revenues from the Personal Income Taxes is expected to the amount of BGN 64.3 million (0.06% of the projected GDP).

- increasing the maximum insurable income from 2,600 to 3,000 BGN for all employed in the country and increasing the personnel resources in the budget sphere, incl. of the pedagogical personnel in secondary education, are expected to have a positive effect on the proceeds from insurance contributions – BGN 403.5 million (0.35% of the projected GDP).
- amending local taxes and fees; most essential is the amendment to the vehicle tax, with a new method of defining it on the basis of two components – property and environmental. The property component is determined by the tax rate, the engine power and the manufacturing year of the vehicle; the environmental component is determined by the ecological category of the vehicle. The expected effect of the amendments is an increase in the revenues from local taxes and fees in municipal budgets amounting to BGN 20.0 million (0.02% of the projected GDP).
- increasing the excise rates on the heated manufactured tobacco from BGN 152 per kg to BGN 233 per kg, effective from 01.10.2018, is expected to have a positive effect on excise and VAT revenues amounting to BGN 13.8 million (0.01% of the projected GDP).
- increasing the required retirement age and length of service, and the effect on the income from insurance contributions is expected to be BGN 0.5 million.
- increasing the revenues from insurance contributions as a result of a change in the choice of insurance and transfer from a private fund to the NSSI – BGN 17.6 million (0.02% of the projected GDP).

In 2019, for non-taxable revenues, the following measures having an effect on the revenue side have been provided:

- in connection with the implementation in 2019 of the electronic toll collection system for the use of the national road network based on the distance travelled for vehicles with a total technically permissible maximum mass of over 3.5 tonnes (TOL) and based on the time for passenger cars with a total technically permissible maximum mass of up to 3.5 tons (electronic vignette) an increase in the revenues from state fees amounting to BGN 263.0 million (0.23% of the expected GDP) is expected.
- due to the introduction of tolls, revenue from vignettes is expected to decrease by BGN 47.7 million (0.04% of projected GDP) in 2019.

Priorities on the expenditure side:

Spending policies are a tool for implementing government priorities, and their successful implementation is also directly linked to sectoral reforms. Measures to improve the efficiency of public spending, including by strengthening the role of market mechanisms and compliance with budgetary ceilings and constraints, have been envisaged.

Income Policy

From 1 January 2019, the country's minimum salary shall increase from BGN 510 to BGN 560. The measure taken is a further stepping-stone of the declared government policy in this area and a component of the overall policy of raising workers' incomes. The increase in the minimum salary is aimed at achieving a nominal increase in the income of the lowest income groups in the labour market. Implementing such an income policy will contribute to achieving social cohesion and creating equal opportunities for a meaningful social and productive life for all social groups of the population that is fully in line with established practices in the EU Member States to protect income and the standard of living of low-paid workers. The increase in the minimum wage will reflect on the increase in personnel costs (salaries and social security contributions) by BGN 65.9 million (0.06% of the projected GDP).

In 2019, an increase of 10% in the salaries, remunerations and social security contributions of the personnel recruited under employment and service contracts has been planned, which will reflect on the remuneration of the employees in the budget sector. This creates the opportunity, on the basis of the increased personnel costs, to increase the individual basic monthly salaries of the employed persons on the basis of the position occupied and the performance assessment. The 10% increase in personnel costs is reflected in an increase in costs of BGN 494.9 million (0.49% of the projected GDP).

In the Education sector the implementation of the measures concerning the improvement of the social status of pedagogical specialists continues. To this end, additional BGN 330.0 million (0.29% of the projected GDP) will be allocated to achieve a 20% increase in the workers' salaries in the sector. This measure aims at attracting young people to the profession, the starting salary for teachers being increased from BGN 760 to BGN 920 in 2019.

Measures in respect of pensions and social assistance:

In the field of pension policy, spending is affected by the following measures:

- As of 1 January 2019, as a sequential step of the schedule adopted and enshrined in the SIC in 2015, the increase in the required retirement age and length of service has continued for all categories of employees, including those working under the third category of labour, those working in the Defence and Security sector, those working under the first and second categories of labour who are not eligible for retirement under a professional pension fund or have changed their insurance.
- For pensions granted after 31 December 2018, the percentage (weighting) for each year of pensionable service in the pension formula shall be increased from 1.169 to 1.2.
- From 1 July 2019, pensions granted until 31 December 2018 inclusive shall be increased by 5.7 % (the percentage is determined in conformity with the provisions of Article 100 of the SIC); the increase also includes the new "weighting" of a year of pensionable service.
- The minimum amount of the old age pension and the old age social pension, as well as the related pensions and supplements, shall be increased by 5.7% as of 1 July.
- The maximum amount of one or more pensions received from 1 January 2019 to 30 June 2019 shall be maintained at BGN 910 and from 1 July 2019 it shall be increased to BGN 1200 (40% of the maximum amount of the insurable income for the same calendar year – BGN 3,000 for 2019).
- Since 1 January 2019, the formula for calculating the individual coefficient has been changed, and in addition to Art. 70(9) of the SIC its maximum value has been defined.
- In line § 7, para. 1 of the Transitional and Final Provisions of the Persons with Disabilities Act, as of 1 January 2019 social disability pensions amounting 25% shall be discontinued. This is expected to result in decrease in the pension expenditures, covered by the state budget, by BGN 125.4 million for 2019 compared to the expenditures in the State Social Securirty (SSS) budget for 2019.
- As a result of all these measures, the pension expenditure in the SSS budget for 2019 has increased by BGN 406.9 million (0.35 % of the projected GDP).
- In order to support the pensioners with the lowest pensions, in April 2019, a supplementary one-off amount was paid to all pensions below the poverty line of BGN 348. The total amount of this benefit of BGN 52.9 million, will increase the spending of the projected GDP by 0.05%.

The main features of the policy on social benefits and assistance paid by the State Social Security in 2019 are sustainable support, predictability for the concerned persons and steps towards broadening the coverage of social risks. This means to preserve: the minimum and maximum daily amount of unemployment benefits; the period of payment of cash benefits for pregnancy and childbirth and the amount of child-raising allowance from one to two years of age of the child; the possibility for mothers (adoptive mothers) who are entitled to use a leave during pregnancy and childbirth until the child reaches one year of age but who do not use it, to be able to return to work and receive from the State Social Security 50% of their compensation for pregnancy and childbirth; the regime for the payment of cash benefits for temporary incapacity for work; the period and income to be taken into account when calculating the amounts of short-term benefits in the case of temporary incapacity for work, during pregnancy and childbirth, and unemployment; the amount of the one-off allowance in case of death of an insured person. The modifications that occurred in relation to the amendments to the arrangements for the payment of cash benefits for the adoption of a child up to the age of five, which entered into force on 1 July 2018, have been taken into account. The maximum amount of the guaranteed claims has been increased from BGN 1,300 to BGN 1,400.

Social assistance policy

A priority for 2019 is to ensure social protection of the most vulnerable population groups, focusing on people with disabilities, by better targeted social benefits, increased effectiveness of measures and programmes, applying an individual approach to each case, improving the regulatory framework and reducing bureaucratic obstacles in the field of social assistance and support for people with disabilities, and optimizing the institutional structure related to the social protection of the lowest income and high-risk groups of the population.

Social protection and equal opportunities policy guarantees social protection for the vulnerable groups of the population and creates conditions for full social inclusion, helps to ensure equal access to the resources of the society and equal participation of all disadvantaged groups in their creation and consumption. In connection with the expected increase in energy prices, additional BGN 40.4 million (0.03% of projected GDP) have been envisaged for targeted heating aids.

The Policy on integrating people with disabilities aims to create conditions and guarantees for equality, social integration, exercise of rights, protection of people with disabilities and their families, and their integration into working environments. The findings made in the society with regard to the existing disability policy have made it necessary for the existing social policies for people with disabilities to be thoroughly reviewed and reformed in order to guarantee the rights of this vulnerable group of people and their adequate social protection, while improving the mechanism for allocating funds from the state budget to these policies. The strategic goal of the newly adopted Persons with Disability Act is to ensure that the necessary and adequate socio-economic support for the people with disabilities shall be provided by the state to maximize their inclusion in society. To guarantee the financial framework of the Persons with Disability Act, an additional BGN 150 million (0.13% of the projected GDP) have been earmarked to the budget of the Ministry of Labour and Social Policy.

An essential part of the social inclusion policy is to provide material support to families with children and families who care for children at risk. The 2019 amendments to the *Family Allowances* for *Children Act* provide for the introduction of a new type of monthly allowances for children without the right to a survivor's pension from a deceased parent. The assistance aims at ensuring access to financial assistance on equal terms for all children without the right to a survivor's pension. The amount of the aid is BGN 115 and the amount of funds needed for this new type of aid is BGN 7.0 million (0.01% of the projected GDP).

Measures in the field of healthcare

In 2019 again, the main focus of public health and health insurance policy is to achieve the priorities of the National Health Strategy 2020 by implementing its Action Plan in order to improve the efficiency and satisfaction of citizens with the functioning of the sector. Programmes and measures have been provided to support the implementation of the recommendations to Bulgaria to improve the cost effectiveness of the healthcare system, in particular by reviewing the valuation of healthcare activities and strengthening out-patient care. In 2019, it is planned to continue to improve the functioning of emergency medical aid provided in out-patient and hospital settings in order to ensure better quality, sufficiency and timeliness, in line with the "Concept for the Development of the Emergency Medical Aid in the Republic of Bulgaria 2014-2020" adopted by the Council of Ministers. An additional right to health insurance payments to the amount of BGN 485.9 million (0.42% of the projected GDP) shall be provided to the NHIF budget for 2019. The envisaged funds target several main areas of healthcare. First of all, it is the area of diagnostics and treatment, the policy which is aimed at improving the health-related well-being and quality of life of Bulgarian citizens and reducing health inequalities. The main objective is to provide accessible, quality and timely medical assistance to the health insured persons and equal access to the healthcare facilities. The main scope of the policy on medicinal products and medical devices is to provide medicinal products that meet the quality, safety and efficacy standards in terms of meeting the needs of the population. The policy in the field of public health promotion, prevention and control aims at ensuring the quality and effective satisfaction of the citizens' health needs through the implementation of primary prevention, health promotion and integrated prevention of communicable diseases. Priority areas and activities in the field of healthcare include emergency medical aid, e-health, maternal and child healthcare, assisted reproduction, hospital care and drug policy.

Measures in the field of education

The total estimated expenditure for education in 2019 is BGN 4,203.4 million, which is 3.6% of the GDP. The education priorities for 2019 are aimed at meeting the key challenges and supporting the implementation of key sector policies.

Ensuring broad access to pre-school and school education; reducing the rate of school dropouts and early school leavers are key factors in creating favourable conditions for personal and professional realization, reducing social exclusion, improving quality characteristics and competitiveness of the workforce and the well-being of citizens. In 2019, the increase in the funds for maintenance of the activities for education and training of children and pupils which started in 2017 has continued on an annual basis by an additional BGN 330.0 million. These funds are dedicated to increasing the remuneration of the pedagogical specialists on average by 20% for 2019, and with the increases in 2020 and 2021 a doubling of the funds to be achieved compared to 2017. The effect of this measure is indicated in the consideration of income policy. As part of the income policy concerning pedagogical specialists for the period 2019–2021 it is envisaged to maintain the mechanism for providing additional funds for working with children and pupils from vulnerable groups. For 2019 it is envisaged to include all pupils in this mechanism, not only those up to grade 7, with a total of BGN 8.0 million more than in 2018 for this purpose (0.01% of the projected GDP).

As part of the measures for the extension of vocational education in the period 2019-2021 a larger number of pupils will be included in the dual form of education. In 2019, the provision of additional funding will be continued for priority areas and protected specialties and professions with a shortage of specialists in the future.

In 2019, additional funding has been provided for the following priority measures and activities in the field of pre-school and school education:

- Additional funds have been earmarked to introduce a supplementary standard of 2% to the basic standard for a high school pupil. The aim is to achieve a fairer allocation of funds under the new funding model as additional costs are incurred for the training of high-school pupils due to the extended curriculum.
- For the transport of children and pupils, including maintenance of buses, more funds have been foreseen compared to 2018. In recent years, there has been an upward tendency in the number of travelling pupils.
- An increase in the funds allocated to interest-based activities has been planned for some 700,000 pupils who were eligible for funding from the European Union prior to 2018. Interest-based activities have supported the development of key competences of pupils in mathematics, informatics, natural sciences and technology, and their career guidance.

- It is envisaged to increase the funds supporting the nutrition of children from preparatory groups and pupils from grades 1 to 4 in 2019 compared to 2018. This measure aims to improve the quality of the snacks provided to children and pupils.
- Additional funds have been earmarked for scholarships for students in vocational schools and classes in the dual form of education, and for those who are trained in state-protected specialties and specialties with an expected shortage of specialists in the labour market. The measure is in line with the policy of encouraging training for acquiring a profession in the upper secondary education.
- Additional funds have been earmarked for scholarships for learning outcomes assessed by the national external evaluations of pupils on the basis of the outcomes achieved and maintained in the schools.

The overall effect of the measures described in pre-school and school education is an increase in expenditures by BGN 48.8 million (0.04% of the projected GDP).

The policy in the field of equal access to quality higher education aims to promote the efforts of autonomous higher education establishments to continuously raise the quality of the higher education they offer, to be assisted in the introduction, development and improvement of the internal systems for assessment and maintenance of the quality of education and of the academics, to create conditions for the implementation of good practices of higher education establishments of the EU Member States, and to provide conditions for access to quality higher education aimed at successful lifelong realization.

In 2019, additional funding has been provided for the following priority measures and activities in the field of higher education:

- additional funds for means of subsistence of students and PhDs. Since the introduction of this funding model in 2011, the relative share of funds to assist training, resulting from an assessment of the quality of training and its matching with labour market needs, has risen from 2.28% in 2011 to 55.15% in 2019.
- in order to keep specialties in higher education establishments with identified future shortage in the labour market and in order to promote the interest in them, it is envisaged to exempt the students from paying tuition fees. For this measure funds have been allocated to the budget of the Ministry of Education and Science.
- additional funds have been provided to increase student scholarships, incl. scholarships of students from the historical Bulgarian Diaspora abroad, admitted for training in Bulgarian state higher schools.
- in 2019, funds for additional scholarships for PhD students will be provided according to a differentiated approach, consistent with the intensity of scientific activities.
- as a result of the measures described, the expenditures in the sphere of higher education have increased by BGN 46.0 million (0.04% of the projected GDP).

The approved state guarantee under the Student and PhD Student Loans Act for 2019 has amounted to about BGN 50.0 million. Student and postgraduate student credits as part of student support provide an opportunity to raise the education level of young people who are unable to pay their own tuition fees and means of maintenance during their education. From the start of the programme on 01.09.2010 to date, the contracted loans totalled 20,031 and their total amount is BGN 132.4 million.

Policies in the field of science

The vision for the development of science in Bulgaria in the period 2019-2021 is connected with the enhancement of quality and international recognition of research and innovation. The emphasis is placed on funding research in priority and competitive areas to solve important societal challenges, support young scientists and carry out joint research with Bulgarian scientists abroad, and attract leading scientists from abroad. The programmes are based on the principle of financing a project jointly developed by leading institutions in the field.

For science in the 2019 budget, BGN 529 million have been allocated. The increase in the public sector financing, makes science a priority of the Government for the budget forecast period.

The implementation of measures to improve the innovative infrastructure and promote innovation in enterprises with funds from the Operational Programme "Innovation and Competitiveness" 2014-2020 (OPIC) continues. At the end of 2018, support was provided to 381 enterprises to develop and implement innovations amounting to BGN 213.1 million. In 2019, under OPIC, procedures aimed at the development of innovation infrastructures and the improvement of science-business relationships, as well as procedures aimed at promoting innovation in enterprises will be announced. The total budget for planned measures amounts to BGN 508.9 million. Amendments to the Law on the Promotion of Research and the creation of a new structure for research and innovation funding have been envisaged, with a particular focus on public-private partnership and science-business relationship.

Policy in the field of defence

Policy in the field of defence is related to the maintenance of modern, capable and interoperable Armed Forces (AF). Its implementation will be a result of maintaining and developing effective and efficient capacity-based defence planning in line with the NATO Defence Planning Process, the *Coordinated Annual Review* on *Defence* (CARD) of the EU and in the context of the *Permanent Structured Cooperation* (PESCO) in the area of security and *defence* policy of the EU. The aim is to build, develop, maintain and use the necessary capabilities of the Bulgarian Air Force to perform the country's defence tasks within NATO's cooperative defence, contribute to the Alliance's cooperative defence, participate in NATO- and EC-led operations and missions, and also contribute to the national security in peacetime. In the medium term, Bulgaria should implement the commitment to make investment in defence which was undertaken in the 2014 NATO Summit in Wales and "Bulgaria's *National Plan* for Increasing the *Defence Spending* to *2%* of the *Gross Domestic Product* until *2024".*

In 2019, additional costs have been earmarked for the maintenance of the existing defence capabilities and the gradual development of new defence capabilities in order to: ensure the airworthiness of MiG-29 aircraft and implement investment projects to develop the defence capabilities of the Armed Forces of the Republic of Bulgaria to a total of 397 million (0.34% of the projected GDP).

Measures in the field of energy

The revenues of the Electricity System Security Fund have been increased by BGN 615.0 million (0.53% of the projected GDP) in line with a requirement adopted on 01.07.2018 – the Fund's budget shall receive the revenues from the price and/or the component of the price by which all end customers connected to the electricity system, including the transmission system operator and the electricity distribution system operators, shall participate in the compensation of the costs under Article 34 and 35 of the Energy Act. The same amount will be added to the expenditures of the Fund which will be granted as a premium to the generators under Article 162a of the Energy Act (heating plants and CHP) and the generators with a total installed capacity of 4 MW and over 4 MW under the Renewable Energy Act, determined by a decision of the *Energy and Water Regulatory Commission*, including for past regulatory periods. The expected budget effect is neutral.

Policy in the field of transport

The policy in the field of transport focuses on developing the basic transport infrastructure, which is an important condition for maintaining sustainable economic growth. The main priority of transport policy is the improvement of the quality of the offered transport services and the sustainable development of transport. One of the main priorities is the maintenance and development of the national road infrastructure in accordance with the modern requirements of road transport through the construction of the national network of motorways and speedways, its connection with the European transport corridors, modernization and renewal of the road network and ensuring good operational condition and good level of safety of the existing road network. The additional costs involve: the introduction of the toll and e-vignette, including the cost of implementing the toll system in 2019, the costs of operating and maintaining the system, and the costs of building road infrastructure, costs of ongoing repairs, rehabilitation and maintenance of the national road network amount to BGN 215.3 million (0.19% of the projected GDP).

In 2019, the envisaged capital transfers from the budget to the state-owned enterprises in the transport sector have increased by BGN 209.0 million (0.17% of the projected GDP). The additional funds (BGN 200 million) provided to the SE "*Bulgarian Ports Infrastructure*" will contribute to the development of the port infrastructure in Varna in connection with the current trends for ship size increase, which puts certain requirements regarding the depth of the approaches to the port terminals.

2.4 Medium-Term Perspectives, Including Description and Quantification of the Strategic Policy Impact

The government's medium-term strategy is detailed in the Medium-Term Budgetary Forecast, the National Reform Programme and the Action Plan for the implementation of the National Development Programme: Bulgaria 2020 for the period 2019–2020. The latter provides for the implementation of a wide range of measures grouped into several key priority areas, which are expected to lead to a more balanced regional development, enhanced quality of human capital, promotion of innovation, improved infrastructure quality and an increase in the competitiveness of the economy, as well as employment and income levels. The relevant funding will be secured primarily from the EU funds which complement the expenditure from the national budget.

- **Improved access to and quality of education and training and qualitative features of the labour force: allocations in the amount of BGN 2.3 billion**

The policy is focused on the formation of human capital and enhancing its quality in all dimensions. It is primarily aimed at modernisation, improving access to the educational system and introducing mechanisms for better quality management. Activities in that area include measures to improve access to education, as well as gearing education towards creativity and innovation which lead to personal development, and reducing the rate of early school leavers. In order to improve the quality of education, more efficient models of funding will be developed, introducing a credit system, raising the qualification of the educational staff and improving the link with the business sector. The enhanced qualitative features of the labour force will be ensured via measures aimed at adapting policies in the area of lifelong learning to the needs of the labour market. These measures include: improving the mobility of the workforce, conducting annual surveys on the employers' needs of a labor force with certain characteristics, organizing and financing targeted training for unemployed and employed persons, the introduction of a system of course credits, strengthening links with the business sector and promoting the adoption of up-to-date forms of work organisation in enterprises.

In addition, increasing the social role and relevance of research, improved career development and working conditions for researchers, developing scientific potential through integration into the European Research Area, as well as bolstering research and development through programme financing via competitive procedures, are envisaged. Measures to ensure national access to European and global infrastructure, e-infrastructures and databases of key importance for the development of science in the country will be funded. In terms of improving the quality of healthcare, innovations are envisaged for a sustainable and efficient health system as well as improving the quality of healthcare and ensuring access for all citizens to healthcare and services. Measures are also envisaged to improve the physical activity and health of students, pupils and other population groups by improving the conditions for practicing sport, as well as to financially support the development of school sport organizations and to conduct international competitions. Measures for supporting art projects in the field of stage arts will also be funded.

- **Poverty reduction and promoting social inclusion: allocations in the amount of BGN 2.3 billion**

Emphasis is placed on guaranteeing the adequate participation of vulnerable groups of the population in all areas of public life through a set of comprehensive measures, covering areas such as the provision of opportunities for employment and for starting one's own business, improving the quality of social services, deinstitutionalisation of care for children, the elderly and people with disabilities, as well as a number of legislative changes. Planned activities include improving the qualifications of the unemployed, enhancing the quality of intermediary services to ensure that they better match the needs of the labour force, as well as measures to support entrepreneurship and to ensure more flexible employment, so as to improve the possibilities for reconciling private and work life. Measures are also envisaged to reduce the shadow economy in the labour market by better protecting labour rights and reducing undeclared work.

- **Achieving sustainable integrated regional development and utilisation of local potential: allocations in the amount of BGN 4.6 billion**

Regional development in Bulgaria is geared towards developing the potential of the Bulgarian regions, reducing interregional disparities and improving the attractiveness of all regions as places for living and doing business. The key areas of government intervention are: strategic planning and regional governance through enhanced capacity of the local authorities; promoting the development of towns and improving the integration of Bulgarian regions through integrated sustainable urban development and strengthening of the functions of the polycentric network of cities; improving urban labour mobility; developing and improving access to cultural services and sports in the regions and the building of broadband infrastructure; support for effective and sustainable utilisation of tourism potential in the regions through development of the infrastructure for specialised forms of tourism and through marketing of the tourism regions and development of regional tourism products; support for the development of underdeveloped regions and improving the quality of life in rural areas; creating conditions for environmental protection and improvement in the regions by improving the quality and efficiency of water supply services for businesses and citizens, and building and upgrading sewage and waste water treatment systems for sustainable water resource management; as well as enhancing territorial cohesion through the development of cross-border, interregional and transnational cooperation.

- **Support for innovation and investment activities to enhance the competitiveness of the economy: allocations in the amount of BGN 313 million**

The key priority areas in the two-year period will be the building of innovation and scientific infrastructure to improve the connections between business, science and education, and the implementation of measures under the Investment Promotion Act. There will be comprehensive measures for promoting investments in manufacturing and in high-tech industries and services, such as support for infrastructural projects, education, job creation and financing innovation projects. Concrete steps will also be taken to improve the quality of services in the tourism sector. Pro-active marketing will help support the attraction of targeted investment to the economy and the promotion of the country as a tourist destination. The sector of small and medium-sized enterprises will be supported by measures aimed at improving the conditions for starting up business and implementing good practices, including wider use of ICT and support for R&D projects. EU funds will be used to finance the building and completion of innovation and scientific infrastructure in Bulgaria, while national financing will be used to support the participation of Bulgarian enterprises in EU programmes such as Horizon 2020 and Eureka.

- **Strengthening the institutional environment for greater efficiency of public services for citizens and businesses: allocations in the amount of BGN 89 million.**

In the period until 2020, the government focus will remain, inter alia, on the introduction and mainstreaming of integrated administrative services and the review of all regulatory regimes set up by means of special legislative act, with the aim of reducing the regulatory burden and preventing its subsequent increase, as well as ensuring better coordination among the territorial units of the central government administration which provide services. The emphasis of government policy will be on measures that include, among others, the development of e-government and ensuring the interconnectivity and interoperability of the information systems in the public administration. Insolvency procedures will be streamlined and the use of the tacit agreement principle will be expanded. Improved cooperation among the various units within the structures of the judicial system and the wider implementation of information and communications technology are expected to improve its effectiveness. Measures to enhance law enforcement and restrict the environment for unregulated and corrupt practices will be implemented. To make the administration more effective, the system for assessing and planning the need for experts will be improved and a wider choice of up-skilling options will be offered. Measures to modernise selection methods and improve mobility options are also envisaged. Work to improve the dialogue with the public on state policy-making and monitoring government policies will continue by developing the capacity of the private sector in that field and improving access to information.

- **Energy security and improving resources efficiency: allocations in the amount of BGN 200 million.**

Government efforts will be geared towards enhancing the energy security, independence and efficiency of the economy, as well as towards aiding the environment. To ensure Bulgaria's energy security, conditions will be created that enable the diversification of sources and routes for the supply of natural gas by building gas interconnections with neighbouring countries and supporting the construction of the necessary gas transmission infrastructure to connect the natural gas markets in the region with Central and Western Europe, as well as by promoting the maintenance of a reasonable balance between the energy resources available in Bulgaria and the EU clean energy targets. Reducing the use of electricity in households by replacing it with natural gas will result in a more efficient use of resources, lower costs and a higher quality, healthier environment. In terms of resource efficiency, actions will be undertaken to promote the introduction of low-carbon, energy-efficient and clean technologies, and the increase of the proportion of waste recycling and recovery. As regards the creation of an integrated internal energy market, efforts will be geared towards the full liberalisation of the market for electricity in the context of the Third Energy Liberalisation Package of the EU.

- **Improving transport connectivity and access to markets: allocations in the amount of BGN 4.9 billion**

During the period until 2020, the key focus of the policy aimed at creating optimal conditions for the development of the economy, improving access to markets and limiting environmental pollution will remain on the efficient maintenance, upgrade and development of transport infrastructure, the sustainable development of public transport and on the ongoing reform of the railway transport system. A number of projects along the trans-European corridors which cross national territory are planned. The largest projects include the completion of the Struma motorway, upgrading the Sofia-Plovdiv railway line, rehabilitation of the Plovdiv-Burgas railway line, development of the Sofia railway junction. With a view towards ensuring sustainable development of mass public transport, efforts are focused primarily on the construction and development of smart networks and services. The extension of the subway in Sofia is of paramount importance in this respect. As regards the implementation of the reform in the railway transport system, the main efforts will focus on improving the management of the railway sector, as well as on restructuring BDZ Holding EAD and the National Railway Infrastructure Company (NKZI).

2.4.1 Ex-ante impact assessment

The table below presents the expected effects from the implementation of the measures planned. The SIBILA (Simulation model of Bulgaria's Investment in Long-term Advance) [32] model has been used for this purpose. The assessment covers the effects[33], defined as changes in the levels of key macroeconomic indicators.

The interventions planned are expected to result in a positive change in employment (an increase of 7.2% against the baseline scenario) and in the unemployment rate (a decrease of 2.8 p.p.) at the end of 2020. This is due both to direct effects from the inflow of the funds into the economy (job creation) and to indirect effects (expressed in improved quality of employees and the labour force as a whole).

Table 2: **Effects from the implementation of the measures planned**

Macroeconomic indicator	Effect as of 2020
GDP	9.7%
Export of goods and services	2.5%
Current account balance,% of GDP	-3.8 p.p.
Employment rate (aged 15-64), in thousands	7.2%
Unemployment rate (aged 15-64)	-2.8 p.p.
HICP inflation	3.8 p.p.
Budget balance, % of GDP	-2.5 p.p.

Source: MF, SIBILA.

According to the analysis, the net effect of the planned measures on the budget balance will reach -2.5 p.p. of GDP by the end of 2020. As a whole, the overall effect is a combination of several effects acting in opposite directions – increasing government spending, and higher income levels and a favourable economic situation, which leads to increasing budget revenue. In the medium-term, the interventions are expected to contribute positively to the budget balance as a result of the improved economic situation, the increase in output and increased consumption.

Over the period under review, the country's output and GDP will grow smoothly, allowing a gradual real convergence with the EU. The implementation of the planned measures would play a significant role in this respect, with simulations showing that their impact on GDP by 2020 would be 9.7% above the baseline scenario without realizing the planned funds in the Action Plan. Inflation will accelerate by 3.8 p.p. against the baseline scenario. Exports of goods and services will also grow faster than the baseline scenario (2.5%) as a result of the planned interventions.

[32] For more details on the methodology and technical specification used, see: https://www.eufunds.bg/archive2018/index.php/en/normativna-baza/guidelines

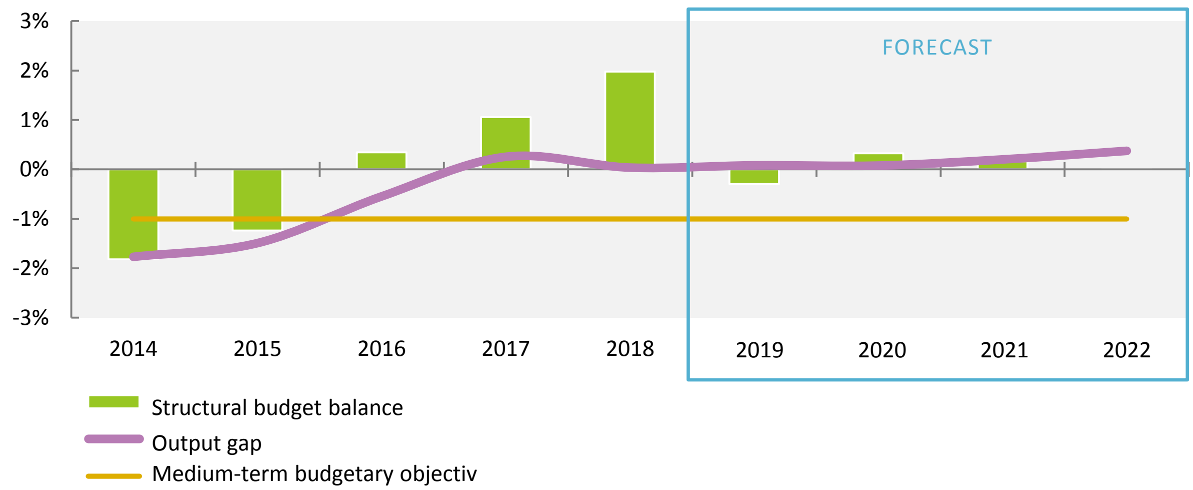
[33] The overall effects for the economy from the implementation of measures are calculated as the difference between two scenarios: a baseline scenario (scenario 0), which simulates the development of the economy without the Action Plan interventions, and a hypothetical alternative scenario (scenario 1), which takes account of the implementation of the measures within the deadlines set in the Action Plan and with the resources planned for this purpose.

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

An updated budget sensitivity parameter[34] to the economic cycle is used for the present assessment of the structural budget balance.

The structural budget balance for 2018 is estimated as a surplus of 2% of GDP (compared to 1.1% in 2017). The improvement in the fiscal stance in structural terms was in the amount of 0.9 p.p., while the positive output gap shrunk from 0.3% of GDP in 2017 to theoretical potential level of production in 2018 (the "output gap" indicator is estimated as 0). In accordance with the government expenditure policy for increase of the incomes and investments, the factual budget result in the present year is expected to be a deficit of 0.3% of GDP. The structural deficit is estimated approximately at the same level. In the next years, the fiscal stance goes back and remains positive until the end of the forecast horizon. The structural surplus for the period 2020-2022 is estimated as 0.3, 0.2 and 0%, respectively, of the forecasted GDP. The medium term objective for the structural budget balance (-1% of GDP) is overachieved during the entire forecast period.

Chart 10: **Fiscal stance (% of GDP)**



Source: MF own calculations

The assessment of compliance with Stability and Growth Pact and Public Finance Act requirements in terms of budget expenditure growth is based on the common methodology for the so called expenditure benchmark, taking into account the division between public investments funded by the national budget and the EU. In 2019, as well as in the projection period 2020–2022, Bulgaria is expected to overachieve its medium-term budgetary objective and therefore, according to the EU fiscal governance rules, the reference rate of the costs are allowed to temporarily exceed the potential GDP growth. According to the EC calculations, this reference rate of growth is in the amount of 2.7% for 2019.

The change in actual terms of the expenditure indicator used for the purposes of the fiscal management in the European Union is estimated respectively at 5.4% for 2019, 1.2% for 2020, 1.6% for 2021 and 2.0% for 2022. The cited values are based on the updated forecasts for the budgetary parame-

[34] Updated weights are used for selected revenue and expenditure over the period 2008-2017. For additional information –p.39-45 of the Report on Public Finance in EMU: https://ec.europa.eu/info/sites/info/files/economy-finance/ip095_en.pdf

ters presented under the ESA 2010 methodology, as well as on the GDP deflator for the respective year of the most recent macroeconomic forecast of MF.

2.6 Debt levels and developments, below-the-line operations

By the end of 2018, the size of the consolidated debt of the General Government sector decreases on the basis of the preliminary annual data compared to the level, registered at the end of the previous year both in nominal terms and as a share of GDP. In nominal terms the debt level is reduced by about BGN 1.5 billion to about BGN 24.4 billion (compared to BGN 25.9 billion in the end of 2017), while the value of the „ General government debt/GDP“ ratio is reduced by 3 p.p. to 22.6%, respectively (compared to 25.6% in the end of 2017), significantly below the 60% reference value. The reported low debt level in 2018 ranks the Republic of Bulgaria on a leading position among the 28 EU Member States with one of the lowest government indebtedness.

In structural terms, in 2018 a major share and component with the most significant impact on the sector's debt continues to occupy the Central Government sub-sector. For 2018, this component is about 97.0%, which preserves its dominant share in each of the forthcoming three years. The other two components – the Local Government sub-sector and the Social Security Funds sub-sector – have almost a neutral impact on the total debt of the sector.

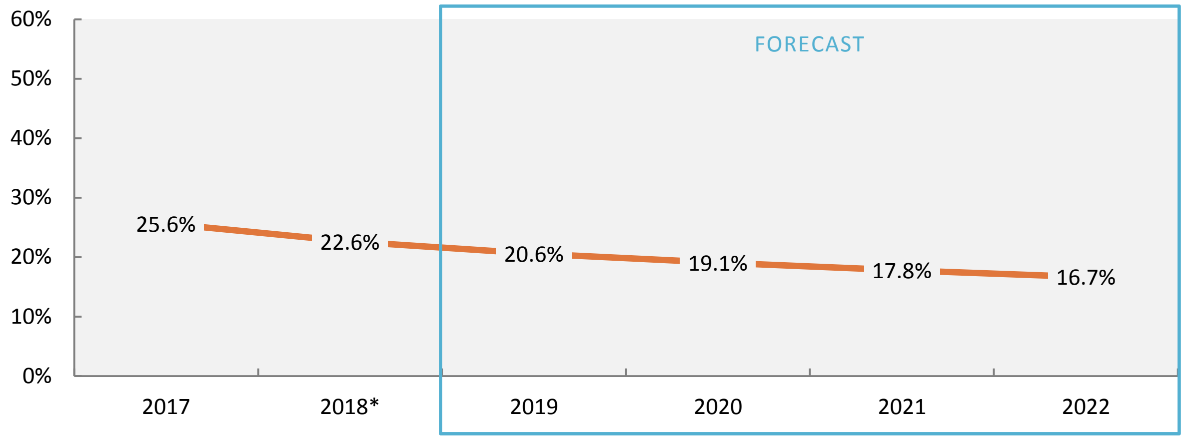
In nominal terms, the registered decrease in the debt of the General Government sector in 2018 is mainly due to the performed regular repayments of the debt of the Central Government sub-sector in the total amount of BGN 2.5 billion (BGN 1.6 billion under the government debt, which has a 92.4% share of the sub-sector debt), incl. BGN 1.4 billion under domestic government securities and BGN 1.1 billion under government loans. The implementation of the state budget in 2018 and the reported positive balance under the consolidated fiscal programme were a prerequisite for the minimized need for provision of financing resource from debt sources. The accumulated resource in the fiscal reserve allowed smooth government debt servicing in 2018, in accordance with the agreed amortization schedules , without issuing of new government debt.

The financing received by the Central Government sub-sector in 2018 amounts to BGN 0.7 billion in the form of loan (domestic and external) disbursments, incl. under a Framework Loan Agreement between the Council of Europe Development Bank and the Republic of Bulgaria, a mechanism for co-financing of projects implemented with EU funds and of the institutional entities, which fall within the scope of the sub-sector – state hospitals, "FLAG" EAD, Bulgarian Deposit Insurance Fund, etc. In structural terms, the part of the domestic financing of the sub-sector reaches a share of about 77% of the total amount of the new borrowing, and of the external – about 23%, as the financing of the entities in the sub-sector scope amounts to 83.1%.

Based on the debt level forecast for the period 2018–2022 (BGN 24.4 billion – BGN 23.1 billion), the debt to GDP ratio is expected to be between 22.6% and 16.7%, decreasing in each of the years under review. Compared to the assumptions set out in the previous Convergence Programme for the period 2018–2021, lower debt/GDP ratios are projected. This positive adjustment stems from the macroeconomic developments , the improvement in the budgetary position and the decreasing need to provide the budget financing from debt sources.

Preliminary estimates of parameter dynamics over the current and next three years remain well below the Maastricht convergence criterion maximum admissible value of 60%, and ensure that the level of government indebtedness remains within sustainable limits.

Chart 11: **Consolidated Government Debt-to-GDP Ratio**



* 2018 – preliminary data

Source: MF

The Central Government sub-sector is the main contributor to the change in the General Government debt. The debt indebtedness of the entities included in the subsector is of relatively low share and has a minimal impact on the total debt of the sector as the government indebtedness, respectively, the conducted government debt management policy will remain a leading factor influencing the debt dynamics of the sector. In this relation, the efforts are geared to control the level of government debt and keep it at low risk and are reflected in the debt ceilings provided for in the State Budget Act of the Republic of Bulgaria for 2019:

- The maximum amount of government debt at the end of 2019 cannot exceed BGN 22,2 billion;
- The maximum amount of the new government debt, which can be assumed under the Government Debt Act, is BGN 1.0 billion

Under circumstances that would lead to a negative development, resp. a risk of breaching the 60% threshold of the General Government debt-to-GDP ratio, a legislative option is foreseen in the annual state budget act to lay down additional restrictions on the assumption of debt by municipalities and social security funds.

In the next three-year period 2020-2022 the debt financing of the budget in the form of government securities is planned to be in the range of BGN 0.8 – 3.0 billion per annum, based of the amount of maturing debt outstanding (BGN 1.1 – 3.0 billion per annum). The total disbursements from contracted government loans for the period amounting to EUR 300.0 million (BGN 586.7 million), incl. EUR 150.0 million under a Finance Contract between the Republic of Bulgaria and the European Investment Bank (Bulgaria EU Funds co-financing 2014-2020 /SPL/) and EUR 150.0 million under a Framework Loan Agreement between Council of Europe Development Bank and the Republic of Bulgaria, EU co-financing facility for Operational Programmes co-financed from European Structural and Investment Funds for the 2014-2020 programming period. During this period nonew debt assummed in the form of financial leasing or other debt forms by the first-level spending units.

In the period under review, the debt level of the Local Government sub-sector is not expected to change notably from the level reported at the end of 2018 (according to preliminary annual data about BGN 1.3 billion), stabilizing within the range of about BGN 1.1 billion as at the end of 2022. The main factors behind this are the restrictions laid down in the Public Finance Act and the Municipal Debt Act. They stipulate that the annual sum of municipal debt payments for any municipality in any relevant year may not exceed 15% of the annual average amount of its own revenue and general balancing subsidy for the past three years calculated on the basis of data from the annual reports on the implementation of the budget of that municipality, and that, within the current budget year, municipalities may assume new debt to perform long-term energy performance contracts (ESCO contracting) in an amount up to 15% of the annual average amount of the reported capital expenditure in the past four years in the respective municipal budget. The estimates for 2019 show that the regulated statutory restrictions as well as the expected flexible municipal financing schemes in the new programming period will retain its share within about 1.2% to 1% of GDP, respectively a share of about 2% of the total amount of the consolidated obligations for the entire period from 2019 to 2022.

The Social Security Funds sub-sector does not have any debt obligations and it is not expected to take any new ones in the coming years. The sub-sector will continue to exert its influence in the direction of a reduction in the General Governmentdebt through the accumulation of financial assets in the form of Government Securities issued by the Central Government sub-sector. For 2018, they amount to about BGN 621 million.

The assumptions about the debt size of the Local Government and Social Security Funds sub-sectors in the period 2019–2022 show preservation of the level of influence of these sub-sectors in measuring the debt burden of the General Government sector.

Table 3: **Privatization revenues - (BGN million)**

	Report 2018	State Budget Act of the Republic of Bulgaria for 2019	Forecast 2020	Forecast 2021	Forecast 2022
Revenues from privatisation and post-privatisation control in the central budget	6.07	4.69	4.3	4.58	35

Source: MF

The values in the table are based on a forecast of revenues from privatisation sales and post-privatisation control for the period 2020-2022, prepared in February 2019 by the Privatisation and Post-Privatisation Control Agency.

2.7 Budgetary Implications of Major Structural Reforms

2.7.1 Implications on the Expenditure Side of the Budget

– **Income policy**

The Medium-term budgetary forecast for the period 2020-2022 provides for an increase in the minimum wage from BGN 560 in 2019 to BGN 610 as of 1 January 2020 and to BGN 650 as of 1 January 2021, which will be maintained also in 2022.

The implementation of measures in the Education sector related to the improvement of the social status of pedagogical specialists will continue, and for this purpose additional funds in the amount of BGN 360.0 million will be provided annually for 2020 and 2021 for the increase in salaries of the pedagogical staff. The objective is to double the funds for salaries of the pedagogical specialists in 2021 compared to 2017.

Under discussion is an increase in 2020 in the salaries and remuneration of the employees in the budgetary sector, including an increase in the funding for social security contributions compared to that in 2019. At this stage, this has not been reflected in the expenditure ceilings of first-level budget spenders and the municipalities, as the final decision will be taken in the second stage of the budget procedure for 2020, based on the current macroeconomic forecasts of the autumn macroeconomic framework.

– **Changes in the Pension System**

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

The pension expenditure forecast for the period 2020 – 2022 takes into account the provisions laid down in the Social Security Code and the assumptions set out in the Medium-Term Budgetary Forecast of the government.

The length of insurance service required to obtain an entitlement to pension for category 3 workers has further increased, rising by 2 months for women and by 1 month for men. The required length of insurance service required to obtain an entitlement to pension for both sexes continues to increase by 2 months to reach 36 years and 2 months for women and 39 years and 2 months for men in 2022.

The eligibility requirements for retirement in the period 2019 – 2022 are shown in the table below:

Table 4: **Conditions for retirement under Article 68(1)-(2) of the Social Security Code, 2019–2022**

year	WOMEN		MEN	
	age	length of service	age	length of service
2019	61 г. и 4 м.	35 г. и 8 м.	64 г. и 2 м.	38 г. и 8 м.
2020	61 г. и 6 м.	35 г. и 10 м.	64 г. и 3 м.	38 г. и 10 м.
2021	61 г. и 8 м.	36 г.	64 г. и 4 м.	39 г.
2022	61 г. и 10 м.	36 г. и 2 м.	64 г. и 5 м.	39 г. и 2 м.

- The minimum retirement age in the event of incomplete length of service for a third category of labour continues increasing by 2 months until it reaches 66 years and 10 months in 2022.
- The minimum retirement age for persons employed in the Security sector continues to rise by 2 months until it reaches 53 years and 10 months in 2022.
- The minimum retirement age for persons who have been employed under Labour Categories 1 and 2 and do not meet the retirement requirements for an occupational pension fund laid down in Article 168 of the Social Security Code or have opted for a switch in their social security scheme under Article 4c of the Social Security Code continues to rise by 4 months for women and 2 months for men until it reaches in 2022 50 years for women and 53 years and 10 months for men for Category 1, and 55 years for women and 58 years and 10 months for men for Labour Category 2.
- Over the period 2020–2022, the value of the percentage under Article 70 (1) of the Social Security Code for every year of insurance service in the pension formula is preserved at the level reached in 2019 amounting to 1.2%.
- In the period 2020–2022 the pensions for labour activity awarded until 31 December of the previous year are intended to be updated as of 1 July of the relevant year in accordance with the so called "Swiss rule" (Article 100 of the Social Security Code) with a percentage equal to the sum of 50 per cent of the increase of the social security income and 50 per cent of the index of consumer prices over the previous calendar year. The amounts of the minimum pension for insurance service and age and of the social pension for old age, as well as the pensions and benefits related thereto, also increase by the same percentages as of 1 July of the relevant year.

The expected effect on the expenditure for pensions is as follows:

– for 2020 – the pensions granted by 31 December of the previous year are intended to be updated by 5.3% (percentage determined under Article 100 of the Social Security Code), as the required funds amount to BGN 282.5 million;

– for 2021 – the pensions granted byl 31 December of the previous year are intended to be updated by 4.5% (percentage determined under Article 100 of the Social Security Code), as the required funds amount to BGN 253.0 million;

– for 2022 – the pensions granted byl 31 December of the previous year are intended to be updated by 4.4%(percentage determined under Article 100 of the Social Security Code),as the required funds amount to BGN 249.2 million.

- The maximum amount of one or more pensions received for the period 2020 – 2022 is preserved in the amount of BGN 1 200 (40% of the amount of the maximum social insurance income for the relevant year), as it applies to all pensions, regardless of the initial date of granting thereof.

In the reference medium-term programme, the cash expenditure for pensions and supplementing allowances remains in the range of 8.7% to 8.4% of GDP.

Table 5: **Pension and allowances expenditure estimates, 2019–2022**[35]

year	Pension expenditures	
	BGN million	% of GDP
2019 (Budget of the State Social Security Act)	9 988.2	8.7
2020	10 519.7	8.6
2021	11 054.5	8.5
2022	11 580.1	8.4

2.7.2 Implications on the Revenue Side of the Budget

– **I. Legislative Changes in the Tax Policy Area**

Table 6: **Estimated budgetary effect from discretionary revenue measures, BGN million**

Discretionary measures	2019	2020
Positive effect on excise duty and VAT revenue from increased excise duty rates for heated tobacco product	13.8	
Change in local taxes and fees	20.0	
Revenues from social security choice	17.6	26.2
Revenues from raising the retirement requirement for length of covered service by 2 months	0.5	0.5
Revenues from social security contributions due to the increase in public sector wages and the increase of the maximum social insurance income as from 2019 from BGN 2 600 to BGN 3 000.	403.5	86.1
Revenues from social security contributions due to a change in the minimum wage, the mini-	68.3	124.1

[35] The data up to 2022 are based on the revenue and expenditure forecast of the consolidated budget of the PSS for 2020-2022 of March 2019.

Discretionary measures	2019	2020
mum social insurance thresholds and the minimum social insurance income		
Revenues from personal income tax due to an increase of the public sector wages and the increase in the maximum social insurance income as from 2019 from BGN 2 600 to BGN 3 000.	45.3	25.2
Revenues from personal income tax due to an increase in the minimum wage, the minimum social insurance thresholds and the minimum insurable income	33.2	33.2
Incomes from property	-1.0	
Introduction of a toll fee and electronic vignette	215.3	263.0
Revenues of the Security of the Electricity System Fund from the "obligation to the public" price	615.0	
Total	**1 431.5**	**558.3**

Corporate taxes

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

In 2018 amendments were made in the provisions of the Corporate Income Tax Act regarding the tax treatment of operating leasing contracts. A rule was introduced for restricting the deduction of interests upon preservation of the regulation of the thin capitalization, as well as rules for determining tax financial result in the cases of a controlled foreign company. Amendments were made with respect to the procedure for organising a tender for issuing a permit/refusal for food vouchers operator and regarding the use by the operators of the amounts received from employers under the vouchers granted to them.

Amendments were introduced regarding the procedure for declaring and paying corporate tax, withholding tax, tax on the expenses and of alternative tax in the cases of dissolution through liquidation or on account of bankruptcy, cessation of the activity of a permanent establishment of a foreign legal entity in Bulgaria or dissolution of an unincorporated association or an social insurance fund. Filing an annual tax return is made possible when activity was not carried out.

Personal Income Taxes (PIT)

The forecast for the revenue under the PIT for the period 2019–2022 has been made while preserving the flat tax rate of 10% (with no tax-exempt minimum amount) for all taxpayer incomes, with the exception of income from economic activities of sole traders, for which the tax rate is 15%. Personal income tax revenues also include patent tax proceeds in the municipal budgets.

The amount of the PIT revenue is influenced by the growth of the average wage, the decrease of the unemployment level in the country, the results declared with the natural persons' annual tax returns, the interests under bank accounts of citizens. The higher collection rate of the PIT revenue is also supported by the measures undertaken for decreasing the undeclared labour, the measures for increasing the collection rate of obligations for past periods and the information campaigns conducted by the National Revenue Agency, as well as the adopted legislative changes.

In 2018 a change was made in the regime of taxation of the acquired taxable monetary and in-kind prizes from games, races and competitions, which are not given by an employer or principal, as well as the subsidies, state aids and others obtained from natural persons not registered as farmers, on which final tax will be imposed.

Amendments were adopted regarding the submission by the taxpayers directly to the National Revenue Agency of the information contained in the certificates issued at that time for the taxable incomes acquired over the year and the deducted personal income tax, as in this relation the issue and enclosure to the annual tax return on a paper carrier of the certificates under Article 45 of the Personal Income Tax Act is removed. The data will be automatically loaded in the forms of the annual tax returns of the persons and they will be able to use them upon the filling-in thereof.

Value Added Tax

The forecast of VAT revenues includes the assumption that the current proportion of VAT proceeds to consumption will be maintained. Due consideration is given both to the forecasts for the macroeconomic indicators and to the positive effect from the changes made in the legislation.

Changes were made in the VAT Act for the introduction in the national legislation of the provisions of Council Directive (EU) 2016/1065 of 27 June 2016 amending Directive 2006/112/EC as regards the treatment of vouchers, where the goods or services to be supplied. The established tax treatment rules aim at guaranteeing secure and equal treatment, presence of compliance with the principles of common consumption tax, which is accurately proportional to the price of the goods and services, avoidance of inconsistencies, distortion of competition, double or non-taxation or tax avoidance.

The possibility set forth in Article 211 (2) of Directive 2006/112/EC for postponed accrual of VAT by an importer upon import of goods on the territory of the country was introduced. This option will be able to be applied as of 1 July 2019 for certain types of goods. Those that satisfy the conditions set forth in the law will be able to accrue the tax due upon import in the VAT return, as it is no longer required to effectively pay the tax in the respective customs institution.

The period of implementation of the VAT reverse charge mechanism upon supply of cereals and industrial plants, which was introduced in the national legislation on 1 January 2014, is extended to 30 June 2022.

The forecast for the VAT proceeds for 2019 takes into account the expected positive budgetary effect of BGN 2,3 million from the increase of the excise duty rate for heated tobacco product from 152 BGN/kg to 233 BGN/kg, effective from 1 October 2018.

Excise duties

The forecast for excise duty revenues takes into account, in addition to the macroeconomic indicators, also the positive effect from the measures for improving the control of trade in excise goods, as well as the legislative amendments.

A series of amendments were made to the Excise Duties and Tax Warehouses Act (EDTWA), which aimed at coping with problems that may have arisen upon the application of the law, for continuing the harmonization of the Bulgarian tax legislation with the requirements of the European directives and the judgments of the European Union Court of Justice, as well as in view of decreasing the administrative burden in application of the law.

A positive effect is included for 2019 on the excise duty revenues from the increase of the excise duty rate of a heated tobacco product from 152 BGN/kg to 233 BGN/kg, effective from 1 October 2018 in the amount of BGN 11.5 million.

CHAPTER 3
SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS UPDATE

3.1 Alternative Scenario: lower consumption growth rate

The main risks to the baseline macroeconomic scenario are related, on the one hand, to lower increase of domestic demand due to private consumption, and on the other – to a deterioration of the external environment. This section presents the results from an alternative scenario with lower increase in household consumption in 2019.

In the period January–September 2018 the household consumption in Bulgaria increased on the average by 7.9%. Growth slowed down to 2.4% in the fourth quarter of 2018. In view of the ongoing income growth, the lower consumption in the end of the year is related to the decreased consumer confidence[36]. The alternative scenario assumes that consumption will remain suppressed in 2019 too. Private consumption growth is decreased to the growth in the fourth quarter of 2018. The lower consumption will restrict the domestic demand for foreign goods and services. Respectively, in the alternative scenario, the import growth is also lower compared to the baseline (by 0.7 p.p).

The lower domestic demand will lead to slowdown of core inflation. As a result, total inflation in 2019 will be lower compared to the baseline scenario, both in terms of end-of-year inflation and annual average.

The decrease of inflation will lead to a slight improvement in the price competitiveness of Bulgaria and thereof in a minimum increase of the real export compared to the baseline scenario (mostly as higher services export to foreigners). However, the more significant decrease in the import growth will determine the dynamics of the net export and in the alternative scenario the negative contribution of the net export to GDP will decline.

The shock on the above components leads to real GDP growth in 2019 lower by 0.8 p.p. than the baseline scenario. In the following years the growth rates will remain unchanged. The deceleration of real GDP growth and of the GDP deflator in 2019 will result in a lower nominal value of GDP by BGN 1.3 billion. The lower GDP level in the first forecast year brings about accumulation of a gap between the absolute value and the one from the baseline scenario, which by the end of the period will stand at a little more than BGN 1.7 billion.

[36] Monthly observation of the consumers, source Eurostat.

As a result from the lower import growth in 2019, an imrprovement of the current account is observed in the alternative scenario. The deviation from the baseline scenario is more significant in 2019 and is minimal in the other forecast years.

The lower increase of the real consumer expenditures in the alternative scenario will bring about lower production, which will affect households' disposable income. The nominal growth in the compensation of employees will be 1.1 p.p. lower compared to the baseline scenario, incl. -0,8 p.p. on account of the compensation per employee and -0.3 p.p. on account of employment. The latter will also bring about an increase in the unemployment rate to 5% compared to 4.6% in the baseline scenario.

Table 7: Effects on basic macroeconomic indicators

Indicator	2019	
	Alternative scenario (%)	Difference compared to the baseline scenario (p.p.)
GDP (real growth):	2.6	-0.8
Final consumption	2.9	-1.7
Export of goods and services	1.9	0.2
Import of goods and services	4.4	-0.7
Labour market and prices		
Average annual inflation (HICP)	1.6	-0.2
GDP deflator	3.1	-0.4
Employed, ESA 2010	0.1	-0.3
Unemployment ratio	5.0	0.5
Compensation of employees	7.2	-1.1

Indicator	Alternative scenario				Difference compared to the baseline scenario			
	2019	2020	2021	2022	2019	2020	2021	2022
Nominal value, BGN million								
GDP	114 112	121 300	128 839	136 699	-1325	-1526	-1625	-1734
Final consumption	88 744	94 540	100 315	106 302	-1652	-1844	-1933	-2025
Export of goods and services	73 161	74 945	76 823	78 859	98	126	130	135
Import of goods and services	72 699	75 326	78 097	81 086	-458	-471	-481	-493
Employees' compensations	49861	53233	56545	59773	-527	-615	-658	-702

Source: MF

3.2 Sensitivity of Budgetary Projections to Various Scenarios

The sensitivity analysis presents the change in basic budgetary parameters that would occur in case of materialisation of the alternative macroeconomic scenario with a lower growth of the households' consumption in 2019. The assessment is made under the assumption that the budget expenditure policy from the baseline scenario remains unchanged.

As a result from the more significant slowdown of the households' consumption in 2019, the budgetary proceeds from indirect taxes will be lower compared to the baseline scenario by approximately BGN 300 million. As regards direct taxes and social security contributions, the effects of the alternative scenario on the labour market result in lower proceeds with an approximate total value of BGN 175 million. In the next years the gap in the nominal level of the theoretical tax bases compared to the baseline scenario remains present as in the end of the forecast period it is most significant. As a result, in 2022 the tax proceeds in the alternative scenario would be lower by a total of approximately BGN 737 million. The aggregate effect for the budget under this scenario would be a deterioration of the budget balance by 0.5 p.p. of GDP for each year of the forecast period, respectively if debt financing is needed – increase of the government debt by about 0.3 p.p. of GDP on an average annual basis for the period.

3.3 Comparison with the Previous Programme

In 2018 Bulgaria's GDP increased by 3.1% compared to expected increase of 3.9% in the previous Convergence Programme. The lower growth was due to a decrease of the export of goods and, respectively, the stronger than expected negative contribution of net export. The domestic demand was the main growth driver of growth, as its growth rate was similar to the one forecast in the Convergence Programme 2018-2021.

The international environment in 2018 was exceptionally dynamic, as a considerable part of the negative risks materialized (incl. introduction of international trade restrictions; financial and economic difficulties among Bulgaria's major trade partners). These developments were the reason for the more pessimistic expectations for the dynamics of the global and European economy in a mid-term perspective. The current forecasts for the external environment, the changed assumptions for the development of the international prices and the foreign exchange rate, as well as the revisions in the outturn data for the Bulgarian economy lead to the update of in the medium-term macroeconomic forecast of the Ministry of Finance.

The current Convergence Programme forecasts lower economic growth over the entire period. As in the previous programme, domestic demand will have the highest contribution to the GDP growth. More significant increase is expected in investments in 2019 mainly due to the planned increase in the public capital expenditure. The rate of growth of investments is slightly lower, while the expected change in consumption is close to the Convergence Programme 2018-2021 forecast. Domestic demand will continue supporting import growth over the entire forecast period. An the same time, export is lower, bearing in mind the reported data for 2018 and the deteriorated expectations for the international environment in the next years. The dynamics among the years is also changed, as instead of a slight slowdown of export growth over the entire forecast period, the present Convergence Programme sets out an expectation of a slight acceleration in 2019-2020 and a more moderate growth in the next years. As a result, the negative contribution of net exports in the current Convergence programme is a little stronger over the entire forecast period compared to the previous one.

The differences in average annual inflation in 2018 between the forecast values in the previous Convergence Programme and the actual ones are due to the considerably higher prices of oil in 2018 compared to the expectations of international institutions at the time, which were part of the assumptions of MF. For example, Brent crude oil price in 2018 was then expected to be around USD 64, while the reported price was USD 71 – more than 10% higher. Households consumption was also slightly higher, which along with the second round effects from the higher oil prices was reflected in a higher increase in the prices of services and hence – higher core inflation. The deviations in the expectations for the development of inflation processes in the period 2019-2021 compared to the ones in the previous Convergence Programme are not so significant.

The main differences in the present scenario labour market dynamics compared to the previous programme come from the materialised risk of a decrease in the economically active population in 2018, given an expectation in the previous forecast for gradual discontinuation of the growth of workforce, after its considerable increase in 2017. This was also related to a lower than expected dynamics of employment, as well as to a lower unemployment rate. In the present forecast, the expectations for a slowdown in labour demand over the entire forecast horizon remain unchanged but the sectorial developments of employment in 2018 and the considerable impact of agriculture on the total number of employed persons brought about a revision of the expectations to a slight acceleration in the dynamics of employed persons to 0.4% in 2019 under the conditions of a minimum 0.1% decrease reported in 2018, while in the previous forecast a slowdown in the employment growth to 0.3% for 2019 was expected given the expected 0.6% increase for 2018. The economic activity of the population, which is lower than expected in the previous forecast, reflects also the lower unemployment level, the value of which is revised downwards for the entire forecast horizon. As regards the compensation of employees, more considerable differences were reported in 2018 and 2019. On the one hand, the GDP revisions by income approach resulted in a higher increase in compensation of employees of 10.9% in 2017, which resulted in a lower increase of the indicator in 2018. Thus, the expectations for the dynamics of the compensation per employee from the previous programme exceeded the reported value for 2018 (7.4% against 5.6%, respectively). Unlike 2018, 2019 was revised upwards. The latter reflected higher labour costs in priority areas of the public sector, which had not been planned a year earlier.

Table 8: **Key macroeconomic indicators**

	2018			2019			2020			2021		
	CP 2019	CP 2018	Difference, p.p.	CP 2019	CP 2018	Difference, p.p.	CP 2019	CP 2018	Difference, p.p.	CP 2019	CP 2018	Difference, p.p.
GDP, real growth, incl.:	3.1%	3.9%	-0.8	3.4%	3.8%	-0.4	3.3%	3.7%	-0.4	3.3%	3.7%	-0.4
Final consumption	6.0%	5.0%	1.1	4.6%	4.9%	-0.3	4.0%	3.9%	0.1	3.6%	3.8%	-0.2
Investments	6.6%	9.6%	-3.0	9.0%	6.4%	2.6	4.9%	6.7%	-1.8	6.1%	6.8%	-0.7
Export of goods and services	-0.8%	4.9%	-5.7	1.8%	4.9%	-3.1	2.0%	4.7%	-2.7	1.8%	4.6%	-2.9
Import of goods and services	3.7%	8.1%	-4.4	5.0%	7.0%	-2.0	3.3%	5.9%	-2.5	3.2%	5.8%	-2.6
Average annual inflation (HICP)	2.6%	1.8%	0.8	1.8%	2.0%	-0.2	2.5%	2.1%	0.4	2.3%	2.1%	0.2
Employed persons	-0.1%	0.6%	-0.7	0.4%	0.3%	0.1	0.2%	0.2%	0.1	-0.1%	0.0%	-0.1
Unemployment ratio	5.2%	5.9%	-0.6	4.6%	5.7%	-1.1	4.1%	5.5%	-1.4	4.0%	5.4%	-1.5

Source: MF

CHAPTER 4
SUSTAINABILITY OF PUBLIC FINANCE

4.1 Policy Strategy

This chapter deals with the sustainability of the fiscal position by evaluating the current status of public finance in view of the future increase in age-related public expenditures. For this purpose, the sustainability indicators S1 and S2 are used, calculated under the methodology elaborated by the European Commission[37].

The medium-term fiscal sustainability indicator (S1) shows the necessary adjustment to the primary structural budget balance within five years from the end of the forecast period (2022 in the case of MF, 2020 for EC), which is needed to guarantee that the government debt in the period t+15 (2034) does not exceed the reference value of 60%.

The long-term fiscal sustainability indicator (S2) shows the adjustment to the primary balance required to fulfil the inter-temporal budget constraint (the discounted value of the future primary structural balances should cover the current debt level) over infinite horizon including additional age-related costs.

The positive value of the indicators means a need for fiscal consolidation or structural reforms to reduce the burden of the ageing population on public finance.

Table 9: **Sustainability indicators**

	MF (base 2022)		EC (base 2020)	
	S1	S2	S1	S2
Value, of which:	-4.5	0.6	-4.2	1.8
Initial budgetary position	-1.2	-0.3	-1.5	-0.4
Debt requirement	-3.4		-3	
Future changes in the budgetary position [38]	0.0	0.9	0.4	2.2

Source: MF, Fiscal Sustainability Report 2018

37 Annex 2 of Fiscal Sustainability Report 2018.

38 Бъдещи промени в бюджетната позиция са свързани най-вече с разходите за пенсии, здравеопазване и образование. При изчисляването на тази позиция в настоящата Конвергентна програма са използвани прогноза за разходи за пенсии подадена от Националния осигурителен институт и прогнози за разходите за здравеопазване и образование получени от дългосрочния модел на МФ по методология описана в http://www.minfin.bg/upload/9114/D.E.2008.pdf

The table presents the assessments of MF for the sustainability indicators and those of EC from the Fiscal Sustainability Report 2018 (FSR 2018), published on 18 January 2019. The assessment of the sustainability of the fiscal policy is strongly dependent on the long-term economic development prospects. The presence of differences in the values of the indicators S1 and S2 between the two institutions is due most of all to differences in the expectations for future changes in the budgetary position, which are related to the pension, healthcare and education costs. In the preparation of the long-term macroeconomic forecast and the respective estimates of population ageing related expenditure, MF uses the Commission's methodology and assumptions laid down in the Ageing report 2018, but also takes into account the latest economic developments. At the same time, the Commission's forecast for age-related costs is based on a long-term development scenario, which used as a reference point of the calculations a forecast of the European Commission of the spring of 2017.

The estimates of the Ministry of Finance show that the value of the S1 indicator for is negative, which according to the Commission's reference values[39] means low fiscal sustainability risk in the medium-term and presupposes maintenance of the debt level below 60% of the GDP. The S2 value also corresponds to a low fiscal sustainability risk due to the favourable initial budgetary position.

The conclusions of the analysis of MF coincide with these of FSR 2018. According to the report, the fiscal sustainability risks in Bulgaria in the medium term are low. The negative value of S1 is supported by the low debt level and the favourable budgetary position. It shows that Bulgaria has a fiscal space. The debt sustainability analysis also indicates low risk both in the baseline scenario and in the alternative scenario. Due to the low level of debt no significant effect on the debt-GDP ratio is expected in case of a shock on the interest rates or the nominal GDP growth. Furthermore, the Commission states that in the long term the risk faced by the fiscal sustainability is low. In a scenario involving higher increase of the age-related costs compared to the baseline scenario, the risk in the long term is estimated to be medium.

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

4.2.1 Social security

The long-term budgetary forecast for the development of the pension system is based on the current (2019) pension legislation and on the provisions of the SSC. For the preparation of the pension expenditure forecast in the period 2019–2070, the most recent Eurostat demographic projections and a macroeconomic forecast made available by the Ministry of Finance were used.

In the long term it is possible to distinguish three stages in the dynamics of the pension expenditures as a share of GDP.

Within the first stage covering the period between 2019 and 2037 the share of the pension expenditures in GDP is expected to decrease due to the gradual increase of the retirement age and of the required length of insurance service, reaching its lowest value of 7,9% in the period 2031-2037.

The second stage covers the period from 2038 to 2062 when as a result from the process of ageing of the population and the expected higher average life expectancy, the fiscal pressure on the state pension system will increase and the pension expenditures as a percentage of GDP will start growing, reaching their highest value of 9,7% in the period 2057-2062.

[39] Reference values set in the Fiscal Sustainability Report 2018, which indicate the risk level for the public finance sustainability:

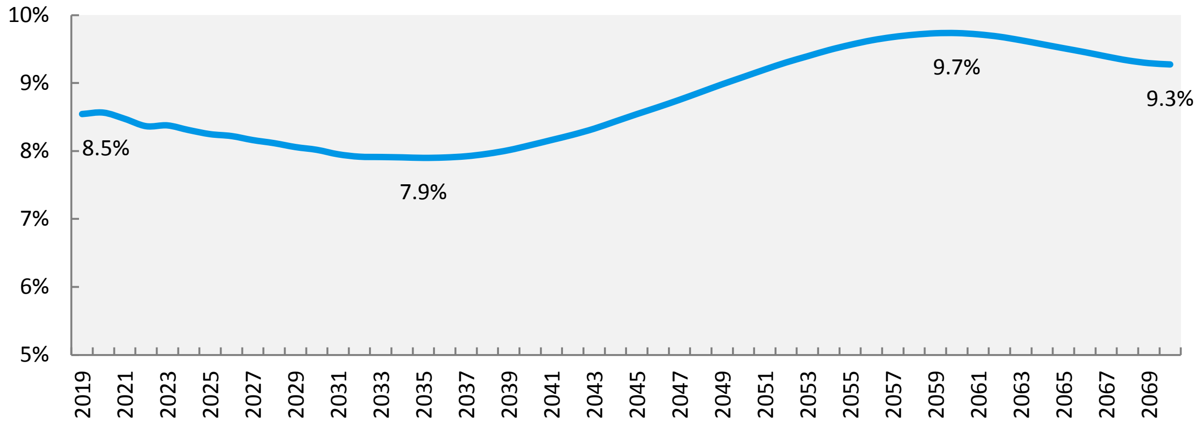
S1<0 – low risk; 0<S1<2,5 – moderate risk; S1>2,5 – high risk;

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

The third stage covers the last eight years of the forecast period, when a decrease in the share of the pension expenditures to about 9,3% of GDP is expected due to the higher fertility rates and gradual increase of the share of the working age population in the end of the period forecast by Eurostat.

In addition to the demographic factors, the dynamics of the pension expenditures will be influenced in the long run also by the opportunity given to the insured persons born after 1959, who were mandatorily insured until August 2015 in the public social security (pillar I) and in an universal pension fund (pillar II), to change their insurance and to shift to insurance in the first pillar only with an increased social security contribution. Due to the fact that the presently available data do not allow making a specific assumption for the percentage of the persons born after 1959 who would shift to insurance in the public social security only, the forecast is developed on the assumption that 100% of the insured persons born after 1959 will remain insured in both pillars[40]. In order to calculate the effect of the provided opportunity, separate simulations are also made under the conditions of different assumptions for the percentage of insured persons born after 1959 who will choose insurance in the public social security only (the so called first pillar). The next figure shows the pension expenditures in the period 2019-2070, which is paid by the public social security, on the assumption that 100 per cent of the insured persons born after 1959 will remain insured in both pillars.

Chart 12: **Pension expenditure % of gdp 2018–2070**



Source: National Social Security Institute

The share of the pension expenditures in GDP varies depending on different assumptions about the percentage of the insured persons who will choose insurance in the public social security (the so called “first pillar”) only. It is lowest (9.3% in 2070) in the case, in which the insured persons born after 1959 continue being insured in both pillars as the pensions from the public social security of all persons born after 1959 will be reduced pro-rata to the social security contribution that is transferred to pillar II. The share of the pension expenditures of GDP is highest in the case, in which 100% of those born after 1959 chose insurance in the first pillar only due to the fact that all persons will receive pensions in full amount. In this case the pension expenditures will reach 11.8% of GDP in 2070. Thus, in the end of the period, there will be an increase in the pension expenditures amounting to about 0.25% of GDP per every 10% of insured persons who transferred to the first pillar.

The possibility of fully transferring the social security to the first pillar will also bring about an increase in the revenues in the public social security because the social security contribution for the Pensions fund, respectively the Pensions for Persons under Article 69 fund, for the persons who have

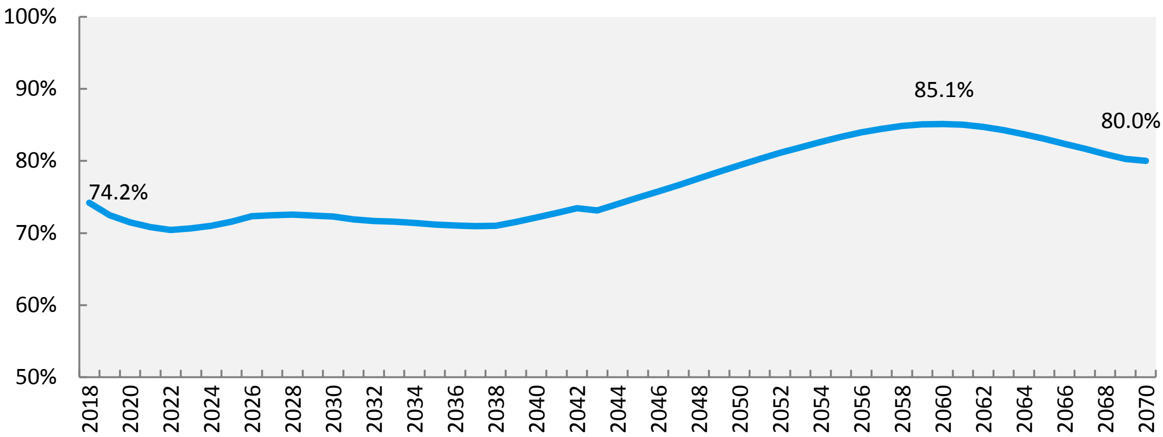
40 Until the end of march 2019, 31 573 insured persons have filed in applications in the National Revenue Agency for transferring their ensurance from an universal pension fund to the state public insurance, which constitutes 1.3% of all insured persons, born after 1959.

chosen social security in the first pillar only will be 5 p.p. higher. Upon retirement the funds from the individual accounts of these persons will also be received as an income to the public social security budget. The results from the additional simulations show in the end of the period an increase of the public social security revenue of around 0.16% of GDP for every 10% of persons transferring to insurance in the first pillar only.

The key indicators of the financial condition of the pay-as-you-go systems are the dependency ratio[41] and the income replacement rate[42].

As regards the dependency ratio, the data shows that in 2018 a hundred social insured individuals corresponded to 74 pensioners with pensions for labour activity. According to the forecast results, In the period until 2037, when the retirement age for women and men will become equal at the level of 65 years of age, the dependency ratio will decrease to 71% due to the increase in the retirement age and in the required length of insurance 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. In the period 2037 – 2060 the values of this indicator are expected to grow considerably due to the ageing of the population and the increasing life expectancy, as in 2060 a hundred social insured individuals are expected to correspond to more than 85 pensioners with pensions for labour activity. Between 2060 and 2070 there is a certain improvement in the dependency ratio as a result from the forecast of Eurostat for a gradual increase of the total fertility rate from 1.5 to 1.8, which brings about an increase in the share of the working age population as at the end of the period, when a hundred social insured individuals are expected to correspond to about 80 pensioners.

Chart 13: **Pensioners for labour activity to socially insured persons 2018–2070**



Source: National Social Security Institute

The first pillar income replacement rate is considerably influenced by the percentage for every year of length of insurance service in the pension formula, which increases from the beginning of 2019 ce from 1,169 to 1,2. The forecast makes an assumption that this value will be preserved until the end of the forecast period, which will considerably decrease the first pillar replacement ratios compared to the variant, in which this percentage was envisaged to increase to 1,5. For new pensioners, the new percentage will apply upon determination of the amount of their pensions and as regards pensions granted until the end of 2018, recalculation of the amounts will be made counted from 1 July 2019 based on the higher percentage for a year of length of insurance service.

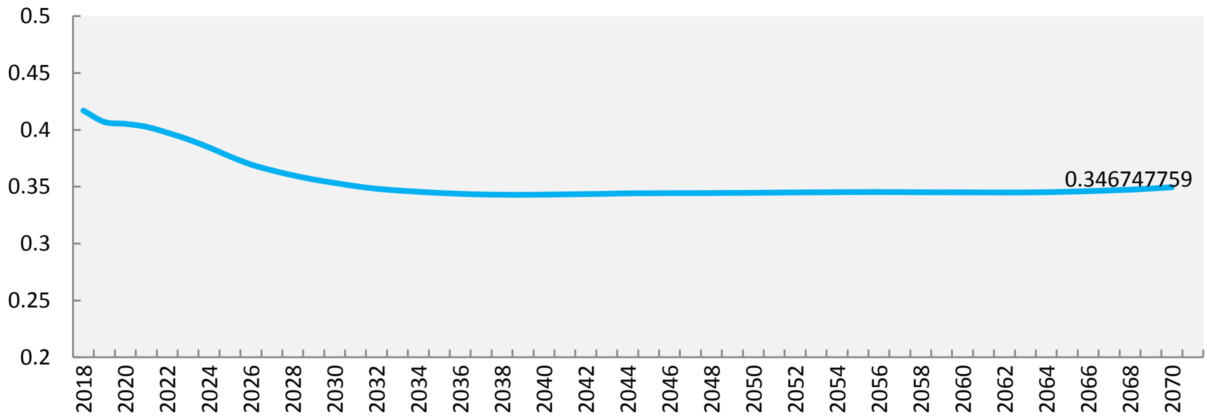
Considerable impact on the income replacement rate from the first pillar will also be caused by the possibility, provided in the legislature, to transfer social security rights from the first and second pil-

41 The ratio between the number of pensioners for labour activity and the number of insured persons

42 The ration between the average pension for labour activiry and the average insurance income in the country

lars to the first pillar only. Replacement rates will be lower for pensioners insured in both pillars because their pensions will be reduced pro-rata to the social insurance contribution that was transferred to the second pillar but they will receive a second pension from a universal pension fund. The next figure shows the values of the average gross income replacement ratio from the first pillar of the pension system subject to the assumption that 100 percentage of insured persons born after 1959 will continue being insured in both pillars. From values close to 42% in the beginning of the period, the first pillar income replacement ratio will decrease to about 35% in 2070. The possibility to transfer social security rights entirely to the public social security has a favourable influence on the first pillar income replacement rate in the long run, as in the case of the insured persons born after 1959 who choose to pay contributions in pillar I only, the average gross replacement ratio will be about 10 p.p. higher.

Chart 14: **Average labour activity pension to average social insurance income 2018–2070**



Source: National Social Security Institute

4.2.2 Healthcare

The ageing of the population is a long-term trend, which started several decades ago in Europe. It Is visible in the transformations of the age structure of the population and is expressed in an increasing share of older people combined with a decreasing share of the working-age people in the total population.

The current demographic situation in Bulgaria is characterised with continuing decrease and ageing of the population, low birth rates and high levels of general mortality. The imbalance in the territorial distribution of the population gets deeper and deeper.

Table 10: **Healthcare expenditure**

		2030	2040	2050	2060	2070
MF	Share of the healthcare expenditure, % of GDP	5.3	5.5	5.6	5.4	5.3
Ageing report 2018	Share of the healthcare expenditure, % of GDP	5.3	5.5	5.6	5.5	5.2
Ageing report 2018	Share of the long-term care expenditure, % of GDP	0.5	0.5	0.5	0.6	0.5
	Share of the population 65+	24.6	27.9	31.4	33.3	30.9

As shown in Table 5-2 the expected increase of the healthcare expenditure is due to an aggravation of the demographic structure of the population. The share of people aged more than 65 increases considerably, by about 10 p.p. until 2060. Bearing in mind that in most of the cases the main healthcare expenditure of an individual are made in the years immediately before his death, the ageing of population logically results in an increase of the healthcare expenditure for the aged population compared to the total expenditure. In the end of the period under review they are expected to exceed 50% of the total expenditure. The total healthcare expenditure is expected to increase from 4,9%[43] of GDP in 2017 to 5.6% in 2050 and then to slightly decrease to 5.3%. Similar dynamics is also expected in the Ageing Report 2018. It deals, in addition to the baseline scenario, with other 10 scenarios for the development of the healthcare expenditure related to a different demographic and economic dynamics. In them, the Bulgarian costs in the end of the period vary from 4.6% to 7.4% of GDP.

4.2.3 Education

Table 11: **Education expenditure**

		2030	2040	2050	2060	2070
MF	Share of the education expenditure, % of GDP	3.6	3.6	3.8	4.1	4.0
Ageing report 2018	Share of the education expenditure, % of GDP	3.3	3.3	3.5	3.8	3.7

The MF's forecast for the educational public expenditure is based on the long-term demographic forecast and on the assumption that the expenses will be indexed by the increase of the nominal labour productivity. In the period after 2040 the stabilization of the demographic dynamics of the population aged up to 18 is expected to bring about a gradual increase of the total educational expenditure, which will cause certain pressure on the budget.

4.3 Contingent Liabilities

The change in the scope of the General Government sector (by a decision of Eurostat of 2018) led to significant change in the size and structure of the guaranteed debt of the sector compared to the date reported in the Convergence Programme of the Republic of Bulgaria 2018-2021, which at the end of 2017 decreased considerably from BGN 732,0 million to BGN 260,8 million. In its sectoral structure a significant change was observed in the share of financial sector guarantees, which decrease from 69% to 13% on account of the respective increase in the part of the remaining sectors.

The guaranteed debt of the General Government sector as at the end of 2018 amounted to BGN 178,1 million or 0,2% of GDP (BGN 260,8 million or 0,3% of GDP as at 31 December 2017). Most of it is formed by the guarantees issued by the Central Government sub-sector, as the majority are obligations to external creditors (61%). In 2018 the Energy sector had the highest contribution with 41,5%, followed by the share of the guarantees issued under the Student and Doctoral-Candidate Loans Act in the amount of 38,2%, financial sector of 17,7% and other guarantees – 2,6%.

In 2018 no new guarantee agreements were ratified.

In the period 2019-2022 the nominal amount of the guaranteed debt of the General Government sector is expected to increase, reaching around BGN 340.0 million at the end of 2022 , and the ratio to the forecast GDP is expected to remain around 0.2%. The planned change in the nominal value of the guaranteed debt is due to assumption for the issuance of new guarantees in 2019, in accordance with the possibilities provided for in the State Budget Act of the Republic of Bulgaria, resp. the intentions to start the implementation of the project "Gas Interconnection Greece-Bulgaria (IGB)" financed with a state-guarantee loan from the European Investment Bank.

[43] Data from General government expenditure by function (COFOG)

Table 12: **Guaranteed debt of the General Government sector**

% of GDP[44]	2018	2019	2020	2021	2022
Guaranteed debt of the General Government sector	0.2%	0.2%	0.3%	0.3%	0.2%

Source: MF

Pursuant to item 1.12 of Resolution No. 52 of the Council of Ministers of 31 January 2019 on the Budgetary Procedure for 2019 and in conjunction with Subparagraph 8 of Article 73, of the Public Finance Act, all state and municipal enterprises having a total amount of their obligations as at 31 December 2017 in excess of 0.1% of the GDP of the country, which are not a part of the consolidated fiscal programme and do not fall within the scope of the General Government sector, are subject to monitoring. They are supposed to present information and evaluation of the forecasts for revenues and expenses and for the assets and liabilities with reported data for 2017 and 2018, an estimate for 2019 and a forecast for the period 2020–2022.

The companies falling within the scope of the specified criterion are 11, according to a submitted list from the NSI, and are included in BU No. 1/08 February 2019.

On the basis of the thus received information, the amount of the outturn long-term and short-term obligations of these companies reported as of 31 December 2018 is in total BGN 8.43 billion or 7.81% of GDP, and according to the forecasts as of 31 December 2022 they will decrease to 6.14% of GDP. For the period of 2020-2022 the total liabilities of these companies are forecasted to decrease with 0.96%. In addition, the total aggregate leverage ratio decreases from 1.23 as of 31 December 2018 to 1.14 in the end of the forecast period, and the aggregate debt ration vis-à-vis their assets decreases from 55% at the end of 2018 to 53% in 2022. Their liquidity ratio is expected to increase from 1.55 in 2018 to 1.83 at the end of 2022.

At present, no information is available for contracted public or municipal public-private partnership/concession agreements with payments from the grantor, whose assets are booked off the balance sheet (Liabilities related to off-balance public-private partnerships (PPPs).

[44] In accordance with the spring macroeconomic forecast 2019.

CHAPTER 5
QUALITY OF PUBLIC FINANCES

5.1 Policy Strategy

The policy strategy in the area of the quality of public finances follows the consistent actions for institutional, legal and methodological changes towards improvement of the public finance management.

Regardless of the established permanent regulation of the budgetary framework by the Public Finance Act, the efforts for improving the budgetary legal framework continue as they are accompanied by monitoring and analysis of the application of the budgetary legislation and of the budgetary practices as well as of the compliance with the fiscal rules.

An appraisal of the efforts of the Ministry of Finance towards improvement of the quality of the budgetary process and of the public finance as a whole is the conclusion of the European Commission set out in the report on Bulgaria, which includes a thorough review concerning the prevention and adjustment of the macroeconomic imbalances, dated 27 February 2019. It is noted that the budgetary developments are positive.

An important element for the improvement of the quality of public finances is the process of application of programme and result-oriented budgeting on the part of the budgetary organizations in charge of the pursuit and implementation of public-sphere policies. A new point in the budgetary procedure for 2020 is the expansion of the scope of the budgetary organizations applying programme budgeting. In accordance with its powers, the Council of Ministers determined with the decision for the budgetary procedure for 2020 that, in addition to ministries and state agencies, the other first-level spending units whose budgets are a part of the state budget (except for the budgets of the judiciary and of the National Audit Office) must apply programme budgeting for 2020.

The steps taken by the government to increase the cost-effectiveness are also positively assessed. In 2018 a part of the initiatives in this sphere were completed, one of which is the expenditure review conducted by the World Bank. The review was carried out as a result of a request made by the Ministry of Finance for carrying out an analysis of the effectiveness and efficiency of the public expenditure, for the purpose of identifying options for economies and reallocation of funds to more effective activities in the public sector.

The first phase of the review included an analysis of the remuneration, operating activity and maintenance expenditure of seven ministries and 21 municipalities. The second phase was aimed at elaborating and developing two pilot projects, focused on a specific area. On the basis of the analysis made in the first phase, the government chose two programme spheres for detailed reviews of the expenditure in the second phase: 1) public order and security and 2) waste management.

The second part of the expenditure review ended successfully in the beginning of 2019. The result from the conducted exercise are two reports: 1. Review of the police and fire-fighting activity expenditure and 2. Review of the expenditure: Improvement of the effectiveness and efficiency of waste management costs, containing results from the analysis made and recommendations for further actions, as well as guidance on the conduct of future expenditure reviews.

The expenditure review under the budget of the Ministry of Foreign Affairs initiated by Resolution No. 52/2019 of the Council of Ministers is a way to improve the effectiveness and efficiency of public expenditure. In this context, the efforts will be focussed on a review of the topics determined in the agreement signed between the Ministry of Finance and the Ministry of Foreign Affairs with identified problems that must be resolved in view of achieving optimal effectiveness with respect to the planning and implementation of the budget of the Ministry of Foreign Affairs.

The expenditure review requires the creation and maintenance of information on the implementation to be used as a basis for tracing the development of the sectorial policies. Within the second stage of the budgetary procedure for 2019 an initiative started for the inclusion in the main national budgetary documents of more information upon the presentation of the expenditure policies, with a focus on key indicators for measuring the extent of their implementation, for the purpose of tracking the progress made and for more effective and efficient management of the public expenditure. The identified key indicators and their target values were included in the updated Medium-Term Budgetary Forecast for the period 2019-2021, as well as in the Medium-Term Budgetary Forecast for the period 2020-2022.

It should also be noted that the international rating agency Fitch Ratings raised the prospect of the long-term credit rating of Bulgaria from stable to positive. The agency confirmed the “BBB” long-term credit rating of Bulgaria in a foreign and local currency, the country rating ceiling “A-”, as well as the short-term credit rating in a foreign and local currency “F2”.

The improvement of the prospect to positive reflects the assessment of Fitch Ratings that key indicators influencing the final rating assessment show better performance for Bulgaria compared to other countries having a “BBB” rating, indicating the factors that would individually or jointly cause an increase of the rating assessment. These are the continuing improvement of the external and fiscal balances, the progress in the process of accession to the Eurozone, the favourable economic growth prospects, which lead to faster convergence to the levels of the incomes for the countries from the group with a similar rating.

Future developments that would, individually or jointly, bring about negative actions with respect to the rating are the occurrence of external imbalances, deterioration of the external competitiveness, as well as the sharp increase in the government debt as a result of a fiscal loosening or materialization of contingent obligations in the balance of the state.

The accession of the Republic of Bulgaria to the Organization for Economic Cooperation and Development (OECD) is a top-priority cause for the country because the activity of this organization covers almost all aspects of the socio-economic life. The government of the Republic of Bulgaria has clearly declared its intentions for enhanced cooperation with OECD.

On the basis of an Agreement between the Ministry of Finance of the Republic of Bulgaria and OECD a budgetary review of Bulgaria will be carried out, which would evaluate the long-term efforts of the country to introduce reforms in the sphere of budget and the results from them, and would give a positive signal for the commitment of Bulgaria to apply international standards and good practices in the process of budgeting and management of public finances.

In March 2019 Bulgaria received an invitation from the International Budget Partnership to participate again in the Open Budget Survey by answering the Questionnaire for 2019 on the budget transparency in Bulgaria. In 2017, Bulgaria submitted useful comments on the transparency of the budget and the commitment of the public in the budget process. The contribution of each party in the survey is related to the provision of an open forum for discussions for evaluation of the transparency and enhances the accuracy of the open budget survey. In this connection, the International Budget

Partnership has invited the Ministry of Finance to nominate its representative as a governmental reviewer. The results from the survey are another factor allowing the making of a decision for increasing both the transparency and the quality in the public finance management.

5.2 Composition, efficiency and effectiveness of expenditure – COFOG

Table 13: **Budget expenditure by function**

	% of GDP		% of the total budget expenditure	
	2017	2022	2017	2022
1. General public services	3.2	3.8	9.2	10.5
2. Defence	1.1	1.6	3.0	4.4
3. Public order and safety	2.5	2.1	7.1	5.9
4. Economic affairs	4.0	6.5	11.4	18.2
5. Environmental protection	0.7	0.7	1.9	2.0
6. Housing and community amenities	1.6	1.0	4.5	2.7
7. Health	4.9	4.7	14.1	13.1
8. Recreation, culture and religion	1.0	0.6	2.9	1.7
9. Education	3.6	3.7	10.2	10.3
10. Social protection	12.5	11.3	35.5	31.4
11. Total expenditure	**35.1**	**36.0**	**100.0**	**100.0**

The expenditure on the **General public services** function increases its share from 3.2% of GDP in 2017 to 3.8% in 2022. The increase of its share is due to the increase of the expenditure for science and for executive and legislative authorities.

The expenditure on the **Defence** function increases as a share of GDP from 1.1% to 1.6% due to the action taken for modernization of the equipment of the Bulgarian Army. Acquisition of aviation equipment and main military equipment for the setting-up of battalion battle groups is envisaged.

The expenditure on the **Economic affairs** function increases from 4.0% of GDP in 2017 to 6.5% of GDP in 2022. The function includes the state-owned enterprises which form part of the General Government sector and excludes the expenditure covered by EU funds which, according to ESA 2010 methodology, does not have any impact on revenues and expenditure in the General Government sector. The expenditure in the Mining, fuels and energy sectors has the largest contribution for the expenditure increase in this function, mainly due to the increase in the subsidies for non-financial enterprises where the expenditure of the “Security of the Electricity System” Fund is taken into account as well as in the “Transport and communication” sector due to a significant increase in capital expenditures.

The expenditure on the **Environmental Protection** function preserves its level of 0.7% of GDP in the period under review. The expenditure on the function includes measures for continuing the accelerated construction of an ecological infrastructure of the country and under the Natura 2000 ecological network, which will support the improvement of the life quality of the population and the protection of the ecosystems, as well as the fulfilment of the country’s commitments to the EU.

The expenditure on the **Health** function slightly decrease to 4.7% of GDP in 2022. This is related to the measures for optimizing the activities and improving the control over the expenditure in the healthcare system, which aims at stabilizing the health insurance model and increasing the financial independence of the Healthcare sector as a whole.

The expenditure on the **Education** function increases from 3.6% of GDP for 2017 to 3.7% of GDP in 2022. There is an increase in the funds for supporting the activities of education and training of children and students, which are determined on the basis of standards for financing, determined by the Council of Ministers and on the basis of the number of the institutions, classes and of the children and students. Measures for higher transparency and efficiency of the spending of public funds, optimization of the structures in the school network system and more comprehensive coverage of students within the system are also envisaged.

The reduction of the expenditure on the **Social protection function** from 12.5% of GDP in 2017 to 11.3% of GDP in 2022 reflects the decrease of the expenditure on pensions as a share of GDP as of the end of the period. The pension reform continues in the medium term, as an increase is envisaged of the required age and length of insurance service required to obtain an entitlement to pension.

5.3 Structure and Efficiency of Revenue Systems

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

– **Tax Policy and Legislation**

The tax and social security policy in the Republic of Bulgaria is oriented towards supporting the economic growth, improving the business environment, combating tax offenses and increasing the fiscal sustainability in the long run. In an international aspect, the tax policy in the period 2019–2022 is oriented to support the functioning of the Single Market of the European Union, the successful implementation of the digital transformation of the society and economy in Europe and of the activities guaranteeing that Europe makes use of the new opportunities provided by the changing global environment.

The improvement of the collection rate of revenues is the leading line also in the specific recommendations made by the Council of EU to Bulgaria in recent years. In response to Council Specific Recommendation 1 of 2014, the Single national strategy for improving the tax collection, tackling the shadow economy and reducing the compliance costs 2015-2017 (Resolution No. 806 of 15 October 2015 of the Council of Ministers) was developed and adopted. The implementation of the SNS and the Action Plan thereto brought about the deepening of the interinstitutional coordination and cooperation and the increase of the quality of the risk assessment, audit and capacity of the administration in the field of information technologies. Annual reports are drawn up for the progress made in the implementation of the measures from the SNS Action Plan. In view of the issued recommendations and the reported positive results from the implementation of the measures to the strategy, Bulgaria will continue applying them even after the expiration of the mandate of the strategy as the measures are included in the strategic documents that each of the responsible institutions develops and applies. The implemented measures for improving the tax collection rate can be presented in the following three main aspects:

- **Encouragement of the voluntary compliance with the legislation** related to the implementation of measures intended to increase the quality of service, incentivising voluntary performance, improvement of the tax-and-social security culture of the clients and decrease of the costs both of the clients and of the administration;
- **Optimization of the control activity of the revenue administrations** is a permanent measure that is permanently improved through legislative and administrative measures.

The development of this measure results in restriction of the possibilities of tax evasion and avoidance and improvement of the collection rate of the revenues, which is manifested and assessed in the long run.

- **Decrease of the administrative burden**. Electronic services are constantly developed and improved. More than 90% of all main declarations (tax returns, insurance declarations, notifications under the Labour Code) are received in the NRA electronically.

Permanent Measures in the Field of Tax Policy

The main measures related to increasing the tax revenues include:

- Exerting **fiscal control over the movement of high fiscal risk goods (**HFRG). The measure was put in place in 2014. The list of high fiscal risk goods was determined by an Ordinance of the Minister of Finance, which is published on the websites of the MF and the NRA;
- Implementation of a mechanism directed towards preventing the possibilities of tax offenses and frauds involving VAT in the trade in liquid fuels. In the period after 2011 comprehensive control was put in place of the process related to the supplies and movement of liquid fuels from the producer and importer to the end consumer and exchange of data between the information systems of the two revenue agencies. In 2016 amendments to the Value Added Tax Act (VAT Act) put in place a mechanism, by virtue of which when carrying out trade in liquid fuels having a tax base in excess of BGN 25 thousand, the persons are bound to mandatorily present a security for a term of one year before the competent territorial directorate of the NRA;
- Application of the VAT reverse charge mechanism upon supplies of cereal and technical cops as an effective tool for prevention of VAT frauds and for increasing budgetary revenues. The mechanism was put in place since 1 January 2014 and is among the most effective tools for prevention of and fight against VAT tax frauds, since the tax is charged by the recipient, which rules out any possibility of unlawful recovery of VAT from the budget and commitment of VAT frauds. The term of validity of the measure was extended until 30.06.2022;
- Application of a mechanism for repayment of public obligations of persons with receivables against municipalities, other departments or state-owned enterprises under public procurement contracts and contracts awarded in pursuance of EU operational programmes. The measure was introduced in 2014;
- Performance of constant monitoring of debtors with overdue obligations exceeding BGN 100 thousand (BGN 200 thousand for the Sofia City Territorial Directorate of the NRA) for taxes and mandatory health and social security contributions and an approved plan for conducting telephone campaigns under a timetable.

Legislative changes in 2018

Introduction in the national legislation of European Directives in the field of taxes and excise duties, as well as setting of the national legal framework in conformity with the case-law of the EU Court of Justice.

The national legislation (VAT Act) introduced the provisions of the directives amending Council Directive 2006/112/EC on the common system of value added tax – Council Directive (EU) 2017/2455 of 5 December 2017 as regards certain value added tax obligations for supplies of services and distance sales of goods , of Council Directive (EU) 2016/1065 of 27 June 2016 as regards the treatment of vouchers, as well as of Council Directive (EU) 2018/912 of 22 June 2018 as regards the obligation to respect a minimum standard rate. In relation to a received official notification letter from the European Commission for an opened infringement procedure for the failure of the Republic of Bulgaria to comply with its obligations referred to in Article 273 of Council Directive 2006/112/EC and Article 16 of European Union Charter of Fundamental Rights, amendments were adopted to the VAT Act with respect to the obligation to provide a security for the taxable persons who commit in the current tax period supplies of liquid fuels in excess of BGN 25 000, as there is no longer the requirement for the amount of the security to be not less than BGN 50 000.

Amendments to the VAT Act put in place also the possibilities provided for in Article 211 (2) of Directive 2006/112/EC for deferred charging of VAT by an importer in case of import of goods on the territory of the country. This option may be applied for certain types of goods, which are not excisable goods and are not intended for final consumption. The persons who meet the relevant conditions set forth in the law will be able to charge the import tax due in the VAT tax return, as there is no longer an obligation for effective payment of the text in the relevant customs institution.

A provision in the Excise Duties and Tax Warehouses Act (EDTWA) was made more precise, in view of a Judgment of the EU Court of Justice under case C-30/17, which holds that Article 3 (1) of Council Directive 92/83/EEC of 19 October 1992 on the harmonization of the structures of excise duties on alcohol and alcoholic beverages must be interpreted in a sense that upon determination of the tax base for taxation of flavoured beers according to the Plato scale, the dry extract of the original wort must be taken into consideration but not the aromatic substances or sugar syrup added after the completion of fermentation.

In relation to a Judgment of the EU Court of Justice (EU CoJ) of 6 April 2017 under case C-638/15 and in accordance with the provisions of Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco, an amendment was adopted to the EDTWA, whereby dried, flat, irregular, partly stripped leaf tobacco which have undergone drying and controlled dampening and in which the presence of glycerine is detected and are capable of being smoked after simple preparation by means of crushing or hand-cutting can be regarded as “smoking tobacco”.

Two rules were put in place in the Corporate Income Tax Act (CITA) in accordance with the provisions established by Directive 2016/1164, which restrict the possibilities for aggressive tax planning and tax avoidance – a rule restricting the interest deduction (Article 4 of Directive 2016/1164) and a rule for the controlled foreign companies and calculation of the company’s income (Articles 7 and 8 of Directive 2016/1164). The aim of the first rule is the prevent practices resulting in base erosion and profit shifting excessive interest payments, by restricting the deduction of the excess under the loan expenses. The introduction of taxation of the retained profit of a foreign entity and of profit on a permanent establishment, in the cases falling within the scope of a controlled foreign company and, what is more, only on the condition that it does not perform material business activity (in accordance with the second rule), on the one hand prevents the tax avoidance in the country through shifting of profits to countries with lower tax rates, and, on the other hand, guarantees the respecting of the fundamental freedoms and does not bring about excessive increase of the administrative burden for the persons.

An amendment was made to the Local Taxes and Fees Act (LTFA), which is related to the introduction of a new concept for determination of the tax on light vehicles and trucks with a technically admissible maximal mass of no more than 3,5 tones through the introduction of a property and ecological component. The property component takes into account the power and year of production of the vehicle and the ecological component takes into account the vehicle ecological category, respectively the pollution caused by the respective vehicle.

In 2018 Regulation Amending and Supplementing Ordinance No. H-1 of 22 January 2014 on the Specific Requirements and the Control Implemented by the Customs Authorities over the Excisable Goods Measurement and Control Devices was prepared and promulgated. A legal amendment was subsequently made to the ordinance related to the need to settle an explicit case in order to avoid different interpretation as to which persons are covered by the scope of the ordinance, in view of the legally prescribed requirements in Article 103c (1) of the Excise Duties and Tax Warehouses Act (EDTWA) that all persons, whether or not taxable under the EDTWA, who receive, unload, keep or remove energy products from ports and customs warehouses, are bound to use means of measuring and control under Article 103a of the EDTWA at the places for entry and removal of energy products in the respective facility, as well as at the places for storage of the energy products in the facility.

In 2018 the Regulation Amending and Supplementing Regulation No. H-7 of 19 September 2016 on the Determination of a Procedure, Manner and Format for Sending Measurement and Control Device Data under Article 103a, paragraph 1 of the EDTWA was prepared and promulgated. The amendment was made in relation to the need of providing for clear rules about the format for transferring data from the measurement and control devices under Article 103a (1) of the EDTWA, taking into account the respective specificity of the excisable product being measured, as well as the type of the taxable person.

Measures geared to optimise the control activity of revenue administrations, in view of preventing the possibilities evasion of and failure to pay taxes and tax evasion or avoidance

An amendment to the VAT Act was adopted for generation in an electronic form of the fiscal/system slip and the submission thereof to the buyer, in the cases of sales of goods or services through an electronic shop where there is no physical contact between the supplier and the recipient under the supply. NRA will maintain a public electronic list of the electronic shops, through which Bulgarian obligated persons perform commercial activity on the internet, for the purpose of protecting the consumers when shopping online and decreasing the grey sector in the online commerce.

For the purpose of removing the disproportionality of the administrative sanctioning rule applied by the law, the measure for coercive sealing of a site for a term of 30 days in the cases of failure to comply with the procedure or manner of day-to-day reporting of the turnovers from sales, when this is mandatory, was repealed.

A provision was adopted in the EDTWA, which introduces joint and several liability for the collection of the excise-duty obligations in the cases of consumption of energy products otherwise than in compliance with the conditions for exemption from payment of excise duty. The purpose is to avoid the refund of excise duty upon failure to meet the conditions with respect to the ultimate intended use, and in cases of supply of energy products for refuelling/recharging of vessels and aircrafts. The amendment is in compliance with Article 21 (4) of Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity.

It was provided for that for the purposes of arising of the obligation for payment of excise duty there is no need of presence of an identified violation, including with a legally effective penal decree, for an audit procedure to be able to be conducted.

An amendment was made aimed at the creation of a legal framework of the condition for payment of the full excise duty obligation in case the annual admissible production of 200 000 hectolitres of beer by a person awarded a certificate of independent small brewery is exceeded.

Texts in EDTWA related to the prohibition of the publication of announcements and messages, including in electronic form, through which excisable goods as well as tobacco waste are offered for sale, were refined. The prohibition does not apply to traders offering alcoholic beverages through an electronic shop when the goods are with excise label on them, when such is obligatory, or the excise duty due is paid.

Regarding the statutory registration of the specialized small distilleries and of the wine-making establishments of small winemakers was established an identical procedure corresponding to the other procedures in the EDTWA, which is related to the finding of irregularities on the part of the customs administration upon the submission of documents to the request for issue of registration by the persons, respectively provision of an identical procedure for remedial of the irregularities or completion of the proceeding before the head of customs. In this relation, the respective supplementations to Article 142a and Article 142b were made in the Wine and Alcohol Beverages Act.

For the purpose of avoiding difficulties in the utilisation of bank guarantee amounts, the text was amended, implementing the obligation prescribed for the bank – joint and several guarantor in item 2 of the bank guarantee form under annex No.9e of the Excise Duties and Tax Warehouses Act

Implementing Regulations with the hypothesis of excise duty obligations upon the termination of the operation of the tax warehouse management license.

A legal possibility was provided for in the Excise Duties and Tax Warehouses Act, to seal sites or parts of them for a definite period of time by the customs authorities, upon full or partial utilisation of the security, for the purpose of preventing generation of additional public obligations.

Legal framework was introduced, according to which a permit for trade in tobacco products must be issued to sites for refuelling of motor vehicles. The term “gas station” used until the amendment is restrictive.

Article 78 of the Excise Duties and Tax Warehouses Act Implementing Regulations was amended in relation to the obligation of licensed warehousekeepers to document recorded losses from natural wastage. The change is aimed at creating an imperative provision, which imposes an obligation to file a standard document together with the excise declaration, to increase the effectiveness of the excise control. In the cases where for the respective tax period are recorded and entered in the "Warehouse Stock Log" register natural losses, they should be established upon completion of an inspection (inventory) by the licensed warehouse keepers, documented with a document in accordance with the model Appendix No. 23 of the Excise Duties and Tax Warehouses Act Implementing Regulations.

An amendment was adopted to the LFTA, which is related to the prevention of unfair use of a tax relief for the main dwelling. The real estate tax is determined in full for all dwellings of the taxable person, provided that it is ascertained that they are declared as main dwellings and for the period, in which they are simultaneously declared as main dwellings.

A 7-day term after the performance of a transaction or action for the acquisition of a real estate or motor vehicle was introduced for the notaries to notify the relevant municipality of the transferred in-rem rights in the real estate or the motor vehicle, as well as to provide information for the amount of the tax paid and for the basis, on which it is assessed.

Measures for reducing the administrative burden and compliance costs for business and for the citizens

Amendments were made in 2018 in all tax laws for reducing the administrative burden and compliance costs for business and for citizens. A part of these measures are geared towards relieving the administrative regimes and procedures, and another part are related to an increase in the share of the electronically submitted documents.

Amendments were made to the CITA, the PITA and the VAT Act with respect to the obligations for the last tax period under the respective law. The objective of the introduced amendments is to relieve the process of declaration and payment of the tax for the last tax period, as the time-limit for submission of tax returns and for payment of the respective taxes is unified for all hypotheses of deregistration/ dissolution of a person taxable under the CITA or the PITA. For the purpose of relieving the persons upon deregistration under the VAT Act the time-limit for payment of the tax under the tax return for the last tax period is intended to increase until the end of the calendar month following the month, in which it should have been filed.

The creation of a new article in the EDTWA created a legal regulation of the possibility for annulment/ deactivation of wrongfully submitted requests, lists and reports concerning excise duty labels on the person’s written request.

As regards the use of tax reliefs for young families, for children and for children with disabilities, an amendment was made to the PITA, whereby the obligation to enclose to the annual tax return a written declaration from the spouse that he/she will not use a tax relief is removed. To avoid abuses related to the relieved regime of use of these tax preferences, recovery of the part of the tax by both parties, which corresponds to the amount of the relief used is provided for, if the tax relief was unlawfully applied by both persons.

An amendment was adopted in the regime of taxation of the acquired cash and in-kind prizes from games, contests and competitions, which are not provided by an employer or principal, as the change is from imposition of tax on the annual tax base to imposition of final tax. There is no longer obligation either of the enterprises paying the prizes to issue certificates. At the same time, the value of the non-taxable prizes increased from BGN 30 to BGN 100, which will also relieve both those who received such prizes and the payers of the prizes.

A new provision was introduced in the PITA, which makes more precise the way of rounding of the annual personal income taxes, so that the tax due subject to further payment according to an annual tax return is to be paid without stotinkas but in levs only.

In 2018 a completely new concept for removal of the paper carrier of the certificates under Article 45 of the PITA for the taxable income acquired throughout the year and the deducted tax of natural persons, was introduced, as it was intended in this relation to eliminate the legal obligation of the employers to issue certificates, and to provide for that this will only happen on the request of the persons. The mechanism of the change provides for that the information from the certificate will be provided by the income payers with the information statement submitted by them under Article 73 (1) of the PITA after small supplementations to its present form. In this way, in addition to the elimination of the obligation for issue of the certificates and of the obligation to enclose them to the annual tax return, the submitted data will be automatically loaded in the forms of the annual tax returns of the persons, which will considerably streamline the process of their electronic filling-in and submission. The introduction of this concept with all the resulting changes is intended to enter into force for incomes paid after 31 December 2018, as their earlier adoption is intended to support the preparation and the trouble-free application of the change by the affected parties.

An amendment was made to the LFTA, pursuant to which notaries must make an inspection – when a transaction or an act of acquisition of a motor vehicle is made – of the presence or absence of tax obligations with respect to the motor vehicle through automated data exchange with the information exchange system maintained by the Ministry of Finance.

There is no longer a requirement to affix a seal of the enterprise and a seal of the accounting enterprise on annual financial statements due consideration being given to the fact that there is no legal instruction in the country providing for a requirement for the corporate enterprises to have a seal.

In view of the general trend towards electronic submission of data to the National Revenue Agency and reduction of the administrative burden, a change was made whereby the register of intra-community supplies of new transport vehicles, in respect of which recipients are persons not registered for VAT purposes in other member states is to submitted electronically rather than on a technical carrier.

An amendment was adopted, according to which the enterprises payers of incomes, as well as self-employed persons within the meaning of the Social Security Code are supposed to file only electronically the tax return under Article 55 (1) and the tax return under Article 73 (1) of the PITA.

For the purpose of reducing the administrative burden for licensed warehouse holders, registered recipients, temporarily registered recipients and registered senders, the amendments made to the EDTWA ruled out the need of providing the customs administration with the names of the employees authorized to sign electronic administrative documents and specimens of their signatures.

Moreover, in view of reduction of the administrative burden concerning the compliance with the Customs Act (CsA) amendments were made to the Customs Act. With the aim of restructuring customs offices, which will in the long run bring about cutting the budgetary expenditure, increase in the revenues made by the Customs Agency, as a result from intense control in the field of customs, excise-duty and FX violations and offences, improved effectiveness of the operation of the customs offices, including the effectiveness upon the implementation of the customs control and supervision, achievement of higher effectiveness and efficiency in the human resource management in the administration, enhancement of the quality of the administrative capacity and better quality servicing of the public and economic interest.

The amendments that entered into force in 2018 to the Excise Duties and Tax Warehouses Act Implementing Regulations (EDTWAIR) are directly relevant to the reduction of the administrative burden for the business, by optimizing the administrative procedures for the issue of an authorization for trade in tobacco products by the customs authorities. The first measure is related to the removal of the requirement for the persons registered in the Commercial Register who undertake to submit to the customs authorities a request for the issue of authorization for trade in tobacco products as well as to enclose also to the required documents a declaration that they are not in bankruptcy or liquidation proceedings. The presence of this circumstance is only declared by the persons who are not registered in the Commercial Register. The second amendment is directed towards the removal of the obligation for the persons filing a request for the issue of an authorization for trade in tobacco products to declare before the customs authorities the circumstance that they did not perform trade and/or storage of tobacco products without authorization in the last 24 months. In view of the introduced amendments, a respective modification is also set forth in the forms of documents, annex to the regulations implementing the law.

In view of the legally determined time-limit in Article 80 (7) of the law and for the purpose of avoiding difficulties upon the adoption of annexes to bank guarantees, amendments to EDTWAIR were introduced. According to the adopted rule the trader's seat and registered address is not specified in the document form.

The provision of Article 72b (6) of EDTWAIR, according to which the economic operators are obligated to file the excise-duty declaration after the payment of the excise duty due, which happens too often in the end of the prescribed period, was repealed. This removes the reason for delay of the submission of declarations by the persons and impedes the process of receipt and processing thereof. The customs authorities may ex officio establish the date of payment of the excise duty to the budget.

In accordance with the amendments to the EDTWA towards reduction of the administrative burden for the economic operators, EDTWAIR no longer contains the requirement that the persons must submit a criminal conviction certificate, except for those who are not Bulgarian citizens and who remain obligated to declared this circumstance.

National Revenue Agency (NRA)

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

- **Improvement of the conditions for voluntary compliance with the legislation:**
    - Constant monitoring and communication with obligated persons forming a significant share of the economy in the country;
    - Improvement of the approach encouraging the voluntary fulfilment of the obligations on the part of good-faith persons;
    - Appointment of meetings with obligated persons for the purpose of encouraging the voluntary fulfilment and preventing tax evasion and avoidance. Improvement of service in view of stimulating voluntary fulfilment through:
    - Applying innovative solutions upon the provision of services;
    - Streamlining the administrative procedures and requirements related to declaring and paying obligations;
    - Ex-officio exchange of the information with other administrations;
    - Less public tolerance to the shadow economy and promotion of the rights and obligations of the citizens and business and increased trust in the public administration and the policies.

- **Improvement of the collection of public obligations overdue:**
  - A change in the approach towards and mechanisms of collection of the public obligations in accordance with the Concept for development of the processes and activities of collection of public receivables in the period 2016–2020. Segmenting the approaches to collection of public receivables overdue on the basis of obligated persons classified in terms of behaviour and type, the amount and categorization of their debt.
  - Improvement in the communication, incl. electronically, with debtors, public execution creditors and interested parties for early treatment of the new debt;
  - Early application of methods stimulating voluntary payment of obligations overdue for the public of avoiding the need of applying coercive actions;
  - Implementation of constant monitoring with respect to persons having high fiscal effect obligations.
- **Risk management and development of the control activity**
  - Analyses and periodical assessments of the risk of non-compliance with the legislation and of the presence of indications of concealing profits and other forms of the shadow economy, participation in schemes of tax and/or social insurance frauds or deviations from the usual commercial practice;
  - Implementation of the measures laid down in the Programme for compliance with the legislation and decrease of the risk levels;
  - Improvement and effective exerting of fiscal control over the movement of high fiscal risk goods;
  - Continuation of the joint activities of the Customs Agency and the National Revenue Agency, incl. conducting joint workshops and/or trainings, operating exchange of information and/or joint risk analysis, organisation and performance of inspections or other forms of control, whether individually or jointly;
  - Monitoring and effective control of e-commerce.
- **Intense interdepartmental coordination and cooperation in the ascertainment of tax frauds and violations**
  - Implementation of exchange of information among the National Revenue Agency, the Ministry of Interior, the State Agency for National Security and the Prosecutor's Office, which is related to specific cases of evading the ascertainment and payment of tax liabilities;
  - Functioning in the Specialized Prosecutor's Office of a Specialised unit investigating tax criminal offences related to organized criminal groups;
  - Continuation of the activity of the single interinstitutional coordination centre for counteracting smuggling and controlling the movement of risk goods and cargo set up in 2015.

Customs Agency

In 2018 the Customs Agency (CsA) continued implementing a number of projects related to the development and improvement of the integrated information systems. Within the projects, new components were created or their existing components were improved for the purpose of increasing the quality of service of the citizens and business through the provision of new electronic services, decrease of the administrative burden, timely reflection of changes that occurred in the legal framework, improvement of the processes of shifting to paperless environment, etc.

In 2018 the information systems, components and functionalities that were improved in the Customs Agency are, as follows:

- Bulgarian Excise Duty Centralized Information System (BACIS);
- Module Road Tolls and License Regime (PTRR);
- Uniform “Data warehouse” of the Customs Agency;
- Cognos information platform;
- National Service Desk System;
- ITMS TARIC calculation module;
- Follow-up control (PK) module;
- Risk Analysis Module (MAR);
- “System providing information for governance purposes from customs documents” (MISAA).
- REZMA – Obligations to the Customs Administration Register;
- ecustoms.bg – the electronic portal of the Customs Agency.

In view of implementing more effective control of excise-duty and high-risk goods transported in containers across the internal borders of the Republic of Bulgaria, the Road Tolls and License Regime (PTRR) Module was improved. A new functionality has been developed and implemented allowing (in the presence of several pieces of one type of an excise-duty document accompanying LCLs) inspection of the condition of more than one excise-duty document (up to 5), as well as a functionality directly related to the making of an inspection for the presence of previous instance of passing with an excise-duty document (e-EDD) in an “exit” direction whereby additional control over the transportation of the excisable goods is implemented.

In 2018, in relation to the adopted amendments to the EDTWA and the EDTWAIR, the implementation of the BACIS Improvement Project started in the Customs Agency, which concerns changes in the EMCS module (changes in the delivery receipt under Subparagraph 3 of Article 73b (10) of the EDTWA), changes in the Excise Duty Management System (SUA): “Finance” module (according to § 28 of the Amending and Supplementing Act of the VAT Act); “Registrations”; “Register of Technical Devices”, changes in the Risk Event Identification (IRS) module and the PTRR module, as well as changes in BACIS in relation to the amendments to the EDTWAIR (§§ 2, 3, 18 and 20).

As regards BACIS several projects were finalized in 2018 for development and improvement of the system, as follows:

- “Improvement of BACIS in relation to the changes in the European Specifications in the field of excise-duty information systems, in accordance with the envisaged activities under “EMCS Master Plan” project. The performance of the activities resulted in the putting into operation of EMCS and SEED versions for phase 3.3 of EMCS in February, version 1.1. of SEED, as well as version 1.2 of the SAS (Administrative cooperation system) module in December;
- “Improvement of BACIS in relation to the compliance with Article 103c of the Excise Duties and Tax Warehouses Act – Transitional Project“ project for the purpose of securing the control functions of the customs employees regarding the entry and removal of fuels in and from river and marine ports and the tracking of their movement to a tax/customs warehouse or to a final consumption facility through application of risk event identifiers (REI);
- “BACIS Improvement” project, within which modifications of the system are implemented, which originate from amendments and supplementations to the Excise Duties and Tax Warehouses Act (EDTWA) and the Excise Duties and Tax Warehouses Act Implementing Regulations (EDTWAIR) effective from 2018.

Three projects are scheduled to start in 2019 for the improvement of BACIS in relation to the amendments to the EDTWA and the EDTWAIR, the putting into operation of new information systems that BACIS interacts with and changes in the European specifications of excise-duty systems, and namely:

- Project “Update of the BACIS communication module for sending data to the Fuel Control information System (FCIS) of the National Revenue Agency in relation to the putting into operation of a new CICIS” project. Due to the implementation of the new Customs Import Control Information System (CICIS) from 07 January 2019 a modification is stated in the communication module ensuing the contact between BACIS and the Fuel Control information System (FCIS) of the National Revenue Agency, through which fuel import declarations are automatically sent to the NRA. The project should be completed in the middle of 2019;
- “Improvement of BACIS modules” project, in which modifications will be made in the SUA: “Requests” and “Notices” modules of BACIS, as well as in the provided electronic administrative services under the EDTWA, in relation to amendments to the EDTWA and the EDTWAIR, which enter into effect in 2019. The project is to be completed by 01 July 2019.
- Project for the improvement of “EMCS”, “SEED” and “CAC” modules from “BACIS” in relation to the modifications in the European specifications of the excise-duty systems for EMCS phase 3.4. The modifications made will be implemented in 2020.

Improvement of the BACIS system is forthcoming in 2020 in the Customs Agency in relation to the modifications set in **“**Master Plan v2.95 - CED 563 rev7”, which will be implemented with EMCS phase 3.4 and SEED v.1.12

In relation to BREXIT the CD-BREXIT-2 activities from “EMCS National Project Plan for BREXIT No Deal Scenario” for EMCS and SEED are performed.

The improvement of the ITMS TARIC Calculation Module, which started in 2018, will continue in 2019. In the present 2019, the “System providing information for governance purposes from customs documents” (MISAA) will be improved in view of the need for provision of data from the import operations processed in the new Customs Agency Customs Importing Information System (CIIS).

The measures related to the activity of the Customs Agency in 2018 were focussed on counteracting the excise-duty evasion through the implementation of joint initiatives with other control authorities. In 2018 the Customs Agency participated jointly with the Ministry of Interior (MoI), the Bulgarian Institute of Metrology (BIM), the State Agency for Metrological and Technical Surveillance (SAMTS) and the National Revenue Agency (NRA) in the control of the persons manufacturing and trading in excisable goods. A large number of joint activities and inspections with other state institutions were conducted, as follows:

- Intense control through permanent physical presence (monitoring) in the tax warehouses for manufacturing and storing of tobacco products (Customs Agency jointly with the National Police General Directorate - Gendarmerie Directorate). The intense control will continue in 2019 too;
- Permanent physical presence during the unloading of fuels from vessels in the period January-June 2018 (Customs Agency jointly with the National Police General Directorate, the Border Police General Directorate and the General Directorate for Combating Organized Crime). The activity was conducted in relation to the setting of port operators and customs warehouses, where energy products and unloaded and re-loaded, in compliance with Article 103c of the EDTWA;
- Intense control through permanent physical presence (monitoring) in a tax warehouse for manufacturing and storing of ethyl alcohol (Customs Agency jointly with the National Police General Directorate - Gendarmerie Directorate). The activity conducted in the autumn of 2018 ~~is~~ was a result of customs authorities’ inspections, during which possibilities were identified excisable goods to be removed from the production facility without indicating it by means of measuring devices and means of control;

- Joint inspections with the NRA bodies during the active summer tourist season of 2018, which were carried out at sites along the Bulgarian Black seaside.
- Joint inspections with the NRA, MoI, BIM and SAMTS authorities in facilities for trading with liquid fuels. Most of these inspections were organized by the Interdepartmental Coordination Centre – General Directorate for Combating Organized Crime and conducted under its coordination.

In addition, in the period 01 January 2018 – 31 December 2018 45 audits were made for identification, alteration and/or set-off of excise-duty obligations, as well as for recovery and/or set-off of amounts paid by or collected from the person without being due under the procedure of the Tax and Social Security Procedure Code, in conjunction with the provisions of the EDTWA. The obligations for payment of an excise duty ascertained by certificates of audit amount to BGN 22 000 757.98, interests in arrears – BGN 2 409 507.44 and overpaid excise-duty amounts – BGN 194 791.54. The amounts effectively received in the state budget are BGN 1 984 666. 9 from excise duties and BGN 254 205.85 from interests. Compared to the same period of the last year, the number of conducted audit procedures increases by 7.14 %, and at the same time the growth in the identified obligations is 82.54 %.

For the period January-December 2018, 178 inspections (crosschecks, delegation based, for the ascertainment of facts and circumstances) were made. Compared to the same period for the last year, the number of inspections made increases by 14.1 %.

For the sake of reduction of the administrative burden and compliance costs for business and for the citizens the renovated webpage of the Customs Agency was also put into operation in 2018. This webpage was built on the basis of an agreement between the Customs Agency and the State E-Government Agency. Through the implementation of the “Upgrade of the existing, and construction of new, central e-government systems in view of improving the information and communication environment for better administrative servicing of the citizens and business” project – Contract No. К13-32-1/30 September 2013, implemented with the financial support of Operational Programme “Administrative Capacity”, co-financed by the European Union, through the European Social Fund, the Customs Agency was elected for integration of its institutional site as a federated portal to the Single Portal for Access to Electronic Administrative Services (SPAEAS). According to an agreement (the State E-Government Agency – reg. No. 15 of 22 November 2017 Customs Agency – reg. No. 32-10.11.2017) the State E-Government Agency grants to the Customs Agency free of charge the right to use a federated portal of the Customs Agency in the SPAEAS (the Federated Portal) and all content and functionality management related means, within the environment, with which the egov.bg portal is developed.

The Customs Agency is the administrator of REZMA put into operation in the Customs Agency with Order No. 142/12 April 2010 of the Director of the Customs Agency. The activities performed towards the improvement of the register in 2018 (building new functionalities) were also imposed by the measures adopted by the government to reduce the administrative burden for the citizens and business. The Customs Agency issues certificates of the presence or absence of obligations for public state receivables as an administrative service under No. 381 “Issue of a certificate of the presence or absence of obligations for public state receivables collected by the Customs authorities”, which is registered in the Administrative Register in accordance with Article 61 (4) of the Administration Act and the Ordinance on the Administrative Register. A legal ground for the provision of the service is Article 87 (6), Article 87 (10) and Article 87 (11) of the Tax and Social Security Procedure Code, in conjunction with Article 162 (2) of the Tax and Social Security Procedure Code. The information is provided without indication of a specific amount of the obligations when the persons have obligations. The certificate is issued both on a paper carrier and electronically. This takes place through a Single point of access to the e-services provided by the Customs Agency, on the following URL: https://onlinefrontoffice.ecustoms.bg/customs/aidaportal.nsf/serviceDesc.xsp.

The electronic administrative service is relevant to all who file applications for the issue of certificates under the procedure of Article 87 (6), Article 87 (10) and Article 87 (11) of the Tax and Social

Security Procedure Code. REZMA is joined to the RegiX platform and data for the obligations may be submitted to all administrations in the Republic of Bulgaria, which have presented themselves as consumers. The data covers information for customs and excise-duty obligations. For the period 01 January 2018 – 31 December 2018, the Customs Agency issued on a paper carrier 957 certificates of presence or absence of obligations under the procedure of Article 87 of the Tax and Social Security Procedure Code.

CHAPTER 6
INSTITUTIONAL FEATURES OF PUBLIC FINANCES

6.1 National budgetary rules

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

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

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

As regards the scope, there are rules for indicators both under the national methodology – for the budget balance and the expenditures under the consolidated fiscal programme (on a cash basis) and for the state debt, as well as indicators in accordance with the European methodology – for the General Government (for some rules as well as for its relevant subsectors) – for the medium-term budgetary objective for the structural deficit, the budget balance and the consolidated debt of the General Government .

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

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

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

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

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

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

In the beginning of March 2019 it was established that the municipalities, which meet three and more criteria for being classified as municipalities in financial difficulty, are 17 municipalities, against 13 municipalities classified as municipalities in financial difficulty in 2018. The municipalities included in the list of municipalities with financial difficulties in 2019, compared to 2018, are 8, of which only Tsar Kaloyan municipality is determined as such a municipality for the first time from the introduction of the conditions referred to in Article 130a (1) of the PFA for determination of municipalities with financial difficulties.

The municipalities that in 2019 cease to be on the list of municipalities with financial difficulties are 4. It is assumed with respect to them that the recovery measures and plans adopted by them brought about positive results and improvement of one or several indicators, on the basis of which an evaluation of their financial condition is made.

The municipalities that are permanently on the list of municipalities with financial difficulties in 2016, 2017, 2018 and in 2019 are 7, incl. the municipalities of Septemvri, Pernik and Stambolovo, in respect of which financial recovery places are coordinated on the grounds of Article 130f (4) of the PFA.

The established in 2015 independent Fiscal Council of Bulgaria contributes to the improvement of the quality of the budgetary framework and is a reference point with respect to the fiscal policy being conducted by the government, considering the functions performed by it related to monitoring the adherence to the numerical fiscal rules and for indicating the presence of potential risks for the budget. In the beginning of February 2019, with the amendments to the Fiscal Council and Automatic Corrective Mechanisms Act, the powers of the Council were further reinforced – a new obligation was introduced for the performance of a periodical and ex post evaluation of the macroeconomic and budgetary forecasts of the Ministry of Finance. In this way full transposition in the Bulgarian legislation of Directive 2011/85/EU on budgetary frameworks of the Member States was achieved, as well as the role of the Fiscal Council as an independent observer of the fiscal rules was further strengthened.

6.2 Budgetary procedures

- **Budgetary procedure for 2020**

Budgeting is a constant process but the stages and steps for the implementation thereof develop subject to many factors – organizational, economic, political, statutory and others, which predetermine the need for the development of a time-table for the organization of the process of planning and composition of the budgetary documents.

Since the PFA defines the main stages and participants in the budgetary procedure, as well as the deadlines for the composition of the budgetary documents, the structuring of a budgetary procedure is not a challenge. However, at the same time, the constant strive to improve the quality of the budgetary documents as a form of expression of the good management of the public finance requires that the budgetary procedure takes into account both the varying requirements to all responsible institutions, and the requirements to Bulgaria as a member state within the so called European Semester – the timetable, through which consistency of the national economic and budgetary policies is implemented within the European Union.

The budgetary procedure for 2020 was drawn up in accordance with the rule and requirements of the Public Finance Act, as its preparation reflected the requirements set for the structure and contents of the key budget documents and the deadlines for their adoption. The procedure was approved by Resolution No. 52 of the Council of Ministers of 31 January 2019.

In terms of scope and participants in the budgetary process, the responsibilities of all institutions (budgetary organizations) whose budgets are a part of the consolidated fiscal programme, but also of other legal entities falling within the scope of the General Government, are defined in the procedure.

With the budgetary procedure for 2020 the Council of Ministers resolved that all first-level spending units whose budgets are a part of the state budget (except for the budgets of the Judiciary and of the National Audit Office) shall apply programme budgeting. The first-level spending units, which are newly ordered to apply programme budgeting must initially formulate functional areas and budgetary programmes, as well as indicators for measuring the performance against the products/services provided under the budgetary programmes within the scope of their competence and responsibility. This process is expected to increase the accessibility and transparency of the information about the performance of the functions of the budgetary organizations and their contributions to the benefits for the public, which result from the acts of the Executive branch for the citizens and business.

Another important point related to the initiative for the performance of checks of the expenditure for the purpose of increasing their effectiveness upon the implementation of the policies in various sectors and lines, is that by the resolution for the budgetary procedure, the government assigned the Minister of Finance and the Minister of Foreign Affairs with the organization of a review of the expenditure under the budget of the Ministry of Foreign Affairs, along mutually agreed thematic lines in the current year. The agreement signed defines also the roles and responsibilities of the stakeholders, in accordance with terms of reference.

The procedure for 2020 is divided into two main stages.

At the first stage of the procedure, in April 2019 the Council of Ministers will consider and approve the Medium-Term Budgetary Forecast for the period 2020-2022 and adopt the standards for the state-delegated activities with natural and value indicators in 2020, as well as the motives prepared by the Minister of Finance upon rejection of the reasoned opinion and the recommendations of the Fiscal Council about the spring macroeconomic forecast and/or the Medium-Term Budgetary Forecast for the period 2020-2022. In June 2019, the Council of Ministers will consider and approve the draft resolution drawn up by the Minister of Education and Science for approving the maximum amount of the new state guarantees that may be issued in 2020 under the Students and Doctoral Students Crediting Act, as well as the draft resolution drawn up by the Minister of Finance for approving the projects that will be financed with state and/or state-guaranteed loans in 2020. The stage will end in July with the setting by the first-level spending units of their budgetary forecasts for the period 2020-2022 in conformity with the resolutions adopted by the Council of Ministers.

At the second stage of the procedure, the Ministry of Finance will prepare the draft State Budget Act of the Republic of Bulgaria for 2020 and the draft acts amending and supplementing the tax laws. By the end October 2019, the Council of Ministers will consider and approve the drafts drawn up by the Minister of Finance of the State Budget Act of the Republic of Bulgaria for 2020 and of an updated Medium-Term Budgetary Forecast for the period 2020-2022, which is reasoning to the draft act, as well as of reasoning in case of rejection of the reasoned opinion and the recommendations of the Fiscal Council about the autumn macroeconomic forecast and/or draft State Budget Act of the Republic of Bulgaria for 2020 and the updated Medium-Term Budgetary Forecast for the period 2020-2022. In the same term, the Council of Ministers will consider and approve the drafts prepared by the Head of the National Health Insurance Fund and submitted through the Minister of Health to the Council of Ministers of the Budget of the National Health Insurance Fund for 2020 Act and of reasoning in case of rejection of the reasoned opinion and the recommendations of the Fiscal Council about the draft act, as well as the drafts prepared by the Head of the National Social Security Institute and submitted through the Minister of Labour and Social Policy to the Council of Ministers of the Budget of the Public Social Security for 2020 Act and of reasoning in case of rejection of the reasoned opinion and the recommendations of the Fiscal Council about the draft act.

The holding of consultations with the National Association of the Municipalities in the Republic of Bulgaria on the draft State Budget Act of the Republic of Bulgaria for 2020 in its part concerning the municipalities, including for further specification of the total amount of the main budgetary relations of the municipal budgets with the central budget is also a part of the second stage. If need arises, the Council of Ministers will approve amendment and supplementation to the resolution for the adoption of standards for the state-delegated activities with natural and value indicators in 2020.

Within one month from the promulgation in State Gazette of the State Budget Act of the Republic of Bulgaria for 2020, the Council of Ministers shall adopt on a proposal of the Minister of Finance a Decree for the Implementation of the State Budget of the Republic of Bulgaria for 2020.

If necessary, within one month from the promulgation of the State Budget Act of the Republic of Bulgaria for 2020, the Budget of the Public Social Security for 2020 Act, the Budget of the National Health Insurance Fund for 2020 Act and of the tax laws, the Council of Ministers will hold a session where it will consider and approve modifications in the updated Medium-Term Budgetary Forecast for the period 2020-2022 in accordance with the parameters of the adopted laws.

If necessary, within one week from the approval of the modifications in the updated Medium-Term Budgetary Forecast for the period 2020-2022, the first-level spending units under the budgets of the budgetary organizations which are ordered to apply programme budgeting will update the programme formats of their budgets, send them to the Ministry of Finance, the Court of Auditors and the National Assembly and publish them on their webpages upon observance of the requirements of the Protection of Classified Information Act, and the budgetary procedure for 2020 thereby ends.

In view of supporting the processes of planning, development and updating of the Medium-Term Budgetary Forecast and the planning and drawing-up of the draft-budgets of the spending units, including in case of programme budgeting, the Minister of Finance must issue detailed instructions at both stages of the budgetary procedure.

The time-limits and the responsible budgetary organizations that are to publish on their webpages the respective documents related to the budgetary procedure for 2020 are determined.

The compliance with the budgetary procedure creates conditions for transparency and is an element of the good governance of public finance. The good-faith participation in the budgetary process by all budgetary organizations is a condition for the overall success of the procedure and a premise for the achievement of the desired final outcomes from the conduction thereof, and namely sustainable Medium-Term Budgetary Forecast and annual state budget.

CHAPTER 7
ANNEX A

Table 1a: Macroeconomic prospects

	ESA 2010 code	2018	2018	2019	2020	2021	2022
		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	104 156	3.1	3.4	3.3	3.3	3.3
Nominal GDP	B1*g	107 925	6.8	7.0	6.4	6.2	6.1
Components of real GDP							
Private consumption expenditure	P.3	66 830	6.4	4.6	4.5	4.1	3.9
Government consumption expenditure	P.3	17 818	4.7	4.5	2.1	2.0	2.0
Gross fixed capital formation	P.51	20 549	6.5	9.9	5.0	6.3	6.8
Change in inventories and net acquisition of valuables (% of GDP)	P.52+ P.53	1 814	1.6	1.6	1.6	1.6	1.6
Export of goods and services	P.6	69 606	-0.8	1.8	2.0	1.8	1.7
Import of goods and services	P.7	68 691	3.7	5.0	3.3	3.2	3.2
Contributions to real GDP growth (In percentage points)							
Final domestic demand		-	5.8	5.5	4.1	4.2	4.2
Change in inventories and net acquisition of valuables	P.52+P.53	-	0.1	0.0	0.1	0.1	0.1
External balance of goods and services	B.11	-	-2.8	-2.1	-0.9	-0.9	-0.9

Table 1b: Price developments

	ESA 2010 code	2018	2018	2019	2020	2021	2022
		Level	Rate of Change[45]	Rate of Change	Rate of Change	Rate of Change	Rate of Change
GDP deflator		100	3.6	3.4	3.0	2.8	2.7
Private consumption deflator		100	2.5	2.0	2.5	2.3	2.3
HICP[46]		100	2.6	1.8	2.5	2.3	2.2
Public consumption deflator		100	7.9	2.6	2.9	2.6	2.6
Investments deflator		100	3.3	3.1	4.0	3.5	2.8
Export price deflator (goods and services)		100	3.0	3.2	0.4	0.7	1.0
Import price deflator (goods and services)		100	2.9	1.4	0.3	0.4	0.6

Table 1c: Labour market developments

	ESA 2010 code	2018	2018	2019	2020	2021	2022
		Level	Rate of Change	Rate of Change	Rate of Change	Rate of Change	Rate of Change
Employment (thousand persons)[47]		3 521.6	-0.1	0.4	0.2	-0.1	-0.3
Employment (millions of hours worked)[48]		5 791.6	0.0	0.4	0.2	-0.2	-0.4
Unemployment[49]		5.2	5.2	4.6	4.1	4.0	4.0
Labour productivity (BGN per person employed)[50]		30 646.3	3.2	3.0	3.1	3.4	3.6
Labour Productivity (BGN per hour worked)[51]		18.6	3.1	3.0	3.1	3.5	3.7
Compensation of employees (MBGN)[52]	D.1	46 504	6.5	8.4	6.9	6.2	5.7
Compensation per employee		17 845	5.6	7.8	6.6	6.3	6.1

45 Percentage change as compared to the previous year.
46 Optional for Stability Programmes.
47 Occupied population, national accounts definition.
48 National accounts definition.
49 Harmonised definition, Eurostat; levels.
50 Real GDP per one person employed.
51 Real GDP per one hour worked.
52 In MBGN.

Table 1d: Sectorial balances

% of GDP	ESA 2010 code	2018	2019	2020	2021	2022
Net lending/borrowing vis-à-vis the rest of the world	B.9	6.0	3.9	2.7	2.0	0.5
of which: –balance of goods and services		1.9	0.3	-0.4	-1.0	-1.8
–balance of primary incomes and transfers		2.7	2.2	1.8	1.8	1.0
–capital account		1.4	1.4	1.3	1.3	1.3
Net lending/borrowing of the private sector	B.9	4.0	4.3	2.3	1.8	0.4
Net lending/borrowing of the general government	EDP B.9	2.0	-0.3	0.4	0.2	0.1
Statistical discrepancy		-	-	-	-	-

Table 2a: General government budgetary prospects

	ECC 2010	2018*	2018	2019	2020	2021	2022
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	2 148.7	2.0	-0.3	0.4	0.2	0.1
2. Central government	S.1311	1 899.5	1.8	-0.3	0.3	0.2	0.0
3. State government	S.1312		0.0	0.0	0.0	0.0	0.0
4. Local government	S.1313	144.8	0.1	0.0	0.0	0.0	0.1
5. Social security funds	S.1314	104.4	0.1	0.0	0.0	0.0	0.0
6. Total revenue	TR	39 677.2	36.8	37.7	37.3	36.9	36.1
7. Total expenditure	TE	37 528.5	34.8	38.0	36.9	36.7	36.0
8. Net lending / borrowing	EDP B.9	2 148.7	2.0	-0.3	0.4	0.2	0.1
9. Interest expenditure	EDP D.41	712.9	0.7	0.6	0.6	0.5	0.5
10. Primary balance		2 861.6	2.7	0.3	0.9	0.7	0.6
11. One-off and other temporary		0.0					

measures							
12. Total taxes (12=12a+12b+12c)		22 589.6	20.9	21.9	21.8	21.6	21.3
12a. Taxes on production and import	D.2	15 956.7	14.8	15.7	15.5	15.4	15.1
12b. Current taxes on income, wealth, etc.	D.5	6 347.3	5.9	5.9	6.0	6.0	5.9
12c. Capital taxes	D.91	285.6	0.3	0.2	0.3	0.2	0.2
13. Social contributions	D.61	9 514.1	8.8	9.0	9.0	8.9	8.7
14. Property income	D.4	747.4	0.7	0.7	0.5	0.5	0.5
15. Other		6 826.0	6.3	6.1	6.0	5.9	5.6
16=6. Total revenue	TR	39 677.2	36.8	37.7	37.3	36.9	36.1
Tax burden (D.2+D.5+D.61+D.91-D.995)		32 103.7	29.7	30.9	30.7	30.5	30.0
17. Compensation of employees + intermediate consumption	D.1+P.2	15 731.8	14.6	14.5	14.3	14.1	13.6
17a. Compensation of employees	D.1	10 264.0	9.5	9.7	9.8	9.7	9.2
17b. Intermediate consumption	P.2	5 467.9	5.1	4.8	4.5	4.4	4.4
18. Total social transfers (18=18a+18b)		14 269.8	13.2	13.7	13.7	13.6	13.4
of which Unemployment benefits	D.621, D.624	431.4	0.4	0.4	0.4	0.3	0.3
18a. Social transfers in kind	D.6311. D.63121. D.63131	2 263.6	2.1	2.6	2.6	2.7	2.7
18b. Social transfers other than in kind	D.62	12 006.3	11.1	11.1	11.1	10.9	10.7
19=9. Interest expenditure	EDP D.41	712.9	0.7	0.6	0.6	0.5	0.5
20. Subsidies	D.3	1 488.4	1.4	2.5	2.3	2.2	2.0
21. Gross fixed capital formation	P.51	3 143.5	2.9	4.5	4.0	4.4	4.5
22. Capital transfers	D.9	1 115.3	1.0	0.7	0.5	0.3	0.3
23. Other		1 066.6	1.0	1.5	1.5	1.6	1.6
24=7. Total expenditure	TE1	37 528.5	34.8	38.0	36.9	36.7	36.0
Government consumption (nominal))	P.3	17 817.5	16.5	16.6	16.3	16.1	15.9

* Income from the sale of emission permits is reported as a decrease in D.99 "Other capital expenditure" in 2017 and 2018. For the period 2019-2022, this revenue was reclassified to D.2 " Taxes on production and import ". In accordance with the Eurostat guidelines, the NSI will review the data for General Government sector in October 2019.

Table 2b: No-policy change projections

	2018	2018	2019	2020	2021	2022
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Total revenue at unchanged policies	39 677.2	36.76	36.43	36.83	36.43	36.05
2. Total expenditure at unchanged policies	37 528.5	34.77	36.14	36.04	35.67	35.55

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

	2018	2018	2019	2020	2021	2022
	Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	1 507.1	1.4	1.6	1.3	1.2	1.1
1a. Investments fully matched by EU funds revenue	978.2	0.9	1.1	0.9	0.8	0.8
2. Cyclical unemployment benefit expenditure	431.4	0.4	0.4	0.4	0.3	0.3
3. Effect of discretionary revenue measures	1 142.3	1.1	1.2	0.5	0.4	0.0
4. Revenue increases mandated by law	0.0	0.0	0.0	0.0	0.0	0.0

Table 3: General government expenditure by function

% of GDP	ESA 2010 code	2017	2022
1. General public services	1	3.2	3.8
2. Defence	2	1.1	1.6
3. Public order and safety	3	2.5	2.1
4. Economic affairs	4	4.0	6.5
5. Environmental protection	5	0.7	0.7
6. Housing and community amenities	6	1.6	1.0
7. Healthcare	7	4.9	4.7
8. Recreation, culture and religion	8	1.0	0.6
9. Education	9	3.6	3.7
10. Social protection	10	12.5	11.3
11. Total expenditure (= item 7 = 24 of Table 2)	TE1	35.1	36.0

Table 4: General government debt developments

% of GDP	ESA code	2018	2019	2020	2021	2022
1. Gross debt[53]		**22.6**	**20.6**	**19.1**	**17.8**	**16.7**
2. Change in gross debt level		**- 3.0**	**-2.1**	**-1.5**	**-1.3**	**-1.1**
Contributions to changes in the gross debt to GDP ratio						
3. Primary balance[54]						
4. Interest expenditure[55]	EDP D.41	**0.6**	**0.5**	**0.5**	**0.5**	**0.5**
5. Stock-flow adjustment						
of which:						
Differences between cash and accruals[56]						
Net accumulation of financial assets[57]						
of which: privatisation proceeds						
Valuation effects and other[58]						
Implicit interest rate on debt[59]		**2.5**	**2.5**	**2.7**	**2.7**	**2.9**
Other relevant variables						
6. Liquid financial assets[60]						
7. Net financial debt (7=1-6)						
8. Debt amortization since the end of the previous year		**9 .6**	**7 .0**	**6 .0**	**4 .7**	**13 .7**
9. Percentage of debt denominated in foreign currency		**80 .1**	**81 .5**	**80 .1**	**80 .8**	**79 .3**
10. Average maturity		**7 .1**	**6 .7**	**6 .3**	**5 .7**	**6 .2**

53 As defined in Regulation 479/2009 (not an ESA concept).

54 Cf. item 10 in Table 2.

55 Cf. item 9 in Table.

56 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.

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

58 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.

59 Approximately calculated as interest expenditure divided by the debt level of the previous year.

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

Table 5: Cyclical developments

% of GDP	ESA 2010 code	2018	2019	2020	2021	2022
1. GDP growth (%)		3.1	3.4	3.3	3.3	3.3
2. Net lending of general government	EDP B.9	2.0	-0.3	0.4	0.2	0.1
3. Interest expenditure	EDP D.41	0.7	0.6	0.6	0.5	0.5
4. One-off and other temporary measures		0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		3.3	3.4	3.3	3.2	3.1
Contributions:						
labour		0.4	0.2	0.1	-0.1	-0.3
capital		1.0	1.2	1.2	1.3	1.4
total factor productivity		2.0	2.0	2.0	2.0	2.0
6. Output gap		0.0	0.1	0.1	0.2	0.4
7. Cyclical budgetary component		0.0	0.0	0.0	0.1	0.1
8. Cyclically-adjusted balance (2-7)		2.0	-0.3	0.3	0.2	0.0
9. Cyclically-adjusted primary balance (8+3)		2.6	0.3	0.9	0.7	0.5
10. Structural balance (8-4)		2.0	-0.3	0.3	0.2	0.0

Table 6: Divergence from previous update

	ESA 2010 code	2018	2019	2020	2021	2022
Real GDP growth (%)						
Previous update		3.9	3.8	3.7	3.7	
Current update		3.1	3.4	3.3	3.3	3.3
Difference (p.p.)		-0.8	-0.4	-0.4	-0.4	
General government net lending (% of GDP)	EDP B.9					
Previous update		0.0	0.3	0.5	0.2	
Current update		2.0	-0.3	0.4	0.2	0.1
Difference (p.p.)		2.0	-0.6	-0.1	0.0	
General government gross debt (% of GDP)						
Previous update		23.3	22.1	20.7	19.4	
Current update		22.6	20.6	19.1	17.8	16.7
Difference (p.p.)		-0.7	-1.5	-1.6	-1.6	

Table 7: Long-term sustainability of public finances

% of GDP	2007	2010	2020	2030	2040	2050	2060	2070
Total expenditure	37.6	35.9	36.9	36.9	37.1	38.5	39.3	38.6
Of which: age-related expenditures	15.1	17.8	17.3	17.3	17.5	18.8	19.6	18.9
Pension expenditures	7.4	9.3	8.6	8.0	8.1	9.1	9.7	9.3
Social security pension	7.1	9.1	8.4	7.9	7.9	8.9	9.5	9.0
Old-age and early pensions	5.6	7.5	6.9	6.0	6.0	6.9	7.7	7.6
Other pensions (disability, survivors)	1.5	1.6	1.5	1.8	2.0	2.0	1.7	1.4
Occupational pensions (if in general government)								
Healthcare	4.0	4.4	5.0	5.3	5.5	5.6	5.4	5.3
Long-term care								
Education expenditure	3.6	3.6	3.5	3.6	3.6	3.8	4.1	4.0
Other age-related expenditures	0.1	0.4	0.2	0.4	0.4	0.4	0.4	0.4
Interest expenditure	1.1	0.7	0.6	0.4	0.3	0.6	1.4	1.8
Total revenue	38.7	32.8	37.3					
Of which: property income	1.3	1.2						
Of which: from pensions contributions (or social contributions if appropriate)	5.7	7.0						
Pension reserve fund assets								
Of which: consolidated public pension fund assets (assets other than government bonds)								
Social contributions diverted to mandatory additional pension scheme[61]	0.7	1.0						
Pension expenditure paid by mandatory additional pension scheme[62]	0.0	0.0						
Labour productivity growth	2.6	8.0	3.1	3.1	2.5	2.2	1.8	1.5
Real GDP growth	7.3	1.3	3.3	2.1	1.2	0.8	1.2	1.1
Participation rate males (aged 20-64)	78.3	76.8	82.0	84.1	83.9	84.2	85.4	84.8
Participation rate females (aged 20-64)	68.4	67.0	72.2	73.6	73.0	72.8	74.3	73.6
Participation rate total (aged 20-64)	73.3	71.9	77.1	78.9	78.6	78.6	80.0	79.3
Unemployment (%. 15-64)	6.9	10.3	4.1	6.5	6.5	6.5	6.5	6.5
Population aged 65+ over total population	17.3	17.5	21.7	24.6	27.9	31.4	33.3	30.9

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

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

Table 7a: Contingent Liabilities

% of GDP[1]	2018	2019
General Government sector guaranteed debt	0.17	0.22
Of which: linked to the financial sector	0.03	0.03

Table 8: Basic assumptions

	2018	2019	2020	2021	2022
Short-term interest rate (annual average) 6-month LIBOR in EUR, %	-0.32	-0.28	-0.17	0.01	0.24
Short-term interest rate (annual average) 6-month LIBOR in USD, %	2.49	3.22	3.81	3.48	3.19
Long-term interest rate (annual average), %	0.89	0.67	0.74	0.88	1.02
USD/EUR exchange rate (annual average)	1.18	1.13	1.13	1.13	1.13
Nominal effective exchange rate. percentage change. previous year = 100[63]					
EUR/BGN exchange rate (annual average)	1.95583	1.95583	1.95583	1.95583	1.95583
World economy (excluding EU). GDP growth, %	3.7	3.5	3.6	3.6	3.6
EU GDP growth, %	1.9	1.5	1.7	1.6	1.5
Growth of relevant foreign markets. %					
World import volumes, excluding EU, %					
Oil Brent (USD/barrel)	71.1	61.5	61.4	60.5	60.0
International prices of non-energy goods, %	2.1	-0.2	1.1	0.7	0.6
International prices of food products, %	1.0	-2.9	2.1	0.1	0.1
International prices of agricultural raw materials, %	0.3	-3.7	-0.2	-0.4	0.0
International prices of metals, %	5.5	2.4	-2.2	0.5	0.6

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