International Monetary Fund

Bulgaria and the IMF

Press Release:
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May 18, 2005

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Bulgaria: Letter of Intent and Memorandum of Economic and Financial Policies

April 26, 2005

The following item is a Letter of Intent of the government of Bulgaria, which describes the policies that Bulgaria intends to implement in the context of its request for financial support from the IMF. The document, which is the property of Bulgaria, is being made available on the IMF website by agreement with the member as a service to users of the IMF website.

Sofia, Bulgaria, April 26, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. de Rato:

1. The attached Supplementary Memorandum of Economic and Financial Policies (SMEFP) describes the performance under the economic program that is supported by the Stand-By Arrangement (SBA) approved by the International Monetary Fund on August 6, 2004 and the policies that the government and the Bulgarian National Bank (BNB) intend to pursue in 2005 as part of the 2004-06 economic and financial program outlined in the Memorandum of Economic and Financial Policies (MEFP) attached to our letter of July 21, 2004. Our core objectives, supported by the policies described in the SMEFP, remain the maintenance of macroeconomic stability and sustained high rates of economic growth in the run up to EU membership in 2007.

2. As described in the SMEFP, macroeconomic performance in the second half of 2004 was better than anticipated and the program objectives were largely exceeded. However, two quantitative and two structural performance criteria for December 31, 2004 were missed, and we request waivers for their nonobservance.

- The general government expenditure ceiling was exceeded by BGN 308 million (0.8 percent of GDP). This nonobservance, which also involved the nonobservance of the structural benchmark proscribing the creation of new state-owned enterprises, had no macroeconomic implications since it resulted from the transfer on December 16 of BGN 340 million (0.9 percent of GDP) to a new enterprise for implementing public investment projects, but which did not engage in any spending in 2004. Without this transfer, the expenditure ceiling would have been observed.

- We did not manage to eliminate completely central government arrears by year-end. A very small amount (BGN 2.2 million) remained outstanding. These arrears will be eliminated in early 2005 and we will seek to avoid accumulating new arrears by the central government in 2005. However, as indicated in Annex II of the SMEFP, we are proposing to allow a small margin for arrears that may arise in the autonomous bodies of the central government and which the Treasury can monitor only with a considerable time lag.

- We were able to incorporate all lev-denominated accounts of the autonomous bodies into the unified budgetary payment system (SEBRA) by December 31, 2004 except for the expenditure accounts of the judicial system. We have received assurances from the independent judiciary that all necessary steps will be taken by September 30, 2005 to incorporate the judicial system's expenditure accounts into SEBRA and propose this action as a structural performance criterion for September 30, 2005.
- An exceptionally heavy agenda (including approval of the 2005 budget and EU accession related legislation) prevented parliament from approving before year-end the draft law to use the Bulstat number as the single identification for all tax and social security payments.

Under our 2005 program, we will ensure observance of the conditionality in the last bullet above as well as at least partial completion of two structural benchmarks missed on December 31, 2004 as prior actions before Executive Board consideration of the first review under the SBA. Altogether, we will implement five prior actions (Annex I of the SMEFP).

3. The SMEFP proposes quantitative performance criteria for June 30, 2005 and September 30, 2005 as well as indicative targets for March 31, 2005 and December 31, 2005, as described in its Annexes II – IV. In addition, program implementation is proposed to be monitored by the three structural performance criteria and the 10 structural benchmarks listed in Annex I of the SMEFP. The indicative targets and structural conditionality for December 31, 2005 may be revised during the second program review, which is scheduled to take place on December 15, 2005. The third review is scheduled to take place by June 13, 2006, and the fourth review by September 5, 2006.

4. We believe that the policies set forth in the SMEFP are adequate to attain the objectives of our program, but we will take any further measures that may become appropriate for this purpose. Bulgaria will consult with the Fund on the adoption of these measures, and in advance of any revisions to the policies contained in the SMEFP, in accordance with the Fund's policies on such consultation. We will provide the Fund with such information as it requests on policy implementation and achievement of program objectives. Apart from setting the performance criteria and structural benchmarks for the remainder of 2005, the forthcoming second review will focus on whether the fiscal stance needs to be tightened in the second half of 2005 in light of external current account developments (as mentioned in ¶4 of the SMEFP).

5. We would like to reaffirm our intention not to make the purchases under the SBA that will become available upon observance of its performance criteria and completion of its reviews and to make all outstanding repurchases to the Fund on the expectations schedule.

Indeed, as mentioned in the SMEFP, we are considering making advance repurchases to the Fund as one option under our plan to reduce further the government's external debt in 2005.

Sincerely yours,

/s/	/s/	/s/
Milko Kovachev Minister of Economy Republic of Bulgaria	Milen Veltchev Minister of Finance Republic of Bulgaria	Ivan Iskrov Governor Bulgarian National Bank

Attachment: Supplementary Memorandum of Economic and Financial Policies

SUPPLEMENTARY MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

I. Recent Economic Developments and Objectives for 2005

1. **Economic performance in 2004 was stronger than expected during the program discussions in mid-2004.** Real GDP grew by 5.6 percent thanks to a rebound in agricultural output, a record summer tourist season, and the continued expansion of industrial output in response to strong investment. Compared to the mid-year projection, credit growth was faster than projected, but domestic demand remained broadly unchanged, reflecting a much stronger than expected fiscal performance. Concurrently, the foreign component of aggregate demand improved strongly as the current account deficit was more than 1 percentage point lower than projected, at 7.5 percent of GDP. For the trade balance, the oil price shock during the second half of the year was largely offset by higher margins on the exports of petroleum products and price increases for metal exports. Hence, the current account improvement resulted mainly from higher net services and transfer receipts. Notwithstanding the oil price surge, consumer price inflation abated to 4 percent at year end, leaving average inflation in 2004 at 6.1 percent, compared with 6.3 percent under the program. Registered unemployment reached a five-year low of 11.7 percent of the labor force in September, before increasing for seasonal reasons to 12.2 percent in December 2004.

2. **In view of the better-than-expected economic outcome in 2004, we have set ourselves slightly more ambitious economic objectives for 2005 than had been envisaged under the original program.** We now expect real GDP growth to amount to 5½ percent, and exceed the projection in the original program. Compared to 2004, private domestic demand is expected to grow more slowly in response to higher oil prices and a slowdown of credit expansion. Reinforced by slower growth in real public spending, the slowdown of domestic demand growth is projected to exceed the expected improvement in the external contribution to real GDP growth. The external current account deficit is projected to widen modestly to 7.6 percent of GDP (against 8.3 percent of GDP under the original program), mainly due to the full-year effect of higher oil prices. Meanwhile, with smaller administered price increases than in 2004, the annual rate of inflation is expected to decline to 4 percent and 3½ percent on an average and year-end basis (against 3.6 percent for both under the original program), while a continued fall in the unemployment rate would result from some growth of the labor force and further employment gains.

II. The Economic Program for 2005

3. **Our economic program aims at providing a stable policy framework before and after the mid-year parliamentary election and to prepare the economy for EU accession, which we expect to attain at the start of 2007 after signing the accession treaty in April 2005.** The currency board arrangement will remain the cornerstone of our economic policy and will be maintained until targeted euro adoption in 2009-10 under a strategy agreed last year between the government and the Bulgarian National Bank (BNB). Accordingly, our program for 2005 continues to rely on a judicious mix of fiscal and

incomes policies, measures to restrain credit expansion, and structural reforms to bolster the competitiveness of the economy at an unchanged exchange rate peg.

A. Fiscal policy and reform

4. **The recent and prospective reduction of overheating and external vulnerability has allowed a modest easing of the fiscal stance in 2005 in accordance with ¶15 of the MEFP.** Thus, in light of an overall fiscal surplus of 1¾ percent of GDP in 2004, we intend to ease the fiscal stance somewhat to achieve a general government surplus (defined to treat capital transfers and spending by the new public investment projects enterprise as government expenditure, and adjusted for the net variation of arrears) of at least 1 percent of GDP in 2005 (a performance criterion)[1]. Flexibility in attaining this target will be provided by contingency reserves of 1 percent of GDP and the delay of discretionary nonpriority spending equivalent to 0.7 percent of GDP until the fourth quarter of 2005. However, we are prepared to tighten the fiscal stance at the time of the second review if the current account position turns out to be weaker than currently expected. Moreover, we intend to save 69 percent of any cumulative quarterly tax overperformance (excluding the personal income tax) of the general government in 2005, and the performance criterion on the fiscal balance will be adjusted accordingly. We will seek to avoid the accumulation of new central government arrears (a performance criterion) and urge the local governments to eliminate their arrears (which amounted to less than 0.1 percent of GDP at end-2004).

5. **As a result of tax reductions and the privatization of profitable enterprises the revenue ratio will decline from 39.2 percent of GDP in 2004 to 38.8 percent of GDP in 2005.** In line with its long-standing goal the government has further reduced direct taxes and increased indirect taxes. Direct tax collections will be reduced by a higher standard deduction and by lower tax rates for the personal income tax, and by lower tax rates for the corporate income and dividend taxes. The full impact of the latter tax reductions, as well as of tax breaks for families with children, will be felt in 2006. The low-yielding inheritance tax was abolished, and the delay for VAT export refunds was reduced from 45 to 30 days. The tax losses will be mitigated by higher excises on alcohol and tobacco products in line with EU accession requirements, a slight broadening of indirect tax bases, and improved compliance in response to various measures. In this connection, the government has taken steps, in cooperation with our external consultants, to reverse the surge of excise tax refunds to duty-free shops and gas stations, including through the establishment of an interagency National Control and Coordination Center and the creation of additional mobile teams focused on the prevention of excise tax fraud. The loss of nontax collections in the wake of

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[1] The environment enterprise, with revenue and expenditure of 0.2 percent of GDP, has also been consolidated with the general government in 2005, raising the revenue and expenditure ratios by the same amount. The enterprise will be closed and its operations will become part of the Ministry of Environment and Waters.

the privatization of profitable enterprises has been partly offset by the extension of the vignette scheme to passenger cars, which replaced the road tax in January 2005.

6. **The expenditure ratio will rise from 37.5 percent of GDP in 2004 to37.8 percent of GDP in 2005.** Compared to 2004, capital expenditure shows the largest increase in relation to GDP, reflecting in part water, road, and environmental projects financed by the public investment projects enterprise. Social expenditure, mainly welfare assistance and health care, is also rising in relation to GDP. By contrast, expenditure on maintenance and operations, subsidies, and interest is declining in relation to GDP: maintenance and operations because of the budgetary treatment of employment programs as social assistance transfers; subsidies because of the elimination of energy subsidies and the reduction of heating subsidies; and interest payments because the effect of debt reduction operations outweighs that of higher market interest rates. The higher contingency reserves contain 0.3 percent of GDP of additional expenditure on education, mainly for computers and to repair and upgrade schools.

7. **Our efforts to strengthen the sustainability of the public pension and health care systems will continue.**

- With the stepwise implementation of the 1999 pension reform the dependency ratio has declined below one for the first time. In December 2004, the pension indexation formula was enshrined in the social security code and the National Social Security Institute (NSSI) was empowered to verify and re-certify all disability certifications. At the same time, the possibility of converting old-age pensions into disability pensions was eliminated. A council of ministers decree limiting retroactive payments of disability pensions to no more than six months will be issued by September 30, 2005. The NSSI budget has been prepared consistent with an expected 7 percent pension increase from June 1, 2005. The transfer to the second pension pillar remains at 3 percent of the contributions of eligible persons in 2005 but will be increased by one percentage point each in 2006 and 2007.

- A national framework agreement for 2005 with the health care providers introduced new fees to reimburse hospitals and physicians. The number of clinical paths was raised from 80 to 120, and work continues to replace the clinical paths with a larger number of more precisely defined diagnosis related groups covering all inpatient diagnoses and procedures. After this work is completed in 2005, we intend to shift all financing of health care provision for curative and rehabilitative services from the Ministry of Health to the National Health Insurance Fund (NHIF) to streamline and consolidate provider payments, and to convert the Ministry of Health into only regulatory and policy making body. In the course of 2005, we will develop plans for restructuring and closing hospitals and rationalizing staffing and bed distribution and use on the basis of the National Health Map. We will also facilitate hospital choice by the development of a new system of accreditation, and contemplate greater use of copayments while encouraging voluntary supplementary health insurance.

- To reduce nonwage labor costs, we have reduced the employer's share in social contribution payments from 75 percent to 70 percent from January 1, 2005 and will continue to reduce it to 50 percent by 2009.

8. **Structural reforms will continue to be implemented to enhance fiscal transparency and performance.** A fiscal ROSC, conducted in March-April 2005, provided valuable input to, and possible widening of the scope of, ongoing fiscal reforms.

- To enhance transparency, we will prepare an economic classification of the consolidated general, central and local government and social security expenditures for 2001-05 by September 30, 2005 (a structural benchmark). In particular, we will ensure that expenditure for defense and security is fully classified under the appropriate economic categories.

- The 2006 budget will be based on revenue projections which are in line with the expected revenue performance of 2005 and the macroeconomic outlook for 2006. At the same time, expenditure estimates will include the provision of the expected amount of year-end bonuses for government workers and pensioners. With EU accession looming in 2007, the 2006 budget will be the last opportunity to lay the groundwork for the absorption of a sharply increased availability of EU financing, which requires room for local counterpart spending and the payment of the membership contribution. The medium-term objective should be approximate budget balance, after a one-time deficit in 2007 that would result from the delayed refunding of EU agricultural subsidies.

- Preparatory work for the start-up of the National Revenue Agency (NRA) on January 1, 2006 is progressing. There has been solid progress towards making the NRA operational, including some key resource areas such as information technology and human resource management. Staffing plans are well advanced and will start being piloted soon in collaboration with the NSSI. The consultant in charge of customization and the implementation of the revenue management software has been selected and the software acquired. Parliamentary approval of the legislation on the Bulstat number is expected soon (a prior action), and parliamentary approval of the NRA procedural code (the Tax and Social Security Procedural Code) is expected by September 30, 2005 (a structural performance criterion), following its first reading in parliament (a prior action). Drafts of new PIT, CIT, VAT and excise tax laws have been submitted to parliament (a prior action) and are expected to be approved by parliament by September 30, 2005 (a structural benchmark).

- We will incorporate all lev-denominated expenditure accounts of the judicial system in the budgetary payments system (SEBRA) by September 30, 2005 (a structural performance criterion). To promote fiscal transparency, we will not create any new extrabudgetary funds or state-owned enterprises during 2005 (a structural benchmark). The Financial Management Information System (FMIS) has started operating on a trial basis in the Ministry of Finance in January 2005 and will be used exclusively in this ministry from September 1, 2005 (a structural benchmark) and piloted in one additional ministry and one agency in January 2006.

- With its extension to four more ministries in 2004, program budgeting now covers seven ministries. Four more ministries are scheduled to adopt program budgeting in 2005, with a view to preparing the central government budget on a program basis by 2007. To improve budget execution, we intend to move from cash to accrual accounting with the 2006 budget report and have requested technical assistance from the Fund to prepare for the change.

- Further progress will be made to ensure the smooth functioning of fiscal decentralization, especially by enhancing transparency and establishing clear and predictable financial relations between the central government and the municipalities. Expenditure standards for central government mandates have been developed and all mandates are now fully funded. The equalization grant, although at an adequate level, will be better targeted to the poorest municipalities. To help avoid arrears on municipal governments' own mandates, we will assist municipalities in finding replacements for the road and inheritance taxes and raise their own revenue level. To this end, we will update the property tax valuations by September 30, 2005 (a structural benchmark), submit a constitutional amendment to parliament by June 30, 2005 that would allow municipalities to set their own tax rates (a structural benchmark), and transfer the patent tax (a presumptive tax on small businesses) to the municipalities in 2006. A new municipal debt law that introduces procedures for, and limits on, the contracting and guaranteeing of debt by municipalities has passed the second reading in the budget and finance committee and is expected to be approved by parliament later this year. Finally, an amendment to the municipal budget law covering local government insolvency procedures is expected to be prepared by end-2005.

- The government is trying to minimize its future financial obligations arising from two large infrastructure projects involving state-owned enterprises. In March 2005 a public-private partnership contract for the construction and operation of the Trakia highway was signed. We estimate the government's potential obligations arising from shadow tolls for trucks and possible traffic shortfalls at altogether €170 million, spread over 5 to 6 years after the expected completion of the highway in 2007. In addition, the government has decided to support the construction of a nuclear power plant at Belene, in part to compensate for capacity lost from the pending decommissioning of two reactors of the Kozlodui nuclear plant. In deciding on the financing plan, we are examining various approaches to minimize the government's financial involvement.

B. Incomes and Labor Market Policies.

9. **Wage restraint remains crucial to maintain competitiveness and stimulate employment.** To provide guidance to private sector wage bargaining, we are pursuing a restrained wage policy in the public sector. The increase in the budgetary wage bill on July 1, 2005 will be 3.6 percent, with individual wage increases of up to 5 percent. The increase in the aggregate wage bill of the 58 largest public enterprises that are monopolies, received government subsidies, made losses, or had arrears in the third quarter of 2004 has been limited to 4 percent in 2005. The observance of the limit on the wage bill will be monitored as a performance criterion. In consultation with the social partners, we intend to amend our labor regulations with a view to making working conditions more flexible. An attempt to incorporate existing seniority bonuses into the pay scales has recently failed due to union resistance. However, the social partners have recently resumed their discussions, and we expect them to find a solution soon. As a minimum, we intend to issue a decree by December 31, 2005 eliminating the portability of the seniority bonus in the case of unemployment (a structural benchmark), in particular to enhance the re-employment chances of older unemployed persons. We also want to increase work time flexibility by raising the legal limits on maximum working hours, lengthening (perhaps annualizing) calculation periods, and expanding the reasons for work outside regular hours. We expect to reach consensus on a draft law satisfying these requirements and submit it to parliament by September 30, 2005 (a structural benchmark). Following its increase by 25 percent to BGN150 per month in January 2005, we intend to raise the minimum wage in 2006 and 2007 to no more than BGN160 and BGN170, respectively.

C. Financial Sector and Public Asset and Liability Management Policies

10. **Under its monetary program for 2005 the BNB intends to reduce the annual rate of credit expansion to the non government sector from 48¾ percent at end-2004 to 30 percent at end-2005.** This represents a reduction of the expansionary impulse of credit growth by 2 percent of GDP with respect to 2004, thus helping to moderate the external current account deficit. We realize that the currency board peg and an open capital account make the pursuit of an independent monetary policy impossible, but we have taken a series of prudential and administrative measures to ensure that credit expansion slows as programmed and that credit portfolios remain sound.

- In addition to the prudential measures taken before the start of the current SBA (MEFP ¶19), we have implemented all the liquidity draining measures listed in ¶20 of the MEFP. In December 2004, the BNB reduced the proportion of cash in vault that banks can use in fulfilling reserve requirements from 50 percent to zero and subjected all bank deposits and liabilities (except subordinated debt, debt-capital hybrid instruments, and repo agreements among banks) to the standard

8 percent minimum reserve requirement rate by eliminating the special 4 percent rate that had been applied to such deposits and liabilities after July 1, 2004.

- In February 2005 the BNB announced that banks whose credit portfolio expands by more than 6 percent per calendar quarter will be subject to an unremunerated deposit requirement of twice the excess credit expansion, unless the ratio of their credits (including risk weighted off-balance sheet items) minus capital to deposits, other than those by other financial institutions, is below 60 percent. This measure took effect in the second quarter of 2005 and was preceded by a December 2004 IMF technical assistance mission that advised on alternative responses to the credit boom and on the need to address likely undesirable side effects if direct controls were introduced.[2]

- For purposes of capital adequacy calculations, the risk weight of mortgages financing more than 70 percent of assessed value will be raised as of July 1, 2005 from the standard 50 percent to 100 percent.

- After hiring an additional team of experts, the BNB has intensified its targeted on-site inspections to, inter alia, enforce the use of strict credit quality criteria by banks to assess debtors' payment capacity.

- The BNB has also met with aggressive banks to explain its concern about the adverse macrofinancial implications of the pace of bank lending and plans to conduct a public awareness campaign about the risks of excessive borrowing. In this connection, the BNB has prepared a draft law enhancing consumer protection in this area, which the government intends to submit to parliament by September 2005.

- In a step toward meeting EU requirements, the government will raise the deposit insurance limit from BGN15,000 to BGN25,000 during 2005.

11. **The recommendations of the generally favorable safeguards assessment by the Fund are being implemented.** The BNB's governing council has made it a formal practice for the external auditors to present the findings of the annual audit to a session of the full governing council. In March 2005 the BNB's internal audit department began to submit biannual reports on the status of implementation of internal and external audit recommendations to the governing council. The latter will adopt a formal rotation policy for the selection of external auditors, or the responsible audit partner, by mid-2005.

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[2] The BNB has taken steps to exclude fictitious loans booked by some banks in late March from the base on which the credit limits are applied.

12. **With the parliamentary approval in January 2005 of an amendment that brings the BNB law in line with ECB requirements, the institutional framework of the banking sector is now almost fully developed and financial sector reforms will focus mainly on nonbanks.** The Financial Supervision Commission's (FSC) supervisory capacity will be strengthened further. A new deputy commission chairman in charge of insurance supervision has been appointed (prior action), and the FSC's statutes will be changed to allow the chairman to designate acting deputies when their positions become vacant. A draft insurance law compliant with EU regulations and facilitating supervision was submitted to parliament in January 2005 and is expected to be approved by parliament by end-June 2005. With the rapid growth of leasing, we are reviewing international practice and intend to adopt an appropriate strategy for reporting requirements and/or supervision of leasing companies by September 30, 2005. We intend to adopt all necessary legal provisions by December 31, 2005 (a structural benchmark) to require the leasing companies to report regularly their ownership structure and financial operations. Finally, given the growing importance of nonbank sources of credit and the possibility of transferring credit risk to nonbanks, we intend to intensify the cooperation between the BNB bank supervision and the FSC.

13. **The government will continue its efforts to reduce the public debt and external borrowing.** In this regard, it redeemed US$938 million of Brady interest arrears bonds in January 2005, financed from resources accumulated in the Fiscal Reserve Account, reducing the external and public debt ratios by some 3½ percentage points of GDP. The government is considering buying back or prepaying other external obligations equivalent to some 2½ percent of GDP, subject to maintaining an adequate level of international reserves. To strengthen external sustainability, the government has established ceilings on the contracting and guaranteeing of external public debt (performance criteria). The government's ongoing strategy of shifting from external to domestic borrowing will also help absorb bank liquidity, provide assets to the private pension funds, and develop the domestic capital market. We are considering expanding the range of assets eligible to meet private investment funds' portfolio requirements to include EU government securities. We continue to improve the administrative capacity of the State Treasury to strengthen the control of debt operations.

D. Other Structural Reforms

14. **Reforms to improve the business climate will continue in 2005, although the mid-year election has slowed down the legislative calendar.** In addition to areas listed below, the broader reform of the judicial system, which aims at making judicial procedures faster and less cumbersome, will also help to improve the business climate.

- The council of ministers has decided to move business (and other entity) registration from the courts to a unified registration agency under the Ministry of Justice. The strategy to implement this decision is expected to be approved shortly by the council of ministers (a prior action), after which the drafting of legislation can begin with inputs from the business community. We intend to submit draft legislation to parliament by September 30, 2005 (a structural benchmark), with a view to achieving parliamentary approval by December 31, 2005. EU funding for the development of software for the registration process has already been obtained.

- The draft law on mediation as an out-of-court dispute resolution alternative was approved by parliament in December 2004. With the regulation of the new profession, establishment of the mediation association, and appropriate confidentiality provisions, the court-referred mediation of commercial disputes is expected to commence in 2005.

- Two laws on a private enforcement system and to amend the enforcement provisions of the civil procedures code were sent to parliament in September 2004. The government expects the legislation to be adopted in the first half of 2005.

- A draft collateral law was submitted to parliament in December 2004, and the government expects the legislation to be adopted by end-2005.

- A donor assessment in June 2004 came to the conclusion that it was not necessary to amend the commercial code to improve corporate governance. Instead, the government decided to train the judges in the area of commercial law (mergers and acquisitions, collateral law, etc.). A training program will start in Spring 2005 at the National Institute of Justice.

15. **We recognize that corruption remains a serious problem and are committed to fight against it.** In accordance with its 2001 National Anti-Corruption Strategy, the government focuses on education, prevention, and criminal investigation and prosecution.

- Existing training programs encompass secondary school students, teachers, civil servants, and judicial officials. A new code of ethics for civil servants is being applied following its adoption by the council of ministers in 2004. Intentions for 2005 include the introduction of web-based training of civil servants and the adoption of a master's degree program on anti-corruption by Sofia University.

- Prevention is being promoted by the progressive introduction of one-stop shops and the spread of e-government. Anti-corruption councils have recently been set up in all regions with the participation of civil servants, the judiciary, businessmen, NGOs, and the media. In cooperation with the United Kingdom, anti-corruption audits have been developed and the first such audits will be conducted in the Ministry of Justice and the Ministry of Youth and Sports. The first results are expected by March 2006. Such audits will be extended to all ministries.

- The reform of the judiciary will help in increasing the number of indictments and convictions for corruption from the current annual rates of 800 and 450 cases, respectively. Meanwhile, training at the police academy is strengthening the capacity of staff in the ministerial inspectorates to handle code of ethics violations. Inspectorates will be introduced in all executive agencies, and the work of all inspectorates will be coordinated by the chief inspectorate at the council of ministers.

- We have issued regulations for public procurement below the EU thresholds and parliament approved the asset forfeiture law in February 2005. During 2005 we intend to introduce legislation requiring purchases and sales of goods and services and movable and immovable property, with a unit value above BGN 10,000, to be settled through bank accounts.

16. **The restructuring of the energy, railway and education sectors will be pursued in close collaboration with the World Bank.** The financial position of the electricity and district heating companies has been strengthened by the mid-2004 tariff increases, which completed the government's three-year price reform. The electricity market has been liberalized further in 2005 with the reduction of the threshold for the right to free contracting of electricity from 40 to 20 gigawatt hours per year for large users. The railway sector has undergone significant restructuring leading to growth in revenues and activity indicators, shutting down of inefficient lines, reduction of the number of passenger trains, staff reductions, and improved financial management. The railway sector has also benefited from tariff increases, the conclusion of public service contracts (PSCs) with the government, and some much needed investment in rolling stock. Nonetheless, we will continue to strive to improve the sector's financial position and efficiency. We will ensure that the parties concerned will fully abide by their commitments under the PSCs in the 2006 budget. Structural reforms in education will aim at boosting quality, efficiency, and competitiveness.

17. **The government intends to complete its privatization program in 2005-06.**

- The remaining 35 percent of the telecommunications company BTC was privatized on the stock exchange in January 2005 against compensatory instruments issued to expropriated owners.

- We have sold five tobacco processing plants and are in the process of selling one other, but attempts to sell the larger cigarette companies of Bulgartabac Holding have been unsuccessful. Following the withdrawal of the only bidder for those cigarette companies in February 2005, we will reopen the bidding process with a view to completing this privatization by end-2005. The remaining units of Bulgartabac Holding are expected to be sold, as assets or shares, within 2005 or dissolved under the commercial code procedures.

- Three large thermal electricity generation companies are expected to be privatized in 2005. The winning bids will be selected by September 30, 2005 (a structural performance criterion). We will examine whether the government's share in other nonnuclear power plants and remaining district heating companies can be privatized as well.

- We intend to sell the airline, the remainder of the river shipping company, and the maritime shipping company by end-2005.

- We will examine whether some companies currently exempt from privatization as per Annex I of the privatization law can be removed from that list for privatization in 2006.

- In addition to these privatizations we are offering all ports and airports with the exception of Sofia airport to concessionaires on a long-term basis.

Bulgaria: Conditionality Under the Stand-By Arrangement in 2005

Prior Actions

1. Adoption by parliament of a draft law to use the Bulstat number as the single identification for all tax and social security contribution payments.

2. Completion of first reading in parliament of the NRA procedural code.

3. Submission to parliament of new PIT, CIT, VAT and excise tax laws required to make the NRA operational.

4. Approval by the council of ministers of a strategy to transfer business registration to a nonjudicial administrative body and establish a unified national electronic register with limited judicial oversight and simplified administrative procedures.

5. Appointment by parliament of a deputy chairman of the Financial Supervision Commission in charge of the insurance sector.

Quantitative Performance Criteria

1. Floor on the overall surplus of the general government (Annex II).

2. Ceiling on central government arrears (Annex II).

3. Ceiling on the wage bill of the 58 largest SOEs in financial distress or monopoly situation (Annex III).

4. Ceiling on the contracting or guaranteeing of nonconcessional external public debt (short term, 1-5 years, longer) (Annex IV).

Structural Performance Criteria

1. Selection of winning bids for the sale of three large thermal electricity companies (Varna EAD, Ruse EAD, and Bobov Dol EAD) (September 30, 2005).

2. Adoption by parliament of the NRA procedural code (September 30, 2005).

3. Incorporation of all lev-denominated expenditure accounts of the judicial system in the budgetary payments system (SEBRA) (September 30, 2005).

Bulgaria: Conditionality Under the Stand-By Arrangement in 2005 (Concluded)

Other Performance Criteria

1. No imposition of new or intensification of existing restrictions on the making of payments and transfers for current international transactions, nor introduction or modification of multiple currency practices, nor conclusion of any bilateral payments arrangements that are inconsistent with Article VIII of the IMF Articles of Agreement, nor imposition or intensification of any import restrictions for balance of payments purposes, nor accumulation of any external payments arrears (continuous)

Structural Benchmarks

1. No new extrabudgetary funds or state-owned enterprises to be created during the program period (continuous).
2. Submit a constitutional amendment to parliament to allow municipalities to set their own tax rates (June 30, 2005).
3. Ministry of Finance to use only the Financial Management Information System (September 1, 2005).
4. Submit to parliament draft legislation to transfer business registration to a nonjudicial administrative body and establish a unified national electronic register with limited judicial oversight and simplified administrative procedures (September 30, 2005).
5. Approval by parliament of new PIT, CIT, VAT and excise tax laws required to make the NRA operational (September 30, 2005).
6. Ministry of Finance to prepare an economic classification of consolidated general, central and local government expenditures (September 30, 2005).
7. Submission to parliament of a draft law raising the legal limits on maximum working hours, lengthening calculation periods, and expanding the reasons for work outside regular hours (September 30, 2005).
8. Government to update the property tax valuations (September 30, 2005).
9. Issuance of a government decree eliminating the portability of the seniority premium in the case of unemployment (December 31, 2005).
10. Approval of legal provisions requiring leasing companies to report regularly their ownership structure and financial operations (December 31, 2005).

Performance Criteria on the General Government Deficit and Central Government Arrears and Indicative Tax Revenue Targets for the General Government

	Fiscal Surplus Floor	Arrears Ceiling	Tax Revenue Target 1/
	(In millions of leva)		
Cumulative change from January 1, 2005			
March 31, 2005 1/	198	5	2,802
June 30, 2005	383	5	5,642
September 30, 2005	605	5	8,522
December 31, 2005 1/	417	5	11,568

1/ Indicative limit or target.

All quarterly limits in this Annex are cumulative.

The general government accounts are defined to comprise the consolidated budget (including the republican budget, the budgets of ministries and local governments, and the social security funds NSSI and NHIF) as well as all extrabudgetary funds and accounts at the central and local government levels, the public investment projects (PIP) enterprise, and the environment enterprise. The central government is defined as the general government minus the sum of the local government budgets and the extrabudgetary funds and accounts at the local government level.

For program monitoring purposes, the arrears of the central (general) government are all overdue obligations on the payment for central (general) government expenditure excluding items in dispute. The stock of central government arrears as of December 31, 2004 amounted to BGN 2.2 million.

For program monitoring purposes, the fiscal balance (surplus/deficit) will be defined as the difference between general government revenue (taxes, nontaxes, and grants) and general government expenditure, including net capital transfers (net acquisition of shares and net lending) and adjusted for the net change of the stock of general government arrears. The quarterly fiscal balance targets will be raised by 69 percent of the excess of actual over targeted cumulative general government tax revenue (including social security and health insurance contributions but excluding the personal income tax), whose total amounted to BGN10,615 million in 2004.

Reporting on the fiscal balance will be cross checked from the financing side as the sum of net credit from the domestic banking system to the general government, general government deposits and accounts abroad, net domestic nonbank credit to the general government, privatization receipts of the central and municipal government budgets, receipts from external loans for project implementation and direct budgetary support minus amortization due, net disbursement/repayment of loans whose final payee is an entity outside the general government consolidation (onlending operations), and the net increase/decrease of general government arrears, including those on the amortization of principal. For calculating the performance against this ceiling, all privatization receipts are treated as financing items. External flows will be converted into leva at the BNB daily exchange rate. Valuation changes in deposits and accounts that are denominated in foreign currencies will be recorded daily and reported by the BNB and the Ministry of Finance at the end of each quarter, and such changes will be netted out.

All data in this Annex will be reported quarterly by the Ministry of Finance (and by the BNB for some of the financing items in the preceding paragraph) within 60 days of the end of each calendar quarter.

Performance Criteria on the Wage Bill of 58 State-Owned Enterprises (SOEs)

	Wage Bill of 58 SOEs
	(In millions of leva)
Cumulative from 1 January 2005	
March 31, 2005 1/	95.0
June 30, 2005	189.9
September 30, 2005	284.9
December 31, 2005 1/	379.9

1/ Indicative Limit

The quarterly ceiling on the aggregate wage bill of the 58 state-owned enterprises closely monitored for their large losses or arrears, for receiving subsidies, or for being monopolies, is 4 percent above the level of the aggregate wage bill in the third quarter of 2004 and is accumulated by the same amount for each subsequent quarter. The wage bill is defined to include wages and payroll taxes paid by the employer but does not include additional compensation under Article 12 of the 2005 Incomes Ordinance.

Those enterprises that have been privatized or ceased operations will be excluded from the list for the respective test dates. Those enterprises that register profits in each of the first two quarters of 2005 will also exit the list in the second half of 2005 unless they are monopolies, have arrears, or receive state subsidies. If an enterprise is excluded from the list, the wage bill ceiling for each subsequent quarter will be adjusted down by the amount of that enterprise's wage bill in the third quarter of 2004 plus 4 percent times the number of quarters it has been excluded from the list. The 58 enterprises monitored are in the table below (enterprises numbers 1 to 4 are considered monopolies).

List of 58 Monitored State-Owned Enterprises

1. BDZ EAD
2. Railway Infrastructure Company
3. Bulgargas EAD
4. National Electric Company
5. NPP Kozlodui EAD
6. TPP Maritza Iztok 2 EAD
7. TPP Bobov Dol EAD (Golemo Selo)
8. Bulgarian Rivershipping Company EAD
9. Mini Bobov Dol EAD (Bobov Dol)
10. Pirin Mine EAD
11. Vazov Machinery Works
12. Dinarit AD
13. Port Burgas EAD
14. Port Burgas - Labor Force
15. DHC - Plovdiv EAD
16. DHC - Shumen EAD
17. DHC - Ruse EAD
18. DHC - Sofia EAD
19. DHC - Sliven EAD
20. DHC - Varna EAD
21. DHC - Pernik EAD
22. Capital Autotransport EAD
23. Sity Transport Varna EAD
24. Sity Transport Plovdiv EAD
25. Ruse Municipal Autotransport EOOD
26. Electrik Bus Transport Pernik EOOD
27. V&K - Dobrich EOOD
28. V&K - Dupnitca EOOD
29. V&K - Turgovishte EOOD
30. Autobus Transportation EAD
31. Passenger Transportation EAD
32. Meden Kladenec EOOD
33. Diana - Bus EAD
34. Plovdiv - BT AD
35. Asenovgrad BT AD
36. Dupnitsa BT AD
37. Yambol BT AD
38. Kurdzali - Bulgartabac AD
39. Haskovo BT AD
40. Shumen BT AD
41. Smolian BT AD
42. Balkan Car 6th September EAD
43. Balkankar - Dunav AD
44. Balkancar - Erma AD
45. Constructing and Rebuilding EAD
46. Transport Constructing and Rebuilding EAD
47. Bointech EOOD
48. Intendanse Service EAD
49. Terem EAD
50. Terem - KRZ Marine Arsenal - EOOD
51. Terem - Georgi Benkovski EOOD
52. Bread and Paste Products - EOOD
53. Balkancar - Zarya AD
54. Beltrans EOOD
55. Electrosteel EAD
56. Rozen Express EAD
57. Niti EAD
58. Terem - Han Krum EOOD

Performance Criteria on the Contracting or
Guaranteeing of Public Sector External Debt 1/2/
(In millions of euros)

	One year and under 3/	Over 1 year 4/	1-5 years 4/
Cumulative change from December 31, 2004			
March 31, 2005 5/	0	38.0	0
June 30, 2005	0	229.8	0
September 30, 2005	0	229.8	0
December 31, 2005 5/	0	229.8	0

1/ The public sector comprises the central government, the local governments, the social security and health insurance funds (NSSI and NHIF) and all other extrabudgetary funds and the Bulgarian National Bank.

2/ The term "debt" has the meaning set forth in point No. 9 of the IMF Guidelines on Performance Criteria with Respect to Foreign debt adopted on August 24, 2000 (Executive Board Decision No. 12274-(00/85)). Excluded from this performance criterion are (i) normal import-related financing credits; and (ii) outstanding balances under bilateral payments arrangements. Debt and commitments falling within the ceilings shall be valued in euros at the program exchange rates of 1.30 US$/€ and 135 ¥/€.

3/ The ceilings apply to debt with original maturities of up to and including one year. The actual stock of short-term debt outstanding (according to this definition) as of December 31, 2004 was zero.

4/ The ceilings apply not only to "debt," but also to commitments contracted or guaranteed for which value has not been received.

5/ Indicative limits.