

REPUBLIC OF BULGARIA

COUNCIL OF MINISTERS

R E P O R T

**TO THE DRAFT OF A 2010 STATE BUDGET OF THE REPUBLIC OF
BULGARIA ACT**

*Meeting the Challenges of the Crisis and Providing
Support to People in Hard Times*

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Meeting the Challenges of the Crisis and Providing Support to People in Hard Times

I. FOREWORD

This report presents the basic budget parameters underlying the draft of a 2010 State Budget of the Republic of Bulgaria Act. These parameters are consistent with the objectives of fiscal policy and with the Government's priorities and anti-crisis measures while conforming to the fundamental budgeting principles.

The 2010 budget ushers in the implementation of the policies of the Government of European Development of Bulgaria for management of the effects of the global financial and economic crisis and recovery of the Bulgarian economy, focused on honouring the State's social commitment to citizens in conditions of a social market economy.

The decline of economic activity, deceleration of gross domestic product growth and concurrent contraction of budget revenues, detected in early 2009, presupposed the taking of immediate action. Instead, a substantial volume of long-term commitments were assumed without ensuring their financing for the current and succeeding years.

The realistic assessment of the current implementation of the consolidated fiscal programmes for 2009 and its individual constituent elements depart dramatically from the projections of Programme 2009 to last year's draft budget. The steadily expanding imbalance, considerably exceeding the fiscal buffers provided for in the 2009 Budget Act, necessitated the taking of urgent action to reverse this negative trend through restriction of expenditures and improvement of revenue compliance.

The new Government's first decisions targeted optimising and effectively containing non-interest expenditures and transfers from the executive budget. The measures approved on the expenditure side by the adoption of Decree No. 196 of 11 August 2009 totalled an amount of BGN 1,150 million. Nevertheless, the year-on-year assessments of the implementation of the budget suggested an impossibility to achieve a neutral budget position at the end of 2009. This necessitated the taking of additional active steps to improve revenue compliance

through tightening customs control at the borders and strict control and checks on the part of the revenue administrations to interdict contraband import into the country and to suppress the schemes for fraudulent recovery and/or evasion of VAT, excise duties, customs duties and other taxes.

The delay of the 2010 budget procedure, largely due to a lack of political will to approve a medium-term fiscal and budget framework before the parliamentary elections compelled the incumbent Government to adopt urgently a new budget procedure for 2010 with updated stages and timeframe for preparation of the budget documents.

By a decision of 31 August 2009, the Council of Ministers approved a medium-term fiscal framework and key assumptions for the 2010-2013 period covering the term of office of the Government. Pursuing the approved economic and fiscal objectives, as well as the budget policy priorities, the Government took the necessary steps and developed the three-year budget forecast and expenditure ceilings allocated to first-level spending units (FLSU), excluding municipalities, for the 2010-2012 period, and the 2010 State Budget Bill.

With a view to mitigating the adverse impacts of the world economic down-turn, the Government approved a package of 76 anti-crisis measures effective until the end of April 2010, developed with the active co-operation of the business community and the trade unions.

The “Economic Measures for Recovery of the Bulgarian Economy (27 July 2009 – 27 April 2010)”, adopted by a Council of Ministers Decision on 1 October 2009, include measures intended to ensure stability of the macroeconomic and financial systems, to improve the business environment, to energise agricultural production, to construct better infrastructure, to promote employment and social assistance, to build a knowledge-based economy, and to manage effectively the resources provided by EU funds.

With the present state of the economy, the Government should direct its efforts to achieving a creation of new jobs in the real economy at a rate outpacing the redundancies generated by the optimisation in the public sector.

In a situation of diminishing economic activity, leading to contraction of the revenue side of the budget, as an essential measure for achievement of stability of the macroeconomic system, the Government committed itself to maintenance of a balanced budget excluding the resources from the EU funds and programmes. A

balanced budget is necessary to support the economic recovery drive, as proof that public spending is under control even at the time of a crisis. A balanced budget signals the stability of the country's public finances in support of the efforts to join the Eurozone. This approach makes it possible to set rigid expenditure ceilings allocated to the individual sectors financed with Bulgarian taxpayers' money and to give the ministries managing resources from the EU budget leeway to implement the operational programmes to a maximum extent, regardless of the fiscal framework restrictions.

Difficult decisions had to be taken to reallocate expenditures among the individual sectors so as to meet the fiscal objective set, and the 2009 framework, on which the preparation of the 2010 budget is based, was revised.

The new Government's agenda attaches paramount importance to a mitigation of the effects of the global economic contraction and to Bulgaria's earliest possible return to sustained economic growth. The principal economic policy instruments for meeting these targets at home remain in the sphere of fiscal policy and structural adjustment.

The slow-down of the economy and the lack of timely response at the onset of the crisis affect adversely revenues under the consolidated fiscal programme, and the risks to the implementation of that side of the budget linger in 2010 as well.

Declining budget resources amidst an economic recession call for identifying areas of priority financing within the capacities of the 2010 budget and for making an effort to effectively ensure social protection and support to vulnerable social groups.

For 2010, the Government envisages no change in the rates of direct taxes, an increase of indirect taxes in respect of certain rates of excise duty, as well as a reduction of the social insurance burden as the best incentive to job security in conditions of economic recession.

The Government's conservative tax strategy is intended to avoid abrupt changes in the incomes policy implemented in conditions of economic down-turn. The package of tax laws does not provide for substantial changes in respect of tax rates, with the exception of the rates applicable to certain excisable goods.

The proposed provisions amending and supplementing the tax laws are intended to streamline taxation practice, address existing difficulties and improve compliance with the tax laws, as well as remove non-conformities of tax legislation with EU law.

Apparently, one of the tasks is to improve the effectiveness of tax compliance, which includes increasing the number of on-site inspections, more frequent and more thoroughgoing audits, as well as

more rigorous accounting rules and judicial prosecution of offenders.

A strategic priority is set on the optimum and effective allocation of public resources, including the resources from the EU funds, for the purpose of enhancing the competitiveness and accelerating the real convergence of the Bulgarian economy to the EU average levels.

The Government is facing the challenge of implementing the planned policies and programmes in the individual sectors in the conditions of economic down-turn, having less budget resources at its disposal.

The expenditure side of the 2010 Budget prioritises education, health care, the social sector, the environment and road infrastructure.

In the last months of the current year, the production sector in both the US and Europe has been showing signs of stabilisation and recovery. The US may register a positive growth as early as in the fourth quarter of 2009, with the European countries following suit somewhat later.

Because the crisis manifested its negative impact in Bulgaria later, the national economy is forecast to decline by 2% in real terms in 2010. The positive development of the economy is expected to restart in 2011, with export as a growth catalyst. The expected economic growth will be accompanied by an increase in employment and a decrease in unemployment.

The maintenance of a currency board arrangement, a prudent fiscal policy and a stable banking system create the most adequate conditions for economic recovery and for joining the country to ERM II and adoption of the euro within the shortest possible time.

II. ECONOMIC FRAMEWORK

II.1. STATE AND DEVELOPMENT OF THE GLOBAL ECONOMY

The global economy in conditions of a global financial crisis

During the past 2008, the global financial crisis and the ensuing negative effects led to a slow-down of the global economy, which made itself most tangibly felt at the end of the year. Due to slack domestic consumption and investment contraction, the American and the European economy decelerated their growth in the second half of 2008 and showed a negative growth in the last three months of the year.

Table 1: *GDP growth by quarter, year on year*

	III 2008	IV 2008	I 2009	II 2009
US	0.0%	-1.9%	-3.3%	-3.8%
EU-27	1.0%	-1.6%	-5.2%	-5.6%

Source: Eurostat, Bureau of Economic Analysis (USA).

Signals of stabilisation and recovery of the global economy

Since the beginning of 2009, the adverse development has continued and the decline deepened in the second quarter. In the last months of the current year, the production sector in both the US and Europe has been showing signs of stabilisation and recovery. The US may register a positive growth as early as in the fourth quarter of 2009, with the European countries following suit somewhat later. The stabilisation signals may just be an effect of governments' expansionist policies, and they should be treated with caution, as the impact may fade as fiscal incentives are reduced and/or discontinued.

Global-scale consumer price inflation slowed down in the second half of 2008. This was largely due to a decline in the price of raw materials and to a weaker consumption against the background of the global economic and financial crisis. Persistently low demand levels led to an annual price decrease since March 2009 in the US and, later one, in the Eurozone since June.

II.2. STATE AND DEVELOPMENT OF THE NATIONAL ECONOMY

Gross Domestic Product

The effects of the crisis spread to the national economy

The gross domestic product grew by 6% for 2008. For the January-September 2008 period, the GDP growth accelerated, reaching 7.0% in real terms, mainly due to an improvement of the foreign trade balance. In the fourth quarter of last year, the effects of the global economic crisis spread to Bulgaria's economy and GDP growth slowed down to 3.5%. The principal factors were a decline in the export of goods and a deceleration of individual consumption.

The negative development continued during the current year, with GDP dropping 4.2% in the first half of 2009 as a result of a contraction of domestic demand. For the same period, the external sector made a positive contribution to economic growth, as the decline of import (22.8%) outran the decline of export (16.5%).

Over the last two years, gross fixed capital formation has been growing at rates of over 20%, and it reached a share of 33.4% of GDP by the end of 2008. Owing to the scarcity of financial resources and the volatile economic environment worldwide in the first half of 2009, investments in Bulgaria dropped by 26.9% in real terms. The growth of private consumption slowed down from 1.5% in the fourth quarter of 2008 and turned to negative in the first half of 2009, due to the credit crunch and the increase of savings, as well as due to a year-on-year reduction in the number of employed.

While agriculture was recovering vigorously in 2008 after the bad harvest in 2007 and achieved the highest growth rate in real terms (24.6%), since the beginning of 2009 this sector has been in recession. Industry was soonest hit by the global economic crisis, with its value added starting to show a decline as early as in the third quarter of last year (the decline reached 9.7% for the first half of this year). The growth of services, which took most of the credit for the GDP increase in 2008, slowed down by up to 1.9%, year on year, in the January-June 2009 period.

Inflation

Inflation, measured by the Harmonised Index of Consumer Prices (HICP), was high in the first half of 2008 (14.7% for June, year on year). As from the second half of the year, due to the outbreak of the global financial and economic crisis, international prices started to

fall, pushing domestic prices down with them. The bumper crops, too, had a favourable impact on the behaviour of food prices. Year-on-year inflation started to decline, reaching 7.2% at the end of 2008. Average annual inflation remained relatively high (12%) because of its high levels in the second half of 2007 and in early 2008.

Year-on-year inflation fell in January-September 2009.

Monthly inflation continued to fall, year on year, during the January-September 2009 period, reaching 0.2% by September. Producer prices of industrial products destined for the domestic market have been deflating, year on year, since March 2009. The negative inflation measured by this index hit 9.8%, year on year, in August. The producer prices of products destined for export have been falling even faster. The substantial decrease of both producer and consumer price inflation was due to the decline of international prices and the contracted demand.

Financial sector

Crisis affects financial system

Certain indirect effects of the international crisis started to make themselves felt on the country's financial system in 2008. As a particularly significant impact of the volatility of the markets, the Bulgarian Stock Exchange-Sofia entered into a bearish trend, leading to a negative year-on-year return on investors' resources, including pension funds and collective investment schemes. The exchange indices edged up in 2009, and this situation persisted in August and in the first half of September, but a sustained bullish trend on the local capital market is out of the question at this stage.

Slow-down of private sector credit

With market participants increasingly cautious, lending rates rising, and external financing for Bulgarian banks ever less readily available, private sector credit slowed down. By the end of 2008, the annual growth rate of the claims on the non-government sector fell to 31.6%. Credit continued to slow down in 2009, too, affecting loans for both corporations and households. By the end of August 2009, the annual growth of claims on the private sector amounted to 5.9% while the monthly volumes of change remained historically low.

The slack growth of credit, the more expensive borrowing, as well as the economic slow-down since the last quarter of 2008, resulted in an outpacing rate of non-performing loans and a deterioration of bank portfolio quality. In February 2009 the BNB revised its regulations concerning the classification and allocation of specific provisions of risk exposures so as to allow commercial banks greater flexibility in managing their loan portfolios. Nevertheless, the share of non-performing loans reached 5.63% by the end of August, compared to 2.15% a year earlier.

Steps to preserve confidence in the financial system and to ensure liquidity for the economy

As from October 2008, the BNB took a series of steps for the gradual reduction of the minimum required reserves (MRR) maintained by commercial banks. The action was intended to preserve confidence in the country's financial system and to ensure liquidity for the economy. As from the beginning of 2009, the minimum required reserves on funds attracted from abroad were decreased further to 5% and, at the same time, reserves ceased to be charged on funds attracted from the state budget and from local government budgets.

Bulgarian banks continue to maintain good indicators of capital adequacy and liquidity. The overall capital adequacy ratio has been increasing steadily, from 13.3% at the end of 2007 to 14.86% at the end of 2008 and 17.66% for the first half of 2009. The liquid asset ratio was 20.7% at the end of July 2009, compared to 21.71% in December 2008.

Balance of payments

The principal factors determining the dynamics of the external sector of the Bulgarian economy over the last few years have been the high rates of economic growth, the rise in income, productivity and competitiveness, the levels of the international prices of metals and energy resources, as well as the record-large inflow of foreign direct investment.

The current account deficit decreased in January-August 2009

In 2008 the balance of payments on current account reached a deficit of 25.4% of GDP, with a surge of the adverse trade balance being mainly to blame for this high value.

In January-August 2009, the current account deficit decreased by 56.4% in nominal terms from the same period a year earlier. The factors affecting the balance are: a drastic slump of the prices of energy resources and metals, a slow-down of global economic growth, low investment activity and shrinking domestic and external demand.

In 2008 the trade deficit increased by 18.7% in nominal terms, reaching 25.2% of GDP. Export of goods grew by a nominal 12.5%, and import of goods advanced 14.7%. Foreign trade slowed down in the second half of last year and receded in the fourth quarter. This trend persisted in January-August 2009, with export of goods decreasing by 29.9% and import by 34.9%. The slump of foreign trade turnovers was due to the lower prices of energy goods and metals, slack investment activity and a deteriorating demand.

In 2008 the balance on services increased by 2.1% from the previous year. The credit generated by earnings from foreign tourists was 10.8% higher. The analysed period saw a substantial growth of residents' trips abroad, as a result of which the debit on foreign travel

increased by 21.5%. For January-August 2009, the balance on services was favourable and 43.4% higher than a year earlier.

Contraction of FDI in almost all sectors

The financial account amounted to EUR 11,380 million in 2008 and covered entirely the current account deficit. The inflow of foreign direct investment (FDI) reached EUR 6,500 million by December. For January-August 2009, FDI added up to EUR 1,952.3 million, against EUR 4,605.3 million for the comparable period of the previous year. FDI contracted in almost all sectors, with the most significant nominal decline in real estate, financial intermediation, industry and trade. The economic and financial crisis is the key factor of the heightened investment risk, inducing caution in foreign investors.

Labour market and incomes

The vigorous economic growth and investment activity in 2008 led to a 3.3% increase in employment compared to 2007, accompanied to a fall in unemployment. Branches of the services sector, such as wholesale and retail trade, real estate, renting and business activities, hotels and restaurants and financial intermediation, as well as construction, were mainly responsible for the large number of employed in 2008. The number of unemployed averaged 199,700 for the year, or 5.6% of the labour force¹. Unemployment in 2008 was 1.3 percentage points down from 2007. The economic activity rate of the population aged 15 and over increased by 1.2 percentage points, reaching an average 53.8% in 2008.

Registered unemployment increased to 8% by September 2009, up 2.2 percentage points from the like month a year earlier.

Contraction of employment accompanied by decline in economic activity

In the first half of 2009, the average number of the employed decreased by 1.5%² compared to January-June 2008. The contraction of employment was accompanied by a decline in the economic activity of the population, with the labour force participation rate of persons aged 15 and over reaching 53.2%. Since the beginning of the year, the number of discouraged workers has been rising on an annual basis, the growth being 8.1% or 12,600 persons for the January-June period.

Income from work grew in 2008, as it had tended to do during the previous couple of years. According to estimates of the National Statistical Institute (NSI), the average wage for the overall economy increased by 21.7% in nominal terms and 8.3% in real terms. During the period under review, income from work grew faster in the public

¹ Source: Labour Force Sample Survey (LFSS).

² Source: Labour Force Sample Survey (LFSS).

sector than in the private sector, with the dynamics of this indicator being influenced above all by the education sector as a result of its restructuring during the past year. Still, it was again the private sector that contributed decisively to the positive development of income, considering the large share of persons employed there. The average wage grew by a nominal 20.6% and a real 7.3% in the private sector, compared to 25.1% and 11.3%, respectively, in the public sector.

Gradual deceleration of wage growth in part of economic activities

Wage growth in part of the economic activities gradually decelerated in 2008, the export-oriented branches being most strongly affected in this respect as a result of the contracted demand on external markets. The tendency in the change of income, which emerged in the second half of last year, persisted in the first months of 2009. The nominal growth of the average wage in the overall economy in the first half of 2009 amounted to 15.8%, year on year, which was the lowest value of the indicator since the beginning of 2007. The average wage increased by 10.2% in real terms, year on year.

In 2008, the dynamics of labour productivity³ in the Bulgarian economy was characterised by steady improvement, true to a tendency in recent years, and grew by 2.7% in real terms from 2007, and in the first quarter of 2009 the value of the indicator showed a 2.5% decline in real terms as a result of the economic slump in conditions of stagnant employment. In the second quarter, labour productivity decreased by 0.1%, year on year, and the level of the indicator did not change from the previous year as a result of the accelerated contraction of the number of persons employed in the economy.

II. 2.1. Modification of the economic situation forecasts

Key assumptions underlying the macroeconomic framework

The present forecast is based on an assumption that the European economy will recede by 4% in 2009 and by 0.1% in 2010, with a recovery expected to begin as late as in 2011, when the EU GDP will grow by 2% in real terms. A recovery of the global economy is expected to begin next year, thanks to the more dynamic development of the developing countries.

Considering the steps taken by the European Central Bank (ECB) to stimulate the economies for an early exit from the crisis, as well as the considerable levelling of inflation, the three-month LIBOR set in the macroeconomic framework is expected to vary from 1.5 to 2% until the end of next year. Similar expectations apply to the variations of six-month LIBOR in US dollars. The present forecast is based on an

³ The indicator is calculated as a ratio of gross value added (GVA) at constant prices to the number of employed persons according to the System of National Accounts (SNA) concept.

average exchange rate for 2009 of BGN 1.45/USD 1.00, and the dollar is expected to ease insignificantly to BGN 1.40/USD 1.00 in 2011.

Table 2: Key Macroeconomic Indicators

Macroeconomic Indicators	2008 Reported	2009 Expected	2010 Forecast
GDP (BGN mln)	66,728	63,710	63,518
- real growth (%)	6.0%	-6.3%	-2.0%
Harmonised inflation (%)			
- end of year	7.2%	1.8%	2.2%
- period average	11.9%	2.3%	2.2%
Exchange rate (USD/BGN)			
- end of year	1.39	1.45	1.45
- average annual	1.34	1.45	1.45
Current account (EUR mln)	- 8,653.1	-3,579.0	-2,584.5
- % of GDP	-25.4%	-11.0%	-8.0%
Foreign direct investment (EUR mln)	6,549.0	3,000.0	3,300.0
- % of GDP	19.2%	9.2%	10.2%

II. 2.2. Development of, and challenges to, the national economy expected in 2010

Gross domestic product

Expectations of a 6.3% real-terms contraction of the national economy in 2009

As a result of the financial crisis and the deterioration of the global economy, the Bulgarian economy is expected to contract by 6.3% in real terms in 2009. The uncertain economic situation is likely to compel economic agents to reconsider their investment intentions. This process will be reinforced further by the credit squeeze due to a liquidity reduction on a global scale and a risk reassessment on the part of financial institutions. The share of investment is expected to shrink to 26.5% of GDP in 2009 (from 38.4% of GDP in 2008) which, in turn, presupposes a contraction of 30% in real terms.

The slower wage growth and the rising unemployment are expected to impact household income adversely. This, coupled with the limited supply of household credit, will result in a 4% reduction of household consumption in real terms. The measures taken to cut government spending will lead to a decrease of general government consumption by 3% in real terms. As a result, total consumption expenditures are expected to contract by 4.2% in real terms in 2009.

Owing to shrinkage of domestic demand, the export of goods and services is expected to fall by 19.5% in real terms in 2009. Along with

that, the deterioration of the economies of this country's principal trading partners will have a negative effect on Bulgarian export, pressing it down by 12.3% in real terms.

***Bulgarian economy
forecast to contract by
2.0% in 2010***

In 2010, the Bulgarian economy is expected to contract by 2%. A process of economic recovery will start in 2011, with exports as a growth catalyst.

Inflation

Foods and energy goods are expected to contribute most to the fall of total inflation until the end of 2009, as their annual values were already negative by June and may stay that way at the end of December, too. Producer price deflation, which is typical of the EU at large and of Bulgaria in particular, is expected to persist until September 2009, after which the base effect may stop the slide of these price levels.

***Foods and energy goods
will show low but
positive inflation values
in 2010***

The total annual inflation rate at the end of 2009 is forecast at 1.8%, and the average annual rate at 2.3%. The industrialised economies are expected to start recovering in 2010. The international prices of both energy and non-energy goods will grow. This will boost the external inflationary factors and low but positive inflation values for foods and energy goods can be expected at the end of 2010. In 2010, internal factors will contain the overall increase in prices as nominal labour costs this year will not act as a pro-inflationary factor. Unemployment will be rising, and wage growth will lag behind the growth of labour productivity. The higher rates of excise duty on cigarettes will push total inflation up by 0.4 percentage points at the end of 2010. The average annual inflation and end-of-year inflation for 2010 are forecast at approximately 2.2%.

Balance of payments and financial sector

***The current account
deficit will contract
mainly due to an
improvement of the
trade balance deficit***

The current account deficit is expected to drop to 11.0% of GDP in 2009 from 25.4% in 2008, mainly due to an improvement of the trade balance deficit. With the export of goods contracting by 10.5% in real terms, the slackened domestic demand will lead to an 18.9% shrinkage of the import of goods. Combined with the lower international prices of metals, foods and energy goods, this will bring down the trade balance deficit from 25.2% of GDP in 2008 to 16.0% in 2009.

Less foreign investments

The global financial crisis will have a negative impact on the financial account inflows that the Bulgarian economy manages to attract. Foreign direct investment (FDI) in this country will contract tangibly in 2009 and is not expected to exceed EUR 3,000 million at the end of the year. Despite this negative tendency, the slower economic activity

at home leads to a substantial decrease of the current account deficit. As a result of this, FDI will finance 84% of this deficit, compared to 76% a year earlier.

The annual growth of money supply is expected to be 1.5% by the end of 2009 and to advance gradually to 10.4% at the end of 2012. Banks' net external assets will be improving and are expected to reach -BGN 2,690 million at the end of the period.

Labour market and incomes

Sluggish domestic demand and domestic investment activity expected to impact the labour market negatively

Sluggish domestic demand and domestic investment activity in 2009 and 2010 are expected to impact the labour market negatively during both years in question. The total employment rate is expected to drop by 4.9% in 2009 and by 2.5% in 2010. The employment rate will bottom in the second half of 2009, and this situation will linger in 2010, too, because of the delayed response of the labour market to slackened economic activity. Employment can be expected to come under the heaviest pressure in the export-oriented branches of the manufacturing industry producing construction inputs, as well as in certain branches of the services sector.

Labour productivity is expected to deteriorate on an annual basis in 2009 because of employers' delayed reaction to the economic recession. In conditions of a lower expected drop of GDP and continuing shedding of jobs, labour productivity is expected to rebound in 2010. The unemployment rate is expected to rise to 9.5% in 2009 and 11.4% in 2010. The depressed economic activity in the medium term is cause to expect a substantial slow-down of the growth rate of income from work.

III. CONSOLIDATED FISCAL PROGRAMME

III.1. REVIEW OF THE CONSOLIDATED FISCAL PROGRAMME (CFP) BY AUGUST 2009

At the end of August 2009, the budget balance under the CFP was in a deficit amounting to BGN 478.8 million as a result of a national budget deficit amounting to BGN 577.4 million and an excess of EU funds revenue over expenditure amounting to BGN 98.6 million.

The fiscal reserve at exchange rates current at 31 August 2009 amounted to BGN 7,667.5 million.

Table 3: *Implementation of the key parameters of the consolidated*

budget at 31 August 2009 (BGN million)

INDICATOR κ.1	Target 2009 CFP κ.2	Reported at 31 August 2009			Implementation 31 August 2009/target κ.6=κ.3:κ.2
		CFP κ.3=κ.4+κ.5	National budget ¹ κ.4	EU funds ² κ.5	
REVENUES AND GRANTS	32,556.3	16,581.6	15,788.1	793.4	50.9%
Tax revenues	25,728.2	13,254.8	13,253.7	1.0	51.5%
Direct taxes	4,943.5	2,785.2	2,785.2		56.3%
Indirect taxes	13,797.0	6,548.0	6,548.0		47.5%
Revenue from social and health insurance contributions	6,002.6	3,453.2	3,453.2		57.5%
Other taxes*	985.1	468.3	467.3	1.0	47.5%
Non-tax revenues	3,817.8	2,381.6	2,369.8	11.8	62.4%
Grants	3,010.3	945.2	164.6	780.6	31.4%
EXPENDITURES AND CONTRIBUTION TO EU GENERAL BUDGET	30,362.0	17,060.4	16,141.1	919.3	56.2%
Non-interest	27,902.2	16,599.0	15,679.8	919.2	57.7%
Current	22,692.4	13,619.2	13,230.4	388.8	60.0%
Capital	5,209.8	2,488.4	1,958.0	530.4	47.8%
Interest	636.7	461.4	461.3	0.1	72.5%
Reserve for pressing and contingent expenditures ³	891.3				
Contribution to EU General Budget	931.8	491.4	491.4		52.7%
Transfer from central government budget			-224.5	224.5	
BUDGET BALANCE	2,194.3	-478.8	-577.5	98.7	

* Incl. revenues from levies on sugar

Implementation of revenues

Revenues under the CFP tend to slow down, with a delay reported above all in VAT revenue

The consolidated budget revenues collected by August 2009 amounted to BGN 16,581.6 million, which represents 89.0% of the revenues for the same period of 2008. Implementation as a proportion of the annual targets under the State Budget of the Republic of Bulgaria Act (SBRBA) for 2009 was 50.9%, compared to 68.5% for the like period a year ago. Revenues under the CFP clearly tended to slow down in the January-August 2009 period. A delay from the targets is reported above all for tax receipts and particularly for revenues from VAT. Receipts from corporation taxes, revenues from social insurance contributions, revenues from income taxes on natural persons, the property taxes under the municipal budgets etc. did not meet the targets for the period, either.

This negative tendency is basically due to the economic slow-down and the substantial contraction of foreign trade. The negative tendencies in the real economy find further expression in a growth of

¹ The national budget grants item includes the resources provided to support the implementation of the Schengen Agreement and improve (facilitate) cash-flow in the national budget.

² EU funds: includes the resources under the EU pre-accession instruments, the resources under operational programmes co-financed by the EU Cohesion Fund and Structural Funds (managed by the National Fund under the Ministry of Finance), as well as the European Agricultural Fund for Rural Development and the European Fisheries Fund (managed by the Paying Agency under the Agriculture State Fund). The EU funds also include the resources provided in national co-financing.

³ The "reserve for pressing and contingent expenditures" item shows only the target data, and the target expenditures are shown in the respective expenditure items under which the expenditures were committed.

unemployment, reduction and suspension of production in a number of enterprises, a slump in the construction sector etc., which affects adversely the receipts from corporation taxes, social insurance contributions, the income tax on natural persons, the property taxes under the municipal budgets etc.

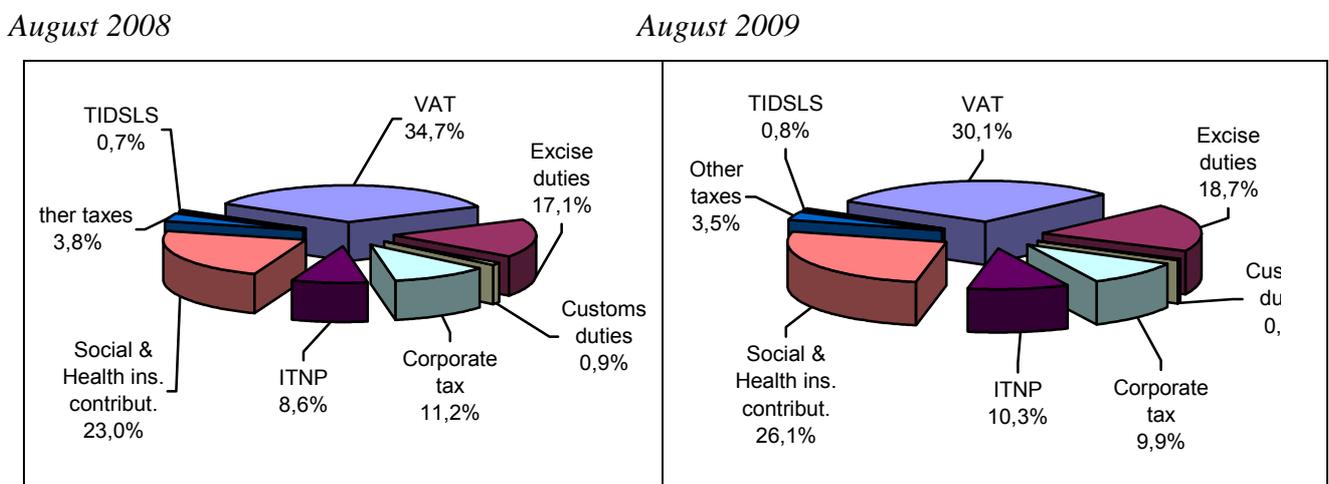
The decline in foreign trade, combined with a dive in the prices of oil, metals and other basic raw materials, nearly halved the current account deficit by May 2009 from the same period a year ago. On the one hand, this tendency narrows the imbalance in the country's external position but, on the other, leads to a steep decline in the receipts from VAT on imports. The gas crisis in January also depressed revenues.

By the end of 2009, the annual targets were met as follows, disaggregated by main constituent budgets:

- BGN 10,996.7 million, or 52.5% of the amount set in the 2009 SBRBA, accrued in revenues and grants to the executive budget for the reporting period;
- BGN 3,489.0 million, or 57.4% of the amount planned for the year, accrued to the budgets of the social and health insurance funds;
- BGN 68.5 million, representing 79.5% of the amount planned by the 2009 SBRBA, accrued to the judiciary budget;
- the revenues to the municipal budgets amounted to BGN 1,009.9 million, or 44.7% of the annual target, etc.

The chart below visualises the structure of tax revenues under the CFP for the January-August period of 2008 and 2009:

Chart 1. *Structure of tax revenues under the CFP for January-August 2008 and 2009*



Tax receipts (incl. revenues from social insurance contributions) amount to BGN 13,254.8 million, or 51.5% of the amount planned for the year.

Direct tax revenues amount to BGN 2,785.2 million, which represents 56.3% of the amount planned for the year, compared to BGN 3,025.8 million for the same period last year. In nominal terms, direct tax revenues shrank by BGN 240.6 million from the previous year as a result of the lower receipts from corporation taxes in March and April 2009 at the annual closing of the financial year 2008 and to the lower amount of tax prepayments in 2009.

Indirect tax revenues amount to BGN 6,548.0 million, down by BGN 1,264.1 million, and represent 83.8% of the amount reported for the same period of 2008. The receipts for the period meet 47.5% of the annual target, compared to 64.1% for the same period a year ago.

At 31 August 2009, VAT receipts amounted to BGN 3,986.3 million, which represents a nominal diminution of BGN 1,148.2 million (22.4%) from the same period of 2008. As little as 42.8% of the annual target was met, against 62.7% for the same period of 2008. A revenue reduction was reported mainly for VAT on imports, as a result of the factors mentioned above: a contraction of the volume of imports, a decline in the price of fuels and metals compared to the same period of 2008 etc. Just the effects of the lower price of oil and metals (steel, iron, copper) are estimated at a BGN 555 million and a BGN 370 million decrease, respectively, in receipts for January-August 2009 compared to the same period of the previous year.

Excise duty receipts for the period amount to BGN 2,475.3 million, a nominal BGN 62.2 million or 2.5% less than in the like period of 2008. This performance meets 58.1% of the annual targets, down from 66.8% for the same period of 2008. In accordance with the timeframe for adjustment of the level of excise duty rates, agreed with the European Commission, the rates of duty on kerosene, coal, coke, electricity and cigarettes were increased from the beginning of 2009. Receipts from customs duties and customs charges for January-August 2009 amounted to BGN 86.4 million, or 40.2% of the annual targets.

Revenues from **other taxes** (including other taxes under the Corporate Income Tax Act, property taxes, receipts from levies on sugar etc.) amount to BGN 468.3 million, which represents 83.5% of the receipts for the same period of last year.

Revenues from **social insurance and health insurance contributions** at 31 August 2009 amounted to BGN 3,453.2 million, or 57.5% of the

annual target under the 2009 SBRBA.

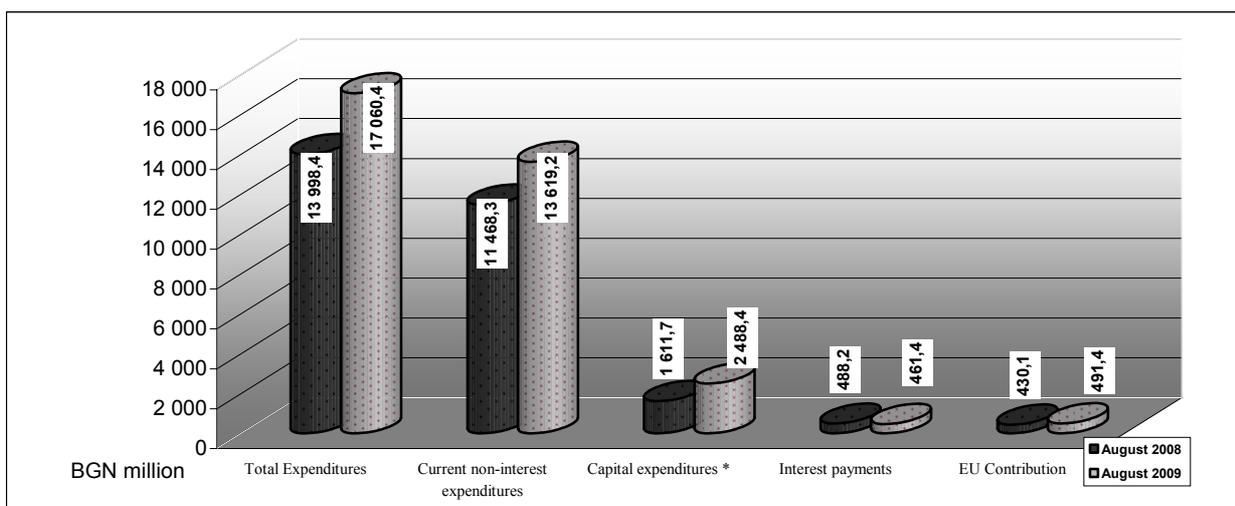
Non-tax revenues amount to BGN 2,381.6 million, which represents 62.4% of the annual targets. This figure is by BGN 444.6 million (15.7%) smaller than in the same period of 2008, and the comparison should take into account incidental revenues (revenues from interest to the amount of BGN 286.6 million) in connection with the agreement on settlement of the Iraqi debt to Bulgaria. The annual contribution of the excess of income over expenditure of the BNB for 2008, amounting to BGN 401.0 million, was credited in revenue to the executive budget during the reporting period. This contribution exceeds the target set in the 2009 SBRBA by BGN 101.0 million.

The **grants** (mainly advance payments from the EU Structural Funds and Cohesion Fund on the budget of the National Fund and receipts from the European Agricultural Fund for Rural Development and the European Fisheries Fund on the budget of the Paying Agency under the Agriculture State Fund) received for January-August 2009 amount to BGN 945.2 million (31.4% of the planned level), down from BGN 1,002.9 million for the same period of 2008.

Implementation of expenditures

The expenditures committed under the consolidated fiscal programme (including the contribution of the Republic of Bulgaria to the General Budget of the EU) at 31 August 2009 amounted to BGN 17,060.4 million, which represents 56.2% of the annual target in the programme.

Chart 2: *Main expenditure items under the consolidated budget, August 2008 and 2009*



Expenditures under the CFP disaggregated by main constituent budgets

1) Executive budget:

The non-interest expenditures under the executive budget (excluding the transfers to other budgets), effected in January-August 2009, amount to BGN 5,081.5 million, which accounts for 50.5% of the resources allocated in the 2009 SBRBA. Compared to the same period of 2008, non-interest expenditures increased by BGN 820.6 million or 19.3%.

For the main expenditure items of the group of *current non-interest expenditures*, the annual target was met as follows: wages, salaries, social and health insurance contributions 59.4%; social expenditures (incl. scholarships) 46.1%; current maintenance 45.3%; subsidies 96.2%.

The resource spent on *capital expenditures* (incl. net state reserve gain) amount to BGN 1,046.1 million, or 39.5% of the annual target.

The **interest payments** effected by the end of August amounted to BGN 450.4 million, of which BGN 316.3 million were paid in interest on external loans and BGN 134.1 million in interest on domestic loans. Compared to the same period of last year, interest expenditures under the executive budget are by BGN 27.2 million less, and they take up 4.1% of total expenditures for the reporting period, down from 5.2% for 2008.

Transfers from and to other budgets under the executive budget represent net transfers provided to the amount of BGN 5,049.2 million, or 61.1% of the resources planned in the 2009 SBRBA.

2) Expenditures under the budgets of the social security funds

The expenditures under the budgets of the social security funds (the NSSI, the NHIF, the UPF and the FOWGCF) amount to BGN 6,097.1 million for the reporting period, or 63.2% of the annual target, including pensions, allowances and benefits under the Social Insurance Code (SIC) to the amount of BGN 4,849.9 million and health insurance payments to the amount of BGN 1,145.9 million.

3) Expenditures under the municipal budgets

The expenditures effected under the local budgets, including for the account of targeted transfers provided by other budgets, amount to BGN 2,988.6 million, or 75.2% of the target set in the 2009 SBRBA. Current expenditures amount to BGN 2,255.0 million, and capital expenditures to BGN 733.6 million.

III.2. ASSESSMENT OF THE IMPLEMENTATION OF THE CONSOLIDATED BUDGET UNTIL THE END OF 2009

Since the beginning of the year, the economic situation has been developing according to a more pessimistic scenario than the one forecast at the end of last year when the targets under the 2009 SBRBA were set.

The expected undercollection of revenues for the year at consolidated level exceeds the buffer set in the 2009 SBRBA limiting non-interest expenditures and transfers under the executive budget to 90% of those planned in the Act and the 3% budget surplus of a total amount of some BGN 3,900 million.

The consolidated budget balance for 2009 is likely to deteriorate seriously as a result of the following factors:

- contraction of revenues and a forecast of a substantial shortfall of annual targets on the revenue side of the budget;
- the larger expenditures effected for January-July 2009, mainly because of outpacing financing in the absorption of capital expenditures.

The efforts intended to achieve a neutral budget position for 2009 dictated the approval of additional urgent measures to restrict non-interest expenditures and transfers under the executive budget. The fiscal effect of these measures approximates BGN 1,150 million, while the shortfall to achieving a balanced budget for 2009 is estimated at some BGN 2,500 million. Continued efforts will be made to economise expenditures, with the limits on expenditures for the remaining months until the end of the year being approved after a careful particularisation and depending on the priority and urgency status of expenditures.

Apart from curtailment of expenditures, measures have also been taken to improve revenue compliance, as a result of which extra revenues of some BGN 1,000 million are expected to be collected. Action has been taken to tighten customs control at the borders and the revenue administrations have taken intensified measures to interdict contraband import into the country and to suppress the schemes for fraudulent recovery and evasion of VAT, excise duties and other taxes.

The delay in the collection of tax revenues and specifically of VAT revenues is most tangible. The key factors affecting receipts from this tax are the economic slow-down and a substantial contraction of foreign trade, accompanied by a drastic slump of the prices of oil, metals and other basic raw materials on the international markets.

The updated assessments of the key parameters under the CFP for the

year, with an allowance for the expected effect of the measures, suggest a major shortfall on the revenue side from the targets of the programme. Revenues and grants under the consolidated budget for the year, including the measures, are forecast to stay below the planned annual target, with the possible shortfall amounting to some 20-22%. The bulk of this shortfall is likely to be in tax revenues, mainly from indirect taxes (VAT, excise duties), corporation taxes, revenues from contributions to the public social insurance funds and to the NHIF, income taxes on natural persons, property taxes etc.

Indirect taxes, which traditionally contribute over half of the tax revenues under the CFP, are likely to lag most tangibly. Judging from first-half figures and the forecast for the rest of the year, the shortfall of indirect tax revenues is likely to vary from 20 to 25%, depending on the effect of the measures. Forecasts suggest that VAT receipts for the year will reach some 70-75% of the annual target, excise duty revenues are expected to be close to the annual target, and customs duty revenues to meet some 60% of the target.

Direct taxes are expected to be collected at some 79% of the annual target, of which corporation taxes some 71% and income taxes on natural persons between 87 and 88%. The tendencies and factors that affected direct tax revenues for the January-June period are expected to keep their influence in the months left until the end of the year, which explains the expected shortfall from the annual target.

Revenues from social and health insurance contributions are expected to fall short of the annual targets by some 9-10%. The share of these revenues in the tax revenues under the CFP approximates 27%.

Non-tax revenues implementation is forecast to be below the annual targets, with a lag likeliest in the planned revenues from the sale of land and tangible fixed assets under the municipal budgets, which in previous years raised considerable revenue from such sales. Considering the tendencies that emerged in the first half of the year, 92-93% of the non-tax revenues targeted in the 2009 SBRBA for the year are expected to be collected.

A substantially lower absorption is also expected of the EU resources: the grants from the Structural Funds and the Cohesion Fund, as well as the resources from the European Agricultural Fund for Rural Development and the European Fisheries Fund etc. The shortfall (an expected absorption of some 50% of the planned grants) is due to a delay of procedures and to the suspension of payments imposed on the part of the European Commission.

III.3. CONSOLIDATED FISCAL PROGRAMME FOR 2010

To ensure a stable budget position next year under the changed economic conditions and with limited budget resources, efforts are focused on tightening fiscal discipline, optimising and prioritising revenue compliance and achieving a balanced national budget for 2010.

Revenues under the consolidated fiscal programme for 2010 are planned at an amount of BGN 26,400 million, down 19% from the 2009 Programme and some BGN 435 million up from the implementation expected at 31 December 2009. The amount of revenues is forecast on the basis of an increase of the rates on certain excisable goods and unchanged rates of the other direct and indirect taxes, as well as a reduction of the overall social insurance burden by 2 percentage points.

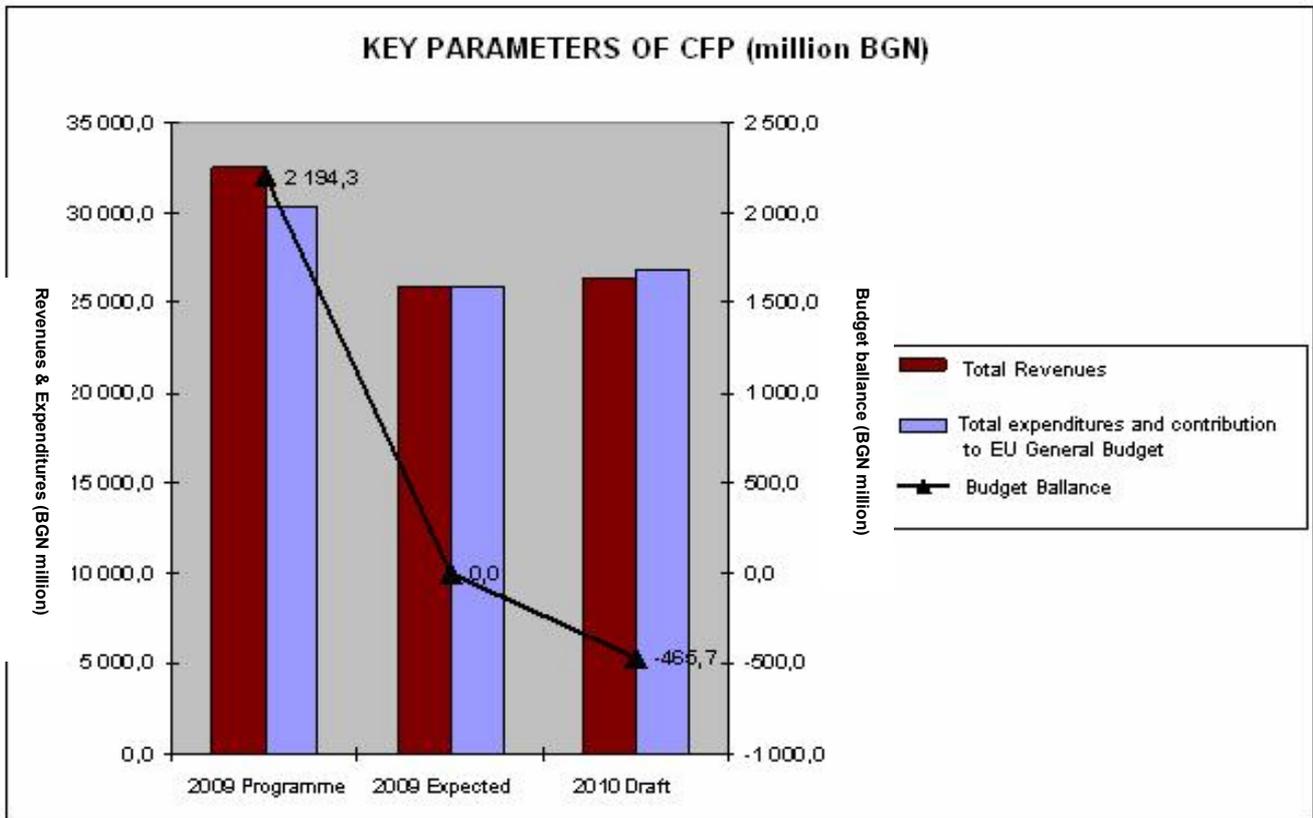
Table 4: Consolidated fiscal programme (2009 and 2010)

Indicators (BGN million)	2009 Programme	2009 Expected	2010 Draft
Total revenues	32,556.3	25,960.2	26,395.0
(% of GDP)	44.3%	40.7%	41.6%
Total expenditures	29,430.2	25,153.9	26,081.0
(% of GDP)	40.0%	39.5%	41.1%
Contribution to EU General Budget	931.8	806.3	779.7
(% of GDP)	1.3%	1.3%	1.2%
Total expenditures and contribution to EU General Budget	30,362.0	25,960.2	26,860.7
(% of GDP)	41.3%	40.7%	42.3%
Budget balance	2,194.3	0.0	-465.7
(% of GDP)	3.0%	0.0%	-0.7%

Compared to the targets under the 2009 Budget Act, 17% less indirect tax revenues are forecast to be collected: 29% less from VAT and customs duties and 6% more from excise duties. Direct tax revenues are expected to decline 20%, most substantially from social and health insurance and from corporation taxes.

Non-tax revenues for 2010 target BGN 3,400 million, 11% less than under the 2009 Programme. In 2010 the grants, most of which come from the EU budget, will be 32% less than in 2009.

Chart 3: Key parameters of the CFP (2009 and 2010)



Cutting expenditures to maintain a balanced budget position

The total expenditures financed with resources raised from the national economy amount to BGN 24,400 million, which represents 38.4% of GDP, whereas the total expenditures under the consolidated fiscal programme amount to BGN 26,900 million or 42.3% of GDP, including the resources originating from the assistance from the EU.

Social expenditures: the largest item under the consolidated fiscal programme

Social expenditures are among the largest items under the consolidated fiscal programme. The amount of expenditures in the social sector has been steadily growing in recent years, and for 2010 it accounts for 36.7% of total expenditures or 15.1% of GDP. Compared to the 2009 Programme, social expenditures increase by 2.3% of GDP.

This growth should be offset by a reduction of expenditures in the rest of the sectors excluding those which the Government treats as priorities.

Priority allocation of resources for education

Public spending on education has been standing at over 4.0% of GDP in recent years, and the 2010 budget projects this level at 4.2% of GDP. The expected smaller amount of GDP for 2010 requires a more effective spending of the resources, through prioritisation of measures to improve the quality of education and ensuring equal access.

Keeping public spending on health care at the levels reached

Public spending on health care will remain at its 2009 level of 4.2% of GDP, its nominal amount being BGN 2,600 million. Cushioning the impact of the crisis on the health system requires a launch of the delayed reforms for restructuring and improving the effectiveness of the system.

More public money for environmental protection

The existing serious environmental challenges with substantial financial and economic implications compel the State to continue to play an important role, at central and local level, in the strategic planning and financing of environmental investments mainly by mobilising public investments financed by the EU budget. The 2010 budget plans spending on environmental protection amounting to 1.6% of GDP, compared to 1.3% of GDP under the 2009 Programme.

No change in level of expenditures on transport and communications

With the limited opportunities for national investments financed from the proceeds from vignettes and other road tolls, the major road infrastructure projects can be implemented either by increasing the tolls for use of the road infrastructure or by improving the management of the assistance provided by the EU. The indicative expenditure targets in the 2010 framework amount to 3.1% of GDP, compared to 3.0% of GDP for 2009.

Shift in the ratio of capital expenditures sourced in EU funds and those sourced in the national budget

The investment expenditures planned in the 2010 budget prioritise environment and road infrastructure. The total capital expenditures under the consolidated fiscal programme amount to 6.1% of GDP: 3.0% sourced in the national budget and 3.1% sourced in EU funds.

The capital expenditures are decreased from the 7% of GDP set in the 2009 Programme by reducing the investments sourced in the national budget by 1.7% of GDP while increasing the resources from the EU by 0.9% of GDP.

III.4. ASSESSMENT OF THE STABILITY OF PUBLIC FINANCES AND MAJOR RISKS TO THE IMPLEMENTATION OF THE CONSOLIDATED FISCAL PROGRAMME FOR 2010

Potential growth and deviation from potential GDP

The material disparities between the macroeconomic framework used for preparation of the 2009 budget and the latest forecasts of the development of domestic demand (in particular investments), the labour market and the gross domestic product also lead to different

assessments in respect of the potential economic growth and the deviation from potential GDP. The value of the potential GDP growth, calculated for 2008, amounts to 5.2% (compared to 6.3%, calculated in the latest annual update of the Convergence Programme, dated December 2008). The deviation from potential GDP for 2008 is positive, amounting to 6.8%.

In 2009, the effects of the economic and financial crisis on Bulgaria's economy are expected to decelerate the potential economic growth to 3.7%. In 2010, the potential growth is expected to reach 2.7%.

With this forecast of economic development, the deviation from potential GDP is expected to reach -3.5% in 2009, i.e. the economy is to enter a recession phase. The crisis is expected to have its strongest manifestation on the cycle phase in 2010, with the deviation from potential GDP accordingly reaching almost -8%. An approximation to potential GDP is expected in the following years as a result of strengthening demand.

Table 5: *Potential growth and deviation from potential GDP*

Indicator	2007	2008	2009	2010
Potential growth	4.9%	5.2%	3.7%	2.7%
Deviation from potential GDP	5.9%	6.8%	-3.5%	-7.9%

Source: Agency for Economic Analysis and Forecasting

Table 6: *Potential growth inputs (percentage points)*

Year	Labour	Capital	TFP ⁴
2007	0.95%	2.58%	1.34%
2008	0.93%	3.11%	1.14%
2009	1.14%	1.46%	1.09%
2010	0.44%	1.14%	1.13%

Source: Agency for Economic Analysis and Forecasting

Fiscal sustainability

The process of

Long-term fiscal sustainability is influenced considerably by the

⁴ Total factor productivity.

population ageing will exert serious pressure on public finances in the long term

present level of the budget balance and government debt, as well as by their expected change as a result of population ageing. The process of population ageing poses a credible risk to public finances as it will exert a serious pressure for an increase of budget expenditures on pensions and health care.

The standard approach to assessment of fiscal sustainability, adopted by the EC, is the so-called S2 indicator, which can be interpreted as the gap between the current (forecast) fiscal position for each year ahead in the future and the position which meets the sustainability condition for an indefinite period ahead in the future. The indicator consists of two components: current budgetary position and the discounted present value of the effect of population ageing in the long term.

A positive value of the indicator signifies a need of fiscal consolidation and structural reforms to ease the burden of population ageing on public finances.

Conversely, a negative value presupposes that the initial budgetary position is sufficiently strong to ensure fiscal sustainability even with the risk of population ageing.

Table 7: *Fiscal sustainability indicator*

Baseline scenario (% of GDP)	
Initial budgetary position 2008	-2.01%
Effect of population ageing	3.04%
S2	1.03%

In the case of Bulgaria, the value of the S2 indicator is positive, which shows that the current fiscal position is sufficiently sustainable. The decomposition of the indicator into components presupposes that the stability of public finances is based only on the budget surplus policy and that it is necessary in the long term to offset the considerable negative impact of the process of population ageing. A potential loosening of the fiscal position, unaccompanied by other measures, will lead in the long term to a build-up of debt and will breach the criteria for sustainable budget policy.

Assessment of fiscal risks

The major risks to the implementation of the budget in the medium term are related to:

- A slow-down of domestic demand and economic growth and the related non-implementation of the revenue side of the budget.
- Difficulties in financing the budget.
- Potential need of capital support for the banking system.
- Population ageing, leading to pressure on the pension system.

The slow-down of growth in key trading partners, as a result of the bank credit crunch and an impeded access to liquidity, is expected to lead to a marked slump of Bulgaria's economic growth. The data about the GDP decline confirm these forecasts and put at risk the revenue side of the budget. The risks to the implementation of the revenue side of the budget persist in 2010.

The economic slow-down and the extraneous effects of the crisis have an adverse effect on the revenue side of the budget

The economic slow-down and the extraneous effects of the crisis have an adverse effect on tax receipts. Revenues tend to lag most tangibly in indirect tax revenues, which are strongly influenced by the contraction of foreign trade and the changed international and domestic market situation. Direct taxes, too, generate lower receipts, especially corporation taxes and income taxes on natural persons, as well as the revenues from social insurance contributions.

The financial crisis and the shaking of investors' confidence in the markets of Central and Eastern Europe may result in problems for budget financing. Some of the countries in the region experienced difficulties in the placement of domestic government debt due to insufficient demand on the part of investors. Bulgaria, too, felt certain pressure on the primary market of government securities in the form of a steep decline of demand for government securities and, respectively, an increase in the yield. This may necessitate a reorientation of debt policy towards issuing shorter-term government securities and adds yet another argument in favour of avoiding a large budget deficit, so as to prevent an excessive depletion of fiscal reserves.

The relatively high current account deficit remains a medium-term risk

The relatively high current account deficit is another medium-term risk that continues to warrant the implementation of a conservative fiscal policy. This deficit was a key factor of maintaining a prudent fiscal policy in recent years, and its persistently high level despite the crisis continues to require budget discipline so as to minimise the risks to its financing.

The need to provide capital support to the banking system would put public finances under pressure. The likelihood of the banking system

needing capital support from the budget is relatively small, but the risk is not insignificant considering the large amount of the potential capital assistance.

A considerable increase in the share of elderly people and a deterioration of the demographic structure of the population is forecast in the long term, which poses a serious risk to fiscal policy and may lead to pressure on budget expenditures on pensions and health care. This process is a serious challenge to the sustainability of public finances and calls for the launch of reforms in the pension system, an improvement of the quality of public spending in the health-care and education systems, as well as the maintenance of a conservative policy in respect of the budget balance. The reforms will make it possible to cope with the burden of an ageing population in future without jeopardising the stability of public finances.

IV. PARAMETERS OF THE 2010 BUDGET

IV.1. MAINTAINING A BALANCED BUDGET POSITION

Budget policy should be balancing between the objectives of stimulating the economy and preserving macroeconomic stability.

The measures for achievement of stability of the macroeconomic system envisage:

- Keeping the currency board arrangement and the fixed exchange rate of the lev against the euro until entry into the Eurozone;
- Maintaining a balanced budget;
- Invigorating the efforts to join Bulgaria to ERM II and to adopt the euro in Bulgaria after meeting the Maastricht criteria;
- Daily and consistent fight with fiscal theft and tax fraud.

In the conditions of economic crisis, Bulgaria's fiscal policy is expected to have a pronounced pro-cycle nature in 2009. This is due to a dramatic slump of the economy below the potential for that period, which leads to a reduction to zero of the budget surplus. The planned discretionary measures to balance the budget in the second half of 2009 seek to minimise the fiscal risk resulting from the economic recession. Setting an objective of a balanced budget in 2010 practically implies a pro-cycle influence of the budget on the economy this and next year. The fiscal position will retain its pro-cycle nature, which will not be markedly pronounced and, in the medium term, will be holding back economic recovery.

IV.2. TAX AND SOCIAL-INSURANCE POLICY

IV. 2.1. Goals of tax and social-insurance policy

Tax and social-insurance policy has as a goal to preserve the stability of the economy in economic crisis conditions and seeks:

- to stimulate business and investment activity through preservation of the rates of direct taxes in combination with a lower social insurance burden for employers in support of economic growth and employment.
- to improve compliance with taxes and social insurance contributions and to roll back the grey economy.

Increasing the rates for certain excisable goods

In respect of direct taxes, it is planned to keep the tax rates unchanged. The consistent lowering of the rate of corporation tax to 10% in recent years has been instrumental in increasing the corporation tax revenue to the state budget, as a result both of the promotion of foreign and local investments and of a roll-back of the grey sector.

Keeping the rates of the other direct and indirect taxes unchanged

In respect of indirect taxes, it is planned to increase the rates for certain excisable goods, according to the transitional periods agreed with the European Commission and with a view to attaining the Community minimum rates of excise duty.

Lowering the total social insurance burden by 2 percentage points

One of the measures with the strongest effect for overcoming the negative consequences of the crisis on employment and Bulgarian citizens' income is the planned reduction of the social insurance contribution to the Pensions Fund by 2 percentage points, effective 1 January 2010. This will give the business community the incentives needed to keep the existing jobs, from which low-skilled workers and workers in worst crisis-hit sectors of the economy will benefit the most. In 2010, the social insurance contribution will be reduced by 1.1 percentage points for employers and 0.9 points for employees.

Better social insurance protection for factory and office workers

To improve the social insurance protection of factory and office workers who have lost their jobs by reason of their employer's bankruptcy, in 2010 the maximum monthly amount of the benefit from the Factory and Office Workers' Guaranteed Claims Fund will be increased from two and a half minimum wages (BGN 600) to three minimum wages (BGN 720).

The minimum and maximum amounts of the monthly unemployment benefit remain unchanged from 2009, at BGN 120 and BGN 240, respectively. The same applies to the amount of the monthly child care benefit payable until the child's second birthday, which remains BGN 240 in 2010 as well.

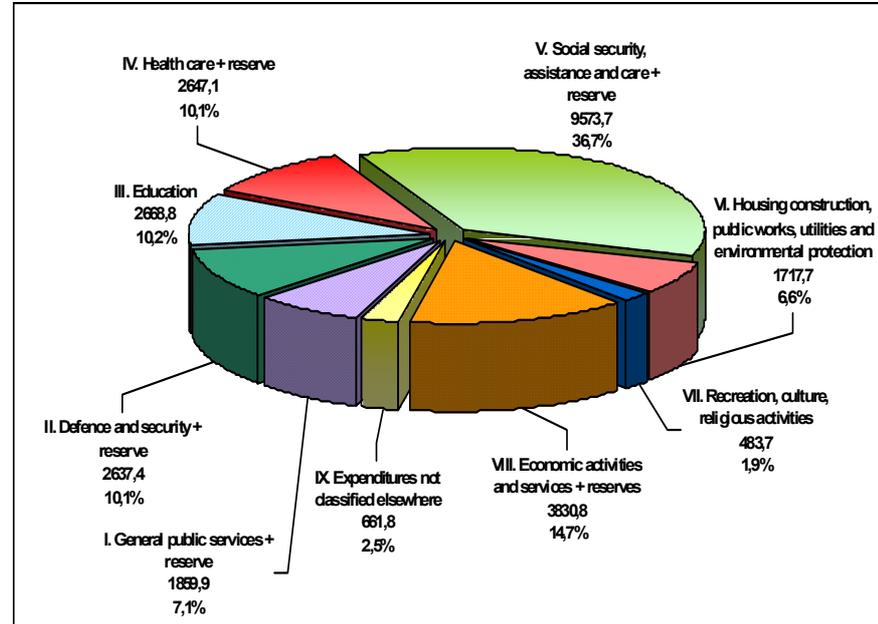
As a measure to increase revenues from social insurance contributions and to contain the grey economy, in 2010 the minimum monthly amount of the contributory income for self-insured persons will be increased from BGN 260 to BGN 420, and the minimum amount of the contributory income for agricultural producers and tobacco growers will be set at BGN 240 from 1 January 2010.

The maximum monthly amount of the contributory income remains unchanged at BGN 2,000 for 2010.

IV. 2.2. Structure of consolidated revenues by principal source

The structure of consolidated revenues in the 2010 Budget reflects the forecasts of receipts by individual sources of revenue in the consolidated fiscal programme in accordance with the Government's tax and social-insurance policy. The amount of revenues is forecast on the basis of an increase of rates for certain excisable goods and keeping unchanged the rates of the other direct and indirect taxes, as well as a reduction of the total social insurance burden by 2 percentage points.

Chart 4: *Structure of consolidated revenues by principal sources of revenue for 2010*



Tax revenues

The proposed provisions amending and supplementing the tax laws are intended to streamline taxation practice, as well as remove non-conformities of tax legislation with EU law.

The principal revisions proposed in the acts to amend and supplement the tax laws are presented below.

Corporate income tax

The revisions of the Corporate Income Tax Act (CITA) will streamline taxation practice and will remove certain non-conformities with EU law. Unequal tax treatment will no longer be extended to resident and non-resident persons from the EU/EEA and an identical tax burden is imposed on them, proposing that non-resident legal persons be able to have part of the tax withheld at source refunded upon accounting for the expenses incurred by them.

Another amendment to the Act provides that taxable persons, which have not carried out activity and which have not accounted for income or expense, be exempt from the obligation to submit an annual financial statement, so as to ease the administrative burden on inoperative enterprises, as well as to facilitate the collection and storage of information at the NRA.

It is proposed to repeal the tax relief for enterprises making large investments in agriculture, the manufacturing industry, production, high technologies and infrastructure, according to which enterprises which have performed an investment of not less than BGN 10 million were allowed to retain 100 per cent of the corporation tax for a period of five years. Application of this relief requires a favourable decision of the EC because, under EU law, this constitutes State aid. Bulgaria has notified the relief to the EC, but a decision has not been issued so far. Because of their great social significance, the Assisted Reproduction Fund and the Transplantation Fund Centre are added to the range of persons in favour of which a donation qualifies for a tax relief.

As from next year, the tax on the gambling activities of toto and lotto, betting on the outcome of a sports competition and uncertain events will be increased from 10% to 12%. The change is intended to equalise taxation on all organisers of games of chance. At present, the gambling activities of lotteries, raffles and bingo and keno numbers lotteries attract a tax of 12%. The positive effect for the budget is expected at some BGN 12 million annually.

Corporation tax revenues are typically raised above all through tax prepayments and an annual balancing payment or request for offset/refund of an overremitted tax. The tax prepayments are statutorily fixed on the basis of the taxable profit for the year before the last preceding year (first quarter) and for the last preceding year (second, third and fourth quarters), adjusted by a coefficient reflecting the expected changes in the economic conditions (the coefficient is 1.1

for 2009). It is important to note that if the companies determine that with the current tax prepayments fixed in this way they will overremit the tax, they have the right to reduce these prepayments.

This rule also applies to forecasting the receipts, because when the economy recedes it is logical to have a substantial decrease in tax prepayments and a low level of the balancing annual payment for the financial year following the current year (2010).

A positive element of the tax policy of the Republic of Bulgaria is the rate of corporation tax of 10%, which is among the lowest in the European Union. This makes our country an attractive investment destination in terms of taxation. The low tax levels stimulate the “coming to light” of the economy and economic development.

The key factors taken into consideration in forecasting corporation tax revenues for 2010 can be grouped in three main areas:

1. Internal economic

Expected economic recession: a 4.9% year-on-year decrease of GDP reported for the second quarter of 2009, with the GDP expected to drop 5.7% for 2009 and 2% for 2010.

Corporation tax revenues also depend on the “coming to light” of the economy, inflation, the price of credit and the availability of credit to companies, the level of productivity etc.

2. Foreign economic

Bulgaria’s principal foreign economic partners are the Member States of the European Union, in which the economic crisis depressed the GDP and deflated prices. In this sense, the recovery of the European economies, of which there are positive signals, will have a favourable impact on the profits of export-oriented Bulgarian enterprises.

Another particularly important factor is the price of raw materials that Bulgaria’s economy imports.

3. Regulatory

The forecast is based on an unchanged legislative framework affecting receipts from corporation taxes.

- Unchanged 10% rate of corporation tax;
- Unchanged 5% rate of the taxes on income from dividends and shares in a liquidation surplus accruing to resident and non-resident legal persons.

Considering the above, receipts from corporation taxes for 2010 are expected at an amount of BGN 1,663.9 million, or 11.5% less than the BGN 1,879.9 million expected to be collected for 2009.

Some BGN 150 million of these BGN 1,663.9 million originate from new measures taken by the revenue agencies, leading to a reporting of companies’ turnovers and, respectively, to a larger amount of the

receipts from the tax.

Other taxes under the CITA

Tax on gambling activity under Article 220 of the CITA: the rate of tax is changed from 10 to 12% for the gambling activities of toto and lotto, betting on the outcome of a sports competition and uncertain events. The effect of this change in the statutory framework is estimated at increase of some BGN 12.1 million of budget revenues.

Income taxes on natural persons

The provisions amending and supplementing the Income Taxes on Natural Persons Act (ITNPA) for 2010 seek the achievement of two main objectives: elimination of the conflict detected between Bulgarian tax legislation and the law of the European Union, and particularisation of the provisions of the Act.

Non-resident natural persons from the EU/EEA are granted the right to recalculate the tax withheld at source in the manner applicable to resident natural persons.

Income from the sale or exchange of a residential immovable property will be non-taxable if the property was owned for at least three years before being disposed of. The condition of a specified length of ownership of the property will guarantee that the transaction is incidental and cannot be qualified as speculative or as concluded with the intention to evade payment of taxes.

Income from the sale of shares/interests acquired through allotment in consideration of a non-cash contribution to a commercial corporation is added to the taxable amount.

The tax relief for young married couples: debiting interest payments under mortgage loans, is repealed.

Persons who have lost 50 per cent and more than 50 per cent of their working capacity will make tax prepayments in respect of income accruing from other than employment relationships after their income during the year exceeds the amount of the tax relief. Donations for the Assisted Reproduction Fund Centre and the Transplantation Fund Centre are added to the donations eligible for tax relief.

An obligation is introduced for natural persons to declare loans of an aggregate annual amount exceeding BGN 5,000. The measure implements Point 33 of the Timetable of Urgent Measures and Actions by the Government and the Judicial Authorities for Implementation of the Benchmarks in the Areas of Judiciary Reform, the Fight against Corruption and Organised Crime for the September – December 2009 Period, approved by Council of Ministers Decision of 9 September 2009.

The forecast of the revenues from the taxation of natural persons' income for 2010 is based on keeping the 10% flat rate of tax for all

taxpayers (without a tax threshold), with the exception of the income accruing from economic activity to sole traders, which attracts tax at the rate of 15%.

The following have been taken into consideration in forecasting receipts from income taxes on natural persons:

- the expected number of employed persons, considering the downward trend in the number of persons in employment in connection with the impact of the global crisis on the Bulgarian economy and the expectations that this impact will persist in 2010;
- the expectations that the level of wage resources reached in 2009 will not change appreciably in 2010;
- the amounts of the social insurance contributions and the ratio in which they are shared between employer and employee, set for 2010.

The expected amount of revenues from personal income tax includes revenues from the tax on the income of persons employed under employment relationships and legal relationships equivalent to an employment relationship, income under non-employment relationships, as well as the revenue from licence tax credited to the local budgets. The receipts from the taxes under the ITNPA for 2010 are forecast at an amount of BGN 1,987.3 million (including BGN 22.1 million revenues from licence tax, credited to the local budgets), compared to an expected amount of revenues for 2009 of BGN 2,009.9 million.

Value added tax

The amendments to the Value Added Tax Act (VATA) are intended to streamline taxation practice and to remove certain non-conformities to EU law. In connection with Council Directive 2008/8/EC, the place of supply of services will depend on the status of the person to whom the services are rendered: whether this is a taxable or a non-taxable person. The time limit for deduction of credit for input tax is increased from three months to twelve months. Procedural representation, by which natural persons exercise their right to defence in pre-trial, administrative and arbitration proceedings, will be excluded from the scope of exempt supplies.

In connection with the measures to fight tax fraud, the amendments provide that, upon registration under the Act of any persons who do not or have not properly fulfilled their obligations under the VATA, such persons will be required to declare an electronic address for correspondence with the revenue administration. The proposed revisions are intended to limit the opportunities for protracted proceedings under the VATA in respect of non-compliant persons. The idea is to save time and money to the administration, without

restricting the rights of compliant persons.

A remote link of the fiscal cash register devices with the National Revenue Agency is introduced for the purposes of fighting the grey economy. The revenue authorities will be able to deny or terminate registration under the Act to persons who incur public liabilities collected by the NRA. So far this measure applied only to tax liabilities. The sequence of persons who should be held liable for the tax under a taxable supply is repealed.

Table 8: VAT revenues for 2010 (BGN million)

REVENUES	Expected to be collected 2009	Down 2009/ 2008	Draft 2010	Up 2010/ 2009
VAT under same statutory framework as in 2009, incl.:	6,670.1	82.4%	6,650.0	107.8%
- domestic transactions and ICA	3,700.0	107.2%	3,950.0	106.7%
- third countries	2,467.1	68.2%	2,700.0	109.4%
Effect of legislative amendments and old liabilities for prior years	500.0		150.0	
VAT – consolidated budget	6,670.1	89.1%	6,800.0	102.0%

Revenues from domestic transactions and intra-Community acquisitions (ICA): the draft for 2010 targets a growth of 5.4%, with an allowance for the 2.5% contraction of consumption and a rise in inflation according to the macroeconomic framework for the period.

The total forecast of VAT revenues for 2010 (aggregating domestic transactions, ICA and import from third countries) stands at BGN 6,650 million, on a taxable amount of BGN 33,250 million.

Effect of legislative changes: because of the new rates of excise duty on tobacco products and electricity, which forms part of the VAT taxable amount in respect of these goods, an extra BGN 150 million will be credited to the budget in VAT. The provisions supplementing the VATA also introduce a remote link between the NRA and the fiscal cash-register devices.

This forecast of BGN 6,800 million revenues from VAT for 2010 can be achieved with an effective compliance rate of 90.5%, compared to an effectiveness of 90% expected for 2009.

Excise duties

The revisions of the Excise Duties and Tax Warehouses Act basically concern the commitments assumed to attain the Community minimum rates of excise duty on the various types of goods and tightening control by the customs authorities and the measures to fight the grey economy.

It is proposed to increase the rates of excise duty on the various types of excisable goods:

- Cigarettes: from BGN 41 per 1,000 items and BGN 40.50 of the selling price to BGN 74 per 1,000 items and BGN 36 of the selling price. An overall minimum excise duty on cigarettes is introduced at the rate of BGN 137 per 1,000 items. The increase is part of the commitments assumed under the Treaty concerning the Accession of the Republic of Bulgaria to the European Union and is undertaken considering the policy for public health protection as well as for safeguarding the fiscal interest;
- Kerosene: from BGN 565 per 1,000 litres to BGN 600 per 1,000 litres;
- Electricity for business purposes: from BGN 1.40 per 1 megawatt hour to BGN 2.00 per 1 megawatt hour.

The changes are expected to bring an additional BGN 232 million into the state budget in 2010.

Amendments transposing Directive 2008/118/EC, which enters into force on 1 April 2010:

- computerising the movement and surveillance of excisable products through the Excise Movement and Control System (EMCS);
- introducing new concepts and procedures for handling the computer system.

Amendments in connection with the fight against the grey economy:

- Repeal of the hitherto effective arrangements for refund of the excise duty on motor fuel (on the basis of 75 litres per hectare of arable land), used for tillage of agricultural land by agricultural producers approved for financial support under the Agricultural Producers Support Act;
- Introduction of a system for the sale of fiscally marked gas oil and kerosene used for heating and tillage of agricultural land subject to excise duty at a rate of BGN 50 per 1,000 litres;
- Imposition of an obligation on the persons who will be releasing fiscally marked fuels for consumption to hold a certified document in a standard form from the person who will be using these goods for the relevant assigned use. In case they do not hold such a document, such persons will be liable for the difference between the reduced rate and the standard rate of excise duty on the type of fuel concerned as fixed in the Act. This proposal is intended to establish the use of fiscally marked fuels for the assigned use (for agricultural purposes

and heating);

- Introduction of excise duty at the rate of BGN 600 for heavy ship fuels;
- Introduction of a zero rate of excise duty on lubricants, which will thus be subject to control by the customs authorities;
- Introduction of additional requirements related to the issuance of licences for management of a tax warehouse and the registration of the registered merchant and an unregistered merchant;
- Separation of the process of manufacture from the processes related to a purely physical mixing of fuels. Determination of the habitual operations which may be performed in a tax warehouse, as well as those which may be performed after advance written notification of the competent customs office;
- Repeal of the obligation to pay excise duty upon the lapse of the 60-day time limit for receipt of the excise revenue stamps for goods the excise duty on which has not become due on other grounds. In this connection, it is specified that the excise revenue stamps are ordered monthly on the basis of the average monthly quantity of goods released for consumption. Larger quantities may be ordered after a decision of the chief of the competent customs office;
- Limitation of the aggregate capacity of containers for production of ethyl alcohol at small distilleries to 500 litres;
- Prohibition of the storage of goods on which the excise duty has been paid at a tax warehouse. In exceptional cases, this can be done after authorisation by the competent customs office;
- For the purpose of tightening administrative control, introduction of more rigorous administrative penalty provisions and broadening the powers of customs authorities:
 - to seize and impound the goods by means of which the Act is violated;
 - to impose precautionary measures, including garnishment of movable things and receivables, including receivables on bank accounts; garnishment of goods in circulation and preventive attachment of corporeal immovables;
 - tightened control in respect of measuring instruments;
 - increased amount of pecuniary penalties.

Further draft revisions of the Act concern the movement of excisable goods under excise duty suspension arrangement. This will mandatorily require a validated electronic administrative document. An obligation is imposed on the persons applying the excise duty suspension arrangement to mandatorily unload the goods at the

facilities specified in the licence or in the registration certificate.

The delivery of excisable goods within the national territory will be confirmed by the consignee through the computer system. This will be done by submission of a notice not later than five working days after the date of receipt.

Forecast of excise duty revenue for 2010

Table 9: Excise duty revenues by groups of excisable goods (BGN million)

GROUPS OF EXCISABLE GOODS	Expected to be collected 2009	Total effects	Total 2010	Up 10/09
1. Tobacco products	1,940.3	225.0	2,165.3	111.6
2. Fuels	1,940.0	60.0	1,993.9	102.8
3. Beer, intermediate products and alcoholic beverages	182.0	18.0	200.0	110.0
4. Electricity	23.0	8.0	31.0	134.8
5. Others, including effect of improved compliance	120.0		120.0	
Excise duties in executive budget	4,205.3	304.9	4,510.2	107.3
% of GDP	6.6%		7.1%	

The total amount of revenues from excise duties under the consolidated fiscal programme for 2010 is expected at BGN 4,510.2 million (7.1% of GDP).

As a result of the increase of the rates of excise duty in 2010, according to the transitional periods for attainment of the Community minimum rates of excise duty agreed with the European Commission, the following additional revenues are expected in comparison with 2009:

- **Kerosene:** the Community minimum excise duty is EUR 330 per 1,000 litres (BGN 645 per 1,000 litres). A commitment has been assumed to attain the Community minimum rate by 1 January 2013. The increase of the rate of duty on kerosene will not have an effect on the budget during the period under consideration because kerosene is used as aircraft fuel and the excise duty is refunded within the time limits provided for in the Excise Duties and Tax Warehouses Act;
- **Electricity:** the Community minimum excise duty is EUR 1.00 per 1 megawatt hour (BGN 1.96 per 1 megawatt hour). A commitment has been assumed to attain the Community

minimum rate by 1 January 2010. The increase of the rate of excise duty on electricity, coal and coke will produce a positive effect on the budget, estimated at some BGN 8 million;

- **Cigarettes:** The European Union requires a minimum rate of excise duty of 57% of the retail selling price of the cigarette brand most in demand but not less than EUR 64 per 1,000 items (BGN 125.2 per 1,000 items) or BGN 2.50 per hard pack of 20 items. At present the excise duty on cigarettes in the Republic of Bulgaria is at the rate of BGN 102.3 per 1,000 items or BGN 2.04 per hard pack of 20 items, which represents 67.8% of the retail selling price of cigarettes of the price category most in demand. In 2010, the excise duty is planned to be BGN 2.97 per hard pack or 72% of the price of cigarettes of the most popular brand. The increase of the rate of excise duty on cigarettes will produce a positive effect on the budget estimated at BGN 225 million.

The rates of excise duty on fuels, beer and alcoholic beverages will not be increased in 2010.

The calculation of the revenues from excise duties has taken into account, apart from the rates, also the expected volumes of consumption of the groups of excisable goods, the behaviour of import, the effect of tightened control and improved compliance etc.

The aggregate effect of the new rates of excise duty is BGN 233.0 million, and the cumulative effect of all factors discussed is a BGN 304.9 million increase in excise duty revenues compared to 2009.

Customs duties

The forecast of revenues from customs duties and customs charges takes into consideration the impact of the following factors:

- the forecasts of total imports at CIF prices;
- the share of imports from third countries in the total imports. For 2008, this share stands at 43.4% and is expected to approximate 44% for the period of the forecast;
- the abolition of customs duties on agricultural products by the EU;
- the changes in the tariff rates as a result of forthcoming preferential agreements within the EU and the World Trade Organization (WTO): some 2% for industrial goods and some 8% for agricultural goods for the 2010-2012 period.

Customs duty revenues are forecast separately for the industrial and agricultural goods. In respect of agricultural duties, since considerable volumes of industrial goods, such as fuels, ores etc. are not subject to customs duty, the forecast is based on a sample of the leading goods. The forecast of agricultural duties is based on the volume of imports, the share of agricultural goods in it and the average rate for the respective year.

Local taxes and fees

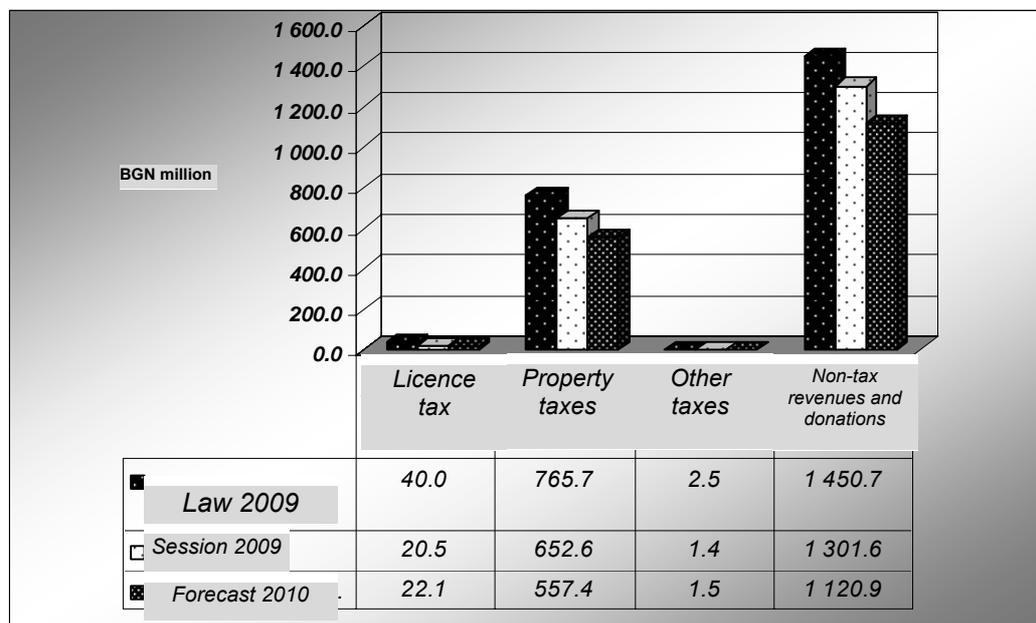
Central government focuses its efforts on an improvement of the financial standing of municipalities. In this aspect, state transfers to municipalities have become more transparent, more objective and predictable. Municipalities allocate ever more resources to investments and thus create conditions for greater prosperity, economic growth and employment. On the whole, the degree of financial decentralisation in Bulgaria is gradually increasing but remains below the average in the European countries.

As far as revenues are concerned, the tendency towards greater financial autonomy is clearly manifested. This tendency relates to the granting of full powers to municipalities to administrate local taxes and powers to fix the rates of these taxes by themselves under the terms, according to the procedure and within the range established by the Local Taxes and Fees Act.

Municipalities' revenues from own sources

The global economic and financial crisis impacts the collection of municipalities' revenues from own sources, with the downward trend being particularly steep in the receipts related to the real estate market and the sales of municipal property. In this connection, the receipts from local revenues to the municipal budgets in 2010 are planned at BGN 1,701.9 million, which is some 25% less than under the 2009 State Budget Act. The largest decline is forecast for revenues from the tax levied on the acquisition property and for receipts from the sale of non-financial assets.

Chart 5: Municipal budget receipts from local revenues



The provisions amending and supplementing the Local Taxes and Fees Act (LTFA) cover changes in two main aspects:

- part of the changes are related to the evolution of the process of municipalities' financial decentralisation and an expansion of their own source revenue base;
- the rest of the proposals are intended to streamline the wordings of the Act and to achieve equitable taxation of the taxable persons.

The bulk of the revisions are based on a package of proposals submitted by the National Association of Municipalities in the Republic of Bulgaria (NAMRB). Examples include the proposals to raise the upper limit of the immovable property tax, as well as to broaden the scope of taxable immovable properties.

The principal amendments to the Local Taxes and Fees Act include:

- To increase municipalities' revenue base, they are enabled to set higher rates of the immovable property tax (the upper limit is raised from 2 per mille to 2.5 per mille of the assessed value of the corporeal immovable) and of the tax on onerous acquisition of property (the upper limit is raised from 2.6 per cent to 3 per cent of the assessed value of the transferred property);
- Considering the fact that a large part of the corporeal immovables in nucleated settlements of low category remain outside the scope of taxation, it is proposed to lower the

threshold of properties' non-taxability from BGN 2,520 to BGN 1,680. In this way, small nucleated settlements will raise more revenues for the improvement of their infrastructure;

- Municipal administration officers are vested, in addition to powers of revenue authorities, also with powers to impose precautionary measures, i.e. part of the powers of public enforcement agents of the National Revenue Agency;
- It is proposed to change the manner of determination of the tax base of the corporeal immovables of enterprises: from the book value according to the effective version of the law to the higher of the book value and the assessed value;
- It is proposed to levy a tax on the acquisition of immovable properties, limited rights *in rem* to such properties and transport vehicles incorporated into the assets of an enterprise which is transferred or transformed, excluding transformation through change of the legal form.

The rest of the amendments to the LTFA target a more equitable taxation of taxable persons. The provision on refund of the tax on transport vehicles whose registration certificate has been returned to the Ministry of Interior and which are suspended from operation is streamlined. The refund will apply to the months next succeeding the month of termination of the registration for operation of the transport vehicle.

The property taxes revenues for 2010 are forecast at the amount of BGN 557.4 million.

Non-tax revenues

The expected total of non-tax revenues for 2010 amounts to BGN 3,394.2 million. It includes revenues from rental of property and land (BGN 153.4 million), net revenues from sales of goods and services (BGN 649.0 million), an excess of income over expenses of the BNB (BGN 300 million), and interest revenue (BGN 166.4 million). Revenue and income from property aggregate BGN 1,113.3 million, or 32.8% of the total non-tax revenues.

Revenues from fees include: stamp duty (BGN 740.5 million), municipal fees (BGN 733.5 million) and court fees (BGN 82 million).

The forecast of non-tax revenues is prepared on the basis of the following assumptions:

- Unchanged amount of revenue and income from property, as well as of the revenue from fines and sanctions;
- In 2009 concession royalties are expected to bring some BGN 53.7 million to the executive budget and BGN 7.3 million to

the municipalities' budgets.

The forecast of dividend for 2010 is based on the reports received on the financial performance for the first and second quarter of 2009 of the principal commercial corporations paying dividend to the State.

Revenues from concession activities for 2010 are forecast on the basis of expected receipts under concession agreements for items constituting public state property in various sectors of economic activity: civil airports for public use (Bourgas and Varna), metallic and non-metallic minerals, building and rock facing materials, oil and natural gas, solid fuels, beaches, part of the coastal beach strip, port terminals, parts of public-transport ports.

Revenues from concession royalties

The revenues from concession royalties in 2010 are expected to amount to BGN 61 million (excluding revenues to municipal budgets). These revenues are forecast on the basis of expected receipts from the effective concession agreements on items constituting public state property in the various sectors of economic activity, taking into consideration the following key factors affecting revenues from concessions:

- the volume of extraction of metallic minerals and the fluctuation of the international prices of metals on the London Metal Exchange;
- the demand for port and airport services;
- the effectiveness of the administration in conducting procedures for the conclusion of new concession agreements;
- the efficiency of control over the fulfilment of the obligations assumed by concessionaires by the agreements concluded;
- the early termination of effective concession agreements through the fault of non-compliant concessionaires.

New concession agreements tend to be concluded, the number of concession awards is tending up, involving large infrastructure facilities, mainly in the transport sector (ports, airports, motorways), and control over the fulfilment of obligations under effective concession agreements tends to be tightened – hence the compliance of receipts from concession royalties (considerations) tends to improve.

Considering the factors and tendencies listed above and the changed macroeconomic environment, the fiscal risk to the revenues from concessions is limited to a possible crash of the prices of metals extracted from deposits under concession and/or an early termination and performance in bad faith of the concession agreements on infrastructure facilities, as well as a failure of forecasts about the award of concessions for properties in the transport sector.

Revenues from dividend Revenues from dividend for the State in 2010 are expected to amount to BGN 60 million, on the basis of a 50% deduction of the profit to shareholders and after contributions to the Reserve Fund. The forecast of the dividend for 2010 is based on the reports received on the financial performance for the first and second quarter of 2009 of the principal commercial corporations which pay dividend to the State.

IV. 4. PUBLIC EXPENDITURES

PRE-ACCESSION AND STRUCTURAL INSTRUMENTS OF THE EUROPEAN UNION AND CONTRIBUTION OF THE REPUBLIC OF BULGARIA TO THE GENERAL BUDGET OF THE EUROPEAN UNION

Absorption of EU funds resources with an optimum positive effect on the economy and the budget In the period before and after its accession to the European Union (EU), Bulgaria has been receiving substantial financial and technical assistance in support of the economy, infrastructure and human resources, for maintenance of a favourable business environment and social inclusion. Bulgaria prioritises above all becoming a competitive EU Member State with a high quality of life, incomes and a social sensitivity of society.

Achieving an optimum positive effect on the economy and the budget from the absorption of resources from the EU funds is a strategic priority within the Government's general fiscal policy both in this particular period and in the long term.

Table 10: Indicative targets for 2010

Programmes	Amount (BGN mln)
TOTAL EXPENDITURE	2,367.7
<i>EU pre-accession instruments and others</i>	<i>584.4</i>
Phare	48.2
Cohesion Fund (Regulation 1164/94) / former ISPA Programme	411.9
Schengen Facility	101.0
Transition Facility	11.6
European Economic Area	11.7

<i>Structural Funds and Cohesion Fund of the EU</i>	<i>1,783.3</i>
OP Environment	248.0
OP Transport	313.0
OP Regional Development	423.4
OP Development of the Competitiveness of the Bulgarian Economy	472.1
OP Administrative Capacity	96.5
OP Human Resources Development	207.5
OP Technical Assistance	15.3
Programmes for European Territorial Co-operation in the 2007-2013 period on the EU external borders	7.6

The pre-accession programmes: Phare, SAPARD and Cohesion Fund (Regulation 1164/94) (ISPA Programme) and the temporary financial support provided for in the Act concerning the Accession (the Transition Facility and the Cash-flow and Schengen Facility) are intended to assist Bulgaria in the socio-economic reform and in the preparation for absorption of the resources from the Structural and Cohesion Funds. All these programmes are at an advanced stage of implementation. Payments under part of them will be completed before the beginning of the next three-year period (SAPARD) and under other will continue until 2011 (Phare, Transition Facility).

The Structural and Cohesion Funds (SCF) included in the present Financial Perspectives are still at an early stage of implementation. Nevertheless, along with the advance payments, a number of intermediate payments have been made as well. The first intermediate certificates have been prepared and sent to the European Commission. Hard work is in progress for obtaining a positive assessment of the conformity of the Operational Programmes (OP) within the SCF

framework.

A common goal in the implementation of the Community policies by the separate institutions is to accelerate the pace of contracting and paying so as to achieve a high absorption rate. This will have a direct and favourable impact on the priorities identified by the Government, bound mainly with budget discipline, management of the effects of the financial and economic crisis and successful implementation of the structural reforms.

Implementation of publicly significant projects in the field of transport and the environment figures among the key priorities of the Government

Implementation of publicly significant projects in the field of transport and the environment, financed under the Cohesion Fund (Regulation 1164/94) (ISPA Programme), figures among the Government's key priorities. At this stage, the projects in question are due for completion until the end of 2010, but preparatory steps necessary for the extension of this time limit until the end of 2011 have already been taken.

Implementation of infrastructure projects remains a priority during the new programming period 2007 – 2013. This is particularly valid for Operational Programmes Transport and Environment and is substantiated by the fact that:

- ⇒ the budget of the two operational programmes takes up the largest share of the total financial resources to which Bulgaria is entitled for the 2007-2013 programming period;
- ⇒ the useful effects of their implementation have a long-term impact;
- ⇒ they have a socio-economic and strategic significance both regionally and nationally.

The principal policies in the medium term are outlined in the Medium-term Fiscal Framework, and in respect of the absorption of resources from the EU funds the emphasis is laid on three priority policies:

1. The executive departments upgrade to priority status the performance of activities for the absorption of resources from the EU funds: the programmes under which Bulgaria is a beneficiary of financial resources are perceived as an essential mechanism for attainment of the Government's priorities.

2. Implementing an adequate strategic planning of the notices of the launch of calls for proposals for the award of grants: the departments in the state administration lay a special emphasis on the determination of the exact period for announcement of the procedures, so that their planning and conduct could be best synchronised with the Government's programme priorities as well as with the current socio-

economic situation. The timeframes and the activities under the procedures in the Indicative Annual Working Programmes are interconnected with the activities envisaged in the general government programme.

3. Preparing an objective and critical analysis of the scope of the effects of implementation of the activities under the pre-accession instruments with an emphasis on the Cohesion Fund (Regulation 1164/94) (ISPA Programme), so as to identify the areas of concern and to assess them adequately. The conclusions are used as a basis for a more adequate and realistic strategic planning and management of the programmes co-financed by the Structural Funds with a focus on the activities under Operational Programmes Transport and Environment.

Achieving a high quality of life, incomes and social sensitivity of society

OP Regional Development 2007-2013 ranks third in the amount of financing committed among the operational programmes co-financed by the European Regional Development Fund. Its general objective is to enhance the quality of life and the working environment with better accessibility to basic services and to create new opportunities for improved regional competitiveness and sustainable development.

Within this priority, with a view to achieving a high quality of life based on sustainable socio-economic development, OP Development of the Competitiveness of the Bulgarian Economy, which is implemented in the Republic of Bulgaria in the 2007-2013 period, covers the preparedness of Bulgarian enterprises for the Common European Market and for the fast changing conditions on international markets, as well as the condition of the environment in which they function.

Strengthening administrative capacity so as to enhance the absorption of EU funds and human resources development and to ensure higher employment, incomes and social integration

Enhancing the qualification of state administration employees, improving the quality of administrative services and the effective functioning of the judicial system is supported by the implementation of Operational Programme Administrative Capacity, co-financed by the European Social Fund, in the 2007-2013 period. This operational programme targets the establishment of common standards and rules for the administrative reform at all levels: central, regional and local; enhancement of the professionalism of the administration towards better addressing the needs of society at lower administrative costs and in a less bureaucratic way. The Programme will introduce operational internal and external control mechanisms for better transparency and accountability. This Programme also addresses the reform in the judicial system.

Operational Programme Human Resources Development in the 2007-2013 period focuses on investing in the acquisition of new knowledge and skills; strengthening the practice of lifelong learning, improving the quality of education and training in line with the labour market

needs for building a knowledge-based economy; promotion of economic activity; improving the effectiveness of labour market institutions and of social and healthcare services.

Operational Programme Technical Assistance is implemented in Bulgaria within the context of enhancing the absorption of EU funds. It seeks to strengthen the necessary capacity and functioning of the structures of central and local government administrations involved in the absorption of SCF, as well as to improve public information and awareness of the effective and efficient utilisation of SCF.

A key priority in 2010 is the absorption and effective spending of the resources from the EU, while guaranteeing maximum transparency and publicity of the contracting process and effective mechanisms for control over the spending of the funds.

The following specific measures have been taken with a view to guaranteeing the effective management of the EU funds:

1. Measures to improve the vertical and horizontal co-ordination among institutions:

- Introducing additional control mechanism to prevent overlapping of financing from various sources (EU funds, executive budget, municipal budgets);
- Conducting effective monitoring and holding monthly meetings of the sectoral monitoring committees.

2. Control over the absorption process:

- Introducing additional control mechanisms to ensure non-restrictivity of public procurement and equal opportunities for all potential participants;
- Developing objective assessment criteria and methods;
- Elaborating detailed instructions for the work of the evaluation commissions;
- Improving the publicity and transparency of the procedures conducted through publication of all information on the procedures in progress in publicly accessible places (official Internet sites of the MoF);
- Permanent external control over the strict observance of the applicable laws, ordinances and internal rules;
- Auditing the management systems and reviewing the transactions.

In 2010 it is planned to complete the activities and effect the payments under the pre-accession programmes Phare, the Transition Facility and the Schengen Facility financed by resources from the EU and the

national budget.

CONTRIBUTION OF THE REPUBLIC OF BULGARIA TO THE GENERAL BUDGET OF THE EU

The contributions of the Member States, including the contribution of the Republic of Bulgaria, to the General Budget of the European Union (EU), are formed on the basis of several components:

1. Traditional Own Resources (TOR): comprise customs duties on import from third countries and levies on surplus stocks of sugar and isoglucose;
2. VAT-based resource;
3. GNI-based resource;
4. Correction of budgetary imbalances granted to the United Kingdom;
5. Gross annual reductions for the Netherlands and Sweden.

The forecast of Bulgaria's contribution to the General Budget of the European Union for 2010 has been prepared according to the effective Council Decision of 7 June 2007 on the system of the European Communities' own resources (2007/436/EC, Euratom) and an Interinstitutional Agreement between the European Parliament, the Council and the Commission on budgetary discipline and sound financial management (2006/C139/01), as amended by Decision 2008/29/EC of the European Parliament and of the Council of 18 December 2007, whereby the 2007-2013 Multiannual Financial Framework was revised. The forecast has taken into account the key macroeconomic indicators prepared by the Agency for Economic Analysis and Forecasting, forecast data for the purposes of calculation of the contribution of the Republic of Bulgaria to the General Budget of the EU provided by the competent structures responsible for the application of the own resources system in the Republic of Bulgaria, and forecast data disaggregated by Member States for the purposes of own resources for 2009 and 2010.

The 2010 budget makes provisions for the resources required for payment of the national contribution to the EU General Budget

The resources planned in the 2010 budget for the contribution to the General Budget of the EU amount to BGN 779.7 million.⁵ This is a forecast amount and in a way guarantees the payment of the national contribution to the EU budget. It is conventional because of:

- the possibility of additional needs and/or contingencies arising during the year which must be financed by the EU budget;

⁵ The forecast of the total amount of the contribution to the General Budget of the EU for 2010 will be updated after the official endorsement of the updated forecast of the key macroeconomic indicators, according to Point 20 of the Timetable for Preparation of Information under the 2010 Budget Procedure, endorsed by the Deputy Prime Minister and Minister of Finance.

- the payment of the Traditional Own Resources (TOR) on the basis of actual receipts;
- the periodic updates of the data about the VAT-based resource, the GNI-based resource, the correction of budgetary imbalances granted to the United Kingdom and the gross annual reductions for the Netherlands and Sweden in connection with the latest available information with a view to achieving complete accuracy.

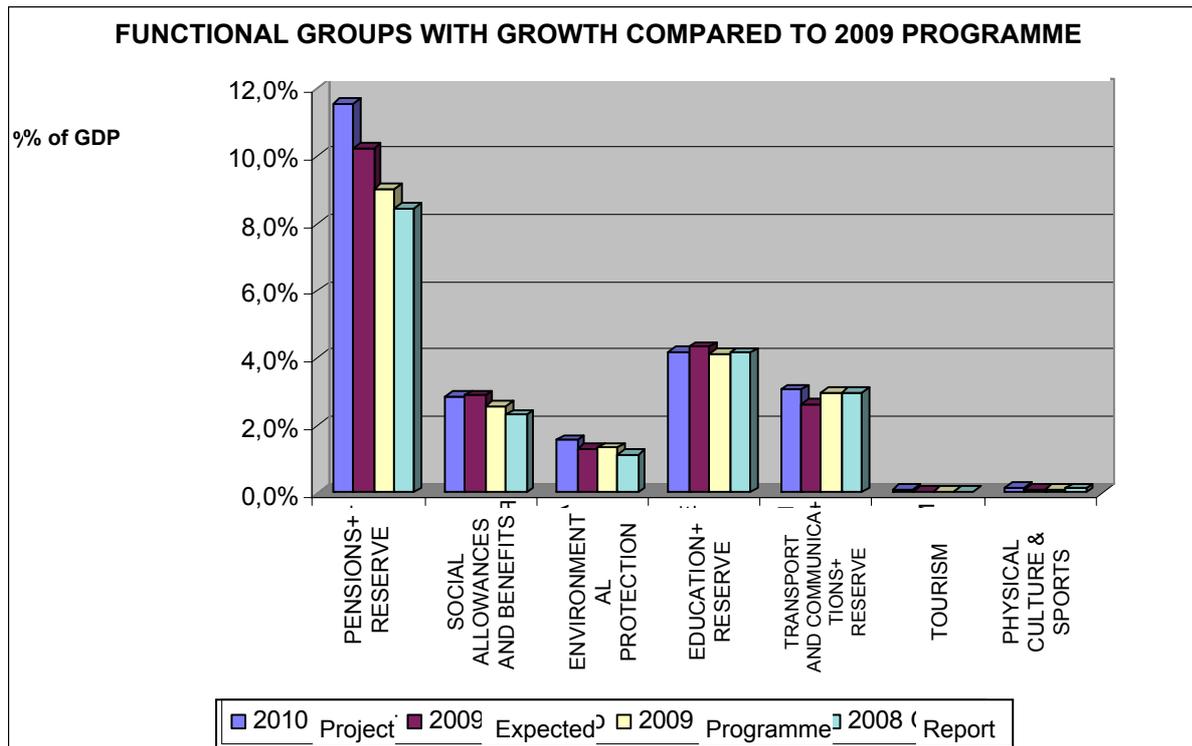
Reducing expenditures to maintain a balanced budget position

The total expenditures financed with resources raised from the national economy amount to BGN 24,400 million, which represents 38.4% of GDP, whereas the total expenditures under the consolidated fiscal programme amount to BGN 26,900 million or 42.3% of GDP, including the resources originating from the assistance from the EU.

The expenditure side of the 2010 Budget prioritises:

- Social security: 15.1% of GDP, up 2.3% of GDP from the 2009 Programme (including 2.5% of GDP for an increase of pensions);
- Education: 4.2% of GDP, up 0.1% of GDP from the 2009 Programme;
- Health care: 4.2% of GDP, level of expenditures unchanged from the 2009 Programme;
- Environmental protection: 1.6% of GDP, up 0.3% of GDP from the 2009 Programme;
- Transport and communications: 3.1% of GDP, up 0.1% of GDP from the 2009 Programme.

Chart 6: 2010 Budget expenditures with increases from 2009 Programme



INCOMES POLICY

Wages

One of the principal goals of incomes policy is to close the gap between the growth of labour productivity in the economy and the growth of wages so far.

In support of the efforts to manage the effects of the crisis, the medium-term fiscal framework for the 2010-2013 period envisages that the nominal levels of wages reached in 2009 be retained in 2010 and that the public-sector wage bill to GDP ratio reached during each preceding year remain unchanged for the 2011-2013 period.

Since the beginning of 2009, the global financial and economic crisis started to exert a negative impact both on the economy as a whole and on the public-financed sector, with the effects extending to employment, unemployment and incomes.

Economic recession is accompanied by a rise in unemployment. The registered unemployment figures for August 2009 show an increase in the rate of unemployment to 7.9%, up 2 percentage points from the like month of the previous year.

In 2010 the average

In 2010 the average wage will continue to grow, albeit at a slower

wage will continue to grow, albeit at a slower pace than in 2008 and 2009

pace than in 2008 and 2009. Despite a 4.8% drop of GDP in the second quarter of 2009, a 3.1% year-on-year decline in real labour productivity and a gradual increase of unemployment to 7.9% in August, the average wage continues to grow. In the second quarter of 2009, the average monthly wage reached BGN 588, 15.3% more than in the comparable period of 2008. The growth was 16.9% in the public sector and 14.2% in the private sector. Evidently, labour remunerations react to the economic slump with a certain lag, which is why the average wage can be expected to keep growing next year as well, albeit at a more moderate pace in line with the expected recovery of the national economy.

Incomes policy in the public-financed sector will reckon with the capacities of the state budget

Incomes policy in the public-financed sector will reckon with the capacities of the state budget and will seek to peg pay to productivity even closer. In 2010 the wage bill of the separate public-financed organisations and activities will be retained at the nominal level reached. A reduction of administrative costs, including the wage bill, is planned as from 1 January 2010. This will enable the heads of administrative structures to reallocate the wage bill within their organisations so as to provide incentives to those who contribute most to the attainment of the organisation's objectives.

After 2010, every year the ratio of the wage bill to the physical GDP volume will be kept at the level reached during the preceding year. The growth of the wage bill will thus depend on the speed at which the Bulgarian economy will be recovering.

The minimum wage policy in 2010 will reckon with economic development and the state of the labour market. The level of the minimum monthly wage from 2009, BGN 240, is planned to be carried over in 2010. The amount of the minimum wage will be fixed in a manner that does not restrict the employability of people in a disadvantaged position on the labour market, the lower skilled and the less experienced, or of people working in crisis-affected economic sectors. The Government will take every opportunity to protect the income of minimum wage earners, and the specific amount of the minimum wage will be determined in co-operation with the social partners after a careful analysis of the economic environment parameters.

Pensions

The principal goal of pension policy in 2010 is to keep the level of social security protection of people of retirement age and to improve the financial security of the elderly in the most vulnerable position: the oldest and the senior citizens who live alone. The following measures in this respect are envisaged next year:

- Introduction of the so-called “old age supplement” to the pensions of people aged over 75. The monthly amount of this supplement will be up to BGN 50 and will be differentiated according to the amount of the pension;
- An increase of the amount of the supplement to the pension calculated as a percentage of the deceased spouse’s pension under Article 84 of the Social Insurance Code. From 20% at present, the amount of this so-called “widow’s supplement” is to rise annually by 5 percentage points until it reaches 40% of the deceased spouse’s pension in 2013. In this way, the protection of the most vulnerable among the elderly pensioners – the oldest and the ones living alone – will be considerably improved.

Next year pensions will be adjusted according to a flexible mechanism geared to economic development, the state of the budget, the growth rates of contributory income and inflation, and the behaviour of employment. The pace at which the Bulgarian economy will be recovering will be decisive for the capacity of the budget and for the margin by which pensions will be raised annually. All options will be carefully and regularly analysed jointly with the social partners.

The maximum monthly aggregate of the one or multiple pensions received in 2010 will remain BGN 700.

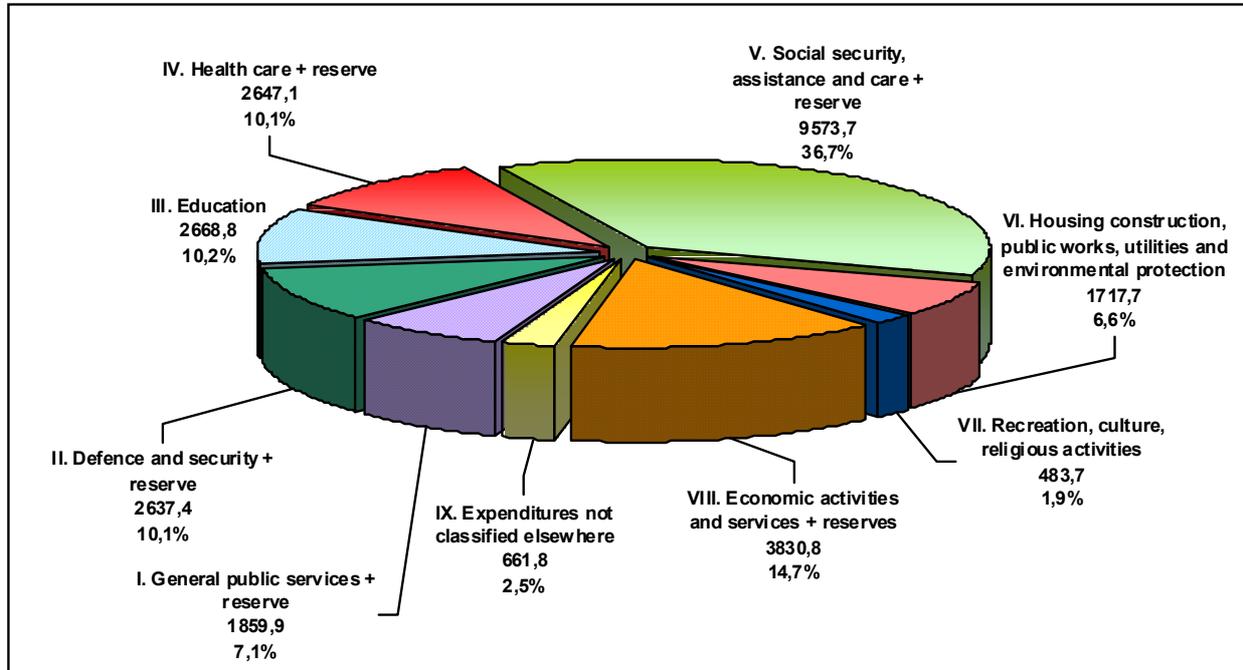
The 2010 Budget has been prepared within an expenditure framework envisaging to compensate the growth of expenditures in the social sector by a decrease in expenditures in the rest of the sectors excluding the priority ones, by means of:

- achieving a creation of new jobs in the real economy at a rate outpacing the redundancies generated by the optimisation in the public sector;
- keeping the nominal level of the wage bill reached at the end of 2009 in 2010, with a GDP share of 6.2%.

Next year the State will have less budget resources at its disposal for implementation of policies in the separate sectors, which foregrounds the need of reforms and improvement of the management and effectiveness of public spending. A restructuring of the administration, the health and educational system is forthcoming. Savings should come from the 15% downsizing of the administration in 2010, undertaken by the Government. The unreformed spheres will not receive larger financing without it being contingent on reforms and an improvement of the effectiveness of the administration and the

quality of public services.

Chart 7: Share of principal functions in the total consolidated non-interest expenditures for 2010 (including reserve, excluding contribution to EU General Budget).



Active labour market policy

Measures for social assistance, for employment promotion, measures in the sphere of industrial relations etc.

The principal goal of the active labour market policy in 2010 is to create opportunities for job retention, for a fast transition from unemployment and inactivity to training and employment through active measures. To integrate all labour resources into the labour market, activating the long-term unemployed and the inactive persons will remain a key priority of the labour market policy in the short term.

In 2010 employment policy will be supported by the Phare Programme and Operational Programme Human Resources Development. A total of BGN 267.4 million under the two programmes will be allocated for implementation of projects for human resources development and employment promotion, enhancing the productivity and adaptability of the employed, improving access to education and training etc.

Industrial relations policy

The priorities of industrial relations policy target preservation of the labour and social rights of factory and office workers, improvement of labour legislation and guaranteeing its proper application, as well as improvement of working conditions at enterprises. Activities for

containment and resolution of collective labour disputes by the instruments of mediation and labour arbitration will be an important area of the policy in the conditions of a crisis and deteriorated conditions on the labour market.

Social assistance policy

In 2010 the principal goal of social assistance policy will be a better focusing of welfare allowances and increasing the effectiveness and efficiency of programmes addressed at the most vulnerable Bulgarian citizens. Resources under the social assistance policy are spent on the provision of:

- Monthly, lump-sum and targeted allowances under the Social Assistance Act;
- Targeted heating allowances to persons on low income;
- Allowances for diagnostics, treatment and hospital care of Bulgarian citizens who do not have an income and/or personal property;
- Resources for implementation of measures and programmes under the Child Protection Act;
- Initiatives to modernise social services and to accelerate the deinstitutionalisation process;
- Resources for financing projects for the provision and arrangement of community-based social services and various social assistance programmes.

Family policy

In 2010 family policy will emphasise birth encouragement through the creation of a favourable environment enabling Bulgarian families to have and bring up the number of children they wish. State budget resources will finance monthly allowances of BGN 35 for nearly 879,000 children of families in which the average monthly income per family member does not exceed BGN 350. The allowance for twins is 50% larger: BGN 52.50 per child, and the amount for a child with permanent disability is double the standard amount: BGN 70 and is available without a means test.

The amount of the lump-sum child-birth allowance remains unchanged: BGN 250 for a first child, BGN 600 for a second child, and BGN 200 for a third and each additional child. A total of 77,000 lump-sum child-birth allowances will be paid next year.

To implement the family policy in respect of children, resources are allocated in 2010 for monthly child-care allowances and lump-sum child-birth allowances, as well as for:

- payment of lump-sum child-care allowances for up to 1 year old twins to the amount of BGN 600 per child;
- lump-sum child-care allowances for up to 1 year old children of student mothers, to the amount of BGN 2,880;
- monthly child-care allowances until the child's first birthday, payable to mothers without social insurance, to the amount of BGN 100;
- lump-sum pregnancy allowances, payable to mothers without social insurance, to the amount of BGN 100;
- targeted allowances for first graders to cover part of the expenses at the start of the school year.

Integration of people with disabilities

In the sphere of integration of people with disabilities, initiatives will be implemented in 2010 for the purpose of:

- Achieving a full-fledged rehabilitation and equal opportunities of people with disabilities through provision of employment and occupational rehabilitation;
- Raising disabled people's awareness of their rights and raising public awareness of their problems and opportunities and changing the public attitude to people with disabilities;
- Creating the necessary conditions for integration of people with disabilities through absorption of financial resources from European social and other funds;
- Ensuring equal opportunities for social inclusion of people with disabilities;
- Effective planning of activities related to the beneficiaries' social integration, through an analysis of their socio-economic status;
- Optimising the system for control over the implementation of activities related to the provision of public services for integration of people with disabilities.

People with disabilities will be paid integration supplements, and children with permanent disabilities will receive a supplement to an amount equivalent to 70% of the minimum wage.

Apart from financial support, resources are allocated in 2010 for implementation of projects and programmes for:

- Targeted allowances for the purchase and repair of medical devices, technical aids, assistive devices and equipment;
- Adjustment of workplaces for the needs of people with disabilities;
- Projects for start of independent economic activity of people

with disabilities;

- Refunding 30% of the social insurance contributions paid by employers for persons with disabilities;
- Projects for rehabilitation and social integration of people with disabilities;
- Projects to ensure an accessible environment to people with disabilities.

The budget forecast for 2010 allocates a total of BGN 163.3 million for State-delegated activities in the Social Security, Assistance and Care function. The resources for current expenditures amount to BGN 161.3 million, with BGN 87.0 million allocated for maintenance of the establishments providing social services. Capital expenditures for 2010 are forecast at BGN 2 million.

In connection with the long-term process of deinstitutionalisation, on a proposal by the Ministry of Labour and Social Policy, compensated modifications have been effected in municipalities' budget relationships with the central government budget so as to improve the living conditions and the quality of services provided to recipients of social services.

In accordance with the action taken by the 2010 budget forecast in the social services sphere for implementation of Council of Ministers Decree No. 33 of 2008 on the Provision of Resources for Financing the Activities in Connection with the Reform and Closure of the Specialised Institutions Providing Social Services to Children, the opening of new places for community-based social services is forthcoming: at Day Centre for Children with Disabilities, Public Support Centre, Sheltered Housing, Family-Type Environment Placement Centre, Monitored Housing, and Transitional Housing.

Education, training and youth policy

The specific tasks of the Ministry of Education, Youth and Science in the sphere of secondary and primary education are related to containing early school-leaving and ensuring a high quality tuition of children.

A new School Education Act is being drafted, and it will introduce the new educational structure planned several years ago. Thus, basic education will be completed with the seventh grade, and the secondary-school stage will be divided into two. The distribution of school hours will seek to adapt pupils better to labour market needs. The first part of the secondary-school stage (until the tenth grade) will provide solid general educational training, and the second part will be more vocationally oriented.

A national plan for upgrading teachers' qualifications is being drafted for the purpose of improving the quality of education. Teachers' enrolment in qualifications upgrading will be mandatory. The first

part of this plan is already under implementation: enhancement of the competencies of IT and foreign language teachers. Financing for the 2009/2010 school year amounts to BGN 1 million and is provided by OP Human Resources Development.

Work is underway on streamlining the delegated budgets system so as to peg financing to the attainment of particular education quality standards. An effort is also made to improve the standardised external evaluation system, with the external evaluation in the seventh grade being merged with the entrance examinations in 2009/2010. To achieve realistic results, the results of the national examinations in Bulgarian language and mathematics after the seventh grade are submitted to external evaluation.

Particular attention is paid to the objective to contain early school-leaving, as well as to the integration of minority-group children, where early school-leaving is a major problem.

In the sphere of vocational education, a new structure will be introduced. The idea is to cease settling on an occupation as late as in the last year at school but to enable pupils who do not wish to proceed with the next stage of secondary education to attain professional qualification through short-term modules. A national system for forecasting and monitoring of demand for labour by employers is being set up jointly with the Ministry of Labour and Social Policy and all employer associations.

The vocational education system, which is outdated, still strongly centralised and largely unconnected with business at the regional level, will shortly undergo a radical reform. The system will be decentralised, leaving just several vocational schools of national importance under the direct jurisdiction of the Ministry and transferring the rest to the local authorities.

Work on lifelong learning will be pursued in close co-operation with the Ministry of Labour and Social Policy. Two action plans will be adopted, and a number of measures in them are already implemented, such as optimising learning content, adapting syllabi to the needs of the labour market demand etc.

BGN 1,189.2 million are planned for the State-delegated activities, financed through the municipal budgets, to implement the secondary education policy in 2010. These expenditures are to finance the following main programmes and activities:

- Ensuring the tuition and character-education process in the schools and kindergartens of the public education system. These are the resources under the standards which form the schools' delegated budgets and the wage costs at the kindergartens and the auxiliary units. They ensure the tuition

of 648,394 pupils at the municipal schools, the preparation and character education of 226,634 children at the kindergartens and preparatory groups, the financing of pupils' dormitories, and the scholarships of pupils at the municipal schools.

- Broadening the coverage and facilitating the equal access to secondary education is achieved through financing the costs of scholarships, of pupils' dormitories and of extracurricular activities.

Scientific research and innovations

In the sphere of higher education, science and innovations, the Government is working on the implementation of certain urgent measures:

A National Strategy for Development of Science in Bulgaria will be adopted within the next couple of months (preparation for its adoption is in progress). The Strategy will cover the national priorities for development of scientific research. The universities will be included as entities engaged in scientific pursuits, along with the institutes of the Bulgarian Academy of Sciences, which are up for a thoroughgoing reform.

All measures are intended to peg financing to results. The reforms in the sphere of science and innovations is to be financed from several sources: the national budget, the EU Structural Funds (OP Human Resources Development and OP Competitiveness), and the Seventh Framework Programme. Co-ordination among the various institutions, as well as enlistment of external experts in auditing the process, will be crucial for a success of the reform.

Health care

The Health Ministry will prioritise the optimisation of the hospital infrastructure on a regional basis through amendments to the Medical-Treatment Facilities Act. It is planned to elaborate a new type of health map. The method of financing health care will be changed.

The 2010 budget forecast allocates BGN 190.5 million for the State-delegated activities in the Health Care function, of which BGN 187.5 million for current expenditures and BGN 3.0 million for capital expenditures.

The resources for children's and schoolchildren's health care amount to BGN 92.7 million.

The resources for the provision of hospital care at the various types of dispensaries amount to BGN 94.8 million. The increase is due mainly to the larger incidence of malignant neoplasms, the larger frequency of tuberculosis cases and the enhanced prevalence of mental diseases.

Tangible opportunities for physical exercise and

The 2010 draft budget plans expenditures for support of the development of physical education and sports in Bulgaria.

sports

The expenditures set in the draft budget ensure conditions and tangible opportunities for physical exercise, competitive sports and proper development of children and adolescents capable of remarkable sporting achievements.

The total amount of resources planned include spending to finance the programmes for preparation for the Olympic Games and professional sports, the arrangement and holding of world and European championships hosted by the Republic of Bulgaria, prizes and medical treatment of Bulgarian athletes. Allocations are made for support of the implementation of sports programmes for people with disabilities, conduct of medical and doping control, and financial assistance to other sports and tourist activities.

Investments in the real sector and improvement of the business environment

Measures to improve the business environment

In their part on improvement of the business environment, the Government-approved “Economic Measures for Recovery of the Bulgarian Economy” include:

1. Reduction of the initial capital required for the incorporation of a commercial corporation to BGN 2 (done);
2. Accelerated refund of VAT input tax claimable: from BGN 620 million due at 27 July 2009 to BGN 200 million due to date;
3. Reduction of the social insurance burden by 2 percentage points in 2010 and by 1 percentage point in each of the three succeeding years, or by an aggregate 5 percentage points for the Government’s term of office;
4. Establishment of centralised management of concession activity with strict rules for control;
5. Adoption of new provisions of the Public Procurement Act with a view to discontinuing the controversial and non-transparent procedures and abolishing the notion of ‘small public procurement’, enhancing the role and powers of the Public Procurement Agency;
6. Reduction of the quasi-tax burden through liberalisation of product markets regulations as a condition for a decrease in corruption and the influence of special interest groups;
7. Diversification of investor classes, part of which will be assisted and administrated by the State and the rest by the municipalities;
8. Development of venture capital investment funds and guarantee funds for financing;
9. Speeding up bankruptcy proceedings at court, simplifying the procedures and introducing mechanisms for debt settlement through

clearing and building a market of debt instruments;

10. Setting transparent, unambiguous and categorical rules for the authorisation and registration schemes (revision of the Act Restricting Administrative Regulation and Administrative Control over Economic Activity);

11. Control over the resources provided by the Bulgarian Development Bank to the commercial banks, so as to ensure their effective use for loan financing of business activities.

Transport infrastructure

A number of projects are planned for implementation in the sphere of transport infrastructure. They are listed in the Government's package of anti-crisis measures approved at the end of September 2009.

Road infrastructure

Road infrastructure

The Government's purposeful efforts to bring road infrastructure into conformity with European standards will target absorption of the guaranteed resource from the EU funds. With the limited opportunities for national investments financed from the proceeds from vignettes and other road tolls, the major road infrastructure projects can be implemented either by increasing the tolls for use of the road infrastructure or by improving the management of the assistance provided by the EU.

In respect of the road infrastructure, there are plans for accelerated implementation of major infrastructure projects under Operational Programme Transport:

- Completion of the Trakia Motorway: Lots 2, 3 and 4;
- Construction of the Strouma Motorway: Lots 1, 2 and 4;
- Construction of the Maritsa Motorway: from the 5th to the 72nd km;
- Linking the Hemus Motorway with Sofia's Ring Road;
- Modernisation of a sector of Road I-1 (E-79) Vratsa - Botevgrad;
- Construction of a sector of Road E-79 Vidin – Montana;
- Rehabilitation of the Kurdjali – Podkova road sector etc.

Construction of the Lyulin Motorway is financed by CF/ISPA (Regulation 1164/94).

The State shares, up to the capacities of the state budget, in the financing of public transport services of a general economic interest and in the financing of the activities for current maintenance and operation of the railway infrastructure, on the basis of long-term contracts with the National Railway Infrastructure Company and the

operator providing obligatory public transport services assigned by the State.

Railway system

The state and development of the railway system in Bulgaria is determined mainly by the status of the National Railway Infrastructure Company and the licensed principal carrier Bulgarian State Railways (BDZ) EAD and, respectively, BDZ – Passenger Transport EOOD, providing the obligatory public transport services assigned to them in accordance with the Rail Transport Act.

Railway infrastructure

The financial support on the part of the State for the building and development of the railway infrastructure targets an improvement of the quality and safety level of transport services, an acceleration of the implementation of projects related to the European transport axes and corridors within the national territory, repair and rehabilitation of the railway network. A gradual approximation to the European standards in the field of rail transport is needed. The new projects along the main European corridors included in OP Transport are to be financed mainly with resources from the EU Cohesion and Structural Funds.

Notwithstanding the expenditures on the principle new start projects included in Operational Programme Transport, the investment programme of the National Railway Infrastructure Company will continue to be financed and implemented through the facilities included in the long-term contract with the State.

At present, the infrastructure of the Bulgarian railways has inferior characteristics and is far from the objective of achieving comparability with the parameters of the infrastructure in the EU countries.

Reckoning with the forecasts of the changed macroeconomic environment, the 2010 budget allocated BGN 90 million for construction of facilities included in the long-term contract with the State. These resources will make it possible to carry on the implementation of the projects related to the repair and renovation of the railway tracks and equipment and of certain new start projects of a priority nature, which are not earmarked for financing by the EU funds.

The principal projects, which will be implemented on resources from capital transfers in 2010, are related to restoration of the design parameters of the Sofia-Karlovo-Zimnitsa railway, repair of the railway tracks to support the achieved speed, renovation and electrification of the Dragoman-Dimitrovgrad railway, duplication and electrification of the Karnobat-Sindel railway, remodelling of certain junction railway stations in line with the European requirements,

modernisation of safety systems and level-crossing devices and modernisation of the overhead wires and the rectifier substations.

Rail transport

For the period after 1 January 2010, BDZ – Passenger Transport EOOD will be granted State aid on the basis of a contract concluded between the company and the State, represented by the Minister of Transport, Information Technology and Communications, for provision of public transport services within the national territory.

For 2010, BGN 20 million are allocated in capital transfers to aid the company in repairs, rehabilitation and purchase of new carriages and other rolling stock necessary for the safety of the transport operation.

Qualitative upgrading of the passenger rolling stock and guaranteeing safe transport require the procurement of 420 new passenger railway vehicles at the aggregate cost of EUR 430 million in the years to come. At present, an investment programme of such magnitude is impossible to implement. The resources for 2010 are allocated within the capacities of the state budget, and the planned allocations will partially finance the performance of the most urgent repairs and the purchase of the most essential rolling stock.

Port infrastructure

The objects of the Port Infrastructure State-Owned Enterprise are specified in the Maritime Space, Inland Waterways and Ports of the Republic of Bulgaria Act.

The Enterprise self-finances most of its investment activities using the proceeds from port charges. This is also the source from which the Enterprise is repaying principal and is paying interest on a loan from the Japan Bank for International Co-operation for a Port of Bourgas Expansion Project. BGN 12-14 million annually of the Enterprise's own resources from port charges go towards servicing this loan, which is why the balance is insufficient to ensure the financing of projects related to the construction, maintenance and repair of port facilities of the ports of national importance. The capital transfers to the amount of BGN 9 million, allocated for 2010, will ensure the resources necessary for financing the investment programme of the Port Infrastructure State-Owned Enterprise.

State participation in the financing of activities for the provision of obligatory public services of a general economic interest

The need to subsidise the railway carrier derives from the public character of rail transport as a whole and the social orientation of most of the passenger services it provides. State aid in the form of subsidies for non-financial undertakings is granted to compensate a financial loss incurred as a result of the fulfilment of an obligation to provide a public service of a “general economic interest”, in offering tariff rates below the level of the costs of passenger transport operation.

The amount of the subsidies reckons with the change in the GDP level for the period, keeping an insignificant, relatively outpacing growth, in the order of 2 to 4%. Therefore, additional measures and extra sources of income will have to be sought to achieve the goals set.

Urban and inter-city passenger bus transport

In accordance with § 4 (3) of the Carriage by Road Act, the state budget annually allocates resources to subsidise the carriage of passengers on loss-making bus lines in urban transport and transport in mountainous and other areas on a proposal by the Minister of Transport. These transport services are predominantly socially oriented: public transport for commuters within city limits, and transport to small outlying settlements, providing a connection to the municipality seat.

Through this type of financial assistance, the State ensures satisfaction of public demand for passenger transport of a specified guaranteed quality level and at affordable prices in line with purchasing power, by means of introducing tariff obligations for transport operators. Meeting the criteria for quality, reliability and affordability of bus transport will also contribute to the attainment of the objectives of Operational Programme Regional Development: increasing the mobility and communications of the population, minimising regional disparities, improving employment and decreasing unemployment.

Compensations for riding privileges on inland rail and bus transport

The state budget resources compensating for the riding privileges of specified categories of passengers (war veterans, war disabled, senior citizens, pupils and students and others, in aggregate some 40% of the population of the country) are statutorily regulated by laws and acts of government, intended to make up the difference to the price under the standard tariff.

The resources allocated for next year are reduced and conform to the forecast of the GDP level. The only exception made is in respect of the resources financing free transport of pupils up to the age of 16 to focal-point schools. The amount of these resources is planned on the basis of needs declared by municipalities according to transport contracts concluded, own transport maintenance costs etc.

Environment sector

There are plans for accelerated implementation of major infrastructure projects in the environment sector. Next year will see the start of performance of contracts for the design, construction and rehabilitation of water-supply and sewerage networks, regional landfills and pre-treatment facilities, as well as regional waste

management systems, urban wastewater treatment plants etc. In addition, strict control will be exercised and the implementation of infrastructure projects in the environment sector will be expedited.

Energy and energy infrastructure

The Government's priorities in the sphere of energy infrastructure are related to the completion of major projects for rehabilitation and flue-gas desulphurisation installations in connection with the meeting of environmental protection requirements by power plants of the Maritza East Complex. Priority is also given to the projects for the establishment of gas system interconnections with the neighbouring states with a view to diversifying natural gas supplies and routes.

Bulgaria will continue its active participation in the future enlargement of the Energy Community and in the implementation of projects contributing to the security of energy supplies, strengthening and expansion of electricity and gas system interconnections with the neighbouring states. All these projects will be implemented on own resources of the energy companies and, if the applications succeed, on resources provided by the European Economic Recovery Plan, as well as taking the opportunities to attract resources from the EBRD, the EIB and standard commercial credit.

Measures related to the performance of structural reforms, biological reclamation, environmental remediation and other measures related to the adjustment of the national economy to the European structures and markets

In 2010 the State will continue to provide financial support to non-financial undertakings of the real sector in accordance with the commitments and participation of the Government in the performance of structural reforms, biological reclamations, environmental remediation and other measures related to adaptation of the national economy to EU structures and markets.

Financing liquidation action in ore-mining industry

Implementation of the programmes for restructuring and liquidation of inefficient production capacities in the ore-mining industry will continue in 2010 on state budget resources. Projects and activities are implemented in the sub-branches of ore mining, uranium mining and coal mining.

The action taken in accordance with the Programmes for Restructuring of Ore-mining and Elimination of the Consequences of the Extraction and Processing of Uranium Raw Materials and Ores, are related mainly to technical liquidation of mines, minefield sections, overground buildings and facilities, technical and biological reclamation of land areas disturbed as a result of mining activity, cleaning contaminated water and soil, as well as other action to

eliminate the environmental impact.

BGN 2.1 million are allocated for activities in ore mining for 2010.

BGN 3.2 million are allocated for activities in uranium mining. The resources are intended for maintenance of the uninterrupted processes: the installations for cleaning water contaminated with radioactive elements, monitoring water in the areas where uranium was extracted and facilities for technical and biological reclamation of contaminated ground.

BGN 4.7 million are allocated in the central government budget for the activities of technical liquidation in coal mining for 2010. They will finance mainly reclamation activities: technical and biological reclamation of land areas disturbed by the operation of the liquidated coal mines.

Financing programmes and projects for remediation of past environmental damage caused by the operation of privatised enterprises

Implementation of the Programme for Remediation of Past Environmental Damage Caused by Acts or Omissions of Privatised Enterprises Prior to their Privatisation will continue in 2010. These programmes are financed by the budget in pursuance of § 9 of the Transitional and Final Provisions of the Environmental Protection Act, according to which the responsibility for damage inflicted on the environment by past acts or omissions rests with the State, under terms and according to a procedure established by an act of the Council of Ministers.

In 2008, an amendment of the Environmental Protection Act relieved the State of the obligation to finance new programmes. Until the amendment of the law, 21 programmes of privatised companies had been approved, of which six will be completed until the end of 2009 and another 12 programmes for remediation of past environmental damage will continue to be implemented.

Work under another nine programmes is expected to be completed in 2010, and the rest are expected to end until 2015. BGN 7 million are allocated for 2010.

Agriculture and rural development. Fisheries sector

The financial package for agriculture and fisheries upon Bulgaria's EU accession includes financing from the European Agricultural Guarantee Fund (EAGF), the European Agricultural Fund for Rural Development (EAFRD) and the European Fisheries Fund (EFF).

Resources amounting to BGN 627.8 million are planned to be spent under direct payment schemes from the EAGF.

In 2010 the EU is expected to reimburse direct payments amounting to

BGN 549.6 million.

The resources planned from the EAFRD, transferred to the direct payments for 2010, amount to BGN 52.1 million, and the resources reimbursed by the EU from the EAFRD, transferred to the direct payments, amount to BGN 86.8 million.

The measures included in the Common organisation of markets for agricultural products cover resources for trade mechanisms (licences), milk and school milk, field crops (intervention, charity), wine (vineyard restructuring), promotions, meat and apiculture, fruits and vegetables. In these sectors, resources for market support are provided depending on the market situation and after a decision of the European Commission. The resources allocated for market measures in 2010 amount to BGN 100.0 million, and the resources spent are to be reimbursed by the EU before the end of the year.

Rural Development Programme

Under the Rural Development Programme (RDP), EU financing is provided through the European Agricultural Fund for Rural Development (EAFRD). The EAFRD finances rural development support along the following axes:

1. Improving the competitiveness of the agricultural and forestry sector;
2. Improving the environment and the countryside;
3. The quality of life in rural areas and diversification of the rural economy;
4. Leader.

Bulgaria is planning to spend BGN 611.0 million on rural development in 2010, including BGN 119.7 in national co-financing. Co-financing of the resources from this Fund amounts to 20% with the exception of the measures under axis 2, where the co-financing amounts to 18%.

It should be noted that 7% of the resources agreed for financing under the EAFRD to the amount of BGN 357.2 million, allocated for Bulgaria, were provided as an advance payment in 2008, and must be set off against the balance due in 2010.

Agricultural financing by national resources

In addition to the resources which the Agriculture State Fund, as a Paying Agency, will absorb under the programmes of the EAGF, the EAFRD and the EFF, the Agriculture State Fund is planned to continue to perform the functions and provide the financing under the national programmes. To this end, the 2010 state budget allocates BGN 40 million for payment of State aids through the Fund for financing the programmes notified to the European Commission as

existing State aids.

Bulgaria is entitled to provide payments from the national budget complementary to the direct payments – complementary national payments, which may be used for various sectors at the country's discretion.

BGN 100 million are allocated for complementary national payments to the direct payments.

Unchanged parameters are set to the allocation for investment credit to agricultural producers to an amount of up to BGN 80 million, and the amount of temporary financial assistance for 2010 is up to BGN 20 million.

Provisions are made for the financing of the remuneration and maintenance of the administration of the Agriculture State Fund which works under the EU and national programmes.

Financial support for the fisheries sector

The principal objective of the EU Common Fisheries Policy (CFP) is to achieve sustainable development of the sector, through responsible fishing and conservation of living aquatic resources, providing a fair standard of living for those depending on fishing activities, stabilisation of the markets, and ensuring a sufficient supply of fisheries products at reasonable prices.

At present the fisheries sector in the EU receives grant financial assistance through the European Fisheries Fund (EFF), which supports the implementation of measures and actions for building a sustainable fisheries and aquaculture sector.

The principal priority axes of the EFF are:

1. Measures for adjustment of the Bulgarian fishing fleet to available resources;
2. Aquaculture, inland fishing, processing and marketing of fishery and aquaculture products;
3. Measures of common interest;
4. Sustainable development of fisheries areas;
5. Technical assistance.

Resources to the amount of BGN 18.2 million are planned to be spent in 2010 for the implementation of the CFP, including BGN 4.6 million in national co-financing.

According to Council Regulation (EC) No 1198/2006 of 27 July 2006

on the European Fisheries Fund, in 2007 the Commission made the envisaged advance payment of BGN 11.1 million, representing 7% of the EFF financial participation. A second advance payment was received in 2009 under the EDD-financed Operational Programme Fisheries Sector Development, to the amount of BGN 11.1 million or 7% of the resources provided under the Operational Programme for the entire Programming Period. These resources should be set off against the balance due in 2010.

V. IMPROVING THE QUALITY OF PUBLIC FINANCES

According to the Global Competitiveness Index, the effectiveness of public institutions depends on the following factors: respect for and protection of property rights, ethics of government behaviour, prevalence of corruption in the state administration, independence of the judiciary, government inefficiency reflected in the waste of public resources, and protection of contracts. According to the institutions effectiveness index, the activity of institutions in this country is far from the best practices in the world.

The budget reform that has been implemented in recent years has, as its prime objective, the achievement of a sustainable process of planning the expenditures of first-level spending units by policies/programmes pegged to pre-set results. The assertion of the role of programmatic and results-oriented budgeting in the management of public expenditures will help optimise government spending and improve its effectiveness.

The following measures are planned in the medium term for an improvement of the effectiveness and efficiency of the services provided:

- periodic review of the effectiveness and appropriateness of government programmes;
- adoption of a new statutory framework for planning and management of public finances;
- assertion of the role of programmatic and results-oriented budgeting.

Programmatic budgeting will work only if mechanisms for monitoring and objective evaluation of public institutions are implemented. Duplicating units must be eliminated, the number of institutions must be reduced, and specific benchmarks must be established to follow up the implementation of particular programmes and projects.

Improving the productivity and quality

To guarantee a medium-term fiscal consolidation and to ease the pressure of population ageing on public funds, the Government is

of the public services provided by the State

planning a substantial reduction of expenditures through optimisation of the extensive structure of a large part of the public sectors (including of the administration) and improvement of the productivity and quality of the public services provided by the State.

Restricting the amount of institutional expenditures

In support of the efforts to overcome the crisis, the medium-term fiscal framework for the 2010-2013 period envisages a maximum restriction of the amount of departmental administrative-support capital expenditures of high import intensity, as well as of the repairs of administrative buildings, with the exception of the measures for energy efficiency and accessible environment, at the expense of investment expenditures proper, creating conditions for economic growth and employment.

Optimising structures

The worrying tendencies in the implementation of the revenue side of the 2009 Budget as a result of the contraction of the economy and the serious deterioration of the budget balance this year necessitated the taking of urgent steps to cut spending and to optimise public-financed structures.

The process of optimising public-financed structures has already started, and the measures include:

- Reducing ineffective expenditures in the 2009 state budget structure by 15% (implemented by Council of Ministers Decree No. 196 of 11 August 2009) and a further reduction at the end of 2010;
- Reducing the number of Cabinet portfolios by two after a functional analysis of administrative units and structures in the entire administration, effective 1 January 2010. Reorganising and downsizing the administration.

Two ministries were closed down (the Ministry of Emergency Situations and the Ministry of State Administration and Administrative Reform) and, at the same time, the number of deputy ministers in the particular ministries was reduced to two.

In addition, agencies are closed down and their functions are taken over by the competent ministries (the Ministry of Economy, Energy and Tourism took over the functions of the State Agency for Tourism; the Ministry of Transport, Information Technology and Communications took over the functions of the State Agency for Information Technology and Communications; the Ministry of Regional Development and Public Works took over the functions of the National Road Infrastructure Agency; as from 1 January 2010, the Ministry of Agriculture and Food will take over the functions of the State Forestry Agency).

The state administration apparatus is instrumental in the development of the economy because the structure and vision of the administration and the quality of administrative services largely pre-determine the effectiveness of institutions in this country. The business environment in an economy, which is crucial for its competitiveness, depends on the functioning of the formal and informal institutions and structures of the state apparatus.

In recent months, the evaluation of and debate about administrative capacity in this country has been seen mainly through the prism of receiving the subsidies and resources from the EU funds. Indeed, to minimise the negative effects of subsidisation, it is important to build an administration with transparent resource reallocation mechanisms and minimum prevalence of corruption. Still, it is important to evaluate the effectiveness of the state administration in each sphere and activity of the executive branch of government.

For implementation of a genuine reform in the state administration, the following steps will be taken:

- Effective downsizing of the state administration.
- Introducing mechanisms to assess the need of operation of the various institutions and making a periodic independent analysis of the existing administrative structures for the purpose of optimising staff size and closing down unnecessary or duplicating units.
- Setting up an effective e-government, i.e. implementing information technology in the state administration. Information technology facilitate the connection between the public and the administration, a faster provision of services and a readier access to information, which makes the work of civil servants more transparent, limits the conditions for corruption and reduces expenditures in government structures.

***Financial
decentralisation and
tightening the financial
discipline of municipal
government***

The objective of the financial decentralisation reform is the provision of public services whose quantity and quality satisfy demand and whose price is affordable to recipients, on the basis of a sustainable and long-term balancing of the spending liabilities of municipalities with steady revenue sources and effective citizens' control. To attain this objective, the national policy of financial decentralisation should be backed by implementation of a responsible and effective policy of the municipalities in the observance of financial discipline.

Implementing financial decentralisation is a continuous process which extends to the comprehensive system of financial relationships at all levels of public governance. This process is a tool to achieve

important social goals: better services for citizens, more effective utilisation of resources, better quality of life. A successful implementation of financial decentralisation presupposes expansion of municipalities' autonomy with a view to satisfying the interests of the population to a greater extent.

On the whole, the degree of financial decentralisation in Bulgaria is gradually increasing but remains below the average in the European countries. As far as revenues are concerned, the tendency towards greater financial autonomy is clearly manifested. This tendency relates to the granting of full powers to municipalities to administrate local taxes and powers to fix the rates of these taxes by themselves under the terms, according to the procedure and within the range established by the Local Taxes and Fees Act.

In the conditions of a global financial crisis, local authorities have a particularly important role to play in taking measures for reduction of economic and fiscal risks so as to guarantee stability of the financial system in the country. With the deteriorated economic environment, more efforts are needed for an effective and efficient utilisation of the scarce budget resources for attainment of the fiscal objectives, and it is especially important to carry out financial management and control under tightened financial discipline and clearly defined priorities, without assuming financially unresourced commitments.

Particular attention should be paid to prioritising expenditures in local activities and to Municipal Councils considering procedures for restoration of financial stability where arrears are owed. It will be just as important to take all actions provided for in legislation for the collection of overdue receivables and to improve revenue compliance in general.

The resources allocated by the 2010 State Budget of the Republic of Bulgaria Act (SBRBA) create conditions for development of positive tendencies in the financial decentralisation process.

Within the context of implementation of financial decentralisation, the responsibility for the successful absorption of the financial resources provided by the EU through the Structural and Cohesion Funds is getting ever greater. The local authorities must try very hard to strengthen their administrative capacity, to enhance their capabilities for absorption of the EU funds effectively and with successful projects which would earn support from the EU institutions. Along with public-private partnership, it is precisely the participation of municipalities that is one of the key instruments for implementation of a large part of the projects related to regional development, environmental protection and rural development.

VI. DEBT MANAGEMENT AND FINANCING

Effective government debt management

The 2010 Budget guarantees the implementation of a conservative policy in respect of undertaking new government debts, while remaining ready to react promptly to any risks to the country's financial stability.

The increase of the domestic debt next year will reckon with the macroeconomic situation at home, with the state of the local and the international financial markets and their prospects, the state and structure of the government debt, and an emphasis will be laid again on the development of the domestic government securities market, which will also be a prime objective of the debt issuing policy to be implemented next year.

The risks related to external debt service are minimised, considering the dominant share of issues of lev-denominated government securities and payments on fixed coupon issues, and possible fluctuations of international interest rates and exchange rates would affect insignificantly the payments on government securities issued in connection with the structural reform.

External debt payments in 2010 will be influenced both by the variations of the international interest rates and by the exchange rate of the US dollar and the Japanese yen against the euro. The size of the foreign debt is also closely linked to and interdependent on the drawings on previously contracted government investment loans, as well as the undertaking of new loans to help the Government in the implementation of important projects in priority spheres of socio-economic life.

Government debt

At 31 August 2009, the nominal amount of the government debt totalled BGN 9,284.8 million, of which:

- external debt: BGN 6,500.1 million, and
- domestic debt: BGN 2,784.7 million.

In nominal terms, the government debt decreased by BGN 184.5 million from the level reported at the end of December 2008. The decrease resulted mainly from operations for cancellation of bought-back global bonds to a nominal value of EUR 17 million and USD 184.2 million, regular amortisation payments and negative internal financing from transactions in government securities, on the one hand

and, on the other hand, from the drawings on two World Bank Development Policy Loans to an aggregate amount of EUR 251 million.

The government debt/GDP ratio stood at 14.6% at 31 August 2009

The government debt/GDP ratio stood at 14.6% at 31 August 2009, up 0.4 percentage points from the figure reported for 2008. Considering the decrease of the debt in absolute terms, the reported upward adjustment of the government debt/GDP ratio was due to the decline of the GDP indicator.

In structural terms, the external government debt accounted for 70%, and the domestic debt for 30% of the total government debt in circulation at the end of August 2009.

The external government debt increased in nominal terms, but the external debt/GDP ratio is expected to remain unchanged at about 10.5% by the end of 2009

By 31 August 2009, the external government debt increased in absolute terms by BGN 104.1 million from the end of 2008. During the same period, the debt/GDP ratio rose by 0.6 percentage points, reaching 10.2%. By the end of 2009 the external government debt is expected to amount to some BGN 6,700 million, and the external debt/GDP ratio will remain unchanged at about 10.5%, considering the expected decline of the GDP.

In the currency composition of the external government debt, the euro-denominated debt is expected to keep its dominant share which, by August 2009, was reported at 71.6%. The share of dollar-denominated debt for the same period was 24.2%, and the share of debt denominated in other currencies, 4.2%.

In the interest rate composition of the external debt, the share of floating interest debt grew to 32.0% by the end of August 2009 from 25.9% at the end of 2008. This change was due mainly to the bought-back and cancelled fixed-coupon global bonds to a value of BGN 301.4 million and to the release of two floating-interest external loans by the World Bank to a combined amount of BGN 490.9 million. The increase of the share of floating interest debt in the interest rate composition of the external debt leads to an increase of the interest rate risk, lowering of the predictability of interest expenditures of the budget, and is a prerequisite for an increased need of reserve funds.

The size of the foreign debt is closely linked to and interdependent on the drawings on already contracted government investment loans

External debt payments in 2009 and 2010 will be influenced both by the variations of the international interest rates and by the exchange rate of the US dollar and the Japanese yen against the euro. The size of the foreign debt is also closely linked to and interdependent on the drawings on previously contracted government investment loans, as well as the undertaking of new loans to help the Government in the implementation of important projects in priority spheres of socio-economic life.

The domestic debt/GDP ratio will remain unchanged at around 4.6%

By the end of 2009, the nominal amount of the domestic government debt is not expected to exceed its BGN 3,000 million level from the end of 2008, and the domestic debt/GDP ratio, too, will not change appreciably from the 2008 figure of some 4.6%.

In 2009 the Ministry of Finance carried on its policy of prioritising the issuing of government securities on the domestic market, at the expense of the foreign market, with a view to redressing the existing imbalance between internal and external debt and supporting the development of a secondary government securities market.

The effect of adverse external and internal factors and conditions on the capital markets, which led to a negative net issue at the end of 2008, persisted in 2009. At 31 August 2009, the net external issue was negative, amounting to BGN 302.3 million. Under the circumstances, the share of domestic debt in the total government debt for the same period decreased to 30.0% from 32.5% in 2008. The government securities issued to finance the budget predominate at 89% of the total amount of government securities in circulation on the local market.

Investors' heightened expectations of a return on their investment in line with the increased risks on a global scale have also led to an increase in the yield of newly issued government securities. A large part of the primary dealers participated in the market solely motivated by the need to block government securities for budget resources.

At 31 August 2009, budget financing through government securities issues totalled BGN 233.7 million. Two new issues of 3-month Treasury Bills at a nominal value of BGN 28.2 million and one new issue of 5- and 10-year government securities at a value of BGN 43 million and BGN 97.5 million, respectively, were placed on the market. One issue, with an original maturity of 5 years and a residual maturity of approximately 2 years and 8 months at the first reopening date, was reopened during the period with an additional quantity of BGN 65 million. The reopening was prompted by a change in market trends, with investors in sovereign debt switching their preferences above all to short-term and medium-term government securities.

The average maturity of the issues in circulation, calculated on the basis of the maturity structure of the debt issued for budget financing, reached 8.1 years.

In the currency composition of the domestic debt, the lev-denominated component remains dominant, with a share of 74.8% at the end of August 2009. The shares of dollar- and euro-denominated government securities reached 4.9% and 20.3%, respectively. To eliminate the effects of the market shift in the levels of the other currencies, maintaining the euro- and lev-denominated shares of the

debt at some 75% remains a priority of government debt management in future, too.

In the interest rate structure of the domestic debt, the share of fixed interest obligations remains unchanged

In the interest rate structure of the domestic debt, at 31 August 2009 the share of fixed interest obligations remained unchanged from its 90% level at the end of 2008. The volumes of the planned securities issues will be realised in accordance with the policy of asserting a stable and liquid domestic market, with due consideration for the interests of the issuer and the market participants. These instruments are customarily issued at fixed coupon rates, considering the market standards, and are intended to attract a broader investor base. Thus, in line with the principle of priority financing at fixed coupon rates and following the planned scheme for redemption of floating coupon debts, the obligations with fixed costs of service will be increasing.

Emphasis on the development of the domestic government securities market, which will also be a prime objective of the debt issuing policy to be implemented next year

The increase of the domestic debt next year will reckon with the macroeconomic situation at home, with the state of the local and the international financial markets and their prospects, the state and structure of the government debt, and an emphasis will be laid again on the development of the domestic government securities market, which will also be a prime objective of the debt issuing policy to be implemented next year.

The risks related to domestic debt service are minimised, considering the dominant share of issues of lev-denominated government securities and payments on fixed coupon issues, as well as possible fluctuations of international interest rates and exchange rates would reflect insignificantly on payments on government securities issued in connection with the structural reform.

The present structure of the domestic debt provides opportunities for future pro-active diversification of the newly issued securities in respect of maturity, interest terms, target investor groups (general public, pension funds etc.) within the context of attracting a broader investor base. Such diversification largely responds to the need of enhancement of the role of domestic debt financing to meet the requirements of the budget.

Financing

The external financing under the central government budget is expected to be positive in 2010, amounting to some BGN 670 million. The planned drawings on government investment loans, administrated under the ministries' budgets, considerably exceed the regular payments made in accordance with the agreed amortisation schemes. As a result, net external financing from these sources is expected to be positive. A positive net financing to an approximate amount of BGN 3 million is expected for government investment loans with a

commercial corporation as a final beneficiary.

Government securities to a nominal amount of some BGN 800 million are planned to be issued on the domestic debt market in 2010, including Treasury Bills and Bonds amounting to BGN 160 million and BGN 640 million, respectively. The net financing under the central government budget from operations in government securities will be positive, amounting to some BGN 150 million.

Interest expenses

Government debt interest expenses are expected to edge up in 2010 both in absolute terms and as a ratio to GDP

Government debt interest expenses are expected to edge up in 2010 both in absolute terms and as a ratio to GDP and tax revenues as a result of an increase in the size of the debt, on the one hand, and, on the other, as a result of the expected negative economic growth and lower tax compliance.

Interest expenses on external loans are expected in the order of BGN 435 million. The bulk of interest expenses are on government loans, and some BGN 66 million are on government investment loans, of which BGN 52 million on government investment loans administrated under the ministries' budgets and BGN 14 million on government investment loans with a commercial corporation as a final beneficiary.

Expenditures on the domestic debt are expected to approximate BGN 150 million.

The government debt structure predetermines a sensitivity of interest payments to fluctuations of international interest rate levels and the dollar/euro and yen/euro exchange rate. Despite an improvement achieved in recent years, some 25.0% of the payments are bound to floating interest rates, which makes them dependent on their dynamics. Exchange rate variations also influence the amount of expenditures owing to the fact that 18.4% of the government debt is denominated in US dollars, and 2.9% in other currencies.

Privatisation proceeds

According to a forecast of expected privatisation sales and the accompanying agreed payments, the proceeds from privatisation in 2010 are expected to amount to BGN 201.5 million. The target values set take into consideration the currently available resource of privatisable state-owned commercial corporations. The bulk of the proceeds are expected from the finalisation of the privatisation transactions in blocks of shares/interests in the following commercial corporations: Bulgartabac Holding AD, VMZ EAD, Kintex EAD, Slanchev Bryag AD, Ovcha Kupel EOOD and the minority holdings in the seven electricity distribution companies.

VII. CONCLUSION.

Ensuring the stability of public finances and achieving a balanced national budget in the conditions of a global economic and financial crisis and a recession of the Bulgarian economy will remain a foremost task of fiscal policy next year. Ensuring the stability of public finances and achieving a balanced national budget in conditions of a global economic and financial crisis and a recession of the Bulgarian economy remains a prime task for fiscal policy next year. At the same time, the honouring of the Government's key social and economic commitments in respect of pension income presupposes that the sector policies formulated by the line ministers support the economic and fiscal objectives and priorities common to the Government, and the implementation of these policies should reckon with the expenditure levels in the 2010 budget.

In the short term and medium term, measures are needed to restrict budget expenditures and prioritise them by sector, combined with pressing ahead and speeding up structural reforms, optimising governance and improving the effectiveness in the work of public administration. The expenditure side of the 2010 Budget prioritises education, health care, the social sector and road infrastructure. The Government's purposeful efforts to bring the road infrastructure into conformity with European standards will focus on the absorption of the guaranteed resources from the EU funds.

The Government is committed to an activation of social dialogue at all levels, including through the National Council for Tripartite Co-operation (NCTC) and its standing committees, the industry, branch and regional co-operation councils, through dialogue within the framework of the National Assembly Labour and Social Policy Committee and dialogue at the Economic and Social Council.

KEY TO ACRONYMS

AEAF	Agency for Economic Analysis and Forecasting
BNB	Bulgarian National Bank
CAP	Common Agricultural Policy
CFP	Consolidated fiscal programme
CFP	Common Fisheries Policy
CITA	Corporate Income Tax Act
CoM	Council of Ministers
DWTP	Drinking water treatment plant
EAFRD	European Agricultural Fund for Rural Development
EAGF	European Agricultural Guarantee Fund
EC	European Commission
ECB	European Central Bank

EFF	European Fisheries Fund
EMU	Economic and Monetary Union
ERDF	European Regional Development Fund
ERM II	Exchange Rate Mechanism 2
ESF	European Social Fund
EU	European Union
FDI	Foreign direct investment
FLAG	Fund for Local Authorities and Governments
FLSU	First-level spending unit
FOWGCF	Factory and Office Workers' Guaranteed Claims Fund
FSC	Financial Supervision Commission
GDP	Gross domestic product
GIL	Government investment loan
GNI	Gross national income
GS	Government securities
GVA	Gross value added
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
ITNPA	Income Taxes on Natural Persons Act
LTFA	Local Taxes and Fees Act
MoF	Ministry of Finance
MRR	Minimum required reserves
MTFF	Medium-term Fiscal Framework
NAMRB	National Association of Municipalities in the Republic of Bulgaria
NDP	National Development Plan
NHIF	National Health Insurance Fund
NHIFBA	National Health Insurance Fund Budget Act
NRA	National Revenue Agency
NSI	National Statistical Institute
NSPRD	National Strategic Plan for Rural Development
NSRF	National Strategic Reference Framework
NSSI	National Social Security Institute
OP	Operational programme

PSI	Public social insurance
PSIBA	Public Social Insurance Budget Act
RDP	Rural Development Programme
SAPS	Single Area Payment Scheme
SBRBA	State Budget of the Republic of Bulgaria Act
SCF	Structural and Cohesion Funds
SF	State Fund
SGP	Stability and Growth Pact
SIC	Social Insurance Code
SNA	System of National Accounts
SOE	State-owned enterprise
TF	Transition Facility
TFP	Total factor productivity
TOR	Traditional own resources
UPF	Universal pension fund
VAT	Value added tax
WB	World Bank
WWTP	Wastewater treatment plant

APPENDICES	
Appendix 1	2010 Budget disaggregated by responsibilities
Appendix 2a	Consolidated Fiscal Programme for 2009 and 2010
Appendix 2b	Allocation of expenditures by function under the Consolidated Fiscal Programme for 2009 and 2010