



REPUBLIC OF BULGARIA

CONVERGENCE PROGRAMME (2008–2011)

November, 2008

TABLE OF CONTENTS

Table of contents	3
List of abbreviations	5
List of tables in the text	6
List of figures in the text	7
1. Overall policy framework and objectives	8
2. Economic outlook	9
2.1. World economy and technical assumptions	9
2.2. Cyclical developments and current prospects	9
2.2.1. Economic growth	9
2.2.2. Cyclical position	11
2.3. Medium-term scenario	11
2.4. Sectoral balances	12
2.4.1. Labour market - employment and unemployment	12
2.4.2. Incomes and labour productivity	13
2.4.3. Inflation	14
2.4.4. External sector	17
2.4.5. Monetary sector	19
2.5. Effects from structural reforms	19
3. General government balance and debt	22
3.1. Policy strategy	22
3.2. Medium-term objectives	22
3.3. Actual balances and implications of budget for next year	24
Main tax policy aspects for 2009–2011	26
Main policies on the expenditure side in the three-year budgetary forecast	27
3.4. Structural balance and fiscal stance	29
3.5. Debt levels and developments	30
3.6. Budgetary implications of major structural reforms	31
3.6.1. Social insurance	31
3.6.2. Education	32
3.6.3. Healthcare	33
4. Sensitivity analysis and comparison with previous update	34
4.1 Alternative scenario and risks	34
4.1.1. Considerable deterioration of the external environment	34
4.1.2. Fiscal risks	34
4.2. Sensitivity of budgetary projections to different scenarios and assumptions	37
4.3. Comparison with previous update	37
5. Quality of public finance	38
5.1. Policy strategy	38

5.2. Developments on the expenditure side of the budget.....	38
5.3. Developments on the revenue side of the budget.....	38
6. Sustainability of public finances.....	39
6.1. Policy strategy	39
6.2. Long-term budgetary prospects, including the implications of aging populations.....	41
6.2.1. Social insurance.....	41
6.2.2. Education.....	43
6.2.3. Healthcare	43
7. Institutional features of public finances	45
7.1. Implementation of national budgetary rules	45
7.2. Budgetary procedures, including public finance statistical governance.....	45
7.3. Reforms in the area of revenue administration.....	47
7.3.1. National revenue agency	47
7.3.2. Customs agency	48
7.4. Fiscal decentralisation	48
Appendix 1: Tables	49
Appendix 2: Direct budgetary impact of main structural reforms	62

LIST OF ABBREVIATIONS

AEAF	– Agency for Economic Analysis and Forecasting
BNB	– Bulgarian National Bank
EC	– European Commission
ECB	– European Central Bank
EDP	– Excessive Deficit Procedure
ESA	– European System of Accounts
EU	– European Union
EUR	– Euro
EURIBOR	– Euro Interbank Offered Rate
FDI	– Foreign Direct Investment
FISIM	– Financial Intermediaries’ Services Indirectly Measured
FLSU	– First-Level Spending Units
GDP	– Gross Domestic Product
GNI	– Gross National Income
GVA	– Gross Value Added
HICP	– Harmonized Index of Consumer Prices
IMF	– International Monetary Fund
ISCED	– International Standard Classification of Education
LFS	– Labour Force Survey
LIBOR	– London Interbank Offered Rate
MES	– Ministry of Education and Science
MoF	– Ministry of Finance
MoH	– Ministry of Health
MLSP	– Ministry of Labour and Social Policy
NATO	– North Atlantic Treaty Organization
NHIF	– National Health Insurance Fund
NRA	– National Revenue Agency
NSI	– National Statistical Institute
NSSI	– National Social Security Institute
OP	– Operational Programme
PSS	– Public Social Security
SEPA	– Single Euro Payment Area
SIC	– Social Insurance Code
ULC	– Unit Labour Costs
USD	– United States Dollar
VAT	– Value-added Tax
VIIES	– VAT Information Exchange System

LIST OF TABLES IN THE TEXT

TABLE 1: ASSUMPTIONS ON MAIN MACROECONOMIC INDICATORS	9
TABLE 2: END-OF PERIOD INFLATION RATE AND CONTRIBUTIONS BY HICP COMPONENTS	15
TABLE 3: PRODUCER AND CONSUMER ENERGY PRICE CHANGES AND EFFECTS ON HICP	15
TABLE 4: HICP FORECAST (%)	16
TABLE 5: EXTERNAL SECTOR INDICATORS	18
TABLE 6: MAIN MEASURES ENVISAGED IN THE NATIONAL HEALTHCARE STRATEGY 2008–2013	21
TABLE 7: MEDIUM-TERM BUDGETARY OBJECTIVE.....	23
TABLE 8: MAIN MACROECONOMIC INDICATORS.....	34
TABLE 9: POLICIES AND MEASURES PROVIDED FOR IN THE 2009 BUDGET TO LIMIT THE IMPACT OF THE GLOBAL FINANCIAL CRISIS ON THE BULGARIAN ECONOMY	35
TABLE 10: FISCAL SUSTAINABILITY INDICATOR	40
TABLE 11: EDUCATION EXPENDITURE BY TYPE OF EDUCATION (% OF GDP)	43
TABLE 12: HEALTHCARE EXPENDITURE.....	44

LIST OF FIGURES IN THE TEXT

FIGURE 1: DEMAND-SIDE SOURCES OF ECONOMIC GROWTH	10
FIGURE 2: NUMBER OF EMPLOYED AND UNEMPLOYMENT RATE.....	13
FIGURE 3: REAL UNIT LABOUR COSTS GROWTH, Y/Y.....	14
FIGURE 4: HICP: NON-ENERGY INDUSTRIAL GOODS AND SERVICES (MONTHLY CHANGE ON ANNUAL BASIS)	16
FIGURE 5: BULGARIAN EXPORTS SHARE IN TOTAL EU IMPORTS, Y/Y.....	17
FIGURE 6: FOREIGN DIRECT INVESTMENT IN BULGARIA	18
FIGURE 7: BUDGET BALANCE (% OF GDP)	24
FIGURE 8: REVENUE STRUCTURE, 2009.....	27
FIGURE 9: EXPENDITURE STRUCTURE BY FUNCTIONS, 2009	29
FIGURE 10: CYCLICAL BUDGETARY POSITION.....	30
FIGURE 11: GENERAL GOVERNMENT DEBT (% OF GDP)	31
FIGURE 12: AGE STRUCTURE OF THE POPULATION	39
FIGURE 13: AGEING POPULATION EXPENDITURES (% OF GDP)	40
FIGURE 14: BALANCE OF THE PUBLIC SOCIAL INSURANCE FUNDS (% OF GDP).....	41
FIGURE 15: REPLACEMENT AND DEPENDENCY RATIOS, 2008-2060	42
FIGURE 16: ACTUARIAL BALANCE.....	43

1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

The Convergence Programme (2008–2011) of the Republic of Bulgaria is prepared in compliance with the requirements of the process of multilateral fiscal surveillance in the framework of European Union macroeconomic policies coordination. The Programme addresses the parameters of sustainability of the fiscal policy, in line with the recommendations of the Stability and Growth Pact, and outlines the way to fulfilment of the Maastricht criteria for entry in the Euro area.

The Convergence Programme is focused on the main reforms and the characteristics of the macroeconomic policy the Bulgarian government is committed to execute in the programme period. The Programme is in conformity with the Integrated Guidelines for Growth and Jobs (2008–2010), with the latest recommendations of the European Council and the European Commission, as well as with the main programme documents of the Bulgarian government, namely: The Programme of the Government of European integration, economic growth and social responsibility (2005–2009), the multiannual budgetary framework, the updated National Reform Programme (2008–2010) and the Action Plan to it, the National Strategic Reference Framework, the Agreement between the Council of Ministers of the Republic of Bulgaria and the Bulgarian National Bank on the introduction of the Euro, and the National Employment Action Plan to the Employment Strategy (2004–2010).

Maintaining the macroeconomic stability and the sustainable economic growth rates are the main priorities of the government in the medium term. The key factors to achieve these goals will continue to be the structural reforms and the efforts to improve the business climate and enhance the effectiveness of the institutions. They are addressed in details in the updated National Reform Programme (2008–2010) and the Action Plan to it.

The main assumptions underlying the forecast of the Bulgarian economic development for the period 2009–2011 comprise further deterioration of the external environment and slowdown of the growth of the country's main trading partners. We expect the strongest negative impact of the world financial crisis on the processes in the real sector of the economy to take place in 2009. The main channels through which the world financial crisis is expected to affect the Bulgarian economy are investment demand and lower foreign capital inflows.

The main short term risks for the budget execution come from the international financial crisis and the threat of global recession that could lead to lower exports and decrease in inflows of foreign capital to Bulgaria. The government, taking into account the principles for preserving the financial stability, for active economic policy directed at maintaining the flexibility of the economy, and for protecting the market and the competitive environment from distortions, has prepared a set of measures and reserves to limit the impact of these risks on the Bulgarian economy.

The budgetary objectives, manifested through generation of significant positive budget balances during the programming period, are targeted to smooth the business cycle, decrease domestic-demand-driven inflationary pressures in the economy, and to counteract the increasing external sector imbalances. The efforts to achieve sustainable medium-term fiscal framework, to continue with the introduction of the programme budgeting, and the further development of fiscal decentralisation will be important factors to boost the efficiency and quality of public finances.

The government will continue its efforts to reform the public sector and to improve the business environment in line with the updated National Reform Programme (2008–2010). Social insurance reforms and restructuring of public expenditures towards investments in infrastructure are envisaged in support of the private sector development.

Bulgaria will maintain its currency board arrangement at the existing fixed exchange rate of BGN 1.95583/EUR 1 until the country becomes a member of the Euro area. The government and the central bank confirm that Bulgaria intends to join the Exchange Rate Mechanism II as soon as possible.

2. ECONOMIC OUTLOOK

2.1. World economy and technical assumptions

The Convergence Programme is based on the macroeconomic framework for 2008–2011 used in the preparation of the 2009 state budget, as well as on European Commission, IMF and AEAFF assumptions on main external environment indicators. The forecast values of the indicators used in the Convergence Programme are estimated on the basis of the medium-term macroeconomic model and other auxiliary models of the Agency for Economic Analysis and Forecasting, as well as on estimates by the Ministry of Finance, the National Social Security Institute and the National Health Insurance Fund.

Table 1: Assumptions on main macroeconomic indicators*

	2008	2009	2010	2011
USD/EUR exchange rate	1.50	1.40	1.30	1.25
GDP (in real terms, percentage change) – World economy	4.1	3.9	4.2	4.5
GDP (in real terms, percentage change) – EU27	0.80	0.30	1.40	1.80
Oil price (USD/barrel)	108.0	98.0	91.0	93.8
6-month USD LIBOR	3.1	3.3	4.0	4.5
3-month EURIBOR	4.9	5.0	4.5	4.5
Commodity prices (1995=100)	162.5	155.6	147.1	141.4
Food	170.1	168.7	165.9	162.5
Beverages	159.0	150.9	146.5	142.7
Agricultural raw materials	118.8	118.6	116.5	113.4
Metals	183.4	163.1	140.6	129.0

*Assumptions take into account data available as of September 15, 2007.

Source: EU, IMF, AEAFF

2.2. Cyclical developments and current prospects

2.2.1. Economic growth

Real GDP growth reached 6.2% in 2007 and 7.1% in the first half of 2008 driven by domestic demand mainly. Investments in fixed capital grew in real terms by 21.7% in 2007 and 22.7% in the first six months of 2008, accelerating from 14.7% in 2006. The share of national savings in GDP rose from 13.5% at the end of 2006 to 15.6% at the end of the first half of 2008. However, as a result of the intensified investment activity, national savings covered only 40.4% of the capital expenditures made by the economic agents in the last 12 months, in comparison with 42.6% in 2006.

This dynamics was entirely generated by the private sector as the savings-investment balance of the government has improved marginally during this period. Almost 80% of investments growth in 2007 was concentrated in the following sectors: real estate, renting and business activities, manufacturing, production and distribution of electricity, construction, and trade. These sectors (excluding manufacturing) remained attractive in 2008, despite the reduced liquidity on a global scale, and attracted half of all investments in the first six months of 2008 contributing for about 90% of their growth.

The inflation acceleration from mid-2007 onwards brought gradual decrease in final non-government consumption real growth rate from 7.8% in the first quarter to 2.8% in the fourth quarter of 2007. Since the beginning of 2008, an acceleration of this growth rate has been observed – it reached 5.9% in the first half-year, due to the step up of the employment growth in this period, the disposable incomes high real growth, and to a lower extent, consumer credit. While in 2007 government consumption grew by 3.1% in real terms, it shrank by 1% in the first half of the current year.

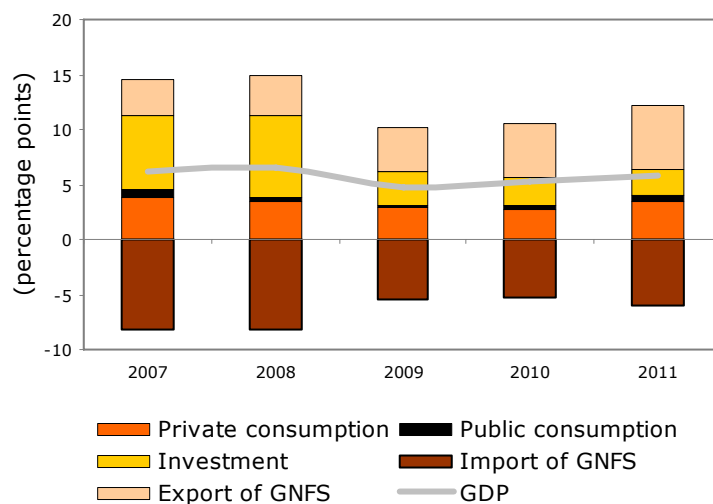
Net exports contribution to economic growth has improved from -5.5 percentage points in 2006 to -4.9 percentage points in 2007, underpinned by exports real growth rate acceleration in each quarter of the year, as well as by gradual deceleration of imports increase. This tendency was preserved in the first quarter of the current year – net exports contribution became positive for the first time since the third quarter of 2004. As a whole, external sector contribution to GDP growth improved to -4.38 percentage points in the first half-year, despite the worsening of this indicator in the second quarter of 2008.

Industry and services had a positive contribution to the value added growth in 2007. The value added of agriculture dropped by almost 30%, mostly because of unfavourable weather conditions. However, from the second quarter of 2008 agriculture began to recover and its value added growth reached 6.5% in the first half-year.

Industry real growth accelerated from 7.8% in 2006 to 14% in 2007, driven by manufacturing and production and distribution of electricity. The share of the sector in total value added reached 32.3% as compared to 30.9% a year earlier. Relatively worse results of food-processing, textiles, oil-refining, and machinery and equipment industries limited industrial growth to 7.4% in the first half-year of 2008.

Services, the biggest sector of the economy with a share of 61% in total value added in 2007, continued to have the highest contribution to economic growth in 2007, as well as from the beginning of 2008. The following branches are the most important for the dynamic development of the sector: financial intermediation, trade, real estate, renting and business activities, and transport. Deepening of financial intermediation and an increase in economic agents real incomes are the reasons why the value added in financial intermediation has been growing by more than 20% annually since 2002. The share of this branch in total value added reached 7% in 2007 as compared to 3.5% in 2002. In 2007 and the first half of 2008 the branch contributed 25% and 30%, respectively, to the GDP growth.

Figure 1: Demand-side sources of economic growth



Source: AEAf, NSI

2.2.2. Cyclical position¹

According to estimates of AEAF, the Bulgarian potential economic growth was about 5% in 2007 as compared to 4.8% in 2006. The revision of the estimate for the potential growth in 2007 presented in the Convergence Programme (2007–2010) is due to new developments in the Bulgarian economy resulting from deep domestic and external shocks (exceptionally strong drop in agriculture and rise of international food and oil prices). Nevertheless, potential growth rate remains at a high level and contributes substantially to the augmentation of the capital and production level of the Bulgarian economy. Rising capital stock, followed by the growth in employment, continue to be the main drivers of potential growth. In comparison with previous years, total factor productivity had unusually low contribution, partially because most of the workers who became employed during the period were relatively poorly qualified.

The output gap for 2007 was about 1.8% and it is expected to reach 1.9% in 2008. Our forecast for the 2008–2011 period is that potential economic growth will gradually slow down from 6.3% to 5.9%. This deceleration reflects expectations about growth rates of the employment and investments in fixed capital. Capital stock, followed by total factor productivity and employment, is expected to be the main contributor to potential growth.

The output gap is expected to shrink to 0.7% in 2009, and to 0.0% and -0.1% in the following years. These expectations are fully in line with the forecast slowdown in domestic demand growth, the taming of the labour market, and the deceleration of inflation.

2.3. Medium-term scenario

The main assumptions, on which the forecast about the Bulgarian economic development for the period 2009–2011 is based on, are for further deterioration of the external environment and slowdown of the growth of the country's main trading partners. We expect the strongest negative impact of the world financial crisis on the processes in the real sector of the economy to take place in 2009. An assumption is made that there will be a recovery of the growth in the world economy and, in particular, in the EU economies in 2010–2011. The main channels through which the world financial crisis is expected to affect the Bulgarian economy are investment demand and lower foreign capital inflows.

Basic assumption of the forecast is that the negative impact from the crisis on the Bulgarian economy will be considerably weaker in comparison to the big European economies. Main factors for this resilience are the good macroeconomic indicators of the country, the stable banking system (with high-risk instruments practically non-existing in bank's portfolios and relatively high capital adequacy), the presence of considerable reserves and buffers in the economy, the restricting nature of the policy of maintaining fiscal surpluses, the strict control of the responsible institutions over the country's financial system, and the continuing structural reforms in the country.

As a result of the assumptions, the economic growth in Bulgaria is expected to slow down from 6.5% in 2008 to 4.7% in 2009. This moderation is expected to be manifested through lower domestic demand mainly as the highest drop is expected in terms of investments growth. Nevertheless, the economic growth will remain high and in view of the expected developments in the EU economies the growth differential with the average EU growth rate will increase slightly, i.e. the real convergence process of the Bulgarian economy will continue. The Bulgarian economic growth rate is expected to accelerate again to 5.2% and 5.8% in 2010 and 2011 respectively.

Households final consumption expenditures growth is expected to shrink next year by about one percentage point to 4.1% as compared to its 2008 value. The envisaged sluggish growth rates of the wages and the employment, as well as the tightened lending conditions are the main factors for this decrease. Our forecast is that in 2010 households consumption growth will remain unchanged at its level of 2009, while in 2011 it is going to accelerate to about 5.0%.

¹ Conventional methodology, with a production function, has been used in the estimations. In the text of the Programme are reported results from this method application. The data about population in working age are not smoothed out because of the ambiguities resulting from that. This leads to slightly lower values of the output gap, and to higher potential growth values. From economic policy viewpoint, these differences are insignificant because, in both cases, the economic cycle profile is almost the same.

Investments in fixed capital are expected to increase by 10.6% in 2009 – a reduction of about 12 percentage points as compared to the previous year's growth. In 2010 and 2011 the projected growth rates are 9.0% and 10.1%, respectively. The foreseen lower growth rates of total investments and investments in fixed capital are direct consequences of the expectations for more restricted access to financing. The forecast takes into account also the achieved already high share of investments in GDP (over 40% in the second quarter of 2008) and the expected slowdown in the external and domestic demand growth rates.

The growth of imports of goods is expected to decelerate to 6.3% in 2009, mostly due to the lower domestic demand growth rates. The expected recovery and the attainment of higher economic growth rates in 2010-2011 reflects initial stabilisation, and after that, certain acceleration of the growth rates of imports of goods to 7.4%.

The growth rate of exports of goods is expected to slow down to 7.3% in 2009 mainly due to the lower external demand. Exports of goods growth is expected to rise to 8.5% and 9.6% in 2010 and 2011, respectively. As a result of that, by the end of the programming period, the trade balance is expected to improve and the current account deficit will gradually shrink to 19.2% of GDP. This improvement relies also on a rise in the share of the national savings in GDP, which is expected to reach 18.8% in 2011 as compared to 14.8% in 2007.

2.4. Sectoral balances

2.4.1. Labour market - employment and unemployment

In 2007 and the first half of 2008 the labour market continued its dynamic development. The number of employed increased at high rates and the unemployment rate hit its lowest level in the past 17 years as of end-September 2008.

The favourable economic development and the high investment activity in the economy were the main factors at play behind the higher labour demand and the creation of new jobs. The average number of employed persons grew by 4.6% in 2007 and 4.3% in the first half of 2008² - entirely a result of the increased private sector employment. The policy of reducing direct tax and social security burden, implemented in the last several years, also contributed to the increased employment opportunities. High rates of employment growth were reported in the construction and the related real estate, renting, and business activities, hotels, and restaurants. There was also fast increase in the number of employed in the trade and financial intermediation sectors.

The expansion of the economic activity was accompanied by intensification of the problem of insufficient labour supply in some sectors of the economy. It was most profoundly expressed in construction and manufacturing and, to a lesser extent, in retail trade and services.³ The higher labour demand put an upward pressure on salaries and unit labour costs but it also created stimulus for increased labour force participation.

Participation rate rose because of the return to the labour force of persons, who were not participating in the previous years. The number of discouraged persons has been steadily decreasing in the last year and a half. They were by 62.7 thousand less in the first half of 2008 as compared to the first half of 2007. The participation rate rose by 1.8 and 1.9 percentage points as compared to 2006 and the first half of 2007, respectively, and reached average values of 66.3% in 2007 and 67.4% in the first half of 2008.⁴

The main reason behind the continuing downward trend in the rate of unemployment was the pick up of job openings on the primary labour market. The unemployment rate reached 6.9% in 2007 and 6.1% on average for the first six months of 2008, registering a 2.1 and 1.3 percentage points drop as compared to 2006 and the first half of 2007, respectively.⁵ The share of the unemployed

² According to NSI Labour Force Survey (LFS) data, for the age group 15+.

³ Data from the enterprise surveys, conducted by the NSI among the employers.

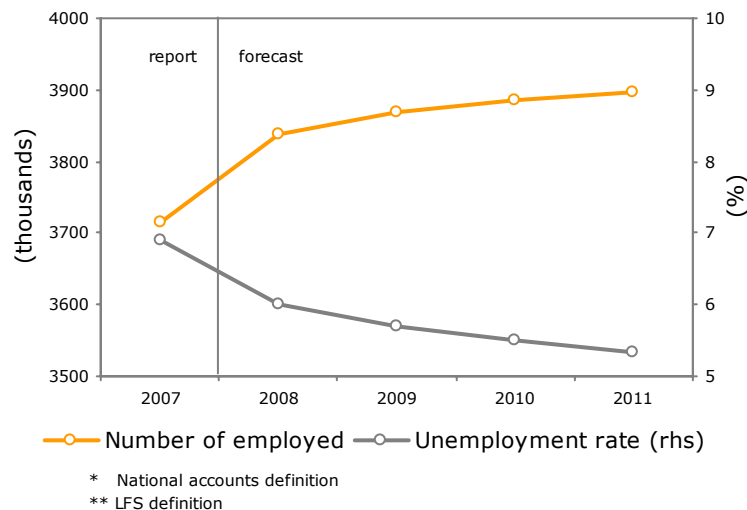
⁴ In the age group 15-64.

⁵ According to the LFS data.

persons in the labour force reached 5.8% in the second quarter of 2008 - its lowest level since the start of the Labour Force Survey. The Employment Agency administrative statistics has also confirmed the downward trend of the unemployment in the country. The level of registered unemployment dropped to 5.8% as of end-September 2008, which is the lowest level of the indicator since mid-1991.

The scope of the active labour market policy has continued to decrease in the last year and a half. The monthly average number of persons under the active programmes and employment enhancement measures was by 19.2% and 12.0% lower in 2007 and in the first nine months of 2008, respectively, as compared to the same period of the previous year.

Figure 2: Number of employed* and unemployment rate**



Source: NSI, AEF

Employment and unemployment are expected to continue their positive development in the period 2009–2011 though under the conditions of a relatively weaker economic growth. Despite the unfavourable demographic trends and the expected further decrease in the working-age population, the number of employed persons is expected to continue to grow in the next three years. The forecasted employment growth is 0.8%, 0.4% and 0.2% in the period from 2009 through 2011 respectively.⁶ The level of unemployment is expected to continue to decrease, but at a lower pace, and to reach 5.3% of the labour force in 2011.⁷ The positive developments of the labour market are expected to be underpinned by the implemented structural reforms, directed to stimulate the labour supply, to increase the quality of the labour force, to improve the business environment and the investment climate – measures that are outlined in the updated version of the National Reform Programme (2008–2010) and the Action Plan to it.

2.4.2. Incomes and labour productivity

The growth rate of the labour incomes accelerated significantly in 2007 and the first half of 2008. The average wage⁸ increased by 19.7% and 24.3% in nominal terms and 11.2% and 9.8% in real terms respectively.⁹ The high productivity in some economic sectors and the shortage of labour supply with specific education and qualifications influenced the growth of the labour incomes. The private sector continued to be the main driving force of the incomes growth.

⁶ The estimates concerning the employment dynamics are based on the national accounts definition of employed persons.

⁷ LFS definition.

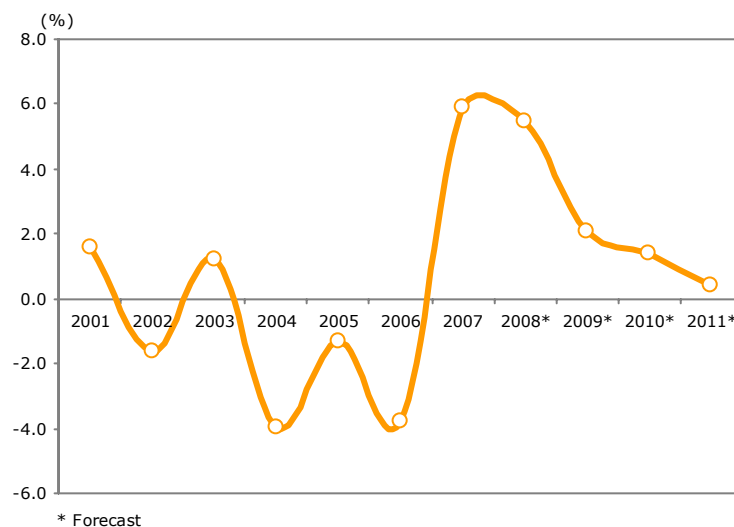
⁸ Preliminary data from the Enterprise Survey.

⁹ The HICP has been used in the calculation of the average wage real growth.

Labour productivity in the Bulgarian economy rose by real 3.4% in 2007 and 3.0% in the first half of 2008 respectively. Despite the positive development of the indicator, however, the accelerated incomes growth led to an increase in labour costs. Real unit labour costs¹⁰ rose by 5.9% in 2007 and by 4.3% in the first half of 2008. Agriculture had the main contribution to their growth in 2007, followed, to a lesser extent, by manufacturing. From the beginning of 2008 the ULC growth is attributed mainly to manufacturing. At the same time, nominal unit labour costs grew by 14.2% in 2007 and by 17.3% in the first half of 2008, which is an evidence for inflationary pressure stemming from the labour market.

Labour incomes are expected to continue to rise in the programme period. Our forecast is that the tendency observed from the beginning of the year will persist until the end of 2008 and a moderation of the indicator's growth will follow in the period 2009–2011. The forecast acceleration of labour productivity growth is in line with the commitments for continuation of the announced structural reforms and improvement of the business environment, presented in details in the updated National Reform Programme (2008–2010) and the Action Plan to it, as well as with the overall positive economic development. Having in mind the lagging of labour incomes growth vis-à-vis labour productivity increase in the last several years, it is possible to see a relatively faster labour incomes growth in next years. It could be assumed that such dynamics is acceptable in the short run and would not affect the country competitiveness considerably because the share of the compensation of employees in gross value added is still well below the average for the EU countries. Our expectations are that labour incomes and productivity will grow by almost equal rates by the end of the programming period.

Figure 3: Real unit labour costs¹¹ growth, y/y



Source: AEF, NSI

2.4.3. Inflation

The registered high inflation rates in 2007 and at the beginning of 2008 are mainly due to the cyclical increase in the international prices of a wide range of goods. For the EU countries, including Bulgaria, the bulk of the rise in inflation has been associated with hikes in food and energy prices. However, Bulgaria has the highest price increases of those two groups within the EU. This is due to some specific characteristics of our economy, such as low initial price level, competition imperfections of the domestic food production and trade markets, high relative share of food expenditures in households' consumption, and high energy intensity of the economy.

¹⁰ The indicator is calculated as a ratio between nominal compensation of employees per employee and nominal GDP per employed.

¹¹ See fn. 10.

Table 2: End-of period inflation rate and contributions by HICP components

	2007		2008*	
	% of change	Contribution (p.p.)	% of change	Contribution (p.p.)
Total	11.6	11.6	11.4	11.4
Food and non-alcoholic beverages	21.1	4.9	9.4	2.3
Alcohol and tobacco	-2.0	-0.1	15.1	0.7
Non-energy industrial goods	6.0	1.3	6.3	1.4
Energy	12.0	1.5	16.1	2.3
Services	10.8	3.9	13.4	4.8

* Data for 2008 indicates the inflation rate on annual basis in September 2008

Source: AEF, NSI

The expected high annual inflation for 2008 is considerably different from the projected in the Convergence programme 2007–2010. The major deviations are in the groups of food, energy goods and services.

The poor weather conditions in the country in 2007 contributed significantly to the high food prices. The existence of unfair competition was an additional negative factor for their rise. In 2008, the Commission for Protection of Competition fined a number of firms and branch associations operating on the markets for milk and dairy products, eggs, poultry meat, bread, and vegetable oil for maintaining certain price levels through cartel agreements and thus harming consumers.

The energy goods price hikes, stemming mostly from the changed international conjuncture, had a considerable direct and indirect contribution to the overall inflation (Table 3).

Table 3: Producer and consumer energy price changes and effects on HICP

	2007 (end-of-period)			Sept. 2008 to Sept. 2007		
	PPI	HICP	Price effect on HICP (p.p.)	PPI	HICP	Price effect on HICP (p.p.)
Liquid fuels	29.5%	17.8%	1.9	39.3%	18.1%	2.3
Electricity	11.3%	7.8%	0.7	13.6%	14.3%	1.0
Heating	1.1%	0%	0.0	6.7%	4.8%	0.1
Natural gas *		13.1%	0.4		36.1%	1.0
Total effect on HICP			2.9			4.5

* Changes in national supplier's end prices for local providers and users

Source: AEF, NSI

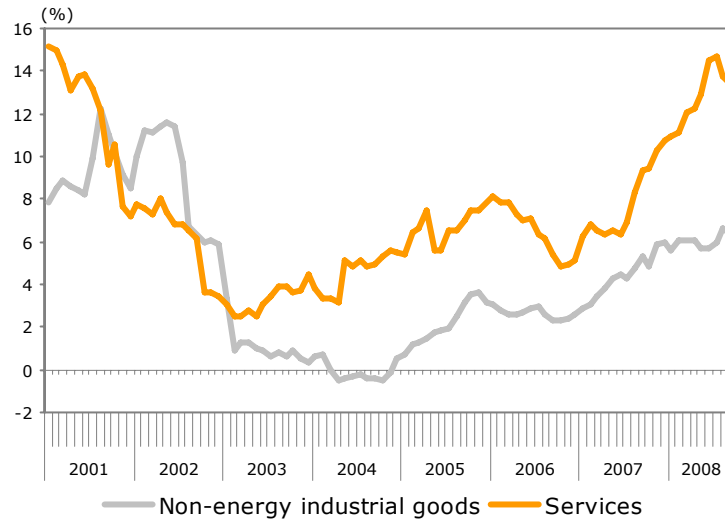
The unanticipated dynamics of the international food and energy prices led also to higher services inflation. This was particularly true for the catering and transport services groups, the relative weight of which represents nearly half of the share of the services in the HICP. The annual price increases of the two groups reached 17.4% and 25.6% as of end-September respectively.

Our estimate is that the current high inflation is temporary phenomenon and, in the absence of further external shocks, it is expected to fall to single-digit levels by the end of the year. In support of this expectation is the registered deceleration of the annual inflation rate in each month since mid-2008 – the June inflation was 14.7% and it fell to 11.4% in September.

In order to improve the flexibility of the economy to better accommodate shocks and taking into account the recommendations of the Council of Ministers addressing the previous Convergence Programme and the need to put inflationary pressure under control, in October the government approved a package of anti-inflationary measures. These measures, part of the updated National Reform Programme (2008–2010) and the Action Plan to it, cover the following areas: fiscal,

restricting the grey economy, stimulating the competition and well-functioning markets of goods and services, improving the communication with consumers in order to raise their awareness, improving the energy effectiveness.

Figure 4: HICP: Non-energy industrial goods and services (monthly change on annual basis)



Source: Eurostat

The assumptions about the external environment, the expected unit labour costs dynamics, the planned increases in administered prices, as well as the schedule for excise tax rates changes were all taken into account in the preparation of the inflation forecast. The inflation dynamics is related to the GDP and the labour productivity growth rates. The expected higher than the EU average rates of labour productivity growth in the country would allow for faster incomes growth and, therefore, for faster rise of the overall price level.

Table 4: HICP forecast (%)

Year	End-of-period	Annual average
2008	9.8	12.4
2009	5.4	6.7
2010	4.1	4.7
2011	4.1	4.0

Source: AEF

The external sector assumptions are affected by the world financial crisis. As a whole, the drop of the world demand is expected to lead to lower international prices, although the risk of unchanged level or a new pick up of the international food prices remains.

New increases of the excise tax on tobacco products are planned for 2009 and 2010 to reach the minimal EU levels. Our estimate is that, as a result of the excise tax changes, the cigarette prices would rise by 16.6% and 16.3% in each of the two years, respectively. The contribution of this measure to end-year inflation is estimated at 0.6 percentage points both in 2009 and 2010. There are no expectations for changes in the excise taxes on liquid fuels in these two years and thus retail prices of the latter will depend even more on the dynamics of the international crude oil prices. Our assumption for the period until 2011 is that the fuel prices would remain unchanged at their 2008 levels.

The energy goods group includes goods with both market and administratively regulated prices. Our expectation for the period 2009–2011 is that the administered prices of electricity and heating will grow on average by 5% annually. The new excise taxes on the electricity and the coal for the

business would have small indirect effect on overall inflation – 0.1 percentage points in total for the period 2009–2010.

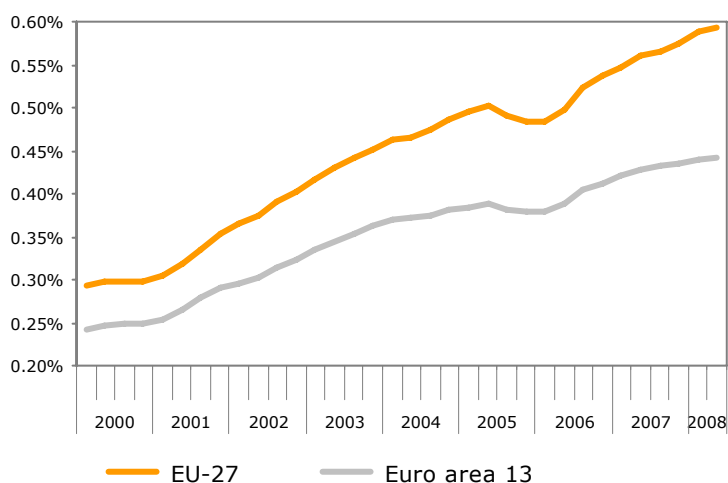
The tendency of a relatively high services inflation is expected to persist – it would be about 8.3% at the end of each year in the programme period. The increase in the real unit labour costs, forecast to continue in the next years, is expected to affect the prices of services more than the prices of goods.

2.4.4. External sector

The main factors that determined the external sector dynamics in the last year and a half are the substantial foreign direct investment inflow, the international prices of metals and energy goods, the high economic growth, as well as the increase in the incomes, the productivity and the competitiveness of the country.

The current account deficit reached 21.8% of GDP in 2007. The external trade deficit was the main factor behind the high negative balance. That tendency continued in 2008. The current account gap reached 13.9% of the projected GDP in the period January-July. Our expectations are that the current account deficit would be 24.0% of the projected GDP at the end of the year and would start to decline gradually afterwards. The projected slowdown of investment and domestic demand growth rates in the short run would lead to a deceleration of the growth of import of goods and would reduce the pressure on the current account balance coming from the trade deficit.

Figure 5: Bulgarian exports share in total EU imports, y/y



Source: Eurostat, BNB

The financial account fully covers the current account deficit. The overall balance was positive in 2007 and the foreign exchange reserves increased by EUR 2.9 billion. The government paid back the outstanding IMF debt of EUR 235.4 million during the year, the third and final repayment. It is expected that in the medium term the financial account inflows would continue to cover the current account deficit.

In 2007 exports of goods registered a nominal annual growth of 12.5%, while the imports growth was 18.4%. Raw materials and investment goods had a significant contribution to the increased trade turnover. In the first half of 2008 the exports of goods increased by 23.9% and the imports of goods growth was 27.8% in annual terms. The exports of petroleum and non-ferrous products registered high growth rates. The value of the imported energy resources rose as well, due to the increase in the crude oil prices. In 2009 we expect a slowdown of the real growth rates of imports and exports of goods. To stimulate and promote exports, and as part of the updated National Reform Programme (2008–2010) and the Action Plan to it, a National Export Strategy – Vision 2013 is expected to be introduced until the end of 2008.

In 2007 the balance of services was positive and 20.3% higher than in the previous year. In the first seven months of 2008 the net services balance deteriorated as compared to the same period last year. That was largely due to the higher transport costs and the greater number of residents

travelling abroad. The higher trade turnover and incomes of the population, together with and the increased opportunities to travel abroad after the EU accession are directly connected to the increased outlays in the services sector. In the medium term we expect the net revenues of the service account to increase and the positive trend of attracting more and more tourists to sustain.

In 2007 the balance on income was EUR -451.3 million. A significant rise of payments on foreign direct investment was registered since the beginning of 2008. In the medium term our expectations are for continuation of the trend in the income outflow and for widening of the income account deficit.

Table 5: External sector indicators

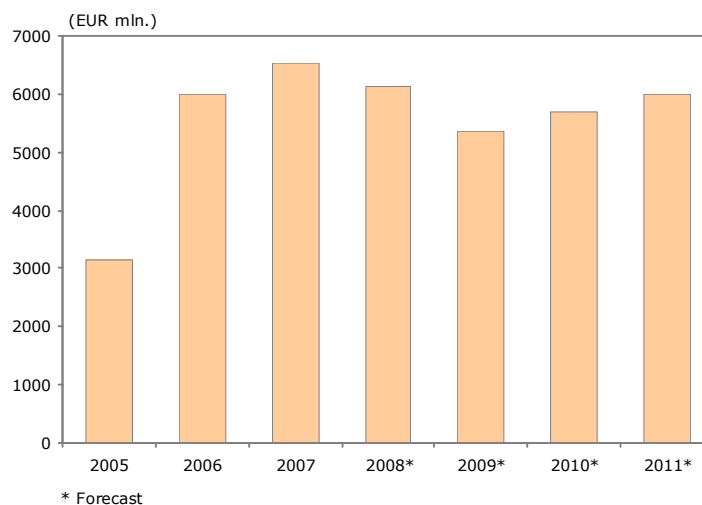
% of GDP	2007	2008*	2009*	2010*	2011*
Current account balance	-21.8	-24.0	-22.2	-20.8	-19.2
Trade balance	-25.3	-27.8	-26.9	-25.8	-24.6
Balance on services	3.9	3.4	3.7	4.1	4.5
Balance on income	-1.6	-2.1	-1.7	-1.7	-1.6
Current transfers, net	1.2	2.6	2.7	2.7	2.5
Capital account balance	1.2	1.1	1.5	2.3	2.5
FDI in Bulgaria	22.6	18.1	14.3	15.1	14.5

* Forecast: AEAf

Source: AEAf, BNB

In 2007 the foreign direct investment inflows were EUR 6.5 billion. Over 60% of the FDI were in financial intermediation and real estate, renting and business activities. In the first half of 2008 investments in real estate dropped by 36.6%, while investments in construction decreased by 24.4% as compared to the same period previous year. Unlike 2007, in the first half of 2008 foreign direct investment inflows in manufacturing increased considerably and their share in the total investment inflow in the country reached 22.1%. Investments in the financial intermediation and the trade sectors have also continued to grow. By the end of the year total foreign investment is expected to reach EUR 6 billion, while in 2009, as a result of the global financial crisis, to fall to EUR 5.4 billion. In the medium term our forecast is that foreign direct investment inflow will stay at the level of EUR 5-6 billion per year. The relatively high economic growth, the sound investment environment, the high rates of return and the openness of the economy are the factors that would continue to support the interest of the foreign investors in our country.

Figure 6: Foreign direct investment in Bulgaria



Source: BNB, AEAf

2.4.5. Monetary sector

The main objective of the monetary policy in Bulgaria is to maintain price stability through securing the stability of the national currency. The framework, within which this objective is being achieved by the BNB, is a currency board arrangement and a fixed exchange rate of the national currency to the Euro. The principles of the currency board arrangement include a full coverage of the monetary liabilities of the central bank by foreign reserves, as well as its obligation to purchase and sell the reserve currency (the Euro) without limitations at the fixed exchange rate. As part of the monetary framework in the country, the central bank cannot perform open market operations and be a lender of last resort to the commercial banks or to the government.

The increased uncertainty on the international financial markets since the beginning of 2008 has manifested itself mainly through a drop of the stock exchange indices. A slight increase of the interest rates on credits, reflecting mostly the rise of the price of the drawn resources, was observed as well. By end-October, at increased turnover, the average interest rate on the interbank money market in BGN rose by about 90 basis points from the beginning of the year until end-October in terms of increased turnover. The increase of the interest rates on interbank deposits in Euro was significantly lower. The higher demand for resources in national currency affected the interest rates on term deposits which rose by more than one percentage point for the same period. This dynamics led to a slow-down of the main money and credit aggregates growth. In September the annual growth rate of the claims on non-government sector slowed to 46.6% as compared to 63% as of end-2007, while the money supply annual growth moderated to 19.5% as compared to 31.2% as of end-2007.

The repercussions of the effects from the US mortgage market crisis and the bankruptcy of some of the leading global financial institutions creates significant uncertainty about the future dynamics of the monetary conditions. On the one hand, the coordinated reductions of the basic interest rates with 50 basis points by the major central banks at the beginning of October is expected to restrain any further increase in the domestic interest rates. On the other hand, if the market interest rates incorporate a higher risk premium for Bulgaria, the price at which the domestic commercial banks get financing could rise. This price would be transferred to the interest rates and, hence, into a slowdown of the private sector credit growth rates.

In order to constrain the volatility of the interbank money market and to promote banks' activity in the credit market, BNB amended the Ordinance on the minimum required reserves maintained with the BNB by banks, on October 21. According to the amendments, 50 percent of commercial banks' cash on hand will be recognised as reserve assets and the commercial banks' access to the reserves they keep with the BNB will be eased. These amendments effectively reduce the commercial banks' reserves at the BNB by approximately EUR 200 million, that banks could use as additional financial resource.

In order to guarantee the financial stability of the country BNB continues to apply strict supervision. With regard to this, a new ordinance on the evaluation and classification of risk exposures of banks and the allocation of provisions to cover credit risk, as well as an amendment of the ordinance on capital adequacy of credit institutions was adopted. The new ordinance on the evaluation and classification of risk exposures of banks sets minimum requirements to the scope of the policy of risk exposures' assessment by defining the responsibilities of the corresponding policy implementation units, the procedures and mechanisms of internal control, as well as the assessment methodology and the credit risk management system. In addition, the adopted amendments of the credit register regulation last year, which enlarged the scope of the register by including credits issued by financial institutions, subsidiaries of the commercial banks' in the country, create better conditions for risk management and control in the financial sector.

The Law on Credit Institutions is expected to be amended by introducing registration regime for all institutions offering credits. In this regard, the scope of the credit register is to be further enlarged to include those institutions.

2.5. Effects from structural reforms

The National Reform Programme (NRP), the National Strategic Reference Framework and the Convergence Programme of the Republic of Bulgaria are the three main documents addressing the economic challenges before the country in middle and long run. The main objectives of the NRP, comprising higher and sustainable economic growth, improving the institutional capacity of the

public administration, decrease of the administrative burden, more efficient monitoring and assessment of the policy implementation and long-term increase of the competitiveness of the Bulgarian economy; are in line with the Broad Economic Policy Guidelines (2008–2010) and are taken into account in the preparation of the medium-term budgetary framework and the Convergence programme.

By October 27, 2008 a progress of the achievement of the goals and measures of the operational programmes (OPs) could be reported – the fulfilment of the financial commitment for the period 2007–2008 on signed EU funds contracts, co-financed under the Structural Instruments, represents 29% of the annual programme. The portion of the signed contracts under OP "Transport" is 54% of the annual financial commitment; the share of the signed contracts under OP "Administrative capacity" is 118%; the utilisation of the funds under OP "Technical assistance" stands at 109%. In other areas, such as OPs "Environment", "Regional development" and "Competitiveness", contracting procedures at the total amount of over EUR 400 million are expected to be completed by the end of the year. Therefore, the fulfilment of the annual financial commitment of the operational programmes will result in transfers from the EU Structural Instruments to the Bulgarian economy of more than one billion Euro by the end of the year.

Reforms are undertaken in the area of the social insurance system, targeted at business environment enhancement and employment stimulation, while ensuring at the same time the long-term stability of the public finances, namely countering the potential risks connected to the adequacy and sustainability of the pension expenditures. These reforms are part of the Bulgarian National Reform Programme and the Action Plan to it.

In 2008, the level of the social insurance contributions remained unchanged but the ratio, which divides the contributions between employee and employer, was changed from 35:65 to 40:60. In accordance with the Social Insurance Code (SIC), in the beginning of July the pensions were indexed by 10.35% (0.85 percentage points higher than planned).

To provide sufficient funds in the public pension system and additional decrease of the total insurance burden, a reduction of the insurance contribution to the Pensions Fund from 22 to 18 percent is foreseen from the beginning of 2009. The contribution of the employers is set at 10% and that of the employees is defined at 8%. In addition, from January 1, 2009 the state is envisaged to make a transfer towards the State Social Insurance Pensions Fund at the amount of 12% of the sum of the social insurance income of all insured persons for the calendar year.

Reforms are also initiated in the educational system, with the aim to improve the quality of education, to guarantee equal access to education, to lower the dropping-out of the educational system and through literacy programmes to stably integrate people with low education in the labour market. The implementation of the reform package in the field of education, described in details in the National Reform Program (2008-2010) and the Action Plan to it, is expected to lead to an increase in the labour supply, the labour force quality and the employment level in the economy.

A new model of financing of the school education system was introduced in the beginning of 2007 (resource distribution on the basis of the number of students). The main objective of the model is to raise the effectiveness of the expenditures, as the financing of all state and municipal schools, kindergartens and supporting units is based on common expenditure standards. Taking into account the objective geographical and demographic characteristics, the standard is differentiated to group the municipalities in four categories. In 2007 the system was applied voluntarily by the financing bodies and the Ministry of Education and Science (MES) encouraged its wider introduction in the schools through series of measures. By the end of 2007, more than 600 municipal schools in 45 municipalities, as well as all state schools, financed by the MES budget (500), had switched to delegated budgets.

From the beginning of 2008 the delegated budgets were introduced as compulsory in the whole system of secondary education (3 062 state and municipal schools.) The school principals gained new authorities, related to determining the teachers' workload, employees' work payment and the number of students per class. As a result of these reforms, a decrease of 3-4% of the employed in the system is expected in this and next year.

In response to the problems in the healthcare system and the recommendations of the Council of Ministers regarding the Convergence Programme (2007–2010), the Government elaborated and

adopted a National Healthcare Strategy 2008–2013.¹² It envisages restructuring of the health care system to guarantee accessible and quality health services, and improvement of the management and the activity of the medical establishments (see table 6). The Government adopted also an Action Plan to this Strategy. The objective of the Action Plan and the Strategy, which are part of the National Reform Programme (2008–2010) and the Action Plan to it, is the development of a restructured, reformed, financially stable and effective healthcare system, providing quality healthcare services.

The Strategy relies on diseases' prophylaxis, introduction of programme budgeting financing, result-oriented application and execution of national programmes, improvement of the preparation for implementation of the European legislation and monitoring of the programme activities, and improvement of the control model of the risks on the working place.

In the Strategy, a restructuring of the sector is foreseen, as well as a change in the way of financing and admission of new players in the health insurance sector, privatization in the sector, and introduction of electronic healthcare. The objective is to provide quality services and control over the public resource spending and the financial stability of the system.

In order to guarantee the financial sustainability of the sector, an elaboration of common methodology for evaluating the costs of the medical services and for common indicators for the financial activity of the hospital service, as well as a gradual increase in the public funds for the national healthcare system is envisaged.

Table 6: Main measures envisaged in the National Healthcare Strategy 2008–2013

The strategy foresees a legal provision of free access for some groups of the population (children, pregnant women, etc.) to specialist, improvement of the coordination of activities between primary and specialized outpatient care, stimulus for group practices establishment and acquirement of "general medicine" specialty, increase of citizens awareness about their rights and obligations as consumers of outpatient care services.

The hospital care is envisaged to reach high-technological level in equipment, comparable with the EU countries, with an even distribution of this equipment over the country's territory, improvement of the hospitals management – linking management contracts to performance, elaboration of hospital effectiveness indicators, standards and norms for basic work capacity for the different activities, improvement of the coordination between the hospital and emergency care through further development of the structure and the functions of the emergency consultation wards, enhancement of owners' responsibility and control of the hospital activities.

In the field of emergency medical care, structural and organizational changes are foreseen, such as abolition of the non-specific activities, provision of resources, staff qualification improvement, readiness for action in case of disasters and accidents in line with the European standards.

In order to improve outpatient and hospital service an elaboration and introduction of clinical pathways for one-day surgery is suggested, as well as introduction of regulations for hospital treatment of patients in pressing need without hospitalising them. It is envisaged that till the end of 2009 the system of medical facilities for post treatment and recuperation will be expanded. The introduction of the electronic health cards is foreseen by 2013, and by the end of 2009 the electronic medical patient dossier will be created.

Source: MoH

¹² Adopted on October 2, 2008 with a Council of Ministers decision; to be adopted by the National Assembly.

3. GENERAL GOVERNMENT BALANCE AND DEBT

3.1. Policy strategy

The economic policy of the Bulgarian government aims at maintaining macroeconomic stability, boosting the competitiveness of the economy and enhancing the quality of social systems for improvement of the standard of living. Special attention is paid to overcoming the macroeconomic challenges – high inflation and current account deficit. These two challenges are clearly and explicitly addressed in the National Reform Programme (2008–2010) and the Action Plan to it. Against the background of a global financial crisis and expectations for recession in the economies of main trade partners of Bulgaria, the Bulgarian government has undertaken a number of measures in order to adequately react to the possible negative effects of the crisis for the Bulgarian economy. At the same time, the pursued fiscal policy will continue to fully take into account the recommendations of the European Commission and the International Monetary Fund regarding the long-term sustainability of public finances.

The fiscal policy will stick to the policies and measures that have been carried out in recent years and which aim at stimulating economic growth, investment activity and employment, as well as at improving the effectiveness and re-allocation of public resources towards priority fields and enhancing the quality of public finances.

The main instruments to retain the sustainable economic growth are maintenance, in consideration of the economic cycle, of a surplus under the consolidated fiscal programme at a level of not less than 3% of GDP, as well as consolidated expenditure (excluding the contribution to the EU budget) of up to 40% of GDP.

Boosting the competitiveness of the Bulgarian economy will be achieved through:

- Balanced distribution of the tax and social insurance burden;
- Increase and balanced distribution, in conformity with the national sectoral strategies and policies, of the total amount of gross government investment at a level not less than 7% of GDP along the different sectors of the economy;
- Ensuring investment for the construction and modernization of tangible and social infrastructure;
- Human capital development.

The improvement of the quality of public finances through enhancement of the strategic planning systems, the adherence to tight budgetary constraints by all economic agents both in the public and private sectors, and the effective control over the appropriate, expedient and provident spending of the available budget resources remain the main principles of the budgetary policy.

3.2. Medium-term objectives

In the medium-term, fiscal policy is in conformity both with the phases of the economic cycle and with the main risks that have been identified for the Bulgarian economy. These risks are mainly related to the ageing population, the high current account deficit, the price levels that are persistently above the average EU levels, as well as the possible deceleration of domestic demand and the economic growth as a result of the slower growth rates of the global and Euro area economies.

Against the background of existing imbalances in the global economy and increasing external risks, related to the financial instability of international markets, the maintenance of a positive fiscal balance and significant fiscal reserve provides for adequate space and flexibility for reaction in case of unfavourable scenario for the economy.

Having in mind the relatively low level of the consolidated government debt (about 15% of GDP at the end of 2008) and the balanced currency and interest debt structure, the fiscal sustainability risks related to the debt servicing are reduced.

The medium-term objective (MTO) which has been set in accordance with the requirements of the revised Stability and Growth Pact (SGP) remains unchanged – a surplus of 1.5% of GDP in 2012. It is more ambitious compared to the recommendations of the revised SGP and ensures adequate

space for manoeuvre against the possibility that the budgetary balance may exceed the maximum reference deficit of 3% of GDP. The targeted MTO fully corresponds also to the requirements regarding the sustainability of public finances under conditions of ageing population. The impact of ageing is estimated at 3.04% of GDP (please see section 6.1), which implies that the medium-term objective fully covers the implicit budgetary burden stemming from the long run demographic developments, without breaching the 60% of GDP government debt reference value.

Table 7: Medium-term budgetary objective

Medium-term objective (% of GDP)	1.5
Function 1 – implicit liabilities	0.0
Debt stabilising balance (60% of GDP level of debt)	-3.1
Implicit liabilities coverage coefficient	1.0
Ageing population impact	3.0
Function 2 – buffer against breaching the SGP	-1.7

Source: MoF, AEF

The 2008 update of the Government Debt Management Strategy was carried out taking into consideration the dynamics of the global financial system, the current levels and trends in the development of the main market and economic indicators at the national level, as well as the risks generated by the current debt structure. In this respect, keeping the main objective of the strategy unchanged, its sub-goals were redefined as follows:

1. Strict monitoring of the debt level.

The increasing current account deficit and the gradually increasing gross foreign and municipal debt, under conditions of unstable external environment, predetermine to a great extent the adopted conservative approach to government debt management. By the end of 2008, government debt is expected to be below 15% of GDP. Except for the introduction of an indicative upper limit for the value of the above indicator, a number of specific measures to guarantee its achievement by the end of the respective period are envisaged. These measures include pursuing sound borrowing policy and assessment of the possible public benefits generated from projects financed with government debt. In the coming years foreign financing is expected to be mainly programme orientated. Government bonds issues floated on the domestic market will take into account the market situation, as they will be used mainly for re-financing of the outstanding debt and for maintenance of effective and liquid government bonds market.

2. Reduction of the debt servicing expenditures.

The established trend in the previous years towards gradual reduction of the ratios of debt servicing expenditures to budget expenditures and to GDP, is expected to be maintained in 2008 as well. This will be achieved mainly in two ways – strict monitoring and control of the debt to GDP ratio and change in the currency and interest structure of the government debt on the basis of preliminary analyses regarding the effects of the pursued debt policy. With regard to the currency structure of the debt, there is a clearly defined strategic priority which will be pursued and which aims at increasing the share of Euro-denominated debt and the debt denominated in national currency.

The increase of the share of fixed-interest-rate debt (as well as the Euro- and BGN – denominated debt) reduces the necessity for allocation of supplementary funds to cover the risk stemming from possible changes in the interest levels (exchange rates). Against the background of significant volatility and difficulties in forecasting the levels of market parameters in the short and medium term, the share of fixed-coupons debt will continue to grow in the coming years, mainly as a result of newly issued domestic debt and absorption of part of the already contracted foreign loans with such characteristics (as well as in case of favourable conditions, contracting of new financing with such parameters).

3. Securing stable sources for budget financing and debt refinancing.

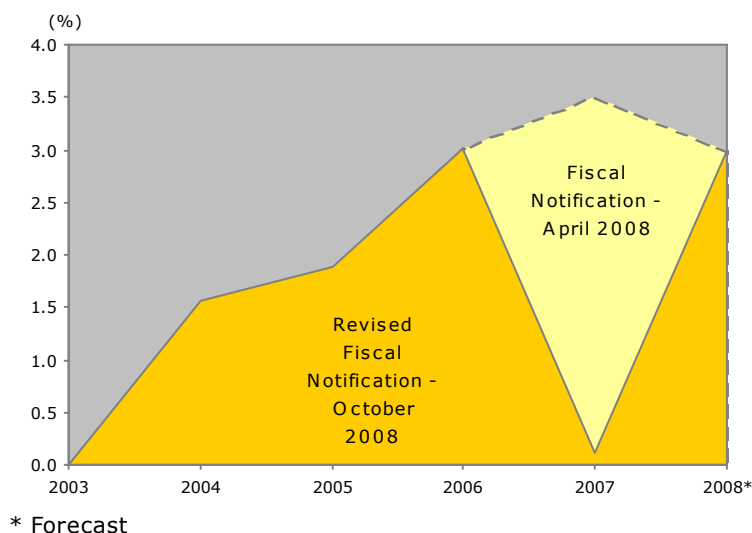
In 2009 as well, the priority sources for budget financing and debt refinancing will be domestic debt issues and loans granted by international financial institutions. In the years to come, government securities issues are planned in the main maturity segments, in volumes which provide for a good market liquidity and with parameters allowing for the maintenance of a comparable yield curve.

In the medium-term, it is expected that foreign financing will be provided mainly through absorption of already contracted government investment loans, government loans in support of government priorities in the field of economic and social policy, as well as loans aiming at supporting the national co-financing in the implementation of European projects.

3.3. Actual balances and implications of budget for next year

In October 2007 an agreement was signed between the governments of the Republic of Iraq and the Republic of Bulgaria for the settlement of the Iraqi debt. The agreement was implemented in July 2008 when Iraq remitted USD 360 million and this was the reason for the cancellation of the remaining part of the debt in the year when the agreement was signed. As a result, in the elaboration of the notification tables 2004–2008, as of 1 October 2008, a revision was carried out regarding the deficit and debt data, in conformity with the methodology of the European System of Accounts 1995 (ESA 95) by the amount of the debt that was cancelled. In conformity with the negotiated clauses, the cancellation was recorded as a capital transfer at the expenditure side of the accounts of the general government sector, i.e. expenditure of the government, which led to a decreased surplus on an accrual basis for 2007. With this, the data regarding the consolidated fiscal programme surplus, submitted together with the April notification of the deficit and debt for 2007, has been corrected from 3.4% of GDP to 0.1 % of GDP.

Figure 7: Budget balance (% of GDP)



Source: MoF

In 2007 the revenues and grants under the consolidated fiscal programme grew by 20.4% in nominal terms on an annual basis as a result of good tax collection and higher revenues due to funds under the pre-accession instruments and other EU funds. The total amount of revenues under the consolidated fiscal programme in 2007 amounted to 41.6% of GDP. The more conservative expectations on the execution of the revenue side of the 2007 budget were not confirmed and the reported revenues for the year significantly exceeded what was planned with the Law on the State Budget.

The approach in the elaboration of the budget plan considered mainly the legislative amendments that were enacted regarding VAT and customs duties taxation, which were expected to have a negative impact on the revenues from these taxes. The execution of the revenues from VAT throughout the year, however, was not influenced significantly by these legislative amendments – the over-performance of the VAT revenues reached 4.7% compared to the planned revenues for the year. As in 2006, the high growth of the revenues from indirect taxes was based mainly on strong imports. The amendments to the Law on the Excise Duties, in continuation of the process of harmonization of the national legislation with the EU *acquis*, also had an impact on the increase of excise revenues. Within the group of indirect taxes, only the revenues from customs duties decreased, due to the application, from the beginning of 2007, of the EU Common Customs Tariff.

The 2006 positive tendency of increase of the revenues in the group of direct taxes continued in 2007 as well, marking an over-performance of the planned revenues from corporate taxes, personal income tax, property taxes and the other taxes regulated by the Law on the Corporate Income Tax. Non-tax revenues and the revenues from social and healthcare insurance contributions also marked an over-performance. The main factors for the higher than planned revenues in 2007 were the increased economic activity, the manifested dynamic effects from the carried out tax reforms, the improved functioning of the revenue administrations, the high imports levels and prices of the energy goods and some other basic raw materials, as well as the higher than expected inflation.

From the beginning of 2007, the next step in the government strategy for encouragement of the economic and investment activity was undertaken through reduction of the tax and social insurance burden regarding the social insurance contributions and the main direct taxes. Regardless of the reduction of the corporate income tax rate from 15 to 10%, the revenues collected during the year were higher than what was initially planned, thus registering nominal growth of corporate tax revenues of 37.4% in 2007. From the beginning of October 2007, the social insurance contribution to the Public Social Insurance System has been reduced by 3 percentage points. In spite of that, the revenues from social insurance contributions rose by 13.5% in nominal terms as compared to the level reported in 2006. The measures undertaken for reduction of the social insurance burden were among the priority requirements of the business related to stimulation of the economic activity.

The amount of the expenditures (including the contribution to the EU budget) according to the 2007 consolidated fiscal programme amounted to 41.5% of GDP, compared to 36.5% of GDP in 2006. The 2007 increase of the expenditures' relative share in GDP, compared to the previous year, was related mainly to the one-off effect of the settlement of the Iraqi debt, which increased the expenditures, in the form of capital transfer, by the amount of the Iraqi liabilities that were cancelled out (3.3% of GDP). Excluding the effect of this transaction, the budget expenditures amounted to 38.2% of GDP, a level within the limits of the commitment to keep their level below 40% of GDP. It is also necessary to take into account the effect of the already started regular transfer of the amounts that are due for the contribution of the Republic of Bulgaria to the EU budget (for 2007, the net contribution amounts to about 0.7% of GDP), which along with the additional expenditures approved at the end of the year, are the other two factors for the growth of the expenditures as a percentage of GDP, compared to the reported level in 2006.

The appropriation of additional expenditures for financing of priority policies and projects at the end of 2007 became possible because of the budget revenues over-performance. At the end of the year, the Council of Ministers proposed, and the National Assembly approved additional budget appropriations of about 2.4% of GDP. Along with that, a more ambitious fiscal target for the year was set – with a planned surplus of 2.0% of GDP, the government set the new target to a surplus of at least 3.0% of GDP. As a result of the savings of part of the revenues over-performance, the reported general government balance (prior to recording the revision with relation to the cancellation of the Iraqi debt) amounted to a surplus of 3.4% of GDP.

The approved additional expenditures were used to finance mainly priority investment projects – activities and projects for constructing road, railway, environment and other infrastructure, fulfilment of commitments undertaken under chapters "Energy" and "Telecommunications and Information Technologies" of the Treaty of Accession of the Republic of Bulgaria to the EU, as well as activities and policies for the modernization of the country's defence and armed forces, activities related to home affairs and security policies, etc. As a result of the improved expenditure structure, due also to the approved additional appropriations of mainly investment type, the share of the general government gross capital formation grew from 4.2% in 2006 to 4.8% of GDP in 2007.

In the first half of 2008, the budget execution continued to a significant degree its 2007 trend. The high economic growth, the broadening tax base and the good revenue collection led to an increase of the budget revenues. In 2008 it is expected that most of the planned budget revenue items will be realized. Significant over-performance is projected of the revenues from social and healthcare insurance contributions and non-tax revenues, respectively by about 11% and 17.8%. Revenues from direct and indirect taxes are expected to be close to what was planned. At the same time, the revenues from grants from abroad are expected to be significantly below the planned for the year, due to the EC suspension of payments to final beneficiaries under some measures of the EU pre-accession instruments. For 2008, total revenues over-performance of about 1.7% is forecasted.

As in 2007, the expenditure policies have been directed mainly to the realization of priority investment projects and policies and the social commitments according to the Government Programme. The expenditures structure continues to shift, as the share of capital expenditures (mainly targeted at construction and improvement of the infrastructure) in total expenditures

increases. Another important priority of the expenditure policies of the government this year are the measures to compensate those population groups significantly affected by the high food and fuel prices and the related with them inflation. The government strategy is to look for ways to support these people through compensating payments, not to implement measures to reduce the taxation of certain products that will have limited effect over the affected groups and will squander budgetary resources.

Thanks to the expected over-performance of the 2008 revenues, while observing the target for a consolidated budget surplus of 3% of GDP, the government proposed and the National Assembly approved additional budgetary appropriations for 2008 amounting to about 1.8% of GDP. The main part of these funds will be earmarked for financing social policy package. These resources will provide for payment of energy subsidies to low-income households, indexation of pensions of part of the pensioners, and payment of one-off supplements to the pensions of all pensioners. With this decision of the National Assembly were approved as well some resources for the implementation of priority investment projects. In accordance with the Budget 2008 expenditure policy priorities, these appropriations will finance important infrastructure projects.

In conformity with the commitment undertaken with the Convergence Programme (2006-2009), the government will save part of the revenue over-performance in 2008. Thus, at the end of the year, the level of the budget surplus is expected to be slightly above 3% of GDP.

Main tax policy aspects for 2009–2011

Tax policy will continue to be in support of the sustainable economic growth, business and employment encouragement. Reduction of the grey economy and increase in the collection of tax and social insurance contributions remain a priority. The trend of shifting the tax burden from direct to indirect taxes will continue during the new programme period with the planned reduction of the social insurance burden and the increase in some of the excise duties rates.

The most important changes in 2009 are planned in the field of the social insurance system. The employers' social insurance burden will be significantly reduced. This measure is targeted to stimulate and to bring employed persons and their incomes out of the grey economy. It will have a positive impact towards labour costs reduction, which, in turn, will stimulate investment activity and labour demand.

From January 1, 2009 a change in the Pensions Fund social insurance contribution from 22 to 18 per cent is envisaged, as the distribution of the social insurance contribution between employers and insured persons will be 10:8. Beside this measure, as from January 1, 2009, it is envisaged that the state will carry out a transfer to the Pensions Fund of the Public Social Security (PSS) amounting to 12 per cent of the social insurance income of all insured people for the calendar year. The healthcare contribution will be raised from 6% to 8% from the beginning of the next year. It is also envisaged the social insurance contribution to the "Guaranteed Claims of Workers and Employees" Fund, paid by the employer, to be reduced from 0.5% to 0.1%. The maximum monthly amount of the social insurance income will be kept at EUR 1 022.6 and the minimum amount will be raised by 8.3% to EUR 132.9.

No changes in the corporate and personal income taxation regimes are envisaged.

According to the National Reform Programme (2008–2010) and the Action Plan to it, the government is committed to adhere to single tax rates, especially as regards to the VAT, in order to prevent any distortions of the market signals.

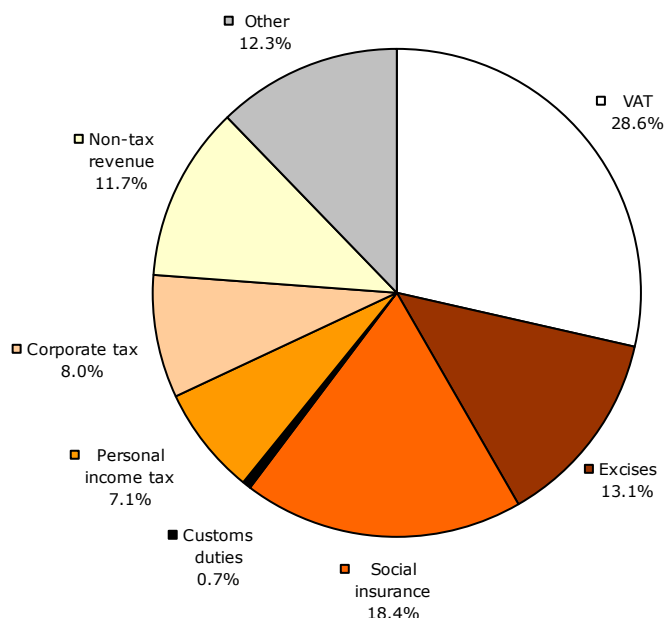
With regard to indirect taxes, the changes in the tax policy in the next year will affect only the excise duty rates on some goods. The increase of the excise rates will continue in accordance with the transitional periods negotiated with the European Commission. For 2009 the increases of the rates are as follows:

- Increase of the excise on kerosene: from EUR 273.5 to EUR 288.9/1 000 litres;
- Increase of the excise on coke and coal: from EUR 0.20 to EUR 0.30 per 1 Gigajoule energy capacity;
- Increase of the excise on electricity for economic and administrative needs: from EUR 0.6 to EUR 0.7 per 1 megawatt-hour;
- Increase of the excise on cigarettes from EUR 40.4 to EUR 52.3 /1 000 pieces.

The budgetary effect from the increased excise rates in 2009 is expected to amount to EUR 87.9 million.

The increase of the excise rates is expected to lead also to EUR 17 million additional VAT revenues. In the planning of the VAT revenues for 2009, an increase of the tax collection from 90.5% to 91% is envisaged.

Figure 8: Revenue structure, 2009



Source: MoF

Main policies on the expenditure side in the three-year budgetary forecast

Public expenditures will be directed towards implementation of policies which have an important role for the achievement of sustainable labour productivity growth and support the competitiveness of the economy.

In the medium term public expenditures are planned in compliance to the priorities of the government policy. Their total amount is limited to 40% of GDP (net of the contribution to the EU budget). Increased expenditures for investment in education and infrastructure are also envisaged, at the expense of reduction of the share of expenditures allocated for ineffective and/or not typical for the budget activities. Along with the budgetary financing, (with national and European public resources), conditions for the development of public-private partnerships will be created in the realization of important projects in the field of road infrastructure, environment protection, healthcare and so on.

In 2009, the funds allocated for salaries in the budgetary sector are envisaged to grow by 10%. In this regard, the amount of the resources planned for salaries according to the Law on the State Budget for 2008, and taking into account the newly-created and/or restructured administrative structures, will serve as a basis for the growth in expenditures on salaries. Provision has been made for increased flexibility in determining individual salaries.

The expenditures for maintenance of the public sector systems will be gradually limited throughout the period in order to release resources to increase the capital expenditures and the expenditures under projects, related to EU funds absorption.

During the programme period, the state will continue to provide financial support for the non-financial enterprises in the real sector, in conformity with the commitments and the interests of the government as regards the implementation of the structural reforms agenda and other measures, related to the adjustment of the national economy to the European structures and markets.

The agriculture subsidies are mainly related to the Common Agriculture Policy. It is also envisaged that the functions and financing of the State Fund Agriculture, related to implementation of national programmes will continue.

Main goal of the investment policy is the achievement of sustainable social and economic development of the country, through improvement and development of the main infrastructure, together with a balanced regional development. The national investment policy is envisaged to be implemented by combining traditional sources of financing with EU funds and with the possibilities that the public-private partnerships provide. EU funds will be supplemental to the national resources.

The approved medium-term fiscal framework for the period 2009–2011 foresees increase and balanced distribution among the individual sectors of the total amount of investment funds (gross) of at least 7% of GDP for each year. Within this framework, an increasing absorption of EU Structural Funds resources is envisaged, as well as a higher amount of absorption of external investment loans under already contracted agreements.

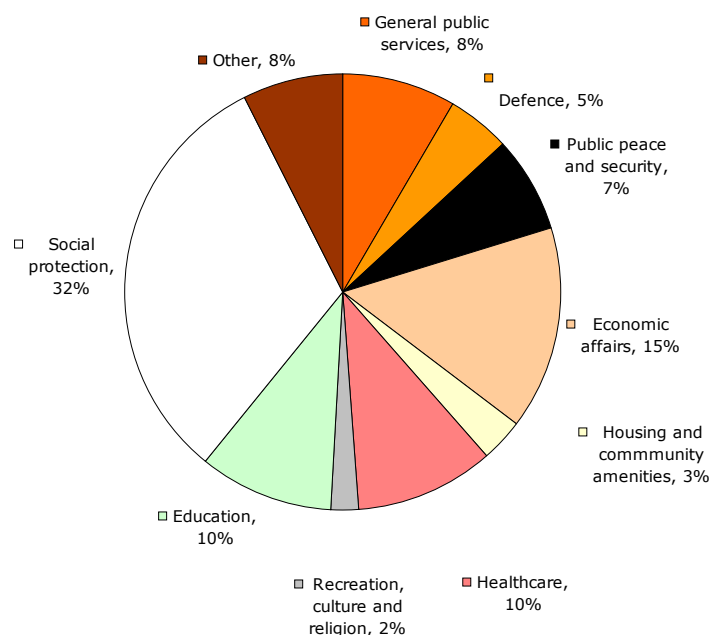
One of the main government priorities during the programme period remains the fast modernization and development of the public road and railway infrastructure. The direction of the public investment is unchanged towards key ongoing infrastructure projects, as the construction of the Second Bridge over the Danube River, the reconstruction and electrification of the railway line Plovdiv - Svilengrad, "Lyulin" highway and the extension of the Burgas Port. Financial support will be provided as well for infrastructure projects of national importance, which will be financed with Operational Programmes funds of the Structural Funds and the Cohesion Fund within the 2007–2013 programme period. Financial resources for the restructuring of the defence system in line with NATO standards are also envisaged.

In 2009, the increase of the amount of the healthcare insurance contribution from 6% to 8% will be combined with measures directed to improve the management and to enhance the control and the effectiveness of the public expenditures spent on healthcare. The provision of an increased amount of public resources on healthcare will be carried out along with internal restructuring and optimization of the expenditures in the system.

In 2009, the level of pensions is planned to be indexed at two steps – as from April 1, through increase of the weight of insurance periods from 1 to 1.1 in the pension calculation formula, and as from July 1, by 9.7 per cent. During the year, the following will be raised:

- The maximum pension amount – from EUR 250.5 to EUR 357.9 per month (35% of the maximum insurance income for the preceding calendar year);
- The minimum amount of old-age pension – from EUR 58 to EUR 70;
- The old-age social pension – from EUR 43 to EUR 51.9, as well as the minimum amounts of other, non-labour-related pensions;
- The average amount of old-age pensions – from EUR 118.7 to EUR 143.9 per month.

A reserve of EUR 455.7 million for unexpected and urgent expenditures is also envisaged. This reserve includes a reserve for structural reforms, reserves on the budgets of the National Healthcare Insurance Fund, the National Social Security Institute, the Supreme Judicial Council and the National Assembly, public investment reserve, and reserve for natural disaster and emergency situations prevention, response and management.

Figure 9: Expenditure structure by functions, 2009

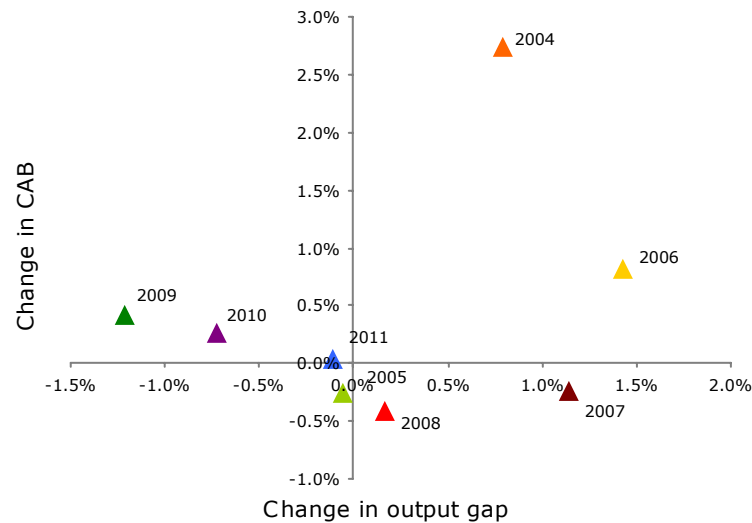
Source: MoF

3.4. Structural balance and fiscal stance

Fiscal policy will continue to observe the rules of the Stability and Growth Pact and will aim at avoiding pro-cyclical influence on the economy. During the programme period, the structural budget balance will remain positive. The cyclical component is expected to slow down to zero, as the real GDP growth converges to potential GDP growth.

In 2007 the value of the cyclically-adjusted budget balance was significantly different from the level of the reported overall surplus, due to the one-off effect of the cancellation of the Iraqi debt during the year, that has been recorded as a capital transfer on the expenditure side of the budget.

During most of the programme period, the planned fiscal position can be identified as neutral. Taking into account the Council recommendation with regard to the Convergence Programme (2007–2010) to avoid a pro-cyclical fiscal stance, the government does not envisage significant fiscal stimulus in contradiction to the cyclical development (including in 2008, when, in fact, there is no expected change in the output gap).

Figure 10: Cyclical budgetary position

Source: AEF

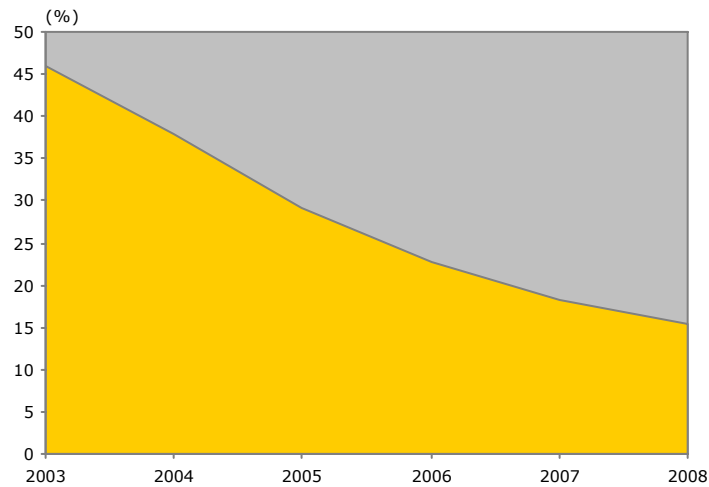
3.5. Debt levels and developments

The government debt level as of the end of 2007 amounted to EUR 5 162.8 million or 17.9% of GDP. By the end of the current year it is expected to decrease further by about 3 percentage points, as a result both of the reduction of the nominal debt and the expected GDP growth. The end-year projection of the debt level is based on the envisaged reduction of the amount of the newly-issued domestic government securities and on the early repayments of about EUR 300 million of World Bank debt carried out during the year.

The maturity in 2007 of the Eurobonds issue with a nominal value of EUR 250 million led to a slight reduction of around 2 percentage points of the share of the Euro-denominated debt, which is expected to be compensated by the planned absorption of foreign debt for the next years. With regard to the interest structure of the debt, it is expected that at the end of 2008 the fixed-interest rates debt payments will increase its share by about 4 percentage points compared to the previous year. This will be due to the new issues of government bonds floated on the domestic market and to the absorption of part of the fixed-interest rates external loans, as well as due to the carried out early repayments of floating-interest rate debt.

By the end of the current year the government-guaranteed debt will grow because of the more active absorption, under priority projects in support of the stabilization and development of the energy sector and for infrastructure improvement. Nevertheless, at the end of the year the government guaranteed debt is expected to remain within the levels of the past year, at 2% of GDP. In 2009, the issuance of new government guarantees is envisaged under external loan agreements amounting to up to EUR 784.1 million, of which EUR 600 million will be allocated for the construction of the Nuclear Power Station at the Belene site.

By the end of 2007 the amount of the fiscal reserve reached EUR 3.8 billion, compared to the minimum of EUR 1.8 billion set in the legislation. The significant size of the fiscal reserve made possible the carried out early repayments of IMF debt in 2007 and of debt to the Confederation of Switzerland at a total amount of EUR 244.3 million. The significant amount of the reserve in the current year as well – by mid-2008 it was twice higher than the minimum level of EUR 3.3 billion, allowed a new early repayment to be carried out, this time of a World Bank debt amounting to EUR 296.9 million. The use of the fiscal reserve for early repayments of debt creates the prerequisites to use future financing in order to achieve the debt management strategic goals and to support the achievement of government priorities.

Figure 11: General government debt (% of GDP)

Source: MoF

3.6. Budgetary implications of major structural reforms

3.6.1. Social insurance

The biggest expenditure of the state social insurance is for pensions. The forecast for the period 2009-2011 displays the following expenditures for pensions and additions to them: 2009 – EUR 3 249.2 million; 2010 – EUR 3 760.3 million; 2011 – EUR 4 112.3 million. For the annual indexation of the pensions on July 1, every calendar year (based on the growth of the average insurance income and the inflation) the envisaged increase by years is: 2008 – 10.35%; 2009 – 19.7%, 2010 – 11.4%, 2011 – 7.5%.

The reduction of the insurance contribution for the Pensions Fund of the Public Social Security since 2000 and the allocation of a share of it to the universal pension funds (currently 5%) led to considerable deficit in the Pensions Fund, which is covered by a subsidy from the central republican budget – 3.7% of GDP for 2008.

The consolidated budget of the Public Social Security (PSS) for the period 2009 – 2011 is expected to be on deficit, as follows: 2009 – EUR 373.2 million; 2010 – EUR 625.8 million; 2011 – EUR 700.8 million.

Since October 1, 2008 all old-age pensions, granted up to December 31, 2007, were recalculated, as for base was taken the average insurance income for 2007 of EUR 203.6. The recalculation was done to uniform the pensions granted by equal pension-determining parameters (individual coefficient and length of service), and as to overcome differences in the size of some of them. The recalculation affected only this part of the pensions for which the newly calculated amount was greater than the amount received at that moment (reached over the years due to the annual indexations). From all 2 078 731 recalculated pensions, 1 105 367 or 53.2% were raised in this line. The average amount of pension for one pensioner reached EUR 113.7, representing a 8.5% increase versus the amount before recalculation.

The funds needed to cover the expenditures on this measure are EUR 38 million for the last three months of 2008, as the expenditure is covered by revenue over-performance of the PSS budget.

From the beginning of 2009, the state will be included in the distribution of the insurance contribution for the Pensions Fund. In the draft budget law the following ratio of 8:10:12 is set, respectively for the employee (8%), the employer (10%) and the state (12%). The envisaged state transfer towards the Pensions Fund of the PSS of 12% of the sum of the insurance incomes of all insured persons for the calendar year will cost the budget respectively EUR 1 058.2 million in 2009, EUR 1 149.3 million in 2010 and EUR 1 249.9 million in 2011.

The old-age pensions will rise as of April 1, 2009 through increase in the weight of each insurance year in the pension formula from 1 to 1.1. The funds needed to finance this measure in 2009 amount to EUR 195.8 million. It is foreseen the minimum levels of the old-age and old-age social pensions to increase by 10% as of April 1, 2009. The required funds for this rise are calculated as EUR 24.8 million in 2009.

The pensions will be updated in July each year as follows: by 9.7% in 2009, by 11.4% in 2010, and by 7.5% in 2011. The increases will absorb EUR 152 million in 2009, EUR 205 million in 2010, and EUR 146.9 million in 2010.

The average old-age pension is expected to reach EUR 143.9 in 2009, EUR 160.3 in 2010, and EUR 172.3 in 2011. As estimated, EUR 120.7 million are provided for the pension increase as of the middle of 2008 until the end of the year.

It is expected that the dependency ratio¹³ will slide gradually in the next three years from 76.0% in 2008 to 73.9% in 2011. The improvement will result from the introduction of stricter requirements for gaining pension rights and an increase in the number of insured persons.

The replacement coefficient of the gross income¹⁴ (from the first pillar of the pension system), which currently stands at 40.2% is expected to increase to 42.1% in 2011, due to the higher growth rate of the average pension vis-à-vis the growth rate of the insurance income.

The sum accumulated as of the beginning of November 2008 in the State Fund for Guaranteeing the Sustainability of the State Pension System is around EUR 538.5 million. By the end of May 2009, 25% of the reported republican budget surplus for 2008 will be added to the above amount. Additionally, 90% of the reported privatization revenues in the republican budget for 2008 will be also transferred to the Fund after making some transfers according to the Law on Privatization and Post-privatization control.

3.6.2. Education

In 2009, the consolidated expenditures for education will increase by 14.3% (EUR 191.1 million). The increase of the funds will be directed mainly to finance the common expenditure standards (for 2009 the planned increase of the funds on them is 19.4%) and to ensure the continuation of the secondary education programme financing.

There are still possibilities for expenditures' optimisation in the educational system. One of the main reserves stems from the expected decrease of the number of students at school age by 3.5% annually – the so-called "demographic dividend".

In 2009 the establishment of the delegated budgets' system remains a priority in the school education reform. With the State Budget Law for 2009 the municipalities will be again obliged to use formulas for distribution of the funds for education to school, kindergarten and service unit level.

The programme "Optimization of the school network" continued in 2008 – 11% of the municipal and 5% of the state schools have been closed. The total number of the closed schools this year, for which the municipalities received funding, is 296, and of the restructured – 13. Moreover, 6 special schools were closed. In 2009 approximately 150 more schools are expected to stop functioning. The funds, which the municipalities will save and receive from the programme for optimization, will amass to around EUR 30.7 million.

The resources supplied due to the optimization of the school network will be used for education and training for the reallocated students, payments to the released teachers, measures to lower the dropping-out of the educational system, modernisation of the school equipment, differentiated payment of the teachers' labour, improvement of the training and qualification of the staff and school principals, refinement of the curricula and introduction of modern teaching methods. As a result, significant improvement of the quality and the results of the educational system is anticipated.

Since January 1, 2008, the common expenditure standard for one student was raised to EUR 592.1, and from July 1, 2008 – to EUR 619.7, thus attributing additional EUR 30.7 million expenses to the budget. In 2009 the standard is envisaged to reach EUR 731.1.

¹³ The number of pensioners per 100 insured persons.

¹⁴ The ratio between the average pension and the average gross insurance income.

To provide and guarantee the access to the education system, from January 1, 2008 the state appropriates funds for free student's books and school appliances to the private schools, too, as the programme already covers the student's books from V to VII grade in the public schools. For the school year 2008/2009 EUR 21 million to finance this programme are approved.

No additional resources will be provided to compensate the decreased education funds in municipalities in which the number of students is dropping. The expenditures on the programme component of the financing model are to be increased with additional EUR 20.5 million. and to reach EUR 122.7 million in 2009.

Under OP "Human resources development" 712 projects to the value of EUR 25.9 million are approved. Under the programme additional EUR 5.11 million will be provided for scholarships, EUR 1.02 million to finance internships for students and training, as well as nearly EUR 2.05 million to support PhD students, post-PhD students and young scientists.

With the intention to support science development and create favourable conditions for sustainable growth, the granted resources to the National Science Fund for 2008 exceed EUR 30.7 million. The objective is the public expenditures for science to increase annually by at least 0.1 percentage point until they reach the level of 1.0% of the GDP.

The expected savings in the education sector, combined with the envisaged average expenditures increase per year for education and the possibilities for financing by the structural funds, will insure the middle-term financial stability of the system.

3.6.3. Healthcare

The total expenditures for healthcare are advancing significantly in the last years. Under conditions of unfinished reforms in the sector, this continuing trend imposes a serious risk to the budget. For 2009 18.1% more public funds (EUR 241.1 million) are planned, as the total sum represents 4.2% of the GDP.

Since October 1, 2008, the NHIF pays on average 10 per cent more to its partners for all kinds of medical and dental activities. The decision for this was taken at a meeting of the Board of Directors of the Fund, which took place on September 15, 2008. The funds have been secured by revenue over-performance of the NHIF budget and from administrative expenditures savings.

In 2009, the practice hospitals to be financed mainly by one source – the NHIF, will continue. The commitment of the state, respectively of the state budget to finance some specific activities in the hospitals, determined as a state responsibility, remains as well.

In the National Health Insurance Fund budget a 69.4% increase in revenues is envisaged. This is mainly due to the rise of the health insurance contribution from 6% to 8%. In 2009 a 21.3% growth of the NHIF expenditures is foreseen.

The price upturn of the medical goods, the new technologies, the aging of the population and the delayed reforms in the sector will continue to impose pressure to increase in expenditures.

4. SENSITIVITY ANALYSIS AND COMPARISON WITH PREVIOUS UPDATE

4.1 Alternative scenario and risks

During the last years the domestic demand was the main contributing factor to the high rates of economic growth. Its increase was financed, to a large extent, by foreign financial inflows. In the context of the global financial crisis, the main risks for the Bulgarian economy come from a slowdown of exports growth and lower financial inflows from abroad.

4.1.1. Considerable deterioration of the external environment

This scenario assumes a pronounced slowdown, followed by a sluggish recovery of the economic activity in the EU and the rest of the world. In comparison with the basic scenario, the drop of the international commodity prices is more pronounced. There is also an assumption for lower international interest rates. The deterioration of the external environment leads to a considerable slowdown of the exports growth, while the net inflow of capital, including foreign direct investment, decreases. The results from this simulation are given in Table 8.

Table 8: Main macroeconomic indicators

Indicator	2009	2010	2011
Real GDP growth	2.1%	3.6%	5.1%
Real private consumption growth	1.4%	2.3%	3.9%
Investment, real growth	1.7%	4.7%	7.1%
Exports, real growth	3.1%	5.2%	6.3%
Inflation	4.8%	4.3%	4.5%
Current account, % of GDP	-20.2%	-18.5%	-17.5%
Employed, change	-0.6%	0.7%	0.7%
Financial account, million EUR	7 159	7 544	8 052
Budget balance, % of GDP	1.6	1.1	0.1

Source: AEF

Weaker external demand and lower financial inflows would lead to considerable slowdown of the economic growth during 2009, followed by a gradual recovery. The components affecting growth most robustly will be investment and private consumption. Weaker demand and low international commodity prices will affect favourably inflation – the latter is expected to fall below the level of 5%. As a result of the economic slowdown, employment is expected to decrease, though by an insignificant rate. An expected more pronounced drop in the imports growth rates will result in faster closing of the current account deficit in comparison with the basic scenario.

4.1.2. Fiscal risks

The main risks that might be faced during the process of budget execution in the short term are linked to the international financial crisis and the prospective global recession. The government has prepared a set of measures and reserves to limit the impact of those risks on the Bulgarian economy (see Table 9). The package of measures is founded on the following main principles:

- preserving the financial and banking systems' stability, in order to stimulate the economy and to maintain the investment activity;
- active economic policy aimed at sustaining, to the greatest extent, the flexibility of the economy and preserving the market and its competitiveness from distortions.

Table 9: Policies and measures provided for in the 2009 Budget to limit the impact of the global financial crisis on the Bulgarian economy

1. Fiscal policy countering the imbalances of the economy (also part of the National Reform Programme and the Action Plan to it):
 - maintaining positive balance under the consolidated fiscal programme of not less than 3% of GDP;
 - maximum level of expenditure to be reallocated through the budget in the medium term of up to 40% of GDP.
2. Policy to increase public investment resources:
 - the Government will create favourable and stable conditions for business development and investment promotion. In 2009 capital expenditure to the amount of EUR 2 654.8 million are provided for in the consolidated fiscal programme (an increase of about EUR 460 million compared to 2008).
3. An option for an additional investment programme to the amount of up to EUR 562.4 million. As sources for the programme implementation could be used:
 - the planned public investment reserve to the amount of EUR 204.5 million;
 - a reduction of the planned positive budget balance under the consolidated fiscal programme by 1 per cent of GDP (EUR 357.9 million). This measure will be activated in the event of significant unfavourable effects on the economy and prospective narrowing of external economic deficits.
4. Measures to foster and develop small and medium-sized enterprises (also part of the National Reform Programme and the Action Plan to it):
 - providing access to credit resources for small and medium-sized enterprises by increasing the capital of the Bulgarian Development Bank AD (former Encouragement Bank).
5. Ensuring better conditions for municipalities to prepare and implement EU funded projects by increasing the capital of FLAG fund with up to EUR 25.6 million.
6. The State will initiate the establishment of a state owned company to set up business parks as to create conditions for attracting highly productive investments and better business environment.
7. Fostering research and development in support of technological innovation and restructuring of the economy (also part of the National Reform Programme and the Action Plan to it):
 - setting up a Research and Innovation fund to replace the existing Scientific Research and National Innovation funds and increasing financial resources by 50% in comparison with the resources available in 2008.
8. Policy of enhancing export capabilities of the Bulgarian enterprises:
 - increasing the Bulgarian Export Insurance Agency credit limit.
9. Policy of maintaining favourable business conditions to attract investments and retain foreign investors (also part of the National Reform Programme and the Action Plan to it):
 - maintaining the favourable tax environment – low rates of corporate taxes and social security burden for the business. Unchanged excise rates on petrol and diesel;
 - exerting further efforts for better administrative service for the business, including speeding up of VAT refunding;
 - improving the business environment through strict implementation of the Better Regulation programme, targeted at simplification and alleviation of the regulatory regimes;
 - measures applied by local government authorities to streamline the regulatory regimes and to reduce the administrative burden;
 - protection of competition through improvement of the regulatory bodies' work and effective enforcement of the new Law on Competition Protection, after its enactment by the National Assembly.
10. Policy of ensuring flexicurity on the labour market (also part of the National Reform Programme and the Action Plan to it):

- encouraging job seeking and creating favourable conditions for employers to open new jobs;
 - improving social networks and their effectiveness in order to address contingent negative effects of the global crisis.
11. Further efforts will be put to increase state receivables collection by improving the effectiveness of the revenue administration and its interaction with control, law enforcement and justice authorities (also part of the National Reform Programme and the Action Plan to it).
12. Fiscal cushions:
- a 7 per cent reduction of expenditures and transfers under the Republican budget, except for investment expenditure, is provided for. This measure will be activated in the event of abiding and significant deterioration of the estimates and forecasts of macroeconomic and other economic indicators for 2009;
 - a possibility for the Council of Ministers to allocate additional appropriations to capital expenditure at the expense of reduced current expenditure is envisaged;
 - provision is made for limiting the possibility of reallocating capital to maintenance expenditure.
13. Sustaining of the stability of the national financial system:
- the existing monetary and currency regime being maintained at the current exchange rate by means of keeping a positive budget balance and conservative management of the fiscal reserve;
 - preserving the high-level coordination between MoF and BNB aimed at participation in the European mechanism responding to the crisis, and, if needed, preparing and undertaking additional measures to ensure the high liquidity of the banking system in Bulgaria;
 - improving the internal mechanisms, established as a result of the participation in the European mechanism to respond to the crisis, as to use funds from the fiscal reserve and thus increase the liquidity in the banking system and in the economy;
 - increasing the level of protection of citizens' bank deposits by means of immediate introduction of the EU legislation on deposits guarantees;
 - rendering, if needed, capital support to banks in line with the European practices.

A slowdown of the economic development of the main trading partners due to the bank credit tightening and a more difficult access to liquidity might result in a pronounced deceleration of the economic growth in Bulgaria. 1 percentage point lower real growth of the Bulgarian economy compared to the baseline scenario would lead to a loss of EUR 120.1 million in budget revenue or 0.3% of GDP. Another risk in the medium term that requires following conservative fiscal policy is the relatively high current account deficit of the balance of payments.

Main risk for the budget execution is the one stemming from the process of European funds absorption. On the one hand, these funds contribute to higher economic growth and stimulate indirectly the growth of budget revenue. On the other hand, the projects financed by European funds require national co-financing, which demands restructuring of the budget expenditure in order to sustain the ceiling of the total expenditure of 40% of GDP. European funds absorption is set as a priority of the governance and the fiscal policy, namely, the national co-financing resources are provided for in the medium term fiscal framework.

Considerable deterioration of the age structure of the population being forecasted, poses a vital challenge for the fiscal policy in the long term. Increasing share of the aged people is expected to result in a noticeable pressure on fiscal expenditure on pensions and healthcare in the long run. This process is a serious challenge for maintaining the public finance sustainability and makes it necessary reforms in the pension system to be undertaken. Moreover, quality of the healthcare and education public expenditure is to be improved, as well as conservative budget balance policy to be pursued. These reforms will allow bearing the burden of ageing population in the future without threatening the stability of the public finance.

4.2. Sensitivity of budgetary projections to different scenarios and assumptions

The alternative scenario for medium-term economic development, based on the assumption of considerable deterioration of the external environment, has a substantial effect on the budgetary execution during the programming period. The sensitivity analysis is made under the assumption of constant budget expenditure in nominal terms, which is justified by the adoption of hard expenditure ceilings within the budgetary procedure. A contingent increase of the total expenditure stemming from a cyclical upsurge of the unemployment expenditure is not taken into consideration, because of its small share.

Under this scenario the budget surplus in 2009 would decline to 1.6% of GDP. The lower fiscal balance is due entirely to the loss of fiscal revenues, as a result of economic growth slowdown and weaker growth of private consumption.

The magnitude of influence of a potential change in the levels of the current exchange and interest rates both on the nominal value of government debt and the amount of impending payments, was determined by the means of a sensitivity analysis. The results show a relatively weak sensitivity of debt-related liabilities with respect to changes in the values of basic market indicators. In particular, for the period 2009–2011 a 10% change in the EUR/USD exchange rate is expected to lead to a fluctuation in the nominal level of government debt of less than EUR 240 million. Under this hypothesis, the interest payments on government liabilities respond with an average deviation of 1.7%, and the planned amortisations – with an average deviation of 0.3%. An equivalent change of 10 base points in the levels of the six-month LIBOR and the six-month EURIBOR leads to a change of 0.3% in the envisaged interest expenditures. The data from the performed analysis shows that under the same assumptions for changes in the six-month LIBOR, the amount of the interest expenditures for the period 2009–2011 will practically remain unchanged.

4.3. Comparison with previous update

The update of the medium-term macroeconomic framework and the growth forecasts was entirely necessitated by the deteriorating external environment due to the financial crisis. According to the updated scenario, the domestic demand is expected to expand by significantly slower pace compared to the last year forecasts, because of the increased interest rates and the limited bank loans. Moreover, the growth of exports will be negatively influenced by the weaker external demand. As a whole, the external trade is not expected to have a significant impact on the total growth of GDP, as the rate of imports growth is also projected to slow down due to lower consumption and investment growth.

The fiscal policy does not foresee any change in the targeted level of the positive budget balance, which is planned to remain at 3% of GDP during the period. On the other hand, the level of the government debt will decrease more abruptly as compared to the one forecasted in the previous update. This is due to the lower base in 2007, as well as to the earlier debt repayment to the World Bank at the beginning of 2008.

5. QUALITY OF PUBLIC FINANCE

5.1. Policy strategy

The Ministry of Finance continues its policy to gradually improve the quality of public finances. These efforts are focused primarily on the expenditure side and are aimed at optimizing the expenditure structure and enhancing their effectiveness. The main objective of the policy is to create conditions for sustainable long term economic growth and higher quality of the services provided by the public sector.

5.2. Developments on the expenditure side of the budget

One of the most important instruments for improving the effectiveness of expenditure is the transition to programme and multiannual budgeting. Taking account of the Council of Ministers' recommendation regarding Convergence Programme (2007–2010) to strengthen the role of programme budgeting, the efforts of the Ministry of Finance in the area of budget reform in the medium term will be to improve the budget legislation and methodology and to include all first-level spending units (FLSU) in the programme and result oriented budgeting process. In 2009 steps are foreseen to enhance the transparency and accountability regarding the results achieved by the ministries and state agencies, first-level spending units. They will prepare and submit to the Ministry of Finance quarterly, half-yearly and annual financial reports on the extent of implementation of the policies and programmes realized, while also publishing the latter on their websites. The half-yearly and annual reports will be submitted to the National Assembly and the National Court of Auditors and they will be subject of discussion and assessment by the Public Sector Accountability Subcommittee with the Budget and Finance Committee of the National Assembly. As regards the ongoing budget implementation, any changes/adjustments during the year will continue to be reflected under the relevant policies and programmes of ministries and agencies.

In relation to the public finance reforms carried out, the extension of their scope and the improvement of budget procedures and practices, the Public Finance School within the Ministry of Finance will continue to make analyses of the training needs, develop programmes and organise courses and workshops to strengthen the capacity of state and municipal administration officials.

Given the uncertainty on international financial markets, the commitment for tight fiscal policy is even more crucial. This commitment has been strengthened by defining a new budget rule, provided for in the Transitional and Final Provisions of the 2009 Budget Law, under which the Ministry of Finance will be entitled to take measures to adjust the monthly ceilings as regards non-interest expenditure and transfers, where this is required due to non-performance of budget revenues. Thus a further flexibility element is provided for in the planning of budget expenditure, which will not allow eventual deterioration of the budget balance compared to the target figure.

5.3. Developments on the revenue side of the budget

The Government has already been quite successful in consistently shifting the tax burden towards indirect taxes and gradually eliminating a number of tax preferences and reliefs from the general tax treatment. The introduction of a flat rate on personal income since the beginning of 2008 has also been an important step towards simplification of the tax system.

Different tax reliefs represent a type of "tax expenditure" which reduces the fiscal policy transparency and compromises the principle of tax neutrality. That is why concrete measures will be taken to improve the effectiveness of the tax system in the medium term by eliminating tax reliefs related to exceptions in the estate tax and tax on property acquisition. The scope of tax reliefs regarding donations by individuals and companies will be reduced, while the existing practice of a 100% corporate tax remittance to companies, ensuring employment in regions with high unemployment rate, will be abolished.

6. SUSTAINABILITY OF PUBLIC FINANCES

6.1. Policy strategy

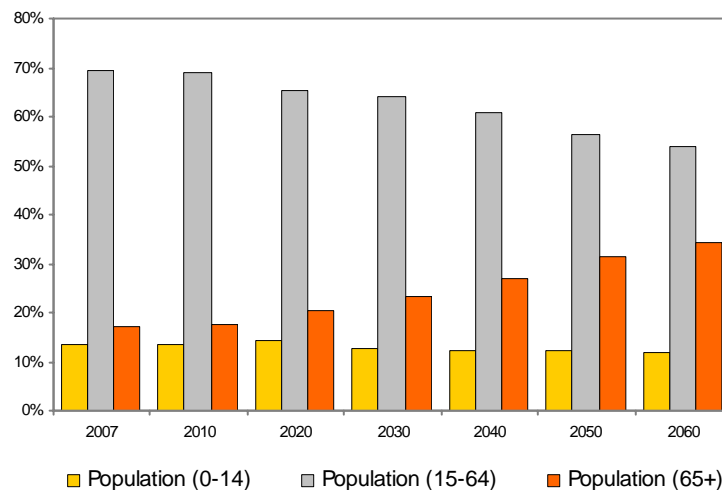
The assessment of fiscal policy sustainability is highly dependent on the assumptions of the long term development of the economy. This Convergence Programme uses the long term EUROPOP 2008 demographic forecast, prepared by Eurostat, and the long term macroeconomic forecasts of DG ECFIN. The key indicators relevant to the long term fiscal sustainability are shown in Table 7 of Appendix 1.

The policy strategy related to the sustainability of public finances remains unchanged compared to the strategy declared in the Convergence Programme (2007–2010).

The long term sustainability of the fiscal stance is influenced considerably by the present levels of the budget balance and government debt, as well as by their envisaged change due to the aging population. The aging process poses considerable risk to public finances, as it will put serious upward pressure on budget expenditure for pensions and healthcare. The dynamics of this expenditure is modelled by a long term model with forecast period until 2060, which is based on the EC methodology and assumptions, adopted after consultations with the EU Member States.

The long term demographic forecast until 2060 is prepared by Eurostat and shows that by the end of the forecast period Bulgaria's population will drop by 2 million to reach 5.5 million. This is due to the low birth rate, which will not be sufficient to ensure reproduction of the population. The migration processes will also have an adverse effect at least at the beginning of the period, as the net migration flow is expected to be negative. The age structure of the population is progressively worsening during the forecast period, the share of people of working age is declining. The share of young people is also decreasing, despite the assumption for higher fertility rate, because the drop in the population of fertility age is expected to have a stronger effect.

Figure 12: Age structure of the population



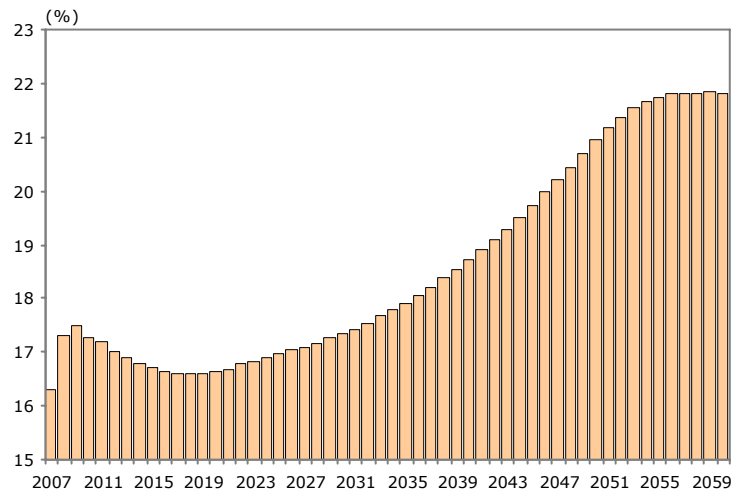
Source: Eurostat

As a result of the worsening age structure the dependency ratio, defined as the ratio between the number of people over 65 and the number of people of working age (15-64), is growing considerably during the period. It reaches 63.4% in 2060 compared to 24.9% in 2007, which is expected in the long term to exert substantial pressure on the stability of the pension system.

For the purpose of assessing the sustainability of public finances in Bulgaria a scenario has been used, which preserves the budget targets for the period 2007–2011, defined in the medium term fiscal framework, while the budget surplus is reduced to reach the medium term objective of 1.5% of GDP in 2012. After 2012 the change in the budget balance is driven by the effect of the aging of the population on public expenditure.

The results of the model indicate that the budget expenditure, related to the aging of the population, will grow by around 5.5 percentage points of GDP by the end of the period. This in fact means that the demographic developments will require financing of the budget through the issue of new debt in the long run.

Figure 13: Ageing population expenditures (% of GDP)



Source: AEF

The generally accepted by the EC approach for assessing the fiscal stance sustainability is based on the S2 indicator, which is defined as the difference between the currently projected fiscal stance for every year ahead in the future and the stance that meets the condition for sustainability for an infinite period in the future. The indicator consists of two components – current budget position and assessment of the discounted current value of the effect of aging in the long run. The positive value of the indicator means a need for fiscal consolidation or structural reforms to reduce the cost of aging on public finances. The negative value of the indicator implies that the initial budget position is sufficient to ensure sustainability of the fiscal policy taking into account the effects of aging.

Table 10: Fiscal sustainability indicator

Programme scenario (% of GDP)	
Initial budgetary position	-3.29%
Aging population impact	3.04%
S2	-0.25%

Source: AEF

The effect of aging is considerably higher compared to the previous Convergence Programme scenario. This is due to shifting the forecast period until 2060, when the increase of the pension expenditure is considerably higher than the initial level. Furthermore, the risk to public finances due to the demographic developments may prove even more serious, because the strong increase of the expenditures related thereto at the end of the period implies that they could have an even greater effect after 2060. This result shows that the current fiscal policy of comparatively high budget surpluses is adequate to respond to the challenges of aging and the planned in the medium term maintenance of such policy is completely justifiable.

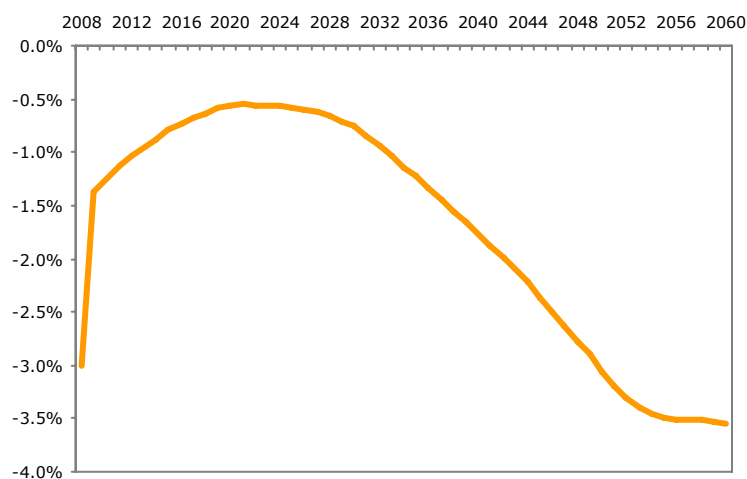
6.2. Long-term budgetary prospects, including the implications of aging populations

6.2.1. Social insurance

The long-term forecast builds on the long term EUROPOP 2008 demographic forecast, prepared by Eurostat, and the long term macroeconomic forecast of DG ECFIN, as well as on assumptions on the Public Social Security, based on the current legislation in the country. It applies the model for long-term projection of the funds of the Public Social Security, used in the two previous Convergence Programmes.

Despite the measures, adopted for boosting the Public Social Security revenue,¹⁵ a deficit is expected for each of the following three years. The deficit is projected to decline and reach around 0.55% of GDP in 2021, before starting to rise back and amount to 3.54% of GDP at the end of the period.

Figure 14: Balance of the public social insurance funds (% of GDP)

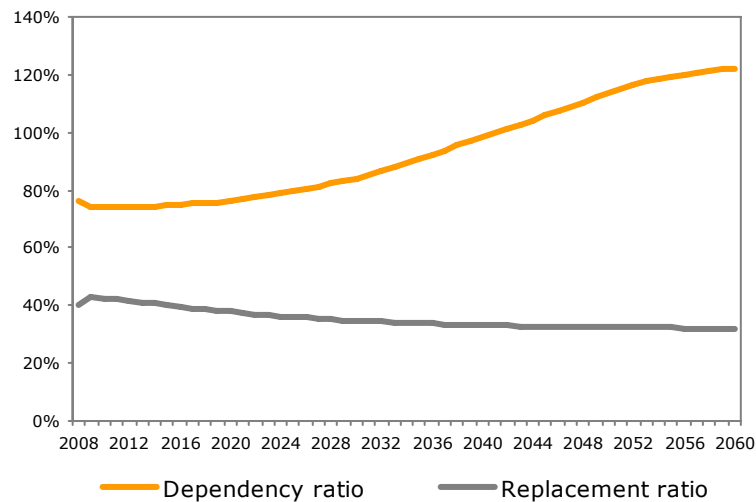


Source: NSSI

The long-term trend for rising spending in the first pension pillar stems from the joint dynamics of the dependency and income replacement ratios. The dependency ratio¹⁶ is projected to decline during the next three years, compared to its current level of 76.7% (in 2008), reaching 73.9% in 2011. This is mainly on account of the increase of the retirement age and the removal of the opportunity for early retirement for some profession categories. In the long term, however, the low fertility ratios and the rising life expectancy are pre-conditions for an increase in the dependency ratio to 122.3% in 2060.

¹⁵ Increase of the minimum insurance income by key economic activity and groups of profession.

¹⁶ Number of pensioners per 100 insured persons.

Figure 15: Replacement and dependency ratios, 2008-2060

Source: NSSI

Beyond 2011, the income replacement ratio is expected to follow a downward tendency throughout the entire period until 2060 due to the faster raising of the insurable income compared to the pension growth rates.¹⁷

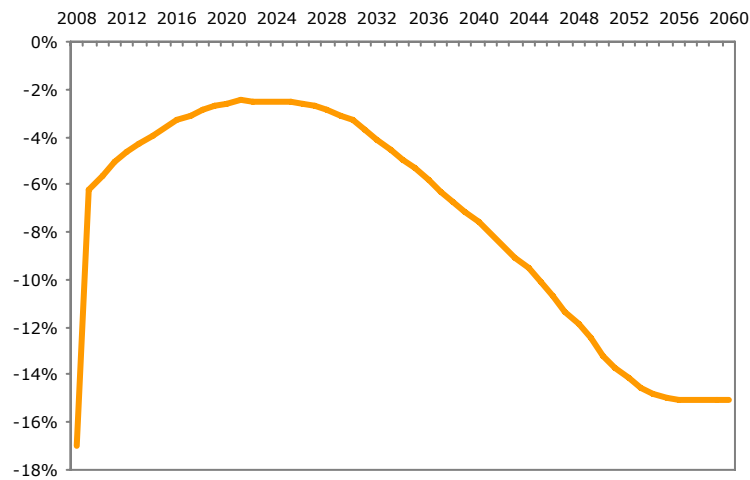
The actuarial balance¹⁸ is expected to remain negative (-17.0%) for 2008, but it will be improving in the next three years, reaching -5.1% in 2011.¹⁹

¹⁷ Projections are made given there are no amendments to existing legislation.

¹⁸ The income level as a percentage of the insurable base (all employment income), minus the costs for Public Social Security (also as a share of the insurable base). The forecasts are based on the long-term actuarial model which is used by the NSSI and includes the projections for the actuarial status of the public social insurance funds for the period 2008 - 2060 on consolidated basis.

¹⁹ Macroeconomic assumptions are based on the macroeconomic forecast prepared by DG ECFIN for the period 2008–2060. Public Social Security assumptions are as follows: 1. Indexation of pensions by 50 per cent of the inflation and 50 per cent of the insurable income for the previous calendar year pursuant to the provisions of Article 10 of the Social Insurance Code; 2. Reduction of the social insurance contribution to the Pension Fund of the PSS from 22% in 2008 down to 18% as from 2009 (the contribution will be divided among the insured person – 8%, the insurer – 10%, with the state transfer amounting to 12% of the sum of the insurable income of all insured persons for the relevant calendar year) 3. Recalculation of all pensions for employment by the average insurable income for 2007.

Figure 16: Actuarial balance



Source: NSSI

6.2.2. Education

The forecast of public expenditure on education is based on the long-term demographic forecast and the assumption that the costs, set in the common expenditure standard for 2009, will be indexed with the nominal labour productivity growth. The long-term forecast does not assume that saved resources, due to a lower number of pupils and students, will be re-invested for other spending in the area of education. Accordingly, education expenditure, as percentage of GDP, will decline from its current level, reaching its minimum around 2040. A stabilisation of the demographic dynamics of the population, aged less than 18 years, will lead to a gradual rise in the total spending after this year.

Table 11: Education expenditure by type of education (% of GDP)

Educational level	2000	2010	2020	2030	2040	2050	2060
ISCED 1	0.80%	0.87%	1.02%	0.92%	0.91%	1.04%	1.03%
ISCED 2	0.90%	0.68%	0.85%	0.82%	0.76%	0.87%	0.89%
ISCED 3-4	0.82%	0.86%	0.81%	0.90%	0.82%	0.88%	0.94%
ISCED 5-6	1.71%	1.56%	1.18%	1.33%	1.35%	1.33%	1.41%
Total	4.24%	3.97%	3.86%	3.97%	3.84%	4.12%	4.26%

Source: AEF, Eurostat

6.2.3. Healthcare

In the long term the aging of the population is expected to deepen. The combination between the sharp decline of the working-age population and the projected rise of the demand for healthcare services by older people explain the increasing financial burden for the employed as well as the growth of the total spending on healthcare.

The forecasted dynamics of long-term expenditure on healthcare is based on indexation thereof with the increase in the nominal labour productivity and the expected population dynamics. This assumption is quite strong as it suggests no change in healthcare policy, concerning the expansion of the scope of healthcare services, financed by the budget. At the same time, a number of econometric studies show that technical progress and other non-demographic factors are among the main reasons behind the increase in healthcare expenditures in developed countries. These considerations are not included in the current forecast and therefore, it might underestimate the healthcare expenditures. At the same time, the forecast also does not take into account the

spending impact, caused by the expansion of financing for medical prevention measures, which would ultimately lead to lower spending on healthcare in the long term.

Table 12: Healthcare expenditure

Indicator	2010	2020	2030	2040	2050	2060
Healthcare expenditure, % of GDP	4.2%	4.3%	4.7%	5.3%	6.0%	6.2%
Share of health care expenditure in total expenditure, 65+	34.4%	38.6%	42.1%	45.7%	51.7%	55.7%
Share of population 65+	17.6%	20.5%	23.4%	26.9%	31.5%	34.2%

Source: AEF

Table 12 shows that the increase in healthcare expenditure is due to the deterioration of the demographic structure of the population. The share of people, aged above 65 years, substantially rises from 17.3% in 2007 to 34.2% of the total population at the end of the period. Having in mind that most expenditures on healthcare for a given individual are concentrated in the last years of their lifetime, the aging of the population logically entails a higher share for healthcare spending of older people in total spending, keeping the ratio of healthcare expenditure of people, aged 65+²⁰ unchanged. At the end of the monitored period, the share for healthcare spending of older people in total spending is expected to reach 56%. Total healthcare expenditures are projected to rise from their current level of 4.2% to 6.2% of GDP by 2060.

²⁰ According to NHIF data, currently they exceed by 85% the expenditure by person in the age group of 0-65 years.

7. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

7.1. Implementation of national budgetary rules

The budget procedure for 2009 has affirmed the practice of introducing rules at political and technical level during the stage of budget planning and preparation. These rules aim at enhancing the stability of the medium-term fiscal framework and the expenditure ceilings by first-level spending units which are linked to the policies pursued and to the commitments taken, approving a result-oriented process of planning and budgeting (in programme format) and enhancing the transparency of the decisions taken.

With the State Budget of the Republic of Bulgaria's Law for 2009 the National Assembly will endorse the expenditure of the Council of Ministers, of the ministries, of the State Agency for Youth and Sports, of the State Agency for Information Technology and Communications, of the State Forestry Agency, of the National Agency for Tourism, of the National Security Agency, and of the National Road Infrastructure Agency under the policies implemented, under other programmes outside these policies and under the Administration Programme according to a separate appendix.

With the draft State Budget of the Republic of Bulgaria's Law for 2010 the Council of Ministers will submit to the National Assembly for consideration and approval the draft programme budgets of the Council of Ministers, of all ministries and government agencies that are first-level spending units, as well as the draft budget of the National Assembly for 2010, including expenditure under programmes as part of the bill.

The State Budget of the Republic of Bulgaria's Law for 2009 envisages to preserve the practice according to which the Minister of Finance shall make parallel corrections pursuant to the Organic Budget Law and corrections to the affirmed budgets of the Council of Ministers, of all ministries, of the first-level spending government agencies and of the National Road Infrastructure Agency. The Minister of Finance may also give consent for internally offset changes in the expenditure approved under the budgets of the Council of Ministers, of all ministries, of the first-level spending government agencies and of the National Road Infrastructure Agency for 2009 under the policies implemented, under other programmes outside these policies and under the Administration Programme.

In view of enhancing the transparency of public finance, government bodies, ministries and institutions shall publish on their websites the affirmed budgets per type of revenue, expenditure, transfers, subsidies/payments and grants as well as per programme within their affirmed expenditure. Government bodies, ministries and institutions shall submit to the Ministry of Finance their financial quarterly statements on the level of policy and programme implementation for the half year, and annual statements which are published on their websites.

As to the national fiscal rules, the ones for the budget balance, the level of consolidated expenditure and of consolidated debt (as a percentage of GDP) continue to be implemented. Given any steady and substantial deterioration of estimates and projections of the macroeconomic indicators and the other economic indicators for 2009, there is an option for the Council of Ministers to reduce Republican budget expenditure and transfers, except for investment expenditure, by 7 per cent.

7.2. Budgetary procedures, including public finance statistical governance

The budget procedure for 2009 is formally divided into three main stages, with one of the stages for 2008 (containing four main stages) being excluded. i.e. the first stage where first-level spending units, excluding the municipalities, update their budgets according to the laws on the state budget for 2006 and 2007 and the expenditure ceilings of first-level spending units for 2008 and 2009 in programme format and by elements of the Unified Budget Classification. The first two stages from the procedure for 2008 were integrated into the first stage of the budget procedure for 2009 ending with the approval by the Council of Ministers of the medium-term fiscal framework and the basic assumptions for the period 2009–2011. The following three stages of the procedure for 2008 have been preserved with some modifications, though. These stages of the budget procedure for 2009 are related to:

- A Government decision taken at an early stage of budget planning of the medium-term fiscal framework and the basic assumptions for the period 2009–2011;
- The approval by the Council of Ministers of the three-year budgetary forecast, the expenditure ceilings by FLSU but not by municipality for the period 2009–2011, the updated Government Debt Management Strategy and the projects to be funded by government and/or government guaranteed loans in 2009;
- Preparation of the draft Law on the State Budget for 2009 together with the budget documents, including the programme format of the budgets of Ministries and State Agencies that are first level spending units.

A new aspect in the 2009 budgetary procedure is also the integration in the draft decision of a procedure of development, coordination and approval of the investment projects to be funded by government and/or government guaranteed loans in 2009, this procedure being completed at the end of the second stage with their consideration and approval by the Council of Ministers. The approved projects have been reflected in the draft Law on the State Budget for 2009.

The 2009 budgetary procedure envisages consultations between the Minister of Finance and FLSUs in view to clarifying the three-year budgetary forecast and the expenditure ceilings of FLSUs for the period 2009–2011 (second stage), as well as the draft budgets for 2009 (third stage).

Another new aspect in the procedure is the reflection of the changes in the process of preparation, planning and adoption of the budget of the National Assembly in connection with the amendments to the Organic Budget Law adopted in 2007. By the decision on the 2009 budgetary procedure the Council of Ministers proposes the Chairman of the National Assembly to prepare and submit for an opinion to the Ministry of Finance the three-year forecast on the budget of the National Assembly for the period 2009–2011 – at the second stage, and respectively the draft budget for 2009 – at the third stage of the budgetary procedure, including with expenditure by programmes.

Since the beginning of 2008 the public authorities, the Ministries and the Agencies that prepare their budgets in a programme format, too, are to prepare and submit to the National Assembly, the National Audit Office and the Ministry of Finance reports on the execution of their policies and programmes for the semester as well as annual reports not later than 45 working days after the end of the reporting period. The semester and the annual reports contain information about the level of execution of the policies pursued and the expenditure for their implementation.

In connection with the activity of the newly established Public Sector Accountability Subcommittee and on request by the Chairperson of the Budget and Finance Committee, first level spending units are to prepare reports on the execution of certain budgets and programmes, which are submitted to the Subcommittee. The meetings of the Subcommittee are attended by the first level spending unit, the Chairperson of the National Audit Office and the Minister of Finance or their substitutes as well as other persons at invitation of the Chairperson of the Subcommittee. After the report is discussed the Chairperson of the Subcommittee prepares a report evaluating the execution of the budget, which is submitted to the Budget and Finance Committee and to the Members of Parliament.

In execution of the Council of Ministers' decision on the budgetary procedure, the Ministry of Finance publishes on its website the approved packages of documents relating to the medium-term fiscal framework and the basic assumptions for the period 2009–2011, the investment projects to be funded by government and/ or government guaranteed loans in 2009, the three-year budgetary forecast, the expenditure ceilings by FLSU but not by municipality for the period 2009–2011, the updated Government Debt Management Strategy and the draft Law on the State Budget for 2009.

In execution of the commitments made to Eurostat, Bulgaria provides statistical information on the debt of the general government sector and its subsectors each quarter (Regulation 1222/2004) as well as Notification Tables on deficit and debt twice a year (Regulation 3605/1993). Our country has declared its readiness to continue its efforts towards achieving synchronization of the government finance statistics with the EU requirements.

The first official mission of Eurostat to Bulgaria on the preparation of the notification tables on the excessive deficit procedure and debt was held in the Ministry of Finance on 4 and 5 March 2008. The purpose of the mission was to clarify the sources and methods of calculating the data on deficit and debt and to identify the areas where further efforts should be made so that our country be able to fully meet Eurostat requirements and standards applicable to EU Member States.

The Eurostat mission concluded that revision should be made of the methodology for assessment of state receivables from taxes and social security contributions on an accrual basis for the purposes of the notification tables. The mission recommended methods to be elaborated for the preparation of

the estimates on a modified cash basis and zero estimate to be applied until the adoption and implementation of these methods (April and September 2008 and not later than April 2009).

In execution of Eurostat recommendations a plan for their implementation has been prepared. One of the main goals was to prepare new methodology for assessment of state receivables from taxes and social security contributions on a modified cash basis. In compliance therewith at end-July the National Statistical Institute prepared and submitted to Eurostat a proposal with estimates under the methods for calculation of the receivables from taxes and social security contributions on a modified cash basis. Steps have also been taken to ensure that MoF, NSI and BNB provide consistent data on the government finance statistics. Eurostat has pointed out that the National Statistical Institute was the competent body to apply the national accounts methodology and for that reason the notification tables should be elaborated by NSI with the active participation of MoF.

7.3. Reforms in the area of revenue administration

7.3.1. National revenue agency

Revenue administrations will take specific steps to combat corruption practices, to improve collection and to raise budget revenues. The most important measures envisaged in this direction are intended to improve cooperation and actions' coordination between the revenue bodies at NRA and the National Customs Agency, and the law enforcement authorities.

The interaction between the National Customs Agency and NRA will be enhanced in view to elaborating joint plans for inspection of taxable persons, targeted risk profiles by branches for the taxable persons that produce, store and consume excise goods. A mechanism will also be built up for exchange and receipt of information among NRA, the National Customs Agency and the Ministry of Economy and Energy.

NRA bodies will improve the services provided to citizens and companies, as well as their control activity and work related to coercive collection in order to protect the revenues against violations and fraud by means of:

- improving the maintenance, integration and unification of the electronic services provided to NRA clients, and developing new electronic services;
- developing new and improving the existing methods of inspections and checks in specific areas (by types of taxes, branches, groups of liable persons) and improving the quality of selection (through an automated annual risk assessment of all liable persons);
- using the information from the VAT information exchange system (VIES) and any other information received under the administrative cooperation with EU Member States in order to make selection in the course of exercising tax control, in connection with intra-Community supplies and acquisitions;
- introducing electronic inspections and strengthening the role of the ongoing control;
- enhancing the interaction and actions' coordination between NRA revenue bodies and law enforcement authorities – the Ministry of Interior and the Prosecutor's Office, so that court proceedings against perpetrators of tax and social security fraud be speeded up;
- developing the systems for exchange of VAT information with the EU (VIES), adapting the payment process and introducing the Single Euro Payment Area (SEPA). The portion of checks made under international cooperation activities will increase.

The measures to combat corruption inside the system of revenue administrations are of key importance. NRA plans to improve the systems of selection, assessment, development of and providing incentives to the staff, to ensure mobility and rotation of the employees engaged in activities exhibited to corruption pressure, to improve professional training and development and to ensure the physical security of the staff.

Preparations are being made for integration of the State Receivables Collection Agency into NRA; thus the process of coercive collection of public receivables will be concentrated in one institution and reduction of both administrative costs and clients' costs on public liabilities' settlement will be achieved.

7.3.2. Customs agency

The customs administration will continue its active cooperation with the bodies of the Ministry of Interior in relation to:

- joint operations to improve control over the persons that produce and store fuels and ethyl alcohol (high-risk goods from a customs point of view);
- preparation and carrying out of international operations to counteract any customs fraud upon imports of goods.

Together with the Border Police General Directorate at the Ministry of Interior it will speed up the introduction of video surveillance at the main border crossing points at EU external borders.

The service of taxpayers will continue to improve, including through development of new electronic services. There are plans for holding regular meetings with large producers and traders of excise goods in order to exchange information so that the counteraction of violations involving such goods be enhanced.

7.4. Fiscal decentralisation

The purpose of the reform towards fiscal decentralization is to provide public services in a quantity, of a quality and at a price corresponding to the needs and consistent with the possibilities of the citizens, on the basis of a sustainable and long-term balancing of expenditure responsibilities of the municipalities with stable sources of revenue and effective civil control.

In general, the degree of fiscal decentralization in Bulgaria has been gradually increasing; however, it remains lower than the average one in the European countries. The indicator of the degree of fiscal decentralization relating to the portion of the own revenues of all revenues of the municipalities marks notable positive development. This indicator has been sustainably growing since 2006 and is projected to be around 42% in 2008. The share of the municipal expenditures of the consolidated budget expenditures is increasing but this share of around 14% remains considerably lower than the average levels in the European countries. The same refers to the indicator "share of municipal budgets to the GDP".

The process of fiscal decentralization will continue developing in 2009, too, by means of carrying out the measures laid down in the Programme for Implementation of the Decentralization Strategy for the first planning period (2006-2009). In 2009 the measures will be carried out in compliance with the adopted Indicative Financial Plan.

APPENDIX 1: TABLES

Table 1a. Macroeconomic prospects

	ESA code	2007	2007	2008	2009	2010	2011
		Level, mln. EUR	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. Real GDP ²¹	B1*g	28 898	6.2%	6.5%	4.7%	5.2%	5.8%
2. Nominal GDP	B1*g	28 898	14.5%	17.5%	10.7%	8.9%	9.3%
Components of real GDP							
3. Private consumption expenditure	P.3	19 982	5.3%	5.0%	4.1%	4.1%	5.0%
4. Government consumption expenditure	P.3	4 667	3.1%	0.8%	0.2%	0.7%	2.6%
5. Gross fixed capital formation	P.51	8 606	21.7%	22.4%	10.6%	9.0%	10.1%
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+P.53	7.0	1.2	0.3	-0.6	-0.6	-1.2
7. Exports of goods and services	P.6	18 320	5.2%	5.8%	6.3%	7.8%	8.8%
8. Imports of goods and services	P.7	-24 704	9.9%	9.6%	6.1%	6.1%	7.0%
Contributions to real GDP growth²²							
9. Final domestic demand		-	9.9%	10.3%	6.3%	5.8%	7.0%
10. Changes in inventories and net acquisition of valuables	P.52+P.53	-	1.2%	0.8%	-0.3%	-0.3%	-0.9%
11. External balance of goods and services	B.11	-	-4.9%	-4.5%	-1.3%	-0.3%	-0.3%

²¹ In 2007 prices.

²² In percentage points.

Table 1b. Price developments

	ESA code	2007	2007	2008	2009	2010	2011
		Level	Rate of change ²³	Rate of change	Rate of change	Rate of change	Rate of change
1. GDP deflator		100	7.9%	10.3%	5.7%	3.6%	3.3%
2. Private consumption deflator		100	6.7%	11.9%	5.7%	3.7%	3.0%
3. HICP ²⁴		100	7.6%	12.4%	6.7%	4.7%	4.0%
4. Public consumption deflator		100	8.0%	13.8%	7.5%	5.2%	4.5%
5. Investment deflator		100	9.3%	4.7%	1.5%	1.1%	1.3%
6. Export price deflator (goods and services)		100	6.9%	12.3%	3.5%	3.6%	3.5%
7. Import price deflator (goods and services)		100	6.9%	10.9%	2.5%	2.8%	2.5%

²³ In percentage points compared to the previous year.

²⁴ Annual average.

Table 1c. Labour market developments²⁵

	ESA code	2007	2007	2008	2009	2010	2011
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
1. Employment (persons, thousand) ²⁶		3 714	2.8%	3.3%	0.8%	0.4%	0.2%
2. Employment (hours worked, million) ²⁷		6 171.8	3.3%	3.5%	0.9%	0.5%	0.3%
3. Unemployment rate ²⁸		6.9%	-2.1 ²⁹	-0.9	-0.3	-0.2	-0.2
4. Labour productivity (EUR per person) ³⁰		7 780.8	3.3%	3.1%	3.8%	4.8%	5.5%
5. Labour productivity (EUR per hour worked) ³¹		4.7	2.8%	2.9%	3.8%	4.7%	5.5%
6. Compensation of employees (EUR, thousands)	D.1	9 982 676	22.3%	24.6%	13.0%	10.5%	9.8%
7. Compensation per employee		3 659.7	17.9%	19.9%	12.0%	10.0%	9.5%

²⁵ The rates of change in items 4 and 5 are in real terms, and those in item 6 – in nominal terms.

²⁶ Occupied population, domestic concept national accounts definition.

²⁷ National accounts definition.

²⁸ Harmonised definition, Eurostat; levels.

²⁹ The rate of change is in percentage points.

³⁰ Real GDP per person employed.

³¹ Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA code	2007	2008	2009	2010	2011
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-20.6	-22.9	-20.7	-18.4	-16.6
of which:						
- Balance on goods and services		-21.4	-24.4	-23.2	-21.7	-19.9
- Balance of primary incomes and transfers		-0.4	0.4	1.0	1.0	0.8
- Capital account		1.2	1.1	1.5	2.3	2.5
2. Net lending/borrowing of the private sector ³²	B.9	-20.7	-25.9	-23.7	-21.4	-19.6
3. Net lending/borrowing of general government	EDP B.9	0.1	3.0	3.0	3.0	3.0
4. Statistical discrepancy		-	-	-	-	-

³² Due to the unavailability of official statistical information for 2007, the values of the indicator are derived as residual using rows 1 and 3 from the table.

Table 2. General government budgetary prospects

	ESA code	2007	2007	2008	2009	2010	2011
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	35.6	0.1	3.0	3.0	3.0	3.0
2. Central government	S.1311	8.7	0.0	3.0	3.0	3.0	3.0
3. State government	S.1312	-	-		-	-	-
4. Local government	S.1313	-13.5	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	40.3	0.1	0.0	0.0	0.0	0.0
General government (S13)							
6. Total revenue	TR	12 014.7	41.6	41.3	43.4	43.4	43.7
7. Total expenditure	TE ³³	11 979.1	41.5	38.3	40.4	40.4	40.7
8. Net lending/borrowing	EDP B.9	35.6	0.1	3.0	3.0	3.0	3.0
9. Interest expenditure	EDP D.41	296.5	1.0	0.9	0.9	0.9	0.9
10. Primary balance ³⁴		332.1	1.1	3.9	3.9	3.9	3.9
11. One-off and other temporary measures ³⁵		-943.6	-3.3	0.0	0.0	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		7 412.7	25.7	26.0	26.5	26.4	26.6
12a. Taxes on production and imports	D.2	5 344.4	18.5	18.7	18.8	18.9	18.9
12b. Current taxes on income, wealth, etc	D.5	1 906.5	6.6	6.7	7.1	6.9	7.1
12c. Capital taxes	D.91	161.7	0.6	0.6	0.6	0.7	0.7
13. Social contributions	D.61	2 500.4	8.7	8.0	8.2	8.2	8.3
14. Property income	D.4	431.0	1.5	1.4	1.2	1.0	1.0

³³ Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

³⁴ The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

³⁵ A plus sign means deficit-reducing one-off measures.

	ESA code	2007	2007	2008	2009	2010	2011
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
15. Other ³⁶		1 670.6	5.8	5.8	7.6	7.7	7.8
16=6. Total revenue	TR	12 014.7	41.6	41.3	43.4	43.4	43.7
Tax burden (D.2+D.5+D.61+D.91-D.995) ³⁷		9 781.3	33.8	33.6	34.2	34.2	34.6
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	4 908.0	17.0	15.8	16.5	16.7	16.6
17a. Compensation of employees	D.1	2 597.2	9.0	8.2	8.7	8.8	8.9
17b. Intermediate consumption	P.2	2 310.8	8.0	7.7	7.8	7.8	7.7
18. Social payments (18=18a+18b)		3 512.1	12.2	11.5	12.4	12.0	11.7
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	366.3	1.3	1.1	1.1	0.8	0.7
18b. Social transfers other than in kind	D.62	3 145.8	10.9	10.5	11.4	11.2	11.0
19=9. Interest expenditure	EDP D.41	296.5	1.0	0.9	0.9	0.9	0.9
20. Subsidies	D.3	227.5	0.8	1.7	2.2	2.3	2.1
21. Gross fixed capital formation	P.51	1 380.5	4.8	6.6	6.7	6.9	7.4
22. Other ³⁸		1 654.5	5.7	1.8	1.7	1.6	2.0
23=7. Total expenditure	TE	11 979.1	41.5	38.3	40.4	40.4	40.7
Government consumption (nominal)	P.3	4 667.1	16.2	15.8	15.4	14.9	14.6

³⁶ P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

³⁷ Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995).

³⁸ D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG code	2006	2011
1. General public services	1	4.5	4.2
2. Defence	2	1.7	1.8
3. Public order and safety	3	2.6	2.6
4. Economic affairs	4	4.6	6.9
5. Environmental protection	5	1.3	1.7
6. Housing and community amenities	6	0.7	2.1
7. Health	7	4.2	4.5
8. Recreation, culture and religion	8	0.8	0.7
9. Education	9	3.9	4.2
10. Social protection	10	12.2	12.1
11. Total expenditure (= item 7 = 23 in Table 2)	TE ³⁹	36.5	40.7

³⁹ Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	2007	2008	2009	2010	2011
1. Gross debt ⁴⁰	18.2	15.4	15.4	15.3	15.2
2. Change in gross debt ratio	-4.5	-2.8	0.0	-0.1	-0.1
Contributions to changes in gross debt					
3. Primary balance ⁴¹	1.1	3.9	3.9	3.9	3.9
4. Interest expenditure ⁴²	1.0	0.9	0.9	0.9	0.9
5. Stock-flow adjustment	-3.8	-4.5	-3.0	-3.5	-3.7
of which:					
- Differences between cash and accruals	0.0	0.0	0.0	0.0	0.0
- Net accumulation of financial assets	-3.3	-4.1	-3.3	-3.7	-3.9
of which: privatisation proceeds	1.0	0.7	0.4	0.1	0.0
- Valuation effects and other	-0.4	-0.4	0.3	0.2	0.2
Implicit interest rate on debt ⁴³	5.2	5.7	6.3	6.4	7.9
Other relevant variables					
6. Liquid financial assets ⁴⁴	-	-	-	-	-
7. Net financial debt (7=1-6)	-	-	-	-	-

⁴⁰ As defined in Regulation 3605/93 (not an ESA concept).

⁴¹ Cf. item 10 in Table 2.

⁴² Cf. item 9 in Table 2.

⁴³ Proxied by interest expenditure divided by the debt level of the previous year.

⁴⁴ AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA code	2007	2008	2009	2010	2011
1. Real GDP growth (%)		6.2	6.5	4.7	5.2	5.8
2. Net lending of general government	EDP B.9	0.1	3.0	3.0	3.0	3.0
3. Interest expenditure	EDP D.41	1.0	0.9	0.9	0.9	0.9
4. One-off and other temporary measures ⁴⁵		-3.3	0.0	0.0	0.0	0.0
5. Potential GDP growth (%)		5.0	6.3	6.0	6.0	5.9
contributions:						
labour		1.4	1.9	1.3	1.1	0.9
capital		2.9	3.5	3.5	3.5	3.5
Total factor productivity		0.7	0.9	1.2	1.4	1.6
6. Output gap		1.8	1.9	0.7	0.0	-0.1
7. Cyclical budgetary component		0.6	0.7	0.2	0.0	-0.1
8. Cyclically-adjusted balance (2-7)		-0.5	2.3	2.8	3.0	3.1
9. Cyclically-adjusted primary balance (8+3)		0.5	3.2	3.6	3.9	4.0
10. Structural balance (8-4)		3.8	3.2	3.6	3.9	4.0

⁴⁵ A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA code	2007	2008	2009	2010	2011
Real GDP growth (%)						
Previous update		6.4	6.4	6.8	6.9	
Current update		6.2	6.5	4.7	5.2	5.8
Difference		-0.2	0.1	-2.1	-1.7	-
General government net lending (% of GDP)	EDP B.9					
Previous update		3.1	3.0	3.0	3.0	
Current update		0.1	3.0	3.0	3.0	3.0
Difference		-3.0	0.0	0.0	0.0	-
General government gross debt (% of GDP)						
Previous update		19.8	18.3	17.4	16.9	
Current update		18.2	15.4	15.4	15.3	15.2
Difference		-1.6	-2.9	-2.0	-1.6	-

Table 7. Long-term sustainability of public finance

% of GDP	2000	2005	2010	2020	2030	2050
Total expenditure	42.4	39.3	40.4	39.7	40.3	44.0
Of which: age-related expenditures	10.1	9.0	17.4	16.6	17.3	21.0
Pension expenditure	9.4	8.8	9.1	8.4	8.6	10.8
Social security pension	-	-	-	-	-	-
Old-age and early pensions	8.3	7.3	7.9	6.9	7.1	9.4
Other pensions (disability, survivors)	1.1	1.6	1.8	1.5	1.5	1.4
Occupational pensions (if in general government)	-	-	-	-	-	-
Health care	3.3	4.9	4.2	4.3	4.7	6.0
Long-term care	-	-	-	-	-	-
Education expenditure	4.2	4.1	4.0	3.9	4.0	4.1
Other age-related expenditures	0.7	0.2	0.1	0.1	0.1	0.1
Interest expenditure	4.0	1.7	0.9	0.9	0.9	0.9
Total revenue	41.4	41.2	43.4	43.4	43.4	43.4
Of which: property income	3.6	1.4	1.0	1.0	1.0	1.0
Of which: from pensions contributions (or social contributions if appropriate)	7.6	7.1	7.6	7.5	7.4	7.3
Pension reserve fund assets	-	-	-	-	-	-
Of which: consolidated public pension fund assets (assets other than government liabilities)	-	-	-	-	-	-
Assumptions						
Labour productivity growth	9.2	3.5	4.8	3.3	2.7	1.7
Real GDP growth	5.4	6.2	5.2	2.4	1.7	0.3
Participation rate males (aged 20-64)	73.4	74.2	78.3	80.0	79.0	77.6

% of GDP	2000	2005	2010	2020	2030	2050
Participation rate females (aged 20-64)	61.0	63.1	68.5	71.2	70.4	68.9
Total participation rates (aged 20-64)	67.1	68.6	73.4	75.6	74.7	73.3
Unemployment rate	16.9	10.1	5.5	4.7	4.7	4.7
Population aged 65+ over total population	16.5	17.2	17.6	20.5	23.4	31.5

Table 8. Basic assumptions

	2007	2008	2009	2010	2011
Short-term interest rate (annual average), 3-month EURIBOR, %	4.3	4.9	5.0	4.5	4.5
Short-term interest rate (annual average), 6-month USD LIBOR, %	5.3	3.1	3.3	4.0	4.5
Long-term interest rate (annual average), %	4.2	4.1	4.0	4.1	4.1
USD/EUR exchange rate (annual average)	1.37	1.50	1.40	1.30	1.25
Nominal effective exchange rate, percentage change, previous year = 100 ⁴⁶	2.4	4.3	-2.5	0.0	0.0
Exchange rate vis-à-vis the EUR (annual average)	1.95583	1.95583	1.95583	1.95583	1.95583
World excluding EU, GDP growth, %	5.0	4.1	3.9	4.2	4.5
EU GDP growth, %	2.8	0.8	0.3	1.4	1.8
Growth of relevant foreign markets, %	8.7	5.2	2.8	4.6	5.5
World import volumes, excluding EU, %	7.8	6.0	3.1	4.7	4.7
Oil prices (Brent, USD/barrel)	71.1	108.0	98.0	91.0	93.8

⁴⁶ Positive numbers denote appreciation, negative numbers – depreciation.

APPENDIX 2: DIRECT BUDGETARY IMPACT OF MAIN STRUCTURAL REFORMS

Main structural reform measures	Category affected	2007		2008		2009	
		mln. EUR	% of GDP	mln. EUR	% of GDP	mln. EUR	% of GDP
1. Urgent and further strengthening of the administrative capacity, in particular, in the key areas of government functions, including regulatory authorities, and the judiciary system.	Total expenditures	1.0	0.00	3.1	0.01	1.5	0.00
2. Measures to contain the current account deficit and the high inflation rates.	Total expenditures	6.2	0.02	11.6	0.03	7.2	0.02
3. Increasing the quality of labour supply and employment by improving the efficiency and effectiveness of active labour market policies and further reform the education system to raise skills to better match labour market needs and reduce early school leaving.	Total expenditures	216.1	0.75	43.5	0.13	320.0	0.85
4. Elaborating an integrated public sector policy for R&D and innovations aimed at reforming the public R&D system, shifting from publicly financed R&D (based on an overall R&D intensity target as percent of GDP for 2010) towards more competitive funding focused on key priorities.	Total expenditures	15.0	0.05	127.8	0.38	113.7	0.30
5. Completing the lifelong learning strategy and increasing participation in it.	Total expenditures	96.2	0.33	-5.2	-0.02	-88.6	-0.24
Total direct impact on the budgetary balance		334.4	1.16	180.9	0.53	353.9	0.94