R E P U B L I C O F B U L G A R I A
C O U N C I L O F M I N I S T E R S

True Copy

D E C I S I O N No. 558
of 29 July 2010

ON APPROVAL OF THE KEY ASSUMPTIONS AND THE BUDGET FORECAST FOR THE 2011-2013 PERIOD, ADOPTION OF THE EXPENDITURE CEILINGS DISAGGREGATED BY FIRST-LEVEL SPENDING UNITS, EXCLUDING MUNICIPALITIES, FOR THE 2011-2013 PERIOD, AND ON APPROVAL OF AN UPDATE OF THE GOVERNMENT DEBT MANAGEMENT STRATEGY

In pursuance of Article 14 (2) and (3) of the State Budget Structure Act and Article 16 (2) of the Government Debt Act

T H E C O U N C I L O F M I N I S T E R S
D E C I D E D:

1. The Council of Ministers approves the Key Assumptions under the Budget Forecast for the 2011-2013 period and for the preparation of the draft budgets of the first-level spending units for 2011 according to Annex 1 hereto.

2. The Council of Ministers approves the Budget Forecast for the 2011-2013 Period according to Annex 2 hereto.

3. The Council of Ministers adopts the expenditure ceilings disaggregated by first-level spending units for the 2011-2013 period of the state bodies, the ministries, the central-government departments, the Bulgarian National Audit Office, the Financial Supervision Commission, the National Social Security Institute, the National Health Insurance Fund, the Factory and Office Workers' Guaranteed Claims Fund and the Teachers Pension Fund according to Annex 3 hereto.

4. The Council of Ministers adopts the expenditure ceilings for the off-budget funds and accounts for the 2011-2013 period according to Annex 4 hereto.

5. The Council of Ministers adopts of the draft of the subsidies/transfers for the Bulgarian National Television, the Bulgarian National Radio, the Bulgarian Academy of Sciences, the state higher schools and the state higher military schools for the 2011-2013 period according to Annex 5 hereto.

6. The Council of Ministers adopts the draft of the amounts of the budget relationships between the central-government budget and the municipal budgets for the 2011-2013 period according to Annex 6 hereto.

7. The Council of Ministers approves an Update of the Government Debt Management Strategy according to Annex 7 hereto.

PRIME MINISTER: /signed/ Boyko Borissov

SECRETARY GENERAL OF
THE COUNCIL OF MINISTERS: /signed/ Rossen Zhelyazkov

Annex 1
to Item 1

Key Assumptions under the Budget Forecast and the expenditure ceilings disaggregated by first-level spending units excluding municipalities, for the 2011-2013 period and under the 2011 State Budget of the Republic of Bulgaria Bill

No.	KEY ASSUMPTIONS FOR THE 2001-2013 PERIOD	Unit	2011	2012	2013
	A	B	1	2	3
1.	Rate of value added tax	%	20	20	20
2.	Standard rate of corporation tax	%	10	10	10
3.	Rate of income tax on natural persons	%	10; 5	10; 5	10; 5
4.	Rate of tax on dividends, liquidation surplus shares and income accruing to resident and non resident legal persons	%			
	of which:				
4.1.	Rate of tax on dividends and liquidation surplus shares of resident legal persons which are not merchants	%	5	5	5
4.2.	Rate of tax on dividend and liquidation surplus shares of public-financed enterprises	%	5	5	5
4.3.	Rate of tax on dividends and liquidation surplus shares of non-resident legal persobs	%	5	5	5
4.4.	Rate of tax on income accruing to non-resident legal persons	%	10; 5	10; 5	10; 5
5.	Excise duties				
	of which:				
5.1.	Excise duty on unleaded petrol	BGN/1,000	710	710	710
5.2.	Excise duty on gas oil	BGN/1,000	615	630	645
5.3.	Excise duty on kerosene	BGN/1,000	615	630	645
5.4.	Excise duty on coke and coal	BGN/gigajoule	0,60	0,60	0,60
5.5.	Excise duty on electricity	BGN/MWh	2,00	2,00	2,00
5.6.	Excise duty on cigarettes: - specific duty per 1,000 items	BGN/1,000 itmes	BGN 101 + 23% of selling price	BGN 101 + 23% of selling price	BGN 101 + 23% of selling price
5.7.	Excise duty on spirit drinks (ethyl alcohol)	BGN/1,000 l	1100	1100	1100
5.8.	Excise duty on ethyl alcohol (rakiya)	BGN/1,000 l	550	550	550
5.9.	Excise duty on intermediate products	BGN/1,000 l	90	90	90
5.10.	Excise duty on beer	BGN/1,000 l per degree Plato	1,5	1,5	1,5
5.11.	Excise duty on natural gas used as motor fuel	BGN/gigajoule	0,0	1,7	3,4
5.12.	Excise duty on natural gas used as heating fuel	BGN/gigajoule	0,0	0,0	0,3
6.	Insurance premium tax	%	2	2	2
7.	Incomes policy in public-financed sector	-	Keeping the nominal amount of the wage bill reached in 2010	In accordance with the pay reform in the public-financed sector, within the wage bill for 2010	In accordance with the pay reform in the public-financed sector
8.	Amount of the minimum monthly wage	BGN	240	240	240
9.	Rate of public social insurance contributions	%	21,2	21,2	21,2
	of which:	%			
9.1.	to the Pensions Fund	%	16	16	16
9.2.	to the General Sickness and Maternity Fund	%	3,5	3,5	3,5

No.	KEY ASSUMPTIONS FOR THE 2001-2013 PERIOD	Unit	2011	2012	2013
	A	B	1	2	3
9.3.	to the Employment Injury and Occupational Disease Fund	%	0,7	0,7	0,7
9.4.	to the Unemployment Fund	%	1	1	1
10.	Rate of health insurance contributions	%	8	8	8
11.	Rate of supplementary compulsory retirement insurance contributions	%	5	5	5
12.	Rate of contribution to the Teachers Pension Fund	%	4,3	4,3	4,3
13.	Rate of contributions to the occupational pension funds	%	12% for persons working under Work Category I conditions; 7% for persons working under Work Category II conditions	12% for persons working under Work Category I conditions; 7% for persons working under Category II conditions	12% for persons working under Work Category I conditions; 7% for persons working under Category II conditions
14.	Rate of health insurance contribution of persons under 18 and past that age if full-time pupils until completion of secondary education	%	4% of the minimum contributory income for self-insured persons	4% of the minimum contributory income for self-insured persons	4% of the minimum contributiory cinome for self-insured persons
15.	Rate of contribution to the Factory and Office Workers' Guaranteed Claims Func	%	0,1	0,1	0,1
16.	Amount of the monthly guaranteed minimum income	BGN	65	65	65
17.	Maximum monthly amount of the contributory income during the calendar yeai	BGN	2000	2000	2000
18.	Minimum monthly amount of the contributory income during the calendar year for self-insured persons	BGN	420	420	420
19.	Distribution of social insurance contributions between contributors and insured				
	of which:				
19.1.	Distribution of contributions to social insurance funds between contributors and insured (except Pensions Fund)	ratio	60:40	60:40	60:40
19.2.	Distribution of the contribution to the Pensions Fund between contributors and insured	ratio	Distribution of contribution to Pensions Fund among employee, employer and State in a ratio of 7.1:8.9:12.	Distribution of contribution to Pensions Fund among employee, employer and State in a ratio of 7.1:8.9:12.	Distribution of contribution to Pensions Fund among employee, employer and State in a ratio of 7.1:8.9:12.
19.3.	Distribution of the health insurance contribution between contributors and insured	ratio	60:40	60:40	60:40
20.	Amount of the transfer to the Pensions Fund as a percentage of the sum total of the contributory incomes of all insured persons for the calendar yeai	%	12	12	12
21.	Minimum amount of the monthly contributory-income and retirement-age pension	BGN	136,08	136,08	136,08
22.	Amount of the monthly social old-age pension	BGN	100,86	100,86	100,86
23.	Maximum monthly amount of the single or multiple pensions received	BGN	700	700	700
24.	Pension policy		Keeping the nominal amount of the resources for pensions reached in 2010	Keeping the nominal amount of the resources for pensions reached in the preceding year	According to the pension adjustment mechanism
25.	Amount of the monthly cash benefit for child care	BGN	240	240	240
26.	Amount of the monthly allowances for child care until the child's first birthday	BGN	90% of contributory income	90% of contributory income	90% of contributory income
27.	Amount of the average monthly income under Article 4 of the Family Allownaces for	BGN	350	350	350
28.	Amount of the lump-sum pregnancy allowance	BGN	150	150	150
29.	Amount of the lump-sum child-birth allowance				
	of which:				
29.1.	- for a first child	BGN	250	250	250
29.2.	- for a second child	BGN	600	600	600
29.3.	- for a third and each additional child	BGN	250 each	250 each	250 each

No.	KEY ASSUMPTIONS FOR THE 2001-2013 PERIOD	Unit	2011	2012	2013
	A	B	1	2	3
30.	Amount of the supplementary lum-sum allowance for a child with a certified extent of permanent disability of more tha 50% until the child's second birthday	BGN	100	100	100
31.	Amount of the monthly child-care allowance until completion of secondary education but not later than the child's 20th birthday	BGN	35	35	35
32.	Amount of the lump-sum child-care allowance for up to 1-year-old twins	BGN	BGN 1 200 per child	BGN 1 200 per child	BGN 1 200 per child
33.	Amount of the lump-sum child-care allowance for an up to 1-year-old child of a full-time student mother	BGN	2880	2880	2880
34.	Minimum monthly amount of the unemployment benefit	BGN	144	144	144
35.	Maximum monthly amount of the unemployment benefit	BGN	1,2	1200	1200
36.	Level of the balance under the consolidated fiscal programme	% of GDP	-2,5	-1,5	-1,0

BUDGET FORECAST
FOR THE 2011-2013 PERIOD

Table of Contents

I. FOREWORD

The Budget Forecast for the 2011-2013 Period presents the key assumptions about tax and social insurance policy, incomes policy, public expenditures, as well as the fiscal objective regarding the budget balance for the next three-year period. Consideration is given to the macroeconomic and fiscal challenges facing the economy and the ongoing reforms, an expression of the measures taken by the Government to cushion and gradually recover from the adverse effects of the international financial and economic crisis.

The Forecast covers the effects of the key assumptions for the development of a three-year budget forecast and expenditure ceilings allocated to first-level spending units (FLSU), excluding municipalities, for the 2011-2013 period. In this way, several steps under the Council of Ministers Decision on the 2011 budget procedure are merged, with the adoption of these decisions being brought forward. This, in turn, will allow spending units to concentrate their efforts on prioritising their goals, policies and programmes in the medium term and for 2011, as well as an earlier consideration of the 2011 State Budget Bill and its accompanying documents by the Council of Ministers and its submission to the National Assembly.

The assumptions about the level of the key fiscal parameters in the next three-year period, contained in the Forecast, are also the result of a dialogue in which the Government has been engaged so far on the priority policies, programmes and measures in the public and real sectors and reckon with the availability of financing for them, combined with an optimisation of the structure of the state administration and improvement of the effectiveness of expenditures.

The budget forecast for the 2011-2013 period takes into account the intervening changes in the 2010 budget, introduced by the Act to Amend and Supplement the 2010 State Budget of the Republic of Bulgaria Act. This sequence ensures the required certainty in the management and allocation of public resources, as well as high degree of predictability for economic agents and the international financial institutions in respect of the Government's goals and priorities, as well as its assessment of the development of the economy in the medium term.

II. ECONOMIC PROSPECTS AND MACROECONOMIC STABILITY

1. Review and tendencies in the development of the global economy

The global financial and economic crisis continues to have a negative impact on the international economy. After declines registered in the first half of 2009, the global economy showed a positive growth in the second half of 2009 and in early 2010. The return to growth was facilitated by monetary and fiscal policy measures, a restored confidence of consumers and business, as well as a longer inventory cycle. World trade started to stabilize after the first quarter of 2009 and, according to the latest figures, grew 25% year on year for the first quarter of 2010.

Economic activity picked up both in the manufacturing and in the services sectors. The growth of production is supported by a substantial increase of new orders. Labour market indicators show first signs of stabilising of overall employment. The recovery of economic activity is more tangible in developing and emerging markets and slower in the developed economies.

The sizable fiscal and monetary stimuli and the inventory cycle in the US contributed to a rebound of the economy in the second half of 2009. According to the latest assessments of the US Bureau of Economic Analysis, real GDP grew by 5.6% in the fourth quarter of 2009 and by 3.2% in the first quarter of 2010.

Last year the European economy declined by 4.2%, even though the contraction decelerated appreciably in the second half of the year, reaching 1.9% for the fourth quarter. In the first quarter of 2010, the economy of the European Union (EU) grew by 0.6% year on year and by 0.2% from the preceding quarter. In the first quarter of 2010, the GDP of the Eurozone showed a growth for the first time since the end of 2008: 0.8%, year on year.

Production also contracted in most EU Member States outside the Eurozone, but the pace of this contraction slowed down in the second half of 2009. The decline was due mainly by a slump of domestic demand and more restrictive conditions for financing. Besides this, the loss of consumer confidence and, in some cases, the negative consequences of falling asset prices, resulted in a substantial contraction of domestic demand in most countries.

2. Review of the development of the national economy

The global economic crisis impacted Bulgaria's economy throughout 2009. GDP for the year was valued at BGN 66,300 million, and the decline in real terms was 5%, largely due to investments. At the same time, a sizable contraction of exports resulted in an improvement of the foreign trade balance. The economy continued to develop negatively during the current year, with GDP dropping 3.6% for the first quarter of 2010. That was due primarily to a persistent shrinkage of demand.

In 2009, the share of gross fixed capital formation dived to 24.8% of GDP, after reaching a level of 33.4% in 2008. In the first quarter of 2010 investments continued to decline, albeit at a slower place. As to final consumption expenditures, they dropped by 10.5% in the last quarter of 2009, mainly due to collective consumption. Collective expenditure increased in early 2010, but domestic consumption nevertheless continues to decline because of households' spending restraints. The export of goods and services fell by 17.4% in the first quarter of 2009, after which the pace of decline started to slow down and the fourth quarter showed a growth which went through into the first quarter of 2010 (5.9%). In 2009, exports were contracting faster, which led to an improvement of foreign trade.

In 2009, industry showed the highest decline in real terms (8.1%). It was soonest hit by the global economic crisis. The beginning of 2010 witnessed a recovery of industry. The contraction in that sector decelerated to -0.9%. At the same time, the negative trend in the development of services continues (-1.2% for the first quarter). Growth in the services sector started to decline with a certain lag, with the impact of the global crisis making itself felt on the second after the second quarter of 2009, the slump reaching 5.1% for the third quarter. The behaviour of this contraction strongly depends on the behaviour of households' final consumption. The agriculture sector registered a decline of 11.3% for the fourth quarter of 2009 and -1.3% for the first quarter of 2010.

Inflation

The behaviour of inflation in 2009 was largely influenced by a weak domestic and external demand and a slump in the prices of foods and energy goods on international markets. Measured by the Harmonised Index of Consumer Prices (HICP), inflation reached 1.6% at the end of the year, and its average annual level was 2.5%.

The prices of food products and energy goods clearly tended downward and were among the essential factors decelerating the growth of inflation. The prices of non-energy industrial goods also slowed down appreciably to 0.8% due to a dramatic contraction of non-food consumption by households. The slackened economic activity in turn led to a decrease in employment and a slower rise of nominal wages, which contributed to a lowering of inflation not only for products of the manufacturing industry but in the services sector as well. Year-on-year inflation for this component thus reached 3.4% at the end of 2009, down from 11.4% for the same period of 2008.

The higher rates of excise duty on tobacco products contributed materially to inflation, pushing their prices up 24% and adding 0.7 percentage points to overall inflation.

Back in the last quarter of 2009, the Harmonised Index of Consumer Prices started to climb, year on year, under the influence of the rising international prices of energy products. By June 2010, the annual inflation rate accelerated to 2.5%, mainly due to an appreciation of energy goods and tobacco products (with a contribution of 0.9 and 1.4 percentage points, respectively). On the other hand, the contracted domestic demand keeps pressing down the inflation rate for services and non-foods. Food prices, too, continue to fall, year on year, reaching -2.9% by June, and their behaviour remains largely influences by international prices.

Monetary sector

The currency board arrangement remained stable in 2009 and in the past months of 2010. The country's forex reserves were growing during most of 2009, and at the end of the year amounted to the equivalent of BGN 25,300 million. At the end of the year, their year-on-year growth reached 1.6%, after negative growth in the March-November period. The forex reserves ensured a high cover of the monetary base and the money supply, these ratios being 195.2% and 52.9%, respectively, at the end of December. The availability of sufficient forex reserves to cover the import of goods and services, as well as the short-term external debt, is essential for the stability of the currency board arrangement. Throughout 2009, the reserves covered more than five months of annualized import, compared to a recommended minimum of three months. At the end of December, this indicator grew to 8%, and the credit goes largely to the dramatic contraction of import. The cover of the country's short-term external debt at the end of 2009 was at a level of 100.2%.

During the first half of 2010, foreign exchange reserves decreased, and at the end of June they amounted to the equivalent of BGN 23,800 million. Despite the downward trend since the beginning of the year, forex reserves increased by 2.2% from the like month of the previous year. By the end of May, the reserves covered 196.6% of the monetary base and 48.9% of the money supply. At the same time, they ensured 7.7 months of annualized import by that time and covered 105% of the short-term external debt.

Bulgarian banks continue to maintain good indicators of capital adequacy and liquidity. The overall capital adequacy ratio has been increasing steadily, from 13.3% at the end of 2007 to 14.9% at the end of 2008 and 17.7% for the first half of 2009.

Balance of payments

Last year the global economic crisis led to adjustments in Bulgaria's balance of payments and the current account deficit dropped to 9.4% of the country's GDP. In 2009 both import and export contracted, with the decline of import being far steeper than of export, both in relative and in absolute terms. The volume of Bulgarian export started to shrink in the last quarter of 2008, when the economic crisis depressed the demand of the country's principal trading partners. The decline bottomed at -39.4% in April 2009, after which the contractions diminished. Bulgarian export has been growing, year on year, since November 2009. Export has been favourably impacted by a recovery of world market demand and a rise of international prices of raw and prime materials in recent months.

As a result of the slack domestic consumption and investment, import has been declining over the last 16 months, bottoming in June 2009, after which the trend reversed, reaching 11%, year on year, in February. In March, however, the direction of change shifted yet again, and the value of goods imported into the country edged 0.9% up to EUR 1,400 million, which may be an indication of a gradual recovery of domestic demand. For the first quarter, import contracted by 5%, year on year. Most of the credit for the decrease of the decline of import goes to the increase of the import of ores and crude oil, as well as of spare parts and equipment and some types of investment goods.

The balance on services has been improving, year on year, since the beginning of 2009, with the exception of August, when fewer foreign tourists visited Bulgaria.

After a decline in the number of foreign tourists was reported for all months of 2009, the number of foreigners who visited Bulgaria in January-April 2010 increased, year on year. As a result of the removal of visa restrictions at the end of 2009, the tourist inflow from Serbia and Macedonia has grown substantially in recent months. The number of Russian and British tourists has risen, too, offsetting the fewer visits by Germans.

Last year the balance on income was in a EUR 1,577.9 million deficit, up 8.5% from the previous year. Payments on foreign direct investments declined by 13.4% from 2008. At the same time, net current transfers amounted to EUR 931.4 million, up 12%. This growth was largely due to amounts coming from European Union funds.

The financial account in 2009 amounted to EUR 2,171.2 million and thus covered 68% of the deficit. The foreign direct investment inflow reached EUR 3,200 million by December, which was half of the level in 2008. Investment activity slackened in all sectors, with the nominal decline being most significant in financial intermediation, real estate and trade. The economic and financial crisis is the principal factor which heightens investment risk and makes foreign investors exercise caution. In January-May 2010, the balance on the financial account was in a nearly EUR 1,000 million deficit, mainly due to the lower foreign direct investments in Bulgaria (EUR 253 million in May, compared to EUR 1,211 million in the same month of 2009). The decrease in non-residents' deposits and in the loans extended by non-residents to residents had an appreciable adverse impact as well.

Labour market and incomes

As a result of the lower economic activity, the reduced income from sales and the limited opportunities for financing of business, in 2009 employers started a process of optimizing and cutting labour costs. This was implemented by redistribution of working time, redundancy of employees and restraining wage growth. Until the middle of the year, employers tried to retain labour and postpone the dismissal of factory and office workers, but the possibilities for this were gradually exhausted and the rate of employment reduction accelerated while unemployment grew rapidly. The annual rate of reduction in the number of employed was 0.8% in the first quarter but reached 5.7% in the last quarter of 2009. The unemployment rate rose to 7.9% for the last quarter, and the average annual rate stood at 7.6%. The employment rate of the population aged 15-64 lost 1.4 percentage points from 2008 and reached 62.6%.

The negative trends on the labour market persisted in the first quarter of 2010. Layoffs accelerated in January-March as a result of an ongoing slump of economic activity and the processes of enterprise restructuring and staff optimization that had started in the previous year. The number of employed dropped by 251,500 or 7.7% compared to the first quarter of 2009. Just as last year, jobs were lost fastest in the industry sector, by an average of 12% for the manufacturing industry, regardless of the recovery of the growth of income from sales in most economic activities there, as well as in construction, where the decline of employment reached 22% in the first quarter, year on year. Affected by the contraction of domestic demand, most branches in the services sector also shed employment.

The jobless total grew fastest for the last year (by 118,800 or 53.5%) and reached 341,000 in the first quarter of 2010, with the unemployment rate standing at 10.2%.

Since March, the level of registered unemployment has been declining month on month thanks to the activation of seasonal activities in tourism, agriculture etc., as well as the subsidized employment programmes. At the end of June, the unemployment rate stood at 9.0%, approximately 2 percentage points up year on year.

The contraction of demand for labour had a restraining effect on personal incomes. In 2009 the average wage in the Bulgarian economy increased by a nominal 8.5% from 2008, which was a substantial slow-down compared to previous years. A process of constraining the growth of income became evident as early as at the beginning of 2009, both in the private sector (7.4%) and in the public sector (9.3%) of the economy, including the public-financed sector (8.4%). The dynamics of this indicator was conditioned by the fact that since the middle of the year income from work have remained at a relatively steady level in a large part of economic activities, and in the last months of 2009 and in early 2010 some of these activities (part of the manufacturing industry and construction) even decreased wages, month on month. In the first quarter of 2010, the average wage for the economy in general increased by 9.9% in nominal terms from the comparable period of 2009, rising by 6.1% and 11.5%, respectively, in the public and private sector of the economy.

The processes of cost optimization, including labour costs, which entrepreneurs started at the beginning of 2009 as a result of the depressed production in the Bulgarian economy, had a favourable impact on the dynamics of labour productivity. In the first quarter of 2010 labour productivity grew 6.7% from the like period of 2009, with all economic sectors with the exception of transport showing year-on-year growth in real terms.

The recovery of labour productivity in the Bulgarian economy and the constrained growth of income had a favourable impact on the dynamics of employers' labour costs per unit of output. In 2009, this indicator decelerated to 3.8%, compared to 4.2% for 2008, and it the first quarter of 2010 it dropped by 0.6% from the respective period of 2009.

3. Tendencies in the development of the national economy and macroeconomic forecast for the 2010-2013 period

According to the present forecast, the EU economy is expected to continue its recovery, after showing a real terms growth of 0.6% in the first quarter of 2010. The growth will reach 0.7% for the full year and is expected to accelerate to 2.4% in 2013. For the same period, the global economy is expected to grow by 3.1% in 2010 and by 5% in 2013.

Key macroeconomic indicators

Indicator	Unit	2008	2009	2010	2011	2012	2013
GDP (nominal)	BGN mln	66,728.1	66,256.3	69,183.7	73,181.0	78,716.1	84,354.0
GDP (real growth)	%	6.0%	-5.0%	0.5%	3.6%	4.7%	4.9%
Harmonised inflation							
end of year	%	7.2%	1.6%	4.1%	3.4%	2.9%	2.7%
period average	%	11.9%	2.5%	2.8%	3.6%	3.5%	2.7%
Exchange rate	BGN/USD						

- end of year		1.41	1.36	1.59	1.58	1.58	1.58
- average annual		1.33	1.40	1.53	1.58	1.58	1.58

Economic growth

A weak economic growth of 0.5% is expected in 2010. The external sector will be the motor force of economic activity. The positive development of the Bulgarian economy is contingent on a heightened demand by the country's trading partners abroad. Bulgaria's export grew moderately in real terms during the first quarter of 2010, and this tendency is expected to persist. The increase of the volume of export will be 5.9% for the full year 2010, and it will reach 6.2% in 2011. A positive growth of domestic demand is expected in 2011.

As a result of the higher unemployment, households cut their spending further in late 2009 and early 2010. Thus, household consumption is expected to fall by 3.1% in real terms for the full 2010. The volume of household consumption will partly recover in 2011, when a growth of 2.3% is expected.

Investments, too, will continue to decline in 2010, albeit at a slower pace (-3.2%) than the abrupt adjustment in 2009. In 2011 investment activity is expected to invigorate and, accordingly, gross fixed capital formation will grow by 5% in real terms. The GDP share of investments is expected to stabilize at some 24.5% in the 2010-2013 period.

The contraction of domestic demand predetermines an ongoing decline of imports in 2010. Acceleration in exports will work in the opposite direction, increasing demand for raw and prime materials needed for export-oriented product lines. Thus, the real drop of imports will be limited to 1.1% in 2010, and the recovery of domestic demand will result in a 3.7% growth of import in 2011.

Inflation

In 2010 inflation processes will almost entirely be dictated by the rise of the international prices of raw materials and energy goods. The prices of goods traded on international markets are expected to rebound after a steep fall in 2009. The weakness that the euro will most probably show against the US dollar in 2010 will make domestic prices even more dependent on international prices.

Producer prices of industrial products will continue to grow, pushed up by both international prices and domestic demand. Producer prices of products destined for export reached a 16.8% increase for May from the like month a year ago, whereas those for the domestic market rose 5.8%.

In the second half of 2010, consumer price inflation is expected to feel the secondary effects of the high prices of oil and other energy goods on non-energy goods and services. As a result of this, inflation is expected to reach 4.1% at the end of 2010, and its average annual level will be 2.8%.

International prices are expected to advance at a slow pace in the coming years. The labour market will not exert pressure for an increase of domestic prices in 2010 and 2011 because of the relatively low growth of wages, which are likely to change in line with the improvement of labour productivity.

Balance of payments

Items (EUR mln)	2008	2009	2010	2011	2012	2013
Current and capital account	-7,921.6	-2,719.2	-403.1	82.1	518.4	874.1
(% of GDP)	*-23.2%*	*-8.0%*	*-1.1%*	*0.2%*	*1.3%*	*2.0%*
Current account	-8,199.0	-3,196.2	-1,132.5	-824.2	-594.6	-166.5
(% of GDP)	*-24.0%*	*-9.4%*	*-3.2%*	*-2.2%*	*-1.5%*	*-0.4%*
Financial and capital account	11,672.8	2,648.2	1,219.8	1,827.0	2,643.6	1,679.2
of which:						
Foreign direct investments	6,696.5	3,212.5	2,600.0	2,626.0	2,678.5	2,732.1
Overall balance	**674.2**	**-649.8**	**87.3**	**1,002.8**	**2,049.0**	**1,512.7**

The imbalance in the country's external positions will continue to be redressed, too. The improvement of the balance on goods and the balance on services will reduce the current account deficit to -3.2% of GDP in 2010 and -2.2% in 2011. The increased savings in the country make it possible to repay external liabilities built up in previous years and thus reduce the country's large private debt.

A moderate economic growth of 3.6 to 4.9% is projected in the medium term. The new growth structure will persist, with GDP growth benefiting from the external sector and domestic demand making a relatively smaller positive contribution. The share of investments will remain unchanged at some 25% until 2013, and private consumption will be growing at a slightly slower pace than the growth of GDP.

The current account balance will continue to improve. It is expected to reach -1.5% of GDP in 2012 and -0.4% in 2013. During the same period, the FDI inflow in Bulgaria is expected to remain largely unchanged from its level in 2010.

Labour market and incomes

A gradual slow-down of the loss of employment is expected until the end of the year. The reduction of unemployment in recent months has been attributable to seasonal factors, which will fade and more jobs will be shed. The average annual unemployment rate is expected to approximate 9%. The economic growth and economic reactivation, expected in 2011, will be accompanied by a negligible rise in the number of employed, some 0.5% from 2010, whereas the unemployment rate is expected to drop to an average annual 8.8%. In the 2012-2013 period the recovery of the positive dynamics of the labour market is expected to continue, with a further increase of employment and decrease of unemployment.

In 2010 the growth of income from work for the Bulgarian economy in general will again lag behind the previous year, considering the expected slackened demand for labour. In the public sector, income from work will not change from its level in 2009, in line with the overall economic development and reckoning with the country's fiscal position. The nominal growth rate of income from work will start to accelerate, year on year, in line with the overall economic dynamics.

4. Fiscal risks

The international economy has started to recover from the financial and economic crisis. This process and its duration, however, are still uncertain and continue to pose a risk to the Bulgarian economy and, hence, to public finances. On the other hand, the medium-term macroeconomic forecast is rather conservative and, therefore, the principal risks to implementation of the budget in the medium term are associated with:

- shifting the structure of economic growth towards a larger contribution of net import and lower tax compliance;
- population ageing, exerting pressure on the pension system.

The deficit under the consolidated fiscal programme (CFP) amounts to an estimated 1.9% of GDP for January-April 2010. The poor implementation resulted from lower tax revenues, combined with growing expenditures as a result of redemption of outstanding obligations. This has accordingly necessitated the adjustment of the budget plans for the year in terms of allowing for a budget deficit.

In previous years domestic demand was the principal motor force of growth, which was favourable for the budget, creating a high tax base. Conversely, an export-generated economic growth would create conditions for a lower growth of tax revenues compared to the GDP growth because export is exempt from tax. On the whole, the risks to implementation of the revenue side of the budget in the medium term exist despite the conservative planning. In addition, other risks may emerge in connection with the expenditure side of the budget, considering the pressure that the economic slump and the weak recovery will exert on spending on social allowances and unemployment benefits.

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

III. IMPLEMENTATION OF THE CONSOLIDATED FISCAL PROGRAMME BY MAY 2010

Review of the fiscal position by May 2010

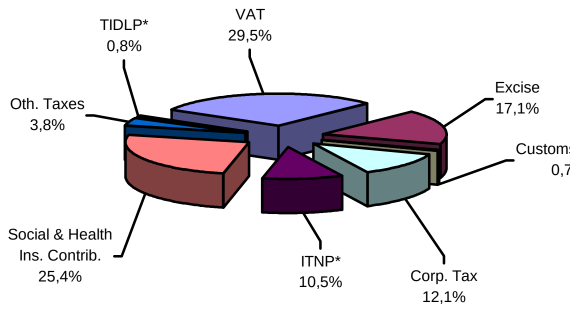
Implementation of revenues

Reports on the implementation of revenues by May show a delay from the targets, especially in the part of tax receipts. Imports persistently tended down in the first months of 2010, while exports sent positive signals and grew in recent months. The lower import, as well as the lower prices of some raw and prime materials for the manufacturing industry resulted in a decline of revenues from VAT on imports. On the other hand, the growth of exports to a larger effective refund of VAT input tax, which also contributes to the lower VAT revenues. The contraction of imports affects revenues from excise duty as well.

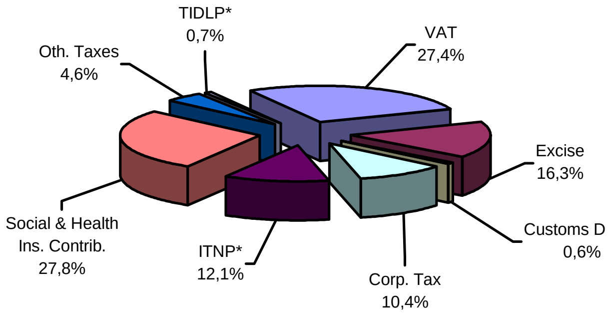
A comparison with the data for January-May 2009 reveals a clear one-time base effect. In January 2009, revenues from VAT on intra-Community acquisitions (ICA) were considerably larger than the weighted average revenues for the rest of 2009. This was due to the one-time receipt of revenues in January 2009 from VAT related to the enormous public spending at the end of 2008. The expenditures for December 2008 at consolidated level doubled the weighted average expenditures for the preceding months of 2008, and this explains the larger amount of VAT payable on ICA declared in January 2009. These revenues, however, had a one-time effect for the year and no such effect occurred in 2010. A comparison of the total amount of revenues for January-May 2010 and 2009 should also take into account the advance payments from the EU funds, which accrued in early 2009 and which, too, had a one-time effect.

The chart below visualizes the structure of tax revenues under the CFP for the January-May period of 2009 and 2010.

May 2009



May 2010



***TIDLP – Taxes on income from dividends and liquidation proceeds**

***ITNP – Income taxes on natural persons**

Tax receipts (incl. revenues from social insurance contributions) amounted to BGN 7,229.4 million. Direct tax revenues amounted to BGN 1,675.3 million, compared to BGN 1,987.0 million for the same period last year. In nominal terms, direct tax revenues shrank by BGN 311.7 million from the previous year, mainly as a result of a contraction of corporate profits due to the global financial and economic crisis.

Indirect tax revenues amounted to BGN 3,206.7 million, down by BGN 812.4 million, representing 79.8% of the amount reported for the same period of 2009. At 31 May 2010, VAT receipts amounted to BGN 1,983.6 million, which represents a diminution of BGN 521.2 million from the receipts at 31 May 2009. The reason was, on the one hand, the substantial revenues that accrued in January2009 as a result of the larger expenditures committed in December 2008 (including a substantial amount of public spending) and, on the other, the smaller volume of transactions inside the country and the EU Member States, which led to a 11.6% contraction of receipts from VAT on domestic transactions and ICA compared to the same period of 2009. Excise duty receipts for the period amounted to BGN 1,179.0 million. Receipts from customs duties and customs charged for January-May 2010 amounted to BGN 44.0 million.

Revenues from other taxes (including other taxes under the Corporate Income Tax Act, property taxes, and receipts from levies on sugar etc.) amounted to BGN 335.7 million.

Revenues from social insurance and health insurance contributions at 31 May 2010 amounted to BGN 2,011.7 million.

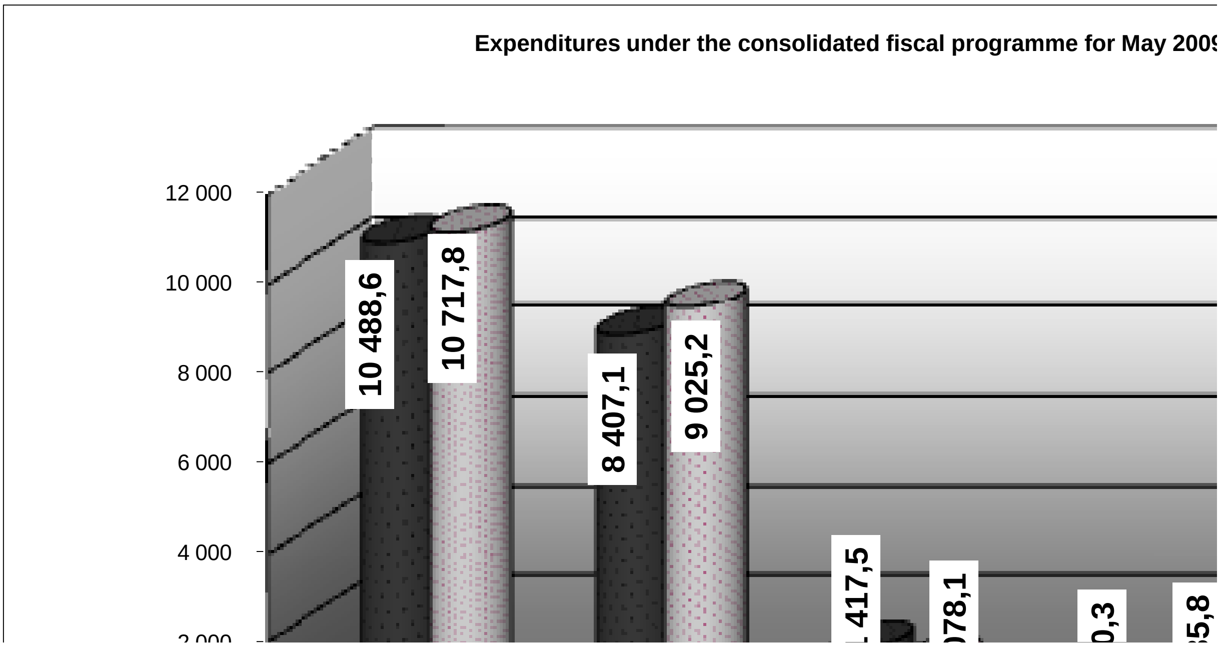
Non-tax revenues under the consolidated fiscal programme amounted to BGN 1.681.8 million. The larger part of non-tax revenues originated under the budgets of ministries and central-government departments. The implementation of non-tax revenues under the central government budget amounted to BGN 485.6 million. The high implementation for the period was due, on the one hand, to the annual contribution of the excess of income over expenditure of the BNB, amounting to BGN 354.7 million, which was credited in revenue to the executive budget in April, and, on the other, to the accrued revenue from dividend of state-owned commercial corporations, amounting to BGN 97.5 million. By the end of May, BGN 411.5 million were credited in revenue to municipal budgets.

The **grants** (mainly co-financing from the EU Structural Funds and Cohesion Fund under the budget of the National Fund and receipts from the European Agricultural Find for Rural Development under the budget of the Paying Agency with the Agriculture State Fund) received for January-May 2010 amounted to BGN 446.6 million.

Implementation of expenditures

The expenditures committed under the consolidated fiscal programme (including the contribution of the Republic of Bulgaria to the General Budget of the EU) at 31 May 2010 amounted to BGN 10,717.8 million.

Main expenditure items under the consolidated fiscal programme, May 2009 and 2010



* Incl. net state reserve gain

Expenditures under the CFP disaggregated by main constituent budgets

Executive budget

The non-interest expenditures under the executive budget (excluding transfers to other budgets), effected during the reporting period, amounted to BGN 2,763.5 million. Compared to the same period of 2009, non-interest expenditures decreased by 15.7 %, which was largely due to the lower capital expenditures (by 44.6%) and subsidy expenditures (by 34.3%). The substantial diminution of capital expenditures from the same period of 2009 (by BGN 303.2 million) was due to the faster-than-planned absorption of resources in the first months of 2009. Compared to May 2009, the expenditures on subsidies under the executive budget dropped by BGN 118.8 million because subsidies amounting to BGN 109.6 million were paid to tobacco producers in April and May 2009. The expenditures on wages, salaries, social and health insurance contributions totalled BGN 1,067.4 million. The expenditures on current maintenance amounted to BGN 766.4 million – mainly the cost of fuel, energy, hired services, current repairs, medicines, consumables, other personnel remunerations and payments etc., incurred by first-level spending units which fall within the scope of the executive budget. Social expenditures (incl. expenditures on scholarships) amounted to BGN 325.6 million and consisted mainly of expenditures under the budget of the Ministry of Labour and Social Policy for benefits under the Integration of Persons with Disabilities Act, the Family Allowances for Children Act, the Social Assistance Act etc. The expenditures on subsidies amounted to BGN 227.6 million. Capital expenditures (incl. the net state reserve gain) amounted to BGN 376.6 million.

The interest payments effected by the end of May amounted to BGN 274.9 million, of which BGN 204.2 million were paid in interest on external loans and BGN 70.7 million in interest on domestic loans. The resources allocated to cover the risk of activation of state guarantees were not used during the reporting period.

Transfers from and to other budgets under the executive budget represented net transfers provided to the amount of BGN 3,301.3 million.

Expenditures under the budgets of the social security funds

The expenditures under the budgets of the social and health insurance funds (the National Social Security Institute, the National Health Insurance Fund, the Universal Pension Fund and the Factory and Office Workers' Guaranteed Claims Fund) amounted to BGN 4,210.2 million by May 2010, including pensions, allowances and benefits under the Social Insurance Code (SIC) to the amount of BGN 3,390.0 million and health insurance payments to the amount of BGN 763.8 million.

Expenditures under the municipal budgets

The expenditures effected under the local budgets, including for the account of target transfers provided by other budgets, amounted to BGN 1,694.0 million. Current expenditures amounted to BGN 1,438.9 million, and capital expenditures to BGN 255.1 million.

At the end of May, the budget balance under the CFP was in a deficit amounting to BGN 1,360.0 million as a result of a national budget deficit amounting to BGN 1,122.6 million and an excess of EU funds revenue over expenditure amounting to BGN 237.4 million.

The fiscal reserve at exchange rates current at 31 May 2010 amounted to BGN 6,584.6 million.

IV. ASSESSMENT OF THE IMPLEMENTATION OF THE CONSOLIDATED FISCAL PROGRAMME UNTIL THE END OF 2010

According to the revised forecasts for 2010, the economy is to grow 0.5%. This economic growth, however, will mainly come from the increased contribution of net exports to GDP growth. The shift of components within the GDP structure does not allow indirect taxes, which are the backbone of tax revenues in the budget, to grow fast because export is exempt from tax. This calls for certain adjustments in planning the revenue side of the budget not only in 2010 but in the medium term as well. A careful analysis and gradual readjustment are needed for fiscal policy and budget planning to the changing economic structure so as to ensure stability of the fiscal position.

The assessments of the key parameters of revenues for 2010 in the first months of the year found a lag from the initial consolidated estimates for 2010 and necessitated an updating of the plan for the year. The lag of revenues, year on year, from the initial estimates of the 2010 State Budget of the Republic of Bulgaria Act was estimated at some 2.9-3.0% of the projected GDP. The key factors of the more pessimistic progress of revenues are related to the ongoing shifts in GDP structure due to the restructuring of the economy and its orientation to export-based growth. On the one hand, this leads to a substantial improvement of the foreign trade balance and hence of the current account balance (the current account deficit contracted to 9.4% of GDP for 2009 and is forecast to recede to some 3.2% of GDP for 2010) but, on the other hand, the base of indirect taxation and above all of taxation under the Value Added Tax Act is shrinking as well. Unlike previous years, when import accounted for some 80% of GDP, in 2009 it dropped to 57.7% of GDP. The decline of imports finds expression in a decrease of receipts from VAT on imports, and the gradual increase of exports leads to a gradual increase of the VAT input tax declared for refund by exporters. The pre-crisis robust pace of growth invariably involved a deepening of the huge foreign trade imbalance and hence substantial current account deficits (26.8% of GDP for 2007 and 24.0% of GDP for 2008). This growth model artificially expanded the base for indirect taxation. In the 2007-2008 period, indirect tax revenues were showing annually a double-digit growth, which was spurred by the growth of import and domestic consumption. The economic crisis radically changed the motor forces of the economy and it gradually reoriented itself to an export-based growth, which reduces the external imbalances.

On the expenditure side, the most serious problem is posed by the liabilities incurred and unsettled in prior years, which surfaced at the end of 2009 and in the first months of 2010, when the results of checks conducted into contracts concluded by several ministries and central-government departments started to emerge. After the completion of all checks and audits ordered, it became clear that the magnitude of the problem was alarming and required an active response so as to prevent its escalation. The insufficiently effective control and the breach of fiscal discipline, especially in the last months of the previous government's term in office, made it possible to sign contracts and annexes to them, as well as to assume commitments for expenditures for which financing was not available considering the contracted fiscal framework in 2009, when the country's economy went into recession. This led to an abrupt increase of the amounts owed by the Government accrued under the balances of spending units at 31 December 2009, submitted in March 2010 with the unaudited annual financing statements for 2009. This increase of payables and the decreased receivables translated themselves into a substantial growth of the deficit for the preceding year 2009, estimated on an accrued basis according to the methodology used by Eurostat. According to the estimates in the April deficit and debt Notification Tables, Bulgaria's deficit on an accrued basis for 2009 amounts to 3.9% of GDP, which exceeds the reference level of 3% of GDP according to Article 126 of the Treaty on the Functioning of the European Union. On the other hand, the 2010 State Budget of the Republic of Bulgaria Act was approved on a cash basis and the fiscal framework of the 2010 budget does not provide for resources for settlement of liabilities for prior years, which exerts a serious pressure on the budget position in the current year 2010.

The Act to Amend and Supplement the 2010 State Budget of the Republic of Bulgaria Act changed the fiscal framework for the year, with the non-interest expenditures and transfers/subsidies under the executive budget being limited to up to 20%, year on year. On the other hand, a reserve for additional fiscal measures was created with the structural reforms reserve, so as to cope with the serious pressure on expenditures for settlement of liabilities for prior years and other priority expenditures.

The updated framework of the Act to Amend and Supplement the 2010 State Budget of the Republic of Bulgaria Act envisages the following measures:

- there are no plans to increase the tax burden with regard to the principal taxes, which would result in further pressure on consumption and hence on the prospects for economic recovery from the crisis. This is very important for the business community, which continues to bear the enormous brunt of the crisis, and with such a measure economic recovery would further recede in time.
- the social responsibilities of the State to the most vulnerable social groups are a top priority. Even though social payments have the largest weight in the expenditures under the consolidated fiscal programme, it is not planned to constrain these payments; on the contrary, it is planned to provide additional resources to cover the likely shortage of funds for payment of social allowances in the budget. In this way, the measures to restrict expenditures will not affect the social sphere.
- the non-interest expenditures of state bodies, ministries and central-government departments for 2010 are limited by up to 20 per cent, and the expenditures and transfers/subsidies from the central-government budget for 2010 are limited. The approved restriction of non-interest expenditures is not on a *pro rata* basis with an identical percentage applicable to all spending units. A differentiated approach was taken to preparing the estimates for the proposed limitation of expenditures, taking into account the need to ensure the specific legally regulated activities and responsibilities of the particular ministries and central-government departments. The uniform spending standards for secondary education, endorsed by the 2010 State Budget of the Republic of Bulgaria Act, have been retained as well. As part of the cost cutting measures, the amount of municipalities' budget relationships with the central government budget has been reduced (with the exception of the expenditures on the functions of education, social assistance and care, defence and security and the resources approved for environmental projects) by up to 10-12 per cent annually, each municipality being again treated on a case-by-case basis and with consideration for its financing standing. The overall effect of the restriction of non-interest expenditures/subsidies under the executive budget amounts to some BGN 900 million.
- resources are provided for to cope with the pressure on expenditures from unsettled liabilities for prior years and other priority expenditures which were not envisaged in the framework for the 2010 State Budget of the Republic of Bulgaria Act. These resources are allocated separately within the reserve for pressing contingent expenditures in its part for structural reforms and additional fiscal measures. The bulk of these resources is earmarked for:

  - ***Settlement of liabilities for prior years***

    Resources are allocated for settlement of uncovered liabilities incurred in prior years (including liabilities under international contracts for procurement of armaments and material for the armed forces, provision of financing for the mechanism for settlement of payables under the executive budget through the Bulgarian Development Bank AD etc.)

The resources allocated for settlement of uncovered liabilities incurred in prior years amounts to some BGN 660 million.

- ***Financing infrastructure projects of national importance***

  BGN 180 million are allocated for financing infrastructure projects of national importance: motorways, road junctions etc.

- ***Payment of premiums to tobacco growers***

  Resources to the amount of BGN 116 million are allocated for payment of premiums to tobacco growers.

- ***Additional resources for current transfers, household benefits and allowances paid by the Ministry of Labour and Social Policy***

  An extra BGN 142 million are allocated for implementation of the measures in the social sphere, agreed with the National Council for Tripartite Cooperation.

- ***Additional subsidy for the National Railway Infrastructure Company to the amount of BGN 45 million***

  An extra BGN 45 million are allocated in subsidies for the National Railway Infrastructure Company to finance the construction, maintenance, development and operation of the railway infrastructure.

The changed fiscal framework reflects the likely deterioration of the executive budget balance, mainly due to the forecast undercollection of revenues, the net effect of the restriction of expenditures and the additional resources in the reserve for pressing contingent expenditures, as well as the forecast deterioration of the balance under the municipal budgets and the budgets of the National Health Insurance Fund and the National Fund compared to the parameters set in the estimates to the 2010 State Budget of the Republic of Bulgaria Act. The changed parameters in the estimates to the Act to Amend and Supplement the 2010 State Budget of the Republic of Bulgaria Act forecast a deficit on a cash basis under the consolidated fiscal programme amounting to 4.8% of the projected GDP.

According to the estimates of the amount of the deficit on an accrued basis, the deficit under the consolidated fiscal programme for 2010 is to improve to 3.8% of GDP during the current year. In the medium term, it will be very important to bring the deficit below the reference value of 3% of GDP as early as in 2011, as the European Commission recommends.

V. FISCAL POLICY OBJECTIVES FOR THE 2011-2013 PERIOD

In defining the parameters of the budget forecast, set out in the appendix, and in the key assumptions to the forecast, the objectives set in the first medium-term fiscal framework for the 2010-2013 period, adopted by the incumbent Government, *viz.*:

- keeping the stability of the currency board arrangement at the present fixed exchange rate of the lev against the euro;
- orienting public spending towards stimulating the factors accelerating economic growth in accordance with the renewed Lisbon Strategy;
- improving the business environment and the investment climate.

In the medium term, the Government will continue to implement a conservative and disciplined fiscal policy, at the same time providing itself with instruments for flexible and prompt reaction to internal and external risks in conditions of an economic crisis.

During the next three-year period, no substantial changes are envisaged in the tax policy as implemented. The policy in the sphere of taxation will be retained with a possibility for operation of automatic stabilisers. Regarding the incomes policy in the public-financed sector, the Government envisages a levelling of the wage bill, with payment pegged to the reform implemented. The nominal amount of the resources for pensions, reach last year, will not change, either until 2012, and the resources for 2013 are to be determined on the basis of a pension adjustment mechanism.

These decisions confirm the Government's resolve to maintain and gradually increase the levels of gross demand by ensuring the necessary predictability for economic agents, non-increase of State intervention in the economy and optimising public administration. The policy implemented is expected to result in an increase of corporate investments, an improvement of the efficiency of production, a reduction of undeclared incomes and an increase of disposable income in real terms.

Achievement of the fiscal policy objectives in the medium-term is related to replacement of the maintenance of a balanced national budget rule by maintenance of a balance under the consolidated fiscal programme which does not exceed the criterion for the amount of the deficit under the consolidated fiscal programme at up to 3% of GDP according to Article 126 of the Treaty on the Functioning of the European Union. In this connection, the medium-term fiscal objective of a balanced budget is revised to a deficit under the consolidated fiscal programme not exceeding 2.5% for 2011, 1.5% for 2012 and 1.0% for 2013, with a view to guaranteeing the operation of the automatic stabilisers in the economy and their anti-cyclical role while using all opportunities for fiscal consolidation and achieving a near-balanced position before the end of the forecast period.

The change in the national fiscal rules is undertaken in response to the economic crisis and seeks to ensure possibilities for rapid economic recovery, effective protection and support of vulnerable social groups while pursuing a policy of stringent fiscal discipline. In support of this, the principal objective of budget policy in the medium term focuses on exercise of tightened control over expenditures and the amount of the budget deficit and efforts to achieve a balanced budget in conditions of economic recovery through measures for implementation of a successful fiscal consolidation. The latter furthermore involves the implementation of successful structural reforms.

In providing financing for the budget systems, the principle observed is priority financing of the basic social responsibilities of the State and equal treatment of the individual budgets in conditions of constrained budget resources. The measures taken for successful fiscal consolidation are selected and combined in a way leading to a positive impact on growth with a gradual reduction of budget expenditures as GDP share. Nevertheless, a diminution in nominal terms of the principal categories of expenditures is not admitted for none of the three years of the period. The amount of expenditures is kept below the threshold of 40% of GDP, thus observing the rule for the amount of consolidated expenditures/public sector. The success of the reforms in the individual sectors will ensure the public sector optimisation sought by the Government, expressed in an improvement of the effectiveness and efficiency of expenditures and the related limitation to the lower levels of the range of 36-38% of GDP.

Achieving the fiscal policy objectives furthermore requires continued efforts to enhance the processes and improve the quality of public finances through real application of programmatic budgeting and introduction of a sectoral approach in public sector financing. The progress achieved in recent years is a prerequisite for improvement of the quality of particular policies and achievement of tangible results of their implementation in the medium term. Broadening the practice of using indicators to assess the effects and of systematic analyses of the costs and benefits of government programmes and policies provides a basis for making political and governance decisions, as well as a commitment to raise public awareness and increase public participation in governance.

The present budget forecast also envisages a further deepening of the fiscal decentralisation process so as to achieve a stable revenue base of revenues from own sources for the municipal budgets and better quality management of municipal public services.

VI. TAX POLICY

Tax policy is intended to cushion the negative consequences of the global crisis for the economy. The efforts are targeted at improving the business environment, stimulating investment activity, promoting employment, as well as containing the grey sector. Tax policy prioritises avoiding abrupt changes in respect of income in conditions of economic recession.

The rates of direct taxes, which are among the lowest in the EU Member States, remain unchanged. The consistent shifting of the burden to indirect taxes continues through an increase of certain rates of excise duty as from the beginning of 2011 in accordance with the arrangements for reaching the Community minimum rates.

Tax policy faces a challenge to improve the effectiveness of tax compliance through a number of measures taken on the part of the revenue administrations. They include increasing the number of on-site inspections, improving the performance of mobile units, conducting more frequent and more thoroughgoing audits, as well as introducing more rigorous accounting rules and judicial prosecution of unlawful practices inflicting losses on the Exchequer.

Corporation taxes

As a result of the deteriorated economic situation in the country, the receipts from corporation tax declined substantially in 2010 due to a lower declared taxable amount, offset and/or refund of overremitted corporation tax and a lower coefficient used to determine the monthly tax prepayments.

The forecast is based on an unchanged legislative framework affecting the amount of receipts from corporation taxes:

- Keeping the rate of corporation tax at 10%. The conservative policy regarding corporation taxes, expressed in the Government’s declared commitment to keep the EU’s lowest tax rates under the Corporate Income Tax Act, is exceedingly important for attracting foreign investments and the related modernisation of the economy, GDP growth etc.
- Keeping the rate of tax on income from dividends, shares in a liquidation surplus and income accruing to resident and non-resident legal persons at 5%.
- The GDP growth projected for 2010 and 2011 justifies the most substantial change in the statutory framework regulating the tax: an increase of the coefficient used to determine the monthly tax prepayments from 1 to 1.1 (§ 2 of the Act to Amend and Supplement the 2010 State Budget of the Republic of Bulgaria Act). The effect of this change is expected to amount to some BGN 35 million for 2010 and some BGN 70-90 million annually for the 2011-2013 period.
- Effective 1 January 2011, the rate of tax withheld at source on income from interest payments and from copyright and licence royalty payments made by resident persons in favour of associated legal persons of Member States will be reduced from 10% to 5%.

According to Council Directive 2003/49/EC, such income is exempted from taxation, but the Republic of Bulgaria has agreed on a transitional period until 31 December 2014, during which it may not apply the Directive. During that transitional period, the Republic of Bulgaria may not tax such income by more than 5% for the 2011-2013 period.

Income taxes on natural persons

The forecast of the revenues from the taxation of natural persons' income for 2011-2013 is based on keeping the 10% flat rate of tax for all taxpayers (without a tax threshold), with the exception of the income accruing from economic activity to sole traders, which attracts tax at the rate of 15%. The following has been taken into consideration in forecasting receipts from these taxes:

- the expected number of employed persons;
- the expectations that the level of wage resources reached in 2010 will not change appreciably until 2012;
- the amounts of the social insurance contributions and the ratio in which they are shared between employer and employee, set for 2010.

The amount of revenues from personal income tax includes the receipts from licence tax credited to the local budgets.

Value added tax

The forecast of revenues from VAT for the 2011-2013 period is based mostly on:

1. an analysis of the implementation of revenues so far;
2. the effective statutory framework;
3. the forecasts of the trends in the development of the global and Bulgarian economy. Account has been taken of the indicators in the forecast macroeconomic framework about GDP and its elements.

The total forecast of VAT revenues for 2011 stands at BGN 6,500 million, on a taxable amount of BGN 32,250 million and can be achieved if the VAT/consumption ratio improves by 0.2 percentage points (one of the indicators of improved compliance).

Excise duties

It is planned to increase the rates of excise duty for 2011-2013 until the Community minimum rates are reached for certain fuels:

Excisable goods:	Rate of excise duty in 2010	Rate of excise duty in 2011
1. Gas oil used as motor fuel	BGN 600/1,000 litres	BGN 615/1,000 litres
2. Kerosene used as engine fuel	BGN 600/1,000 litres	BGN 615/1,000 litres
3. Unleaded petrol	BGN 685/1,000 litres	BGN 710/1,000 litres

- gas oil: the Community minimum rate is EUR 330 per 1,000 litres (BGN 645). A commitment has been assumed to reach the Community minimum rate until 1 January 2013. The increase of the excise duty on diesel fuel will result in a positive effect for the budget estimated at some BGN 37 million;
- kerosene: the Community minimum rate is EUR 330 per 1,000 litres (BGN 645 per 1,000 litres). A commitment has been assumed to reach the Community minimum rate until 1

January 2013. The increase of the rate of excise duty on kerosene will not have an effect on the budget during the forecast period because kerosene is used for fuelling aircraft and the excise duty is refunded within the time limits provided for in the Excise Duties and Tax Warehouses Act;

- unleaded petrol: the Community minimum rate is EUR 359 per 1,000 litres (BGN 702). A commitment has been assumed to reach the Community minimum rates until 1 January 2011. The increase of the excise duty on petrol will result in a positive effect on the budget estimated at some BGN 23 million.

The rates for beer and spirit drinks will not be increased in 2011.

The calculation of the revenues from excise duties has taken into account, apart from the changes in the rates specified above, also the expected volumes of consumption of the groups of excisable goods, the behaviour of import, the effect of tightening the control and improving compliance with excise duties etc.

Customs duties

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

On the basis of the analysis made, customs duties on import of industrial and agricultural goods in the 2011-2013 period are projected to generate the following revenues:

Items *(BGN mln)*	**2011**	**2012**	**2013**
Customs duties: total	**100.0**	**85.0**	**85.0**
Customs duties on industrial goods	97.5	55.0	55.0
Customs duties on agricultural goods	40.5	30.0	30.0

Insurance premium tax

The National Assembly is expected to consider an Insurance Premium Tax Bill, drafted in connection with the implementation of Council of Ministers Decision No. 180 of 1 April 2010 Approving Measures in Support of Employment, Households, the Business and the Fiscal Position.

The proposed new tax does not change the existing arrangements for taxation of insurers' profits according to the Corporate Income Tax Act. The introduction of an insurance premium tax is not in conflict with the *acquis communautaire* in the field of general insurance, which has been fully transposed into Bulgarian legislation.

The tax rate is proposed to be 2%. It is proposed that the taxable amount be the insurance premium which has accrued to the insurance. The tax due will be payable to the Exchequer on a monthly basis. Taxable persons will submit a tax return for each quarter to the National Revenue Agency.

It is proposed that the Act should enter into force as from 1 January 2011 and apply to taxable insurance contracts concluded or renegotiated after 31 December 2010, as well as to insurance premiums received after 31 December 2010 under insurance contracts concluded prior to 1 January 2010. The expected positive effect on the budget will approximate BGN 15 million annually.

Local taxes and fees

The global economic and financial crisis impacts the collection of municipalities' revenues from own sources, with the downward trend being particularly steep in the receipts related to the real estate market and the sales of municipal property.

VII. SOCIAL INSURANCE POLICY

For the 2011-2013 period, it is planned to discontinue the reductions of social insurance contributions and to phase in their determination on the basis of the principles of social insurance and precise actuarial estimates.

There are no plans to change the rates and ratios of social insurance contributions to public social insurance, the Teachers Pension Fund, the Factory and Office Workers' Guaranteed Claims Fund, the supplementary compulsory retirement insurance contributions and the health insurance contributions until 2013. The rate of the social insurance contribution to the Pensions Fund will remain unchanged from its level for 2010: 16% for persons born before 1 January 1960, and the proportion in which the contribution is shared between employer and employee will be the same as now: 8.9% for the account of the employer and 7.1% for the account of the employee, and 11% for persons born after 31 December 1959, the proportion being 6.1% and 4.9%, respectively.

The state participation in the financing of the Pensions Fund will be retained, with the State subsidising the Fund at the rate of 12% of the contributory income for each person insured at the Fund.

There are no plans to change the 60% to 40% ratio in which employers and employees share the contributions for the rest of the social insurance risks. For the 2011-2013 the rates of these contributions are as follows:

- General Sickness and Maternity Fund: 3.5%;
- Unemployment Fund: 1.0%;
- Factory and Office Workers' Guaranteed Claims Fund: 0.1% for the account of the employer;
- Employment Injury and Occupational Disease Fund: from 0.4 to 1.1% for the account of the employer;
- Universal Pension Fund (for persons born after 31 December 1959): 5%;
- Occupational Pension Fund: 12% for the account of the employer for persons working under Work Category I conditions and 7% for the account of the employer for persons working under Work Category II conditions;
- health insurance contribution: 8%.

To enhance the social security protection of factory and office workers who have lost their jobs through their employer's bankruptcy, in 2011 the maximum monthly amount of the benefit paid by the Factory and Office Workers' Guaranteed Claims Fund is retained at BGN 1,000. It is planned to keep this amount until 2013.

Implementing the measures in support of employment, households, the business and the fiscal position, adopted by Council of Ministers Decision No. 180 of 1 April 2010, the maximum amount of the unemployment benefit at 60% of the pre-dismissal contributory income was abolished, effective 1 July 2010. It is planned to keep this mechanism in the medium term.

Effective 1 January 2011, the minimum daily amount of the unemployment benefit will be increased from BGN 6 to BGN 7.20.

The amount of the monthly child-care benefit payable until the child's second birthday will remain unchanged at BGN 240 for the entire period.

For the 2011-2013 period, the expenditures on benefits for temporary loss of working capacity are forecast on the assumption that the currently effective mechanism for payment of the benefits for temporary loss of working capacity will be retained: the social insurance contributor paying for its account 70% of the labour remuneration for the first days of the loss.

The minimum monthly amount of the contributory income for self-insured persons will remain unchanged at an average of BGN 420 for the entire period until 2013. It is planned, as from the beginning of 2011, to introduce differentiation of the minimum contributory income for self-insured persons by profession in several groups.

The maximum monthly amount of the contributory income will remain BGN 2,000 for the entire period.

Pension policy

A financial strengthening of the first pillar of the pension system and improvement of the adequacy of pensions figure among the priorities of economic and financial policy, employment policy and income policy for the 2011-2013 period.

A process of amelioration of the pension model in Bulgaria started in 2010 so as to guarantee financial stability and adequacy of pensions. As from the beginning of 2011, a number of measures will be applied for financial strengthening of the pension system – within the context of population ageing and the increase of life expectancy it is planned to introduce more stringent criteria for access to pension; restriction of early retirement, streamlining the procedure for certification for eligibility for invalidity pension etc.

The maximum monthly amount of the single or multiple pensions received simultaneously will not change from BGN 700 for the entire period.

Active labour market policy

The principal goal of the active labour market policy in the 2011-2013 period is to create opportunities for job retention, for a fast transition from unemployment and inactivity to training and employment through active measures. To integrate all labour resources into the labour market, activating the long-term unemployed and the inactive persons will remain a key priority of the labour market policy in the short term.

BGN 75 million are allocated by the state budget for active labour market policy in the coming years, which is BGN 10 million more than the resources for 2010. In 2011-2013 employment policy will be supported by the Phare Programme and under Operational Programme Human Resources Development.

Industrial relations policy

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

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

Social assistance policy

The principal goal of social assistance policy will be a better focusing of welfare allowances and increasing the effectiveness and efficiency of programmes addressed to the most vulnerable Bulgarian citizens.

Resources under social assistance policy will be spent on the provision of:

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

There are no plans to change the amount of the monthly guaranteed minimum income from the BGN 65 in 2010.

Family policy

For the 2011-2013 period, family policy will emphasise birth promotion through the creation of a favourable environment enabling Bulgarian families to have and bring up the number of children they wish. The estimates of expenditures under the Family Allowances for Children Act have been prepared on the assumption that a means text of BGN 350 per family member will continue to apply and that the monthly allowance will amount to BGN 35. The allowance for twins is BGN 52.50 per child. Parents rearing children with permanent disabilities up to the age of 18 and until completion of secondary education but not past the age of 20 are entitled to a monthly supplement amounting to 70% of the minimum monthly wage or BGN 168. Statutory revisions were introduced at the beginning of the year, according to which the monthly supplement for children with permanent disabilities will be paid according to the procedure established by the Family Allowances for Children Act. Other statutory revisions envisage the transfer of the targeted allowance for free travel by train and bus for mothers who have given birth or adopted three and more children over 1 year of age from the Regulations for Application of the Social Assistance Act to the Regulations for Application of the Family Allowances for Children Act.

The amount of the supplementary lump-sum allowance for a child with a certified extent of permanent disability of 50 and more than 50% until the child's second birthday is BGN 100. The amounts of the lump-sum child-birth allowance will remain unchanged: BGN 250 for a first child, BGN 600 for a second child, and BGN 200 for a third and each additional child. To implement the family policy in respect of children, BGN 478.9 million are allocated annually for the 2011-2013 period, which will be spent on monthly child-care allowances and lump-sum child-birth allowances, as well as on payment of:

- lump-sum child-care allowances for up to 1 year old twins, to the amount of BGN 1,200 per child;
- lump-sum child-care allowances for up to 1 year old children of student mothers, to the amount of BGN 2,880 (12 minimum monthly wages);
- monthly child-care allowances for up to 1 year old children of mothers without social insurance, to the amount of BGN 100;

- lump-sum pregnancy allowances payable to mothers without social insurance, to the amount of BGN 150;
- targeted allowances for first graders to cover part of the expenses at the start of the school year.

Integration of people with disabilities

In the sphere of integration of people with disabilities, initiatives will be implemented in the 2011-2013 period for the purpose of:

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

BGN 152.6 will be allocated annually for payment of integration supplements to people with disabilities.

Incomes policy

The Government is making an effort to apply an incomes policy reckoned with the constrained capabilities of the budget in conditions of unfavourable economic development and recession of production.

The nominal level of the wage bill reached at the end of 2009 at the various public-financed organisations and activities was retained in 2010 г. Efforts focused on achieving the planned 20% reduction of administrative costs, including the wage bill.

Over the next three years, incomes policy will target pegging the growth of incomes to an improvement of labour productivity and to the capabilities of the economy and the budget. The risk of planned budget revenues being unimplemented in crisis conditions necessitates the taking of measures to constrain the increase of certain expenditures, including the cost of wages, with a view to improving the budget balance. In 2011-2013 incomes policy in the public-financed sector will be implemented in accordance with the pay reform in the public-financed sector, and in 2011 and 2012 this policy will be implemented within the limits of the wage bill reached in 2010.

In crisis conditions, measures should be taken to optimise existing structures and the staff in them, which will release resources for raising wages. The remuneration system also needs to be reformed, so as to motivate high-quality performance and improvement of the effectiveness of the state administration.

A process of optimising the personnel of ministries and central-government departments has been underway since the beginning of September 2009, with a view to eliminating duplicating functions and activities while keeping the volume and quality of the services they provide.

A new model of pay in the public administration will be introduced as from January 2011, intended to enhance motivation and, hence, to improve the quality of public servants' performance.

Wage growth in the public sector depends on two main factors. One is the development of the private sector, in which an improvement of labour productivity is the determining factor of raising wages. The other factor, on which wage growth in the public sector depends, is the product created by employees in that sector. The public sector performs rather ineffectively and, therefore, a substantial increase of wages is unwarranted.

Productivity and wages

The dynamics of nominal and real incomes in a currency board arrangement must be bound to a matching improvement in the use of the factors of production and above all in labour productivity. The major discrepancy in per capita personal income between Bulgaria and the European countries reflects a large lag in labour productivity, in physical and human capital, and, hence, in the quality of institutions and policies.

The level of real incomes in this country is relatively low, but the easy and quick ways to increase them through the budget are short-lived and, as a rule, detrimental to financial stability. These measures would require an increase of reallocation processes, which inhibit the growth stimuli for the real economy and catalyse an expansion of the grey sector.

The problems with employees' low incomes will hardly be solved without vigorous and consistent structural reforms in the product markets and better synchronization between the labour market and the education system, as a result of which labour productivity and the competitiveness of the economy would improve, growth would be stimulated, and incomes would grow in the long term.

In the EU countries, labour productivity grows faster than wages, but in Bulgaria in recent years wage growth has outpaced the improvement of productivity and, moreover, this tendency was in evidence during the 2002-2007 period. If wages grow faster than labour productivity:

- Investment activity would contract and the competitiveness of the economy would deteriorate, which would additionally impede recovery of economic growth despite the efforts to overcome the consequences of the global financial and economic crisis;
- The country's current account deficit would increase as a result of the larger personal incomes and the faster increase of imports of consumer goods;
- Inflation would be spurred.

Minimum wage

The amount of the minimum monthly wage is planned to remain unchanged at BGN 240 for 2011-2013, in accordance with the policy pursued for containment of the growth of all expenditures, including the wage bill, in conditions of a financial and economic crisis. In the medium term, after a discussion between the Ministry of Labour and Social Policy it is possible to develop a mechanism for fixing a specific amount of the minimum wage, and until then the ratio of the minimum wage to the national average wage will be retained at the 40% level applicable in recent years.

The minimum wage is an unskilled labour remuneration, and any increase will lead to a pressure on the higher income brackets, as well as on the minimum contributory income thresholds. Besides this, the minimum wage is a threshold below which the employer may not fix remuneration for full-time work, but in case the employer is financially capable he may fix higher individual wages without restraint. Worse yet, a larger amount of the minimum wage will narrow the differentials between remuneration for the most unskilled work and for more skilled work, which will create tensions and increase the unemployment rate in case the employer is unable to ensure the differentials that currently exist.

The minimum wage does not lead to a growth of investments, labour productivity, GDP or value added. In this sense, it cannot lead to an increase of prosperity. The average wage indicates a change in incomes and prosperity, and its increase results from reforms rather than from administrative decisions.

VIII. DEBT POLICY

Maintaining domestic economic stability requires from the Government to continue to pursue prudent fiscal policy, containing and controlling the growth of expenditures with a view to the currently existing external imbalances and difficulties in the implementation of the revenue side of the budget.

The update of the Government Debt Management Strategy, annexed to this document, retains the long-term objective, with due consideration for the short-term and medium-term forecasts of the macroeconomic environment, the market situation and the risks associated with the structure and parameters of government debt.

Regarding the amount of the debt, the Government's steps will target adherence to a prudent policy of controlled increase of the debt, containment of the budget expenditures on debt service, and ensuring stable sources of budget financing and debt refinancing.

An increase of government liabilities is envisaged for the coming three-year period, accompanied by larger interest expenditures as a result of the growth of the debt related mainly to financing major infrastructure projects and ensuring the resources required for budget financing. Implementing this priority will be ensured by action in two main areas: on the one hand, strict monitoring and control over newly agreed financing and, on the other, maintenance and, as far as possible, increase of the share of fixed interest debt and the share of debt in risk-neutral currency: euro and leva.

Interest expenditures on the public debt over the next three years are expected to approximate 1% of GDP. The amount of interest payments on the government debt is expected to range from some BGN 700 million in 2011 to some BGN 900 million in 2013.

IX. MANAGEMENT OF EU FUNDS AND CONTRIBUTION TO EU GENERAL BUDGET

Pre-accession instruments

In 2011, too, the implementation of the ISPA Programme (Cohesion Fund Regulation 1164/94) remains a key priority for the country considering the publicly significant infrastructure projects in the field of transport and the environment. Bearing in mind that the period for implementation of part of the projects may be extended until the end of 2011/2012, absorption of the resources under this Programme is expected to improve. It is important to note that the projects under the Programme which will not be completed within the period for implementation should be financed by the national budget.

Structural and Cohesion Funds (SCF)

The three operational programmes (OP) with the largest budgets: Transport, Environment, and Regional Development, account for the bulk of the National Fund expenditures in the 2011-2013 period. Implementation of major projects, related to the European transport axes and corridors within the national territory, rehabilitation of the railway network and the secondary road network; water conservation and improvement of water status, and improvement of waste management and soil protection; enhancement of the quality of life and the working environment with better accessibility to basic services and creation of new opportunities for improved regional competitiveness and sustainable development, are planned to be implemented through the absorption of these resources.

The expenditures planned for the 2011-2013 period under OP Development of the Competitiveness of the Bulgarian Economy will assist activities targeting achievement of high quality of life based on sustainable socio-economic development. The expenditures planned under OP Administrative Capacity and OP Human Resources Development target strengthening the administrative capacity with a view to assisting the effective functioning of the administration, improving the quality of the services provided to individuals and companies, and human resources development for the purpose of ensuring a larger employment, incomes and social integration. Within the context of improving the absorption rate of EU resources, expenditures are also planned under Operational Programme Technical Assistance.

The expenditures under the bilateral cross-border cooperation programmes along the external border of the European Union have the smallest share for the 2011-2013 period. The role of these programmes is essential for an increasing closeness of people, communities and economies in the participating border regions.

With all programmes, the pace of absorption of funding depends on administrative capacity.

Peculiarities of revenues under Operational Programmes co-financed by the SCF

The forecast amount of revenues for the 2011-2013 period is a net of the volume of expenditures effected, verified and certified during the last quarter of the preceding year and during the first, second and third quarter of the current year, less the ineligible expenditures which will be excluded from the expenditures declared for reimbursement to the European Commission.

It is exceedingly important to note that any delay in the pace of commitment of expenditures under the programmes co-financed by resources of the European Union from the target timeframe would lead to a reduction of the amount of expenditures, which are a base for certifying to the European Commission, and this will result in decreased receipts for the Republic of Bulgaria during the relevant years.

Common Agricultural Policy and Common Fisheries Policy for the 2011-2013 period

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

EU Common Agricultural Policy

The main instruments of the Common Agricultural Policy (CAP) are direct payments and market support to farmers (1st pillar of CAP) and rural development policy (2nd pillar of CAP).

First pillar of CAP:

Through the European Agricultural Guarantee Fund, the EU provides resources for assistance to farmers under direct payment schemes and market support schemes.

Direct payment schemes: According to the Accession Treaty, direct payments in Bulgaria (in the form of single area payment) in 2011 will amount to 50% of the level of EU-15, and thereafter it will be proceeded with a 10% annual increase of direct payments until 100% of the level of EU-15 is reached in 2016.

Under the Single Area Payment Scheme (SAPS), it is planned to spend BGN 1,060.8 million in 2011, including BGN 767.4 million from the EAGF and up to BGN 293.4 million in complementary national payments, and direct payments amounting to BGN 627.8 million are expected to be reimbursed by the EU. Resources are also planned for complementary national payments under the animal schemes, to the amount of up to BGN 53 million.

The resources for market support, allocated to Bulgaria, are not expressly stated in the Treaty concerning the Accession of the Republic of Bulgaria to the European Union because they are formed on the basis of specific market measures implemented during the year.

In those sectors, market support resources are made available depending on the market situation and after a decision of the European Commission, with the required financing being provided by the national budget, after which they are supposed to be reimbursed by the EU budget.

The resources for market measures planned for 2011 amount to up to BGN 98.1 million, and the resources spent are to be reimbursed by the EU before the end of the year.

Second pillar of CAP:

The European Agricultural Fund for Rural Development finances rural development along the following axes (areas):

Axis 1: Improving the competitiveness of the agricultural and forestry sector: increasing the competitiveness of agriculture, forestry and the food processing industry;

Axis 2: Improving the environment and the countryside: protection of natural resources, conservation of biodiversity and protection of the environment of rural areas;

Axis 3: The quality of life in rural areas and diversification of the rural economy: diversification of job opportunities and improvement of the quality of life in rural areas;

Axis 4: Leader: an instrument for decentralised governance and integrated local development in rural areas.

According to Article 5 of Council Regulation (EC) No 1290/2005, the EAFRD may finance the preparatory, monitoring, administrative and technical support, evaluation, audit and inspection measures required to implement the CAP.

The national co-financing of the EAFRD resources amounts to 20%, with the exception of the Axis 2 measures, where the national co-financing amounts to 18%.

The EAFRD has made an advance payment of 7% of the resources agreed to be allocated to Bulgaria, which should be set off against the balance due in the 2011-2013 period.

This country is planning to spend BGN 579.9 million on rural development in 2011, including BGN 113 million in national co-financing.

BGN 32 million are planned in the 2011 budget of the Agriculture State Fund to finance municipalities' costs of value added tax (VAT) for projects approved for support under the Rural Development Programme for the 2007-2013 period.

Common Fisheries Policy of the European Union

According to Council Regulation (EC) No 1198/2006, the EFF has made an advance payment of 7% of the resources agreed as its financial participation, which should be set off against the balance due in the 2011-2013 period.

This country is planning to spend up to BGN 10 million on implementation of CFP, including BGN 2.5 million in national co-financing.

In addition to the resources which the Agriculture State Fund, as a paying agency, will absorb under the programmes of the EAFRD, the EAGF and the EFF, the Agriculture State Fund is planned to continue to perform its functions and provide financing in connection with the implementation of national programmes.

To this end, resources amounting to BGN 30 million are budgeted for payment of State aids in 2011.

Unchanged parameters are set to the allocation of investment credit to agricultural producers to an amount of up to BGN 80 million and temporary financial support of up to BGN 20 million.

Bulgaria's contribution to the General Budget of the European Union

The amount of the contribution of Bulgaria to the General Budget of the EU for 2011 is projected to be BGN 811.5 million. This is a forecast amount and in a way guarantees the payment of the national contribution to the EU budget. It is conventional because of: the possibility of additional needs and/or contingencies arising during the year, which must be financed by the EU budget; the periodic updated of the data about the VAT-based resource, the GNI-based resource, the correction of budgetary imbalances granted to the United Kingdom in connection with the latest available information with a view to achieving complete accuracy; considering that regardless of the projected revenue from customs duties and levies on surplus stocks of sugar, Member States pay to the EU budget the Traditional Own Resources (TOR) on the basis of actual receipts.

The contributions of Member States to the General Budget of the EU are modified during the relevant budget year (after adoption of amending budgets) depending on the Community's expenditure policy.

Item	2011	2012	2013

Total contribution - BGN mln - EUR mln	 811.5 414.9	 884.7 452.4	 957.4 489.5
GNI of Republic of Bulgaria - BGN mln - EUR mln	 70,134 35,859	 75,747 38,729	 81,535 41,689
Contribution as % of GDP	1.11%	1.12%	1.13%
Contribution as % of GNI	1.16%	1.17%	1.17%

X. CONCLUSION

In conclusion, this Budget Forecast has been developed reflecting the objectives of fiscal policy and of the main horizontal policies in the present external and internal macroeconomic environment and on the basis of the key assumptions. They respond to the challenges facing the Government in the medium term. As institutions make meaningful efforts at all levels to meet the objectives of policies, greater prosperity will be created for society.

Achieving a successful budget consolidation, supported by an improved budget management and enhanced effectiveness, should provide a basis for preservation of the currency board arrangement. The existence of a stable fiscal position guarantees the adaptability of fiscal policy, considering that fiscal policy should bear the brunt of action taken in case of demand shocks in currency board conditions.

The pace and quality of economic growth furthermore depend on the systemic structural reforms, which will lead to an improvement of labour productivity, the effectiveness and quality of institutions and markets.

APPENDIX

BUDGET FORECAST FOR THE 2011-2013 PERIOD

CONSOLIDATED FISCAL PROGRAMME	2011	2012	2013
BGN mln			
Total revenues	**25,833.2**	**27,633.4**	**29,304.1**
Tax revenues	**20,320.7**	**21,757.5**	**23,236.2**
Direct taxes	***9,168.5***	***9,763.6***	***10,431.0***
Corporation taxes	1,702.6	1,983.9	2,306.8
from non-financial corporations	1,540.8	1,793.8	2,084.1
from financial institutions	161.9	190.1	222.7
Income tax on natural persons	2,092.4	2,159.3	2,256.1
Social and health insurance revenues	5,373.4	5,620.4	5,868.1
Social insurance contributions to public social insurance	3,711.9	3,958.9	4,206.6
Health insurance contributions	1,661.6	1,661.6	1,661.6
Indirect taxes	***10,400.0***	***11,185.2***	***11,915.0***
Value added tax	6,500.0	6,900.2	7,400.0
Excise duties	3,800.0	4,200.0	4,430.0
Customs duties and customs charges	100.0	85.0	85.0
Levy on surplus stocks of sugar and isoglucose	***1.2***	***1.2***	***1.2***
Other taxes	***751.1***	***807.5***	***889.1***
Non-tax revenues	**3,291.9**	**3,316.0**	**3,315.6**
Transfers from BNB	300.0	300.0	300.0
Other	2,991.9	3,016.0	3,015.6
Revenues from fees	1,555.1	1,576.1	1,595.2
Revenues and income from property	1,039.0	1,034.6	1,036.1
Fines, sanctions and penalty interest	147.2	150.1	150.1
Receipts from sale of non-financial assets	213.3	217.6	221.8
Revenues from concessions	88.5	93.9	73.5
Other non-tax revenues	-51.2	-56.3	-61.1
Grants	**2,220.6**	**2,559.9**	**2,752.3**
domestic grants	14.5	14.8	15.1
external grants	2,206.1	2,545.1	2,737.3
Total expenditures and contribution to the General Budget of the EU	**27,694.2**	**28,842.4**	**30,181.8**
Total expenditures	**26,882.7**	**27,957.7**	**29,224.4**
Total non-interest expenditures	***26,221.6***	***27,178.2***	***28,324.1***
Current non-interest expenditures	**22,075.6**	**22,921.5**	**23,797.3**
Wages, salaries and scholarships	3,855.0	3,853.5	3,948.9
Wages and salaries	3,796.3	3,794.8	3,890.2
Scholarships	58.7	58.7	58.7
Social and health insurance contributions	936.9	937.0	962.1
Maintenance	4,633.4	4,714.7	4,960.9
Subsidies – total	1,852.2	2,421.9	2,529.6
Subsidies	1,663.8	2,233.5	2,341.3
Subsidies for provision of hospital care	188.4	188.4	188.4

CONSOLIDATED FISCAL PROGRAMME	2011	2012	2013
Social security and welfare	10,798.1	10,994.4	11,395.7
Pensions	7,020.0	7,075.3	7,327.8
Current transfers, benefits and allowances for households	1,971.2	2,012.3	2,061.1
Health insurance payments	1,806.9	1,906.9	2,006.9
State reserve gain and purchase of agricultural produce	**50.8**	**50.8**	**50.8**
Capital expenditures	**3,698.0**	**3,808.7**	**3,978.8**
Reserve for pressing contingent expenditures	**397.2**	**397.2**	**497.2**
- for structural reforms and additional fiscal measures	185.0	185.0	285.0
- budget	131.2	131.2	131.2
National Health Insurance Fund	130.1	130.1	130.1
National Assembly	0.5	0.5	0.5
Judiciary	0.6	0.6	0.6
- for prevention, management and mitigation of effects of disasters	81.0	81.0	81.0
Interest payments	***661.1***	***779.4***	***900.3***
External interest payments	502.6	584.9	685.7
Domestic interest payments	158.5	194.6	214.6
Contribution to the General Budget of the EU	**811.5**	**884.7**	**957.4**
Primary balance (+/-)	**-1,199.9**	**-429.6**	**22.6**
Budget balance (+/-)	**-1,861.0**	**-1,209.0**	**-877.7**
Financing (+/-)	**1,861.0**	**1,209.0**	**877.7**

CONSOLIDATED FISCAL PROGRAMME	2011	2012	2013
% of GDP			
Total revenues	**35.3%**	**35.1%**	**34.7%**
Tax revenues	**27.8%**	**27.6%**	**27.5%**
Direct taxes	***12.5%***	***12.4%***	***12.4%***
Corporation taxes	2.3%	2.5%	2.7%
from non-financial corporations	2.1%	2.3%	2.5%
from financial institutions	0.2%	0.2%	0.3%
Income tax on natural persons	2.9%	2.7%	2.7%
Social and health insurance revenues	7.3%	7.1%	7.0%
Social insurance contributions to public social insurance	5.1%	5.0%	5.0%
Health insurance contributions	2.3%	2.1%	2.0%
Direct taxes	***14.2%***	***14.2%***	***14.1%***
Value added tax	8.9%	8.8%	8.8%
Excise duties	5.2%	5.3%	5.3%
Customs duties and customs charges	0.1%	0.1%	0.1%
Levy on surplus stocks of sugar and isoglucose	***0.0%***	***0.0%***	***0.0%***
Other taxes	***1.0%***	***1.0%***	***1.1%***
Non-tax revenues	**4.5%**	**4.2%**	**3.9%**
Transfers from BNB	0.4%	0.4%	0.4%
Other	4.1%	3.8%	3.6%
Revenues from fees	2.1%	2.0%	1.9%
Revenues and income from property	1.4%	1.3%	1.2%
Fines, sanctions and penalty interest	0.2%	0.2%	0.2%
Receipts from sale of non-financial assets	0.3%	0.3%	0.3%
Revenues from concessions	0.1%	0.1%	0.1%
Other non-tax revenues	-0.1%	-0.1%	-0.1%
Grants	**3.0%**	**3.3%**	**3.3%**
domestic grants	0.0%	0.0%	0.0%
external grants	3.0%	3.2%	3.2%
Total revenues and contribution to the General Budget of the EU	**37.8%**	**36.6%**	**35.8%**
Total expenditures	**36.7%**	**35.5%**	**34.6%**
Total non-interest expenditures	***35.8%***	***34.5%***	***33.6%***
Current non-interest expenditures	**30.2%**	**29.1%**	**28.2%**
Wages, salaries and scholarships	5.3%	4.9%	4.7%
Wages	5.2%	4.8%	4.6%
Scholarships	0.1%	0.1%	0.1%
Social and health insurance contributions	1.3%	1.2%	1.1%
Maintenance	6.3%	6.0%	5.9%
Subsidies – total	2.5%	3.1%	3.0%
Subsidies	2.3%	2.8%	2.8%
Subsidies for provision of hospital care	0.3%	0.2%	0.2%
Social security and welfare	14.8%	14.0%	13.5%
Pensions	9.6%	9.0%	8.7%
Current transfers, benefits and allowances for households	2.7%	2.6%	2.4%
Health insurance payments	2.5%	2.4%	2.4%
State reserve gain and purchase of agricultural produce	**0.1%**	**0.1%**	**0.1%**
Capital expenditures	**5.1%**	**4.8%**	**4.7%**
Reserve for pressing contingent expenditures	**0.5%**	**0.5%**	**0.6%**

CONSOLIDATED FISCAL PROGRAMME	2011	2012	2013
- for structural reforms and additional fiscal measures	0.3%	0.2%	0.3%
- budget	0.2%	0.2%	0.2%
National Health Insurance Fund	0.2%	0.2%	0.2%
National Assembly	0.0%	0.0%	0.0%
Judiciary	0.0%	0.0%	0.0%
- for prevention, management and mitigation of the effects of disasters	0.1%	0.1%	0.1%
Interest payments	***0.9%***	***1.0%***	***1.1%***
External interest payments	0.7%	0.7%	0.8%
Domestic interest payments	0.2%	0.2%	0.3%
Contribution to the General Budget of the EU	**1.1%**	**1.1%**	**1.1%**
Primary balance (+/-)	**-1.6%**	**-0.5%**	**0.0%**
Budget balance (+/-)	**-2.5%**	**-1.5%**	**-1.0%**
Financing (+/-)	**2.5%**	**1.5%**	**1.0%**
G D P (BGN mln)	**73,181.0**	**78,716.1**	**84,354.0**

				Annex 3
				to Item 3
	EXPENDITURE CEILINGS FOR THE 2011-2013 PERIOD			
				(in thousand BG
No.	**State bodies, ministries, central-government departments, Bulgarian National Audit Office, Financial Supervision Commission, National Social Security Institute, National Health Insurance Fund, Factory and Office Workers' Guaranteed Claims Fund and Teachers Pension Fund**	**Expenditure ceiling 2011**	**Expenditure ceiling 2012**	**Expenditure ceiling 2013**
	1	**2**	**3**	**4**
1	Administration of the President	4 185,6	4 185,6	4 185,6
2	Council of Ministers	77 750,0	77 750,0	77 750,0
3	Constitutional Court	1 992,0	2 692,0	1 992,0
4	Ministry of Finance	269 291,0	269 491,0	269 491,0
5	Ministry of Foreign Affairs	106 000,5	106 000,5	106 000,5
6	Ministry of Defence	990 630,0	990 630,0	990 630,0
7	Ministry of Interior	1 006 000,0	1 006 000,0	1 002 000,0
8	Ministry of Justice	148 495,0	148 495,0	148 495,0
9	Ministry of Labour and Social Policy	951 270,8	951 270,8	951 270,8
10	Ministry of Health	570 094,6	570 094,6	570 094,6
11	Ministry of Education, Youth and Science	357 449,9	357 449,9	357 449,9
12	Ministry of Culture	94 292,1	94 292,1	94 292,1
13	Ministry of Environment and Water	45 309,3	45 542,5	45 742,5
14	Ministry of Economy, Energy and Tourism	82 771,2	82 771,2	82 771,2
15	Ministry of Regional Development and Public Works	248 216,2	248 216,2	248 216,2
16	Ministry of Agriculture and Food	257 142,0	257 142,0	257 142,0
17	Ministry of Transport, Information Technology and Communications	68 137,4	68 137,4	68 137,4
18	Ministry of Physical Education and Sports	33 656,6	33 656,6	33 656,6
19	State Agency for National Security	82 340,0	82 340,0	82 340,0
20	Committee for Disclosing the Documents and Announcing Affiliation of Bulgarian Citizens to State Security and the Intelligence Services of the Bulgarian People's Army	7 000,0	7 000,0	7 000,0
21	Commission for Protection against Discrimination	2 160,0	2 160,0	2 160,0
22	Commission for Personal Data Protection	2 560,0	2 560,0	2 560,0
23	Commission for Establishing of Property Acquired from Criminal Activity	5 145,0	5 145,0	5 145,0
24	National Bodyguard Service	31 240,0	31 240,0	31 240,0
25	National Intelligence Service	19 120,0	19 120,0	19 120,0
26	Ombudsman	2 128,0	2 128,0	2 128,0
27	National Statistical Institute	17 291,3	17 291,3	17 291,3
28	Commission on Protection of Competition	3 605,2	3 605,2	3 605,2
29	Communications Regulation Commission	10 121,9	10 121,9	10 121,9
30	Council for Electronic Media	1 120,0	1 120,0	1 120,0
31	State Energy and Water Regulatory Commission	3 151,3	3 151,3	3 151,3
32	Nuclear Regulatory Agency	4 966,9	4 966,9	4 966,9
33	State Commission on Information Security	4 960,0	4 960,0	4 960,0
34	State Agency "State Reserve and War-Time Stocks"	75 617,8	75 617,8	75 617,8
35	Bulgarian National Audit Office	15 056,1	15 056,1	15 056,1
36	Financial Supervision Commission	9 360,5	9 360,5	9 360,5
37	National Social Security Institute	8 233 576,6	8 330 754,2	8 639 066,7
	of which Pensions	7 006 300,0	7 061 167,4	7 313 100,9
38	National Health Insurance Fund	1 986 342,0	2 086 342,0	2 186 342,0
	of which Health insurance payments	1 806 856,4	1 906 856,4	2 006 856,4
39	Factory and Office Workers' Guaranteed Claims Fund	1 866,3	1 666,3	1 566,3
40	Teachers Pension Fund	13 779,3	14 224,3	14 824,3

Annex 4
to Item 4

EXPENDITURE CEILINGS FOR OFF-BUDGET FUNDS AND ACCOUNTS FOR THE 2011-2013 PERIOD

(in thousand BGN)

No.	Off-budget funds and accounts	Expenditure ceiling 2011	Expenditure ceiling 2012	Expenditure ceiling 2013
	1	2	3	4
1.	Agriculture State Fund	1 059 942,9	1 587 025,5	1 704 481,6
2.	Privatisation and Post-privatisation Expense Recovery Fund with the Privatisation and Post-privatisation Control Agency	7 008,0	2 494,0	
3.	Off-budget account of the National Fund with the Minister of Finance	2 371 411,7	2 253 855,2	1 902 778,9

Annex 5
to Item 5

DRAFT OF SUBSIDIES/TRANSFERS FOR THE BULGARIAN NATIONAL TELEVISION, THE BULGARIAN NATIONAL RADIO, THE BULGARIAN ACADEMY OF SCIENCES, THE STATE HIGHER SCHOOLS AND THE STATE HIGHER MILITARY SCHOOLS FOR THE 2001-2013 PERIOD

(in thousand BGN

No.	Bulgarian National Television, Bulgarian National Radio, Bulgarian Academy of Sciences, State Higher Schools and State Higher Military Schools	2011	2012	2013
	1	2	3	4
1.	Bulgarian National Television	60 100,0	60 100,0	60 100,0
	of which under Item 2 of Article 70 (4) of the Radio and Television Act	8 100,0	8 100,0	8 100,0
2.	Bulgarian National Radio	48 065,0	48 065,0	48 065,0
	of which under Item 2 of Article 70 (4) of the Radio and Television Act	5 918,7	5 918,7	5 918,7
	Transfers from the budget of the Ministry of Education, Youth and Science to the Bulgarian Academy of Sciences and the state higher schools	**349 118,9**	**349 118,9**	**349 118,9**
3.	Bulgarian Academy of Sciences	59 756,1	59 756,1	59 756,1
4.	State higher schools	289 362,7	289 362,7	289 362,7
	Transfers from the budget of the Ministry of Defence to the state higher military schools	**21 610,4**	**21 610,4**	**21 610,4**
5.	State higher military schools	21 610,4	21 610,4	21 610,4

Annex 6
to Item 6

DRAFT OF THE AMOUNTS OF THE BUDGET RELATIONSHIPS BETWEEN THE CENTRAL BUDGET AND THE MUNICIPAL BUDGETS FOR THE 2011-2013 PERIOD

(in thousand BGN)

No.	Items	2011	2012	2013
1	**2**	**3**	**4**	**5**
	Budget relationships - Total	**2 167 583,7**	**2 209 840,4**	**2 211 687,7**
	of which:			
1.	General subsidy for State-delegated activities	1 828 681,2	1 834 300,4	1 836 147,7
2.	Transfers for local activities	248 692,5	253 640,0	253 640,0
	of which:			
2.1.	General equalizing subsidy	234 640,0	234 640,0	234 640,0
2.2.	For winter maintenance and snow clearing of municipal roads	14 052,5	19 000,0	19 000,0
3.	Target subsidy for capital expenditures - Total	90 210,0	121 900,0	121 900,0
	of which:			
3.1.	For environmental projects	20 000,0	20 000,0	20 000,0
3.2.	For construction and overhaul of municipal roads	42 500,0	50 000,0	50 000,0
3.3.	Target subsidy according to methodology	27 710,0	51 900,0	51 900,0

Annex 7
to Item 7

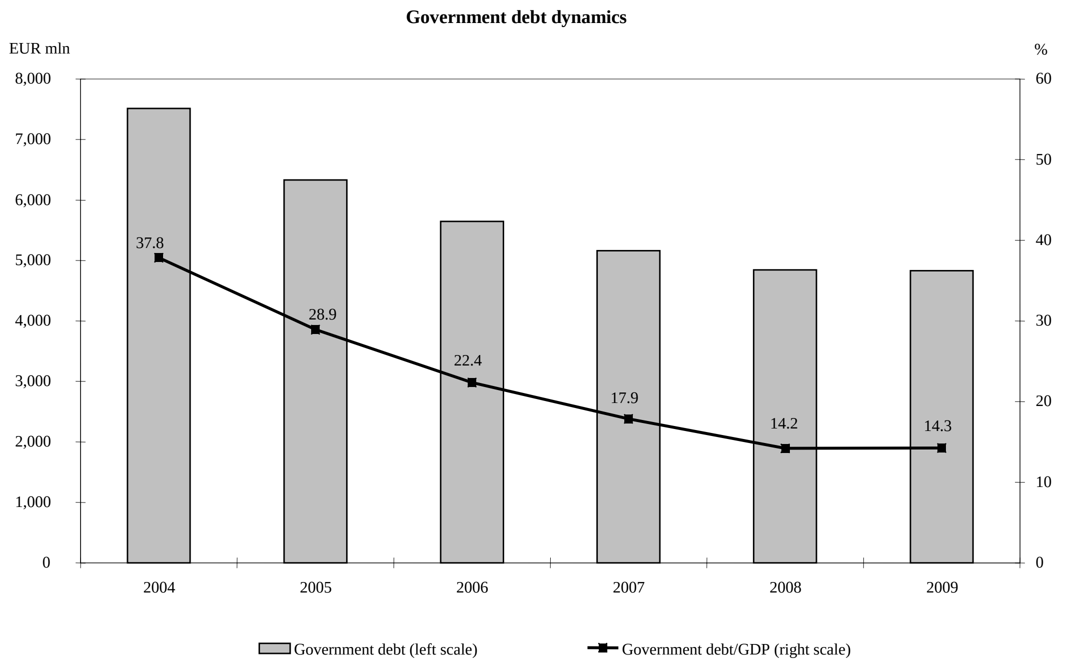
UPDATE OF THE GOVERNMENT DEBT MANAGEMENT STRATEGY

2010

I. Amount and structure of the government debt in 2009

The reported results about the amount and structure of the government debt are entirely consistent with the objectives set in the Government Debt Management Strategy 2009-2011[1]. In nominal terms, government liabilities diminished by EUR 13.1 million from the end of the previous year and stood at EUR 4,828.5 million. The government debt/gross domestic product[2] ratio edged 0.1% up, reaching 14.3% at the end of the period because of the reported decrease in the amount of GDP, but still remaining far below the 25% reference upper limit set in the Strategy.

Chart: Government debt dynamics



Source: MoF

Regardless of the modest amount of the reduction, account should be taken and an emphasis should be laid on the fact that the country managed to maintain the downward trend of sovereign liabilities for yet another successive year, achieving this decrease in conditions of a strong volatility of the international capital markets and a sovereign debt crisis engulfing Europe.

The main reasons for this result include: regular repayments to an aggregate amount of EUR 420.3 million, effected in June by the Ministry of Finance[3], a cancellation of bought-back global bonds equivalent to an aggregate EUR 149.2 million, and foreign exchange rate gains in respect of the currencies other than euro and lev in which the debt is denominated.

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[1] GDMS 2009-2011- hereinafter referred to by this acronym
[2] GDP – hereinafter referred to by this acronym
[3] MoF – hereinafter referred to by this acronym

Another significant reason is the negative net issue of domestic debt to the amount of (BGN -87.4 million), which led to a reduction of the domestic government debt by EUR 32.6 million, bringing it to BGN 3,009.5 million (EUR 1,538.7 million) or 4.5% of GDP at the end of the year. Of these, BGN 2,705.3 million (89.9%) are the debt under government securities issued to finance the budget, and the balance of BGN 304.1 million (10.1%) is the share of government securities issued in support of the structural reform.

The gross financing implemented during the year amounted to BGN 488.7 million, raised by government securities issued in the following maturity groups: 10-year government securities to the amount of BGN 157.5 million and 5-year government securities to the amount of BGN 288.0 million, of which 5-year government securities (issued in 2006) to the amount of BGN 70.0 million, 5-year government securities (issued in 2007) to the amount of BGN 115.0 million, and 5-year government securities (issued in 2009) to the amount of BGN 103.0 million. In the short-term group, three issues of 3-month government securities were offered to an aggregate value of BGN 43.2 million.

As a result of the reopening of medium-term issues with a short residual maturity, the average residual maturity of the issues in circulation on the domestic market was reduced by two months, reaching four years and five months at the end of the period.

Interest in the domestic debt offered by the Government varied during the year, with a pronounced investor activity at the beginning and especially at the end of the period, as a result of the flexible policy, adequate to the current market situation, pursued by the Government.

Last year, too, demand exceeded supply, with the average bid-to-cover ratio disaggregated by type of security being as follows: 1.25 for the 3-month Treasury bills, 1.95 for the 5-year government securities and 1.99 for the 10-year government securities, and 2.99 and 2.01, respectively, for the reopened issues issued in 2006 and 2007 with approximate residual maturities of two and three years at the opening dates. The issuance of the 10-year securities reckoned both with the need to maintain a suitable instrument for the calculation of a long-term interest rate for assessment of the degree of convergence with the EU Member States and to attain the objectives set in the effective GDMS 2009-2011 for priority borrowing on the domestic market.

The issues offered on the domestic market were denominated in lev and with fixed coupons.

The debt payments made in 2009 totalled BGN 684.5 million, of which BGN 543.5 million were amortisation and BGN 141.0 million were interest expenditures.

The government securities in circulation issued in support of the structural reform totalled a nominal amount of BGN 304.1 million at the end of last year, down BGN 33.1 million from the end of 2008. The decrease resulted from the planned repayments and a foreign exchange loss generated by the US dollar-denominated ZUNK[1] bonds.

The external government debt amounted to BGN 3,289.8 million, up BGN 19.5 million from the previous year. Government securities were not issued on the external markets in 2009. The main factors of the positive net external financing were two DPL[2]-type loans, contracted with the International Bank for Reconstruction and Development[3], to an aggregate nominal value of EUR 251 million, which offset the reduction resulting from the cancellation of the global bonds bought back in 2008 (EUR 17 million and USD 184.2 million), the regular debt amortisation and the foreign exchange loss. At 9.7%, the external government debt/GDP ratio was practically unchanged.

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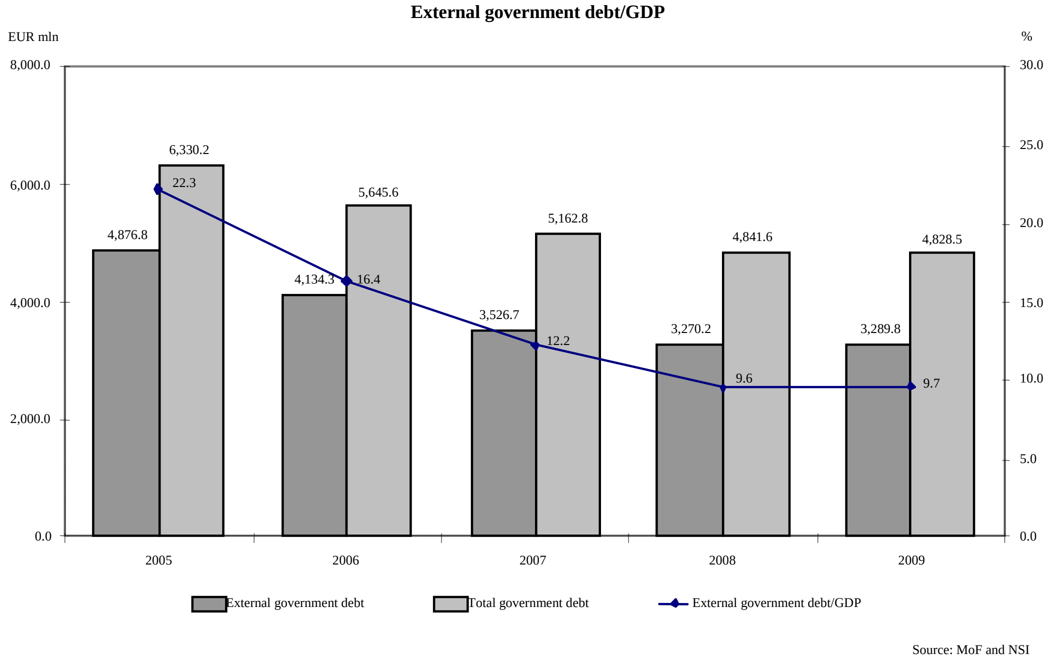
[1] Government securities issued in pursuance of the Act to Settle Non-performing Loans Contracted by 31 December 1990

[2] Development Policy Loans

[3] IBRD – hereinafter referred to by this acronym

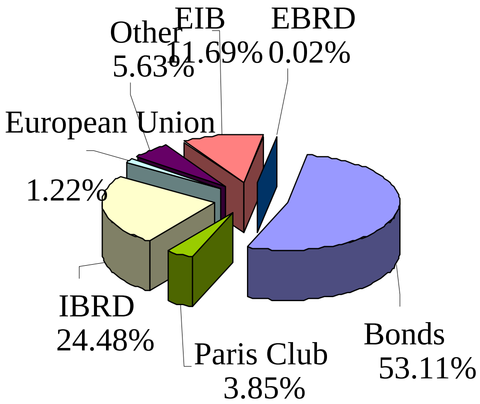
Chart: External government debt/GDP

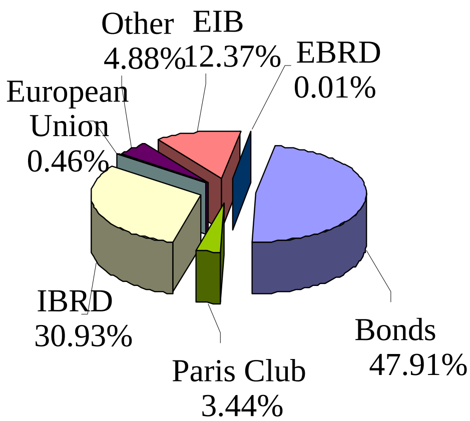


The financing implemented during the year largely predetermined the changes in the debt structure by creditor. The share of the debt to the IBRD increased by 6.5 pp[1] , reaching 30.9%. The portion of the bonds issued on the international capital markets decreased by 5.2 pp to 47.9%. As a result of these changes, the share of the debt to the European Investment Bank[2] increased to 12.4% at the end of 2009.

Chart: External government debt structure by creditor

[1] Percentage points
[2] EIB – hereinafter referred to by this acronym





31 December 2008 **31 December 2009**

In the external debt structure by debt instrument type, only government loans (extended by the IBRD) and the government investment loans[1], administrated under the ministries' budget, showed a positive net result at the end of the year. The share of GIL amounted to 23.5% of the external government debt at the end of 2009, but considering the nature and specificity of these loans: mainly intended to finance important infrastructure projects and social programmes, their share is expected to increase further in future.

Net external financing for the year was positive, to the value of EUR 186.0 million.

The contracting and absorption of floating interest rate government loans [2] of the DPL type, due to the more lucrative conditions offered and the cancellation of fixed rate debt, did not change the prevalence of fixed interest debt, which accounted for 69.2% of the total at the end of the period.

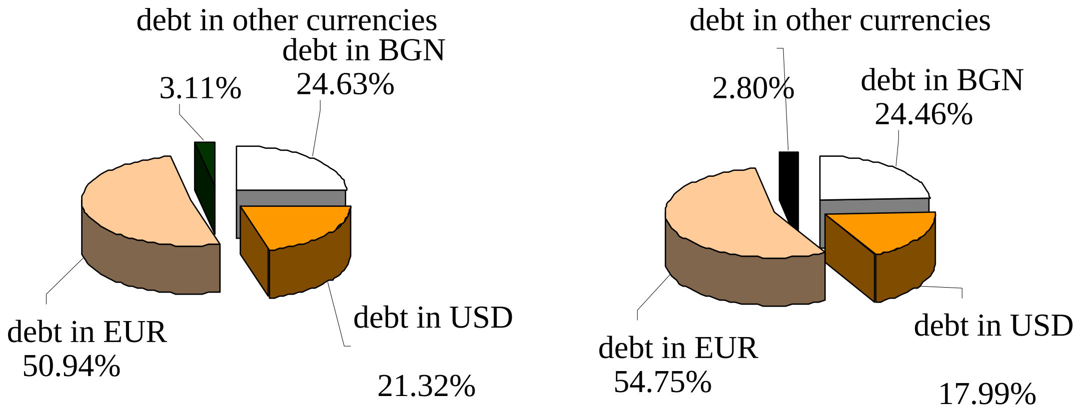
The external government debt service payments made during the year amounted to EUR 322.2 million, of which EUR 139.0 million in principal repayments and EUR 183.2 million in interest payments.

The dynamics reported in the level and structure of the domestic and external government debt accordingly led to changes in the currency and exchange-rate composition of the government debt.

Compared to the end of 2008, the portion of the debt denominated in risk-neutral currencies reached almost 80%, of which 54.7% in euro and 24.5% in lev. The reported change was largely due to the absorptions of euro-denominated external debt and the cancelled amounts in US dollars and is fully consistent with the objective set in the effective GDMS 2009-2011 to maintain this percentage at over 75%. The USD-denominated debt decreased by 3.3 pp, and of the debt denominated in other currencies by 0.3 pp. The shares of these debt liabilities at the end of 2009 were 18.0% and 2.8% of the total, respectively.

[1] GIL – hereinafter referred to by this acronym
[2] GL – hereinafter referred to by this acronym

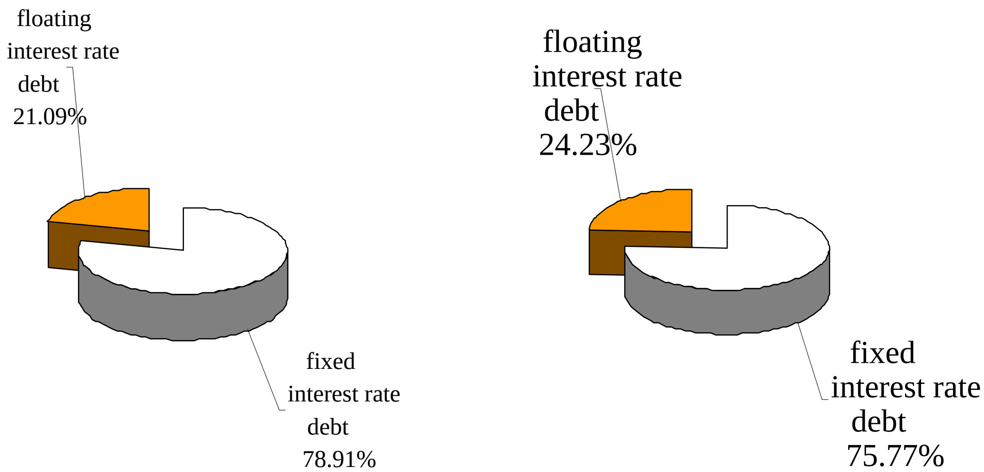
Chart: Currency structure of government debt



31 December 2008 **31 December 2009**

Albeit slightly reduced (by 3.1 pp), the fixed interest debt remained prevalent with a share of 75.8%. In conditions of lower international interest levels, as a result of the global economic and financial crisis, the edging up of the share of floating interest debt is favourable and makes it possible to save planned budget resources to cover debt expenditures. The reported result complies with the restrictive requirement for the interest rate structure of the debt according to the GDMS 2009-2011 to maintain it at over 70%, intended to achieve better foreseeability and predictability of the interest payments due.

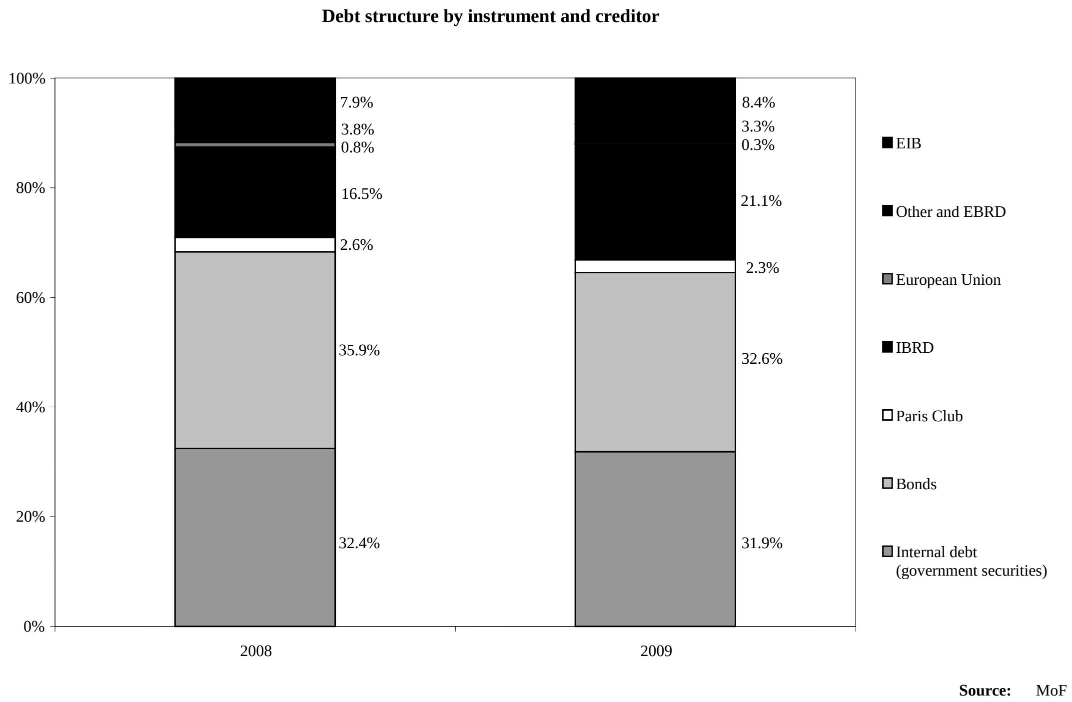
Chart: Interest rate structure of government debt



31 December 2008 **31 December 2009**

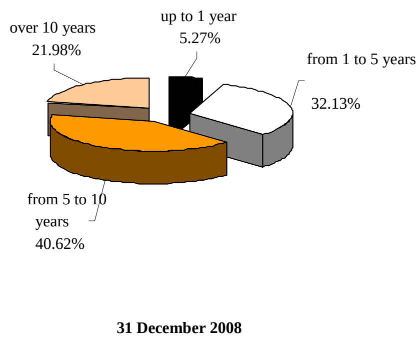
In the structure by instrument type, the share of liabilities under government securities remained dominant: 64.5% (issued on the domestic and external market) despite the cancellation. Government loans took up a share of 35.5%.

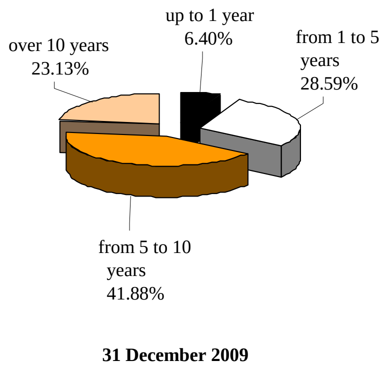
Chart: Government debt structure by instrument and by creditor



The government debt remained well spaced out, with the prevalent share of government liabilities, 41.9%, being concentrated in the 5- to 10-year interval. The debt in the rest of the maturity groups was distributed as follows: 6.4% up to 1 year, 28.6% from 1 to 5 years, and 23.1% over 10 years.

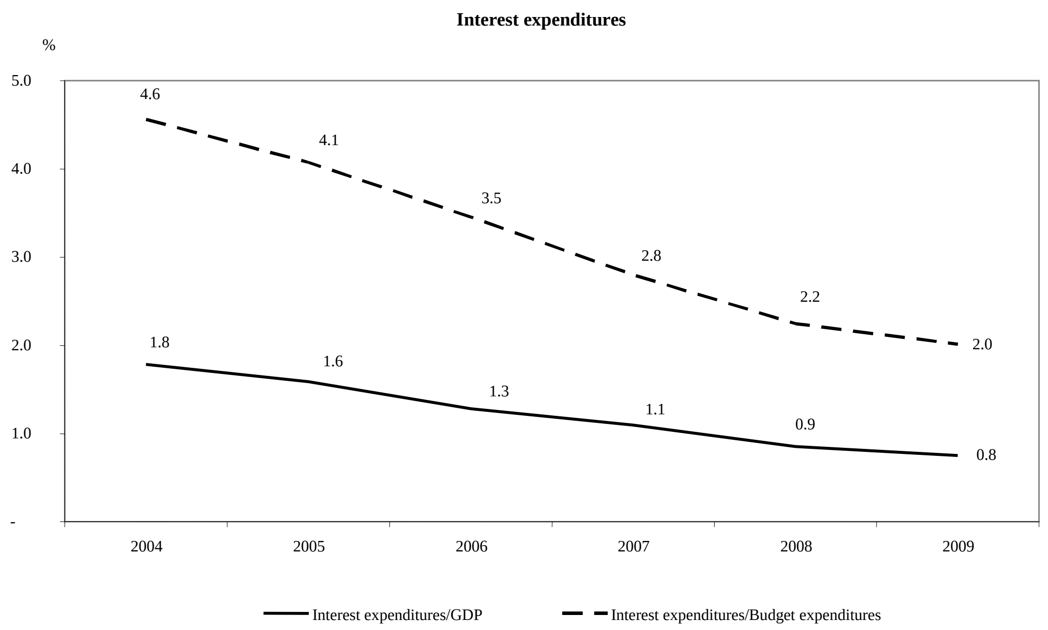
Chart: Time to maturity of government debt





Compared to the previous year, debt payments declined by nearly EUR 500 million in 2009, mainly due to the lower level of the government debt and the foreign exchange gains in respect of the foreign currencies other than the euro in which the debt is denominated, as well as the international interest rates. Debt service during the period amounted to EUR 672.2 million, of which EUR 416.9 million in principal repayments and EUR 255.3 million in interest payments. Both the interest expenditures/GDP ratio and the interest expenditures/total budget expenditures ratio went down, with the former remaining below 1% while the latter amounting to 2%.

Chart: Interest expenditures on the debt



Source: MoF and NSI

The approach to the management of the government-guaranteed debt to external creditors remained conservative and strongly restrictive in 2009. That debt dropped by EUR 22.2 million, reaching EUR 612.1 million. The main reasons for this were the planned repayments and the foreign exchange gains. Government-guaranteed liabilities represented 1.8% of GDP.

During the year, the resources allocated in the central-government executive budget to cover the risk of call of government guarantees were reduced by USD 185,000 (BGN 244,700) by reason of payment in arrears of amounts owed by the Pernik District Heating Company to the IBRD. Until the end of the period under review, the company refunded the bulk of the resources paid to the amount of BGN 239,780.

The partial call of the government guarantee clearly predetermines a continued commitment to a strongly restrictive policy on approval of new government guarantees and, respectively, careful selection of beneficiaries, especially in crisis conditions which further mounts the pressure on public undertakings and potentially increases the likelihood of spending the budget resources allocated in the reserve.

II. Main government debt management objective and steps to attain this objective

On the basis of the expected change in the values of the key macroeconomic indicators in the short and medium term, within the context of the domestic and international market situation, as well as considering the assessment made of the risks associated with the current structure and indicators of the government debt, **the objective defined in the effective Government Debt Management Strategy remains unchanged, and its sub-objectives are retained, taking into consideration the following specificity:**

1. **Controlled increase of the amount of debt.**

The restrictive and prudent debt management policy that is implemented will continue to be pursued during the current year as well, in support of the Government's efforts to preserve the country's macroeconomic stability. In the middle of this year, the National Assembly passed the updated 2010 State Budget of the Republic of Bulgaria Act (SBRBA), effective 1 August 2010, which fixed a minimum amount of the fiscal reserve[1] at BGN 4,500 million and a budget deficit/GDP ratio at (-4.8%) on a cash basis.

The conceptual idea of setting up the FR was that it should cover government debt payments in a short term, up to one year. In the 2010-2011 period, servicing government liabilities, including principal repayments and interest payments, costs approximately EUR 700 million[2] per annum. Apart from the need to provision resources to cover debt payments, account should also be taken of the assumptions for the period about the levels of the other parameters influencing the amount of the reserve, such as: proceeds from privatisation, net amount of the financing of direct payments to farmers, paid by the Agriculture State Fund, as well as resources for non-grant financing, acquisition of participating interests and shares and other financing. The amount of the clearing settlements (deficits and surpluses) also exerts influence.

Considering the current expectation of a slower recovery of the EU economy, on account of the fiscal problems encountered in certain Member States, confirmed by the decision of the European Central Bank to keep the key interest rates unchanged for a fourteenth successive month, as announced on 8 July 2010, as well as considering the vulnerability of the open-type economy like Bulgaria's, it is possible to use various debt sources to finance the FR so as to maintain it at an adequate level. The budget deficit of 4.8% of GDP, planned for the current year, is another prerequisite for an increase of the government debt.

In this sense, apart from the possibility to issue government securities on the international capital markets[3], in the two remaining years of the effective GDMS 2009-2011 a marked priority will be set on promoting the development of an effective and liquid domestic market, with the characteristics (volume, maturity, interest terms etc.) of the newly issued government securities being determined depending on the current market situation and the state of the financial markets in the country. Besides this, continued absorptions are expected of old and new GIL, concluded above all for construction of a modern road infrastructure of the country, as well as in support of the Government's social policy. Opportunities are also being weighed to seek financing from the international financial institutions[4]. In addition, it is planned to start, until the end of 2010, the absorption of resources under a Credit Agreement with the EIB for a Structural Programme Loan, intended to ensure national co-financing of a number of projects.

In this sense, the amount of government debt will be gradually increasing, while the government debt/GDP ratio will be maintained at levels below the limit set in the GDMS 2009-2011.

Apart from setting a limit to the value of this indicator, provisions are made for specific measures guaranteeing compliance with it until the end of the period as a consequence of the conservative borrowing policy which presupposes an analysis of its effects, as well as an assessment of the possibilities to generate public benefits. Such prudent approach to the increase of government liabilities will be followed throughout the period,

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[1] FR – hereinafter referred to by this acronym

[2] The estimates provide resources for servicing the currently active loans, certain assumptions about new financing, and include the reserve covering the risk of government guarantees being called.

[3] ICM – hereinafter referred to by this acronym

[4] IFI – hereinafter referred to by this acronym

taking into account the negative effect of the large gross external debt (as a percentage of GDP) and the gradually increasing municipal debt.

Public-sector project financing through government-guaranteed loans will follow the established law-regulated practice, calling for an analytical and restrictive approach, making it possible to carry out public monitoring and control.

Implementing a borrowing policy according to this scheme will guarantee keeping the indicative parameters of the debt and complying with the law-established government debt limits, and will influence debt service expenditures.

2. Limitation of budget expenditures on debt service.

The tendency of containment of the debt service expenditures/budget expenditures ratio and of the debt service expenditures/GDP ratio is expected to be maintained during the next two-year period. Attainment of the sub-objective as set is ensured mainly by two factors: on the one hand, strict monitoring and control of the debt/GDP ratio and, on the other, adhering to the limits set to the currency and interest-rate structure of government liabilities in the GDMS 2009-2011.

- Currency structure

Considering the specificity and the concrete parameters set by the current market situation, the medium-term trends of the financial markets at home and worldwide, as well as within the context of the macroeconomic framework: an effective currency board arrangement, a permanently fixed exchange rate of the lev against the single European currency, the country’s membership of the EU and, last but not least, a substantial share of euro receipts in export revenues, the currency structure of the debt is largely predetermined.

The priority financing by resources from the local market is a prerequisite for an increase of the lev- and euro-denominated share of the debt. If the conditions are lucrative, the planned new external borrowing will be contracted in euro. Considering the current levels of the euro/dollar rate and on the basis of market expectations of a more prolonged devaluation of the single currency, if an expert analysis proves that this is economically advisable, debt denominated in US dollars may be issued. In principle, the strategic priority in the management of government liabilities will be adhered to over the next two years, and it calls for maintaining the portion of euro- and lev-denominated liabilities at levels fixed in the GDMS 2009-2011.

- Interest-rate structure

Pursuing an effective spending policy presupposes the most accurate possible determination of the budget resources required to cover debt expenditures. The increase of the portion of fixed interest debt (in euro and lev) largely reduces the need to allocate additional resources to cover the risk of variations in the planned levels of interest rates (currencies). Considering the expectations of a gradual rise of euro interest rates, the portion of the fixed coupon debt will continue to increase gradually over the next two-year period, mainly as a result of the newly issued domestic debt, entirely intended to be offered at such parameters, the probable offering of a global bonds issue on the IFM, as well as part of the absorptions of external loans. Still, account should also be taken of the fact that in the conditions of an open economy like Bulgaria’s, possible slumps in the growth of the leading economies will press down the price of the financial resources supply and accordingly send up the volume of state budget resources allocated to ensure payment of the debt expenditures. In other words, the portion of the floating coupon debt must be planned and determined within reasonable limits.

At the end of 2010, **the interest expenditures/budget expenditures ratio and the interest expenditures/GDP ratios are planned to be close to those in 2009.**

3. Ensuring stable sources of budget financing and government debt refinancing

Considering the complicated international economic and financial situation and its impact on the country, as well as the strong volatility of the sovereign debt market, all debt instruments have been assessed and analysed as a possibility to use if necessary, either separately or appropriately combined, to maintain the role of the FR as a guarantor of the country's macroeconomic stability, as well as to finance the budget deficit.

3.1. Market-oriented financing

Market-oriented debt sources of financing are available on the local and on the international capital markets.

3.1.1. Domestic market

Issuance of government securities on the domestic market, as a form of market-oriented financing, will retain its priority importance in the debt policy of the MoF. Considering the state and development of the financial system both at home and internationally and with a view to implementing, as intended, an issuing policy for market financing which is flexible and adequate to the financial situation, the MoF will continue its efforts for development of the government securities market.

Efforts in this direction include diversification of the 3-, 5- and 10-year securities which are offered and have gained a foothold on the market, through expansion of the maturity and currency structure of the newly issued government securities. The MoF intends to fill up the maturity groups at the short and long end of the debt curve by putting in circulation a 15-year issue of euro-denominated government securities, as well as one-year issues of lev-denominated Treasury bills. The idea of lengthening the debt curve is intended to meet the demand of institutional investors (pension funds and insurance companies) for securities having a long investment horizon and an optimum risk/yield ratio. The offering of euro-denominated government securities also makes it possible to attract foreign participants to the domestic debt market. Offering new issues of 1-year government securities is motivated mainly by a desire to improve the placing conditions, as well as to offer benchmark instruments at the short end of the yield curve where a lower risk premium is respectively expected against the relevant benchmark. The issuing policy on the domestic market will be diversified within the limits for undertaking new debts and for the amount of the debt at the end of 2010, set in the 2010 State Budget of the Republic of Bulgaria Act.

In 2011 the MoF is planning a gross financing of the domestic debt market to the approximate amount of BGN 800 million, and intends to offer government securities with a standardised maturity of 3, 5 and 10 years, as well as to reopen the long-term euro-denominated issue.

3.1.2. External market

The Ministry of Finance will continue to watch the international capital markets and the opportunities that those markets offer for market-oriented financing. Government bonds are issued on the international capital markets through issues of Eurobonds or global bonds on markets outside the jurisdiction of the monetary authorities of the issuer State.

Eurobonds are a suitable instrument for the issuance of euro-denominated securities because the principal investors in euro-denominated instruments are based in Europe, of which banks account for the largest share. The debt crisis that has engulfed Europe and the European banks' reluctance to take on new risk exposures are factors that at present partially depress demand for sovereign securities issued by emerging markets such as Bulgaria with all its idiosyncrasies.

Therefore, mindful that, under the effective State Budget Act, the Minister of Finance, acting on a Council of Ministers decision, may issue government securities on the international markets to an amount of up to **BGN 2,000 million** or their equivalent in another currency subject to subsequent ratification, the MoF will continue to follow closely and to analyse the international market situation.

At this point, Bulgaria has in circulation two issues of EUR-denominated global bonds with a 7.5% coupon, maturing on 15 January 2013, and of USD-denominated global bonds with an 8.25% coupon, maturing on 15 January 2015. On the one hand, the approaching maturity of these bonds shortens the reference sovereign yield curve which banks use as a benchmark yield to calculate commercial and other lending rates and, on the other hand, predetermines the need to procure the financial resources needed for their repayment.

To minimise the currency risk in government debt service, the exposure of debt payments must be predominantly in lev and euro, as required by the GDMS 2009-2011 adopted by the Council of Ministers. Upon entry in the international markets, the currency risk can be minimised through:

- Issuance of euro-denominated securities;
- Issuance of securities denominated in another currency with subsequent hedging of the currency risk incurred.

The market environment was favourable in the period between the beginning of 2010 and the end of April, and a number of countries of Central and Eastern Europe took advantage of this to enter the markets with new issues of EUR-denominated Eurobonds, Eurobonds in Swiss francs, Eurobonds in yen, and global bonds in US dollars.

The fiscal difficulties experienced by some Eurozone countries and the uncertain timing and efficacy of the adjustment measures taken have led to a temporary standstill on the Eurobond market on the Old Continent. These circumstances predetermined a reorientation of part of the sovereigns to financing in dollars on the American market.

In assessing the opportunities to offer an issue of government securities on the ICC, reckoning with a number of circumstances will be prioritised: on the one hand, an exceedingly accurate expert analysis and assessment of the parameters of the issue, considering its direct impact on the debt level and structure (and, respectively, on the expenditures), including the time when it is to be offered and, on the other, bearing in mind that this is a complicated and time-consuming process which presupposes, even before its proper start, the performance of a large volume of activities in connection with the requirements of national legislation, adopting criteria and selecting a manager bank and consultants in English and Bulgarian law, drafting an information memorandum and a prospectus and a number of other activities habitually accompanying the entry in the international markets.

3.2. Supplementary loan financing

3.2.1. Financing from official creditors

In Bulgaria’s contemporary history, the international financial institutions have played a substantial role for economic development by providing broad-ranging financial and technical assistance. Loan financing from official creditors has established its leading role because of the country’s relatively limited capabilities, in a not too distant past, to obtain unimpeded and market-oriented financing from the capital markets (above all because of the difficulties related to the restructuring of public finances and the transition to a market economy), as well as due to the price of the possible market financing (the lack of an investment-grade rating, investors’ mistrust etc.). Account was also taken of the circumstances that the IFI provide a relatively eased access to long-term resources with soft financial parameters but, certainly, bound to honouring certain commitments and implementing certain programmes on the part of the government. Just as important are the circumstances related to the access to those institutions' expertise, as well as their control over the financed programmes and projects, and last but not least the introduction and application of the best practices and international standards. Bulgaria has established traditionally good relationships with creditors like the World Bank (WB), the European Union (EU) and the International Monetary Fund (IMF) as a result of many years of cooperation.

External financing during the current year will be largely oriented to the planned absorptions of government investment loans and in support of the absorption of resources from EU funds. The 2010 State Budget of the Republic of Bulgaria Act and the draft 2011 State Budget of the Republic of Bulgaria Act include an aggregate of five projects for financing with government investment loans, mainly for infrastructure development.

The approved government-guaranteed loans for the forthcoming two-year period are intended to ease access to higher education and to support the reforms in railway transport.

4. Maintaining close coordination and exchange of information between the MoF and the BNB, Eurostat and IMF, rating agencies

4.1. Relations with BNB

The Ministry of Finance continues to work actively and effectively and to cooperate with the BNB in its capacity as government debt agent. In connection above all with the regulation of the procedures for the issuance of euro-denominated government securities, the Government Debts Agency Agreement between the Ministry of Finance and the BNB has been modified. The two institutions are engaged in active correspondence related to the questions raised by the advance process of integration into the European Union in line with the support expressed for the EIB TARGET 2 – SECURITIES Project. The Ministry and the Central Bank often discuss questions concerning the improvement and development of the Electronic System for Registration and Servicing of Trade in Government Securities (ESROT) and the Government Securities Auction System (GSAS), raised by the dynamics of the market environment and, accordingly, an expansion of the possible range of instruments used on the government securities market. Amendments will be introduced shortly to the Government Debt Act to regulate the activity of sub-depositories upon conduct of transactions in government securities. Procedures for exchange of information and assessment of the state of the financial system help reduce the risks of disruption of the financial stability of the State.

4.2. Relations with Eurostat

Just as vigorous development and rapid progress characterise the cooperation with various EU institutions in connection with the commitments assumed by Bulgaria to submit statistical information on a regular basis in its capacity as EU Member State. By virtue of Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community, the MoF prepares and submits to the Statistical Office of the European Commission (Eurostat) deficit and debt Notification Tables (EDP Notification Tables) before 1 April and 1 October of each year, as well as data on the quarterly government debt for the sector of general government (according to the requirements of Council Regulation (EC) No 1222/2004 of 28 June 2004 concerning the compilation and transmission of data on the quarterly government debt). Apart from an improvement of the scope of the information submitted, in accordance with the methodological provisions of the European Commission, progress in the sphere of government financial statistics has also been achieved in respect of the provision of consolidated data on the debt of the sector of general government and its sub-sectors: "central government", "municipalities" and "social security funds", according to the requirements of the European Central Bank.

In September 2010, senior Eurostat experts are expected to pay a regular methodological visit for the purpose of analyzing the information sources used, as well as the degree of reliability of the data submitted to the European Commission, mainly through the EDP Notification Tables.

During the period, efforts will focus on achieving an optimum degree of compliance of the data provided with the guidelines of the EU methodology regulations.

4.3. Relations with rating agencies

At present the Republic of Bulgaria maintains contractual relations with three rating agencies: Moody's Investors Service, Standard & Poor's, and the Japan Credit Rating Agency (JCRA). This meets the country's needs of credit ratings awarded by internationally recognised credit agencies, which is an important condition to ensure Bulgaria's access to capital markets. The regular communications with the rating agencies centre on the arrangements for their annual visits, the preparation of the presentations required for this purpose, which contain an overview of the country's key macroeconomic parameters and assumptions of their change in the medium term, as well as organising conference talks if necessary. All these activities seek to support the process of realistic assessment of the current macroeconomic situation in the county. The provision of prompt, accurate and comprehensive information is essential for building investors' confidence.

As of today's date, Bulgaria does not have an effective Credit Rating Agreement with Fitch Ratings Ltd. However, considering the agency's obligations to other entities which it rates (commercial banks, enterprises etc.), representatives of Fitch Ratings continue to monitor the macroeconomic situation in this country, which will be covered in the reports they prepare.