

**REPUBLIC OF BULGARIA**

---

**COUNCIL OF MINISTERS**

**REPORT**

**TO THE DRAFT 2011 STATE BUDGET OF THE REPUBLIC OF  
BULGARIA ACT**

---

**SOFIA**

**SEPTEMBER 2010**

## Table of Contents

I.	INTRODUCTION .....	3
II.	ECONOMIC FRAMEWORK.....	5
1.	THE GLOBAL ECONOMY: CURRENT STATUS AND OUTLOOK.....	5
2.	THE NATIONAL ECONOMY: CURRENT STATUS AND OUTLOOK .....	6
3.	MACROECONOMIC OUTLOOK .....	13
III.	2010 CONSOLIDATED FISCAL PROGRAMME .....	16
1.	EXECUTION OF THE CONSOLIDATED FISCAL PROGRAMME AS OF JULY 2010.....	16
2.	EXPECTED EXECUTION OF THE CONSOLIDATED FISCAL PROGRAMME AS OF THE END OF 2010 .....	21
IV.	KEY ASPECTS OF THE 2011 BUDGET POLICY AND FISCAL POSITION SUSTAINABILITY .....	21
1.	FISCAL AND BUDGET POLICY GOALS FOR 2011.....	21
2.	KEY PARAMETERS OF THE CONSOLIDATED FISCAL PROGRAMME FOR 2011 .....	22
3.	TAX AND SOCIAL SECURITY/HEALTH INSURANCE POLICY AND REVENUE STRUCTURE IN TERMS OF REVENUE SOURCES .....	24
4.	SPENDING POLICIES AND PRIORITIES.....	30
5.	PUBLIC EXPENDITURE BY FUNCTION .....	33
6.	DEBT MANAGEMENT AND FINANCING .....	51
7.	ASSESSMENT OF PUBLIC FINANCE SUSTAINABILITY AND FISCAL RISKS .....	54
V.	MANAGEMENT OF EUROPEAN FUNDS AND PROGRAMMES.....	58
VI.	QUALITY OF PUBLIC FINANCE AND REFORM GUIDELINES .....	63
1.	STREAMLINING THE PUBLIC SECTOR.....	63
2.	FINANCIAL DECENTRALISATION .....	64
3.	FINANCIAL AND BUDGET DISCIPLINE .....	65
4.	ACCOUNTABILITY AND TRANSPARENCY .....	67
VII.	CONCLUSION .....	68

## I. INTRODUCTION

The 2011 Draft Budget was developed in line with the basic assumptions concerning tax and social security/health insurance policy, income policy, public spending, and the fiscal goal concerning the budget balance for the next three-year period, as adopted by the Council of Ministers; these then became the basis for estimating the adopted spending ceilings for individual first-level spending units (FLSUs). The Government set itself the goal to identify mechanisms to deal with the macroeconomic and fiscal challenges facing the economy.

Budget parameters for 2011 were defined in pursuit of the goals set in the first mid-term fiscal framework as adopted by this Government, spanning the Government's term of office, namely:

- To maintain a stable Currency Board at the current pegged BGN/EUR rate;
- To target public expenditure at strengthening factors which accelerate economic growth, in accordance with the relaunched Lisbon Strategy;
- To improve the business environment and investment climate.

The 2011 budget framework has been prepared on the basis of an expected economic growth rate of 0.7 per cent to be achieved as early as in the current year, driven mainly by the external sector. Forecasts show a continuing trend of a moderate growth in exports in real terms. Next year is expected to see also a partial revival in household consumption which reached its lowest at the end of 2009 and early 2010. This will be driven by the Government's determination to ensure that income levels, comprising salaries and pension benefits, is retained while the level of tax/social security burden remains unchanged next year and through to 2013.

The main thrust in fiscal policy for next year is a level of deficit in the consolidated fiscal programme below the threshold of 3 per cent in GDP terms, in accordance with the EU Stability and Growth Pact. The mid-term fiscal goal was revised, from a balanced budget to a deficit in the consolidated fiscal programme, in GDP terms, not to exceed 2.5 per cent for 2011, 1.5 per cent for 2012, and 1.0 per cent for 2013, respectively, with the goal of enabling the operation of automatic stabilisers in the economy and their anti-cyclical role, while making the best of all opportunities for fiscal consolidation and reaching a near-balanced position before the end of the three-year period.

The main risks to fiscal sustainability involve:

- A shift in the structure of economic growth, towards a higher contribution share of net exports and a lower tax collection rate;
- Population ageing, resulting in pressure on the pension and health system;
- Absorption of European funding.

In the 2011 budget, the Government retains direct tax rates at current levels, which are among the lowest in the EU. For example, corporate and personal income tax rates are the lowest compared to all other Member States, and only Cyprus has the same corporate income tax rate of 10 per cent.

The Government will push on with the process of shifting consistently the tax burden towards indirect taxes by raising certain excise tax rates in early 2011, in accordance with its undertakings to reach *de minimis* EU levels. Our tax policy continues to address the challenging task of how to improve tax collection efficiency through measures to be implemented by revenue administrations.

Budget expenditures for 2011 have been estimated on the basis of the following principle: ensure priority financing for the core social responsibilities of the state, and equal treatment for all budgets, in an environment of financial austerity. The budget policy is focused on

strengthening control over public spending and the budget deficit, and the related structural reforms.

The adopted measures for a successful fiscal consolidation have been selected and put together in a mix to ensure a positive impact on growth, with a smooth reduction in budget spending in GDP terms. The fiscal reserve provides fiscal policy flexibility in the course of budget execution and reduces the risks from adverse macroeconomic and fiscal developments.

Fiscal consolidation will enable us to limit the adverse budget effects caused by the decelerated trend in economic growth and the change in its structure.

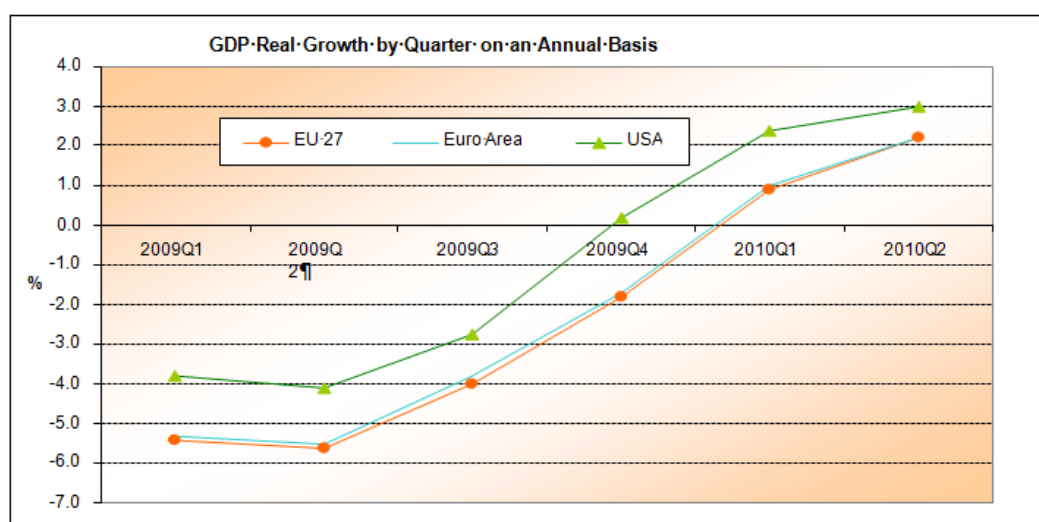
Until this year, all previous governments kept to the deadline for submitting the Draft State Budget Act to the National Assembly as provided in the Organic State Budget Act, which is 31 October. As early as the first week of the political season, the Ministry of Finance concluded its dialogues with the relevant budget appropriations spending units on the 2011 draft budget. This made it possible to keep the commitment to submit it to the National Assembly for discussion earlier, one month before the deadline set in the Council of Ministers' Decision on the Budget Procedure for 2011. The goal is to provide a longer-term time horizon for holding the political debate, and the predictability necessary to companies and households with regard to next year's economic situation and development.

## II. ECONOMIC FRAMEWORK

### *Global economic recovery and first indications of stabilisation in employment rate*

#### 1. The Global Economy: Current Status and Outlook

The global economy is recovering faster than expected. After the dips registered in the first two quarters, the global economy picked up again in the second half of 2009 and early 2010. Indications for a turn-around in the global negative trend became noticeable as early as in the beginning of the second quarter of 2009, when global trade began to stabilise. This recovery has been assisted by monetary and the fiscal policy measures and by a rise in consumer and business confidence. Business activity is on the revamp, both in manufacturing and in the service sector. The rise in output was supported by a considerable increase in new orders placed. The labour market indicators, which reacted to the deteriorated international environment with a certain time lag, exhibited some signs of stabilisation in total employment rate.



Source: Eurostat, US Bureau of Economic Analysis

### *Positive trends in economic development in the US and the European Union*

The positive trends in the economic development of the US and the European Union continue through the first half of 2010. In 2009 the US economy shrank by 2.6 per cent. The anti-crisis fiscal and monetary measures significantly helped recovery in the second half of 2009. According to recent data released by the US Bureau of Economic Analysis, GDP in real terms grew by 0.2 per cent in the fourth quarter of 2009, and growth accelerated to 2.4 per cent in the first quarter of 2010 compared to the same period last year, and 3 per cent in the second quarter, respectively.

In 2009, the European economy also experienced a drop (from 4.2 per cent in EU-27 and 4.1 per cent in the Euro Area), but the downturn slowed down considerably in the second half of the year and stood at 1.8 per cent in the fourth quarter. The recovery was noticed in manufacturing, which stabilised in the second quarter of 2009 and registered a positive growth in the second half of the year, along with the improvement in financial conditions and the

increase in international trade. Outside the Euro Area, output went down more significantly but the fall slowed down in the second half of 2009. The causes of this drop include primarily the dramatic decrease in external demand and tighter restrictions on financing. In addition, diminished consumer confidence and, in some cases, the adverse effects of falling asset prices led to a considerable reduction in domestic demand in the majority of countries. The economy of the EU 27 grew by 0.9 per cent on an annual basis in the first quarter of 2010, and in the second quarter the growth rate accelerated to 2.2 per cent.

After bottoming out in the second half of 2008, oil prices stabilized in the first quarter of 2009, and subsequently moved up, supported largely by the strong demand coming from the Chinese economy. In late 2009, the Brent crude oil price settled at USD 74.7 per barrel, approximately at its mid-2007 level, but for the year as a whole its average price was 36.7 per cent below the 2008 level. From the beginning of 2010, the price of this crude exhibited an upward dynamism; July Brent prices, however, dropped back down to end-of-2009 levels as a result of the US dollar appreciating sharply against the Euro and the increase in US oil stocks. The price is expected to remain in the vicinity of those values in the coming months, and to move up slightly in the mid-term. The reasons lie in expectations for a weaker demand, linked with the accumulation of large oil stocks in developed economies and adequate supply coming from oil-producing countries.

The main risks relating to a sluggish global economic recovery stem from the insecurity surrounding the dynamics of sovereign debts, and the lack of improvement in private consumption. Similar signals are coming from confidence indicators, which recently show a certain relapse of economic agents into more pessimistic attitudes.

## **2. The National Economy: Current Status and Outlook**

### **Gross Domestic Product**

#### ***Shrinking 2009 investment a key factor in the drop in real GDP***

The drop in Bulgaria's 2009 gross domestic product amounted to 4.9 per cent, primarily due to investment shrinking by 29 per cent. Overall, domestic demand had a strong negative contribution in GDP last year, which in turn led to a considerable reduction in imports and an improvement in the balance of trade. The impact of the global economic crisis on the Bulgarian economy was felt in the fourth quarter of 2008, when the GDP growth experienced a slowdown. Throughout 2009, the decline of GDP in real terms kept increasing.

In the first half of 2010, GDP continued to shrink on an annual basis, yet at a decreasing rate. The GDP drop for the first quarter of the year was 3.2 per cent, and 1.4 per cent in Q2. Unlike 2009, the decline in GDP in 2010 was mostly determined by the shrinking consumption. Individual consumption fell by 4 per cent on an annual basis in 2009. In 2010, the trend of declining household consumption continued, and spending by households in the second quarter fell by 4.6 per cent in real terms. A key driver in this negative trend was the insecurity about the future dynamics in household income levels. As regards collective consumption, the decline in 2009 amounted to 4.9 per cent, with expectations for envisaged fiscal consolidation in the current year to result in a negative contribution of government consumption to GDP for 2010 in total.

On the other hand, the contribution of investments for the general reduction of GDP went down in the first half of 2010. In 2009, there was a considerable decrease in investment activity, and the share of gross fixed capital formation in GDP reached 24.4 per cent. Since the beginning of 2010, there has been a slowdown in the decline rate of investment and gross fixed capital formation showed a decrease of 12.2 per cent in real terms in the second quarter. Investment is the most volatile component of GDP and is strongly dependent on the stage in the business cycle and entrepreneur expectations as to the development of the economy in the mid-term.

The contribution of international trade in this semester remained positive. Exports of goods and services accelerated to 12.4 per cent in April-June, and imports are improving at a fast pace and in the second quarter of 2010 have already reached their level from one year ago, mostly due to the higher demand for raw materials in export-oriented industries.

On the output side, the highest negative contribution in 2009 came from manufacturing, but it is already showing signs of recovery. This sector was the first to be affected by the crisis, and in 2009 the decline in value added was 8 per cent. In 2010, the situation in industry started to improve and in the second quarter there is already a positive change of 2.9 per cent on an annual basis. Services were affected by the crisis after a certain delay and reported a decline as late as in the second half of 2009. According to preliminary NSI data for the second quarter, services experienced a minimal decline (by 0.3 per cent on an annual basis). Agriculture reported a 3.8 per cent growth for the April-June period, against a 3.5 per cent drop for the whole of 2009.

### **Labour Market and Income Levels**

*Registered unemployment going down since March 2010 due to seasonal factors*

In 2009 employers focused on cost optimization and labour cost-cutting, as a result of economic activity slowdown, declining sales and limited room for financing their working capital. This was done mostly through rescheduling working hours, cutting jobs and restricting pay rises. Until mid-year, there were noticeable efforts to retain jobs and postpone lay-offs, but the opportunities to sustain those efforts gradually diminished. The average number of employed personnel was down by 0.8 per cent in the first quarter, and the decline worsened to 5.7 per cent in the fourth quarter on an annual basis, while the unemployment rate went up to 7.9 per cent over the last quarter of 2009<sup>1</sup>.

The impact of the crisis on the labour market, which was felt with a time lag of one to two quarters in the various economic activity areas, triggered a process of restructuring enterprises, which in turn led to a diminishing employment rate and a rise in unemployment in late 2009 and early 2010. The fall in

---

<sup>1</sup> According to data from Labour Monitoring (LM).

employment reached 7.7 per cent in the first quarter of 2010 on an annual basis, slowing down slightly in the second quarter but still remaining considerable at 6.9 per cent. From 10 per cent<sup>2</sup> on the average for the April – June period, the unemployment rate plateaued at its record high for the period since the second quarter of 2005. The steepest fall in employment in the first half of 2010 was recorded in manufacturing (11.3 per cent in processing industry, and 20.2 per cent in construction). In the service sector, personnel downsizing accelerated in the first half of the year by 3.5 per cent compared to the first half of 2009.

The limited hiring capacity has been pushing the employment rate down during the past year and a half. In the first six months of 2010, the economic activity rate of the population (aged 15+) was down by 1.5 percentage points compared to the first half of the previous year, and stood at 51.8 per cent.

Since March 2010, registered unemployment has been going down on a monthly basis, driven mainly by seasonal activity increases in the areas of tourism, construction, agriculture, etc. As of late August, the unemployment rate was down to 9.1 per cent, yet remained 1.3 percentage points higher than the unemployment rate in July last year.

***Labour productivity  
bounced back up, income  
levels growth sluggish***

The shrinking of general economic activity in Bulgaria acted as a deterring factor in the dynamics of income from salaries and wages during in the past year and a half. In 2009, the average monthly wages<sup>3</sup> in the Bulgarian economy went up by 8.5 per cent in nominal terms compared to 2008, and the value of that indicator demonstrated a significant slowdown compared to previous years. This trend was manifested both the private and in the public sector of the economy, where, in the period under consideration, wages grew by 7.4 per cent and 9.3 per cent on the average, respectively. The 2009 trend in wages persisted into the first half of the current year. On the average, for the period between January and June 2010, the value of this indicator<sup>4</sup> decelerated to 9.4 per cent in nominal terms, compared to 15.8 per cent in the same period of 2009, with restrictions on wage increases clearly felt both in the public sector (from 18.1 per cent to 4.9 per cent) and in the private sector of the economy (from 14.6 per cent to 11.2 per cent).

The processes of cost optimization observed since the beginning of 2009 had a positive effect on the dynamics of labour productivity<sup>5</sup>. After falling down over the first nine months of 2009, this indicator recovered its positive dynamics in the fourth quarter. In the second quarter of 2010, the real growth rate of this indicator reached 7.4 per cent compared to the respective period of

---

<sup>2</sup> As defined in LM.

<sup>3</sup> According to data from Enterprise Monitoring.

<sup>4</sup> According to preliminary data from Enterprise Monitoring.

<sup>5</sup> This indicator is defined as the ratio between Gross Value Added (GVA) in constant prices and the number of persons employed according to data from NAS.



2009 as a result of the successful adaptation of entrepreneurs in most economic activities. The revival of labour productivity in the Bulgarian economy on the one hand, and the restriction on rate of wage increase on the other, had a beneficial effect on the dynamics of employers' labour costs per unit of production<sup>6</sup>.

## **Inflation**

*Slower inflation growth influenced by low domestic and external demand and falling prices on international markets*

The dynamics of inflation in 2009 was largely influenced by low domestic and external demand and falling prices of foodstuffs and energy goods in international markets. Inflation in terms of a harmonised consumer price index reached 1.6 per cent in the end of the year, while its annual average was 2.5 per cent. Inflation was driven up considerably by higher excise tax rates on tobacco products, which caused a 24-per cent increase in their prices and contributed 0.7 percentage points to total inflation. At the same time, food prices and energy goods prices followed a pronounced downward trend and served as some of the key factors behind the slowdown in the inflation rate increase. Prices of non-energy industrial goods also registered a significant slowdown to 0.8 per cent, due to a strong contraction in household consumption of non-foods.

Reduced economic activity in its turn led to a fall in employment and a slowdown in the dynamics of nominal wages, which contributed to a reduction in the inflation rate, not only for products of the processing industry but also in the service sector. Thus, the inflation for this component at the end of 2009 reached 3.4 per cent on an annual basis, against 11.4 per cent for the same period of 2008.

Following a distinct downward trend, inflation began to rise on an annual basis as early as from the end of 2009, under the influence of the rising international prices of energy products. As of August 2010, the annual rate of inflation was up 3.2 per cent, with energy goods and tobacco products accounting for most of the increase, with 1.1 and 1.4 percentage points, respectively. The impact of higher oil prices was strengthened by the depreciation of the single European currency against the US dollar, which affected domestic prices of oil products as well. As a result of the new, higher excise tax rates on cigarettes introduced at the beginning of 2010, cigarette prices registered a 34-per cent increase over the first eight months. The annualized fall in food prices decelerated considerably, reaching zero per cent as of August, against a fall of -4.2 per cent at the beginning of year. On the other hand, shrinking domestic demand led to a dramatic slowdown of inflation rate for services and non-foods, which continues to-date.

---

<sup>6</sup> This indicator is defined as the ratio between GVA per person employed and employee compensation per person employed in current prices according to data from NAS.

## Balance of Payments

*The current account deficit is down and the trade balance improves*

Over the past year and a half, the external sector dynamics of the Bulgarian economy was affected by the adverse international environment, which resulted in a shrinking economic activity, both in Bulgaria and in our major international trade partners, an lower inflow of foreign direct investment in comparison to previous years, a slowdown in the increase of income levels in Bulgaria, and a fall in international prices of a number of raw materials significant for the Bulgarian economy.

As a result of all those factors, Bulgaria's balance of payments experienced certain considerable adjustments. In 2009, the current account deficit went down to 9.9 per cent in GDP terms and continued to improve in the first half of 2010. The January - July deficit is below 1 per cent of the expected GDP for 2010.

*An increase in Bulgarian exports as a result of a revived external demand and rising international prices of commodities and raw materials*

The improved trade balance had the greatest contribution in reducing external imbalances. In 2009 was marked by decreases in nominal terms both in imports (-33 per cent) and exports (-22 per cent). Exports hit a bottom in their dynamics in April 2009 (-39 per cent compared to its April value the previous year), and then decreases slowed down. In November last year, Bulgarian exports made a turn around, registering an increase on an annual basis as a result of the revived external demand and rising international prices of commodities and raw materials. The upward trend has persisted since the beginning of 2010, and the rate of increase even accelerated, reaching 46 per cent in July.

In imports, the dynamics took considerably longer to turn around. After peaking in June 2009, the decline in imports decelerated to 11 per cent on an annual basis in February 2010, and there has been a positive growth since March. This increase is largely due to higher prices on international markets and the higher demand for commodities and raw materials necessary for manufacturing in the export-oriented industries. The trade balance deficit for January - July 2010 shrank to -4 per cent of GDP, against -8 per cent of GDP for the same period in 2009.

The first half of 2010 was marked by a considerable balance improvement in services. This is largely due to the continuing drop in the travels of Bulgarian nationals abroad and the decline in spending on other services. Despite the increased number of visits by foreign nationals to Bulgaria, the lower prices of tourist services have kept revenues from tourism at the levels recorded last year.

Net income and current transfers also contributed positively to improving the current account position in the period under consideration, due to lower investment income paid out to foreign nationals, and transfers from EU funds, respectively.

In 2009, the balance in the financial account fell by more than EUR 9 billion and stood at EUR 2.2 billion, thus covering 68 per cent of the current account deficit. The inflows of foreign direct investment as of December reached EUR 3.2 billion, which is half of the 2008 figure. A decline in investment activity was observed

in all sectors, most visibly in financial intermediation, real estate and trade.

***Financial account running a deficit***

The negative trend in the financial account continued into the current year. In the first seven months of 2010, FDIs amounted to EUR 731 million, showing a 62-per cent decrease compared to the respective period in the year before. There is a significant drop both in initial investments in equity, and in subsequent intra-company lending. Net repayment of loans and deposits from previous years by Bulgarian banks continued into the current year, and the balance in other investments stood at EUR -635.2 million (against EUR -663.1 million for the same period in 2009). Since the beginning of this year, banks have been withdrawing their funds invested in deposits abroad, and for the first 7 months these withdrawals amounted to EUR 505.8 million. A similar trend was exhibited in other sectors as well. There, foreign deposits totalling EUR 162.8 million have been closed down since the beginning of the year. These actions by the private sector are probably in response to the rise on the price of international loans, which currently makes it cheaper to use one's own funds for financing than to borrow. As a result of the significant drop in foreign direct investment in Bulgaria and this banking activity, the financial account ran a deficit of EUR 459 million for the period January - July 2010 (compared to a surplus of EUR 679 million a year earlier).

**Monetary Sector**

***Maintaining financial system stability***

**The Currency Board remained stable throughout 2009** and over the past months of 2010, enjoying the full confidence of the population and all institutions, and serving as a guarantee for maintaining the stability of the financial system. At the end of 2009, Bulgaria's international reserves reached EUR 12.9 billion and provided a monetary base cover ratio of 195.2 per cent. Over the first several months of 2010, international reserves were going down, yet in the second quarter and early third quarter the trend reversed and at the end of August FX reserves reached EUR 12.5 billion, covering the monetary base 186.2 per cent.

The international reserves cover of imports of goods and non-factor services remained high on an annual basis throughout the period under consideration. At the end of 2009, it reached 8 months, and its improvement was due to the negative dynamics of imports. At the end of July 2010, international reserves cover of imports dipped slightly to 7.6 months. The international reserves cover of short-term external debt went down in early 2009 as a result of BNB's actions to reduce the minimum reserve requirement. The reserves/short-term debt ratio kept improving throughout the year, reaching 100.2 per cent at yearend. As of the end of June of the current year, the international reserves cover of short-term external debt improved to 103.7 per cent.

Private sector lending has exhibited a certain revival since May 2010, yet the annual rates of increase of that indicator remain low. Private sector lending has consistently been slowing down its annual rate of increase from 31.1 per cent in early 2009 to 3.8 per

cent at yearend, and 1.9 per cent in April 2010. In subsequent months, there has been no clear trend in the growth of credit, but it has been increasing at considerably lower rates compared to a year ago (2.4 per cent in July 2010 versus 8.2 per cent in July 2009). Housing loans have been growing at the fastest rate on an annual basis – by 6.2 per cent in July (8.4 per cent in December, and 15.1 per cent at the end of July 2009), with the trend of a slowdown in their rate of increase reversing after the first quarter. Consumer loans grew at 5.5 per cent at the end of July, compared to 3.1 per cent in the same month in 2009, and 6.9 per cent in December. Corporate loans showed the lowest rate of increase, 1.3 per cent, having reached a rate of increase of 6.8 per cent in July the previous year, and 2.3 per cent at the end of 2009.

***A well-capitalised and liquid banking system***

Banks did not experience any difficulty in terms of liquidity thanks to the significant amount of new deposits raised on the domestic market.

The total volume of deposits has been growing at comparatively stable annual rates over the period under consideration. At the end of 2009, deposits grew by 6.4 per cent, and towards the end of July 2010 its annualized rate of increase accelerated to 10 per cent, due to the positive rate of increase in overnight deposits which had been going down on an annual basis throughout 2009.

In the first half of the year, the interbank money market was characterized by the continuing decline in interest rates and in the respective indices, which additionally confirms the increased liquidity and the confidence between banking institutions. A similar trend was registered by the dynamics of interest rates on new deposits and loans in the main currencies (the Bulgarian lev and the Euro). Both trends began shaping in mid-2009. The drop in the interest rates on deposits was more pronounced than the decline in interest rates on new loans. The fall in interest rates on deposits, however, did not lead to a fall in new deposits, and the decline in lending rates did not lead to a recovery of the new loan volumes to higher levels.

The assets of commercial banks reached BGN 70.9 billion at the end of December 2009, and at the end of July of the current year picked up slightly to BGN 71 billion. Their rate of increase on an annual basis was slowing down until the end of the third quarter of the previous year, while remaining relatively stable since the last quarter, oscillating around the 2-per cent level (1.9 per cent in December 2009, and 2.3 per cent at the end of July 2010).

Despite the high rise in loan depreciations, banks manage to run positive profits which totalled BGN 780.2 million for the calendar year 2009 (an annual decrease of 43.7 per cent), while the end-of-July profits reached BGN 401.8 million, or 26.6 per cent lower, in comparison to the profits earned in the same period of the previous year. The banking system is well capitalised, with the total capital adequacy ratio at the end of the second quarter of 2010 standing at 18 per cent (vs. 17.6 per cent a year earlier, and 17 per cent at the end of 2009). The liquid assets ratio in the same period improved from 21.3 per cent to 22.1 per cent. In the past year, a significant deterioration was registered in terms of the quality of bank loan portfolios. The share of loans overdue 90 days plus grew from 4.3 to 8.9 per cent for the period.

### 3. Macroeconomic Outlook

*European economic recovery continues*

*The external sector drives the growth rate of the Bulgarian economy*

#### **Basic Assumptions Used in Developing the Macroeconomic Framework**

This forecast assumes that the European economy will continue to recover, reaching a growth rate of about 1 per cent in 2010 and 1.7 per cent in 2011. Over the same period, the global economy will grow at 4.2 per cent in 2010 and 4.3 per cent in 2011.

The dynamics of international prices in the mid-term remains uncertain, with price volatility expected for both oil and metals. Overall, markets of the main groups of commodities which have a strong influence on the Bulgarian economy (oil, metals and agricultural commodities) enjoy an adequate level of supply, and price increases in the mid-term, if any, will be minimal. The forecast also takes into account the Government's intentions to keep external financing in 2011 positive, at BGN 2 billion.

***Table: Key Macroeconomic Indicators***

Macroeconomic Indicators	2009	2010	2011
	Reported	Expected	Projections
<b>GDP (million BGN)</b>	<b>68537.2</b>	<b>71726.4</b>	<b>77076.7</b>
- real growth rate ( in percentage)	-4.9 %	0.7 %	3.6 %
<b>Harmonised inflation (in percentage)</b>			
- end of year	1.6 %	4.5 %	2.6 %
- average for the period	2.5 %	3.2 %	3.7 %
<b>Exchange rate (USD/BGN)</b>			
- end of year	1.36	1.58	1.58
- annual average	1.40	1.53	1.58
<b>Current account (in EUR million)</b>			
- as a percentage of GDP	-9.9 %	-3.3 %	-3.5 %
<b>Foreign direct investment (million EUR)</b>	3281.9	1500.0	1980.0
- as a percentage of GDP	9.4 %	4.1 %	5.0 %

#### **Expectations about Developments in the Key Macroeconomic Indicators**

##### **Gross Domestic Product**

**2010 is expected to exhibit a weak economic growth of 0.7 per cent, with the external sector as the motor of economic activity.** The positive development of the Bulgarian economy has to do with an increased demand coming from our international trade partners. Bulgarian exports showed a moderate real growth in the first half of 2010, and this trend is expected to continue. For the entire 2010, the increase on the volume of exports will be about 12 per cent, and in 2011 it will reach almost 10 per cent.

**Domestic demand is expected to show a positive growth in 2011.** As a result of the higher unemployment rate and deteriorating expectations about the economic environment, households increased their cost-cutting at the end of 2009 and early 2010. Thus, for 2010 in total, household consumption is expected to register a real decline of 3.5 per cent. Volumes will recover in 2011, when a growth rate of 4.1 per cent is expected.

**Investment will also continue to fall in 2010, although at a considerably lower rate (-4.2 per cent) compared to their quick adjustment in 2009.** In 2011, a higher investment activity and hence a 4.5 per cent real increase in gross capital formation are expected.

**The shrinking domestic demand determines also a low rate of increase in 2010 imports.** Accelerated exports will exert pressure in the opposite direction, as the demand for raw materials necessary for export-oriented industries will rise. The imports growth in real terms will be limited to 2.2 per cent in 2010, and the revival in domestic demand will lead to imports growing at a rate of 8.1 per cent in 2011.

### **Labour Market and Income Levels**

*A slight increase in the number of employed persons in 2011 and a fall in unemployment as a result of expected investment activity revival*

**The 2010 outlook includes a reduction in the number of employed persons and an increase in the unemployment rate compared to 2009, as a result of a certain lag with which the labour market reacts to processes underway in the economy** and the continuing restructuring processes in enterprises. This determines the expected growth in labour productivity, following the decrease in 2009. The fall in the employment rate is expected to slow down gradually by the end of the year. The decrease in unemployment observed in recent months is related to the influence of seasonal factors which will fade away and unemployment will continue to rise. The annual average unemployment rate is expected to stand at about 9.6 per cent<sup>7</sup>. The expected economic growth and revival in investment activity in 2011 will be accompanied by a slight increase in the employment rate of about 0.6 per cent compared to 2010, and a slight drop in unemployment, taking it to about 9.4 per cent.

**In 2010, the dynamics in wages in the total Bulgarian economy will be marked once again by a slowdown compared to the previous year,** taking into account the expectations for a lower labour demand. In the public sector, income is expected to retain its 2009 level, in line with the general economic development and taking into consideration the country's fiscal position. In 2011, the nominal increase in wages will continue along the trend of development exhibited in the previous two years, and for the period 2012-2013 this indicator will speed up on an annual basis in line with the general dynamics in the economy.

### **Inflation**

*The inflation rate will largely depend on developments in international prices*

**At the end of 2010, the annual inflation rate is expected to go up to 4.5 per cent, with an annual average increase of 3.2 per cent.** This acceleration will be caused by food prices which are expected to rise, driven up by higher prices of energy goods and by the fading away of the basic effect of low prices at the end of last year. In non-foods and services, expectations are for the currently low monthly rates of price increases to remain, due to weak domestic demand.

---

<sup>7</sup> Estimates are based on data from LM.

**In the next years of the period 2011 - 2015, the end-of-year inflation will decline gradually.** The economic recovery on the supply side will hold down the rate of increase in prices, mostly in tradable goods, since the outlook envisages a higher growth rate in industrial output and hence in labour productivity in industry than in construction and services. Prices of commodities oil prices in international markets are not expected to grow at high rates. Relatively higher consumer prices are expected in services, in comparison to foodstuffs and non-foods, since the former will be pushed up by the increase in the cost of labour per unit of production.

*Exports will grow faster than imports, stabilizing the balance of trade and the current account balance*

### **Balance of Payments**

The 2010 current account deficit is expected to decrease to 3.3 per cent of GDP, compared to over 9.9 per cent in 2009. The trade balance improvement is a major factor behind this dynamics. The economic recovery of Bulgaria's major international trade partners in combination with domestic demand still remaining weak, will lead to an annual growth in the export of goods of 16 per cent in real terms at the end of 2010, while the increase in imports will stand at 5 per cent. Thus, the trade balance deficit will shrink from 11.9 per cent of GDP in 2009 to under 7.8 per cent of GDP in 2010. The rates of increase of exports are expected to remain slightly ahead of those of imports after 2011 as well, thus stabilizing the trade balance and the current account balance in the mid-term.

*Adequate cover of external imbalances by FDIs*

The global financial crisis will continue to have an adverse effect on financial account flows which the Bulgarian economy attracts. End-of-year foreign direct investments are expected to register a significant drop in comparison to levels recorded last year. Nevertheless, taking into account the dramatic reduction in the current account deficit, external imbalances will be well covered by FDIs. Post-2011, FDI inflows are expected to climb up gradually; their volume, however, will remain at levels considerably below values reached in the period between 2005 and 2008.

### III. 2010 CONSOLIDATED FISCAL PROGRAMME

*A trend of export-based growth, with a negative effect on indirect tax revenues*

#### 1. Execution of the Consolidated Fiscal Programme as of July 2010

In late 2009, the economy began to readjust and gradually focused on a growth model increasingly based on exports, as evidenced by data on the first two quarters in 2010. The changed mix of GDP components does not allow indirect taxes, which are the backbone of tax revenue for the budget, to grow quickly, since exports are tax-exempt. This called for a careful analysis and revision of the fiscal framework for the year.

**Table: Execution of Key CFP Parameters as of 31 July 2010 (in BGN million)**

INDICATOR	Revised projections 2010 CFP	Reported as of 31.07.2010			Execution 31.07.2010/projections
		CFP	National budget	European funds <sup>1</sup>	
c. 1	c. 2	c.3 = c.4+c.5	c.4	c.5	c.6 = c.3/c.2
<b>REVENUE AND GRANTS</b>	<b>24 548.1</b>	<b>1 513.9</b>	<b>12 572.5</b>	<b>941.5</b>	<b>55.1 %</b>
Tax revenue	19 217.9	10 355.8	10 354.8	1.0	53.9 %
Direct taxes	3 477.6	2 152.6	2 152.6		61.9 %
Indirect taxes	9 852.0	4 925.8	4 925.8		50.0 %
Revenue from social security and health insurance contributions	5 167.8	2 829.0	2 829.0		54.7 %
Other taxes*	720.5	448.4	447.4	1.0	62.2 %
Non-tax revenue	3 398.4	2 170.2	2 159.2	11.0	63.9 %
Grants	1 931.8	988.0	58.5	929.4	51.1 %
<b>EXPENDITURE AND CONTRIBUTION TO THE EU GENERAL BUDGET</b>	<b>27 810.2</b>	<b>14 744.9</b>	<b>13 761.1</b>	<b>983.7</b>	<b>53.0 %</b>
Non-interest	25 105.0	13 920.8	12 937.0	983.7	55.4 %
Current	21 311.6	12 453.7	12 048.4	405.3	58.4 %
Capital	3 793.4	1 467.1	888.7	578.4	38.7 %
Interest	507.3	411.5	411.5		81.1 %
Reserve for contingency and urgent needs <sup>2</sup>	1 418.2				
Contribution to the EU general budget	779.7	412.6	412.6		<b>52.9 %</b>
Transfer from the central budget			-113.0	113.0	
<b>BUDGET BALANCE</b>	<b>-3 262.1</b>	<b>-1 230.9</b>	<b>-1 301.7</b>	<b>70.8</b>	

\* Including proceeds from sugar levies.

<sup>1</sup> European funds include funds disbursed under EU pre-accession instruments, funds under operational programmes funded by the EU Cohesion and Structural Funds (managed by the National Fund within the Ministry of Finance), and the European Agricultural Fund for Rural Development and the European Fisheries Fund (managed by the Payment Agency within State Fund Agriculture). European funds include also national co-financing for European programmes.

<sup>2</sup> Line item "Reserve for contingency and urgent needs" shows projections only.



*First positive signs of tax revenue stabilisation*

*Execution of the Revenue Side*

*Revenues under the Consolidated Fiscal Programme (CFP) amounted to BGN 13 513.9 million as of July 2010*, which is 55.1 per cent of annual projections. Tax revenues amounted to BGN 10 355.8 million, or 53.9 per cent of the total amount projected for the year. Non-tax revenue and grants amounted to BGN 3 158.1 million, which is 59.2 per cent of the total amount projected for the year.

The key parameters of revenue execution as of July remain within the projections set out in the 2010 State Budget of the Republic of Bulgaria Act (the 2010 SBRBG Act). The first positive signs of a stabilisation in tax proceeds can already be noticed (mostly in indirect taxes), with the consolidated tax revenue figure for July standing higher than the figure for July 2009. Although exhibiting a modest nominal growth, that has been the first month to register a growth in tax revenue on a monthly basis since the beginning of the year. Tax revenue execution corresponds to the improvement in a number of indicators defining the economic situation and the beginnings of a revival in the manufacturing and agricultural sectors in the second quarter of 2010.

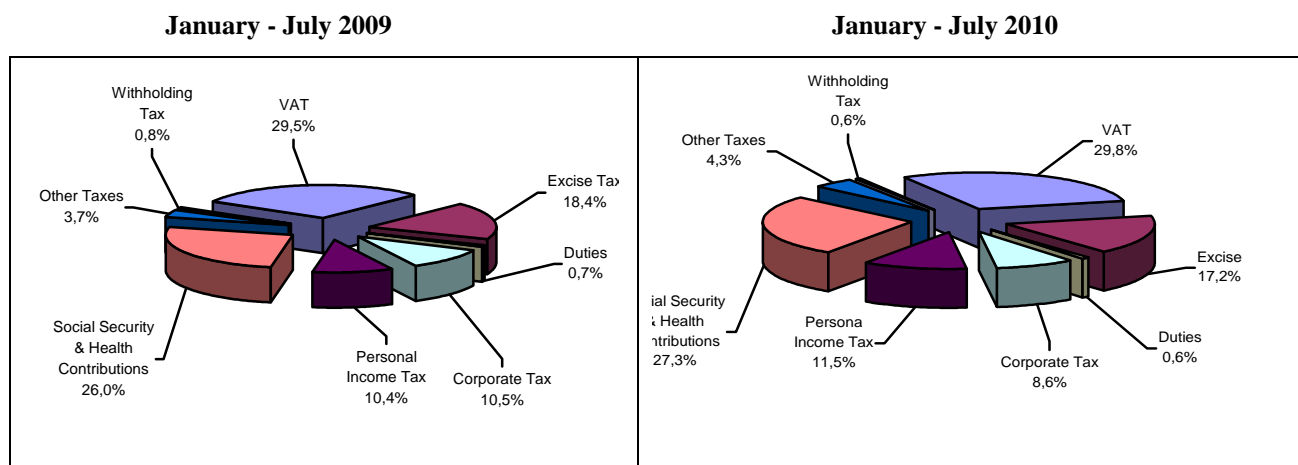
On the other hand, revenue administrations have focused their efforts on improving the tax collection rate. Active measures to strengthen controls in trade in excisable goods, eliminate contraband, counteract any attempts at tax irregularity and fraud are at the core of those efforts, and their consistent application will have a long-term disciplining effect and exert systematic pressure on the shadow economy.

A comparison with data reported for the first seven months of 2009 reveals clearly the impact of certain one-off effects. In January 2009, VAT revenue from intra-Community acquisitions (ICAs) stand considerably higher than the weighted average revenue for the remaining months of 2009. This is due to one-off VAT proceeds in January 2009 linked to expenditure incurred in at the end of 2008. Consolidated December 2008 expenditure is twice as high as the weighted average expenditure in previous months of 2008, which determines the higher amount of VAT from ICAs declared as due in January 2009. Those proceeds however are one-off for the year and 2010 does not exhibit any such effect. On the other hand, in the first months of 2010, there were refunds of VAT and excise tax for previous periods, which also have a one-off effect.

The execution of annual projections in the main compound budgets as of the end of July 2010 was as follows: revenue and grants received in the national budget for the reporting period amounted to BGN 8 469.6 million, or 55.6 per cent of projections budgeted in the 2010 SBRBG Act; proceeds to the budgets of social security and health insurance funds amounted to BGN 2 869.1 million, or 55.0 per cent of revenues budgeted for the year; the revenue in the budget of the judiciary amounted to BGN 72.7 million, which is 76.5 per cent of revenue projected for the year; municipal budgets received BGN 918.7 million, or 53.9 per cent of the total amount projected for the year, and so on.

The following chart shows the tax revenue structure of the CFP for the first seven months of 2009 and 2010:

**Chart: Tax Revenue Structure**



Tax revenues (including revenue from social security and health insurance contributions) amounted to BGN 10 355.8 million or 53.9 per cent of annual projections. Revenue from *direct taxes* amounted to BGN 2 152.6 million, which is 61.9 per cent of annual projections, compared to BGN 2 540.9 million for the same period of last year. In nominal terms, revenue from direct taxes fell by BGN 388.3 million compared to the previous year, which is largely due to the lower economic activity of enterprises.

Revenue from *indirect taxes* amounted to BGN 4 925.8 million, down by BGN 743.1 million, and 86.9 per cent of the amount reported in the same period of 2009. Proceeds for the period correspond to 50.0 per cent of annual projections.

As of 31.07.2010, VAT revenue amounted to BGN 3 081.3 million, or a 52.6 per cent execution of annual projections. Compared to July 2009 proceeds, receipts in the reporting period were BGN 365.9 million less. A decrease in VAT revenue was registered for almost all industries, the greatest being in fuel production and trade, energy, metallurgy and construction.

Excise tax revenue for the period amounted to BGN 1 780.1 million, or 45.6 per cent of the annual projections. Revenue from customs duties and fees in the first seven months of 2010 amounted to BGN 64.4 million, or 70.0 per cent of the annual projections.

Revenue from *other taxes* (which includes other taxes charged under the Corporate Income Tax Act, property taxes, proceeds from sugar levies, etc.) amounted to BGN 448.8 million, which accounts for 62.2 per cent of the total amount projected for the year.

Revenue from *social security and health insurance contributions* as of 31.07.2010 amounted to BGN 2 829.0 million, or 54.7 per cent of projections in the 2010 SBRBG Act.

**Non-tax revenue** for the first seven months of the year within the consolidated fiscal programme amounted to BGN 2 170.2 million, which is 63.9 per cent of the total amount projected for the year. Non-tax revenue received in the budgets of ministries and agencies amounted to BGN 734.7 million. The execution of non-tax revenue in the central budget amounted to BGN 510.9 million, or 90.8 per cent of the projections for the year. The high execution rate for the period is due to the transfer of BNB's surplus of revenue over expenditure, in the amount of BGN 354.7 million, and the receipt of dividends from companies with government equity participation, in the amount of BGN 112.5 million. As of the end of July, budgets of municipalities received BGN 563.5 million, or 51.0 per cent of the amounts projected for the year.

Receipts of *grants* (mostly co-financing from the EU Structural and Cohesion Funds carried in the budget of the National Fund, and proceeds from the European Agricultural Fund for Rural Development to the budget of the Payment Agency within State Fund Agriculture) in the first seven months of 2010 amounted to BGN 988.0 million (51.1 per cent of projections). The July increase in grant revenue is largely due to reimbursements in the amount of BGN 330.8 million by the European Commission in connection with the JEREMIE initiative providing support to small and medium-sized enterprises.

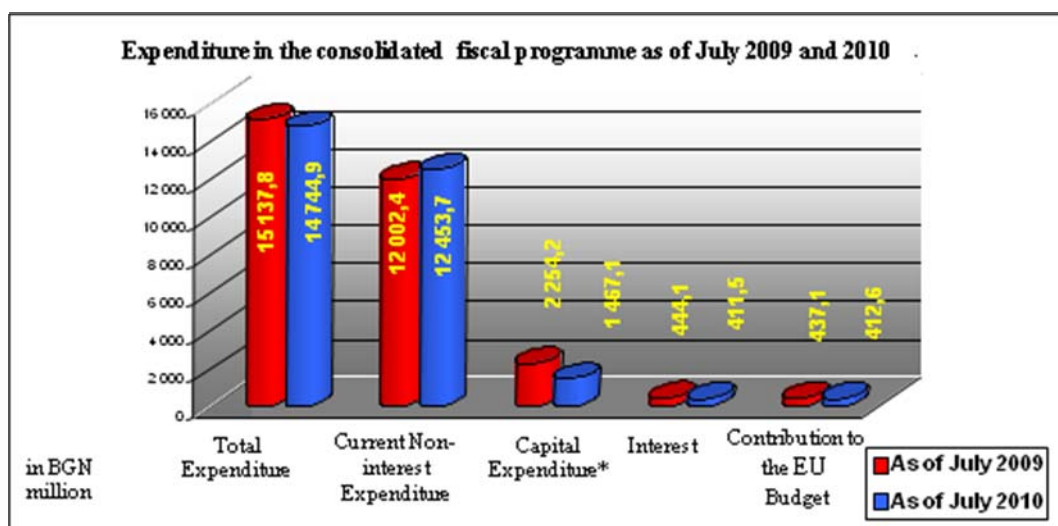
### Execution of the Expenditure Side

*An increase in expenditure for social and health benefits primarily due to the rise in pension benefits in 2009*

In the first seven months of 2010, **expenditure in the consolidated fiscal programme** amounted to BGN 14 744.9 million, which is 53.0 per cent of the annual projections. *Interest payments* amounted to BGN 411.5 million (81.1 per cent of the amount budgeted for 2010), *current non-interest expenses* were BGN 12 453.7 million (58.4 per cent of the total amount projected for the year) and *capital expenditure* amounted to BGN 1 467.1 million (38.7 per cent of annual projections). The nominal amount of expenditure in the first seven months of 2010 was lower than in the same period the previous year.

A year-on-year comparison to the same period in 2009 reveals a considerable change in the structure of expenditure. The increase in social and health expenditure (by 11.9 per cent compared to its level in the same period of the previous year) was primarily due to the impact of the increase in pension levels in 2009.

**Table: Key CFP Expenditure Indicators as of July 2009 and 2010**



\* Including net gain in government reserves

## ***Expenditure in Key Compound Budgets in CFP***

### **National Budget**

As of 31.07.2010, the total amount of **expenditure in the national budget** (including transfers to other budgets and the contribution to the EU budget) was BGN 9 549.9 million, or 50.5 per cent of estimates projected in the 2010 SBRBG Act.

**Non-interest expenditure in the national budget** (excluding transfers to other budgets) incurred in the reporting period amounted to BGN 3 745.1 million, which is 55.3 per cent of the spending budgeted in the 2010 SBRBG Act. Compared to 2009 data, non-interest expenditure was down by 19.0 per cent as a result of measures undertaken to cut spending in 2010. Expenditure for salaries and other personnel remuneration, and for social security and health insurance contributions totalled BGN 1 492.1 million, or 59.3 per cent of the annual estimate. Current maintenance cost amounted to BGN 1 018.4 million (48.9 per cent of the total amount projected for the year). Social spending (including scholarships) amounted to BGN 469.1 million, or 64.2 per cent of the spending item in the 2010 SBRBG Act, and consists mainly of expenditure planned in the budget of the Ministry of Labour and Social Policy for entitlements under the Integration of People with Disabilities Act, the Family Benefits for Children Act, the Social Assistance Act, etc. Expenditure for subsidies amounted to BGN 315.9 million, or 71.2 per cent of annual projections. Capital expenditure (including net increase in government reserves) amounted to BGN 449.6 million, or 45.0 per cent of the total amount projected for the year.

*Interest payments* made as of the end of month July amounted to BGN 398.5 million, of which BGN 288.5 million in interest paid on external loans and BGN 110.0 million in interest paid on domestic loans.

*Transfers* from and to other compound budgets within the national budget totalled net transfers in the amount of BGN 4 993.8 million, or 51.8 per cent of the annual projection.

### **Expenditure in the Budgets of Social Security and Health Insurance Funds**

Spending in the budgets of social security and health insurance funds (the National Social Security Fund, the National Health Insurance Fund, the Teachers' Pension Fund and the Wage Claims Guarantee Fund) as of July 2010 amounted to BGN 5 869.0 million, which is 57.1 per cent of the total amount projected for the year, of which pensions, aid and benefits under the Social Security Code in the amount of BGN 4 725.8 million, and health insurance payments of BGN 1 063.9 million.

### **Expenditure in the Budgets of Municipalities**

**Expenditure incurred in local budgets** amounted to BGN 2 348.1 million, or 63.3 per cent of projections in the 2010 SBRBG Act, including from special transfers from budgets. Current expenditure amounted to BGN 1 985.5 million (65.5 per cent of the annual projection), while capital expenditure amounted to BGN 362.6 million, or 53.3 per cent of the 2010 projection.

**The CFP budget balance** as of the end of July was negative at BGN 1 230.9 million, resulting from a national budget deficit in the amount of BGN 1 301.7 million and a surplus of revenue over expenditure in European funds in the amount of BGN 70.8 million.

The fiscal reserve stood at BGN 6.3 billion in current exchange rates as of 31.07.2010.

*Consolidated budget deficit on an accrual basis is expected to reach about 3.8 per cent of GDP in 2010*

## **2. Expected Execution of the Consolidated Fiscal Programme as of the End of 2010**

Estimates of the execution under the key parameters of tax revenue as of July and preliminary estimates for August indicate that the overall execution of tax revenue in the national budget is likely to remain within projections set in the 2010 SBRBG Act, with the surplus in VAT revenue offsetting likely lower proceeds from excise tax.

The impact of recent amendments to the Social Security Code implies a decrease in expenditure in the budget of State Social Security, which will offset the shortfall of proceeds from contributions relative to the budgeted amount.

The economic slowdown in 2010 has had a significant negative effect on the revenue side of the budget. For the period January–July 2010, tax revenues in the national budget fell by 13.5 per cent compared to the same period in 2009, with a drop registered in both indirect and direct taxes. VAT revenue in particular, which has the greatest contribution in total tax revenue in the national budget, is affected on the one hand by tax refunds paid out at the beginning of the current but generated in 2009, and on the other hand, by the change in the structure of economic activity in Bulgaria, namely, increasing exports and shrinking domestic consumption.

Revised projections adopted in the Amending Act on the 2010 State Budget estimated a cash deficit in the consolidated fiscal programme in the amount of 4.8 per cent of GDP at the time of preparing the amending budget, as a result of a national budget deficit of 3.9 per cent of projected GDP, and a deficit in European funds of 0.9 per cent of projected GDP.

Estimates of the deficit amount on an accrual basis project a consolidated budget deficit for 2010 of about 3.8 per cent of GDP.

## **IV. KEY ASPECTS OF THE 2011 BUDGET POLICY AND FISCAL POSITION SUSTAINABILITY**

### **1. Fiscal and Budget Policy Goals for 2011**

*Fiscal consolidation aimed at keeping CFP deficit under 3 per cent of GDP, in accordance with the Pact for Stability and Growth*

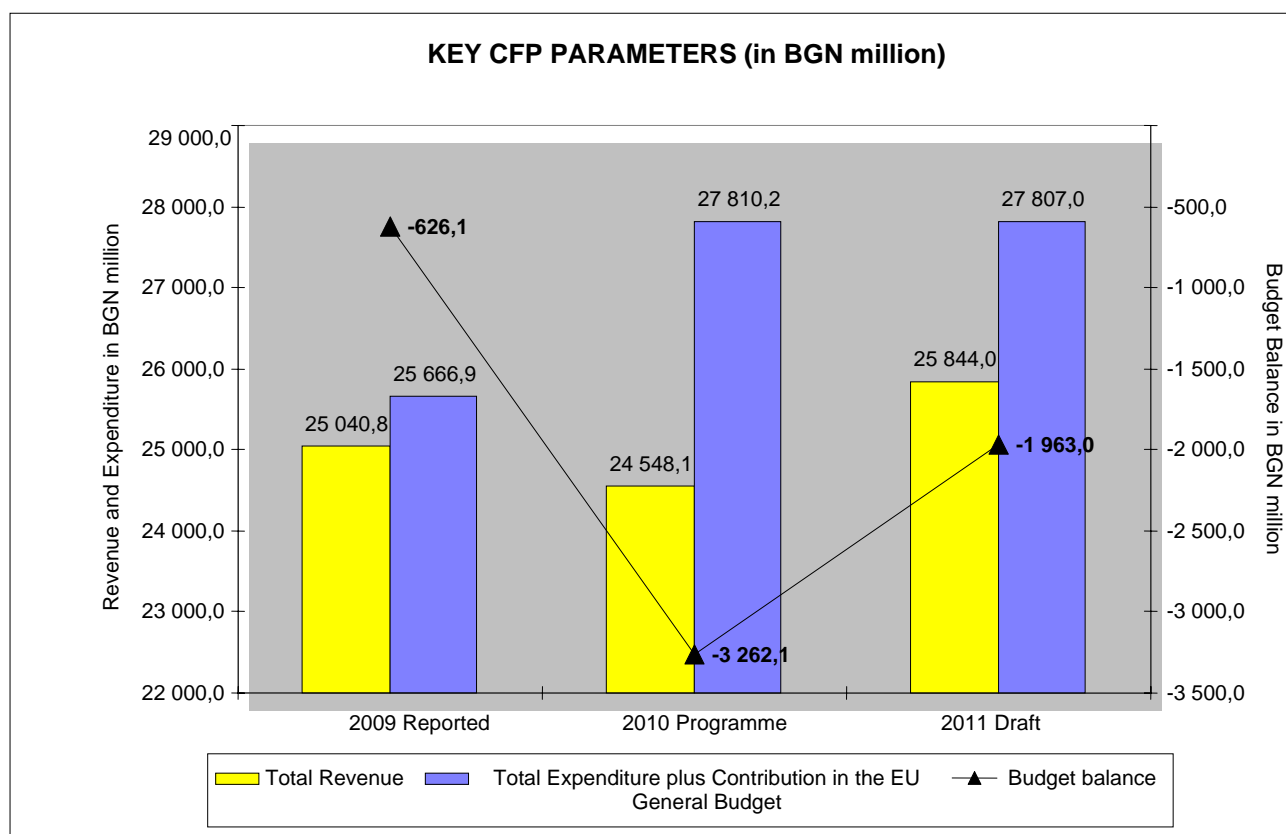
The main goal of the fiscal policy for next year is to keep the deficit in the consolidated fiscal programme below the threshold of 3 per cent of GDP, in accordance with the Stability and Growth Pact. The mid-term fiscal goal was revised, from a balanced budget to a deficit in the consolidated fiscal programme not to exceed 2.5 per cent in 2011, 1.5 per cent in 2012 and 1.0 per cent in 2013 in GDP terms, so as to ensure the action of automatic stabilisers in the economy and their anti-cyclical role while exploring all possibilities for fiscal consolidation and achieving a near-balanced position before the end of the three-year period.

Unlike the other Member States in an excessive deficit procedure, as a result of the fiscal consolidation efforts which Bulgaria undertook as early as in the 2011 budget, the country is back below the 3-per cent threshold and ranks among countries running the lowest deficits such as Sweden, Estonia and Finland, with deficits of 1.6 per cent, 2.4 per cent and 2.9 per cent of GDP, respectively. In the mid-term, the Government will continue to implement a conservative and disciplined fiscal policy, at the same time allowing for flexibility instruments enabling it to respond in a timely manner to external and internal risks in the conditions of economic recovery.

Fiscal policy goals are being achieved through measures aimed at fiscal consolidation, improved revenue collection efficiency and tighter control over spending. Fiscal consolidation measures have been selected and put together in a mix producing a positive effect on the growth rate while gradually reducing consolidated expenditure below the public expenditure threshold of 40 per cent of GDP observed by previous governments. The implementation of the reforms in the respective sectors launched this year will ensure the public sector optimization sought by the Government, which in its turn will improve the efficiency and effectiveness of spending and keep expenditure at the lower end of the range between 35 and 38 per cent of GDP.

## 2. Key Parameters of the Consolidated Fiscal Programme for 2011

The consolidated fiscal programme (CFP) for 2011 makes it possible to implement the Government's priorities while controlling possible risks and observing the necessary budget restrictions in accordance with the pursued fiscal policy in support of macroeconomic stability.



The 2011 consolidated fiscal programme is based on the revised macroeconomic forecast and takes into account the economy's cyclical development.

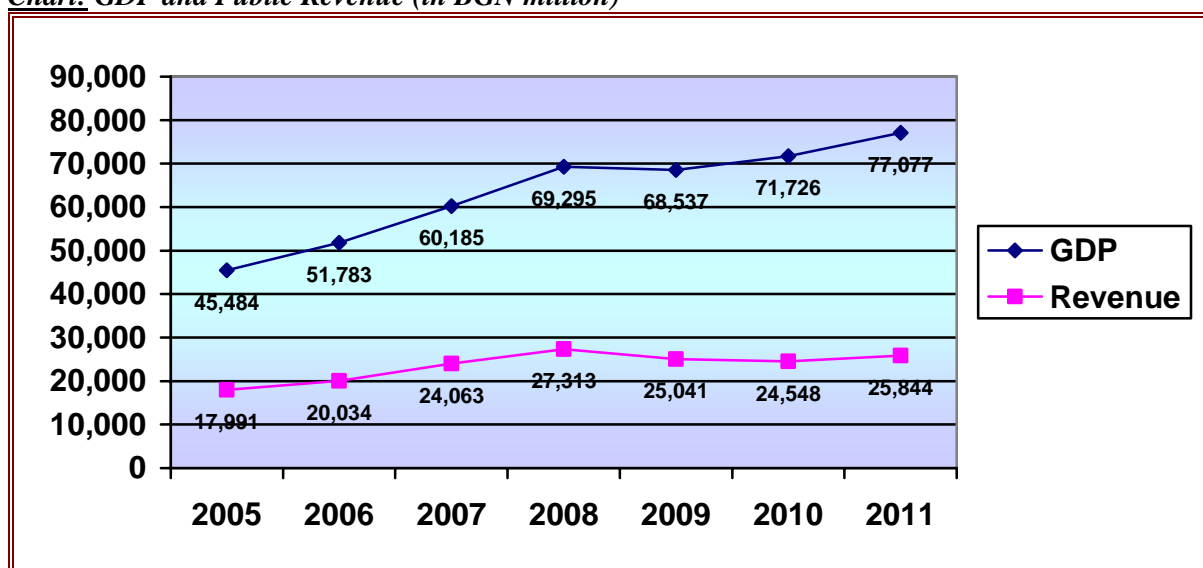
The budget position planned for 2011 in the CFP amounts to BGN -1 963.0 million, or -2.5 per cent of projected GDP. It is expected that the fiscal goal set for 2011 will be reached, assuming an improved revenue execution as a result of the expected gradual economic recovery and applying an austerity policy with regard to spending in order to minimize the budget deficit.

**Table: Consolidated Fiscal Programme (2010 and 2011)**

Indicators (in BGN million)	CFP		Of which:			
			National budget		European funds*	
	2010	2011	2010	2011	2010	2011
Revenue	24 548.1	25 844.0	22 651.8	23 699.1	1 896.4	2 144.8
(percentage of GDP)	34.3 %	33.5%	31.6 %	30.7 %	2.7 %	2.8 %
Expenditure	27 030.6	26 995.5	24 020.6	24 002.1	3 009.9	2 993.3
(percentage of GDP)	37.7%	35.0 %	33.5 %	31.1 %	4.2 %	3.9 %
Contribution to the EU General Budget	779.7	811.5	779.7	811.5		
(percentage of GDP)	1.1 %	1.1 %	1.1 %	1.1%		
Transfer for national co-financing to match EU funding			-526.6	-823.9	526.6	823.9
(percentage of GDP)			-0.8 %	-1.1 %	-0.8 %	-1.1 %
Budget balance	-3 262.1	-1963.0	-2 675.1	-1 938.4	-587.0	-24.6
(percentage of GDP)	-4.6 %	-2.5 %	-3.7 %	-2.5 %	-0.8 %	0.0 %
GDP	71 726.4	77 076.7				

\* Expenditure includes also national co-financing which, however, is not included in the budget balance of funding received from the EU funds.

**Chart: GDP and Public Revenue (in BGN million)**



In 2011, the CFP envisages revenue of BGN 25 844.0 million (33.5 per cent of GDP), with a nominal increase of BGN 1 295.9 million, which is a 5.3 per cent growth compared to the 2010 programme. In comparison to 2010, the share of revenue next year in real redistribution in the budget is expected to be restricted by 0.8 per cent of GDP.

*Tax and social security/health insurance policy aimed at an improved business environment, incentives for investment activity, promoting an increase in the employment rate and limiting the grey sector*

### 3. Tax and Social Security/Health Insurance Policy and Revenue Structure in Terms of Revenue Sources

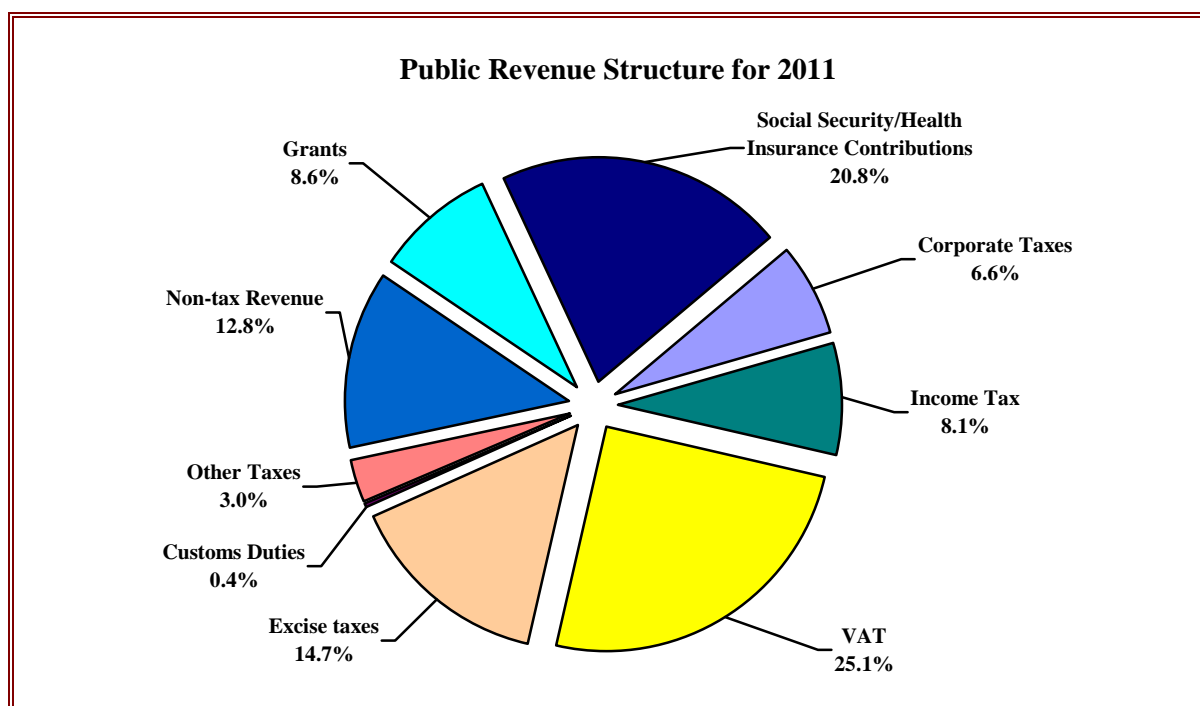
The stable tax strategy has the aim of mitigating the negative effects of the global crisis on the national economy. All efforts are focused on improving the business environment, fostering investment activity, promoting an increase in the employment rate, and curbing the grey sector. A priority in the tax policy is to avoid any dramatic change in terms of income levels in the present economic decline.

Tax rates in direct taxation are retained unchanged, being some of the lowest in the EU. The process of consistently shifting the tax burden towards indirect taxes by raising certain excise tax rates as of the beginning of 2011 continues, in accordance with the agreements to reach *de minimis* EU levels.

Improving the efficiency of tax collection is a challenge for Bulgaria's tax policy. Measures undertaken by revenue administrations include: increasing the number of field tax audits; improving the performance of mobile groups; more frequent and detailed audits; and introducing stricter accounting rules and criminal prosecution of illegal practices bringing fiscal losses.

The amount and structure of consolidated revenue in the 2011 budget reflects the forecast for proceeds from the various revenue sources in the consolidated fiscal programme in accordance with the tax and social security/health insurance policy of the Government.

**Chart: Public Revenue Structure for 2011**





***Retaining the 10 per cent corporate tax rate***

***Corporate Taxes***

The 2011 projections are based on the assumption that there will be no changes in the legal framework affecting the amount of proceeds from corporate taxes, and factoring in the proposed amendments to the Corporate Income Tax Act for 2011. The 10-per cent corporate tax rate remains the lowest in the European Union, which makes Bulgaria attractive to invest in. Low tax rates stimulate the shadow economy to step out into the sunshine and promote economic development. The 5-per cent rate of the withholding tax on dividends and liquidation quotas is to remain unchanged.

In connection with changes to the Corporate Income Tax Act envisaged for 2011, as of 1 January 2011 there would be a reduction from 10 per cent to 5 per cent in the tax on income from interest and royalty payments paid out by resident legal entities in favour of non-resident legal entities from the EU, when the payer and the payee of such income are related parties. In accordance with Directive 2003/49/EC, EU Member States shall not tax interest royalty payments accrued by local companies in favour of companies from other Member States where the payer and the payee of such income are related parties. In the Treaty concerning the accession of the Republic of Bulgaria and Romania to the European Union, our country negotiated a derogation according to which Bulgaria has the right postpone implementation of the directive till 31 December 2014. In this transitional period, the tax rate on interest and royalty payments made to a related company resident in another Member State should not exceed 10 per cent until 31 December 2010 and 5 per cent in the following years until 31 December 2014.

The draft amendments envisage levying a 10-per cent tax on non-resident legal entities established in jurisdictions with preferential taxation (offshore areas) on their income from services or rights earned from a source in Bulgaria as of 1 January 2011.

Projected proceeds from corporate taxes in 2011 amount to BGN 1 702.6 million, or a growth of about 23 per cent compared to expected execution this year.

***Other Taxes under the Corporate Income Tax Act***

No change is envisaged in the legislation regulating alternative taxes under the Corporate Income Tax Act. Revenue is estimated at BGN 178.2 million.

## ***Taxes on Personal Income***

***Retaining the flat tax rate of 10 per cent applicable to all taxpayers (no tax-exempt minimum income), with the exception of income from economic activity of sole proprietorships for which the applicable rate is 15 per cent***

Under The Personal Income Tax Act, non-resident natural persons established in jurisdictions with preferential taxation (offshore areas) would be taxed at 10 per cent on any remuneration received for services or rights, and also on any default penalties and compensation of any kind with a source in Bulgaria. Jurisdictions with preferential taxation are defined in the Act Amending the Corporate Income Tax Act.

The introduction of this measure has the aim to counteract possible tax fraud and money laundering. Transactions with non-resident natural persons established in jurisdictions with preferential taxation are seen as a major tax risk by all Member States of the EU and the Organisation for Economic Cooperation and Development, including by Bulgaria.

Revenue from personal income taxation in 2011 is estimated on the assumption of retaining the 10-per cent flat tax rate applicable to all taxpayers of (without any tax-exempt minimum amount), with the exception of income from economic activity as a sole proprietorship, to which the applicable rate is 15 per cent.

Expected revenue from personal income taxation includes proceeds from tax on income earned by persons employed under the Labour Code or under equivalent terms, as well as revenue earned on other legal bases. Total proceeds from taxes under the Personal Income Tax Act for 2011 are estimated at BGN 2 092.4 million, against an expected total of BGN 2 005 million for 2010.

### ***Value Added Tax (VAT)***

***Equal tax rate on hotel accommodation for organized and individual tourism***

The envisaged amendments to the Value Added Tax Act is proposed in connection with the need to harmonize Bulgarian tax law with the requirements of European directives and rulings of the Court of Justice of the European Communities in the area of indirect taxation, and to clarify certain texts which have been causing problems in the practical application of the law. Changes have to do with the requirements of Directive 2009/162/EU of the Council amending various provisions of Directive 2006/112/EC on the common system of value added tax. The amendment refers to determining the tax basis for supplies under barter conditions. The tax basis would be the market price for each of the goods or services received. A single tax rate would be introduced on accommodation provided by hoteliers. The single rate would be applied to all deliveries of accommodation services and not only to those which are part of organized travel. The current 7 per cent rate on tourist services would be increased but the budget effect of the reduced VAT rate for individual tourists would be offset by the increased rate applicable to organized tourism.

**Table: VAT Revenue (in BGN million)**

REVENUE	Expected execution 2010*	Draft 2011	Growth 2011/2010 (in percentage)
<b>VAT if the 2010 legislation is retained, incl.:</b>	<b>6 000.0</b>	<b>6 450.0</b>	<b>7.5 %</b>
- from transactions in Bulgaria and ICAs	3 200.0	3 580.0	11.9%
- from third countries	2 800.0	2 870.0	2.5 %
<b>Impact of change in legislation</b>	<b>100.0</b>	<b>30.0</b>	
<b>VAT total</b>	<b>6 100.0</b>	<b>6 480.0</b>	<b>6.2 %</b>
Relative share of VAT revenue in end consumption	<b>10,9</b>	<b>11,0</b>	

As a result of the new excise tax rates on fuel (gasoline, diesel fuel) and smoking tobacco, which are included in the VAT tax basis for those goods, the budget would receive an additional amount of about BGN 30 million from VAT. Setting up a remote connection between NRA and fiscal cash registers should contribute for the improvement in the collection rate of this tax. The total estimated VAT revenue for 2011 is BGN 6 480 million, with a tax basis of BGN 32 400 million which can be achieved provided the relative share of VAT in consumption is increased by 0.1 percentage points (one of the indicators for improved collection rate).

### **Excise Tax**

#### **Changes in line with undertakings to reach the EU de minimis excise rates**

The key amendments to the Excise Tax and Tax Warehouses Act are connected with undertakings to reach the EU de minimis rates of excise tax on the various types of goods and strengthening control by customs authorities and measures against the grey economy.

In line with the requirements of Directive 2010/12/EU of the Council dated 16 February 2010, certain amendments will be introduced to the Excise Tax and Tax Warehouses Act dealing with excising tobacco products.

It is envisaged to raise certain excise tax rates for 2011 so as to reach gradually the de minimis Community rates, as follows:

- *Diesel fuel* - the de minimis excise in the Community is EUR 330 per 1000 litres (BGN 645). Bulgaria has undertaken to reach the de minimis excise level in the Community by 01.01.2013. The increase in the excise rate for diesel fuel would have a positive effect on the budget which is estimated at about BGN 37 million;
- *Kerosene* - the de minimis excise in the Community is EUR 330 per 1000 litres (BGN 645 per 1000 litres). Bulgaria has undertaken to reach the de minimis excise level in the Community by 01.01.2013. The increase in the excise rate for kerosene would not have any effect on the budget in the period

under consideration since kerosene is used to fuel aircraft and the excise tax is refunded within the time periods set in the Excise Tax and Tax Warehouses Act;

- *Unleaded gasoline* - the de minimis excise in the Community is EUR 359 per 1000 litres (BGN 702). Bulgaria has undertaken to reach the de minimis excise level in the Community by 01.01.2011. The increase in the excise rate for gasoline would have a positive effect on the budget which is estimated at about BGN 23 million;
- *Smoking tobacco* – as a result of the increased excise rate, an additional BGN 5 million is expected to flow in the budget.

**Table: Excise Tax Rates**

<b>Excisable goods:</b>	<b>Excise rate in 2010</b>	<b>Excise rate in 2011</b>
1. Diesel fuel as motor fuel	BGN 600/1000 litres	BGN 615/1000 litres
2. Kerosene as jet engine fuel	BGN 600/1000 litres	BGN 615/1000 litres
3. Unleaded gasoline	BGN 685/1000 litres	BGN 710/1000 litres
4. Unleaded □ gasoline blends where the content of bioethanol is from 4 to 5 per cent by volume	BGN 664/1000 litres	BGN 688/1000 litres
5. Diesel fuel blends where the content of biodiesel is from 4 to 5 per cent by volume	BGN 582/1000 litres	BGN 596/1000 litres
6. Smoking tobacco	BGN 100/kg	BGN 152/kg

As a result of these amendments, the state budget is expected to receive an additional amount of about BGN 65 million in 2011. Moreover, the excise rate on cigarettes adopted for 2010 in the amount of BGN 148 per 1000 pieces will have a higher positive effect in 2011, estimated at BGN 50 million (at the expense of the first two months in 2010, when cigarettes bearing the old excise stickers were still being sold on the market).

In 2011, excise rates for beer and spirits will not be increased.

In addition to these rate changes, the estimation of revenue from excise tax takes into account expected volumes of consumption of the respective groups of excisable goods, the dynamics of imports, the effect of improved control and the collection rate of excise tax, etc., as a result of which projected revenue from excise tax in 2011 is budgeted at BGN 3.8 billion.

**Table: Revenue from Excise Tax by Group of Excisable Goods (in BGN million)**

<b>GROUPS OF EXCISEABLE GOODS</b>	<b>Expected execution 2010</b>	<b>Projection 2011</b>	<b>Growth 2011/ 2010 (in percentage)</b>
1. Tobacco products	1 540.0	1 595.0	3.6 %
2. Fuel	1 850.0	1 910.0	3.2 %
3. Beer	72.5	75.0	3.4 %
4. Spirits, intermediate products	150.0	160.0	6.7 %
5. Electricity	32.5	35.0	7.7% □
6. Other, incl. the effect of improved collection	5.0	25.0	
<b>Excise in the national budget</b>	<b>3 650.0</b>	<b>3 800.0</b>	<b>4,1 %</b>

### ***Customs Duties***

Projections for revenue from customs duties and fees takes into account the impact of the following factors:

- Projections for total import at CIF prices;
- The relative share of imports from third countries in total imports.
- Changes in tariff rates as a whole, as a result of upcoming preferential agreements in the framework of the EU and the World Trade Organisation (WTO); for the period from 2010 to 2012 the change in the rate for industrial goods is about 2 per cent, and about 8 per cent for agricultural products.

The forecast for customs duties has been made separately for industrial and agricultural goods. Since industrial goods include goods in significant volumes such as fuel, ores, etc. which are exempt from customs duties, the forecast is based on a sample of goods leading in terms of volume. The projection for agricultural customs duties is based on the volume of imports, the share of agricultural goods in imports, and the average rate applicable for the respective year.

Based on the analysis of revenue from customs duties on imports of industrial and agricultural goods, the 2011 forecast estimates a revenue inflow in the amount of BGN 100 million.

***Table: Revenue from Customs Duties (in BGN million)***

	<b>2010 Expected execution</b>	<b>2011 Draft</b>
<b>Customs duties, total</b>	<b>100,0</b>	<b>100.0</b>
Customs duties from industrial goods	65,0	61,0
Customs duties from agricultural goods	35,0	39,0

### ***Tax on insurance premiums***

The Taxation of Insurance Premiums Act (indirect taxation) introduces a tax on insurance premiums from taxable insurance policies (general insurance, with the exception of certain types of insurance), which does not change the existing taxation regime for profits of insurance companies in accordance with Corporate Income Tax Act.

The proposed tax rate is 2 per cent, and the taxable basis is the insurance premium earned by the insurance company.

The Act is planned to take effect as from 1 January 2011, and to apply to taxable insurance policies taken out or renegotiated after 31 December 2010, and to insurance premiums received after 31 December 2010 on insurance policies taken out prior to 1 January 2011.

The expected positive effect for the budget can reach BGN 20 million.

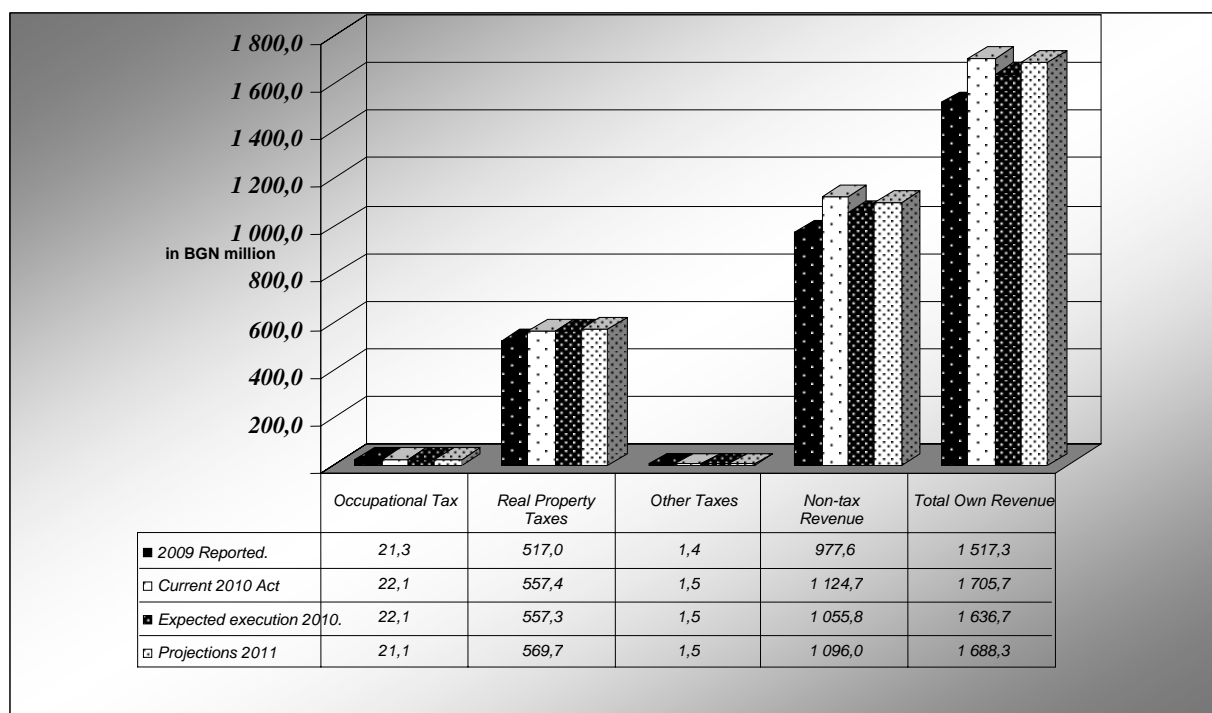
### ***Local Taxes and Fees***

Projected revenue from property taxes in 2011 amounts to BGN 569.7 million.

In terms of revenue, there is a pronounced trend towards a higher level of financial autonomy. This trend is linked with delegating full authority to municipalities to administer local taxes and powers to set the rates of those taxes under the terms and conditions, and within the range set in the Local Taxes and Fees Act, and following the procedure established by it. In order to

improve the collection rate of local taxes, in addition to powers of revenue authorities, since 2010 the staff of municipal administrations have been delegated the powers of public bailiffs in proceedings for securing tax liabilities.

***Chart: Own Revenue of Municipalities***



Projected 2011 proceeds from local revenue in municipal budgets are BGN 17.4 million lower in comparison to those planned in the consolidated fiscal programme under the 2010 SBRBG Act, and the decline is largely due to the lower projections for the tax levied on acquisitions of real property from donation and for consideration, and for proceeds from the sale of municipal non-financial assets.

#### **4. Spending Policies and Priorities**

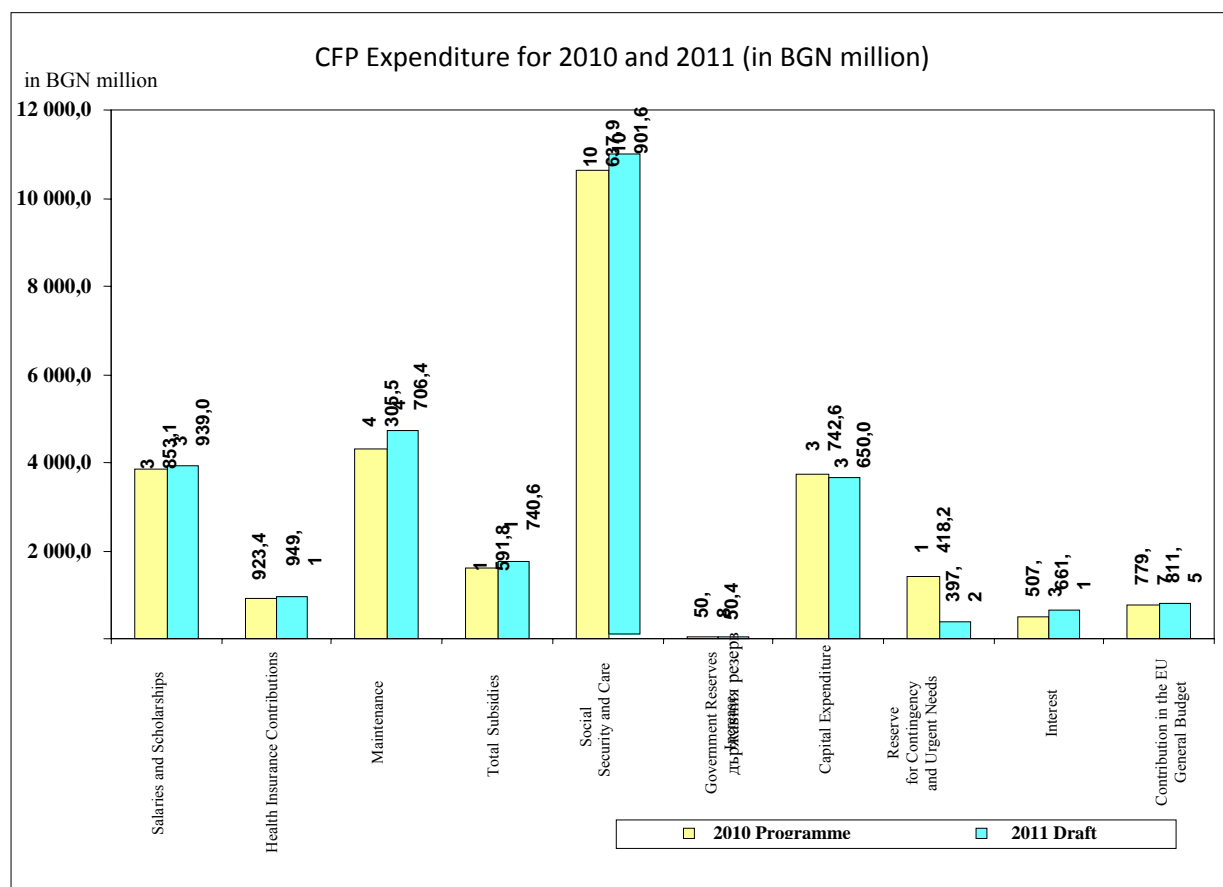
***Expenditure lower in nominal terms than in the previous year in order to meet fiscal consolidation goals***

The total amount of public expenditure in 2011 amounts to BGN 27 807 million. For the first time in our most recent history the Government has planned to spend no more than in the previous year. This manifests the Government's will to adopt fiscal consolidation measures.

The main focus in the spending policy in the 2011 budget is the following:

- retain the nominal level of spending on salaries reached in 2010 and set individual pay levels in accordance with the reform in public sector remuneration;
- ensure funding for national additional payments per hectare of arable land and special premiums for cattle;
- Keep maintenance cost, capital expenditure and subsidies from the national budget at their respective levels from the revised 2010 budget.

**Chart: Expenditure by Economic Elements**



In making financial provisions for all budget systems, the principle is to ensure priority funding for the main social responsibilities of the state, and equal treatment of all budgets in a situation of restricted budget resources. The adopted measures for a successful fiscal consolidation have been selected and put together in a mix to ensure a positive impact on growth, with a smooth reduction in budget spending in GDP terms.

In 2011, the nominal amounts for salaries reached in 2010 in the individual budget organisations and activities will be retained.

Any increase in the salaries item in the public sector is dependent on the development of the private sector where the improvement of labour productivity is the decisive factor in raising salaries, and on the product generated by those employed in the public sector.

The goal in next year's income policy is to retain the amount of appropriations for salaries in the public sector. In the mid-term, the goal is to tie up individual salaries to affordability levels in the economy and the budget, which will be achieved in accordance with the respective stages envisaged in the concept paper on implementing the reform in remuneration in the sector.

Measures to increase the level of real income in Bulgaria through the budget are quick but short-term and as a rule have a negative impact on financial stability. Such measures would require increasing the redistributive processes, which has a negative effect on factors stimulating growth in the real economy and push the grey sector up.

In 2011, it is envisaged to keep the wage minimum at BGN 240, which is in line with the current policy of restricting any increases in expenditure, including salary appropriations in the conditions of the current financial and economic crisis. In the mid-term, and following discussions with the social partners, it would be possible to design a mechanism to determine the specific amount of minimum wages; until then the ratio between minimum wages and the national average monthly wages, which has been about 40 per cent in recent years.

The 2011 draft budget of municipalities provides for expenditure in the amount of BGN 3 760.2 million, compared to BGN 3 710.0 million in projections adopted in the 2010 SBRBG Act. There is an off-set increase of BGN 50.2 million which is the result of increasing current expenditure and reducing capital expenditure. Current expenditure has been increased by BGN 70.2 million, while capital expenditure has been decreased by BGN 20.0 million in the budget line for environmental projects.

In terms of economic elements, there is an increase in appropriations for salaries and benefits, and in the maintenance item, due to a change in the in-kind indicators in the educational sector.

Projections under 'Budget relationships of municipalities' in the 2011 draft budget have been increased by BGN 67.2 million compared to the 2010 SBRBG Act, including BGN 23.0 million under 'Local activities', and BGN 44.2 million under 'Activities delegated by the Central Government'. For 2011, an increase of BGN 23.0 million in the general equalization subsidy for municipalities is envisaged in connection with the forming trend of declining municipal revenues related to sales of real property or municipal assets and in order to ensure a normal level of public services provided by municipalities.

The 2011 draft budget has allocated BGN 1 916.0 million for activities delegated by the Central Government and funded through municipal budgets, against BGN 1 871.8 million in the 2010 SBRBG Act, or an increase by BGN 44.2 million. The appropriations planned in the draft budget for 2011 create conditions for furthering the positive trends in the process of financial decentralisation and increasing the financial autonomy of local governments.

The 2011 consolidated fiscal programme provides for expenditure for the local activities of municipalities totalling BGN 1 844.3 million. The expenditure projection for maintenance cost under local activities takes into account the forecasted own revenue and size of the equalization subsidy. These reflect the expected developments in local activities, and an improvement in the quality of public services provided to the community in the municipality in the area of public works, maintaining municipal infrastructure – roads, water supply and waste water system, street lighting, sanitation, green area maintenance, etc.

In the consolidated fiscal programme for 2011, capital expenditure of municipalities stands at BGN 660.1 million. In terms of funding sources, the total amount of capital expenditure in municipalities in 2011 will be covered by:

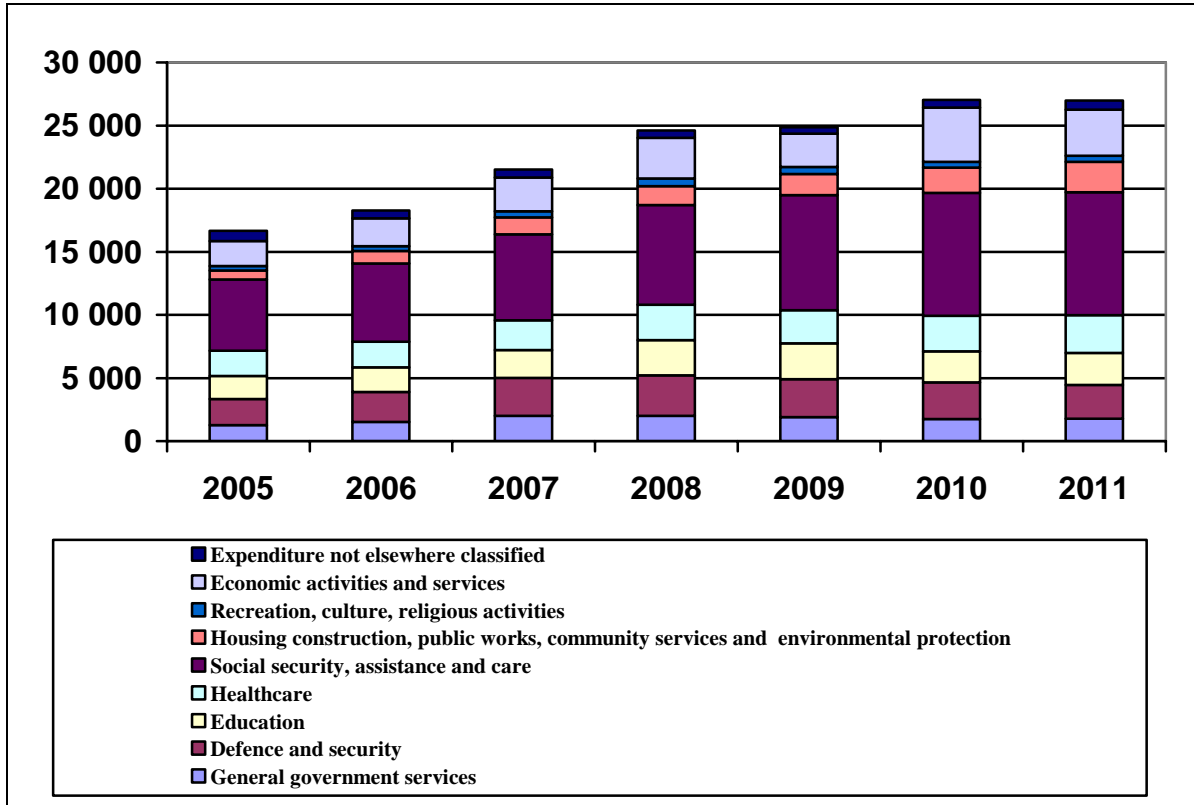
- BGN 90.2 million from a special subsidy;
- BGN 568.0 million from own budget funds;
- BGN 1.9 million from government-backed external loans.

The capital expenditure appropriations provide funding for activities delegated by the Central Government and for local activities. For activities delegated by the Central Government, capital expenditure for 2011 amounts to BGN 37.0 million. For local activities, capital expenditure for 2011 amounts to BGN 623.1 million.

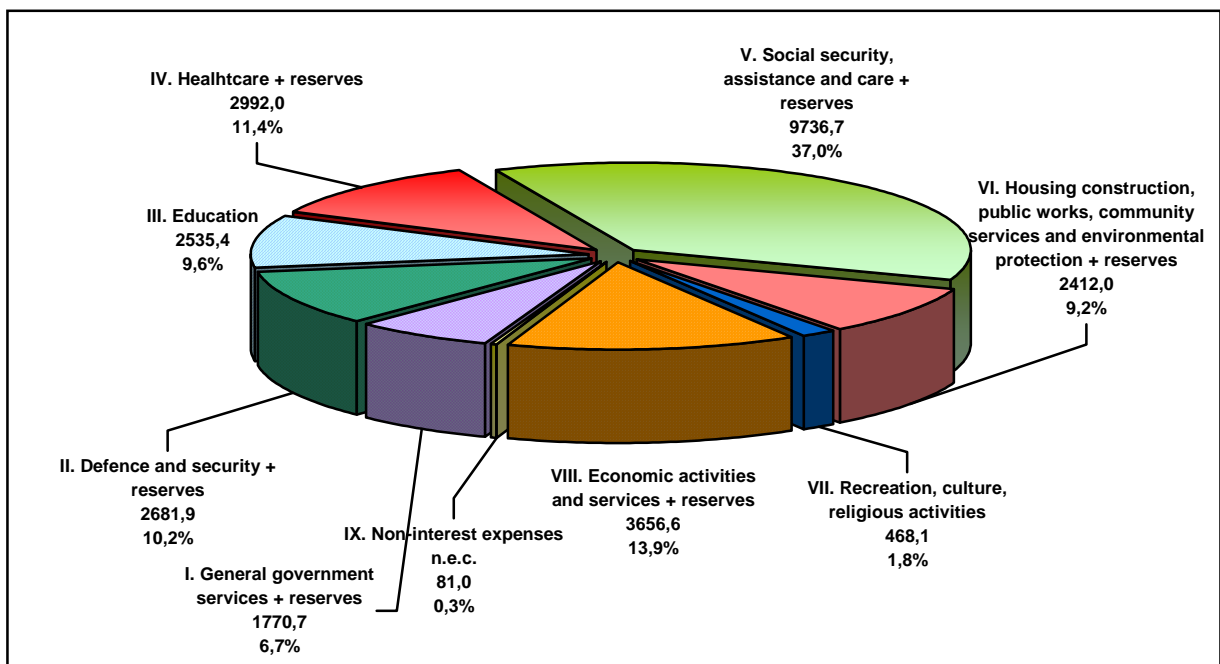


## 5. Public Expenditure by Function

*Chart: Public Expenditure by Year (in BGN million)*



*Chart: Share of Key Functions in Total Consolidated Non-Interest Expenses for 2011, including reserves, not including contribution in the EU General Budget (in BGN million and in percentage)*

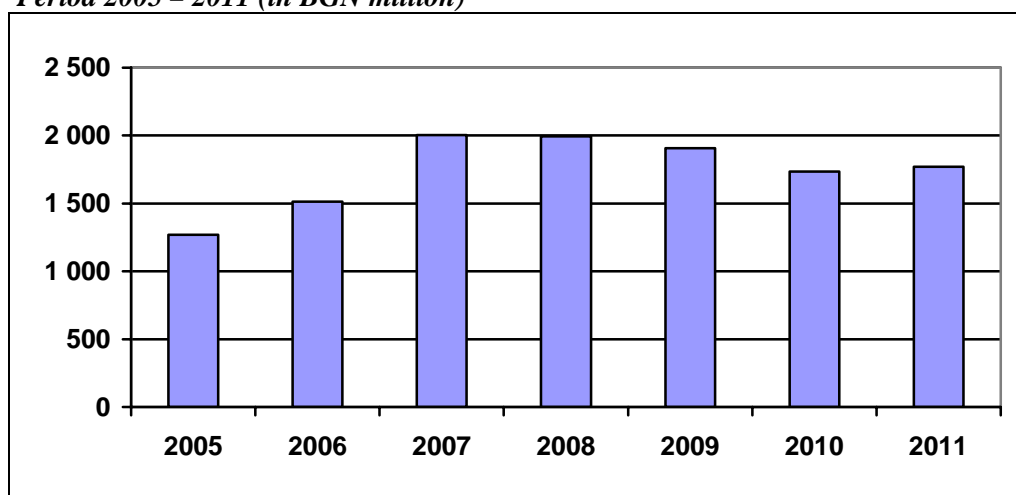


## GENERAL GOVERNMENT SERVICES

### **2.3 per cent of GDP to be spent on the General Government Services function**

In 2011, expenditure for general government services amounts to BGN 1 770.7 million, or 6.6 per cent of total expenditure, and includes funding for the public administration both at the central and local levels. This includes also budget funding for science.

**Chart: Expenditure under the General Government Services Function for the Period 2005 – 2011 (in BGN million)**



The **heading of “Executive and Legislative Bodies”** includes expenditure to fund the main functions of the President, Vice President, National Assembly, the Government, and the operation of central administrations of ministries, state commissions, executive agencies, regional administrations, commercial services abroad, embassies and consulates abroad.

The purpose of these appropriations is to provide for the functioning of the said administrations, enabling them to perform their activities and tasks relating to implementing the internal and external policies of the Bulgaria in all of their aspects, payment of membership contributions in international organisations, establishment and operation of a sustainable system for maximizing efficiency in the collection of taxes and social security/health insurance contributions, curbing corruption, improving the quality of administrative services, improving customs control, counteracting customs and currency regime violations, smuggling and illegal drugs trafficking, etc.

For 2011, the central budget allocates a total expenditure of BGN 20.7 million for government investment loans for the following projects:

1. Reforming the revenue administration, a project with the World Bank;
2. Facilitating trade and transport in South East Europe II, with the World Bank;
3. Improving the water cycle.

Funding under the **heading of “General services“** is earmarked for the execution of the National Statistical Research Programme, preservation of the Bulgarian ethnic and cultural space, protection and dissemination of cultural and historical heritage and protection of the rights of Bulgarians abroad, provisions for the stay of refugees in the Republic of Bulgaria, for the receipt, distribution and supervision of the use of humanitarian aid provided to Bulgaria by other countries, for resolution of collective labour disputes, attracting and supporting foreign investment and priority investment projects in the Republic of Bulgaria and for supporting the

Single Information System concerning foreign investment, implementing the trade policy of Bulgarian exporters in the Russian market and for marketing and promotion of Bulgarian goods in Russia, for accumulation, storage and use of state reserves and war-time stocks in accordance with the requirements of national security, for preparing short-term, mid-term and long-term forecasts on Bulgaria's economic development, for concessions on the operation of the central register and activities related to administrative services provided to individuals and legal entities.

These payment appropriations ensure the functioning of agencies included in the heading.

Expenditure for government reserves and war-time stocks for 2011 amounts to BGN 50 381.9 thousand and is earmarked for replenishment and refreshment of government reserves.

This heading includes expenditure for state agencies, including the State Reserves and War-Time Stocks State Agency, executive agencies, the National Statistics Institute, Bulgaria's Industry Centre in Moscow, etc.

The total amount of funding for **scientific activities** for 2011 provided for in the autonomous budgets of state institutions of higher education, the Bulgarian Academy of Sciences and the National Assembly is BGN 108 070.3 thousand, including for:

- The Bulgarian Academy of Sciences - BGN 99 417.6 thousand;
- State institutions of higher education - BGN 8 042.7 thousand;
- The National Assembly - BGN 610.0 thousand.

Appropriations for scientific activity performed by various entities within the structure of ministries amount to BGN 96 553.0 thousand, including:

- The Ministry of Education, Youth and Science - BGN 59 142.8 thousand;
- The Ministry of Agriculture and Food - BGN 37 350.2 thousand;
- The Ministry of Regional Development and Public Works - BGN 60 thousand.

These appropriations provide funding for the following main activities:

- Hydro meteorological, seismic and geophysical information support and observations; training of R&D specialists; research and development in fundamental and applied sciences in a wide range of areas; participation in international R&D programmes, etc.;
- Bulgaria's participation in the European Organisation for the Exploitation of Meteorological Satellites /EUMETSAT/ (Bulgarian Academy of Sciences);
- Scientific research, information support, applied and extension activities in the area of agriculture, stockbreeding and food and beverage industry (Ministry of Agriculture and Food);
- Project funding for scientific research (the Scientific Research Fund with the Ministry of Education, Youth and Science);
- Gathering, processing and storage of scientific and technical information and documentation (National Information and Documentation Centre with the Ministry of Education, Youth and Science);
- Harvesting, conservation and long-term storage of micro biological samples (National Bank for Industrial Microorganisms with the Ministry of Education, Youth and Science);
- Bulgaria's participation in the European Organisation for Nuclear Research (CERN) and the International Centre for Scientific and Technical Information (Ministry of Education, Youth and Science);
- Core scientific and art activities, publishing of textbooks and scientific research by state institutions of higher education.

The 2011 budget projection under the activity heading of Municipal Administration within the “General government services” function includes appropriations of a total of BGN 217.2 million.

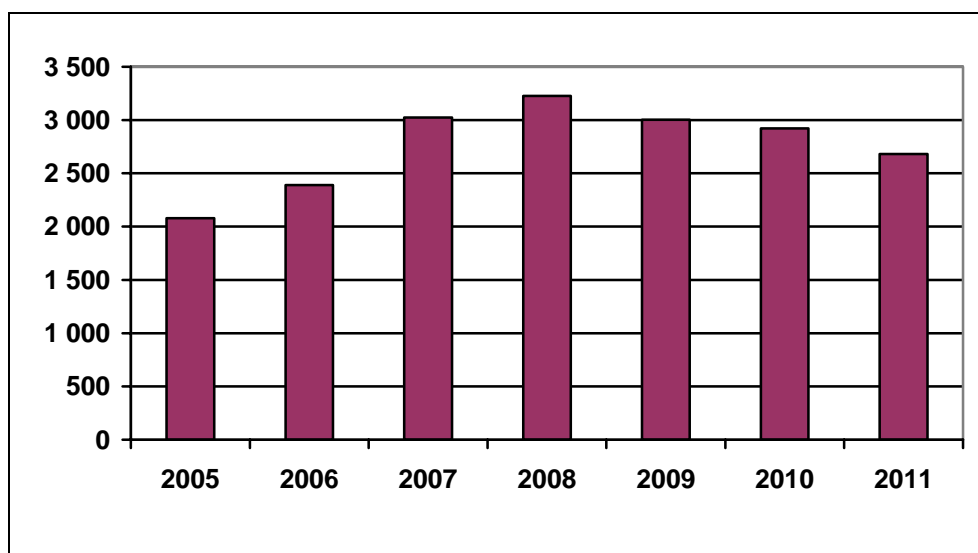
### **DEFENCE AND SECURITY**

#### ***3.5 per cent of GDP to be spent on the Defence and Security function***

This function includes expenditure for defence and security, the judiciary, prison administration, civil protection, management and response activities in case of crises, natural and industrial disasters. For 2011, expenditure under this function includes appropriations in the amount of BGN 2 681.9 million, or 9.9 per cent of total expenditure.

Under this function, the 2011 draft budget includes appropriations totalling BGN 24.5 million as current expenditure for activities delegated by the Central Government.

***Chart: Expenditure under the Defence and Security Function for the Period 2005 - 2011(in BGN million)***



Priorities in the **defence and security** area are determined by the general political goals of the Government and are based on the realities of the global context. Today’s security environment and its main characteristics of extremely difficult predictability and foreseeability firmly established the process of armed forces transformation as the most adequate response to the need for constant adaptation and improvement of capabilities. The pursuit of national interests and commitments undertaken by Bulgaria as a NATO ally and a partner in the EU requires an increase in the capabilities of Bulgarian armed forces.

The Republic of Bulgaria will continue to build modern and effective armed forces in observance of the principles of interoperability, usability, expeditionary capability, modularity and functionality by developing professionally trained armed forces, adequately flexible to perform tasks across the entire spectrum of their assigned missions.

The armed forces of the Republic of Bulgaria will continue to fulfil their missions and tasks in implementing the national security policy and reinforcing the country’s role as a member of the UN, NATO, EU and OSCE and as a reliable partner in the international democratic community.

The Republic of Bulgaria will continue its active participation in the European Security and Defence Policy, in the decision-making process and in building the military capabilities of the EU, and in the joint work in the European Defence Agency.

**The heading “Police, Home Affairs and Security”** includes funding for the maintenance of the Ministry of Interior, the National Intelligence Service, the National Protection Service and the National Security State Agency.

The main tasks in the area of home affairs and security in 2011 include:

- Prevention of any attempts on the constitutionally established rule of law, and prevention and detection of serious crimes;
- Respect for fundamental human rights and freedoms in accordance with international and European standards;
- Action against organised crime and counteracting crime accompanying the transformation of ownership in all sectors of the economy;
- Protection of national security against actions against national interests by foreign special services, organisations and individuals;
- Prevention and detection of violations concerning the customs regimes and the functioning of the fiscal system, effective counteraction to money laundering and illegal trade in arms, goods and technology with possible dual use;
- Detection and interception of attempts to set up terrorist structures and to perform terrorist acts by international terrorist organisations on the territory of the Republic of Bulgaria;
- Fight against trans-border organised crime, high-risk migration, attempts at unauthorized access to classified information of the European Union and NATO;
- Assistance to central and local government authorities and the population in cases of environmental disaster, natural or industrial disaster, or terrorist acts;
- Counterintelligence counteraction to intelligence threats, international terrorism and illegal production, storage and distribution of narcotics and precursors.

For the institutions responsible in the area of protecting national security and internal order to deliver on these priorities, it is necessary to use resources efficiently to ensure the development of forces capable to respond to contemporary challenges in the security environment in real time and build up administrative and institutional capacity to ensure the efficient performance of their statutory duties and the efficient partnership and interaction with the services of EU and NATO Member States.

**The heading “Judiciary”** includes appropriations for funding the activities of judiciary authorities and entities within the Ministry of Justice which are secondary-level spending units (General Directorate “Security”, the Registration Agency and the National Bureau for Legal Aid).

In the budget of the judiciary, appropriations are earmarked for conducting the activities of court institutions, maintenance costs of magistrates and court staff, remuneration to defence counsels, court expert examinations, expert witnesses and jury members. The capital expenditure section includes appropriations of BGN 2 450.0 thousand for purchase, safe-keeping and management of moveable property of the bodies of the judiciary.

For the Ministry of Justice, this heading includes appropriations for:

- Improvement in the facilities supporting the activity of bodies of the judiciary;
- Provision of conditions ensuring the security of court proceedings;

- Provision of buildings, rehabilitation of buildings owned by bodies of the judiciary, and the acquisition of new buildings; this will help improve the working environment, improve the quality and speed of services provided, and overall, this is one of the auxiliary approaches to successful reform in the judiciary system;
- Ensuring a high level of security and public order in court buildings;
- Protection of the health and safety of magistrates and witnesses; timely cooperation with bodies of the judiciary in serving summons, compulsory court appearances and escorting;
- Ensuring the protection of the rights and legal interest of citizens by ensuring equal access to justice through provision of effective legal aid.

**The heading “Prison administration”** includes appropriations for funding the main activities and tasks assigned under the Penalty Execution Act to General Directorate “Execution of Punishments” with the Ministry of Justice, and funding for developing the probation activity in observance of the Criminal Code.

The total amount of expenditure budgeted in this heading for 2011 is retained at its 2010 level. Within funding for maintenance, priority is given to expenditure for food, fuel and medication for imprisoned persons and persons held in detention centres of the Investigation Office.

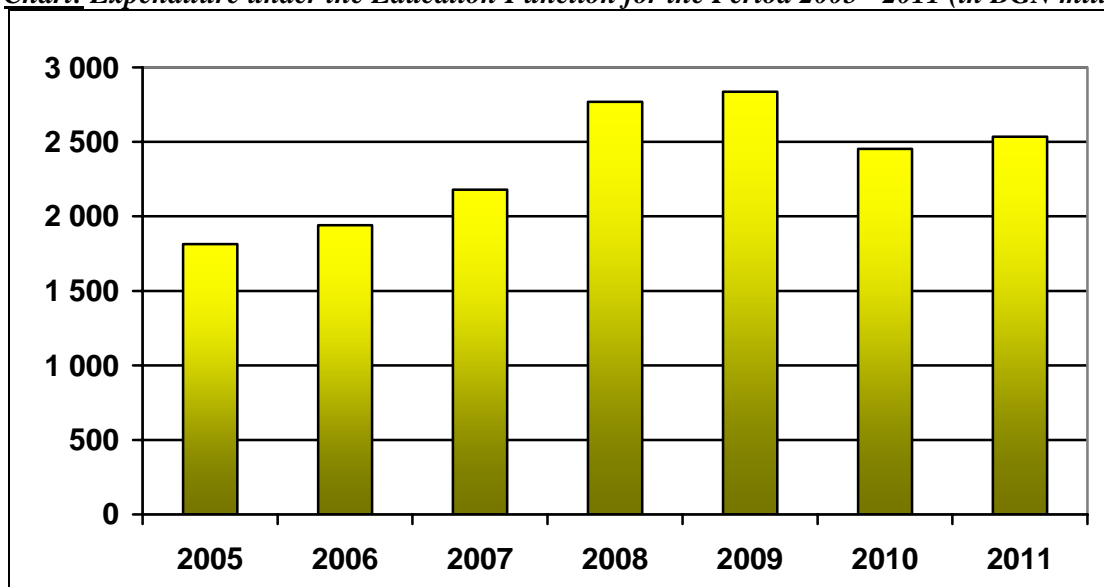
**The heading “Protection of the population, management and response activities in case of crises, natural and industrial disasters”** includes appropriations for funding activities related to defence and mobilization training in observance of the Defence and Armed Forces Act.

### EDUCATION

**3.3 per cent of GDP to be spent on the „Education” function**

For 2011, expenditure under this function includes appropriations in the amount of BGN 2 535.4 million, or 9.4 per cent of total expenditure.

**Chart: Expenditure under the Education Function for the Period 2005 - 2011 (in BGN million)**



Appropriations planned for 2011 under the Education function are earmarked to fund the following programmes and activities in the compound budgets:

- Provisions for the educational process in state vocational and special schools with the Ministry of Education, Youth and Science, the Ministry of Agriculture and Food, the Ministry of Culture and the Ministry of Physical Education and Sports;
- Improvement of facilities and equipment in state schools and support units;
- Management, evaluation, supervision and licencing of activities in the educational system performed by the regional education inspectorates, the National Agency for Attestation and Accreditation and the National Agency for Vocational Education and Training;
- Improving the quality of education in secondary education by developing an external testing system, etc. ;
- Improving coverage and facilitating equal access to secondary education through a range of tools: gradual inclusion of 5-year olds in pre-school training, introduction of all-day form of education in the first grade, scholarships for school students, provision of transport to cluster schools and accepting schools, free text books and training aids, school dormitories, special measures for educational integration and reintegration of children and school students from disadvantaged families, etc.
- Provisions for education in state institutions of higher education for an average equivalent number of students;
- Support for equal access to higher education through a system of student scholarships, student hostels and canteens, and student loans;
- Education and training of cadets and officers at higher military schools and the G. S. Rakovski Military Academy;
- Education and training of cadets and personnel at the Academy of the Ministry of Interior;
- Vocational education and training for employed and unemployed under programmes of the Ministry of Labour and Social Policy.

In the area of secondary education, under activities delegated by the Central Government and funded through municipal budgets, the following major programmes and activities are programmed for funding in 2011:

- Provisions for the educational and training process in municipal schools and kindergartens following the standards used in preparing delegated school budgets and appropriations for remuneration in kindergartens and ancillary units. They make provisions also for education of school students in municipal schools, training and childcare for children in kindergartens and preparatory groups, funding for school dormitories and scholarships for school students in municipal schools;
- Improvement of coverage and facilitation of equal access to secondary education is done by funding expenditure for scholarships, for all-day organisation of education for school students in the first grade, for school students commuting to cluster schools, for food cost-sharing for children in preparatory groups in kindergartens and for school students up to 4<sup>th</sup> grade, and for extracurricular and out-of-class activities.

The 2011 central budget also includes appropriations in the amount of BGN 23 200 thousand for free transport of school students aged up to 16 for commuting between their places of residence and cluster schools.

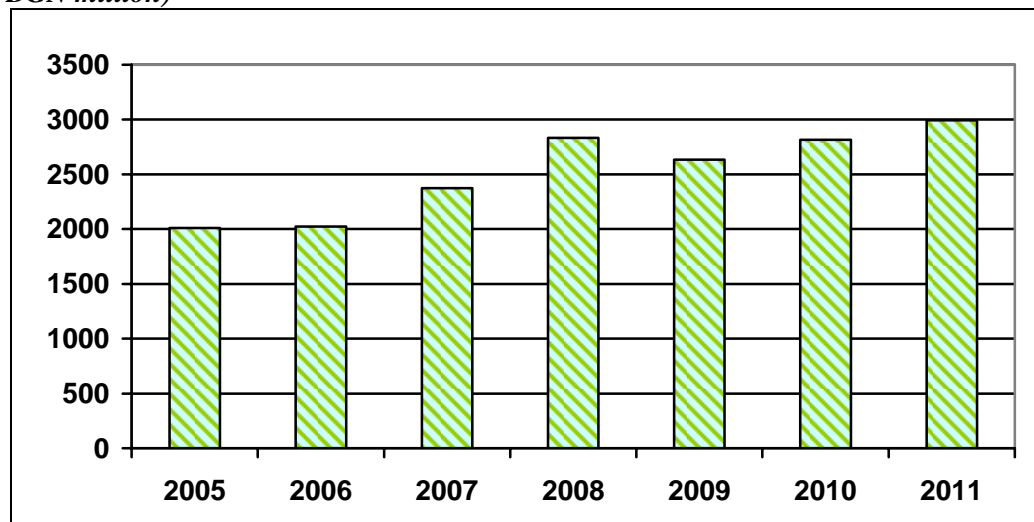
## HEALTHCARE

### ***3.9 per cent of GDP to be spent on the Healthcare function***

Expenditure planned for healthcare in the 2011 draft budget is in line with the government policy in the area of healthcare, and takes into account progress in the reform in the sector.

For 2011, appropriations under the Healthcare function are projected at BGN 2 992.0 million, or 11.1 per cent of total expenditure.

***Chart: Expenditure under the Healthcare Function for the period 2005 - 2011 (in BGN million)***



The 2011 draft budget includes appropriations of BGN 661 356.9 thousand in the budgets of ministries and agencies to fund the main public health systems and certain specific activities carried out by medical and health institutions with the Ministry of Health, the Ministry of Transport, IT and Communications, the Ministry of Defence, the Ministry of Interior, the Council of Ministers and the Ministry of Physical Education and Sports.

The allocation of total expenditure for healthcare among ministries and agencies is as follows:

- Ministry of Health - BGN 563 727.4 thousand;
- Council of Ministers - BGN 12 180.1 thousand;
- Ministry of Defence - BGN 66 761.0 thousand;
- Ministry of Interior - BGN 13 795.0 thousand;
- Ministry of Transport, IT and Communications - BGN 4 713.4 thousand;
- Ministry of Physical Education and Sports - BGN 180.0 thousand.

Appropriations included in the budget of the Ministry of Health will channel funding for activities relating to public health, emergency care, in-patient psychiatric care; for provision of expensive life-saving and life-sustaining medicines and supplies; for national health programmes relating to the treatment and prevention of social diseases. There is also a transfer in the amount of BGN 17 500 thousand in the budget of the National Health Insurance Fund, for obstetric care, in accordance with Article 82, para. 1, item 2 of the Health Act, and for service fee payments, as provided in Article 37, para. 5 of the Health Insurance Act.

The central government has commitments with respect to funding certain activities in medical institutions for hospital care which are the responsibility of the state, such as haemodialysis,



transfusion haematology, treatment of HIV/AIDS, transplantation of tissue, organs and cells, etc. To this end, the 2011 draft budget of the Ministry of Health includes appropriations for subsidies for hospital care of BGN 80 000 thousand.

The Ministry of Health draft budget has investment expenditure in the amount of BGN 21 500.0 thousand which will be used primarily to purchase medical equipment.

The 2011 draft contains the following parameters for **the autonomous budget of the National Health Insurance Fund**: a total of BGN 2 633 729.6 thousand in revenue and transfers for health insurance, and BGN 1 956 208.0 thousand in expenditure (BGN 2 086 342.0 thousand, including the reserves), of which BGN 1 906 856.4 thousand is expenditure for health insurance payments.

The allocation of expenditure for health insurance payments is the following:

- Primary out-patient medical care – BGN 157 000.0 thousand;
- Specialised out-patient care - BGN 154 000.0 thousand;
- Dental care – BGN 91 000.0 thousand;
- Medical diagnostic activities – BGN 61 000 thousand;
- Medicines - BGN 347 000.0 thousand;
- Hospital care – BGN 1 063 856.4 thousand, including BGN 4 500.0 thousand for obstetric care;
- Other - BGN 33 000.0 thousand, including BGN 13 000.0 thousand for service fee.

In the Healthcare function, the budget forecast for 2011 includes appropriations for activities delegated by the Central Government of a total of BGN 183.8 million, including BGN 181.3 million for current expenditure, and BGN 2.6 million for capital expenditure. Appropriations for current expenditure exceed appropriations in the 2010 SBRBG Act by BGN 7.1 million.

Funding for healthcare for children and school students amounts to BGN 94.0 million, or BGN 5.2 million more than in the 2010 SBRBG Act. This increase is due to the increased number of children in kindergartens, crèche groups in day-care centres, crèches, and infant food dispensaries.

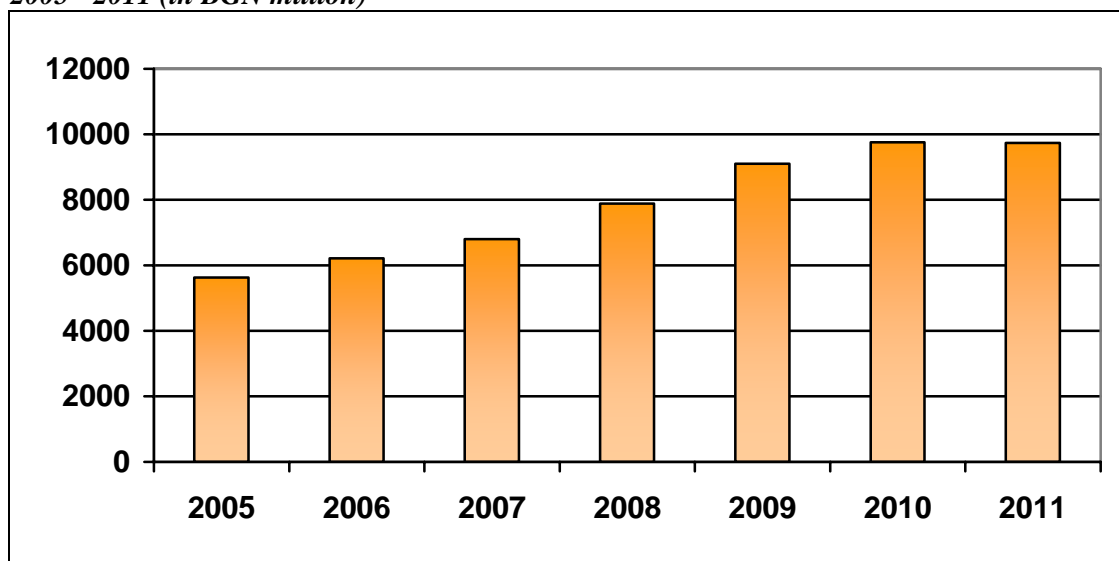
Funding for the provision of hospital care in the various types of out-patient dispensaries (now transformed into specialised centres in accordance with § 70 of the transitional and closing provisions of the Act Amending the Medical Institutions Act) amounts to BGN 87.3 million, which is BGN 1.9 million more than the 2010 SBRBG Act. The increase comes from the growth in the number of patients treated in out-patient centres for mental diseases (transformed in accordance with § 70 of the transitional and closing provisions of the Act Amending the Medical Institutions Act).

### **SOCIAL SECURITY, ASSISTANCE AND CARE**

***12.6 per cent of GDP to be spent on the Social Security, Assistance and Care function***

In 2011, the social sector amounts to BGN 9 736.7 million and continues to hold the largest share in total expenditure, reaching 36.1 per cent.

**Chart: Expenditure under the Social Security, Assistance and Care function for the Period 2005 - 2011 (in BGN million)**



**The heading „Pensions”** includes pensions paid out of the budget of State Social Security and pensions paid out of the Teachers’ Pension Fund; however, it also includes the postage fee, and the respective VAT on postage, due on pension payment transactions.

As from the beginning of 2011, it is envisaged to introduce a number of measures to strengthen the pension system financially: in the context of population ageing and increasing life expectancy, it is envisaged to introduce stricter criteria for pension eligibility, restrictions on early retirement, more detailed procedure for certification of „labour invalidity”, etc. No indexation of pension benefits is envisaged for 2011 under the so-called „Swiss rule”.

The maximum amount of pension benefits is retained at BGN 700.00 per month in 2011 (as a consequence of retaining the maximum reference income).

As a result of these assumptions, expenditure for pensions allocated to the budget of the State Social Security for 2011 reaches BGN 7 032.0 million, or a decrease of BGN 55.9 million compared to estimates in the 2010 Act (the baseline has been reduced with the expenditure planned in 2010 for an increase in the so-called „widow allowances” and old-age payments) and an increase of about BGN 50 million compared to the expected pensions expenditure in 2010.

For 2011, the budget of the Teachers’ Pension Fund includes an appropriation of BGN 17 203.3 thousand for payments of additional allowances to pensions and pensions for early retirement, and the respective postage and VAT accruing on such payments. This expenditure is related to provisions for early retirement of teaching staff employed in pre-school, basic, primary and secondary education.

**The heading “Social aid and benefits”** includes aid and payments to citizens on the basis of the Social Assistance Act, the Integration of People with Disabilities Act, the Social Security Code, the Family Benefits for Children Act.

The 2011 draft budget of the Ministry of Labour and Social Policy plans for a total of BGN 784 727.0 thousand, including:

- Aid entitlements under the Social Assistance Act and its Implementing Regulation: appropriations amount to BGN 54 279.2 thousand;
- Energy aid payments under the Social Assistance Act and its Implementing Regulation: BGN 87 417.0 thousand;

- Special funding for diagnostics and treatment at medical institutions for hospital care of Bulgarian citizens who do not have any income and/or personal assets to afford personal participation in the health insurance process: BGN 2 500 thousand;
- Aid entitlements under the Integration of People with Disabilities Act: planned expenditure amounts to BGN 154 230.8 thousand;
- Funding for measures and programmes under the Child Protection Act includes appropriations of BGN 7 400.0 thousand;
- Expenditure under the Family Benefits for Children Act amounts to BGN 478 900.0 thousand and the appropriation is planned under the assumption of keeping the income per family member according to Article 4 of the Family Benefits for Children Act at BGN 350 and retaining monthly child benefits until completion of secondary education but no longer than the child's 20<sup>th</sup> birthday at BGN 35.

In the budget of the Council of Ministers, the appropriation is BGN 11 130 thousand.

For 2011, the budget of the State Social Security includes appropriations of a total of BGN 1 070 911.8 thousand for benefits and aid entitlements under the Social Security Code. Expenditure for short-term benefits for 2011 is estimated on the basis of the following key parameters:

- Payment of benefits for temporary incapacity for the first three days is set at 70 per cent for the account of contributor;
- The maximum amount of unemployment benefits is set at 60 per cent of the reference income of the insured person before the job loss, and the minimum daily amount of benefits is increased from BGN 6 to BGN 7.20;
- The period for payment of cash benefits for temporary incapacity after the insurance is terminated is shortened from 75 days to 30 days;
- The period for payment of cash benefits for pregnancy and birth remains unchanged at 410 days;
- The amount of the benefits for raising an infant between 1 and 2 years of age remains BGN 240.

The budget of the Wage Claims Guarantee Fund provides for expenditure in the amount of BGN 1 395.8 thousand for payment of guaranteed wage claims accrued and not paid out in case of bankruptcy of the employer and the social security/health insurance contributions due on them.

**The heading “Programmes, activities and services in the area of social security, assistance and employment”** includes appropriations for financing the maintenance of the Employment Agency, the administration of the National Social Security Fund, the Social Welfare Agency, the State Agency for Child Protection, the General Labour Inspectorate Executive Agency, the Working Conditions Fund, the National Institute for Conciliation and Arbitrage, the Social Assistance Fund, the Agency for People with Disabilities and the House of Veterans of Culture.

This heading also includes expenditure under the budget of the Ministry of Labour and Social Policy in the amount of BGN 152 662.2 thousand.

The central budget plans for expenditure for absorption of a World Bank loan for the implementation of the “Social Inclusion” project, and expenditure for loan repayment and interest payments under the following projects: “Reform for Assistance to Children“, „Social Investment and Promotion of Employment”, “Regional Initiatives Fund”.

For implementing active measures concerning the labour market, the appropriations amount to a total of BGN 73 000 thousand which supports the policy of reduction of unemployment, retention and maintenance of labour.

This heading includes also expenditure budgeted in the autonomous budgets of:

- State Social Security – BGN 82 703.9 thousand;
- the Teachers' Pension Fund – BGN 21.0 thousand for maintenance costs of the Fund;
- state institutions of higher education – BGN 508.6 thousand;
- The Wage Claims Guarantee Fund – BGN 523.6 thousand.

Expenditure in the State Social Security budget refers to provisions for maintenance, facilities and equipment, and appropriations for salaries, social security/health insurance contributions and capital expenditure for the system of the National Social Security Institute.

Expenditure in the budget of the Wage Claims Guarantee Fund is intended for social security/health insurance contributions due on benefits paid out by the Fund to workers in case of bankruptcy of their employer, and for maintenance.

The 2011 budget forecast, in its „Social security, assistance and care” function, sub-heading for activities delegated by the Central Government, includes appropriations of a total of BGN 161.6 million, of which BGN 159.9 million for current expenditure, and BGN 1.7 million for capital expenditure.

In connection with the adopted National Strategy entitled „Vision for De-institutionalization of Children in the Republic of Bulgaria”, which lays out the political commitment to reform the system of care for children and families and is directed primarily at replacing the system of conventional boarding-house-type of institutions by a network of community-based services, the Ministry of Labour and Social Policy proposed certain off-setting adjustments in the budget relationships of municipalities with the central budget, which have been taken on board.

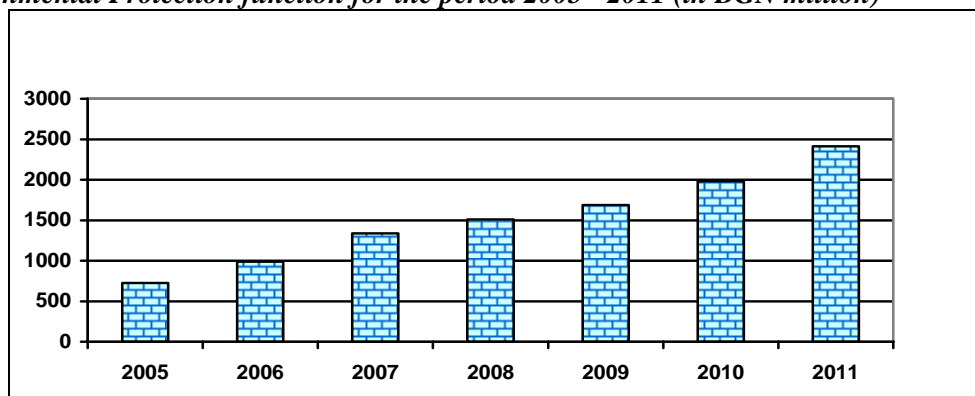
In line with the transformation and closing-down of specialised institutions for the provision of social services for children, the budget provisions for 2011 in the area of social services will fund the creation of new locations for community-based social services, namely: Day Care Centre for Children with Disabilities, Centre for Community Support, sheltered housing, Family-Type Accommodation Centre, supervised housing and transitional housing.

### **HOUSING CONSTRUCTION, PUBLIC WORKS, COMMUNITY SERVICES AND ENVIRONMENTAL PROTECTION**

#### ***3.1 per cent of GDP to be spent on the Housing Construction, Public Works, Community Services and Environmental Protection function***

Public expenditure for housing construction, public works, community services and for environmental protection in 2011 is budgeted at BGN 2 412.0 million, or 8.9 per cent of total expenditure, which is an increase of BGN 430.3 million compared to 2010.

***Chart: Expenditure under the Housing Construction, Public Works, Community Services and Environmental Protection function for the period 2005 - 2011 (in BGN million)***



Appropriations budgeted in **the heading “Housing construction, public works, community services”** will be spent by the ministries to implement the general programme of the Government.

For the Ministry of Regional Development and Public Works, appropriations amount to BGN 24 314.4 thousand. In the budget of the Council of Ministers, appropriations amount to BGN 247.9 thousand and are earmarked for the National Housing Compensation Fund.

In this heading, the 2011 central budget projects a total expenditure for government investment loans administered through the budget of the Ministry of Regional Development and Public Works in the amount of BGN 3 911.6 thousand as project funding for „Development of Municipal Infrastructure”.

In municipal budgets, capital expenditure for 2011 under the heading „Housing construction, public works and community services” amounts to BGN 327.6 million and is directed at public works in various settlements, including for water supply and sewerage and for street asphalt work.

Appropriations in **the heading „Environmental protection”** will be used for expenditure mostly by the Ministry of Environment and Water. For the Ministry of Regional Development and Public Works, the 2011 allocation amounts to BGN 1 208.0 thousand for funding the activities under the Programme for dealing with land slide, erosion and abrasion processes, which implements measures to block landslides, erosion and abrasion processes.

Under this heading, the 2011 central budget has total appropriations for government investment loans in the amount of BGN 10 790.7 thousand, including for the following projects:

- The Bulgaria Project with the Council of Europe Development Bank;
- The Technical Infrastructure 2010-2013 Project with KFW.

This heading includes also planned expenditure for the Enterprise for Management of Environment Protection Activities, which in 2011 amounts to BGN 49 452.0 thousand, including BGN 44 902.0 thousand in capital expenditure (transfers to municipalities and budget entities). Capital expenditure allocations are earmarked for the construction of small water supply facilities; waste water treatment plants, sewerage networks and inlet collectors, and adjustments of riverbeds and ravines; community landfills; waste separation facilities and waste recycling systems; replacement of eco fuel facilities and energy saving technology; safety-related rehabilitation of warehouses for obsolete stocks of pesticides, their collection and packaging; projects concerning bio diversity and eco-tourism; information and educational activity relating to environmental protection.

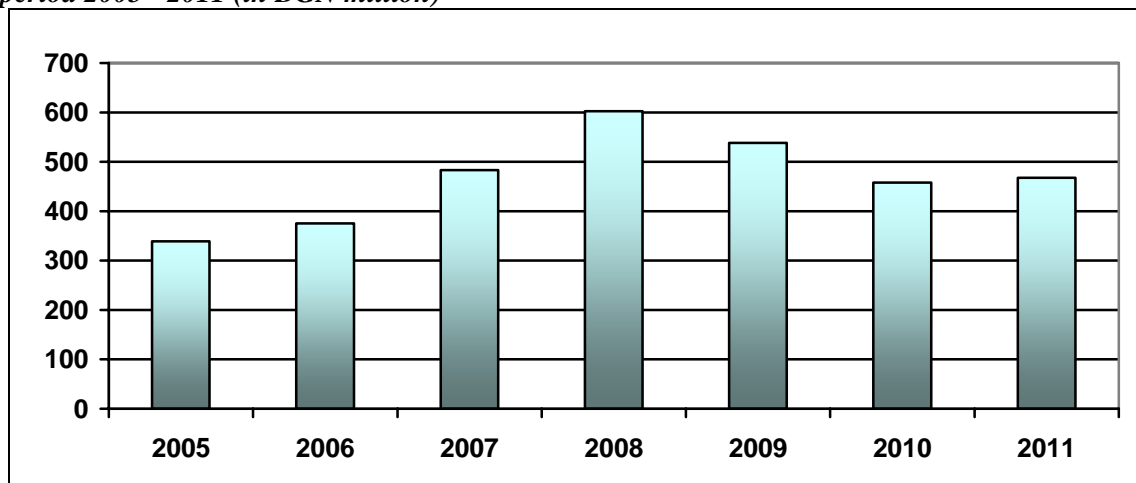
Capital expenditure of municipalities for 2011 in the heading „Environmental protection” amounts to BGN 116.4 million, of which BGN 96.4 million is earmarked for “Urban sanitation” activity for the acquisition of waste bins and waste collection equipment; activity subheading “Green Areas” and activity subheading „Other environmental protection activities”. Provisions are made for a special subsidy for capital expenditure in the amount of BGN 20.0 million for funding construction of environmental sites related to the upgrading and construction of waste treatment infrastructure, in accordance with European requirements and standards, and for continuing the construction of urban waste water treatment plants and inlet waste water collectors.

## RECREATION, CULTURE, RELIGIOUS ACTIVITIES

**0.6 per cent of GDP to be spent on the „Recreation, culture, religious activities” function**

For this function, the 2011 consolidated fiscal programme includes appropriations in the amount of BGN 468.1 million, or 1.7 per cent of total expenditure, covering activities in the area of recreation, physical culture and sports, culture and religious affairs.

**Chart: Expenditure under the „Recreation, Culture and Religious Activities” Function for the period 2005 - 2011 (in BGN million)**



In 2011, the heading „Recreation” contains appropriations necessary for the operation of recreational facilities and for providing conditions for social leisure activities of employees in the various systems.

Appropriations in the heading „Physical culture and sports” are designed to fund expenditure for sports activities and projects within the government policies in the area of physical education and sports, for activities under programmes for preparation for participation in the Olympics and for development of high achievement sports, for funding of sports projects and activities under special programmes, for the development of school sports and recreational sports.

The appropriations in the 2011 draft budget for current expenditure in the amount of BGN 26 883.8 thousand for the Ministry of Physical Education and Sports provide for:

- Funding for activities under the programme for Olympic training/training of athletes and their participation in competitions from the international sports calendar to ensure successful performance at qualifications for the Olympic Games;
- Funding for activities under the programme for development of high achievement sports;
- Assistance in the organization and holding of European and world championships hosted by the Republic of Bulgaria;
- Incentives and awards to Bulgarian athletes for their award-winning performance at world and European championships and Olympic Games and similar championships and games for people with disabilities;
- Support for activities and projects under special programmes for the development of school sports and recreational sports;
- Funding for training and competition activity in sports schools;

- Development of junior sports and support for gifted children and juniors with capabilities for sports development;
- Funding for special sports programmes for people with disabilities;
- Funding for medical supervision and doping control.

**The heading „Culture”** in the 2011 CFP includes appropriations of a total of BGN 368 101.4 thousand. Allocations for culture in the budgets of ministries and agencies, not including the autonomous budgets of the Bulgarian National Radio (BNR), the Bulgarian National Television (BNT) and the Bulgarian Academy of Sciences (BAS) for 2011 total BGN 79 468.3 thousand, including BGN 4 920.0 thousand for capital expenditure.

Appropriations in the budget of the Ministry of Culture amount to BGN 68 749.9 thousand. These funds will be used by the Ministry to implement the major part of its activities in the area of protection of the cultural heritage and support for the creation//production and dissemination of art and cultural products and services, and its policy concerning the promotion of cultural products and values. Some of the main programmes for which the appropriations are earmarked include: protection of immovable and moveable cultural heritage, theatre, music and dance arts, film art, support for the development of Bulgarian culture and art, the Bulgarian book sector, libraries and community cultural centres, promotion of cultural products and values, maintenance of facilities and equipment owned by cultural institutions.

The budget of the Ministry of Education, Youth and Science includes appropriations for supporting the activity of a museum of education in the amount of BGN 91.3 thousand.

In the budget of the Council of Ministers, there is an allocation for maintenance costs concerning the protection and storage of the archive funds of the General Department of Archives with the Council of Ministers in the amount of BGN 7 000.0 thousand.

In the budget of the Ministry of Foreign Affairs, appropriations for maintenance costs of a state cultural institute amount to BGN 192.1 thousand.

The budget of the Ministry of Defence includes appropriations of BGN 3 435.0 thousand for the activity of the museum of military history, the activity of the Ensemble of the Bulgarian Army, and the military TV channel.

As part of the consolidated programme for 2011, the budgets of BAS, BNT and BNR include appropriations for:

- financing the activity of the archaeological institute cum museum within BAS, in the amount of BGN 600.3 thousand;
- financing the activity of the Bulgarian National Radio and the Bulgarian National television in applying their programme licences issued under the Radio and Television Act to produce and broadcast national and regional radio and TV programmes, in the amount of BGN 120 871.8 thousand, including:
  - For the preparation, production and broadcasting of radio programmes – BGN 51 106.3 thousand, including for long-term tangible assets for BNR as per Article 70, para. 4, item 2 of the Radio and Television Act – BGN 5 918.7 thousand;
  - for the preparation, production and broadcasting of a television programme - BGN 69 765.5 thousand for making available for distribution political, economic, cultural, scientific, educational and other information of social importance, including BGN 15 343.6 thousand for capital expenditure for BNT, of which BGN 8 100.0 thousand for long-term tangible assets under Article 70, para. 4, item 2 of the Radio and Television Act.

For activities delegated by the Central Government, the heading „Culture” for 2011 includes appropriations of a total amount of BGN 65.1 million. Appropriations for current expenditure amount to BGN 63.4 million. This funding provides for the implementation of the national policy in the area of culture on the territories of municipalities in connection with protection of cultural and historical heritage, development of library activities and support for the activities of community cultural centres. Capital expenditure amounts to BGN 1.7 million.

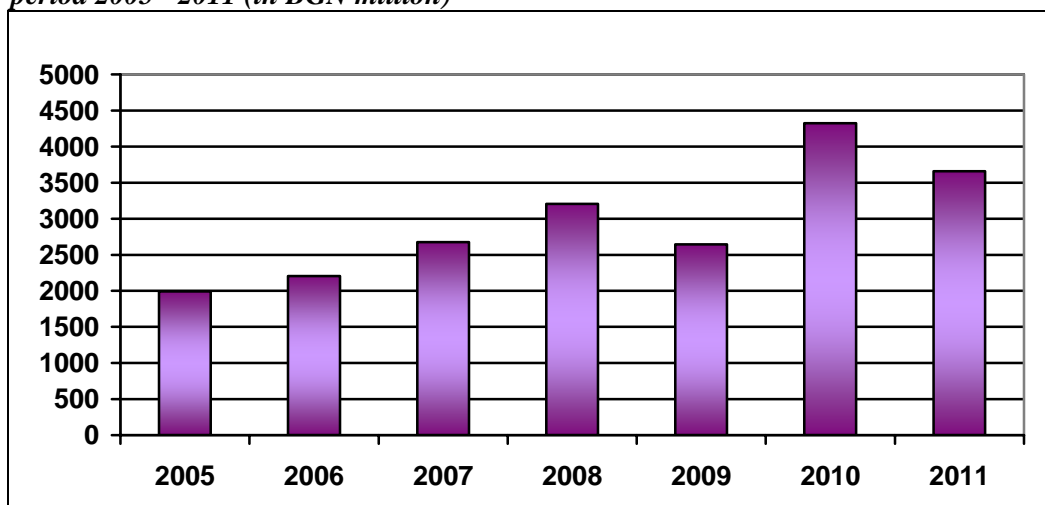
For 2011, the heading “**Religious affairs**” in the budget of the Council of Ministers includes a subsidy in the amount of BGN 3 000.0 thousand for support for the registered religious denominations in the Republic of Bulgaria.

### **ECONOMIC ACTIVITIES AND SERVICES**

#### **4.7 per cent of GDP to be spent on the „Economic activities and services” function**

For 2011, appropriations in the consolidated fiscal programme for this function amount to BGN 3 656.6 million, or 13.5 per cent of total expenditure. This includes funding for agriculture, forestry, hunting and fishing; mining, fuel and energy; transport and communications; manufacturing and construction, for tourism and for other activities relating to the economy.

**Chart: Expenditure under the “Economic activities and services” Function for the period 2005 - 2011 (in BGN million)**



Appropriations under the heading “**Mining, fuel and energy**” are earmarked for funding the activities related to decommissioning of nuclear facilities, safe storage of nuclear waste, expert examinations and audits of energy consumers, development of measures for reducing energy intensity in industrial production, activities and programmes for energy efficiency, technical closure and reclamation of old exploration works in Bulgaria.

Appropriations for implementing programmes for restructuring and closure of inefficient production capacity in the mining and extraction industry amount to BGN 10 000 thousand.

For technical closure and reclamation of old exploration works in Bulgaria, capital expenditure appropriations amount to BGN 88.2 thousand.

For maintenance and the tasks of the Energy Efficiency Agency, the Fund for Nuclear Facilities Decommissioning and the Radioactive Waste Fund operated by the Ministry of the Economy, Energy and Tourism, appropriations amount to BGN 21 597.3 thousand, of which



BGN 17 966.3 thousand for covering current expenditure and BGN 3 631.0 thousand for capital expenditure. For funding expenditure relating to the activities of the two funds, appropriations for 2011 amount to BGN 16 126.2 thousand and are earmarked for delivering on the central government commitments to:

- fund and control activities involved in the management of radioactive waste (RAW) such as manipulation, pre-processing, processing, conditioning, storage or disposal, including decommissioning of RAW management facilities;
- fund and control activities involved in the decommissioning of the NPP Kozloduy nuclear facilities, and the cost of storage and disposal of RAW generated as a result of such decommissioning.

**The heading “Agriculture, forestry, hunting and fishing”** for 2011 includes appropriations for supporting normal operations under activities relating to agriculture and forestry, fisheries and aquaculture.

This heading includes expenditure relating to food protection, control of infectious and parasitic diseases affecting animals and plants, purchase of vaccines and diagnostic kits; purchase of anti-hail rockets; forest security and reproduction; maintenance cost of forest and game ranger services to ensure protection of forests and game; protection, restoration and improvement of soil fertility and the environmental functions of soil cover; development of the vine and wine sector in Bulgaria in accordance with EU requirements; protection of stockbreeding selection with the purpose of improving stock pedigree; grain and fodder control; protection and reproduction of fish stocks and aquaculture, protection and increase in fishing resources in Bulgaria; testing, research and certification of agricultural and forestry equipment; variety testing, certification and control of seed and planting material; national protection against entry and spreading of pests affecting plants and plant products; protection of national sites.

**The heading “Transport and communications”** for 2011 includes appropriations for funding the Government’s policy in the area of transport and communications, namely: for improvement of transport infrastructure, for completion of works on an efficient transport system; for ensuring a high level of safety and environmental safety in all types of transport; for ensuring the proper balance between the interests of all participants in the market of electronic communication services and of postal services; for development and change in the working procedures of public administration in order to make the transition from conventional to electronic services, etc.

In 2011, the heading “Transport and communications” includes a total expenditure in the amount of BGN 183 792.6 thousand for government investment loans which are administered through the budget of the Ministry of Regional Development and Public Works, the Road Infrastructure Agency - Rehabilitation and reconstruction of roads from the national road network, Classes II and III, and Transit roads V.

The appropriations envisaged in this heading make provisions for expenditure for developing the basic transport infrastructure, improvement in the quality of transport services, reducing the negative environmental impact of the various modes of transportation, providing a high level of safety and security in the various modes of transportation, ensuring the proper balance between the interests of all participants in the market of electronic communication services and of postal services as a result of the processes of harmonisation with the European regulatory framework, ensuring on-going updating of the legal and technology framework within which the administration operates in terms of the electronic communications infrastructure, and also a change in the working procedures of public administration in order to make the transition from conventional to electronic services, etc.

In 2011, the heading “Transport and communications” includes total expenditure in the amount of BGN 131 366.2 thousand for government investment loans, which are administered through the budget of the Ministry of Transport, IT and Communications - Reconstruction and

electrification of the rail route Plovdiv – Svilengrad, the second bridge across the Danube and Construction of container terminals in the port of Bourgas and in the Varna-East port.

The appropriations budgeted in heading “Transport and communications” provide funding for the activities of the Special Courier Service, the National System for Monitoring the radio frequency spectrum; a change in the National Numbering Plan, etc.

The need to provide subsidies to the passenger railway carrier stems from the public nature of railway transport as a whole and from the social orientation of most of the passenger services it provides. State aid in the form of subsidies and compensations is provided by way of compensation for the loss-making nature of operations as a result of meeting the obligation to deliver a public service of “general economic interest” when applying tariff prices below cost for passenger transport.

The state participates in financing activities relating to the construction, maintenance, development and operation of railway infrastructure. The approach in determining the amount necessary for 2011 financing was similar to the approach applied to railway transport, taking into account the changed structure of infrastructure fees charged by the rail infrastructure operator.

For activities delegated by the Central Government to municipalities in 2011, the heading „Transport and communications” includes appropriations for current expenditure in the amount of BGN 1.2 million which fund the maintenance cost of the Beloslav ferryboat facility.

For rehabilitation and construction of municipal roads, and for continuing the extension of the Sofia Metro, appropriations amount to BGN 113.4 million.

Appropriations for activities under **the heading “Manufacturing and construction”** provide funding for activities promoting the start-up and development micro, small and medium-sized enterprises.

Appropriations for activities under **the heading “Tourism”** provide funding for activities in the area of national tourist promotion and for improving the sector’s competitiveness in 2011.

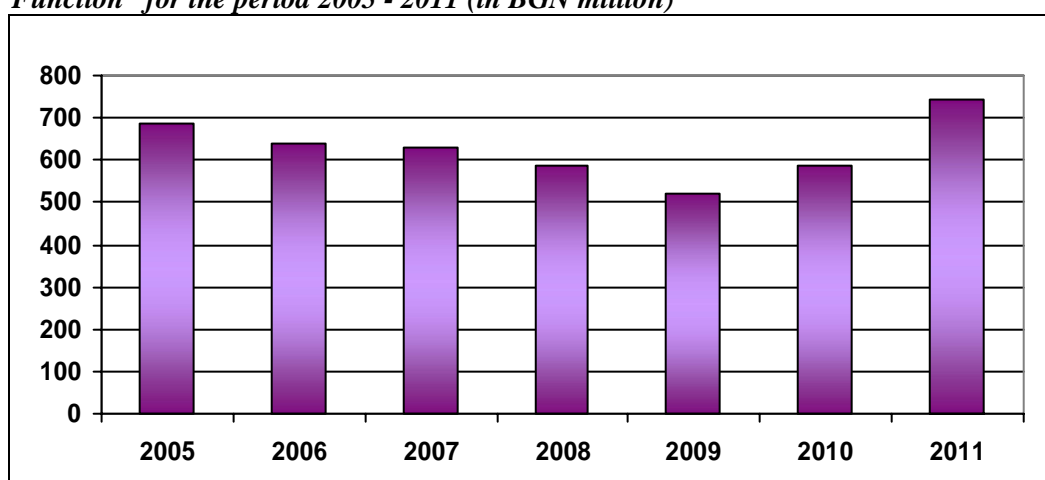
Appropriations for activities under **the heading “Other activities relating to the economy”** provide funding for activities relating to the process of privatization and post- privatization control in 2011.

**EXPENDITURE NOT ELSEWHERE CLASSIFIED BY FUNCTION (NOT INCLUDING RESERVE ALLOCATIONS TO OTHER FUNCTIONS)**

***1.0 per cent of GDP to be spent on expenditure not elsewhere classified by function (not including reserve allocations to other functions)***

For 2011, expenditure under this function includes appropriations in the amount of BGN 742.1 million, or 2.7 per cent of total expenditure.

***Chart: Expenditure under the Function „Expenditure Not Elsewhere Classified by Function” for the period 2005 - 2011 (in BGN million)***



\* The programme for 2010 and 2011 includes also the disaster response reserve which, in the reporting years (2005-2009), has been carried to the respective functions depending on the nature of expenditure.

Appropriations for interest payments planned for 2011 in this function amount to BGN 661.1 million, and appropriations for prevention and control of, and recovery from disaster consequences are set at BGN 81.0 million.

## **6. Debt Management and Financing**

### ***Sovereign Debt***

***The maximum amount of sovereign debt as of 2011 year-end is projected at BGN 14.3 billion, or 18.6 per cent of GDP, or lower***

As of 31 July 2010, the nominal amount of sovereign debt totalled BGN 9 637.5 million, including external debt of BGN 6 571.7 million and domestic debt of BGN 3 065.9 million. In structural terms, external debt accounts for 68.2 per cent, and domestic debt is 31.8 per cent. The sovereign debt/GDP ratio for the same period amounts to 14.2 per cent, and in comparison to 2009 reported data exhibits a decrease of 0.1 percentage points. In nominal terms, sovereign debt grew by BGN 193.8 million in comparison to the reported amount at the end of December 2009. The increase is largely due to currency loss/gain, and also to the increase in domestic debt as a result of new issues of government securities.

As of 31 July 2010, the external sovereign debt was up by

BGN 137.4 million compared to the end of 2009. For the same period, the debt/GDP ratio remained at levels around 9.7 per cent, which was its level at the end of last year. As of the end of 2010, external sovereign debt is expected to be about BGN 6.9 billion, and the external debt/GDP ratio is projected to stand at around 10.0 per cent.

In terms of the currency structure of the external sovereign debt, it is expected that at the end of 2010 the Euro-denominated debt will retain its predominant share which was reported at 69.5 per cent as of July 2010. The share of dollar- denominated debt in the same period was 26.0 per cent, with 4.5 per cent in other currencies.

In the interest structure of external debt as of the end of July 2010, the relative share of floating rate debt was down to 29.5 per cent in comparison to 30.8 per cent at the end of 2009, while fixed rate debt was up, reaching 70.5 per cent. The shift is primarily due to the external financing in the amount of BGN 48.9 million received from the European Investment Bank with a fixed rate coupon, and to regularly made amortization payments on floating rate debt. The increase in the relative share of fixed rate debt in the external debt interest structure results in a reduction of interest risk and facilitates the predictability of interest expenses for the budget.

Until the end of 2010 and in 2011, external debt payments will be influenced both by fluctuations of interest rates, USD/EUR and JPY/EUR rates and by the external debt amount which is closely linked to disbursements on already agreed government investment loans and on new loans assisting the Government in implementing significant infrastructure projects.

As of the end of 2010, the nominal amount of domestic sovereign debt is expected to grow, reaching a level of about BGN 4.1 billion, and domestic debt as a share of GDP is expected to register a slight increase.

The issuance policy of the Ministry of Finance in 2010 takes into account both the measures for attain sustainability of the economy and of the main fiscal parameters set out in the 2010 State Budget of the Republic of Bulgaria Act, and the strategic goal concerning the management of the sovereign debt for the period 2009 - 2011 which is aimed at ensuring the necessary sources for funding for the state budget and for refinancing the outstanding debt at the lowest possible price and the most acceptable level of risk.

The Government's firm position to retain the currency board arrangement in Bulgaria and its clearly stated intentions to join ERM II backed by consistent efforts to stick firmly to the Maastricht criteria determine the growing importance of its issuance policy as one of the key instruments for sovereign debt management and support for its current fiscal policy. In the context of a functioning currency board and a global economic crisis, the Government's efforts to manage its sovereign liabilities in the best way possible is a key prerequisite for insuring access to market financing and boosting the confidence of the capital market in Bulgaria.

Under the said restrictions, the issuance policy is a form and a concrete expression of the overall fiscal policy which to a considerable extent is tasked with the responsibility to maintain Bulgaria's macroeconomic stability in strict observation of the balance between goals and restrictions. In parallel, the issuance policy directly corresponds to and supports and, where necessary, assists, financial system liquidity. Efforts are focused on applying the whole set of possible instruments for promoting the development of the domestic government securities market, while taking utmost care to ensure a smooth execution of transactions adding and tightening liquidity through maturities and issues of government securities in the context of preventing possible market volatility and fragmentation. The investment-class rating of Bulgaria and its macroeconomic fundamentals ensure its ability to obtain freely market financing both at the domestic and international capital markets.

As of 31 August 2010, financing for the budget through new issues of government securities amounts to a total par value of BGN 755.8 million. A 30-month Euro-denominated government note issue was placed on the market, which opened three times since the beginning of the year, with a total volume of BGN 237.7 million. The Ministry of Finance reopened the 2009 5-year issue of government notes (with a residual maturity of 4 years) in the amount of BGN 130.0 million. It also launched 7-year government bonds with a total par value of BGN 100.0 million, and a long-term issue with a tenor of 10 ½ years where the quantity sold for the period reached BGN 288.1 million. The yield realized on the auctions corresponds to the increased investor interest and the situation on the domestic and international financial markets in the period under consideration.

The average duration of issues outstanding calculated on the basis of the maturity structure of debt issued to support the budget reached 8.4 years. The denomination mix of domestic debt continued to be dominated by the BGN component, with an 80.6 per cent share as of the end of July 2010. The shares of government securities denominated in US dollars and in Euro reached 4.4 per cent and 15.0 per cent, respectively. This structure largely eliminated the effects of the market fluctuations in the rates of the remaining currencies and is aimed at keeping the share of Euro- and BGN-denominated debt at volumes levels above 75 per cent. The interest structure of domestic debt is characterized by retaining the level of the share of fixed interest liabilities as of 31 July 2010 around its 2009 year- end level of 90.7 per cent.

The issuance policy pursued this year is focused mainly on the development of the domestic market of government securities and it will remain a key aspect in the debt policy next year. In 2011, gross financing on the domestic debt market is projected at approximately BGN 800 million, and intensions are to continue with the well-established practice of offering government securities with standardized maturities of 3 1/2 and 10 years, and reopening the long-term EUR-denominated issue. In this sense, in addition to the ability to issue government securities on the international capital markets, over the remaining period of the current Strategy for Sovereign Debt Management 2009 – 2011, priority will be given to stimulating the development of an efficient and liquid domestic market, and the characteristics (volume, maturity, interest terms, etc.) of new issues of government securities will be defined depending on current market configurations.

In 2011, the volumes of planned security issues on the local market will be realized with the purpose of establishing a stable and liquid domestic market, taking full account of the interest of the state. Regular issuance of new fixed-coupon debt has the aim of attracting a wider investor base and is an important prerequisite for increasing the relative share of debt denominated in the national currency and in Euro.

The increase in domestic debt in 2011 will take account, on the one hand, of the current macroeconomic situation in Bulgaria, and on the other hand, the situation, dynamics and development prospects of the local and international financial markets. The risks related to servicing domestic debt will be minimized, in view of the prevailing share of BGN-denominated government debt issues and payments on issues with fixed interest coupon. This approach will also minimize the impact of fluctuations in international interest and exchange rates on payments due on government securities issued in connection with the structural reform.

### ***Interest Expenses***

In 2011, projections indicate a slight increase in interest expenses related to sovereign debt in absolute terms as a result of increasing size of the debt and an upward movement in interest rates.

Interest expense on external loans is estimated to reach approximately BGN 500 million. The major portion of this expenditure will be related to government loans, and about BGN 68 million will refer to government investment loans (including BGN 53 million on

government investment loans administered under the budgets of ministries, and BGN 15 million on government investment loans where the end beneficiary is a company).

In 2011, expenditure on domestic debt is expected to stand at about BGN 165 million.

In reporting the debt structure, one should take account of the sensitivity of interest payments to any changes in international interest rates and the US dollar/EUR and JPY/EUR rates, since 23.1 per cent of liabilities are pegged to variable interest rates, making this portion of payments dependent on their movements. Exchange rate fluctuations also have an effect on the amount of expenditure due to the fact that 19.1 per cent of Bulgaria's sovereign debt is denominated in US dollars, while only 3.1 per cent is in other currencies.

### ***Financing***

In 2011, external financing under the central budget is expected to be a positive value, amounting to approximately EUR 1 200 million. In 2011, there will be disbursements under the Bulgaria Credit Agreement for a Structural Programme Loan to support co-financing to complement EU funds in 2007 - 2013 signed between the Republic of Bulgaria and the European Investment Bank, to the amount of approximately EUR 200 million; and an issue of government securities on international capital markets, with a nominal amount of about EUR 1 billion. Disbursements from government investment loans administered under the budgets of ministries considerably exceed the amount of regularly made repayments in accordance with agreed loan retirement plans. As a result, net external financing from those sources is expected to be a positive value, to amount to about BGN 150 million. For government investment loans where the end beneficiary is a company, a positive net external financing of about BGN 107 million is expected.

In 2011, a positive net financing is expected to be realized in the central budget, from transactions in government securities in the amount of about BGN 322 million. It is envisaged to issue government securities with a total par value of about BGN 800 million.

In accordance with the forecast for expected privatization sales and the respective agreed payments for 2011, 40 privatization sales are planned, for a total of BGN 450 million. Most of the proceeds are expected to come from the closing of privatization transactions with blocks of equity shares in the following companies: BulgarTabac Holding AD, minority share holdings in power distribution companies, Montagi EAD, Slanchev Bryag AD, etc.

## **7. Assessment of Public Finance Sustainability and Fiscal Risks**

### **Potential Growth and Deviation from the Potential GDP**

The deviation from the potential GDP for 2009 is negative, in the amount of 2.6 per cent, and indicates a cooling down of the Bulgarian economy. This assertion is supported by additional indicators such as a dramatic drop in the inflation rate, an increase in the unemployment rate, with the respective restrictions on the growth rate of wages, and a swift shrinking in the current account deficit.

In 2010, as a result of the influence of the economic and financial crisis on Bulgaria's economy, the potential economic growth is expected to slow down to 3.1 per cent. The key factors for this decline are expectations for a drop in investment as a result of which capital growth in the economy is considerably slowed down. On the side of production factors, the greatest contribution to potential growth is expected to come from total factor productivity (1.6 percentage points), followed by capital (1.1 percentage points) and potential employment rate

(about 0.4 percentage points). As a result of the slowdown in the investment activity in 2009 and 2010, potential growth is expected to reach its minimum in 2011. In the remaining years of the period under consideration, as Bulgaria emerges from the economic crisis, an increase in the potential growth is also expected. This will come both in terms of capital accumulation in the economy and in terms of rising total factor productivity.

Given this forecast for the development of the economy, the deviation from the potential GDP is expected to reach a negative value of -4.9 per cent in 2010. Although active processes of Bulgarian economic recovery are expected in the remaining years of the period under consideration, these will not be sufficient to offset the sharp cooling down, the deviation from the potential GDP will decrease but remain negative.

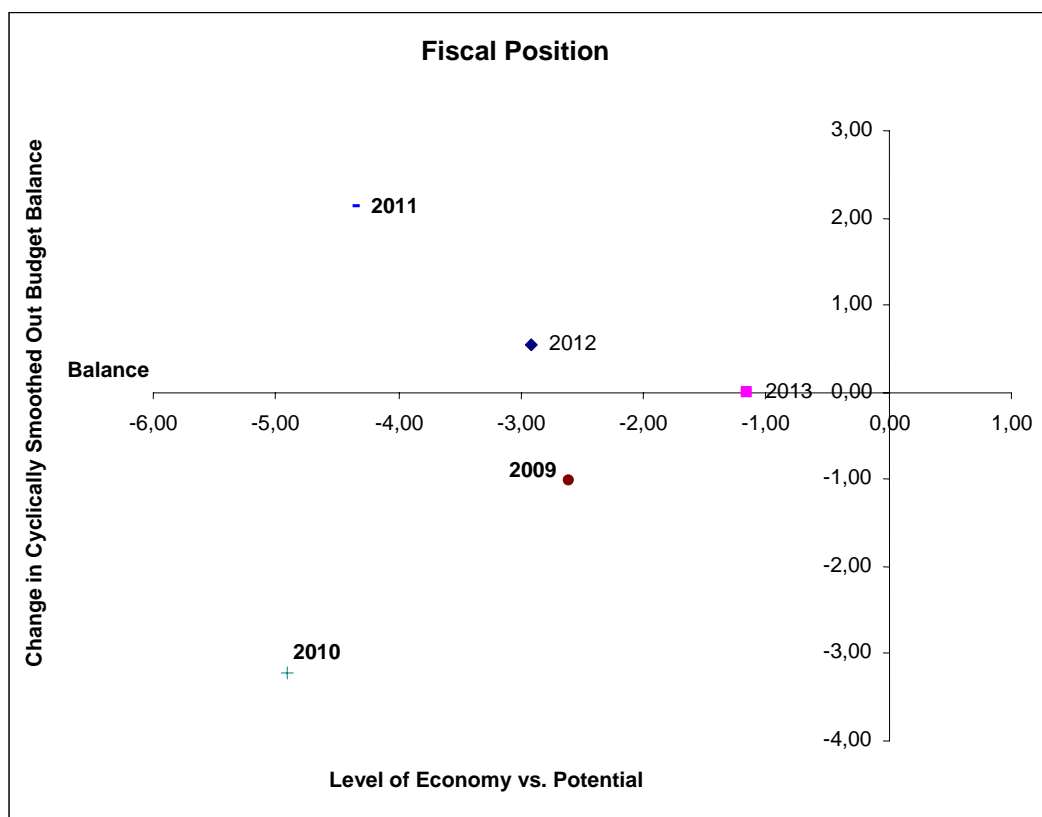
<i>Table: Potential Growth and Deviation from the Potential GDP</i>			<i>Table: Contributions to the potential growth rate (in percentage points)</i>			
Year	Potential growth, in percentage	Deviation from potential GDP, in percentage	Year	Labour	Capital	TFP
2009	3.4	-2.6	2009	0.4	1.3	1.6
2010	3.1	-4.9	□010	0.4	1.1	1.6
2011	3.0	-4.4	2011	0.2	1.1	1.7
2012	3.1	-2.9	2012	0.1	1.3	1.□
2013	3.3	-1.1	□013	0.1	1.4	1.9

### **Fiscal Policy Cyclicity**

In the conditions of an economic crisis, the Bulgarian fiscal policy in 2010 is anti-cyclical in nature. This is due to the persisting decline of the economy below its potential for this period, accompanied by a relaxation in the fiscal position in order to stimulate economic activity. In 2011 and 2012, the economy will move closer to its potential, yet remain at a level below the optimal (-4.37 per cent for 2011, and -2.92 per cent for 2012). Over this period, it is envisaged to tighten the budget policy in order to retain the macroeconomic stability, ensure the sustainability of the fiscal position, and meet the challenges faced by public finance as a result of the population ageing. The current account deficit in the balance of payments and the need to retain investor confidence in the fiscal stability of the country require the pursuit of more conservative budget goals. In this sense, the tightening nature of the fiscal policy in 2011 and 2012 is a reasonable compromise with the requirements of the Stability and Growth Pact. In 2013, fiscal policy will again be quite anti-cyclical in nature, due to a slight easing in the budget position.

No one-off or temporary measures affecting the budget balance are envisaged for the planning period.

***Chart: Fiscal Position Cyclicality***



### **Sustainability of Public Finance**

#### ***Streamlining the spending structure and improving spending efficiency***

The sustainability of the fiscal position relates to the capacity of the budget to finance itself, while at the same time reducing sovereign debt. The long-term sustainability of the fiscal position is considerably affected by current levels of budget balance and sovereign debt, and by their projected change, as a result of population ageing. The demographic ageing process is associated with a significant risk for public finance as it will exert significant pressure toward increasing budget spending for pensions and healthcare.

The generally accepted EC approach to assessing fiscal position sustainability is the so-called S2 indicator which can be interpreted as the difference between current (projected) fiscal position for each year in the future and the position which meets the sustainability requirement for an indefinite period in the future. It is made up of two components – current budget position and an estimate of the discounted present value of the impact of population ageing in the long term. A positive value of the indicator therefore signifies a need for fiscal consolidation or structural reforms which should alleviate the burden of population ageing on public finance. Conversely, a negative value indicates that the starting budget position is strong enough to ensure sustainability of the fiscal policy even vis-à-vis the risk attached to population ageing.



<i>Programme scenario (in percentage of GDP)</i>	
Starting budget position 2009	0.48%
Effect of population ageing	1.32%
<i>S1</i>	<i>-1.08</i>
<i>S2</i>	<i>1.81%</i>

For Bulgaria in particular, the value of this indicator is positive, which shows that the current fiscal position is not sufficiently stable. A breakdown of the indicator into components shows that the sustainability of public finance is adversely affected primarily by the population ageing effect which reaches 1.32 per cent of GDP. The main part of this effect is due to increased expenditure for pensions which has been growing faster than GDP. On the other hand, demographic processes have a positive effect on expenditure for education which is going down but this decrease is more than neutralized by an increase in healthcare spending in the long term. Hence, in order to retain the sustainability of the budget position it is necessary to tighten fiscal policy in the coming 2 years, although the economy will remain below its potential level of output.

The process of population ageing is a serious challenge for retaining the sustainability of public finance and makes it necessary and urgent to reform the pension system, improve the quality of public expenditure in the healthcare and educational systems, and to maintain a conservative policy with regard to budget balance. The reforms, including an increase in the economic activity coefficient and a reduction, respectively, in long-term unemployment, will enable the assumption of the burden of population ageing in the future, without jeopardizing public finance stability.

Government efforts focus on improving both the expenditure and the revenue side of the budget. Their goal is to streamline the structure of spending and improve expenditure efficiency, and also to improve the collection rate of liabilities to the state while broadly retaining the existing structure of revenue.

The measures identified by the Government to achieve the goals of the budget and the fiscal policy in the mid-term include: periodic value-for-money reviews of government programmes, adoption of new legal framework for public finance planning and management, reinforcement of the role of programme- and results-oriented budgeting, and implementing a precautionary policy concerning the assumption of new government debt, while preserving the ability to respond rapidly to risks for the financial stability of the country.

### **Fiscal Risks**

#### ***Conservative mid-term macroeconomic forecast***

The international economy embarked on a road to recovery and is emerging from the financial and economic crisis. This process and its duration, however, remain uncertain and continue to pose a risk to the Bulgarian economy, and hence, to public finance.

On the other hand, the mid-term macroeconomic forecast of the Ministry of Finance is rather conservative and therefore the main risks facing budget execution in the mid-term have to do with:

- A shift in the structure of economic growth towards a higher share of net exports, and indications for declining tax collection rate;
- Population ageing causing pressure on the pension system;
- A second deterioration in external environment due to phasing out fiscal and monetary stimuli, which could suppress the recovery of the Bulgarian economy.

The cash execution of the consolidated fiscal programme registered a deficit of BGN 1.23 billion for the first seven months of 2010, which is the result of declining tax revenue accompanied by growing spending as a result of clearing up old liabilities. This logically required a revision of budget plans for the year, resulting in allowing a moderate budget deficit. The revenue side could hardly be expected to make a large contribution in the necessary adjustment, considering the decision not to increase the tax burden, which necessitates measures to cut budget spending dramatically. In its turn, these measures have an adverse effect on economic recovery and hence result in lower budget revenue growth.

Another risk for the budget, in addition to the slow economic recovery, comes from expectations that the recovery will be driven largely by exports. In previous years, domestic demand was the key driver of economic growth, which was favourable in terms of the budget as it created a high tax base. Conversely, an economic growth generated by exports would create conditions for lower growth in tax revenue in comparison to the GDP growth since exports are tax-exempt. Overall, risks for the execution of the revenue side of the budget in the mid-term do exist, despite conservative planning. In addition, risks associated with the expenditure side of the budget could also emerge, in view to the pressure which the economic downturn and weak recovery will exert on expenditure for social aid and unemployment benefits. Also, there is a certain insecurity in connection with the tax collection rate which has deteriorated since the economic crisis began in 2009, and this process appears to be continuing into mid-2010.

In the long-term, the outlook indicates a possible considerable deterioration in the demographic structure of the population, which poses a considerable risk for the fiscal policy. In the long term, the increasing share of elderly people is expected to lead to a noticeable pressure on budget spending for pensions and healthcare. This process poses a serious challenge for maintaining public finance sustainability and makes it necessary to adopt reforms in the pension system, improve the quality of public expenditure in the healthcare and educational systems, and implement a conservative policy with respect to the budget balance. These reforms will enable the assumption of the burden of population ageing in the future without jeopardizing public finance stability.

## V. MANAGEMENT OF EUROPEAN FUNDS AND PROGRAMMES

### **The Impact of Financial Relationships with the EU on the Budget**

*A positive effect on the economy and the budget due to absorption of EU funds*

The main priorities of the national budget for 2011 include: priority focus on sectors promoting economic growth which are also eligible for significant financial support under Operational programmes co-financed from the Structural and Cohesion Funds 2007–2013 of the European Union, and also from other EU funds and programmes.

Maximizing the positive effect from the absorption of EU funds on the economy and the budget is a strategic priority in the framework of the general fiscal policy of the Government both in the specific period under consideration, and in the long term. The principle of additionality of funding provided from the EU budget is observed: priority goals are realized with national resources which are complemented with funding from EU funds without the latter substituting for national funding from the central budget, budgets of local government authorities, etc.

*Expectations for improvement in the absorption rate of funding under pre-accession programmes in their final stages*

### **Pre-accession Programmes**

The pre-accession programmes PHARE, SAPARD and Cohesion Fund Regulation 1164/94 (the ISPA programme) and the temporary financial support provided for in the Act of Accession – the Transition Financial Instrument (TFI), and the Cash-Flow Facility in support of budget cash-flows and the Schengen Facility for assistance in implementing the Schengen Agreement are all designed to assist Bulgaria in its social and economic reform and in preparing for the absorption of funding from the EU Structural and Cohesion Funds (SCF).

Under the SAPARD Programme, the payment of subsidies to end beneficiaries ended on 31.12.2009 with the expiry of the term of the 2006 Annual Financial Agreement (AFA). In 2011, the programme budget settlement will take place between Bulgaria and the European Commission (the Commission).

In 2011, the ISPA Programme (Cohesion Fund Regulation 1164/94) remains a major priority for Bulgaria in view of the public significance of the infrastructure projects in the area of transport and the environment. Bearing in mind that the period for implementing some of the project could be extended until the end of 2011/2012, an improved absorption rate is expected under this programme.

The PHARE Programme and TFI are at a closing stage of implementation. So is the Schengen Facility, for which the clearance of accounts procedure will begin in 2011.

### **Structural Funds and Cohesion Fund: Operational programmes**

*Measures undertaken to speed up payments to beneficiaries and ensure greater flexibility of Managing Authorities*

A key priority in 2011 is the absorption and efficient use of EU funding while ensuring maximum transparency and openness in the contracting process and efficient control mechanisms on the spending of funds.

In the current year, concrete measures have been undertaken to speed up the process of making payments to beneficiaries and to ensure greater flexibility of the Managing Authorities in terms of making payments with the respective clear managerial responsibility.

Adequate strategic planning for calls for applications when launching grant procedures is also important for the successful implementation of objectives.

As a result of the measures undertaken and the experience gained, the volume of payments disbursed under Operational programmes co-financed from the EU Structural and Cohesion Funds, for both advance and intermediate payments, is expected to increase in 2011 in comparison with 2010 figures.

***The implementation of infrastructure projects of significance for the public in the area of transport and the environment features among the main priorities of the Government.***

This priority receives considerable financial support under Operational Programmes „Transport” and „Environment” which cover large-scale projects relating to transport system development through the development and upgrading of key transport infrastructure for communications of national, transborder and European significance, and protection and development of environmental infrastructure and improvement, protection and restoration of natural environment and biodiversity.

The useful effects of implementing these projects are long-term. Projects implemented under these programmes have social, economic and strategic significance both in regional and in national terms.

***Achieving a high quality of life, income and social sensitivity of the community***

OP Regional Development 2007–2013 is the operational programme with the greatest share in the financial resources committed for 2011. Its main goal is to achieve an improvement in the quality of life and work environment with a better access to the main services and new opportunities for improved regional competitiveness and sustainable development.

In the framework of this priority, in order to achieve a high quality of life based on sustainable social and economic development, OP „Development of the competitiveness of the Bulgarian economy” which is implemented in the Republic of Bulgaria during the period 2007-2013 is aimed at preparing Bulgarian enterprises for the common European market and for the swiftly changing conditions in international markets, and the condition of the environment in which they operate.

***Strengthening the administrative capacity in order to improve the EU funding absorption rate and development of human resources in order to ensure higher employment, income levels and social integration***

The improvement of knowledge and skills of public administration personnel and of the quality of administrative services, and the efficient functioning of the judiciary system are supported by implementing Operational Programme „Administrative capacity” which is co-financed from the European Social Fund in the period 2007-2013. This operational programme is aimed at achieving common standards and rules for reforming public administration at all levels: central, regional and municipal; development of a highly professional administration focused on the needs of the community; and reducing the cost and bureaucratic procedures in its operations. Through this programme, working mechanisms for internal and external control will be introduced, providing for better accountability and transparency. This programme addresses also the judiciary reform.

***Development of human resources in order to ensure higher employment, income levels and social integration***

In the period 2007–2013, Operational programme „Development of human resources” focuses on investing in the acquisition of new knowledge and skills; promoting lifelong learning, improving the quality of education and training in accordance with the requirements of the labour market for building a knowledge-based economy; promoting economic activity; improving the efficient operation of labour market institutions, social and health services.

In the context of increasing the absorption rate of EU funding in Bulgaria, implementation is under way also under Operational Programme „Technical Assistance” which is aimed at strengthening the necessary capacity and the operations of entities of the central and local administrations involved in the absorption of SCF funding, and at improving public awareness concerning the efficient and effective use of SCF funding.

## **Other European Projects and Programmes**

In 2011, the launch of the first projects under the bilateral programmes for transborder cooperation along the external borders of the European Union is expected. These programmes have a considerable role in bringing closer together the people, communities and economies in the participating border regions.

The implementation of a number of projects will continue in 2011. These are in the area of environmental protection, human resource development, strengthening the capacity of local governments and their administrations in the field of administrative and public services, healthcare and child care, protection of European cultural heritage and are supported by the European Economic Area Financial Mechanism.

Under the Framework Agreement with the Swiss Confederation on implementing the programme for cooperation between Bulgaria and Switzerland, in 2011 the Republic of Bulgaria will have the opportunity to receive financial support in the area of security, stability and support for reforms, environment and infrastructure, promotion of the private sector and human resource development and social activities.

The budget sets aside national co-financing for the Norwegian Cooperation Programme for economic growth and sustainable development, the European Economic Area Financial Mechanism, the Bulgaria–Switzerland Cooperation Programme, the Programme for Development Cooperation between the Government of the Republic of Bulgaria and the Hellenic Republic and programmes for transborder cooperation. The programme donors are the Kingdom of Norway, Iceland and Lichtenstein, the Swiss Confederation, the Hellenic Republic, and the EU. The programmes contribute for reducing discrepancies between regions in the EU by implementing projects for environmental protection, renewable energy sources, healthcare, cultural heritage, education, improvement in the institutional capacity of public administration and the non-government sector, improvement in living conditions and inter-regional links in transborder regions, strengthening security along the external borders of the Republic of Bulgaria.

## **Common Agricultural Policy and Common Fisheries Policy**

### ***EU Common Agricultural Policy (CAP)***

The purpose of the CAP is to ensure an acceptable standard of living for farmers, quality foodstuffs for consumers at affordable prices, and to preserve the European heritage in rural areas and contribute to environmental protection.

The main CAP instruments are direct payments and market support for agricultural producers (first pillar of the CAP) and the rural development policy (second pillar of the CAP).

#### ***First pillar of the CAP:***

Through the European Agricultural Guarantee Fund, the EU provides funding for assisting agricultural producers under direct payment and market support schemes.

Under the single area payment (SAP) scheme, it is envisaged to spend BGN 1 060.8 million in 2011, including BGN 767.4 million for direct payments, and BGN 293.4 million for national additional payments. Refunds for direct payments from the EU are expected to amount to BGN 627.8 million.

Appropriations for national payments under the special premium schemes for cattle amount to BGN 53 million.

Funding for market support planned for Bulgaria is not specified in the Treaty on the accession of Bulgaria to the EU since the amounts are determined on the basis of market measures specifically implemented in a given year.

In these sectors, funding for market support is appropriated depending on the market situation and upon a decision by the European Commission, and the necessary funds are disbursed from the national budget and then reimbursed from the EU budget.

Appropriations for market measures in 2011 amount to BGN 98.1 million, and it is expected that the amount will be reimbursed by the EU within the same year.

#### *Second Pillar of the CAP:*

The European Agricultural Fund for Rural Development (EAFRD) provides funding for the development of rural areas.

In accordance with Article 5 of Regulation 1290/2005, EAFRD can be used to fund measures for preparation, monitoring, administration and technical assistance, evaluation, audit and control necessary in implementing the CAP.

Total appropriations under RDP for 2011 amount to BGN 611.9 million, of which BGN 466.9 million from EU funding and BGN 145.0 million from national funding.

For funding expenditure for value added tax payable by municipalities under assistance projects approved under the Rural Development Programme for the period 2007-2013, the budget plan of State Fund Agriculture for 2011 has allocated BGN 32 million.

#### *EU Common Fisheries Policy*

The Common Fisheries Policy of the EU is aimed at ensuring sustainable development in the sector through responsible fishing and conservation of fishery resources, long-term supply of the market and the processing industry with high-quality fish and fishery products at affordable prices, and ensuring a fair standard of living for those employed in fishing activities.

In 2011, the funds which Bulgaria plans to spend in implementing the CFP amount to BGN 10 million, including BGN 2.5 million from national co-financing.

#### *National Programmes in the Area of Agriculture*

In addition to funds which State Fund Agriculture as a Payment Agency will absorb under EAFRD, EAGF and ERDF programmes, it is planned to retain the functions and funding of State Fund Agriculture relating to the implementation of national programmes.

In this connection, the 2011 state budget includes appropriations in the amount of BGN 30 million for state aid payments.

The parameters for extending investment loans to agricultural producers are retained: loan financing of up to BGN 80 million and temporary financial aid of up to BGN 20 million.

The budget plan of State Fund Agriculture for 2011 does not include any appropriations for restructuring as the Programme for restructuring the sugar industry has now closed for Bulgaria.

Following the expiry of the deadline for making payments with European funds under the SAPARD Programme on 31.12.2009, any subsequent payments to beneficiaries need to be made using funds from the state budget.

## **Bulgaria's Contribution in the General Budget of the European Union**

The amount of Bulgaria's contribution in the EU General Budget for 2011 is planned at BGN 811.5 million. This amount is an estimate and a kind of guarantee for the payment of the national contribution in the EU budget. Its conditionality stems from: the probability that in the year of execution additional needs and/or contingencies may arise, which should be funded from the EU budget; periodic revisions of data on the VAT-based resources, the GNI resources and the UK rebate adjustment in connection with the latest information available in view of ensuring full accuracy; it should also be recalled that despite projections concerning revenue from customs duties and fees on the production of sugar, the Member States pay into the EU budget the actual amounts collected as traditional own resources.

## **VI. QUALITY OF PUBLIC FINANCE AND REFORM GUIDELINES**

### **1. Streamlining the Public Sector**

The administrative reform began by closing down the Ministry of Public Administration and Administrative Reform and the Ministry of Emergency Situations. Subsequently, another 12 administrations were closed down; thus as of July 2010 the number of closed down entities is 14:

1. The Ministry of Public Administration and Administrative Reform;
2. The Ministry of Emergency Situations;
3. The Agency for Government Claims Collection;
4. The State Agency for Tourism;
5. The State Agency for Information Technology and Communications;
6. The State Agency for Youth and Sports;
7. The Centre for Translations and Editing;
8. Laws and Regulations Editor's Office;
9. The Social Investment Fund;
10. The Higher Attestation Commission;
11. The Agency for Post-privatization Control;
12. The Agency for Privatization;
13. The Executive Agency for Hydro melioration;
14. The Agency for Economic Analyses and Forecasts.

Five new entities were set up: the Ministry of Physical Education and Sports; the Executive Agency for Electronic Communications Networks and Information Systems"; the Transplantation Fund Centre; Agency for Privatization and Post-privatization control; Commandant's Office with the Ministry of Defence.

The number of administrative units within the central administration is down from 115 to 106, which is 7.8 per cent of the total number of all entities, and the lowest since 2005.

Along with the closing down of structural entities, the following administrations were restructured in the period July 2009 – July 2010:

- The State Forestry Agency with the Council of Ministers was transformed into Executive Forestry Agency reporting to the Minister of Agriculture and Food.

- The National Road Infrastructure Agency with the Council of Ministers was transformed into Road Infrastructure Agency reporting to the Minister of Regional Development and Public Works.
- The Executive Agency for Social Activities of the MoD was transformed into Executive agency for Military Clubs and Recreation” reporting to the Minister of Defence.
- The National Institute for Protection of Immoveable Cultural Values was transformed into the National Institute for Immoveable Cultural Heritage.

In July 2009, the public administration employed 94 373 people, of which 71 676 in the central government administration.

As of 1 July 2010, the administration employs 87 113 people, of which 63 816 are employed in the central government administration and 23 297 in municipalities. For the first year of the term of this Government, the number of staff by establishment in the central government administration was reduced by 7 860, which is a reduction by 10.90 per cent.

The number of staff employed in the Ministry of Interior has been made public and it was reduced by 3 000 staff positions, from 61 170 to 58 170 currently employed by the Ministry of Interior. Thus, just for the first year of its term, the number of staff in the public administration and the Ministry of Interior has been reduced by a total of 10 860.

The initiative for streamlining the public administration was completed on 30 June 2010. The review addressed three areas:

1. Review of functions and activities, and restructuring of the organisational units by eliminating any overlap of functions, decentralisation, outsourcing and reorganisation of territorial units of central government authorities.
2. Review of administrative processes and regulatory regimes, reduction of bureaucracy, time and price of administrative services.
3. Review of the efficiency and effectiveness of each structural unit within the ministry systems.

The review report adopted by the Administrative Reform Board proposes:

- To close down 22 entities;
- To restructure or transform 56 entities;
- To reduce the number of staff in establishment plans in the administration by at least 2 500.

In June 2010, the Council of Ministers approved a concept paper on the new remuneration model in public administration. The goals in this new model are: to recruit highly qualified and highly trained staff who can deliver efficient performance and contribute in the achievement of public administration goals; to link remuneration with performance; to retain members of staff who have the expertise and competence necessary for the execution of the respective functions and perform their duties professionally.

## **2. Financial Decentralisation**

In its Decision No. 454 of 02.07.2010, the Council of Ministers adopted a Revised Decentralisation Strategy and a Programme for implementing the Decentralisation Strategy for the period 2010-2013.

The Decentralisation Strategy sets out guidelines for the division of powers and financial resources between the central, regional, district and municipal levels of government with the aim of providing more efficient and high quality services.



The Strategy is based on the priorities set out in EU policies on decentralisation and sustainable and balanced development of the regions and creates conditions to implement the principles of the Lisbon Strategy in the regional policy of Bulgaria. It is also aligned with the European Charter for Local Self-Government and the all-European efforts for more democracy and increased citizen participation.

The Strategy reflects the commitments undertaken in the Programme of the Government of European Development of Bulgaria to deepen the process of decentralisation, increase own revenues of municipalities, improve the quality of services and the standard of living of citizens.

The purpose of the reform aimed at financial decentralisation is to provide public services in quantities, quality and at affordable prices corresponding to the needs of citizens, on the basis of sustainable and long-term balancing of the spending responsibilities of municipalities with stable revenue sources and efficient citizen control. To achieve this goal, the national policy of financial decentralisation needs to be supported by the implementation of a responsible and efficient policy and financial discipline on the part of municipalities.

Central government efforts are focused on improving the financial positions of municipalities. To this end, central government transfers to the municipalities are more transparent, objective and predictable. The municipalities spend more on investment, and this creates conditions for increased prosperity, economic growth and employment. Overall, the extent of financial decentralisation in Bulgaria gradually increases yet it remains below the European average.

The fiscal policy goals in 2011 will continue to focus on creating conditions enabling fast and sustainable social and economic development. This includes maintaining a high economic growth and implementing efficient public policies. Funding appropriated in the Draft 2011 State Budget of the Republic of Bulgaria Act create conditions for the development of positive trends in the process of financial decentralisation.

### **3. Financial and Budget discipline**

In recent years, all international financial institutions have acknowledged Bulgaria's progress in terms of fiscal and budget discipline. This is evidenced by the fiscal results achieved not only in the years immediately prior to the crisis but also results in the past two years. A comparison of the data concerning some key fiscal parameters in the EU Member States reveals that Bulgaria is well positioned, and the consolidation effort which is required can be made within a brief period of time and in smaller steps towards a balanced budget. This is due also to reforms in the area of the budget and public finance management which have been under way for several years now and will continue next year.

The Draft Act envisages improvements in the processes and procedures concerning the cash management of the budget and debt management. Along with that, efforts to improve the quality of rules and procedures concerning the budgeting stage will continue to focus on improving the efficiency of products/services, on responsibility in making commitments, and in setting expenditure priorities in the framework of the fiscal goals and spending ceilings for FLSUs as approved by the Council of Ministers.

The successful fiscal and budget discipline is primarily due to the fiscal rules concerning the balance, expenditure and debt levels as a percentage of GDP which have been applied consistently over the years. The 2011 Draft Budget has been drawn up in observance of the fiscal policy goals approved by the Council of Ministers, including fiscal consolidation goals which will be achieved on the spending side of the budget by setting target values for deficit in the CFP. Thus the rule from the previous MTFP for maintaining a balanced national budget for the period ending in 2013, which does not include funding from the EU funds and programmes, is transformed into a gradual reduction of the deficit bringing it below the 3-per cent threshold under the budget deficit criterion of the EU Stability and Growth Pact.

As for consolidated expenditure, its total volume is down to levels in the range of 35-38 per cent of GDP. The Government is delivering on its commitment undertaken at the beginning of its term to achieve an optimal amount of public expenditure with a trend towards a gradual decrease in the size of the public sector after implementing structural reforms and increasing the efficiency and productivity of the administration. As regards the fiscal rule as to the amount of debt, the strategy concerning the sovereign debt management does not provide for any change for the period or for the 2011 draft budget in particular.

Assessments of Bulgaria's 2009 budget deficit under the accrual basis method (European System of Accounts 95 /ESA95/), which is employed by Eurostat and is obligatory for all Member States, have placed the accent on the need to strengthen financial discipline in the public sector. The growth in liabilities accrued on commitments but not backed with financial resources in 2009 was significant compared to recent years. These automatically result in an increase in the consolidated budget deficit on an accrual basis. And this indicator is key in the Commission's assessments of the Convergence Programme of each Member State.

In this connection, efforts focus on the overall improvement in the management of budget resources in first-level spending units in the context of managerial responsibility in accordance with the principles set out in the Act on Financial Management and Control in the Public Sector.

In order to provide conditions for the exercise of control in taking up commitments, the Draft 2011 State Budget Act proposes an amendment which enables the Council of Ministers to set and adjust contracting ceilings for government authorities, the ministries and agencies. In addition, there is a proposal to adopt maximum allowable amounts for payables to suppliers as of the end of 2011 for all spending units in order to reduce the risks of deterioration of the budget balance on an accrual basis for 2011 which is expected to be reported, in accordance with the requirements of ESA 95.

Bulgaria's preparation for and participation in the European Semester is expected to be an important aspect in next year's tasks. This initiative is part of the efforts to strengthen economic governance and improve coordination of economic policies. This would be achieved by extending and deepening the scope of monitoring procedures and more specifically in terms of an ex-ante review of key budget parameters, an assessment of risks of macroeconomic imbalances and their effect on the functioning of the Economic and Monetary Union.

To achieve a more integrated monitoring and coordination of economic policies in the framework of the European Semester, the processes and instruments in the framework of the Stability and Growth Pact and the Europe 2020 Strategy have been aligned but remain separate, the goal being to increase the consistency between fiscal policies and microeconomic structural policies. The strategy for improved coordination of economic policies includes three integrated key elements: macroeconomic monitoring, monitoring of growth-stimulating reforms with a focus on structural reforms, and fiscal monitoring in the framework of the Stability and Growth Pact. This last element will be in the focus of attention from the very on-set of the process in order to achieve a faster fiscal consolidation and public finance sustainability.

In the framework of the initiative for enhanced coordination of economic policies, the Member States will be requested to provide preliminary information about budget performance in the current year and expected developments in the following year. Based on this ex-ante review, the Commission will propose recommendations, which would then be approved by sector Councils and the European Council, and which the Member States will have to take into account in adjusting their budgets, and also in designing their National Reform Programmes (NRPs), in the framework of the Europe 2020 Strategy, and their Stability and Convergence Programmes (SCPs) in accordance with the Stability and Growth Pact. The preparation of NRPs and SCPs and their submission to the European Commission at one and the same time will constitute the main commitment of Member States in implementing the initiative for enhanced coordination of economic policies.

A key element in the framework of enhanced coordination of economic policies will be the Annual Growth Review to be presented in January each year and serve as the basis of discussions at the spring European Council.

Based on the Annual Growth Review at the spring European Council, and on the SCPs and NRPs, the Commission will assess whether the Member States have addressed the identified bottlenecks for growth and whether they are making progress towards reaching their national goals in implementing the five flagship initiatives of the Europe 2020 Strategy.

In case of insufficient progress, specific recommendations would be made. In case the planned policies are not consistent with the Integrated Guidelines or where they pose risks for the functioning of the Economic and Monetary Union, the Commission will alert the Member States directly.

In line with the above initiative, the main tasks for improving the quality of public finance next year will aim to improve the principles and norms of maintaining budget discipline at all stages of the budget process, including extending the rules and norms for undertaking payment commitments and improvement of financial management and control.

Maintaining a currency board and a disciplined fiscal policy, and a stable banking system remain the most adequate tools for economic recovery.

#### **4. Accountability and Transparency**

The measures for streamlining public administration in 2011 planned by the Government will affect the efficiency of public spending due to improved functional coordination among ministries and agencies and an improved quality of products and services provided. Another main objective is to concentrate policy-making functions in the ministries and improve horizontal and inter-sectoral coordination at all levels of government.

The reforms in the area of human resource planning and management will provide opportunities for career development and performance-based remuneration tied up with the quality of services provided and results delivered.

The goals to increase the efficiency of public sector institutions are linked to progress in the budget reform and the results expected from the implementation of programme and results-oriented budgeting. In the short term, efforts will focus on developing criteria for evaluation of budget programmes and an ex-post review of their efficiency and effectiveness.

The Government will continue to take an active part in the social dialogue at all levels, including through the National Council for Tri-partite Cooperation (NCTC) and its standing committees, industry, sector and regional cooperation councils through dialogue in the framework of the Committee for Labour and Social Policy in the National Assembly, and dialogue in the Economic and Social Council.

As regards budget transparency and openness, the Government will continue its efforts to extend the scope of information and budget documentation. Being one of the 85 countries participating in the Open Budget Survey initiative, Bulgaria will continue the process of increasing access to budget information and expanding opportunities for public participation in the budget process.

## **VII. CONCLUSION**

Preparation of the 2011 budget reflects the goals of fiscal policy and the main horizontal policies, taking into account the outlook for the macroeconomic external and domestic environment. Considerable efforts towards achieving policy goals at all institutional levels are key in order to meet challenges facing the national economy in the mid-term.

Successful budget consolidation, supported by improved budget management and higher efficiency, is the basis for maintaining the Currency Board. A stable fiscal position ensures that the fiscal policy is capable of adapting, considering that it will need to shoulder the main part of the burden of any intervention in case of shocks on the demand side in the conditions of a Currency Board arrangement.

Efforts to improve processes and the quality of public finance will continue, by implementing into practice programme budgeting and by the introduction of a sector approach in financing the public sector. Expanding the practice of applying indicators in impact assessments, and the systematic cost/benefit analyse of government programmes and policies serve as a basis for policy and management decision-making, and demonstrate a commitment to promote public awareness and participation in governance.

Through the 2011 Draft Budget, the Government reconfirms its commitments undertaken before the international financial community to keep Bulgaria's public finance stable, particularly in comparison to countries in the region and to other EU Member States. This is evidenced also by the recent opinions of the rating agencies Moody's and Fitch which, following the assessment by Standard & Poor's, reconfirm the positive outlook. Fitch's analysis indicates that the outlook for Bulgaria remain stable. This is primarily due to the stability of Bulgarian public finance. Bulgaria's rating is supported also by the relatively high level of development of human capital, the business climate and the political stability as a result of EU membership. This is a strong signal to foreign investors and demonstrates that the Government's policy of maintaining strict fiscal discipline, keeping the tax burden unchanged and improving the business environment is a policy of moving in the right direction.

**PRIME MINISTER:**

**BOIKO BORISSOV**