

MINISTRY OF FINANCE



BUDGET PROJECTION **for the period 2006-2008**

May, 2005

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INTRODUCTION

The Budget Projection Report has been developed by the Ministry of Finance with the main objective of presenting the policy, factors and prerequisites behind directions given, as well as the specific parameters for the next years. Bearing in mind the fact that the Report will be published immediately before the elections for the Fortieth National Assembly of the Republic of Bulgaria, it is important to state from the beginning that it has not been produced as a traditional medium-term framework, but rather like a document, which shall serve and facilitate the next government in the development of its Budget Program. The document follows OECD practices in the preparation of a pre-election report, which provides the framework regarding the expectations for a specific development of the macroeconomic scenario, eventual risks and problems and the necessary reforms.

This Report is the first document developed within the framework of the budget policy procedure; therefore, the directions laid down in it should serve as guidelines for budget-supported organizations in the development of their specific budgets. At the same time, it aims to increase transparency in the state finance management, as well as to be a source of information that provides a full description of the fiscal policy in the country for a certain period of time.

The main economic, regional and sectoral plans and programs, as well as the macro-economic scenario have been taken into consideration during the development of the Budget Projection and of the Report. The Report also contains a detailed analysis of the economic framework, whereas the main assumptions for the development of the economy in the medium-term three-year plan have been drawn on the basis of a review of domestic and international economic trends. Based on the objectives of the economic policy of the country, a conceptual design has been developed and adopted as a leading guideline in defining budget priorities and specific planned steps. The identified factors, tendencies and assumptions are used furthermore as a basis in defining the prerequisites and directions of the fiscal policy for the next three years, while at the same time bearing in mind the possible diversions from the initial scenario and assessing the risk.

The starting point in the development of the three-year budget projection is the assessment of the Ministry of Finance related to the fact that the good results achieved during the last four years create conditions for the economic tendencies for the country in the following years to be very positive. The fiscal policy during the next three years should continue to be directed at sustaining medium-term fiscal stability based on: striving to achieve an almost balanced budget; strict financial discipline in the public sector; restructuring and optimization of the public sector while introducing new market principles; rationalization of expenditures and increasing their efficiency, maintaining a certain level of the fiscal reserve. The main objective of the pursued policy of revenues and expenditures is aimed at encouraging the high and sustainable economic growth, increasing the prosperity of the country's citizens, achieving progress in the process of accession and the forthcoming EU membership.

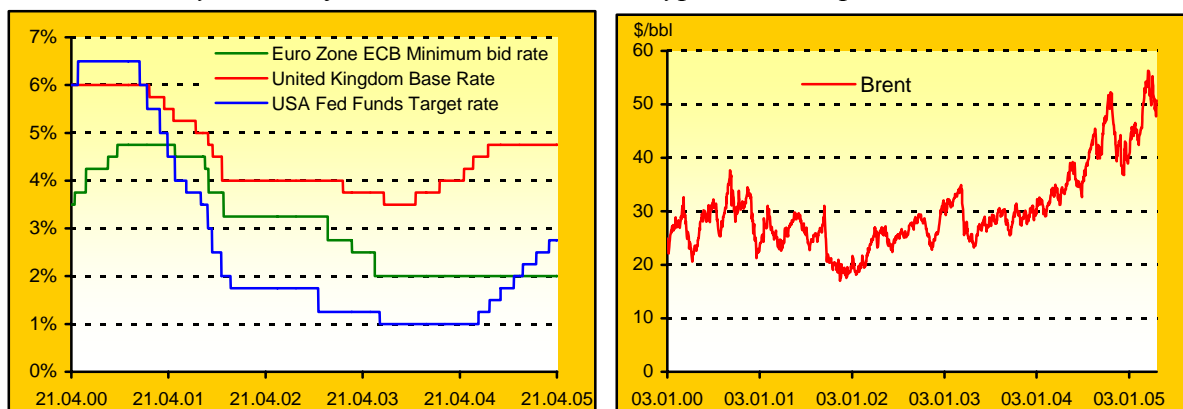
I. ECONOMIC FRAMEWORK

1. Trends of world economic development

The world economic recovery is expected to continue relatively fast throughout the current year, although world economy growth reached its peak in the first half of 2004, with extremely high growth rates in the first quarter registered by China, Japan and the USA. Later on, the growth rates

settled down to relatively normal levels in the USA, while Japan underwent a slight decrease of real GDP in the second and third quarters. In China, after the strong economic growth of 2003 and the first quarter of 2004, the volume of GDP decreased considerably in the second quarter, only to go up again in the second half of the year. Thus, after last year's energetic five-percent growth, the IMF projects a world economy growth rate for 2005 and 2006 between 4.3 and 4.4 percent. The slight slowdown of economic activity will be accompanied by some decline in world trade and industrial output. The discrepancies that exist with regard to the current account balances between the different countries are expected to be preserved and their gradual elimination will only start after 2006. The high crude oil prices, influenced by the strong demand and diminishing reserves for an additional increase of production are the main reason for the projected slowdown of the world economic growth rate. On the other hand, the world fiscal environment is still being dominated by low interest rates, which support growth and help relieve the debt burden.

Chart No. 1: Dynamics of interest rates and Brent type crude oil prices



Source: EcoWin

In 2004, the **U.S. economy** continued to mark a stable growth and to maintain its expansion for a third year in a row, marking the highest GDP growth rate for the last five years – 4.4 percent, driven by a strong household and business consumption. After the sharp decrease in the second quarter, consumer demand marked an energetic growth in the last two quarters, supported by an increase of real disposable income, the diminishing influence of high oil prices and an additional decrease of household savings as a result of improved labour market conditions and the continued price boom in real estate and stock exchange trading. Business investments, in spite of being below their historic rates in the present stage of the cycle, have also marked a stable growth (by approximately 10 percent), supported by low interest rates and rising corporate profits. This is also due to a certain extent to the continued, even though somewhat moderated, improvement of the productivity of labour.

The available data about the development of the U.S. economy as of the beginning of this year is encouraging; it shows a preserved high consumer and business confidence, which provides grounds to project a GDP growth of about 3.6 percent for 2005. A slight decline of private consumption is projected as a result of the gradually diminishing effect of the provided fiscal and monetary incentives and of the growth of household savings.

The main challenges that confront the U.S. economy continue to be the high budget and current account deficits. In 2004, the current account deficit continued to grow and in spite of the considerable depreciation of the U.S. dollar, it reached 5.7 percent of GDP (compared to 4.8 percent in 2003). According to IMF projections, the deficit will remain at 5.7 -5.8 percent of GDP throughout this and the following year, and will start to decline gradually after that. For the time being, the investors' concerns regarding the stubbornness of the current account deficit have not

been substantiated with regard to a more serious forthcoming crisis, as the deficit's funding on behalf of the inflow of foreign capital is not a problem, at least at this stage.

Another important issue standing open before the U.S. administration is the handling of the high budget deficit, which at present is the largest one among all other developed countries (with the exception of Japan). In spite of the expressed intention on behalf of the authorities to cut the budget deficit by half by 2009, the continued military involvement in Iraq and Afghanistan hampers the achievement of more substantial progress in the limitation of expenditures at this stage.

The commencement of the moderate recovery of the countries from the Euro zone and the EU has declined considerably after the second half of 2004. The internal demand remained depressed and was not in a position to provide sufficient support to the economic growth, as the higher exchange rates of the Euro undermined the expansion of exports, which was the main drive behind the growth in the first half of the year. The increase of corporate profits is still expected to contribute to a more significant boost to business investments due to the focus of companies mainly on restructuring and balance strengthening. On the other hand, the low growth of wages and employment slowed down consumption. As a result, GDP in the Euro zone marked in 2004 a tiny growth of 2 percent, while GDP growth of the EU-25 was 2.4 percent; moreover, during the last quarter of the year Germany, Italy, the Netherlands and Greece recorded even a decline of their economies.

The economic indicators of the beginning of 2005 are fairly contradictory and render it difficult to make categorical conclusions and projections about the future development. While industrial output and retail sales have increased significantly, business and consumer confidence still seems fragile and weak. For the present year, the IMF forecast on economic growth in the Eurozone coincided with that of the European Commission (1.6 percent), but even so, it may not become a fact if economic activity remains depressed.

It is expected that inflation will remain at the level around 2 percent, despite of the high oil prices, which so far excludes an intervention on behalf of the European Central Bank with the objective to tighten monetary policy. As a matter of fact, an eventual new decrease of the main interest rate should not be excluded in these circumstances, if recovery processes do not go in accordance with the expectations and projections.

After the robust six-percent growth of the first quarter of 2004, the **Japanese economy** practically stopped growing, marking an almost zero growth in the following three quarters. Weak demand on the world arena of industrial and high technology products brought about a considerable decrease in exports, felt most strongly in the third quarter. On the other hand, consumer demand and public investments also weakened, which had a negative impact on growth. Stagnation in the last three-quarters of last year gave reasons to entertain apprehensions about the short-term development of the economy. Yet, in spite of the objective risks for economic growth related mostly to the continuing rise of crude oil prices and of the exchange rate of the Japanese yen, in the last year a lot was achieved with regard to the strengthening of the economic foundations of the country. The Japanese corporations took advantage of the lively growth in the Asian region and intensified considerably their commercial relations with these countries, which once again confirmed exports as the main driving force behind the country's economic growth. The increased productivity of labour and higher profits contributed to the considerable decrease in company bankruptcy. It seems that the banking sector has also overcome its crisis and consolidated its financial positions – the large banks managed to reduce the number of their bad loans and to expand their capital basis; logically, this resulted in an improvement of their credit rating. Fighting deflation is near its end and the main inflation index shows near-zero values.

This year's projections point at a minimum GDP growth – below 1 percent - and in 2006, it is expected to reach 1.9–2.0 percent. The conditions under which this projection has been made assume growth of private consumption and especially of exports, as well as an increase of private investments.

With regard to monetary policy, the Japanese Central Bank will continue to stick to its announced intention to preserve low interest rates, until indications appear of a healthy and steady inflation. As far as the fiscal policy is concerned, the government's objective is to gradually improve the primary balance through an annual reduction of 0.5 percent and to achieve a balanced budget in the first few years of the next decade.

Table No.1: *Key macro-economic indicators 2003 – 2006*

	GDP Growth				Inflation				Current Account Balance			
	%				(Average annual change of consumer prices)				(in % of GDP)			
	2003	2004	2005	2006	2003	2004	2005	2006	2003	2004	2005	2006
Developed countries	2.0	3.4	2.6	3.0	1.8	2.0	2.0	1.9	-0.8	-1.0	-1.1	-1.1
USA	3.0	4.4	3.6	3.6	2.3	2.7	2.7	2.4	-4.8	-5.7	-5.8	-5.7
Japan	1.4	2.6	0.8	1.9	-0.2	0	-0.2	0	3.2	3.7	3.3	3.5
Euro zone	0.5	2.0	1.6	2.3	2.1	2.2	1.9	1.7	0.3	0.4	0.5	0.5
Baltic republics												
Estonia	5.1	6.2	6.0	5.5	1.3	3.0	3.7	2.7	-13.2	-13.8	-11.0	-9.7
Latvia	7.5	8.0	7.3	6.2	2.9	6.3	5.7	5.3	-8.2	-12.3	-10.9	-9.8
Lithuania	9.7	6.6	7.0	6.8	-1.2	1.2	2.9	3.0	-7.0	-8.6	-9.5	-9.3
Central Europe												
Czech Republic	3.7	4.0	4.0	3.9	0.1	2.8	2.5	2.7	-6.2	-5.2	-4.8	-4.4
Hungary	3.0	4.0	3.7	3.8	4.7	6.8	4.0	3.8	-9.0	-9.0	-8.6	-8.1
Poland	3.8	5.3	3.5	3.7	0.8	3.5	3.1	2.5	-1.9	-1.5	-2.1	-2.5
Slovak Republic	4.5	5.5	4.8	4.9	8.5	7.5	3.6	2.8	-0.9	-3.4	-6.0	-4.6
Slovenia	2.5	4.4	4.0	4.0	5.6	3.6	2.3	2.0	0.1	-0.6	-1.4	-2.2
Southern and South-eastern Europe												
Bulgaria ¹	4.3	5.6	5.3	5.3	2.4	6.1	3.7	3.7	-9.2	-7.4	-7.7	-7.0
Romania	5.2	8.3	5.5	5.0	15.3	11.9	8.2	5.7	-6.8	-7.5	-6.9	-6.3
Cyprus	1.9	3.7	3.8	4.0	4.1	2.3	2.5	2.5	-3.4	-4.1	-3.4	-2.7
Malta	-1.8	1.5	1.5	1.8	1.9	2.7	2.4	1.9	-5.8	-10.3	-4.0	-3.0

Source: IMF, World Economic Outlook, April 2005

2. Trends in the National Economy Development

In 2004, the tendency for a sustainable economic growth continued, as this was the year with the highest reported GDP growth rate for the last ten years – 5.6 percent. The main factors contributing to the results attained can be sought in the improved domestic demand and in the increased foreign trade turnover. The development of the Bulgarian economy in 2004 was determined to a large extent by the following factors: increased volumes of foreign trade transactions; higher consumption (due to comparatively stable incomes and increased lending of consumer credits by commercial banks); expansion of investments. The potential risks for the stability and sustainable development of the economy were related mainly to the current account deficit of the balance of payment, whose main component is the negative trade balance.

Fundamental Macro-economic Indicators for the Period 2005-2008

¹ The data for Bulgaria has been updated by the Ministry of Finance; the figures for 2005 are projections.

Bulgaria is a small and very open economy, which to a large extent determines the dependency of the fundamental macro-economic indicators on factors external to the system. The present projection has been based on an annual average petroleum spot price (APSP) of 46.8 US Dollars per barrel, decreasing down to 40 U.S. Dollars by the end of the period.

On the other hand, bearing in mind the influence of the high crude oil price on inflation expectations in the USA, the projections envisage an increase of the main interest rates in the U.S. economy, which will exercise an influence on international interest rates as well. It is anticipated that in 2006 the six-month LIBOR will exceed 4.1 percent, while towards the end of the projected period it will reach 4.4 percent. Having in mind the low growth rates and the moderate inflation (close to targeted levels) observed in the Euro Zone, the present projections do not anticipate the European Central Bank to undertake in the short term aspect a policy of higher interest rates. This will result in a slight widening of the interest rate differential between the USA and Europe, which may lead to a strengthening of the U.S. currency. Because of this, the present projection has adopted the assumption of an exchange rate of BGN 1.57 per U.S. \$ at the end of the period.

The main assumption in developing the three-year macro-economic and budget projection is that the positive economic development observed in the last few years will be sustained. The projected **GDP** growth is a little over 5 percent per year and at the end of the period, due to Bulgaria's accession to the EU, it is expected to reach 5.5 percent. Factors determining this growth are the large investments in the economy and an increase in exports. It is anticipated that investments will grow faster than the total volume of GDP and their share towards 2008 will reach up to 24.6 percent of GDP. This growth will be funded mainly through domestic savings, which will reach nearly 19 percent of GDP in 2008, while the evident necessary condition for the development of this scenario is the availability of a stable financial system. Bulgaria's EU accession at the beginning of 2007 will have a positive impact on investment dynamics, as the observations in the past two years show. The largest contribution to GDP growth with somewhat over 4 percent will be provided by the end consumption, which during the period has shown a relatively stable annual growth rate of about 5 percent. This growth will be achieved mainly through a real increase of income across the entire economy.

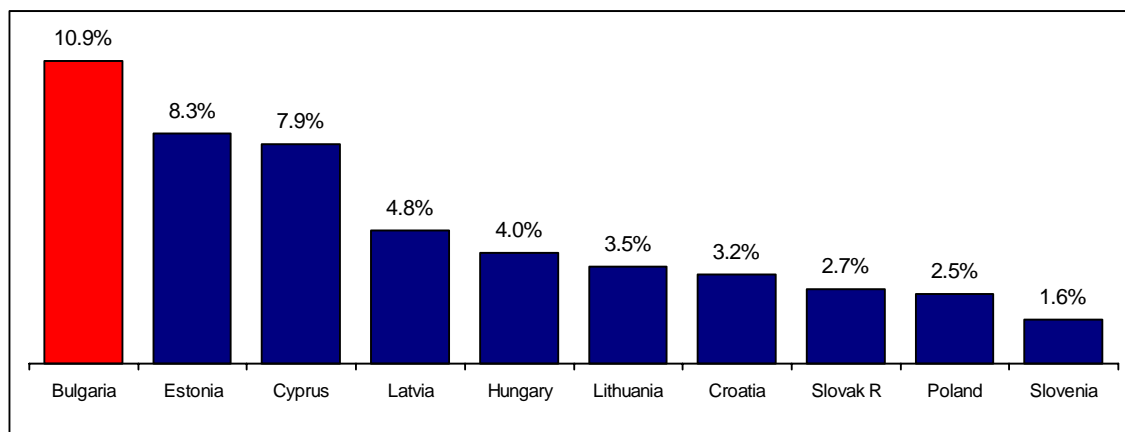
Table 2. Key macro-economic indicators 2002 – 2008

Macro-economic indicators	2002	2003	2004	2005 Plan	2006 ² Projection	2007 Projection	2008 Projection
GDP – BGN mln.	32 335.1	34 546.6	38 008.4	41 343.0	44 655.4	48 761.5	53 021.2
- real growth (%)	4.9	4.3	5.6	5.3	5.3	5.5	5.5
Inflation (%)							
- end of period	3.8	5.7	4.0	3.5	3.9	4.0	3.8
- period average	5.8	2.4	6.1	3.7	3.7	4.0	3.8
Exchange rate (USD/BGN)	2.07	1.73	1.57	1.66	1.57	1.57	1.57
Current account - EUR mln.	- 924.3	- 1 630.3	- 1 447.1	- 1 763.0	- 1 590.7	- 1 937.6	- 1 678.8
- % of GDP	-5.6	-9.2	-7.4	-8.3	-7.0	-7.8	-6.2
Trade balance - EUR mln.	-1 691.8	- 2 199.6	- 2718.0	- 2 943.5	- 3 361.8	- 3 678.0	- 4 028.2
- % of GDP	-10.2	-12.5	-14.0	-13.9	-14.7	-14.8	-14.9
Direct Foreign Investment (EUR mln.)	980.0	1 850.5	2 114.2	1652.3	1 982.1	1 906.1	1 949.3

The moderate development of the world economy and in particular of the EU for the 2005-2008 period, together with the enhanced competitiveness of Bulgarian goods, provide grounds to expect a considerable growth in exports, which for the period 2005-2008 is expected to be in the range between 11-12 percent. The real increase in export of goods set for the 2005-2008 period is mainly based on the assumptions for an increased consumption and sustained high investment rates in the country. The trade deficit during the period under review is expected to be around 15 percent of GDP, and the **current account deficit** will decrease slightly down to 6 percent of GDP in 2008. Looking at the current account through the prism of savings and investments, this trend is based on the faster growth of savings as a percentage of GDP. Bulgaria's accession to the EU has a strong influence on the dynamics of the current account deficit. In 2007, a high growth of the proportion of investments is expected, which will not be compensated by a growth in savings because of the budget deficit related to the absorption of EU funds. Therefore, the current account deficit in 2007 will increase abruptly up to 7.8 percent of GDP, which should not be alarming within the context of EU accession. In the reviewed period, direct foreign investments will fund 100 percent of the current account deficit.

² Based on the projection for 2005

Chart No. 2: *Direct foreign investments (% of GDP at the end of 2004)*



*GDP projections 2004

Source: IMF IFS

The high rates of economic growth in the period are the basis for an annual increase of employment by 1-1.5 percent and the respective decline of unemployment. Towards 2008, the expectations are for the annual average **unemployment** to shrink under 10 percent. With regard to the average wage and salaries, the projections are for an increase in nominal terms amounting to about 7.5 percent per annum. For the 2005-2008 period, the labour productivity growth rate will be ahead of that of the real wages and salaries, which will have a positive impact on the competitiveness of the Bulgarian economy.

For the 2005-2008 period, **inflation** is projected to be around 3.5 to 4 percent. This rate of inflation, which is one of two percentage points higher than inflation in the Eurozone, is due to the steps adopted by the Council of Ministers aiming at a gradual adjustment of the administratively regulated prices and the adjustment of the customs duties and excise taxes in compliance with the commitments undertaken by the country during the EU accession negotiations. The anticipated EU accession of Bulgaria in 2007 and its application for accession to the European Monetary Union, coupled with the coordinated measures of Bulgarian National Bank and the Ministry of Finance for implementation of the ERM II criteria, will result in lower inflation levels in 2008.

The **risks** that confront the implementation of the present projections come from external factors and their impact on the balance of payment. Among external risk factors, the following can be pointed out: interest rate levels, the U.S. Dollar exchange rate against the Euro, the prices of crude oil and metals on international markets. An unfavourable development of prices and exchange rates may additionally deteriorate the trade balance. On the other hand, a sharp increase of international interest rates will have a negative impact on the balance of payments, both through the current account due to the increased income, which will leak out in the form of interests, and through the financial account, where it is possible to have a reversal of the financial flows and a decline in direct foreign investments. Bearing in mind the high current account deficit, such a scenario would confront the economy with a serious challenge, as it will result in a decline of the growth of the monetary mass, which will have a direct impact on GDP growth too, with all fiscal policy consequences arising from that as well.

II. BUDGET FRAMEWORK

1. Execution of the Budget in 2004³

The well-devised and well-directed fiscal policy is the most important condition for stability. Thanks to the strict fiscal discipline imposed by the Currency Board, Bulgaria has maintained in the past few years a budget close to the equilibrium. The surplus for 2004 amounts to 1.7 percent of GDP. For 2005, the budget deficit is planned to stand at 0.5 percent, but the expectations are for an even more substantial improvement of the balance in the course of the budget implementation.

Following the policies established in developed market economies, the tax burden in the last few years has been gradually shifting from direct to indirect taxes, while the overall tax burden is being reduced and the taxation basis in the sphere of direct taxes has expanded. The good economic results and the active foreign debt management policy were the real reasons behind several upgrades of the credit rating of the country during the 2002-2004 period. In this respect, it is necessary to point out that for the first time in 2004, an investment grade rating was awarded to the country for the Bulgarian long-term debt denominated in foreign currency, which will contribute to the future achievement of lower costs of borrowing on the external markets.

➤ Main Parameters of the 2004 Fiscal Program

In 2004 the first results emerged from the consistently applied fiscal policy, as well as from the improved functioning of the Tax and Customs administrations, the enhanced control of the respective authorities and the legalization of a part of the “gray” economy. The Government's policy aimed at an improved collection of state receivables, the general economic upswing accompanied by the increase of fuel prices on international markets and the high growth of the volume of imports for 2004, all this has resulted in a considerable budget revenue overperformance. At the same time, expenditure funding was carried out in compliance with the general ceilings envisaged in the Law on the State Budget of the Republic of Bulgaria for 2004 and in accordance with the priority and the periodicity of expenditures.

- The revenues collected under the consolidated fiscal program for 2004 represent 41.7 percent of GDP against 40.7 percent of GDP in 2003.

The revenues collected under the consolidated fiscal program up to December 31, 2004 amount to a total of BGN 15 855.4 million, which is 110.4 percent of the planned revenues within the program for the year. Compared to revenues accounted for in 2003, a growth rate of 12.7 percent is noticed. This is mostly due to the improved collection of tax receivables, which in 2004 were 15 percent higher than the previous year. The total amount for the reported period – BGN 12 778.5 million, represents an overperformance of 110.8 percent against the annual program.

The essential factor, which contributed to the higher tax revenues is the reported growth of indirect taxes revenues, amounting to a total of 6068.6 million leva, i.e., a growth rate of 24.5 percent against 2003 has been achieved. The reason for these results is in the growth of import volumes, the increased fuel prices on international markets, the higher than initially expected economic growth and the improved performance of the Tax and Customs Administrations.

³ Covers the Central state budget, as well as all autonomous budgets – municipalities, insurance funds, state-run universities, the Bulgarian Academy of Sciences, The Bulgarian National Radio, The Bulgarian National Television, the Supreme Judicial Council, as well as extrabudgetary funds and accounts on a central and local level; the data is presented according to the national methodology applied in that period (acquisitions of shares and stocks, partnerships and other financial assets and the use of borrowed funds are a part of the budget funding)

A good performance is also evident in the collection of revenues from direct taxes, the revenues from which amount to BGN 6300.5 million for the past year. A very good performance against the plans for the year has been reported with regard to tax revenues from the taxation of natural persons, from the tax on dividends and corporate income, and from the tax on insurance and reinsurance premiums. Despite the reduction in some tax rates effective from 2004 within the group of direct taxes (for example, with respect to corporate income tax), overperformance is reported for the year against the annual plan across all indicators from this group. The reported revenues from social security and health insurance contributions also mark a growth against 2003, as for the period in margin they amount to BGN 4082.2 million, or an overperformance of 105.8 percent against the plan for the year. The factors, which contributed to the good performance are as follows: higher than planned growth of the average insurable income, higher than planned growth of the number of employed persons; bonus payments in addition to the wages at the end of 2004; improved efficiency in the collection of contributions as a result of the measures undertaken for the registration of employment contracts and the introduction of minimum insurance thresholds by major professional groups and by occupations, increased control on the retroactive collections of installments under revision acts for defalcations, etc.

The reported non-tax revenues and grants under the Consolidated fiscal program amount to 3 076.9 mln leva, or 108.8% against the plan for 2004.

Consolidated budget **expenditures** for 2004 represent around 39.9% of GDP, against 40.7% of GDP for 2003, or they have decreased by more than 0.7 percentage points as compared to 2003.

In 2004, a balanced and tight fiscal policy was applied with regard to public expenditures, aimed at the implementation of government short-term and mid-term priorities, without causing a negative impact on the budget balance. Furthermore, this was achieved within the -0.7% of GDP deficit planned under the Consolidated fiscal program for 2004 (the real performance on the indicator is a surplus of about 1.7% of GDP). Despite the increase of expenditures in nominal terms, there is a downward trend for current non-interest expenditures, which favours the economic growth of the remaining economic subjects.

The expenditures made under the consolidated fiscal program for 2004 amount to 15 198.9 mln leva. The non-interest expenditures in consolidated fiscal program amount to 14 501.5 mln leva. Structurally, the largest proportion of the current non-interest expenditures in the consolidated fiscal program (42.8%) goes to the social and health insurance funds (the National Social Security Institute, the National Health Insurance Fund and to the universal pension funds), followed by current support expenditures (apart from fuel and energy expenditures, external services, current repairs, medications, etc, they also include expenditures on other remunerations and the state reserve growth) – 21%; expenditures on wages, social insurance payments and scholarships – 18.2%; and subsidies – 6.7%. Capital expenditures amount to 1 505.2 mln leva. Compared to the same period of last year, an increase of 26% is noticed.

The interest payments made under the consolidated fiscal program for 2004 amount to a total of 697.4 mln leva, or 88.5% of the funds planned in the annual program. Compared to the reported interest payments for 2003, a decrease of about 3.7% is seen, while from the structural point of view, they occupy 4.6% of total expenditures against 5.1% for 2003.

- The **surplus** in the consolidated budget⁴ for 2004 represents 1.7% of GDP, or 656.4 mln leva.

⁴ Calculated on a cash basis under the national methodology.

The **fiscal reserve** as of December 31, 2004, calculated according to the so-called program exchange rates⁵ is 4 810.6 mln. leva.

The overperformance in consolidated state budget revenues for 2004 and the applied tight fiscal policy in the sphere of public expenditures resulted in a sizeable budget surplus. This provided opportunities to ensure necessary financial resources to cover additional expenditures in a number of priority areas, without a negative impact on the balance against previous plan. The main priority spheres, where the additional approved expenditures were targeted are healthcare, education, agriculture, construction and maintenance of infrastructural sites, construction of small sites of regional importance and complete refurbishment of municipal schools. In order to avoid a pressure on Budget 2005, additional funds were approved for payment of overdue payables in certain budget systems. Additional funds were ensured for funding government priority expenditures, such as the computerization of schools, universities and development of TV centers and “hot spots” for wireless Internet access, repairs and construction of road infrastructure, improvement of water supply systems, improvement of border and passport control points, advertisement in tourism, culture, development of a unified information system for counteraction to crime, subsidies for the “Railway Infrastructure” National Company and the “Balkan Basin” AD mines.

The relatively high GDP growth and the improved indicators in separate economic areas are typical for the process of attaining and sustaining macroeconomic stability. For a fast-paced economic growth, though, the main priorities are the improvement of industrial competitiveness, export capacity building, energy efficiency and security of supply and directing more investments to the scientific research and development area. Last, but not least is the education system reform, as it is a strong instrument for boosting economic development and for developing the knowledge economy.

In the next few years, the development of an active and targeted policy that takes into consideration the social balances in Bulgaria based on the increase of productivity and competitiveness of the national economy is of key importance for ensuring successful EU integration.

2. The Fiscal Policy – Prerequisites and Directions

2.1 Budget Policy 2005

In 2005 the fiscal policy continues to support the macroeconomic stability and currency board sustainability. Meanwhile, the efforts are also directed towards creating conditions for stable economic growth – implementing infrastructural projects, encouraging the investments in the economy, ensuring public funds spending efficiency and providing a specific range of public services with a quality, which is acceptable to the public, as well as creating the needed reserves for expenditures related to structural reforms or short-term absorption of acute negative impacts.

The budget deficit level amounting to 0.5% of GDP is result-oriented and represents a major element of the economic policy under a currency board regime.

The total volume of revenues envisaged by the consolidated fiscal program for 2005 is 16 265.8 mln. leva.

⁵ The Bulgarian leva equivalence of the currency accounts balances for 2004 are calculated according to the exchange rates valid on December 31, 2003, or the so-called program exchange rates, with the purpose of data comparability for the periods.

The consolidated budget expenditures for 2005 are 16 461.4 mln. leva. This significant increase is mainly due to the expected higher efficiency of the operations of revenue collection administrations and the growing economic activity, regardless of the planned decrease of the tax burden.

The analysis needs to take into account the methodological difference between 2004 and 2005, including the activities of the Enterprise for the management of environment protection activities.

The main tax changes are directed towards total tax burden decrease, tax system stability maintenance, legislative development in compliance with the requirements of the EU directives, simplification of administrative procedures:

- Corporate tax rate in 2005 decreases from 19.5% to 15%, which will leave funds amounting to about 160 mln. leva at the disposal of businesses. The comparative analysis shows that corporate tax rates are among the most competitive among the European countries and in the region, which together with the remaining measures will make the Bulgarian economy more attractive for foreign investors.

- To improve the investment climate, a higher tax-related depreciation rate of 50% has been proposed for new assets in machines, production equipment and appliances;

- Individual income taxation levels for natural persons have been changed, the non-taxable monthly income being increased from BGN 120 to BGN 130, while simultaneously a decrease of the taxation rate has been proposed;

1 734.9 mln. leva are envisaged for wages and salaries in the budget-supported sphere in 2005 and a smooth change towards the decentralization of the pay system is planned to start. The Government accomplished a 25% increase of the minimum working wages from BGN 120 to BGN 150, starting from January 1, 2005. Indexing pensions by 7% from June 1, 2005 and increasing the social old age pension from BGN 53 to BGN 60 are planned. The State Budget envisages BGN 204.0 million for active measures to combat unemployment.

A significant growth of the investment expenditures is budgeted for 2005; this is a necessary condition for the country's future economic growth. The capital expenditures in the consolidated budget for 2005 are BGN 1 605.9 million, i.e. by 20.7% more compared to the same expenditures in 2004. The structure of the capital expenditures funding sources shows a trend for increasing the proportion of external grants from the pre-accession EU funds (the ISPA, PHARE and SAPARD programs), which is preserved in the draft budget for 2005. This exceeds 24% of the total sum of the capital expenditures, which the country intends to absorb in order to be able to respond better to the EU accession requirements through measures for social and economic convergence.

The main directions of the targeting of expenditures by spheres are: social security, assistance and welfare – 13.5% of GDP (compared to 13.6% under the 2004 program), education – 4.2% of GDP (compared to 4.1% under the 2004 program), healthcare – 4.3% of GDP (compared to 4.3% under the 2004 program), defense and security – 5.0% of GDP (compared to 5.0% for 2004), public works and protection of the environment – 2.3% of GDP (compared to 2.1% in 2004).

With respect to the functional breakdown of expenditures, the expenditures for healthcare and education have an indisputable priority. In the draft budget for 2005, healthcare expenditures take into account the place of healthcare as one of the main priorities of the budget-supported sphere and reflect the state healthcare policy.

Education accounts for 1 798.9 mln. leva in the consolidated budget for 2005.

Defense and security costs in 2005 are envisaged to occupy 12.7% of total expenditures. Defense system reform is one of the key elements of the new security policy of the Republic of Bulgaria. The planned funding for 2005 for the implementation of the National program for preparation and accession of the Republic of Bulgaria to NATO amounts to 75.0 mln. leva.

In addition, the budget provides for buffers to guarantee the sustainability in case that internal and external risks materialize. The role of a similar preventive measure is played by the limitation on the granting of 93% of the approved non-interest expenditures of the state bodies, while the remaining 7% will only be granted if the endorsed budget deficit is not exceeded. The reserve for unplanned and urgent expenditures under the consolidated fiscal program amounts to 419.6 mln. leva, which covers 100% of the deficit. It will be allocated upon necessity for unplanned and urgent expenditures and structural reforms. In connection with the conducted reforms, the fiscal reserve should stay at a high level, which in case of need will ensure the trouble-free foreign debt servicing.

2.2 Directions of the Fiscal Policy for 2006-2008

2005 has been marked by two events that are important for Bulgaria. In April 2005, the Treaty on the Accession of the Republic of Bulgaria to the EU was signed. This means that in 2007 our country will become an inseparable part of the common European market. It also means that new challenges facing the economic policy and each citizen will emerge. The second important event is the holding of parliamentary elections for the Fortieth National Assembly of the Republic of Bulgaria.

These events are taking place on the background of the continuing high macroeconomic stability, high GDP growth rate, extremely low inflation and unemployment. An extremely high growth of direct foreign investments has been observed.

The most important factor that has contributed to this favourable picture in our country is the fiscal policy pursued. Under the conditions of a currency board arrangement, it is precisely one of the main tools to achieve economic stability and provide a basis for economic growth. This policy is a fundamental regulator and a tool for economic adjustment until the EU accession of Bulgaria. Because of these reasons, the Ministry of Finance considers that even after this year's parliamentary elections and the eventual changes in the specific economic priorities and budget parameters, the general directions of the fiscal policy that have contributed to the success of the overall economic policy should be preserved.

The main priorities of the fiscal policy pursued need to be directed towards:

- Maintaining a stable macroeconomic environment and meeting the Maastricht criteria for entering the Eurozone.
- Maintaining fiscal stability in the medium-term on the basis of: effort to achieve a near-balanced budget; strict financial discipline in the public sector; restructuring and optimization of the public sector while introducing new market principles.
- Rationalizing expenditures and increasing their efficiency, restructuring the expenditures with regard to the optimum absorption of resources from the EU funds, providing the required co-financing.
- Implementing a restrictive, but sufficiently flexible fiscal policy, which guarantees timely and reliable responses to external and internal risks, which may destabilize the economy, maintaining the established targeted level of the fiscal reserve.

Until the country becomes a full member of the EU, there will be the need to pursue a balanced budget policy as a matter of principle. The expected pressure on the budget in 2007 and 2008 should be absorbed, including through the introduction of the respective changes in the expenditure policies. A priority direction of the budget policy will be the creation of conditions for meeting the Maastricht criteria. The fiscal policy will continue to pursue the achievement of stable economic growth, raising the living standard and neutralizing the eventual external risks for the economy. After the entering of Bulgaria in the Euro zone, the fiscal policy of the country will abide by the requirements of the Stability and Growth Pact.

A main issue is the choice of a tax policy. The main objective of the tax policy strategy should be the achievement of stability and sustainable economic growth. Economic growth in Bulgaria needs a higher investment rate and the reduction of the tax burden would contribute to such a development. The comparative analysis shows that corporate tax rates in Bulgaria are among the lowest in the countries of the region. The preservation and the use of this advantage combined with the simplification of the administrative procedures for the tax payers will make the Bulgarian economy more attractive for foreign investments. It is absolutely imperative to continue the aggressive approach to the tax policy and this approach needs to include: considering the advantages from implementing a flat tax rate, decreasing the costs of employment and reforming

the social security funds. The improvement of the revenue collection rate and the continuation of the control and the assault against the gray economy sector will allow compensating the budget losses that originate from the introduction of the above-mentioned measures without jeopardizing economic stability. An important element of this policy is also the simplification of the tax system.

The driving force behind the new innovative thinking will be the tax relief measures and concessions aimed to encourage the establishment of small and medium-sized enterprises, which will invest in research and development. It will be appropriate to think about support for research and development with regard to the cutting edge technologies, which generate economic growth and simultaneously with that reinforce the research base and increase the leverage in relation to private sector investments for research and development. Public-private partnerships will be encouraged as a main instrument for stimulating investments.

The expenditure policy will be searching for the optimum allocation of funds in compliance with the defined economic priorities and with the necessity to complete the structural reform in the real and the public sectors within the framework of the objectives of lowering the tax burden and achieving a balanced budget or a minimum budget deficit. The private sector needs to assume the leading role in increasing investments, production and employment, while the state needs to direct its efforts towards the effective provision of public services. With the withdrawal of the state from its non-intrinsic activities and services, which may be provided by the private sector, economic growth will be encouraged and the efficiency of management will improve. The size of the public expenditures will stay below 40% of GDP, taking also into account the effect of the resources from the EU funds. A part of the most important conditions for the stability of the fiscal framework are the optimization of the budget expenditures and the increase of their efficiency while preserving a strict financial discipline with respect to the role of the state and its commitment to maintain a determined level of public services, as well as in relation to further institutional strengthening. In this aspect, the main challenge is a change of the systems and the introduction of greater flexibility for budget expenditures.

During the next few years, priority should be given to the completion of the public finance reform, changing the philosophy of the funding of budget expenditures. The programmatic and multi-year budgeting is the instrument, through which the principle of outcome-based funding of the activities will materialize. The changing of the budget system will not be sufficient, if the individual sectors will not be reformed, more particularly the education and healthcare sectors.

In 2007, an extremely important task will be the restructuring of the budget expenditures in a way, which guarantees the optimum allocation of resources from the European funds, following the accession of the country to the EU, as well as securing the respective national co-financing. Therefore, it is necessary to continue to build the required institutional and administrative capacity, so that the country can take full advantage from the participation in the coordination processes related to the formulation of the economic policy of the EU member-countries. The same will be necessary also for the absorption of the resources from the Structural and the Cohesion Funds.

Public-private partnerships should also be transformed into a main tool for rationalizing public expenditures and for sharing the responsibilities to ensure the necessary funding in the transport, environmental, educational and social sphere.

The sectoral priorities and their ensured funding are considered later in this report.

2.3 Challenges emerging from Bulgaria's EU accession

The challenges faced by the Bulgarian economic policy in the light of the future EU membership and the imminent participation in the Economic and Monetary Union may be mainly divided into two large groups:

- ◆ Structural challenges, which are related to the overall economic development, i.e. the real convergence of our economy towards the average EU values.
- ◆ Challenges related to the preservation of the sustainable macroeconomic policy.

The changes in the individual components of these groups are interrelated and their impacts can not be discussed separately. Thus, the structural changes in the economy are reflected on the economic policy pursued and vice versa – the sustainability of the economic indicators favours economic development.

The real convergence

Regardless of the high and sustainable economic growth in Bulgaria during the last few years, the real convergence of incomes and of the productivity of labour is still to be accomplished and it is not expected to happen in the short run. The continuation of the structural reforms and in particular, the institutional build up, the business environment's improvement and the limitation of the share of the gray economy will acquire an extreme importance for this process. The maintenance of the positive economic dynamics, which will lead to a real convergence inevitably includes high investment rates, increased productivity and improvement of the labour market conditions. The commitments of the country for the implementation of the *Acquis Communautaire* can also be referred to the structural challenges. Bulgaria will apply the EU standards in all spheres of the community law, while transition periods have been agreed upon for some of these spheres. Meeting the criteria in some areas, e.g. with respect to the protection of the environment, requires significant investments in infrastructure, human capital and equipment. The successful implementation of the projects requires the expected resources from the Structural funds after 2007 to be supplemented by national (private or state) co-financing. On the other hand, a part of the regulations will have a direct impact on the private sector because of the raised production standards.

The development of the Bulgarian business environment calls for a significant improvement of the judicial system's efficiency, mostly through an acceleration of the procedures and the strict application of the existing legislation. The conditions for starting a business and entering the market should also be improved in order to secure the functioning of the market mechanisms. The reforms related to the completion of privatization and the improvement of the energy and railway transport sectors' efficiency represent necessary conditions for the participation of these sectors in the internal EU market.

Similarly to the situation in the remaining CEE countries, the Bulgarian economy is also lagging behind in the process of transition to a new knowledge-based economy. This raises the question as to how our economy will be able to enter the internal EU market. Considering the existing low investment levels in research and development and the information technologies, there is a real danger that the economy will lag behind in this process and that the increase of productivity will be unsatisfactory. In this connection, encouraging „greenfield” foreign direct investments in high-technologies, which are not linked to the same extent to the current production structure as privatization-related investments are, will speed up the transition to a knowledge-based economy.

Impact on the economy

According to the proposal of the European Commission from 2004, the total assistance, which Bulgaria will receive for the first three years of its EU membership (2007-2009) related to the size of the country's economy is significantly larger than the one, which is envisaged for the ten new EU member countries; on the whole it is compatible with the support intended for Romania. In case of a comparatively intensive and rational utilization of these funds, we can expect a perceptible positive effect for the country's economic development. These funds are focused on four main directions:

- Agriculture
- Structural activities

- Internal policies and administration
- Budget compensations

In the structure of financial support for agriculture, a relative balancing of the three components is observed in contrast to Romania, where a significant portion is allocated to the development of the rural regions. Romania's choice is determined by the large proportion of the population engaged in agriculture, but the rational economic logics and the experience of the member countries show that the implementation of policies, which do not distort the market incentives, will result in long-term sustainability.

The structural funds will support the following activities and spheres:

- * Investment in the transport sector;
- * Energy, energy efficiency and development of renewable energy sources;
- * Investments in education and healthcare; improvement of the educational system;
- * Research and technological development;
- * Information society development;
- * Investments in small and medium-sized enterprises;
- * Structural adjustment, growth and job creation;
- * Tourism;
- * Protection of the environment;
- * Transfrontier economic and social activities;
- * Developing the institutional capacity and efficiency of the public administration;

It becomes clear from the above-mentioned priorities that they are in direct correspondence with the structural challenges outlined earlier, which the Bulgarian economy will face during the process of its integration with the internal market.

An indicator for the importance of the support for the structural activities is provided by the "financing/gross investments" ratio for the respective economy. Compared to the new ten EU members and Romania, the expenditures for structural activities as a share of the gross investments in the economy are at their highest precisely in Bulgaria. The formation of fixed capital in Bulgaria is expected to increase by more than 15% in Bulgaria as a result of the structural funds. This data shows the enormous demand for investments, which is recognized by the EU, and at the same time it underlines their enormous importance for the economy.

The local and regional authorities play an extremely important role for the disbursement of the resources in the EU Structural Funds. The process of fiscal decentralization in Bulgaria has a direct positive influence over the absorption capacity of the local authorities who will use the funds.

Fiscal decentralization will facilitate the raising of additional funds for the co-financing of projects supported by the EU. For this purpose, nevertheless, it is necessary to attract the local business and social partners. Public-private partnerships could help the speeding up of the local economic development, improve the life of the people and work for the prosperity of their regions.

In addition, the delegation of additional responsibilities and rights to the local governments will create a demand for better planning of the activities and of the local budgets, which will ensure the funding of these activities. This in turn will improve the capacity for medium-term planning at the local level, which is a key issue for the disbursement of the Euro funds. According to the Law on Regional Development, the municipal development plans shall be compiled for a 7-year period (2007 – 2013) and they shall guarantee the municipal development. This determines the importance of local level planning, because the periods for the plan validity are linked on the one hand to the governmental policy cycles and on the other hand they are linked to the next programmatic period of the EU.

The EU requirements with respect to the human resources engaged with the participation in the Structural Funds create a necessity to strengthen the capacity of the local and regional administration for participation in the process of absorption of EU funds. The European Commission recommends to the exceeding countries to put more efforts in the preparation of projects, including the use upon demand of technical assistance provided by the European Union under the pre-accession funds.

Sustainable macroeconomic policy and financial flows

Compared to the majority of the ten new member states, the fiscal policy of Bulgaria looks more sustainable due to the planning of a near-balanced budget and even producing a surplus last year. On the other hand though, the structural reform in the public sector has not been completed, which slows down the increase in the sector's efficiency. As it has been mentioned above, the EU accession by itself creates the demand for significant additional public expenditures, hence a pressure on the budget sustainability. It should be mentioned that not all transfers from the EU budget are reflected in the state budget, because a portion of it is designated for the private sector. For the purposes of the present analysis, however, we shall not make a difference between transfers to the private or to the public sector mainly because of two reasons. First, in such a way the difficulties related to the assessment of the separate transfers are avoided; second, the expansion of the scope allows the analysis of the full effect of the transfer on the economy. Moreover, such a direct transfer to the private sector can replace the budget financing and thus improve the budget position.

Box 1: Recommendations of the European Commission with regard to the General directions of the economic policy for the period 2005-2008.

The European Commission proposes the following Integrated general growth and employment related directives:

Macroeconomic directions:

1. Providing economic stability
2. Maintaining sustainable economic development
3. Encouraging efficient resource allocation
4. Encouraging better coordination between the macroeconomic and structural policies
5. Ensuring wage growth, which does not violate macroeconomic stability and growth
6. Contributing to a dynamic and efficiently functioning economic and monetary union

Microeconomic directions:

1. Expanding and deepening the internal market
2. Ensuring open and competitive markets
3. Creating a more attractive business environment
4. Encouraging the entrepreneurial culture and creating an appropriate environment for the small and medium-sized enterprises
5. Expanding and improving the European infrastructure and completing the priority transfrontier projects
6. Increasing and improving the investments in research and development
7. Encouraging innovations and information technologies
8. Encouraging the ecological use of resources and strengthening the combining of environmental protection with economic growth
9. Contributing to a solid industrial base

Employment policy directions:

1. Implementing an employment policy directed towards the achievement of full employment, improving the quality and productivity of labour and strengthening the public and territorial cohesion
2. Encouraging the life cycle approach to work
3. Ensuring access to the labour markets for job seekers and socially vulnerable people
4. Improving the match with the labour market needs
5. Improving flexibility, combined with employment security and decreasing the segmentation of the labour markets
6. Ensuring the development of wages and other labour costs, which do not endanger employment

7. Expanding and improving the investments in human resources
 8. Adapting education and educational systems to the new skill related requirements.

The supplementation requirement for the resources from the Structural funds is most frequently linked to budget co-financing, which is expected to put an additional burden on the country's fiscal position. There is a possibility though, that a part of the investment budget expenditures, which until the moment of accession have been funded through budget resources and in the same time represent an object of the structural EU policies, to be redirected to the co-financing of projects funded through the Structural Funds. Thus an increase of the budget expenditures will be avoided. Consequently, significant flexibility is necessary during the budget's preparation and execution and it needs to reflect the current co-financing needs.

The revenue part should take account of two contradictory effects. In the first place, the increase of the excise duty rates, which will be gradually introduced until the full adoption of the minimum levels for the member countries, will lead to an annual growth of revenues from indirect taxes. A similar effect has already been observed in Bulgaria during the last several years. There is a possible scenario under which the new member countries will run into competition to reduce the tax burden, especially the one of the corporate income tax. It is more likely that the first effect will prevail and the general outcome will be an increase of tax revenues.

The contributions that Bulgaria will make to the European budget have been calculated on the basis of the following factors:

- Gross national income data
- VAT-base and VAT-revenues information
- Working data about Romania from the European Commission
- Working data from the European Commission about the traditional own resources.

The projection has been developed **on the basis of the presently valid European legislation** on the own resources. Currently, proposals for a legislative change are being discussed by the European Commission; they are expected to be approved by 2006 and enacted by 2007. In this connection, alterations in the calculation methodology and the submitted projection data are possible.

Table No 3. *Projection for the Bulgarian contribution to the EU budget*

Payments for own resources	2007		2008	
	<i>Mln. Leva</i>	<i>Mln. Euro</i>	<i>Mln. Leva</i>	<i>Mln. Euro</i>
Total net transfer of own resources	46.9	24.0	48.9	25.0
Resource based on VAT	69.4	35.5	66.0	33.7
Resource based on GNI	404.9	207.0	447.3	228.7
Reserve	1.9	1.0	2.1	1.1
Great Britain Adjustment	47.3	24.2	59.8	30.6
Own resources --Total	570.4	291.7	624.1	319.1
% of GNI	1.18%	1.19%	1.2%	1.2%

Within the **financial framework** of the Community, a difference is being made between the commitment appropriations of the European budget and the payment appropriations. The first ones represent a legal financial commitment, undertaken by the Community, the execution of which may be spread during the next several years, while the second ones may cover costs related to commitments from the current year or from previous years. From the economic point of view the payments are more important for the beneficiaries. That is the reason why the projections for the actual payments acquire such high importance.

The heaviest mismatch between the commitment appropriations of the European budget to Bulgaria and the payment appropriations is expected during the first years, which reflects the gradual disbursement of the resources from the European funds. This particularity, combined with the application of the proviso to pay a full contribution to the EU budget starting from the first year of membership, outlines some budget difficulties and a slower onset of the positive effect from the membership. It should be considered, however, that during the first years after 2007, a part of the programs of the pre-accession funds will continue to operate and that consequently additional payments through the EU budget will be expected. The completion of the pre-accession projects is expected to coincide with the increase of the EU payment appropriations, which will be beneficial for the smooth transition from financing under the pre-accession funds to the use of resources from the EU funds.

There is also another reason because of which it is possible to report a significant deterioration of the budget position during the first year of accession. The expenditures for direct payments related to the General agricultural policy according to the current regulations are reimbursed from the EU budget in the year, following the year of disbursement, i.e., these resources need to be accounted for in the national budget for the relevant year. As has been mentioned before, Bulgaria and Romania receive the largest support for their agriculture as a percentage of their GDP and because of that, the non-repetitive difficulties for the 2007 budget will be more palpable. In the next years, the imbalance due to the delayed payments from the Community budget will be smoothed to a great extent, because the EU compensations paid during the respective year will cover the larger part of the expenditures incurred by the state budget for direct payments. The envisaged gradual leveling of the direct payments with the payments of the first fifteen member countries still means, however, that each year the expenditures for the General agricultural policy will be higher in comparison with the previous year, hence the EU compensations will lag behind the budget financing for the current year.

From everything mentioned above, it becomes clear that the financial scheme for the absorption of a part of these funds requires the budget to finance and co-finance the implementation of the projects approved by the EU, while a portion of the incurred costs will be reimbursed in 2008. This presumes the setting aside of budget resource in 2007 up to about 3% of GDP. The limitations faced by the budgetary policy and the structure of revenues and expenditures determine the lack of a large number of flexibility opportunities and show that it is not possible in the short run for these funds to be absorbed at the expense of giving up other budget expenditures, i.e. in case of all other conditions being equal, this will impose a deficit of 2.0-2.5% of GDP. The acceptance of such high deficit levels, however, creates risks and threatens the country's macroeconomic stability. Therefore, a restructuring of the national expenditures needs to be made and a 0.5-1% surplus of the national budget has to be achieved in order to cover the additional deficit of 2.5-3.0% of GDP or a consolidated budget balance of not more than 2.0% of GDP. This is imperative, because at the present stage the projection for 2007 does not include the financial flows to and from EU that will change the budget structure both by economic elements and by sectors.

Bulgaria will receive EUR 4.6 billion within the three years following the EU accession (from 2007 through 2009). EUR 2.3 billion of the total sum will be spent on structural reforms. Another EUR 733 million will go to the rural areas development, EUR 230 million will be used to strengthen the external EU borders and EUR 1.562 billion will be spent on agriculture. The EU subsidies

designated for **direct payments**, market support and rural areas development will amount to approximately EUR 1 billion for 2007 and 2008. A key to the successful allocation of these funds is the creation by 2007 of a Payment and Intervention Agency (including the setting up of an Integrated Administration and Control System), which will pay the envisaged financial support for agriculture and ensure the efficient mutual control between the state administration in the sphere of agriculture and the users of its services.

Table No. 4. *Financial package for Bulgaria and Romania 2007 - 2009 (mln. Euro, 2004 prices)*

	2007	2008	2009	Total
Commitment appropriations				
Agriculture	1 141	1 990	2 342	5 598.7
Structural actions	1 938	2 731	3 605	8 273
Domestic policies	444	434	426	1 304
Administration	96	125	125	346
Total	3 619	5 279	6 498	15 521.7
Payment appropriations				
	1 648	3 276	4 131	9 056

Table No. 5. *Agriculture 2007-2009 (mln. Euro, 2004 prices)*

	Financial Package for Market Measures	Financial Expenditures for Direct Payments	Rural Regions Development Policy	Agriculture
Bulgaria	388	440.7	733	1 561.7 ⁶
Romania	732	881	2 424	4 037
Total	1 120	1 321.7	3 157	5 598.7

⁶ Includes co-financing of BGN 105 million.

Table No. 6. *Structural actions (mln. Euro, 2004 prices)*

	Structural Actions
Bulgaria	2 300
Romania	5 973
Total	8 273

Table No.7. *Domestic policies for Bulgaria and Romania 2007-2009 (mln. Euro, 2004 prices)*

Domestic policies	1 012
Nuclear safety	210
Institutional development	82
Total	1 304

In accordance with the agreements achieved during the negotiations and the national ceiling laid down in the Draft Accession Treaty, the direct payments for Bulgaria will amount to BGN 391.8 mln and BGN 470.2 mln respectively for 2007 and 2008. In line with the same principle applied for the 10 newly accessed countries as well, these funds in 2007 will be equal to 25% of the level of direct payments of the 15 member countries and to 30% in 2008.

In addition, direct payments can be supplemented from the national budget up to 30% of the EU15 level, i.e. direct payments (including payments from the EU budget and the national budget) in 2007 can reach 55% of the EU15 level, and up to 60% in 2008. This option is applied by all newly accessed countries in order to make up for the lower levels of direct payments compared to the 15 old EU member countries. The additional national payments will amount to 398.6 mln leva for 2007 and 374.7 mln leva for 2008. For the period 2007 – 2009, the additional national payments can be partially funded from the rural development funds (up to 20% of the annual sum for rural development).

The **market support** includes:

- ⇒ Funds for intervention in sectors like field crops, rice, meat, milk;
- ⇒ Export subsidies;
- ⇒ Assistance for the increased consumption of certain products;
- ⇒ Assistance for the production of fresh fruit and vegetables for processing;
- ⇒ Support provision to producer organizations.

The funds for market support are paid from the national budget and are then reimbursed from the EU budget within the same year. According to the financial framework, the funds for market support in 2007 amount to 258.2 mln leva, and for 2008 – to 252.3 mln leva.

According to the new EU draft regulations, the assistance for rural development is taken away from the structural funds and is transferred to the single European Fund for Rural Development (EFRD), which includes the resources of the European Agricultural Guidance and Guarantee Fund (sections Guidance and Guarantees). According to the information from the bilateral meeting held on May 27, 2005 between representatives of the Ministry of Agriculture and Forestry and the “AGRI” General Directorate of the European Commission when the rural development financial package for Bulgaria from the EU budget for the period 2007-2013 was discussed, the precise amounts from the structural funds that will be transferred to EFRD will be fixed at the historic percentage, calculated by the EC for Bulgaria, on the basis of Target 1 for the 10 new countries for the period 2004-2006. The expected percentage is between 14 and 20%.

In case the European Commission decides that 14 % from the structural funds should be earmarked for rural development, the EU funds in this area are expected to amount to 98 mln leva for 2007, 139 mln leva for 2008 and 183 mln leva for 2009. Thus, the total amount of EU funds for rural development is expected to reach 433 mln leva for 2007, 586 mln leva for 2008 and 741 mln leva for 2009.

In case the European Commission decides that 20% from the structural funds be put aside for rural development, the EU funds in this area are expected to amount to 140 mln leva for 2007, 198 mln leva for 2008 and 261 mln leva for 2009. Thus, the total amount of EU funds for rural development is expected to be 473 mln leva for 2007, 642 mln leva for 2008 and 815 mln leva for 2009.

These funds represent 80% of the amount that can be disbursed for rural development measures. The co-financing on the Bulgarian side amounts to an average of 20 %.

When calculating the rural development funds above, 5% have been taken out to fill a reserve fund, established with the purpose of solving specific problems, related to the aggravated total balance of some member countries with regard to the EFRD item.

Table No. 8. *Agriculture (depending on the percentage that will be transferred from the Structural Funds to EFRD)*

BGN Mln.	2007 – 2013	
	14% of the Structural Funds of EFRD	20% of the Structural Funds of EFRD
Direct Payments	4 866.1	4 866.1
Market support	1 713.3	1 713.3
EFRD	4809.2	5 314.1
Co-financing from the national budget for EFRD –20% on average	961.8	1 062.8
Total	12 350.4	12 956.4

2.4. Budget Reform Directions

As it became clear from the previous sections of the Report, the budget reform should be implemented with a clear vision and a steady pace, furthermore that the challenges arising from our EU accession are not few. The main objectives of the reform are restructuring and optimization of the public sector during the introduction of new market principles; rationalizing expenditures and increasing their efficiency; restructuring expenditures from the point of view of the optimal absorption of the EU Funds. According to the vision, these objectives shall be met through maintaining clear sectoral development priorities, developing a sustainable and predictable fiscal framework and through the full implementation of program budgeting. In parallel to this, the institutional capacity of the public administration needs to be developed.

Since the beginning of the budget sphere reform initiated by the Ministry of Finance, considerable progress has been made until now with regard to improving medium-term planning, transparency, predictability, orientation towards results and public benefit.

The introduction of programmatic and result-oriented budgeting marks a rapid progress. Up to the present moment, in the process of development and presentation of program budget formats, seven pilot programs have been implemented and result-oriented budgets have been compiled by the Ministry of Environment and Waters, the Ministry of Labour and Social Policy, the Ministry of

Education and Science, the Ministry of the Economy, the Ministry of Energy and Energy Resources and the Ministry of Youth and Sports. The developed program budgets of the seven Ministries have been included in the package of documents attached to the draft of the Law on the State Budget of the Republic of Bulgaria for 2005.

With Decree of the Council of Ministers No. 74 of February 7, 2005 on the 2006 budget procedure, four other ministries have been identified to take part in the development process of program budget format– the Ministry of Regional Development and Public Works, the Ministry of Culture and Tourism, the Ministry of Health and the Ministry of Agriculture and Forestry.

By virtue of § 56 of the Transitional and Final provisions of the Law on the State Budget of the Republic of Bulgaria for 2006, the Council of Ministers has submitted to the National Assembly for review and approval the draft budget of the Ministry of Environment and Waters for 2006 in a program format as a part of the Law.

One of the main objectives of the current budget reform is the achievement of an effective medium-term expenditure framework and the establishment of programmatic and result-oriented budgeting as a key approach in all phases of the budgeting process.

The problematic and result-oriented budgeting is a process of moving away from the resource-based approach and going towards the desired outcomes of the Administration's activities, respectively focusing on the effects and benefits achieved for the citizens and for society as a whole.

The first step in the process of introduction of for the program and result-oriented budgeting in the pilot Ministries is the development of a program structure – defining the areas of policies, strategic and operational goals and produced/rendered products and services, grouped in programs, the respective projects related to them, as well as defining the performance indicators with their target values, and the delegation of responsibilities for implementation/ results to the managers on different management levels. On the basis of the program structure approved by the management of the respective pilot ministry, the program costs are evaluated – the funds, which the Ministry is planning to utilize, transfer and coordinate in its sector of responsibility in the course of three years. All pilot ministries selected with the Decree of the Council of Ministers to develop program formats of their budgets are at this stage of implementation.

The next step in the reform process is the enforcement of the program approach at all stages of the budget procedure – the development and presentation of the draft budget is the result of the development of a three-year budget projection in a program format. This step is applicable to the Ministries which have accumulated experience, built capacity and have an efficient and operational program structure. To the present moment this applies to the Ministry of Environment and Waters. Through implementation of the program and of a result-oriented approach to budgeting at all stages of the budgeting process, the interconnection is built between the initiating phase, the decision making phase and the preparation of the budget. Thus, the program format of the budget of the ministry will be the result of decisions made on the grounds of strategic planning and operational plans for implementation with details by products and/or delivered services aggregated in programs.

In order to secure sustainability and consistency in the medium-term, the ministries should plan the budgets of their programs on the basis of the structure already identified in the program and result-oriented budget of the respective ministry for the current year – the products, services and projects comprised in the programs. The three-year budget request and the draft budget of the ministry should aggregate the budget requests for the three-year period and the draft budgets (planned and developed in a program format) for all its structural units (central administration and second-level spending units for budgetary appropriations).

In this respect it is envisaged that the budget procedure shall start from the strategic planning. The ministry develops a strategic plan, if it does not have one, or reviews the existing plan and makes corrections where necessary. The strategic plan should cover a period no shorter than five years and should include the mission, the strategic and operational objectives of the ministry and the performance indicators.

The process of operational planning has to follow the strategic plan priorities and define the instruments and actions that shall have to be implemented in the following three years. As a result, a report is produced about the policy development intensions together with a three-year budget request. These serve as the basis for linking together the planning, management and funding processes. The decisions made on the basis of these documents form the parameters for the development of the draft budget of the respective ministry for the following year.

A significant role in the process of enhancing the capacity of the officials engaged in the financial sphere of the public administration is expected to be played by the Public Finance School under the Ministry of Finance.

2.5. Mechanism for the Distribution of Economic Growth

The mechanism for the distribution of economic growth shows the approach for the transition from constant prices to current prices. While constant prices reflect the changes of the structures and policies, current prices represent the real budget approved for the respective sector. A part of the nominal growth in it is due to reporting the impact of the key macroeconomic variables – rate of inflation, exchange rate, interest rates, while the distribution of a larger resource is a consequence of the higher economic growth. Therefore, based on an analysis of the data shown in the mechanism, conclusions can be drawn about the achieved nominal and real growth within the specific budget items and sectors.

<u>GDP – growth in %</u>	<u>Average annual inflation:</u>
2005: 5.3%	2005: 3.7%
2006: 5.3%	2006: 3.7%
2007: 5.5%	2007: 4.0%
2008: 5.5%	2008: 3.8%

Changes in the Deficit:

In 2005, the deficit level according to the program will amount to 0.5% of GDP, i.e. the suggested changes in the balance for the 2006-2008 period are as follows:

- In 2006, the budget will be in equilibrium, which means an improvement in the budget balance against 2005 by 0.5% of GDP.
- For 2007 and 2008, no utilization of funds under the EU Structural and Cohesion Funds has been incorporated. This is the reason to plan a surplus in the projection intended to cover the needs arising for the budget to pay the contribution to the EU budget, as well as for the co-financing and advance financing of some expenditure categories. Therefore, for both years a surplus amounting to 0.7% of GDP has been planned in the budget, i.e. the change in the budget balance against the plan for 2005 amounts to + 1.2% of GDP.

It should be borne in mind that the sectoral expenditure ceilings are subject to change after the development of the operational programs, two-thirds of which will reflect the directing of funds from the EU Structural and Cohesion Funds.

<u>Changes in revenues⁷:</u>	<u>Changes in expenditures:</u>
2005 (program): 39.3%	2005 (program): 39.8%
2006: 0.3% (39.6%)	2006: -0.2% (39.6%)
2007: 0.1% (39.4%)	2007: - 1.1% (38.7%)
2008: -0.6% (38.7%)	2008: -1.8% (38.0%)

III. TAX POLICY. BUDGET REVENUES FOR THE PERIOD 2006-2008

Due to the parliamentary elections for the Fortieth National Assembly of the Republic of Bulgaria in June, the three-year budget projection has been developed on the basis of the existing legislation. Together with this, the possibilities for the implementation of some new policies with respect to some main taxes and the reduction of the taxation rates have been reviewed; the consequences for the budget have also been presented.

For the assessment of the revenues, the updated projection for the macro-frame has been taken into consideration, including the volume of GDP and the exchange rate of the U.S. Dollar, changes of the volume and structure of imports, domestic consumption, as well as the expected revenues in 2005.

The total budget revenues for 2006 are projected to amount to 17 666.7 mln leva, or 39.6% as a proportion of GDP. For 2007, the revenues are projected at 19 217.5 mln leva or 39.4% of GDP; for 2008 the projection is 20 542.8 mln leva or 38.7% of GDP. The reduction of the revenues to GDP ratio is mainly due to the expected reduction of non-tax revenues resulting from economic changes, the facilitation of licensing regimes, and above all, from the privatization processes, while the reduction in 2008 will be due to reduced revenues from grants, assistance and other free funds received under EU pre-accession programs. Moreover, the projection does not include the funds that the country will receive under the EU Structural and Cohesion Funds.

In accordance with the tax policy strategy of the past several years, the main objectives consist in the sustainable economic growth and the economic stability of the Republic of Bulgaria. Economic growth needs higher investment rates and the reduction of the tax burden favours such a development.

The priorities of the tax policy of the Government are:

- Overall reduction of the tax burden within the framework of a balanced budget;
- Maintenance of a stable taxation system;
- Development of the legislation in accordance with the requirements of the EU Directives.

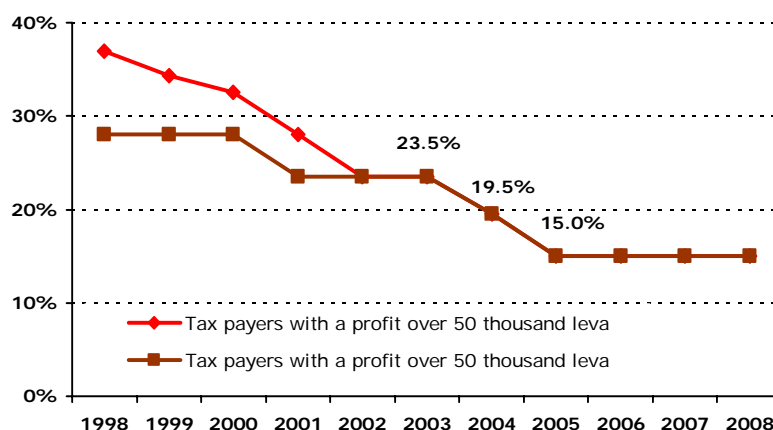
1. Corporate Taxes

The computation of the projections for the revenues from corporate taxes were made on the basis of the unchanged tax rates approved in the Law on Corporate Income Tax for 2005, i.e., 15% for the 2006-2008 period. The tax burden borne by the tax payers who pay corporate income tax does not change, because the effective tax rate for the period is preserved at the levels of the previous year.

The revenues from corporate income tax in the consolidated budget (including tax on dividends and incomes) for the 2006-2008 period are assessed respectively to: 1 115.0 mln. leva, 1 367.0 mln. leva and 1 533.0 mln. leva.

⁷ Changes against the basis (program 2005)

Chart No. 3 Corporate income tax rates 1998 – 2005



An alternative version: A version has been developed under the assumption that the corporate income tax rate drops from 15% to 12.5%, and the loss for the budget varies through the years from 115 to 125 mln leva.

Non-financial enterprises

The corporate income tax from non-financial enterprises (incl. Non-profit organizations and taxes on dividends, liquidation shares and income of local and foreign persons) for 2006 is assessed to 1 000.8 mln leva, to 1 172.8 mln leva in 2007, and to 1300 mln leva in 2008. When developing the projection, the following factors have been taken into consideration:

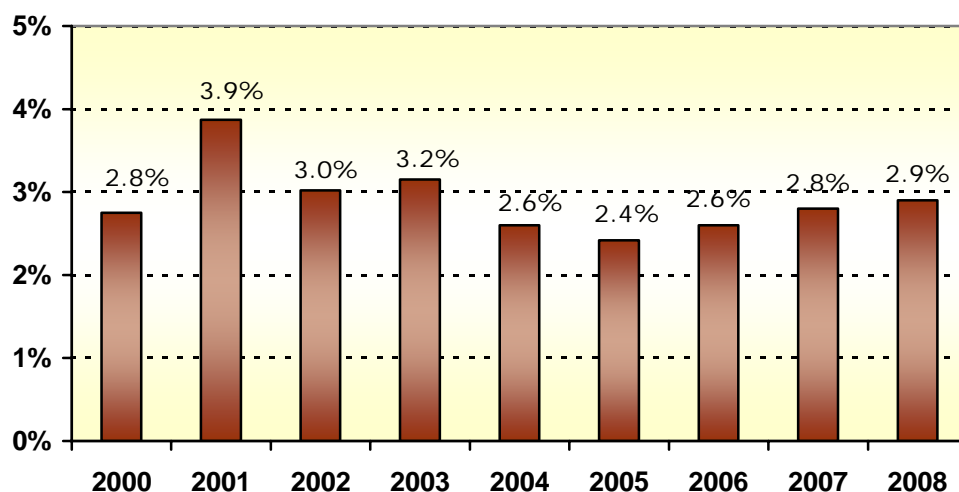
- ✓ Revenues in 2006 from the end-of-year settling of accounts for the fiscal year 2005 are expected to be higher than the ones in 2005, due to the improved collection on behalf of the tax administration and the legalization of a large number of companies from the gray economy, as a result of the low tax rate.
- ✓ Expected execution of the revenues from corporate income tax in the 2005 consolidated budget on the basis of reported revenues during the first quarter of the year.
- ✓ Increase of the taxable profit with the projected growth of real GDP for the 2006 – 2008 period.
- ✓ Granting tax relief to companies investing in regions with high unemployment.
- ✓ Non-recurrent collection of revenue in March 2006 as a result of the enforcement of § 46 of the Law on amendments and additions to the Law on Corporate Income Tax for 2004, assessed to about 9 mln. Leva.

Financial Institutions

The corporate income tax from financial institutions (including corporate income tax from insurance companies) for the 2006 – 2008 period is assessed respectively to 154.2 mln leva for 2006, 194.2 mln. Leva for 2007 and 233 mln. Leva for 2008.

While developing the assessment, a growth of the profits in the banking sector was taken into account as a result of the credit expansion and the increased market shares of this sector.

Chart No. 4. Corporate income taxes (% of GDP)



2. Income tax for individuals

In connection with the Government's policy of reduction of direct taxes and the increased real taxable income in 2005, the non-taxable minimum was raised from 120 leva in 2004 to 130 leva, while at the same time the rates for the low income categories dropped from 12% in 2004 to 10% in 2005, for the middle income – from 22% and 26% in 2004 respectively to 20% and 22% in 2005, and for the high income categories from 29% to 24% respectively. The reduction for the high income categories is from 20.5% in 2003 to 20.2% in 2004.

The effects of the changed scale for the taxation of personal income lead to an alleviation of the tax burden on the average wages by 1%. The growth of the average wages in 2005 and the reduced tax rates increased the nominal income by 11% and the real disposable income by 7%.

During the period 2006 – 2008 under review, the plan is for the income taxation scale according to the Law on the Taxation of the Income of Natural Persons (LTINP) to be coordinated with the inflation rate and the growth of incomes, and to take into consideration the changes through the years of the employee/employer ratio of insurance contributions envisaged by the Social Security Code. The tax scale will change towards relieving the tax burden for all income groups. In 2006 the non-taxable minimum will increase in accordance with the projected growth of the minimum wages for the country. The suggested reduction of the tax rate is 2% for all types of income.

Table No.9 *Monthly tax scale for 2006- 2008*

Monthly tax base	Tax payable under LTINP
Up to 140 lv .	Non-taxable
From 140 to 150 lv .	0 lv. + 8 % for the surplus above 140 lv .
From 150 to 250 lv .	0.8 lv + 18 % for the surplus above 150 lv .
From 250 to 600 lv .	18.8 lv . + 20 % for the surplus above 250 lv .
over 600 lv .	88.8 lv . + 22 % for the surplus above 600 lv .

In preparing the projections on revenues from income taxes for natural persons for the reviewed period, the following key factors were considered:

- the growth of the wages and the change in the minimum working wage for the country. For the budget sector, the income policy includes a 5% growth as of the middle of 2006 and by 10% as of the middle of 2007 and 2008 each.
- The number and type of activities subject to patent tax and the persons engaged in work without an employment contract;
- The effect on the budget from the family income taxation.

The budget losses from the new scale suggested above amount to 120 mln leva.

The following revenues are anticipated from taxes under LTINP in 2006, 2007 and 2008 respectively: 1 190.0 mln leva, 1 348.0 mln leva and 1 560.0 mln leva. This projection reflects the factors listed above, as well as the trend from the past few years for the implementation of measures in the sphere of the income taxation of natural persons, directed at a reduction of the tax burden and at an increase of the real disposable income of employed persons.

3. Value-added Tax

The three-year budget projection for 2006-2008 has been developed with the assumption that the value-added tax (VAT) rates will remain unchanged. The general economic growth, the investment increase and the high consumption will have a positive effect on the results of this key budget source of revenues.

The key factors, which have influenced the development of the VAT projections, are the volume of GDP and its structure in a breakdown by consumption elements, the exchange rate and the rate of inflation. The VAT revenues come from imports and domestic transactions.

The main influence on VAT revenues from imports is exercised by the exchange rate of the US Dollar and the volume of imports. The VAT revenues from imports have been assessed at an exchange rate of the US Dollar of 1.57 BGN for 1 USD and a projected import growth of 10% /per year/.

In the course of the projection's development, a regression analysis has been used. Using a database from previous years, the necessary coefficients have been calculated and the VAT tax base has been computed at the given parameters of GDP and of imports by quarters.

The VAT revenues from domestic transactions depend strongly on the effectively paid tax and the reimbursed tax credit. The projections for 2006 are that effectively paid VAT will increase by 15%

against 2005. A forecast has been taken into account with respect to VAT reimbursements to exporters and others, while the effectively reimbursed tax varies around 70% of the declared amounts for reimbursement. In the calculation of the projected VAT revenues from domestic transactions, the growth of end consumption was taken into account at 7.8%, while the projected inflation is within the range of 3.7 – 4% during the reviewed period.

Other factors, which are expected to influence VAT revenues, are the increased excise taxes on fuel and tobacco products, as well as the more efficient control in the sphere of retail trading. The effect on the VAT revenues from the new excise taxes on cigarettes is about 11 mln. leva, and 10 mln. leva from the fuel taxes.

The projected levels of VAT revenues for the 2006 – 2008 period are respectively 4 760.0 mln leva; 5 060.0 mln leva and 5 540.0 mln leva.

The projected VAT revenues for 2006 can be achieved in case of an effective compliance of 92.5% and 94% for 2007 and 2008, having in mind that the actual compliance for 2004 was 90% and that the expected compliance for 2005 is 92%.

At a compliance of 100%, VAT revenues should be within the range of 10.7% - 11.4% of GDP. The difference between these values and the reported revenues represent the loss in VAT revenues as a result of lower compliance.

An alternative version: If the tax rate is reduced to 18%, the loss for the budget will be around 430 mln. leva per year.

4. Excise duties

The amendments to the Law on Excise Duties have the objective to align the Bulgarian legislation to the EU Acquis Communautaire. The excise duty rates that are presently valid in the country are still lower than the minimum rates in the Community. The Republic of Bulgaria has undertaken the commitment to increase the rates and catch up with the Community as follows:

- For alcohol beverages and mineral fuels – by the date of accession;
- For cigarettes – by January 1, 2010

The projections prepared for the revenues from excise duties during the period 2006 – 2008 are in conformity with the agreements reached between the Republic of Bulgaria and the European Union and with the established program for the gradual increase of excise duties.

Legislative amendments in 2006

In 2006, increases of the excise duties for some **mineral fuels** are envisaged as follows:

- Increase of the excise duty for leaded petrol: from 495 leva per 1000 liters to 670 leva per 1000 liters;
- Increase of the excise duty for non-leaded petrol: from 495 leva per 1000 liters to 530 leva per 1000 liters;
- Increase of the excise duty for gas oil: from 395 leva per 1000 liters to 430 leva per 1000 liters;
- Increase of the excise duty for kerosene: from 350 leva per 1000 liters to 430 leva per 1000 liters.

An increase is also envisaged in the excise duty for **cigarettes**:

- Increase of the excise duty for filter cigarettes from 48.7% to 52.3 % (specific + ad valorem) or 49.97 leva per 1000 pieces;
- Increase of the excise duty for non-filter cigarettes from 27.1% to 52.3 % (specific + ad valorem) or 49.97 leva per 1000 pieces.

The requirement of the European Union is that the excise duty rate should be at least 57 percent from the retail price of the most widely sold brand of cigarettes, but not less than 64 Euro per 1000 pieces (2.50 leva for a package of 20 pieces).

In its negotiation position on Chapter 10 "Taxation Policy ", the Republic of Bulgaria has undertaken the commitment that as of January 1, 2006 the excise duty rate for cigarettes shall reach 50.00 leva per 1000 pieces, which represents 39.9% of the minimum rate for the Community.

Envisaged revenues

During the formulation of the projection for the revenues from excise duties on domestic transactions, the assumptions have been based on the expected volumes of the consumption of the most important goods subject to excise duties, such as liquid fuels and tobacco products, together with the intended amendments to the legislative framework, etc.

The increase of the rates of the excise duties on petrol, gas oil and kerosene will lead to a positive effect for the State Budget evaluated at 127.8 million leva.

The increase of the rates of the excise duties on cigarettes will lead to a positive effect for the State Budget evaluated at 133.2 million leva.

The dynamics of imports is a fundamental factor for the projected revenues from excise duties on imported products. Throughout the entire year 2004 and the first quarter of 2005, a growth of excise revenues has been observed with respect to all groups of goods and this trend is expected to be preserved also in 2006. The other important factor for projected revenues is the amount of the reimbursed excise duties on imported products.

The total amount of revenues from excise duties under the consolidated budget program for 2006 is BGN 2245.3 million.

Legislative amendments in 2007

In 2007, increases of the excise duties for some **mineral fuels** are envisaged as follows:

- Increase of the excise duty for leaded petrol: from 670 leva per 1000 liters to 830 leva per 1000 liters;
- Increase of the excise duty for non-leaded petrol: from 530 leva per 1000 liters to 585 leva per 1000 liters;
- Increase of the excise duty for gas oil: from 430 leva per 1000 liters to 485 leva per 1000 liters;
- Increase of the excise duty for kerosene: from 430 leva per 1000 liters to 485 leva per 1000 liters;

An increase is also envisaged in the excise duty for **alcohol beverages**:

- Increasing the excise duty rate for alcohol beverages from 750 leva per hectoliter of pure alcohol to 1100 leva per hectoliter of pure alcohol.

Envisaged revenues

The increase of the rates of the excise duties on petrol, gas oil and kerosene will lead to a positive effect for the State Budget evaluated at 159.2 million leva.

The increase of the rates of the excise duties on alcohol beverages will lead to a positive effect for the State Budget evaluated at 36.1 million leva.

The total amount of revenues from excise duties under the consolidated budget program for 2007 is BGN 2451.3 million.

Legislative amendments in 2008

In 2008, increases of the excise duties for some **mineral fuels** are envisaged as follows:

- Increase of the excise duty for non-leaded petrol: from 585 leva per 1000 liters to 635 leva per 1000 liters;
- Increase of the excise duty for gas oil: from 485 leva per 1000 liters to 535 leva per 1000 liters;
- Increase of the excise duty for kerosene: from 485 leva per 1000 liters to 535 leva per 1000 liters;

An increase is also envisaged in the excise duty for **cigarettes**:

- Increase of the excise duty for filter cigarettes from 52.3% to 57.2 % (specific + ad valorem) or 74.75 leva per 1000 pieces;
- Increase of the excise duty for non-filter cigarettes from 52.3% to 57.2 % (specific + ad valorem) or 74.75 leva per 1000 pieces.

Envisaged revenues

The increase of the rates of the excise duties on petrol, gas oil and kerosene will lead to a positive effect for the State Budget estimated at 135.4 million leva.

The increase of the rates of the excise duties on cigarettes will lead to a positive effect for the State Budget amounting to 162.4 million leva.

The total amount of revenues from excise duties under the consolidated budget program for 2008 is BGN 2715.9 million.

5. Customs duties

The largest share of customs duty revenues from imported **agricultural products** belongs to the EU member countries, while in the case of industrial product imports, the top position is occupied by member countries of the World Trade Organization or countries that enjoy a "Most favoured nation" clause treatment by virtue of agreements concluded with the Republic of Bulgaria. In connection with the enlargement of the European Union and the further liberalization of trade in processed agricultural products in effect from May 1, 2004, the customs tariff rates will be gradually reduced throughout the period 2004 – 2006 and they will reach the zero level as of January 1, 2007. Customs duty revenues collected from the import of consumer **industrial goods** show a gradual reduction of the average weighted tariff rate for the period 1999 – 2004. This reduction is a consequence of the creation of the free-trade zones between Bulgaria and the countries from the EU, CEFTA, Turkey, Macedonia, Croatia, the Baltic countries (Lithuania, Latvia and Estonia), etc.

Proceeding from the analysis of the customs duty revenues for the period 1999 – 2004 by types of goods (agricultural products and industrial goods) and by groups of countries in compliance with the Customs Tariff of the Republic of Bulgaria and taking into account the average weighted customs tariff rates, the volume of imports, as well as the commitments of Bulgaria as a member country of the European Union from 2007 onwards, the following projections have been produced for the customs duty revenues during the period 2006 – 2008:

Table No. 10: *Customs duty revenues during the period 2006 – 2008*

	BGN million		
	Customs duties - Total	Customs duties for the State Budget of the Republic of Bulgaria	Customs duties for the EU – 75%
2006	277.7	277.7	-
2007	127.3	31.8	95.5
2008	130, 6	32.6	98.0

6. Other taxes

This section covers the other taxes collected by virtue of the Law on Corporate Income Tax (taxation of representative and entertainment expenditures, tax on social expenditures, taxation of expenditures for motor vehicles, tax on donations and sponsorship, final taxation of revenues from games of fortune, tax on the net tonnage of ships and tax on the revenues of budget-supported enterprises), as well as the taxes collected in accordance with the Law on Local Taxes and Levies (real estate tax, tax on motor vehicles, tax on the acquisition of property through donations or against consideration). The projection has been developed on the basis of the presently valid legislation, taking into account the actual growth rates of revenues, as well as the forecast for GDP growth.

The projected revenues by years are respectively BGN 414.0 million, BGN 415.0 million and BGN 417.0 million.

7. Non-tax revenues

The projected receipts from non-tax revenues for the period 2006 – 2008 by years are as follows: BGN 2494.9 million, BGN 2664.1 million and BGN 2733.5 million.

This part of the revenues includes receipts and income from real estate; central state, municipal and judicial system levies; fines, sanctions and penalty interest, concession revenues, dividends accruing to the state, etc.

The factors that determine the level of these revenues include the following considerations:

- During the compilation of the projection for revenues from dividends accruing to the state, the fact has been taken into account that a large part of the state-owned property will be privatized;
- Reduction of the contributions paid by BULGARGAS
- Preservation of the level of interest revenues in view of the high level of the reserves;
- Preservation of the level of revenues from fines and sanctions;
- Revenues from central state, municipal and judicial system levies are an important item, adding up to approximately one billion leva for the entire period of years. Vignette levies (motor vehicle sticker tax) are also included here.

8. Grants

The revenues from grants from external and domestic sources included in the projection for the period 2006 – 2008 by years are as follows: BGN 679.9 million, BGN 778.7 million and BGN 661.8 million.

IV. POLICY DIRECTIONS BY MAIN EXPENDITURE CATEGORIES FOR THE PERIOD 2006 – 2008

1. National level expenditure ceilings

The distribution of expenditures by economic activities and functions allows the opportunity to establish ceilings (limits) for their spending.

The three-year fiscal framework, which represents expenditures in comparable (constant) prices, indicates the limit of expenditures, which at the present stage is proposed for approval on behalf of

the Council of Ministers. The proposal of the Ministry of Finance for a total limit of expenditures in current prices also needs to be approved by the Council of Ministers at this stage. The difference between the two types of expenditure ceilings is shown under the item "Reserve for second stage redistribution according to the attached mechanism". This reserve is distributed in current prices in accordance with the updated macroeconomic framework, allowing for a priority increase of expenditures that depend on the growth of incomes and prices. The mechanism according to which the redistribution calculation has been made is attached to the draft decision for approval of the three-year budget projection and of the expenditure ceilings in constant and current prices.

Table No. 11: Consolidated basis 2005-2008

BGN million	2005 program	2006 projection	2007 projection	2008 projection
Expenditures ceiling in current prices	16 461.4	17 666.7	18 853.4	20 158.6
Total expenditure commitments in comparable (constant) prices		17 130.2	18 024.9	19 037.0
Reserve for second stage redistribution according to the attached mechanism		536.6	828.5	1 121.6

The starting (basic) year for the development of the three-year budget projection is 2005 with data according to the approved consolidated fiscal program for the same year. This process will assist the formulation of a sustainable and predictable medium-term fiscal framework that contains clear procedures for the updating of the indicators. This is the method to establish the modifications in the budget-supported sphere that are caused by structural adjustments and legislative amendments. This method also allows an opportunity to see what are the amounts redistributed each year by the budget because of the pursuit of a certain policy, what are the amounts redistributed as a result of predetermined structural adjustments and what are the amounts distributed as a consequence of macroeconomic transformations. On this basis, meetings were held between the first-level spending units for budgetary appropriations and the Ministry of Finance in order to clarify the priorities and the policies that can be financed during the period 2006 – 2008.

One must keep in mind that during the preparation of their three-year budget projections, the ministries and the agencies have increased substantially their requests for budgetary appropriations once again and that they have understated their expectations for the accumulation of revenues. The total increases of the volume of budgetary appropriation requests for the budget projection after putting together the separate submitted requests on a consolidated basis are in excess of BGN 1.9 – 3.5 billion. After their consolidation, the proposed expenditures for 2006 (in constant prices) exceed by 25 percent the expenditures approved for the past year. If one assumes the hypothesis that the projections proposed by the first-level spending units are approved, the deficit of the consolidated fiscal program (after applying the economic growth redistribution mechanism) would amount to more than 8 percent of GDP for 2006, to about 6.5 percent of GDP for 2007 and to about 5 percent of GDP for 2008. Therefore, the preparation of the three-year budget projection provides an opportunity to prioritize the proposed expenditure levels in the course of the discussions.

Table No. 12: Funding requests submitted on behalf of the first-level spending units (FLSU)

CONSOLIDATED STATE		2005			2006			2007			2008		
BUDGET		Constant prices	Constant	Difference	Constant prices	Constant	Difference	Constant prices	Constant	Difference	Constant prices	Constant	Difference
BGN million	Program		FLSU			FLSU			FLSU			FLSU	
Total revenues		16 265.8	17 666.7	17 552.0	-114.8	19 217.5	18 310.7	-906.7	20 542.8	19 226.5	-1 316.3		

Total expenditure commitments	16 461.4	17 130.2	20 581.1	3 450.9	18 024.9	20 930.1	2 905.2	19 037.0	20 946.7	1 909.6
<i>Total non-interest expenditures</i>	<i>15 666.7</i>	<i>16 394.2</i>	<i>19 863.5</i>	<i>3 469.3</i>	<i>17 287.0</i>	<i>20 215.6</i>	<i>2 928.6</i>	<i>18 350.5</i>	<i>20 300.3</i>	<i>1 949.8</i>
Current non-interest expenditures	13 541.2	14 032.1	16 340.8	2 308.7	14 567.1	16 744.8	2 177.7	15 249.1	17 142.5	1 893.4
*										
Fixed assets	1 605.9	1 933.2	3 113.6	1 180.4	2 245.7	3 080.2	834.5	2 608.7	2 777.9	169.2
Reserve for unforeseen and structural expenditures	419.6	293.1	294.8	1.7	324.2	286.5	-37.7	332.7	298.3	-34.4
Acquisition of equity, shares, participation and other financial and borrowed assets (net)	100.0	135.8	114.3	-21.5	150.0	104.1	-45.9	160.0	81.6	-78.4
<i>Interest</i>	<i>794.7</i>	<i>736.0</i>	<i>717.6</i>	<i>-18.3</i>	<i>737.9</i>	<i>714.5</i>	<i>-23.4</i>	<i>686.5</i>	<i>646.4</i>	<i>-40.1</i>

* The current interest expenditures are shown in constant prices

In view of the considerations explained above, the Ministry of Finance recommends once again that all first-level spending units should propose the restructuring of their expenditures with the objective to achieve their final optimization and to improve the efficiency of the use of their resources. This means that all ministries and agencies should review their structures, the numbers of their workforce, their buildings, installations and other material facilities under their responsibility, suggesting measures for their improved management.

The analysis of the impact of the future structural transformations after 2007 related to the impending accession of the Republic of Bulgaria to the European Union is extremely important. This analysis needs to contain an examination of the first-level spending units' views about the restructuring of their policies and programs ensuing from full EU membership, as well as their repercussions on the ministries' organizational structures and budgets. The adequate and objective assessment of the alteration of the targeting of budgetary expenditures that will be the outcome of the structural adjustments related to the EU requirements has a particular importance for the multi-year planning process in the budget-supported sphere. This needs to be taken into account during the establishment of the expenditures ceilings for the period after 2007.

2. Main policies incorporated in the expenditures part of the three-year budget projection

2.1. Incomes policy

The incomes policy occupies a very special place within the framework of the comprehensive development strategy of the country and this is determined by the entire policy of the government pursued during the last few years with the objective to improve the living standards and to increase the income of the population. The foundations of this policy are based on a competitive and dynamically developing economy determined by economic growth, employment and productivity combined with an adequate incomes policy that ensures the active participation of all citizens. The formulation and the implementation of an appropriate incomes policy, mainly in respect of wages-related income, is the fundamental element of the incomes policy, which is in need of new approaches, having in mind the assessment of the country's economic and social realities.

Wages and salaries

During the last few years in Bulgaria, a consistent policy of poverty reduction and income improvement has been put in place:

- The average working wages have been increased from BGN 240 in 2001 to BGN 301.53 (in excess of EUR 150) according to preliminary data for 2004;
- The minimum working wages have been increased from BGN 87.25 in 2001 to BGN 150 for 2005, which is a total nominal increase of 71.9 percent. An important feature of the dynamics of the minimum working wages is that they were increased repeatedly with a rate, which outpaced the growth of the other incomes of the population. The minimum working

wages will grow gradually in 2006 and 2007 until achieving the level of BGN 1.00 per hour as of the moment of accession of Bulgaria to the EU. Establishing the level of the minimum working wages, the state prevents the possibility of unjustifiably low labour remunerations, which is mostly applicable to the private sector.

- Shifting the social contribution burden.

The incomes policy is in accordance with the general economic policy, as well as with the policies in the field of employment and the limitation of unemployment. The 2001 unemployment level of 18.08 percent was reduced down to 12.67 percent in 2004, which had positive consequences also for the incomes of more than 5 percent of the unemployed who have found jobs.

As a result of the coordinated actions of the government, the households' real incomes in 2003 show an increase of 31.6 percent as compared to the 1996 level (according to observations of the National Statistical Institute). The average per capita total income of households grew from BGN 1589 in 2001 to BGN 2298 for 2004. The increase is BGN 709.00 or 44.6 percent (according to data of the National Statistical Institute for April 2005).

Higher income and living standard levels of the population are achievable through increasing the output of goods and services, through improving the productivity of labour and expanding employment. The dynamics of real working wages and of labour productivity during the period 2007 – 2008 are expected to preserve the same growth rates, that is, in excess of 4 percent.

A fundamental objective of the incomes policy is raising the level of incomes with enhancing the quality of life in view of the successful integration of Bulgaria within the European community. The macroeconomic stability attained by Bulgaria during the last several years enables the preservation of the upward trends for working wages income.

In order to maintain an efficient medium-term incomes policy, particularly in the budget-supported sphere, it is necessary to ensure not only a decision-making process that allows the growth of income, or specifically of wages-related income, but also the medium-term aspect decision-making with respect to establishing and maintaining effective structures with optimum workforce numbers, that is, securing well targeted and controllable employment policies. There is also an immediate need of review and assessment of all budget-supported structures and of the numbers on their payroll list. The attainment and the maintenance of optimum personnel numbers in the budget-supported sphere is the first and foremost condition for ensuring a growth of working wages that is adequate with respect to the economic growth.

The proposed incomes policy in the budget-supported sphere for the period 2006 – 2008 is based on the following premises:

1. Application of a new, more efficient mechanism for determining the volume of funds earmarked for wages and salaries. The staggered introduction of program budgeting is the first stage of the efforts in the direction, being targeted directly at the achievement of the end results and not at the separate economic indicators, including wages and salaries. Therefore, the hitherto applied approach of centralized formulation of the amount for funds and salaries in the separate budget-supported systems and sectors needs to be eliminated.
2. The growth of wages and salaries in the budget-supported sphere needs to be linked to the growth of productivity of labour in the real sector in view of securing a robust and competitive economy, high economic growth rates and a stable macroeconomic environment.

According to the three-year budget strategy, a 10 percent increase of the average monthly salary is envisaged for the middle of each year during the period 2007 – 2008, while for 2006 (also counted from July 1) this increase will amount to 5 percent.

Pensions

After the reform of the social security system and, subsequently, after the elimination of the pension "ceiling" from January 1, 2004, significant positive changes were introduced with respect to the amount of pension benefits:

- The social support pension benefit was increased from BGN 44 in 2001 to BGN 60 in 2005 and it is planned to reach 62.76 BGN in 2006;
- The minimum pension benefit for length of service and completed age grew from BGN 50.60 in 2001 to BGN 69 in 2005 and it is planned to reach BGN 72.17 in 2006;
- The maximum amount of pension benefits was increased to BGN 420. As a result of this, approximately 150 000 pensioners, whose pension benefits until the end of 2003 were restricted to BGN 200, were enabled to receive their real pensions. In 2006, the maximum amount of the pension benefit will reach BGN 455;
- The average amount of pension benefits per pensioner grew from BGN 92.37 in 2001 and BGN 124.76 in 2004 to BGN 133.14 in 2005 according to the Law on the Budget of the State Social Security; it is planned to reach 144.00 BGN in 2006.

A prerequisite for the success of the increased pension benefits policy is the creation of conditions securing the growth of revenues for the social security system. Therefore, the Government undertook and will continue to work on a number of measures aimed at improving the coverage and increasing the compliance for social security contributions.

These processes were regulated with the introduction of the minimum insurable income thresholds by economic sectors and positions and with the obligatory registration of employment contracts.

As of the beginning of 2005, the maximum insurable income for all insured persons was increased from BGN 1200 to BGN 1300, while the minimum insurable income for self-insured persons was increased to BGN 220.

From June 1, 2005, a 7 percent indexation increase of pension benefits is envisaged. The calculation of this indexation includes 75 percent of the rate of inflation and 25 percent of the growth of the average insurable income.

In 2006 – 2008, the total amount of pension benefits is projected to be respectively BGN 4081.2 million; BGN 4386.0 million and 4695.0 BGN million.

Social Security and Health Insurance Contributions

The expenditures for social security contributions, which cover pension and health insurance contributions, have been calculated as a percentage of the expenditures for wages and salaries depending on the contribution burden. The volume of funding for these expenditures in 2005 amounts to BGN 618.9 million.

The total amount of social security contributions for 2006 reflects the amendments introduced to the Social Security Code with respect to the ratio of the distribution of the social security contributions' burden between the employers and the insured persons from 70:30 in 2005 respectively to 55:45 in 2008. According to this ratio, personally paid social security contributions in 2005 amount to 12.45 percent of the total amount of social security contribution, which is 42.2 percent for the third category of labour. In 2006, the distribution ratio between employers and employees will be 65:35, where personally paid social security contributions will be 14.5 percent of the total amount of the social security burden.

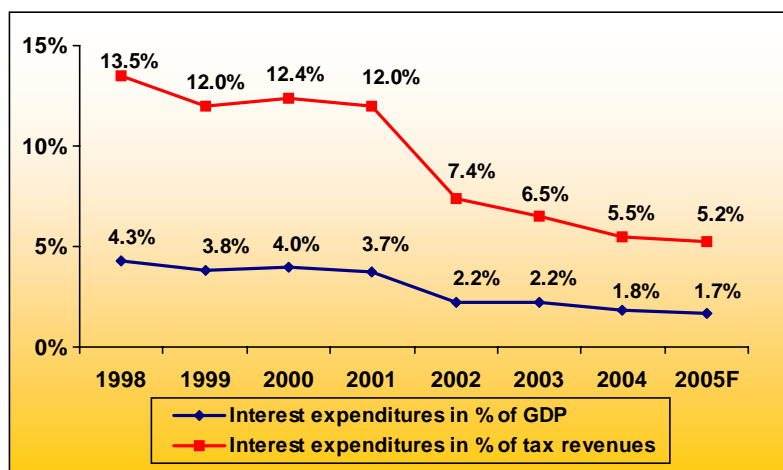
The percentage of the health insurance contribution will be preserved at 6 percent in 2006 too. This contribution is envisaged to be increased to 8 percent starting from 2007.

2.2. Interest expenditures

During the three-year period in margin, **domestic debt** related interest expenditures are expected to amount to BGN 552.9 million. Out of this, BGN 107.7 million will represent interest under the debt owed to the Bulgarian National Bank. The domestic debt interest expenditures are a relatively well predictable and stable quantity, since the predominant part of this debt is represented by government securities with fixed interest coupons. The impact of the international interest rates fluctuations is expected to influence the volume of repayments of the debt to the Bulgarian National Bank, as well as the interest payments on government securities issued for the structural reform.

The foreign debt interest expenditures for the period 2006 – 2008 are expected to amount to a total of BGN 1607.5 million on a consolidated basis. The distribution of this amount by years is as follows: BGN 530.3 million in 2006, BGN 556.3 million in 2007 and BGN 520.9 million in 2008. The main part of these expenditures is related to government loans and bonds, while BGN 180.2 are due on state investment loans administered by the budgets of the ministries. The expenditures for loans where the end beneficiaries are commercial companies are paid by the borrowers and are expected to amount to approximately BGN 60 million. Regardless of the significant improvement of the interest rate structure of the external debt, which was achieved during the last few years, about one-half of the external debt interest coupons remain linked to international interest rates, which makes this part of the expenditures strongly dependent on international interest rate fluctuations. Nevertheless, their influence is not expected to lead to significant alterations of the projected amounts.

Chart No. 5. *Dynamics of the distribution weights of interest expenditures*



2.3. Capital expenditures

The encouragement of sustainable economic development is a central priority of the economic policies pursued. Having set the objective to attain a strong and sustainable economic growth during 2006 - 2008, it is necessary to stimulate the paramount factor for the implementation of this objective, i.e., investments. The main ambitious objectives are linked to the following factors:

- The volume and the rate of growth of "greenfield" foreign investments and of investments directed towards existing industries after the forthcoming completion of privatization;

- The attraction of investments in high-tech industries and services (science, education, information and communication technologies and other high added-value sectors) that require the presence also of highly qualified human resources.

One of the essential mechanisms for improving the investment environment in Bulgaria is the refinement of the regulatory framework that establishes the framework for the functioning of businesses together with the optimization of the administrative services delivered by the central governmental agencies and the local authorities. Support will be provided for new investment projects aimed at expanding the national industrial infrastructure and at enabling the intensification of foreign investment flows.

For 2006, a considerable growth of capital expenditures is envisaged. This is an important trend, which is in support of overall economic growth. The amounts of the capital expenditures envisaged by the consolidated budget for 2006-2008 in a breakdown by years will accordingly be BGN 1933.2 million, BGN 2245.7 million and BGN 2608.7 million, or respectively 4.3 percent, 4.6 percent and 4.9 percent of GDP.

From the point of view of the financing sources' structure, the capital expenditures budget projection for the period 2006-2008 differs substantially from capital expenditures during the present year 2005. The funding has been distributed in a way which takes into account the strengthened participation of the PHARE, ISPA and SAPARD funds. During the next few years, serious progress is expected under the ISPA program, which is entirely devoted to the large infrastructural projects. During 2006 – 2008, the building up of the backbone infrastructural projects will continue. The completion of the projects "Transit Roads III", of the electrification of the railway line Plovdiv-Svilengrad, of the extension of Sofia airport, of the second bridge over the Danube River and of a series of regional household waste disposal depots and wastewater cleaning stations is expected. A considerable growth is envisaged for the share of national co-financing expenditures for the pre-accession instruments.

There is also an increase of the amount of the funds, which Bulgaria will absorb from foreign investment loans under agreements that have already been concluded.

The strengthening of the participation of external grants and of borrowed foreign investment resources for the financing of investment programs and projects leads to a certain reduction of the funding from national sources, that is, from central budget subsidies and from own-budget funds of the first level budgetary appropriation spending units and of municipalities.

In real terms, a growth of the investment expenditures directed towards policy implementation measures is envisaged, counterbalancing a decrease of expenditures in support of administrative activities.

Capital transfers are envisaged for the "Railway Infrastructure" National Company, for the Sofia Airport enlargement project, for the expansion of the Bourgas seaport, for the Bulgarian Telegraph Agency, for the Bulgarian Red Cross and for the "Student Canteens and Hostels" EAD.

It is also important to point out that - within the framework of the fixed-purpose capital expenditures subsidy for municipalities from the central budget - the continuation of the construction of environment protection projects of high regional and national importance (such as wastewater cleaning stations, solid municipal waste disposal depots, etc.) has been secured.

The distribution of the funds in a breakdown by investors has been carried out with a view to ensure the concentration of financial resources for the implementation of investment programs and projects

that represents national priorities. This is the case with the funds envisaged for the program for the restructuring of defense according to NATO standards.

3. Development of the main budget-supported sectors during the next few years

The expenditures by main functional spheres are presented as an attachment to the draft-decision of the Council of Ministers. The present section engages in a brief analysis of the fundamental sectoral priorities.

Table No. 13: Consolidated government expenditures by functions (2004 – 2008)

CONSOLIDATED STATE BUDGET		2004	2005	2006	2007	2008
BGN mln.		Reported	Program	Current prices	Current prices	Current prices
DISTRIBUTION OF EXPENDITURES BY FUNCTIONS		15 198.7	16 461.5	17 666.7	18 853.4	20 158.6
Current expenditures		13 642.4	14 335.9	15 304.6	16 133.5	17 057.2
Capital expenditures		1 505.2	1 606.0	1 933.2	2 245.7	2 608.7
Acquisition of equity, shares, participation and other financial assets (net)			100.0	135.8	150.0	160.0
Reserve		51.1	419.6	293.1	324.2	332.7
% of GDP		40.0%	39.8%	39.6%	38.7%	38.0%
% of Total Expenditures		100.0%	100.0%	100.0%	100.0%	100.0%
% of Non-interest expenditures		104.8%	105.1%	104.3%	104.1%	103.5%
Non-interest expenditures -- total		14 501.3	15 666.8	16 930.7	18 115.5	19 472.1
Current expenditures		12 945.0	13 541.2	14 568.6	15 395.6	16 370.7
Capital expenditures		1 505.2	1 606.0	1 933.2	2 245.7	2 608.7
Acquisition of equity, shares, participation and other financial assets (net)			100.0	135.8	150.0	160.0
Reserve		51.1	419.6	293.1	324.2	332.7
% of GDP		38.2%	37.9%	37.9%	37.2%	36.7%
% of Total Expenditures		95.4%	95.2%	95.8%	96.1%	96.6%
% of non-interest expenditures		100.0%	100.0%	100.0%	100.0%	100.0%

According to the budget framework for 2006-2008, the most significant portion of the total expenditures is envisaged for the following spheres: social security, social assistance and welfare (approximately 34 percent), defense and security (around 13 percent); healthcare (11 percent); education (11 percent) and economic activities and services (11 percent).

The projection for 2007-2008 does not include the financial relationships (flows) from and to the European Union, which will lead to adjustments in the structure expenditures, both in a breakdown by economic elements and by functions.

3.1. General governmental services

Table No. 14: Distribution of expenditures for general governmental services (2004-2008)

CONSOLIDATED STATE BUDGET		2004	2005	2006	2007	2008
BGN mln.		Reported	Program	Current prices	Current prices	Current prices
I. GENERAL GOVERNMENTAL SERVICES - TOTAL (A+B+C) + RESERVE		1 115.2	1 232.0	1 291.0	1 374.1	1 419.9
% of GDP		2.9%	3.0%	2.9%	2.8%	2.7%
% of Total Expenditures		7.3%	7.5%	7.3%	7.3%	7.0%
% of non-interest expenditures		7.7%	7.9%	7.6%	7.6%	7.3%
I. GENERAL GOVERNMENTAL SERVICES - TOTAL (A+B+C)		1 115.2	1 187.0	1 276.0	1 364.1	1 409.9
Current expenditures		968.8	1 017.3	1 084.3	1 166.5	1 214.3

Capital expenditures	146.4	169.7	191.7	197.6	195.6
% of GDP	2.9%	2.9%	2.9%	2.8%	2.7%
% of Total Expenditures	7.3%	7.2%	7.2%	7.2%	7.0%
% of non-interest expenditures	7.7%	7.6%	7.5%	7.5%	7.2%
A. EXECUTIVE AND LEGISLATIVE BODIES	918.8	996.4	1 074.4	1 149.5	1 168.3
Current expenditures	780.1	832.1	889.3	961.5	983.3
Capital expenditures	138.6	164.3	185.1	188.0	185.0
% of GDP	2.4%	2.4%	2.4%	2.4%	2.2%
% of Total Expenditures	6.0%	6.1%	6.1%	6.1%	5.8%
% of non-interest expenditures	6.3%	6.4%	6.3%	6.3%	6.0%
B. GENERAL SERVICES	66.7	57.9	62.5	68.5	71.5
Current expenditures	64.9	55.8	60.0	64.0	66.0
Capital expenditures	1.8	2.1	2.5	4.5	5.5
% of GDP	0.2%	0.1%	0.1%	0.1%	0.1%
% of Total Expenditures	0.4%	0.4%	0.4%	0.4%	0.4%
% of Non-interest expenditures	0.5%	0.4%	0.4%	0.4%	0.4%
C. SCIENCE + RESERVE	129.7	177.7	154.1	156.1	180.1
% of GDP	0.3%	0.4%	0.3%	0.3%	0.3%
% of Total Expenditures	0.9%	1.1%	0.9%	0.8%	0.9%
% of Non-interest expenditures	0.9%	1.1%	0.9%	0.9%	0.9%
D. SCIENCE	129.7	132.7	139.1	146.1	170.1
Current expenditures	123.7	129.4	135.0	141.0	165.0
Capital expenditures	6.0	3.3	4.1	5.1	5.1
% of GDP	0.3%	0.3%	0.3%	0.3%	0.3%
% of Total Expenditures	0.9%	0.8%	0.8%	0.8%	0.8%
% of Non-interest expenditures	0.9%	0.8%	0.8%	0.8%	0.9%

This function reflects the financing of the public administration (at central and local levels) and of science. The current administrative reform aimed at the optimization of the structures, of the levels of staffing and material support and at the improvement of the professional competence of the administration is mainly reflected by this function.

The budget policy aimed at the formation of a lean but highly qualified and well paid administration is in compliance with the policy's main objectives within this sphere: strengthening the administration's capacity required for the efficient application of the Acquis Communautaire and for the improvement of the motivation of civil servants. In order to secure the required financial resources, the reform is directed towards identifying the sectors and the activities that can be removed from the budget sphere through the creation of commercial companies and state-owned enterprises, through the outsourcing of certain activities to private sector entities, as well as through the closure of certain administrative units and/or structures. This approach represents an effort to identify new opportunities to achieve economic efficiency and efficacy in all governmental activity spheres.

With respect to the activities covered by the "Science" group, favourable opportunities exist for establishing a partnership between the private sector and the state, the emphasis being put on a more rational utilization of the various options for its funding.

Incentives are provided for the development of projects in the sphere of science and scientific research that are eligible to apply for funding under programs of the European Union and NATO. The policy in the sphere of science is directed towards securing opportunities for a normal implementation of scientific activities within the framework of joint projects with foreign partners (European partners and partners from leading countries in the field of science), such as the academies of sciences or the national scientific research centers, owing to which scientific

appliances and consumables are provided, short-term development studies for young researchers are arranged, etc.

The Lisbon Economic Reform Program adopted in 2000 by the Council of Europe formulates the specific measures for the improvement of the efficiency of European scientific research activities and of their impact on innovation.

The fundamental challenge in the sector is the attainment of the goal set up by the Lisbon Strategy, that is, to achieve a spending level for scientific research expenditures equal to 3 percent of GDP, out of which approximately one-third is to be provided by the state and two-thirds should be funded by the private sector. In this respect, the government's efforts are directed towards the creation of conditions for the implementation of innovations as a result of attracting more private capitals for the funding of market-oriented applied science research work, as well as the financing of publicly funded research. The good management, the prioritization of the spheres for scientific research work, the optimization of the system, the transformation of the financing model and its linking to the end results, and, most importantly, private sector participation will lead to the attainment of the essential objectives of the government in the field of science.

3.2. Defense and security

Table No. 15. *Distribution of expenditures for defense and security (2004-2008)*

CONSOLIDATED STATE BUDGET		2004	2005	2006	2007	2008
	BGN mln.	Reported	Program	Current prices	Current prices	Current prices
II. DEFENSE AND SECURITY (A+B+C+D)		1 946.4	2 068.2	2 225.9	2 439.4	2 667.1
Current expenditures		1 723.9	1 935.3	2 083.9	2 210.9	2 407.0
Capital expenditures		222.5	132.9	142.0	228.5	260.1
% of GDP		5.1%	5.0%	5.0%	5.0%	5.0%
% of Total Expenditures		12.8%	12.6%	12.6%	12.9%	13.2%
% of Non-interest expenditures		13.4%	13.2%	13.1%	13.5%	13.7%
A. DEFENSE + RESERVE		875.0	978.9	1 033.0	1 156.0	1 303.1
% of GDP		2.3%	2.4%	2.3%	2.4%	2.5%
% of Total Expenditures		5.8%	5.9%	5.8%	6.1%	6.5%
% of non-interest expenditures		6.0%	6.2%	6.1%	6.4%	6.7%
A. DEFENSE		875.0	960.9	1 033.0	1 156.0	1 303.1
Current expenditures		696.2	869.4	937.0	980.0	1 103.1
Capital expenditures		178.8	91.5	96.0	176.0	200.0
% of GDP		2.3%	2.3%	2.3%	2.4%	2.5%
% of Total Expenditures		5.8%	5.8%	5.8%	6.1%	6.5%
% of Non-interest expenditures		6.0%	6.1%	6.1%	6.4%	6.7%
B. POLICE, INTERNAL OLDER AND SECURITY		780.3	784.8	851.9	923.0	982.9
Current expenditures		753.9	762.8	826.9	898.0	951.9
Capital expenditures		26.4	22.0	25.0	25.0	31.0
% of GDP		2.1%	1.9%	1.9%	1.9%	1.9%
% of Total Expenditures		5.1%	4.8%	4.8%	4.9%	4.9%
% of Non-interest expenditures		5.4%	5.0%	5.0%	5.1%	5.0%
B. JUDICIAL SYSTEM + RESERVE		226.2	251.6	268.6	280.0	297.7
% of GDP		0.6%	0.6%	0.6%	0.6%	0.6%
% of Total Expenditures		1.5%	1.5%	1.5%	1.5%	1.5%
% of Non-interest expenditures		1.6%	1.6%	1.6%	1.5%	1.5%
C. JUDICIAL SYSTEM		226.2	251.0	268.0	279.4	297.1
Current expenditures		209.7	232.5	248.0	255.9	273.0

Capital expenditures	16.5	18.5	20.0	23.5	24.1
% of GDP	0.6%	0.6%	0.6%	0.6%	0.6%
% of Total Expenditures	1.5%	1.5%	1.5%	1.5%	1.5%
% of Non-interest expenditures	1.6%	1.6%	1.6%	1.5%	1.5%
D. PRISON ADMINISTRATION	64.9	71.6	73.0	81.0	84.0
Current expenditures	64.1	70.6	72.0	77.0	79.0
Capital expenditures	0.8	1.0	1.0	4.0	5.0
% of GDP	0.2%	0.2%	0.2%	0.2%	0.2%
% of Total Expenditures	0.4%	0.4%	0.4%	0.4%	0.4%
% of Non-interest expenditures	0.4%	0.5%	0.4%	0.4%	0.4%

Modernization of the Armed Forces of the Republic of Bulgaria

When Bulgaria joined NATO, the country undertook a commitment to maintain an adequate national defense budget that can guarantee the availability of efficient combative armed forces capable to participate in joint NATO operations and missions. According to the reform program, the economic sphere will support a commitment to guarantee domestic and external economic stability, the sustenance of reforms and the securing of funding at the macroeconomic level for the defense expenditures in the short-term perspective at a relatively stable level of 2.6 percent of GDP (including defense expenditures distributed under other functions).

The Council of Ministers approved 11 priority investment projects for the modernization of the Armed Forces of the Republic of Bulgaria that have a long-term character and will be implemented during the period 2005 – 2015. These projects envisage the delivery of new helicopters and transport aircraft and the re-arming of the troops with new motor vehicles, as well as of new multipurpose fighter planes and of a "multipurpose corvette" type warship. The execution of these projects involves the large-scale implementation of offset programs on behalf of potential strategic partners before and during the accomplishment of the tasks. This will secure the attainment of economic, technological, financial and – last but not least – of political advantages for the country.

The security strategy of the Republic of Bulgaria, which is the cornerstone and the starting point for the formation of the policy of the Bulgarian State during the coming decade has been submitted to National Assembly for consideration.

Police, internal order and security

The main priorities in the sphere of the protection of public order and of the security of the country are related to the harmonization and the application of the EU Acquis Communautaire with respect to border crossing point control, illegal migration, drugs trafficking, money laundering, organized crime, the interaction between the police and the judicial system, the protection of personal data and the mutual recognition of court decisions.

Until its formal accession to the EU, Bulgaria will maintain strict observance of the valid legislation and will develop the institutional and administrative capacity of all law enforcement and justice administering authorities. The priority spheres include judicial system reform, personal data protection, refinement of the migration policies, improvement of police co-operation, counteraction to fraud and corruption, implementation of the National Anti-Drug Strategy and of the National plan of action against terrorism, strengthening the interaction with foreign specialized and police services with a view to exchange information about specific persons and terrorist organizations.

Judicial system

An important priority of the government is the continuation of the judicial reform with a view to establish an efficiently working justice administering system that is in line with European requirements and standards.

The three-year budget projection for the period 2006 – 2008 envisages the provision of the necessary financial, material and human resources for the normal functioning of the bodies of the judicial system and for their interrelationships with the remaining participants in the judicial process, with particular emphasis on expenditure restructuring in some of the other sectors.

The main priorities related to the judicial system reform are linked to the attainment of the following objectives:

- Strengthening of the law-enforcement capacity and improving the qualification of magistrates and court officials;
- Strengthening the administrative capacity of the bodies of the judicial system, improving the transparency and enhancing the public image of the judiciary;
- Improving the infrastructure and the security of the judicial system;
- Introducing information technologies into the judicial system's operations;

We recommend that the Supreme Judicial Council should make efforts for the efficient, efficacious and economical spending of the restricted amounts of public funds, having in mind that the State Budget's capacity is limited. The privileges for the personnel employed in the judicial system that have been established according to the Law on the judicial system involve substantial discrepancies with the incomes policy approved by the Government and are at variance with the remaining budget-supported systems.

3.3. Education

Table No. 16. *Distribution of expenditures for education (2004-2008)*

CONSOLIDATED STATE BUDGET	2004	2005	2006	2007	2008
	BGN mln. Reported	Program	Current prices	Current prices	Current prices
III. EDUCATION + RESERVE	1 652.4	1 798.9	1 954.0	2 094.3	2 272.0
% of GDP	4.3%	4.4%	4.4%	4.3%	4.3%
% of Total Expenditures	10.9%	10.9%	11.1%	11.1%	11.3%
% of Non-interest expenditures	11.4%	11.5%	11.5%	11.6%	11.7%
III. EDUCATION	1 652.4	1 708.9	1 954.0	2 094.3	2 272.0
Current expenditures	1 566.5	1 632.9	1 796.0	1 935.3	2 108.0
Capital expenditures	85.9	76.0	158.0	159.0	164.0
% of GDP	4.3%	4.1%	4.4%	4.3%	4.3%
% of Total Expenditures	10.9%	10.4%	11.1%	11.1%	11.3%
% of Non-interest expenditures	11.4%	10.9%	11.5%	11.6%	11.7%

The priorities in the sphere of education have been developed on the basis of the new requirements that Bulgarian education has to satisfy according to the decisions of the Lisbon meeting. The necessity to implement a far-reaching modernization of the system within this public sector has been fully recognized. Therefore, it is important that the efforts should now be directed towards drafting a comprehensive national program for a qualitatively new development of Bulgarian education. The implementation of such a program needs to result in the inclusion of knowledge and information as main factors for the Bulgarian economy's competitiveness, for the growth rates and the creation of new jobs. The central emphasis of this program is in line with the educational objectives adopted by the ministers of education of the EU member countries in 2001, namely:

- Improvement of the quality and of the efficiency of the educational and qualification systems;
- Ensuring the equitable access of all to these systems;
- Opening up of the educational systems towards the world.

The cardinal directions for the Bulgarian educational system's reform may be summed up within the following points:

The measures for the improvement of the quality and efficiency of the secondary education system include:

- Updating of the curricula and linking the study contents to the demands of the labour market;
- Introduction of new teaching methods according to which the students become an active partner in the learning process;
- Priority study of foreign languages;
- Early computer training and mass implementation of information technologies at all educational levels;
- Introducing modern and objective methods for performance and achievement assessment on completion of the educational stages and degrees;
- Encouragement of scientific research in the universities.

Development of the system for the management of education through:

- Decentralization of the management of secondary education through delegating prerogatives to school directors enabling them to make decisions related to financial matters, staff management and to the introduction of innovations in the teaching process;
- Achieving a fruitful partnership in the management of schools through assuming rights and responsibilities on behalf of parents and businesses;
- Ensuring opportunities for the continuous training and qualification of teachers and for linking the good results of the teaching process to moral and material incentives that will enhance the economic and social status of Bulgarian teachers.

Introducing a working system of indicators for assessing the quality of education and for a linkage of the funding to the quality of the educational product:

- A three-component model for the financing of secondary education that includes a uniform standard for the per capita funding of education, as well as for the program financing and the co-financing on behalf of the school's owner. The objective of this model consists in a transformation of the system's incentives, encouraging the provision of high-quality teaching by highly qualified specialists in fields that correspond to labour market demand.
- Application of the principle "the money follows each student" with the objective to mitigate and to gradually eliminate the interdependency between the economic circumstances of each family and the access to high-quality education.
- A long-term linkage of the availability of resources within the system to the quality of the educational product – achieving a congruence between the contents and the form of the educational services, as well as with the needs, the requirements and the interests of the students, of the economy and of society as a whole.

3.4. Healthcare

Table No. 17: Distribution of expenditures for healthcare (2004-2008)

CONSOLIDATED STATE BUDGET	2004		2005	2006	2007	2008
	BGN mln.	Reported	Program	Current prices	Current prices	Current prices
IV. HEALTHCARE + RESERVE		1 769.1	1 777.7	1 922.0	2 109.5	2 289.1
% of GDP		4.7%	4.3%	4.3%	4.3%	4.3%
% of Total Expenditures		11.6%	10.8%	10.9%	11.2%	11.4%

% of Non-interest expenditures	12.2%	11.3%	11.4%	11.6%	11.8%
IV. HEALTHCARE	1 769.1	1 677.2	1 810.0	1 971.9	2 147.0
Current expenditures	1 693.5	1 621.2	1 719.0	1 866.9	2 030.0
Capital expenditures	75.6	56.1	91.0	105.0	117.0
% of GDP	4.7%	4.1%	4.1%	4.0%	4.0%
% of Total Expenditures	11.6%	10.2%	10.2%	10.5%	10.7%
% of Non-interest expenditures	12.2%	10.7%	10.7%	10.9%	11.0%

The solidaristic model of funded health insurance that was introduced in 1999 is today in need of development.

In order to respond to the public expectations, the following fundamental problems in healthcare need to be recognized and methods for their solution need to be sought for:

- The patients do not have at their disposal any leverage and representation to be able to actively participate in the decision-making process related to the distribution of resources and in establishing the requirements for the quality of healthcare services;
- The quality of healthcare services is subject to a constant deterioration;
- There is a chronic under-financing of hospital healthcare accompanied by an inefficient spending of the limited available resources;
- The high levels of cash payments under the counter are a categorically unacceptable practice, both from the point of view of the patients and of the doctors;
- Discontent and dissatisfaction from the status of the system on behalf of all participants in it.

Society will only be able to use advantageously the benefits of the socially-oriented health insurance under the conditions of an intensive economic development, which will be able to support a significant increase of the volume of financial resources accumulated for the development of the delivery of healthcare to the citizens. This will be made possible as a result of the sufficiently high level of personal income, which will secure a sustainable source of revenues for the health insurance system on the one hand, while on the other hand it will create an efficient structure of the labour market that will be in a position to ensure a high contribution basis. No less important for the efficiency of health insurance are also the adequate healthcare infrastructure, including a perfectly functioning integrated information system, as well as the incremental development of the required administrative capacity for health insurance.

From the point of view of the imminent accession to the European Union, it is necessary to determine the steps and the specific measures that need to be undertaken for the gradual improvement of the Bulgarian healthcare's system:

- The patient must be put in the focus of the system, obtaining the right to an active selection of the provision of services, the right to public control, information, representation and protection, participation in the decision-making processes related to the negotiation of the public resources' utilization.
- The development of the health insurance model is linked to the introduction of competition; at the first stage, it will be competition between the providers of medical care, while at a later stage there will be competition between health insurance funds.
- The financial resources of the healthcare system will grow gradually together with the growth of GDP, both on account of the share of public funding and through regulating the informal private resources put aside by the population in order to pay for healthcare services.
- With the objective to eliminate informal payments in hospital healthcare, a mechanism of shared additional payments (co-payments) for hospital healthcare services needs to be introduced. The hospital healthcare funding methods will be further developed together with the implementation of diagnostically related groups.

- In order to restrain the growth of the artificially induced demand for healthcare services, a transformation will be undertaken with respect to the structure of the parameters and of the participants in the negotiations on the National Framework Contract.
- The financial participation of the State will be directed towards ensuring the equal treatment of the high-risk groups of the population without violating the model's functioning principles.

3.5. Social Security, Social Assistance and Welfare

Table No. 18. *Distribution of expenditures for social security, social assistance and welfare (2004-2008)*

CONSOLIDATED STATE BUDGET		2004	2005	2006	2007	2008
	BGN mln.	Reported	Program	Current prices	Current prices	Current prices
V. SOCIAL SECURITY + RESERVE		5 238.4	5 596.5	6 047.6	6 431.0	6 766.2
% of GDP		13.8%	13.5%	13.5%	13.2%	12.8%
% of Total Expenditures		34.5%	34.0%	34.2%	34.1%	33.6%
% of Non-interest expenditures		36.1%	35.7%	35.7%	35.5%	34.7%
V. SOCIAL SECURITY, SOCIAL ASSISTANCE AND WELFARE		5 238.4	5 511.5	5 987.6	6 371.0	6 706.2
Current expenditures		5 198.6	5 491.9	5 965.6	6 345.0	6 678.2
Capital expenditures		39.8	19.6	22.0	26.0	28.0
% of GDP		13.8%	13.3%	13.4%	13.1%	12.6%
% of Total Expenditures		34.5%	33.5%	33.9%	33.8%	33.3%
% of Non-interest expenditures		36.1%	35.2%	35.4%	35.2%	34.4%
A. PENSIONS + RESERVE		3 544.3	3 760.1	4 176.2	4 484.0	4 794.2
% of GDP		9.3%	9.1%	9.4%	9.2%	9.0%
% of Total Expenditures		23.3%	22.8%	23.6%	23.8%	23.8%
% of Non-interest expenditures		24.4%	24.0%	24.7%	24.8%	24.6%
A. PENSIONS		3 544.3	3 700.1	4 116.2	4 424.0	4 734.2
incl. support		27.4	32.0	35.0	38.0	39.2
% of GDP		9.3%	8.9%	9.2%	9.1%	8.9%
% of Total Expenditures		23.3%	22.5%	23.3%	23.5%	23.5%
% of Non-interest expenditures		24.4%	23.6%	24.3%	24.4%	24.3%
B. SOCIAL ASSISTANCE AND INDEMNITIES + RESERVE		1 162.9	1 512.0	1 530.4	1 577.9	1 588.0
% of GDP		3.1%	3.7%	3.4%	3.2%	3.0%
% of Total Expenditures		7.7%	9.2%	8.7%	8.4%	7.9%
% of Non-interest expenditures		8.0%	9.7%	9.0%	8.7%	8.2%
B. SOCIAL ASSISTANCE AND INDEMNITIES		1 162.9	1 487.0	1 530.4	1 577.9	1 588.0
incl. support		1.1	0.9	1.0	1.1	1.5
% of GDP		3.1%	3.6%	3.4%	3.2%	3.0%
% of Total Expenditures		7.7%	9.0%	8.7%	8.4%	7.9%
% of Non-interest expenditures		8.0%	9.5%	9.0%	8.7%	8.2%
C. PROGRAMS, ACTIVITIES AND SERVICES RELATED TO SOCIAL SECURITY, ASSISTANCE AND EMPLOYMENT		531.2	324.5	341.0	369.1	384.0
Current expenditures		491.4	304.9	319.0	343.1	356.0
Capital expenditures		39.8	19.6	22.0	26.0	28.0
% of GDP		1.4%	0.8%	0.8%	0.8%	0.7%
% of Total Expenditures		3.5%	2.0%	1.9%	2.0%	1.9%
% of Non-interest expenditures		3.7%	2.1%	2.0%	2.0%	2.0%

The goal of **the employment policies and programs** during the period 2006 – 2008 consists in the increase of employment and in sustaining the reduction of unemployment through the implementation of actions aimed at improving the social and economic environment and the application of active labour market programs and measures. The objective is to attain the social and

economic integration of the disadvantaged unemployed through increasing their employability, providing subsidized employment and improving the quality of labour market services. The applied measures and programs within the framework of the active labour market policies are targeted at the registered unemployed, towards a part of the employed people and towards employers.

The industrial relations policy for the period of the projection is directly related to the implementation of programs targeted at the protection of the health, the working capacity and the life of the workers; at the introduction of modern control forms; at the refinement of the methods and at expanding the infrastructure of units for the provision of advice and assistance to employers, etc.; at the prevention and limitation of collective labour conflicts.

The goal of the social assistance policies and programs consists in guaranteeing social protection for the vulnerable groups of the population. These policies and programs will secure the social protection of the persons and the families that because of reasons of health, age, social circumstances and other causes beyond their own control are unable to ensure the satisfaction of their basic necessities. It is necessary to achieve a better targeting of social assistance benefits, to ensure the prevention of social isolation through the provision of social services and to create conditions for the social integration of the groups of the population at risk.

The program for the provision of social assistance uses a differentiated approach for the payment of social benefits according to the Law on social assistance and the Regulations for the application of the Law on social assistance. The program is being implemented through the provision of monthly, onetime and fixed-purpose benefits after an assessment of the income, the property and the health status, the family circumstances and the employment of the assisted persons and households who are in a most disadvantaged social situation. The poorest families are assisted with monthly benefits, while the fixed-purpose and the onetime benefits are intended to support the persons and the families in the coverage of specific needs. Special attention is paid to the specific social work and the assessment of each and every individual case with view to produce an objective appraisal of the social, property and health status of the assisted persons and families.

The program for the provision of assistance to families with children is aimed at providing support to pregnant women and families with children and its objective is the provision of assistance to the families in the upbringing of their children in a family environment, as well as the encouragement of school attendance. The execution of the program is governed by the Law on family benefits for children. The program is being implemented through the provision of benefits for pregnant women, onetime benefits for the birth of a child, monthly benefits for children until the completion of their secondary education, but not after the age of 20, fixed-purpose benefits for students and monthly benefits for the rearing of small children up to the age of 12 months.

The program for the provision of fixed-purpose heating benefits for the protection of people with low incomes has the objective to ensure the heating of the most severely socially disadvantaged people during the winter period, entirely offsetting the price increases for energy carriers.

During the period that is the subject matter of the projection, funds will also be earmarked for the Child Protection Program through a transition from institutional care to alternative care within a family environment, as well as for the Program for the integration of people with disabilities and for the Program for the social inclusion of other groups of the population at risk.

3.6. Housing construction, public works, public utilities and protection of the environment

Table No. 19. *Distribution of expenditures for housing construction, public works, public utilities u protection of the environment (2004-2008)*

CONSOLIDATED STATE BUDGET	2004		2005	2006	2007	2008
	BGN mln.	Reported	Program	Current prices	Current prices	Current prices
VI. HOUSING CONSTRUCTION, PUBLIC WORKS, PUBLIC UTILITIES AND PROTECTION OF THE ENVIRONMENT (A+B)		586.3	946.8	1 024.0	1 106.0	1 209.8
Current expenditures		339.2	520.7	532.0	490.0	490.8
Capital expenditures		247.1	426.1	492.0	616.0	719.0
% of GDP		1.5%	2.3%	2.3%	2.3%	2.3%
% of Total Expenditures		3.9%	5.8%	5.8%	5.9%	6.0%
% of Non-interest expenditures		4.0%	6.0%	6.0%	6.1%	6.2%
A. HOUSING CONSTRUCTION, PUBLIC WORKS, PUBLIC UTILITIES		197.8	529.3	582.0	612.0	658.3
Current expenditures		90.3	400.3	411.0	365.0	363.3
Capital expenditures		107.6	129.0	171.0	247.0	295.0
% of GDP		0.5%	1.3%	1.3%	1.3%	1.2%
% of Total Expenditures		1.3%	3.2%	3.3%	3.2%	3.3%
% of Non-interest expenditures		1.4%	3.4%	3.4%	3.4%	3.4%
B. PROTECTION OF THE ENVIRONMENT		388.4	417.5	442.0	494.0	551.5
Current expenditures		248.9	120.4	121.0	125.0	127.5
Capital expenditures		139.5	297.0	321.0	369.0	424.0
% of GDP		1.0%	1.0%	1.0%	1.0%	1.0%
% of Total Expenditures		2.6%	2.5%	2.5%	2.6%	2.7%
% of Non-interest expenditures		2.7%	2.7%	2.6%	2.7%	2.8%

The objectives and the priorities of the housing construction, public works and public utilities policies and programs are in compliance with the priority for a balanced development of the regions. These policies and programs must ensure the efficient utilization of public investments and of the funding from the pre-accession instruments of the European Union during the period of 2007 and from the European Fund for Regional Development (EFRD) during the period of 2007 – 2008. The growth of capital expenditures and of the larger part of operational costs is due to the increased foreign financing and co-financing under governmental investment loans. The funding under this heading will be utilized for the creation of favourable conditions for a sustainable and balanced regional development, for the encouragement of the decentralization of state governance, for the efficient use of the pre-accession instruments for social and economic cohesion, for the harmonization of the legislative framework with the Acquis Communautaire requirements and for the building of administrative capacity related to the execution of assumed commitments. Considerable amounts of funds will be directed also towards the creation of conditions for an efficient investment process in the sphere of public works, for the completion and the maintenance of water supply systems, and for the road infrastructure. The process of refinement and improvement of the management and disposal of state-owned real estate properties will continue, as well as the creation and the maintenance of the Cadastre and the Property Register, establishing appropriate conditions for the maintenance of residential buildings and encouraging the construction of affordable housing. The provision of funds for the implementation of pilot projects for the refurbishment and renewal of housing blocks is envisaged in execution of the National Program for the Renewal of Residential Buildings in the Republic of Bulgaria.

The policies and the programs aimed at the **development and the protection of the environment** reflect up to a considerable extent the commitments of the country related to the imminent accession to the European Union. The State Budget expenditures are predominantly intended for the co-financing of projects in the environmental sector, both with respect to the accession funds of the EU and with respect to the EU funds after the accession of the country to the Union. The funding under this heading will be targeted at the improvement of water and waste management, for the

protection of the atmospheric air's purity, for safeguarding the biological diversity, for the management of dangerous chemical compounds and products, for the procurement of software products and for public awareness campaigns, for integrated pollution prevention and control measures, for the management of climate change prevention activities, for the protection of the mineral wealth and soil resources, for the prevention and the elimination of the consequences of landslides, erosion and abrasive processes.

The expenditures related to the protection of the environment will be paid through the budget of the Ministry of environment and waters and the budget of the Ministry of regional development and public works, through the budgets of the municipalities and the Central State Budget, and through the Enterprise for the Management of Environmental Protection Activities.

3.7. Recreation, culture and religious activities

Table No.20: Distribution of expenditures for recreation, culture, sports, tourism and religious activities (2004-2008)

CONSOLIDATED STATE BUDGET	2004		2005	2006	2007	2008
	BGN mln.	Reported	Program	Current prices	Current prices	Current prices
VII. RECREATION, CULTURE, RELIGIOUS ACTIVITIES		303.7	286.1	311.0	318.3	335.6
Current expenditures		265.6	268.0	286.9	292.3	307.0
Capital expenditures		38.2	18.2	24.1	26.0	28.6
% of GDP		0.8%	0.7%	0.7%	0.7%	0.6%
% of Total Expenditures		2.0%	1.7%	1.8%	1.7%	1.7%
% of non-interest expenditures		2.1%	1.8%	1.8%	1.8%	1.7%
A. RECREATION		9.2	6.5	9.1	9.2	8.8
Current expenditures		7.8	6.3	8.0	8.1	7.4
Capital expenditures		1.4	0.2	1.1	1.1	1.4
% of GDP		0.0%	0.0%	0.0%	0.0%	0.0%
% of Total Expenditures		0.1%	0.0%	0.1%	0.0%	0.0%
% of Non-interest expenditures		0.1%	0.0%	0.1%	0.1%	0.0%
B. PHYSICAL CULTURE AND SPORTS		24.5	10.3	16.2	16.4	17.7
Current expenditures		23.3	9.1	15.0	15.2	16.5
Capital expenditures		1.3	1.2	1.2	1.2	1.2
% of GDP		0.1%	0.0%	0.0%	0.0%	0.0%
% of Total Expenditures		0.2%	0.1%	0.1%	0.1%	0.1%
% of Non-interest expenditures		0.2%	0.1%	0.1%	0.1%	0.1%
C. TOURISM		11.3	7.5	12.8	13.3	14.0
Current expenditures		11.0	7.1	12.0	12.5	13.0
Capital expenditures		0.4	0.4	0.8	0.8	1.0
% of GDP		0.0%	0.0%	0.0%	0.0%	0.0%
% of Total Expenditures		0.1%	0.0%	0.1%	0.1%	0.1%
% of Non-interest expenditures		0.1%	0.0%	0.1%	0.1%	0.1%
D. CULTURE		257.1	259.2	270.0	276.4	292.0
Current expenditures		221.9	242.7	249.0	253.5	267.0
Capital expenditures		35.1	16.4	21.0	22.9	25.0
% of GDP		0.7%	0.6%	0.6%	0.6%	0.6%
% of Total Expenditures		1.7%	1.6%	1.5%	1.5%	1.4%
% of Non-interest expenditures		1.8%	1.7%	1.6%	1.5%	1.5%
E. RELIGIOUS ACTIVITIES		1.6	2.7	2.9	3.0	3.2
Current expenditures		1.6	2.7	2.9	3.0	3.2
Capital expenditures						
% of GDP		0.00%	0.01%	0.01%	0.01%	0.01%
% of Total Expenditures		0.01%	0.02%	0.02%	0.02%	0.02%

The main priorities of the policies pursued in the sphere of culture have the following objectives: popularization of Bulgarian cultural values abroad, providing on a competition basis assistance to projects that are significant for Bulgarian culture; development and dissemination of the theatrical and operatic arts, of the musical and dancing arts, of the national movie picture production; for protecting, conserving and exhibiting the material artifacts of Bulgarian cultural heritage in museums, art galleries and ethnographic complexes; for the collection, preservation and usage of the National library fund; for book publishing; for bilateral cultural cooperation projects; for the support of festivals, competitions and other events of national importance that have been included in the cultural calendar; for the conservation and restoration of the immovable monuments of culture, etc.

Tourism is one of the priority sectors of our economy. The economic effectiveness of international tourism is on a constant rise; therefore, the role of the sector for the growth of the economy is in a steady expansion.

The Government’s policy in the sphere of tourism is targeted at the creation of legislative, organizational and economic foundations for the formation of a modern competitive tourist industry. In this connection, efforts are being made in the following directions: sustainable development and improvement of the quality of tourist products and of the infrastructure; active support of initiatives in this area and encouragement for the development of partner projects; increasing the competitiveness of Bulgarian tourism and advertising the country as a tourist destination by means of creating advertisements and information materials; building up and development of a national tourist information system; participation in international tourism exhibitions and exchanges. A priority of the policies in the sphere of tourism is the preservation of the growth rates for summer (sea beaches) and winter tourism, while, on the other hand, particular importance is being attached to the development and establishment of new tourist products on the market – cultural and historic culture tourism, environmental tourism, rural tourism, hunting, wine tourism.

The main directions of the **physical culture and sports policy** are as follows: creation of sustainable mechanisms for the development of youth as the social capital of the country; development of physical education, sports and social tourism; strengthening and enhancing the positions of Bulgaria at world elite sports level; reconstruction and modernization of sporting sites and facilities in compliance with the requirements of the respective international standards and creation of conditions for access of the disabled to the sporting facilities.

The State assists and encourages the registered **religious denominations** in the country in the exercise of their religious, social, educational and curative activities.

3.8. Economic activities and services

Table No. 21: *Distribution of expenditures for economic activities and services (2004-2008)*

CONSOLIDATED STATE BUDGET	2004		2005	2006	2007	2008
	BGN mln.	Reported	Program	Current prices	Current prices	Current prices
VIII. ECONOMIC ACTIVITIES AND SERVICES + RESERVE	1 838.5	1 786.4	1 963.3	2 032.3	2 291.8	
% of GDP	4.8%	4.3%	4.4%	4.2%	4.3%	
% of Total Expenditures	12.1%	10.9%	11.1%	10.8%	11.4%	
% of Non-interest expenditures	12.7%	11.4%	11.6%	11.2%	11.8%	

VIII. ECONOMIC ACTIVITIES AND SERVICES	1 838.5	1 761.4	1 913.3	1 976.3	2 231.8
Current expenditures	1 188.7	1 053.9	1 100.9	1 088.7	1 135.4
Capital expenditures	649.8	707.5	812.4	887.6	1 096.4
% of GDP	4.8%	4.3%	4.3%	4.1%	4.2%
% of Total Expenditures	12.1%	10.7%	10.8%	10.5%	11.1%
% of Non-interest expenditures	12.7%	11.2%	11.3%	10.9%	11.5%
A. MINING, FUELS AND ENERGY	41.3	24.9	28.0	32.0	36.0
Current expenditures	39.3	16.3	19.0	20.0	21.0
Capital expenditures	2.0	8.6	9.0	12.0	15.0
% of GDP	0.1%	0.1%	0.1%	0.1%	0.1%
% of Total Expenditures	0.3%	0.2%	0.2%	0.2%	0.2%
% of Non-interest expenditures	0.3%	0.2%	0.2%	0.2%	0.2%
B. AGRICULTURE, FORESTRY, HUNTING AND FISHING	382.2	543.7	594.0	634.9	750.0
Current expenditures	366.6	432.1	455.0	493.0	571.0
Capital expenditures	15.6	111.6	139.0	141.9	179.0
% of GDP	1.0%	1.3%	1.3%	1.3%	1.4%
% of Total Expenditures	2.5%	3.3%	3.4%	3.4%	3.7%
% of Non-interest expenditures	2.6%	3.5%	3.5%	3.5%	3.9%
C. TRANSPORT AND TELECOMMUNICATIONS	774.7	953.3	1 049.2	1 099.5	1 232.0
Current expenditures	465.8	374.0	395.0	376.0	343.0
Capital expenditures	308.9	579.3	654.2	723.5	889.0
% of GDP	2.0%	2.3%	2.3%	2.3%	2.3%
% of Total Expenditures	5.1%	5.8%	5.9%	5.8%	6.1%
% of Non-interest expenditures	5.3%	6.1%	6.2%	6.1%	6.3%
D. INDUSTRY AND CONSTRUCTION	2.4	3.0	3.1	2.1	2.5
Current expenditures	2.4	2.8	2.9	1.9	1.9
Capital expenditures	0.1	0.2	0.2	0.2	0.6
% of GDP	0.0%	0.0%	0.0%	0.0%	0.0%
% of Total Expenditures	0.0%	0.0%	0.0%	0.0%	0.0%
% of Non-interest expenditures	0.0%	0.0%	0.0%	0.0%	0.0%
E. Other economic activities	637.7	236.5	239.0	207.8	211.3
Current expenditures	314.6	228.7	229.0	197.8	198.5
Capital expenditures	323.1	7.8	10.0	10.0	12.8
% of GDP	1.7%	0.6%	0.5%	0.4%	0.4%
% of Total Expenditures	4.2%	1.4%	1.4%	1.1%	1.0%
% of Non-interest expenditures	4.4%	1.5%	1.4%	1.1%	1.1%

The promotion of sustainable economic development is a fundamental priority of the economic policy pursued. Having set the objective to attain a strong and sustainable economic growth during 2006 - 2008, it is necessary to stimulate the fundamental factors for the implementation of this objective and investments are precisely such a factor. The essential challenging objectives are linked to the following factors:

- the volume and the growth rate of "greenfield" foreign investments and of those investments, which are directed towards existing enterprises after the completion of privatization;
- the attraction of investments to high-technology industries and services (science, education, information and communication technologies, other high added-value industries) that require in addition the presence of highly qualified human resources.

One of the essential mechanisms to improve the investment environment in Bulgaria is the refinement of the regulatory framework that establishes the framework for the exercise of business activities together with the optimization of the administrative services delivered by the central governmental agencies and the local authorities. The provided support will be targeted at new

investment projects intended to expand the national industrial infrastructure and at enabling an intensification of the foreign investment flows.

The energy sector

The policies and programs in the sphere of energy output and consumption during the period 2006-2008 are mainly related to the implementation of the medium-term objectives set up by the National Economic Development Plan. The predominant part of the funding under this heading will be utilized for the development of the energy sector in order to secure the provision of energy and energy resources to the population and the economy. As a tool for the attainment of this objective, the development and the implementation of programs for a functioning energy sector and energy markets are envisaged; of programs for the control and development of nuclear energy production; programs for the development of renewable energy sources and for the energy sector control. Funding will also be provided for the implementation of a policy for the efficient utilization of energy and energy resources by means of developing an energy efficiency program and a program for enhancing the public energy saving culture and awareness. In order to mitigate the impact of energy sector activities on the environment, an environmental protection policy will be put in place with respect to all energy sector activities. The instruments for the implementation of this policy will consist in the application of programs for control of the decommissioning of nuclear power production facilities; for the management of nuclear waste disposal; for the rehabilitation and the restoration of the environmental damages caused by the production of energy and energy resources; of programs for the implementation of emission reduction projects related to specific atmospheric pollutants from large-scale combustion installations.

Agriculture

Agriculture is the main source of income for more than 25 percent of the Bulgarian population. Agriculture is an important factor for the employment situation in the country and has a fundamental social and economic importance. The role of the state in the sphere of agriculture, forestry and rural areas consists in providing support to agricultural producers by means of economic, structural and organizational measures, scientific and information support, through the implementation of programs for the improvement of their qualification and for the facilitation of the formation of alliances of agricultural producers according to sectoral, functional and regional principles. The Government's policy is aimed at the creation of prerequisites for the presence of competition and functioning markets, while the direct involvement and financing of this sector by the state should be at a minimum level. In respect of our relationships with the European Union in this sphere as of the present moment, funding in the sectors of agriculture and fisheries is provided from two EU funds – from the European Agricultural Guidance and Guarantee Fund (EAGGF) and from the Financial Instrument for Fisheries Guidance (FIFG), while as of the present moment, the “Orientation” sections of the EAGGF and FIFG form actually a part of the EU Structural Funds. Their separation from the Structural Funds is envisaged after the adoption of new financing regulations for the Common Agricultural Policy (to be applied as of January 1, 2007).

The fundamental objective of the Government's agricultural policy is the transformation of agriculture into an attractive and profitable occupation, while the villages and small towns in rural areas should become an attractive place for living and creating one's own business that would be appropriate for the specific conditions in Bulgaria and that would be in compliance with the requirements of the Common agricultural policy of the European Union.

A main priority here is the sector's preparation for EU accession, which requires the synchronization of Bulgarian legislation with the *Acquis Communautaire*, as well as the unification of presently valid standards. The rapid harmonization of Bulgarian legislation with that of the

European Union entails stringent requirements that cannot be satisfied without a substantial improvement of the condition of the farms. The transformation of Bulgarian agriculture into a competitive export-oriented economic branch necessitates the rationalization of production and institutional structures and their adaptation to the financial assistance principles and methodologies envisaged by the Common agricultural policy.

The main objectives and priorities of the Government's policy in the sphere of agriculture are aimed at the attainment of the following:

- Promotion of competitiveness and improvement of the efficiency of agricultural production;
- Improvement of the quality of agricultural products;
- Sustainable development of agriculture and of rural regions, including activities related to the protection of the environment and to the rational, reasonable and sustainable utilization of natural resources, preservation of the beauty and the specific character of rural areas, rational protection and management of forests, etc.
- Development of the production of agricultural products in regions with deteriorated social and economic characteristics or with unfavourable natural conditions;
- Improvement of the productive infrastructure of agricultural regions, creation of conditions for increasing the volume of incomes of agricultural producers;
- Harmonization of the Bulgarian legislation in the field of agriculture, veterinary and phytosanitary control with the Acquis Communautaire and preparation for the systematic introduction and application of the funding mechanisms of the Common agricultural policy by sectors and product groups;
- Bringing administrative structures and procedures in line with the EU membership requirements;
- Creation of an organizational structure that will be in a position to ensure the full utilization of legislative mechanisms with the objective to build up the co-operation with European Union within the general framework of the Accession Partnership.

Support in the sphere of investments is one of the most important instruments for the acceleration of the agricultural sector's adaptation with a view to assist agricultural producers in achieving satisfactory living and work standards, improving the quality of their products and their profitability. The investment policy in the agricultural sector needs to mobilize and efficiently integrate the utilization of all financial sources with the objective to attain the European standards of production and trade in the field of agriculture, forestry and rural regions. Investments must contribute to the encouragement and motivation of medium-sized commercially oriented agricultural businesses of young farmers who produce field crops or animal products for the market, for direct sales, for processing or for certain sectors that have a strategic importance for Bulgaria.

The main tool for the provision of state assistance to agriculture is the "Agriculture" State Fund whose objective is the implementation of flexible and efficient governmental policies for the subsidization and provision of loans to agricultural producers. There is an integrated model of financial assistance for agriculture and rural areas, which is applied through a combination of two types of assistance sources – domestic and external assistance – with the parallel application of three types of financial instruments -- investment loans, capital subsidization and current subsidies. State assistance throughout the period 2006 – 2008 will be implemented in compliance with the Law on Assistance to Agricultural Producers and in line with the principles set up by the "Strategy for financial assistance to the development of agriculture and rural areas during the period up to the accession of the country to the European Union", as well as in conformity with the guidelines for the provision of state assistance according to the Common agricultural policy. The financing sources of the "Agriculture" State Fund are as follows:

- an annual subsidy from the State Budget;

- a percentage of the insurance premiums of insurance companies and processing enterprises;
- funding obtained in connection with international programs, etc.

Measures have been undertaken for the facilitation of the access of agricultural producers to borrowed funds by means of the implementation of preferential credit lines and investment programs. Investment loan provision is aimed at the financing of small and medium-sized agricultural producers in order to facilitate their access to direct subsidizing and strengthening their capacity to absorb the assistance funding under the SAPARD program (the state secures the co-financing, which amounts to 25 percent of the assistance). The financial assistance and the encouragement of the investment activity of agricultural producers are the main priorities of the “Agriculture” State Fund’s policy. Another sphere of the activity of the “Agriculture” State Fund is related to the current financial assistance provided to agricultural producers.

With the objective to implement the system, which grants export subsidies for non-processed and processed agricultural products in connection with the harmonization of the national legislation with the Acquis Communautaire, the “Agriculture” State Fund issues export licenses and grants export subsidies.

Through the "Tobacco" Fund under the Ministry of Agriculture and Forestry, the State carries out the provision of state assistance for tobacco growers. Registered tobacco growers obtain free tobacco seeds, the production of which is financed by the "Tobacco" Fund. Another essential activity of the "Tobacco" Fund is the payment of premiums to tobacco growers for the quantities of raw tobacco produced and delivered. The trend is towards an increase of the absolute amount of the premium per one kilogram of tobacco, as well as towards increasing the relative weight of the premium for quality. Another form of state assistance for tobacco growers is the provision of fixed-purpose cash support, the objective being to encourage the production of high-quality raw tobacco and to create larger export resources.

Transport and telecommunications

The national policy in the field of transports is directed towards the development of the backbone transport infrastructure, towards the creation of conditions for the equal treatment of carriers on the Bulgarian, European and international markets, as well as towards the liberalization of the procedures that regulate the access to the profession and to the market. The main priorities represent the following objectives:

- Improvement of the competitiveness of the Bulgarian transportation system;
- Creation of conditions for the optimum utilization of the geographic location of Bulgaria;
- Integration of the Bulgarian transportation system within the European system;
- Equalization of the competition conditions related to the various different types of transport;
- Limitation of the negative impact of transportation activities on the environment and achieving long-term advantages for the entire society as a result of the pursuance of an environmentally friendly transportation policy;
- Improvement of the level of transport safety and reliability;
- Optimum utilization of energy resources.

The coverage of the transport infrastructure is envisaged to expand and include road, railway and internal waterway networks, sea fairways, seaports and internal waterports, airports and other interconnection points between the types of networks.

After 2007, a gradual increase of the absorbed funding from the EU Structural Funds is expected. The specific directions of these investments will be clarified with the adoption of the National development plan 2007 – 2013 and will be coordinated with the European Union. In any case, however, the veritable application of the larger scale infrastructure projects financed under European funds auspices is expected to cover the period starting from 2008. The experience acquired during the absorption of pre-accession funds justifies the making of such an assumption mainly because of the gradually increasing absorption capacity. Thus, it may be inferred that no substantial EU-financed investments in the road infrastructure should be projected for 2007 and, up to a certain extent, also for 2008.

The transport sector expects financial support from the **Cohesion Fund** during the period 2007 – 2013, while the volume of funding will be determined in accordance with the investment and infrastructural needs specific for each member-country within the following spheres:

- Trans-European transportation networks, in particular the priority projects of common European interest;
- Railway, river and sea transportation, as well as intermodal transport systems that extend beyond the trans-European networks; management of automobile and air traffic; clean urban public transport.

The coverage of the transport infrastructure is projected to include road, railway and internal waterway networks, sea fairways, seaports and internal waterports, airports and other interconnection points between the types of networks. Resources for the funding of this function may also be expected from **the European Regional Development Fund (ERDF)**. This Fund contributes to the strengthening of the economy, to the social and territorial harmonization, reducing regional discrepancies and supporting the structural development and readjustment of the regional economies, including the restructuring of industrial areas in decline.

The development of telecommunications and of the information technologies is one of the economic policy's fundamental priorities. The securing of high-quality modern communication and information services for the needs of the businesses and of the citizens is a prerequisite for the sustainable economic development of the country.

3.9. Expenditures uncategorized under other functions

Table No. 22. *Distribution of the expenditures that have not been categorized under other functions (2004-2008)*

CONSOLIDATED STATE BUDGET BGN million	2004	2005	2006	2007	2008
	Reported	Program	Current prices	Current prices	Current prices
IX. EXPENDITURES UNCATEGORIZED UNDER OTHER FUNCTIONS	748.8	1 314.3	1 164.9	1 212.1	1 179.2
Current expenditures	697.7	794.7	736.0	737.9	686.5
Capital expenditures					
Acquisition of equity, shares, participation and other financial assets (net)		100.0	135.8	150.0	160.0
Reserve	51.1	419.6	293.1	324.2	332.7
% of GDP	2.0%	3.2%	2.6%	2.5%	2.2%
% of Total Expenditures	4.9%	8.0%	6.6%	6.4%	5.8%
% of Non-interest expenditures	5.2%	8.4%	6.9%	6.7%	6.1%

The items planned under this function include interest expenditures, the net reimbursable financing granted to the “Agriculture” State Fund, the State investment loans granted to commercial

companies in their quality of end beneficiaries⁸ and the reserve for unforeseen and imperative expenditures. The reserve guarantees stability in the process of the budget's execution, while in addition it also envisages expenditures for the prevention and elimination of the consequences of natural disasters and major industrial accidents.

The net volume of State investment loans granted to commercial companies as end beneficiaries is expected to be positive (approximately BGN 42 million), while for 2007 and 2008 it will be negative in view of the fact that the disbursements under such loans are in their final stages and that in accordance with the contracts signed, the ongoing activity is the loans' repayment only.

V. DEBT AND FINANCING

1. Government debt

As of December 31, 2004, the volume of government debt and State-guaranteed liabilities was EUR 7955 million, which includes external government debt amounting to EUR 6585 million and domestic debt of EUR 1371 million. The debt to GDP ratio for the same period amounts to 40.9 percent, while in respect of external debt exclusively, this ratio is 33.8 percent. Compared to the end of 2003 and in absolute terms, the debt amount has decreased by EUR 554.6 million, while its relative proportion to the volume of GDP has shrunk by 7.5 percentage points. The main factors that have influenced the reduction of the debt are the repayments of principal amounts on government debt and State-guaranteed liabilities, the continued decline of the U.S. dollar exchange rate with respect to the main international currencies, as well as the early external debt repayment operations that have been carried out during the year. The achieved reduction of the debt to GDP ratio is due both to the reduced amount of the debt itself and to the real growth of GDP throughout the year.

As of December 31, 2004, the total volume of government debt only was EUR 7511.2 million.

Having in mind one of the fundamental objectives established by the Government Debt Management Strategy, the efforts during the last few years have been directed towards the attainment of a reduction of the external debt with a view to surmount the existing imbalance between external and domestic debt. For this purpose, the pursued policy preserved its orientation towards the maintenance of a net positive domestic financing and of a negative net external financing. Talking numbers, the share of external government debt at the end of 2004 dropped to 81.8 percent at the expense of domestic debt, which represents a reduction of approximately 4.0 percentage points when compared to 2003. Moreover, during the current year 2005, external government debt continued to show signs of positive development trends. An improvement is being witnessed in the external debt currency structure, since the proportion of the debt expressed in U.S. dollars dropped down to 32.5 percent at the end of February of this year, which represents a reduction of 7.4 percentage points when compared to the end of 2004. This reduction is fundamentally due to the increase of the debt expressed in Euro from 43.5 percent up to 48.8 percent within the same period of time. The reported transformation is a result of the regular repayments of dollar-denominated debt made, as well as a consequence of the early repayment operation for IAB-type Brady bonds carried out in January 2005. The sensitivity of the external government debt with respect to interest developments remained visible during the current year as well, which is due to the still important share of floating interest coupons (51.9 percent as of February 28, 2005). As a whole, the expected net impact of the influence of the rates of exchange and of the interest rates on the external debt will again be a consequence of the state of affairs on the international and capital and currency markets; it will reflect in particular the interest levels

⁸ Exclusively for the period 2006 -- 2008

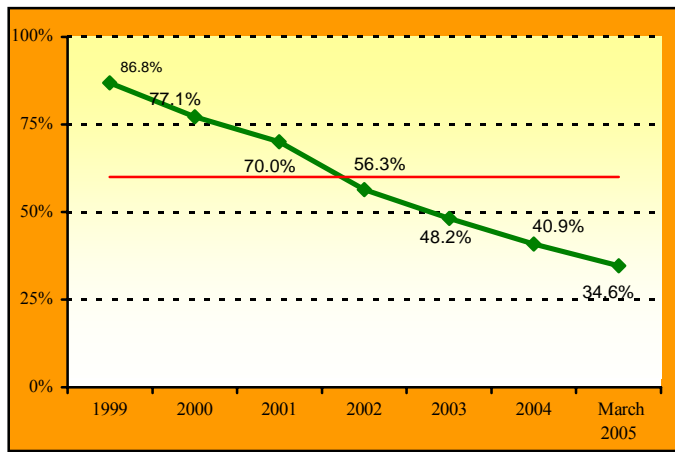
determined by the European Central Bank and by the U.S. Federal Reserve as well as the levels of the two main currencies -- the U.S. dollar and the Euro.

Domestic debt, which on February 28, 2005 amounted to BGN 2724.9 million, recorded an increase of BGN 468.2 million in absolute terms when compared to the end of 2003. Nevertheless, as a proportion of GDP, domestic debt amounts to 6.6 percent, which was its level during the previous period too (7.0 percent). As a whole, the observed improvement of the qualitative structure of the debt and of its indicative parameters continued also during the current year. Correspondingly, the maturity of government securities issued in February of the current year for budget deficit financing was 6 years and 7 months. This circumstance is a consequence of the pursued issuance policies aimed at an increased share of the issuances of medium-term and long-term securities. The expansion of the volumes of these issuances and the accompanying lengthening of their maturities are characterized by a continuing gradual decrease of the profitability achieved at the auctions. The regular amortization of the debt denominated in U.S. dollars, the regular swaps of dollar-denominated ZUNK bonds for Euro-denominated ones, the issuance of government securities on the domestic market denominated in Euro (the reserve currency of the currency board), as well as the devaluation of the U.S. dollar against the Bulgarian Lev have led to a substantial reduction of the proportion of domestic debt denominated in dollars – from 11.3 percent in December 2003 down to 8.0 percent in February of the current year. Analogous qualitative improvements for the period in margin have been recorded also with respect to the interest-rate structure of the debt, where the proportion of fixed-income government securities has risen from 76.2 percent to 83.7 percent.

The volume of the domestic debt projected for the end of 2005 is approximately EUR 1457.2 million, while that of the external government debt is EUR 5464.0 million. The projected amount of repayments on the external debt on a consolidated basis is BGN 2409.2 million, out of which principal amounting to BGN 1903.9 million and interest in the amount of BGN 505.3 million. Repayments on the domestic debt are projected to reach BGN 998.2 million (including repayments to the Bulgarian National Bank /respectively, the IMF/), out of which principal amounting to BGN 801.3 million and interest in the amount of BGN 196.9 million. During the next three years, repayments on government debt under the consolidated budget are expected to be within the range from BGN 2000.0 million to BGN 2600.0 million. Once again, the most powerful impact on these parameters will be exercised by the international interest-rate levels, as well as by the rates of exchange of the U.S. dollar against the main currencies. The total amount of external debt for the period 2006 – 2008 is expected to decrease both in absolute and in relative terms as a result of the negative net external financing of the Central State Budget, as well as a result of the growth of GDP. At the same time, the volume of debt under the negotiated state investment loans will continue to grow - even though the growth will be slow - until the complete disbursement of the loans and the completion of the initiated investment projects.

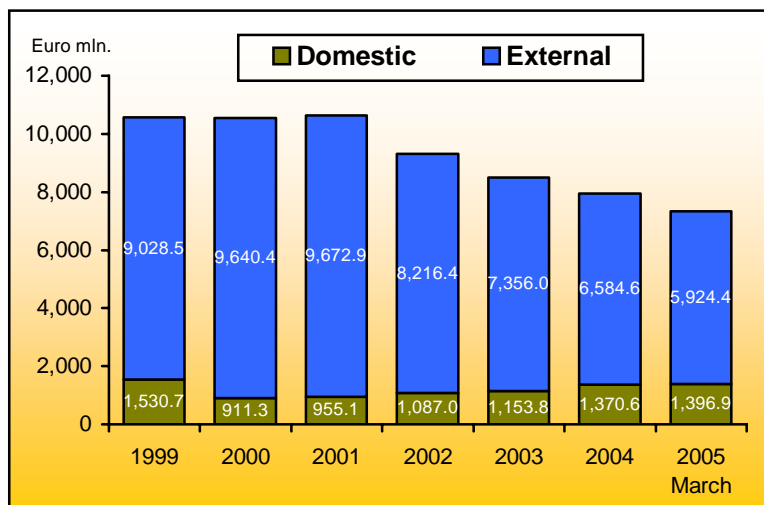
Chart No. 6. *Dynamics of government and state-guaranteed debt for the period 1999-March 2005 (% of GDP)*

Maastricht
criterion



The amount of domestic debt is expected to be influenced during the next few years by the eventual positive financing and it may be pushed towards an increase depending on the general economic and market situation.

Chart No. 7. Structure of government debt (% of total)



2. Financing

External financing within the central budget is expected to be strongly negative for the period 2006 - 2007, which is fully in compliance with the measures set up in the Government Debt Management Strategy. The net external financing of state investment loans administered under the budgets of the ministries for the same period will be positive and will be contained within the limits values of BGN 6 million and BGN 470 million. The reasons for the considerable amount of the absorptions under these loans, and in particular, in connection with the 2006 projection (BGN 532.5 million) consist in the reported delay of the start of a part of the projects and in the final dates for the completion of the disbursement of the borrowed resources that have been envisaged by the loan agreements.

On the whole, an exceptionally restrictive approach for the financing of new projects by means of external government loans and state-guaranteed loans will continue to be consistently applied.

During the period 2006 – 2008, a positive net domestic financing by means of operations with government securities is projected. As a whole, however, domestic financing will be negative in view of the amortization repayments of the debt to the Bulgarian National Bank (respectively the IMF) in the absence of new tranches. The implementation of positive net issuances of government securities during the three-year period in margin will be carried out in accordance with the factors that influence the liquidity of the domestic financial system, taking into account the preferences of the separate various investors with respect to instruments with different maturities and denominated in various currencies, as well as in accordance with the external economic and market situation. The expansion of the domestic issuances of government debt will be pursued in compliance with the yield levels achieved at the auctions for government securities and the financing needs of the State Budget. With a view to encourage savings, the sustained development of the saving bonds market for private individuals with yields slightly above the yields of regular auctions will continue.

CONCLUSION

The medium-term fiscal strategy for the period 2006 – 2008 is based on the achieved sustainable economic growth and the stable macroeconomic environment; this strategy guarantees the prudent management of public finances in the medium term. The three-year budget projection for the period 2006 – 2008 presents the main policies aimed at securing the stability of public finances. At the same time however, the fiscal policy is flexible in order to be able to cope with the possible external shocks and deviations from the program and to absorb the 2007 fiscal impact due to the EU membership. The fiscal strategy incorporates also the appropriate buffers to be activated in case of the emergence of unfavourable economic trends.

The introduced new fiscal framework for the management of public expenditures encourages the budget appropriation spending units to plan and to formulate their own strategic priorities for a more extended time horizon. The medium-term fiscal framework is based on the principles of transparency, responsibility and accountability and facilitates the long-term planning process in the budget-supported sphere. The efforts continue to maximize efficiency within the public sector in order to free additional resources for the priority sectors' development and to achieve further improvements in the public sector as a whole. This presupposes the presence of the right incentives for the budget appropriation spending units to efficiently plan and utilize their budgets and, whenever necessary, to rationalize their structures and to optimize expenditures.

It is imperative now, proceeding on the basis of the achieved economic stability and growth, to make the necessary investments and to prepare the economy for confronting the long-term

challenges related to the EU membership. The quality of public services delivered, as well as the qualitative development of the economy as a whole, depends on the infrastructure of public services and on the transport infrastructure. The low level of investments in the public sector has resulted in a pitiful state of schools, hospitals and roads, which are in need of investments for reconstruction and modernization. The long-term orientation of the public sector presumes an increase of capital expenditures rather than increasing current expenditures in order to surmount this backwardness. Taken by itself, the preservation of sustainable public finances in the medium-term is a serious challenge but it is not sufficient for a country, which is a future member of the European Union. The achieved fiscal discipline and transparency in the budget system need to be combined with a more profound and crosscutting reform in the public sector as a whole. The improvement of public services by means of sustainable investments linked to the reform and to the results is a *sine qua non* condition in order to guarantee that taxpayers should receive the quality of public services they expect and deserve, and that the limited amounts of budget resources are distributed and managed efficiently.

The refinement of the management of public expenditures through the introduction of the result-oriented program budgeting remains a priority of the budget reform. The number of ministries that compile pilot program budgets as a part of the preparation for the general introduction of the program budgeting is increasing. In 2005, the total number of first-level budget appropriation spending units that develop pilot program budgets grew to seven. The ultimate objective is to involve all ministries in the program budgeting process for the 2007 budget and to adopt the legal framework that will regulate the introduction of program budgeting as the main approach at all stages of the budgetary process – planning, compilation, adoption, execution, reporting and control.

The parameters incorporated in the medium-term fiscal framework are compatible with the indicators of the National Macroeconomic Framework and with the fiscal sustainability maintenance standards. The fiscal sustainability analysis of the public finances requires the balancing of the 2006 budget. This is in accordance with the endeavors to alleviate the future generations' debt burden and also represents a response to the external sector's imbalance. In addition, the definition of the medium-term fiscal strategy also needs to take into account the absorption of the resources provided by EU funds, which begins in 2007. The incorporation of the financial interrelationships (money flows) from and to the European Union will make an impact on the fiscal position of the country during the period in margin and will transform the budget's structure in a breakdown both by economic elements and by sectors.

A taxation rate reduction policy for direct taxes could stimulate investment activity and economic growth. Having in mind the objective to guarantee the execution of the revenue part of the budget, the highest priority is attached to the measures aimed at improving the compliance of public receivables and at reducing tax fraud (the National Revenue Agency will start its effective operations in 2006).

Taking into consideration the currency board arrangement that is operational in the country and the responsible current budgetary policy, Bulgaria is prepared to fulfill its firm commitments to observe a strict fiscal discipline and to adhere successfully to the economic and budget management rules within the framework of the Economic and Currency Union.

MINISTER:

Annex No. 2 (to Point 2)

Expenditures in constant prices under the three-year budget projection for 2006-2008

Table: Expenditures according to the consolidated fiscal program 2003-2008

CONSOLIDATED STATE BUDGET	2003	2004	2005	2006	2007	2008
	BGN mln. Reported	Reported	Program	Constant prices	Constant prices	Constant prices
Limit for the expenditures (current prices)				17 666.7	18 853.4	20 158.6
Total expenditures (constant prices)	14 068.8	15 198.9	16 461.4	17 130.2	18 024.9	19 037.0
<i>Non-interest expenditures -- total</i>	<i>13 344.9</i>	<i>14 501.5</i>	<i>15 666.8</i>	<i>16 394.2</i>	<i>17 287.0</i>	<i>18 350.5</i>
Current non-interest expenditures	12 103.6	12 945.2	13 541.3	14 032.1	14 567.1	15 249.1
Salaries and stipends	1 551.6	1 717.6	1 781.1	1 912.5	1 915.1	1 919.2
Salaries	1 506.1	1 671.5	1 735.3	1 866.8	1 867.8	1 870.8
Stipends	45.4	46.0	45.7	45.7	47.3	48.4
Social security contributions	569.8	641.6	618.9	607.5	568.4	529.9
Support	2 515.5	2 722.8	2 752.3	2 817.7	2 871.0	2 959.0
Defense and security	1 395.5	1 450.1	1 632.2	1 715.8	1 793.0	1 963.0
Subsidies - total	940.1	868.1	739.0	388.2	405.2	459.4
Subsidies	439.3	443.9	377.3	388.0	405.0	459.2
Subsidies for healthcare activities	500.8	424.2	361.7	0.2	0.2	0.2
Social assistance and welfare	5 131.1	5 545.1	6 017.8	6 590.4	7 014.4	7 418.6
Pensions	3 161.1	3 516.9	3 668.1	3 831.2	4 105.5	4 380.0
Allowances and household benefits	1 003.7	940.9	1 225.7	1 209.2	1 233.8	1 229.5
Health insurance payments	755.0	853.3	863.6	1 277.3	1 384.3	1 503.3
Other health insurance expenditures	211.3	234.0	260.4	272.7	290.8	305.8
Acquisition of equity, shares, participation and other financial assets (net)			100.0	135.8	150.0	160.0
Fixed assets	1 195.0	1 505.2	1 605.9	1 933.2	2 245.7	2 608.7
Reserve for unpredictable and structural expenditures	46.2	51.1	419.6	293.1	324.2	332.7
- structural reform and other reserves			15.0	50.0	56.0	60.0
- budget			349.1	187.6	208.2	212.7
- natural disasters	46.2	51.1	55.5	55.5	60.0	60.0
Interest	723.9	697.4	794.7	736.0	737.9	686.5
External interest	560.8	516.7	565.9	530.3	556.3	520.9
Domestic interest	163.1	180.7	228.8	205.7	181.6	165.6
Targeted level of deficit	0.9	656.4	-195.6	0.0	364.1	384.2
Reserve for second stage redistribution				536.6	828.5	1 121.6

NOTE: The data reported for 2003 and 2004 has been submitted according to the national methodology applied in the respective period

Annex No. 3 (to Point 3)

Mechanism for the transition from constant to current prices for the period 2006 – 2008

CONSOLIDATED STATE BUDGET		2005 Projected	2006				2007				2008			
REVENUES	BGN mln.		Adjust. structure, legislation	Infl.	Economic growth, etc.	Current prices	Adjust. structure, legislation	Infl.	Economic growth, etc.	Current prices	Adjust. structure, legislation	Infl.	Economic growth, etc.	Current prices
Total revenues		16 265.8	-82.7	566.8	916.8	17 666.7	148.4	629.8	2 173.3	19 217.4	109.8	598.3	3 568.8	20 542.8
Tax revenues		13 195.9	-95.7	475.1	916.8	14 492.0	-122.4	527.8	2 173.3	15 774.6	-118.6	501.4	3 568.8	17 147.5
<i>Direct taxes</i>		<i>6 432.4</i>	<i>-95.7</i>	<i>231.6</i>	<i>226.8</i>	<i>6 795.0</i>		<i>257.3</i>	<i>1 031.3</i>	<i>7 721.0</i>		<i>244.4</i>	<i>1 667.2</i>	<i>8 344.0</i>
Corporate taxes		1 001.6		36.1	117.4	1 155.0		40.1	325.3	1 367.0		38.1	493.3	1 533.0
from nonfinancial enterprises		875.9		31.5	93.4	1 000.8		35.0	261.9	1 172.8		33.3	390.9	1 300.0
from financial institutions		125.7		4.5	23.9	154.2		5.0	63.4	194.2		4.8	102.5	233.0
Natural persons income tax		1 216.6	-70.4	43.8		1 190.0		48.7	82.7	1 348.0		46.2	297.2	1 560.0
Revenues of the social security and health insurance		4 214.2	-25.3	151.7	109.4	4 450.0		168.6	623.2	5 006.0		160.1	876.7	5 251.0
Social security contributions		3 364.2	-25.3	121.1		3 460.0		134.6	131.2	3 630.0		127.8	338.0	3 830.0
Health insurance contributions (for the NHIF)		850.0		30.6	109.4	990.0		34.0	492.0	1 376.0		32.3	538.7	1 421.0
<i>Indirect taxes</i>		<i>6 421.8</i>		<i>231.2</i>	<i>630.0</i>	<i>7 283.0</i>	<i>-122.4</i>	<i>256.9</i>	<i>1 082.3</i>	<i>7 638.6</i>	<i>-118.6</i>	<i>244.0</i>	<i>1 839.3</i>	<i>8 386.5</i>
Value-added tax		4 235.0		152.5	372.6	4 760.0		169.4	655.6	5 060.0		160.9	1 144.1	5 540.0
Excise duties - total		1 946.8		70.1	228.5	2 245.3		77.9	426.7	2 451.3		74.0	695.2	2 715.9
Customs duties and customs levies		240.1		8.6	29.0	277.7	-122.4	9.6		127.3	-118.6	9.1		130.6
<i>Other taxes</i>		<i>341.6</i>		<i>12.3</i>	<i>60.1</i>	<i>414.0</i>		<i>13.7</i>	<i>59.7</i>	<i>415.0</i>		<i>13.0</i>	<i>62.4</i>	<i>417.0</i>
Non-tax revenues		2 549.8	-146.7	91.8		2 494.9	12.3	102.0		2 664.1	86.8	96.9		2 733.5
Transfers from the BNB		146.7	-2.0	5.3		150.0	27.4	5.9		180.0	37.7	5.6		190.0
Other		2 403.1	-144.8	86.5		2 344.9	-15.1	96.1		2 484.1	49.1	91.3		2 543.5
Revenues from levies		920.6	-40.0	33.1		913.8	44.6	36.8		1 002.0	49.5	35.0		1 005.0
Revenues and income from real estate		1 006.6	-128.6	36.2		914.2	-100.9	40.3		946.0	-82.9	38.3		962.0
Fines, sanctions and penalty interest		275.3	-10.2	9.9		275.0	-6.3	11.0		280.0	-0.8	10.5		285.0
Revenues from the sale of state-owned and municipal property		121.6	18.0	4.4		144.0	23.6	4.9		150.0	45.3	4.6		171.5
Revenues from concessions		29.4	-0.4	1.1		30.0	4.4	1.2		35.0	17.5	1.1		48.0
Other non-tax revenues		49.7	16.4	1.8		67.9	19.4	2.0		71.1	20.4	1.9		72.0
Grants		520.1	159.7			679.9	258.6			778.7	141.7			661.8
External grants		505.3	164.8			670.2	263.3			768.7	141.5			646.9
Domestic grants		14.8	-5.1			9.7	-4.8			10.0	0.1			14.9

EXPENDITURES BGN mln.	2005 Projected	2006					2007					2008				
		Adjust. structure, legislation	Constant prices	Inflation	Economic growth, etc.	Current prices	Adjust. structure, legislation	Constant prices	Inflation	Economic growth, etc.	Current prices	Adjust. structure, legislation	Constant prices	Inflation	Economic growth, etc.	Current prices
Total expenditures	16 461.4	668.8	17 130.2	383.2	153.3	17 666.7	1 563.5	18 024.9	629.0	199.5	18 853.4	2 575.6	19 037.0	842.5	279.2	20 158.6
<i>Non-interest expenditures -- total</i>	<i>15 666.7</i>	<i>727.5</i>	<i>16 394.2</i>	<i>383.2</i>	<i>153.3</i>	<i>16 930.7</i>	<i>1 620.3</i>	<i>17 287.0</i>	<i>629.0</i>	<i>199.5</i>	<i>18 115.5</i>	<i>2 683.8</i>	<i>18 350.5</i>	<i>842.5</i>	<i>279.2</i>	<i>19 472.1</i>
Current non-interest expenditures	13 541.2	490.8	14 032.1	383.2	153.3	14 568.6	1 025.9	14 567.1	629.0	199.5	15 395.6	1 707.8	15 249.1	842.5	279.2	16 370.7
Salaries and stipends	1 781.0	131.5	1 912.5	48.4	0.1	1 961.0	134.1	1 915.1	190.4	-1.4	2 104.1	138.2	1 919.2	379.7	6.4	2 305.4
Salaries	1 735.3	131.6	1 866.8	46.7	0.1	1 913.6	132.6	1 867.8	186.8	-1.5	2 053.1	135.6	1 870.8	374.2	6.4	2 251.4
Stipends	45.7	0.0	45.7	1.7	0.0	47.4	1.6	47.3	3.6	0.1	51.0	2.7	48.4	5.6	0.0	54.0
Social security contributions	618.9	-11.5	607.5	15.2	0.0	622.7	-50.6	568.4	56.8	-0.5	624.8	-89.0	529.9	106.0	1.8	637.7
Support	2 752.3	65.4	2 817.7	78.2	5.1	2 901.0	118.7	2 871.0	86.1	15.9	2 973.0	206.7	2 959.0	84.3	18.1	3 061.4
Defense and security	1 632.2	83.6	1 715.8	48.0	0.0	1 763.9	160.8	1 793.0	85.2	-0.2	1 878.0	330.8	1 963.0	62.0	30.0	2 055.0
Subsidies - total	739.0	-350.8	388.2	1.6	0.0	389.8	-333.8	405.2	1.8	-0.1	406.9	-279.6	459.4	1.9	0.0	461.4
Subsidies	377.3	10.7	388.0	1.6	0.0	389.6	27.7	405.0	1.8	-0.1	406.7	81.9	459.2	1.9	0.0	461.2
Subsidies for healthcare activities	361.7	-361.5	0.2			0.2	-361.5	0.2			0.2	-361.5	0.2			0.2
Social assistance and welfare	6 017.8	572.6	6 590.4	191.8	148.0	6 930.3	996.6	7 014.4	208.7	185.8	7 408.8	1 400.8	7 418.6	208.5	222.9	7 849.9
Pensions	3 668.1	163.1	3 831.2	103.4	146.6	4 081.2	437.4	4 105.5	123.2	157.3	4 386.0	711.9	4 380.0	127.0	188.0	4 695.0
Allowances and household benefits	1 225.7	-16.6	1 209.2	37.4	0.0	1 246.6	8.0	1 233.8	40.6	0.0	1 274.4	3.7	1 229.5	38.7	0.9	1 269.1
Health insurance payments	863.6	413.7	1 277.3	41.1	1.2	1 319.6	520.7	1 384.3	34.5	27.2	1 446.1	639.7	1 503.3	32.8	32.3	1 568.4
Other health insurance expenditures	260.4	12.3	272.7	9.8	0.3	282.8	30.4	290.8	10.4	1.2	302.4	45.4	305.8	9.9	1.7	317.4
Acquisition of equity, shares, participations and other financial assets and borrowed funding (net)	100.0	35.8	135.8			135.8	50.0	150.0			150.0	60.0	160.0			160.0
Fixed assets	1 605.9	327.3	1 933.2			1 933.2	639.8	2 245.7			2 245.7	1 002.8	2 608.7			2 608.7
Reserve for unpredictable and structural expenditures	419.6	-126.5	293.1			293.1	-95.4	324.2			324.2	-86.9	332.7	0.0	0.0	332.7
- structural reform and other reserves	15.0	35.0	50.0			50.0	41.0	56.0			56.0	45.0	60.0			60.0
- budget	349.1	-161.5	187.6			187.6	-140.9	208.2			208.2	-136.4	212.7	0.0	0.0	212.7
- natural disasters	55.5	0.0	55.5			55.5	4.5	60.0			60.0	4.5	60.0			60.0
Interest	794.7	-58.7	736.0			736.0	-56.8	737.9			737.9	-108.1	686.5	0.0	0.0	686.5
External interest	565.9	-35.6	530.3			530.3	-9.6	556.3			556.3	-45.0	520.9			520.9
Domestic interest	228.8	-23.1	205.7			205.7	-47.2	181.6			181.6	-63.2	165.6			165.6

NOTE: The mechanism for transition from constant prices to current prices for each of the three years from 2006 to 2008 has been developed on the basis of the 2005 program.

Three-year budget projection for the period 2006-2008 in current prices

Table: Consolidated fiscal program 2003-2008 (BGN mln.)

CONSOLIDATED STATE BUDGET BGN mln.	2003	2004	2005	2006	2007	2008
	Reported	Reported	Program	Current prices	Current prices	Current prices
Total revenues	14 069.7	15 855.4	16 265.8	17 666.7	19 217.5	20 542.8
Tax revenues	11 114.1	12 778.5	13 195.9	14 492.0	15 774.6	17 147.5
<i>Direct taxes</i>	<i>5 879.1</i>	<i>6 300.5</i>	<i>6 432.4</i>	<i>6 795.0</i>	<i>7 721.0</i>	<i>8 344.0</i>
Corporate taxes	1 085.2	972.8	1 001.6	1 155.0	1 367.0	1 533.0
from nonfinancial enterprises	952.3	853.5	875.9	1 000.8	1 172.8	1 300.0
from financial institutions	132.9	119.3	125.7	154.2	194.2	233.0
Natural persons income tax	1 140.3	1 247.5	1 216.6	1 190.0	1 348.0	1 560.0
Revenues of the social security and health insurance	3 653.6	4 080.2	4 214.2	4 450.0	5 006.0	5 251.0
Social security contributions	2 925.8	3 232.5	3 364.2	3 460.0	3 630.0	3 830.0
Health insurance contributions (for the NHIF)	727.8	847.7	850.0	990.0	1 376.0	1 421.0
<i>Indirect taxes</i>	<i>4 875.9</i>	<i>6 068.6</i>	<i>6 421.8</i>	<i>7 283.0</i>	<i>7 638.6</i>	<i>8 386.5</i>
Value-added tax	3 100.8	3 891.3	4 235.0	4 760.0	5 060.0	5 540.0
excise duties - total	1 543.9	1 884.8	1 946.8	2 245.3	2 451.3	2 715.9
Customs duties and customs levies	231.3	292.5	240.1	277.7	127.3	130.6
<i>Other taxes</i>	<i>359.1</i>	<i>409.4</i>	<i>341.6</i>	<i>414.0</i>	<i>415.0</i>	<i>417.0</i>
Non-tax revenues	2 644.3	2 622.2	2 549.8	2 494.9	2 664.1	2 733.5
Transfers from the BNB	132.6	170.9	146.7	150.0	180.0	190.0
Other	2 511.7	2 451.4	2 403.1	2 344.9	2 484.1	2 543.5
Revenues from levies	770.9	860.4	920.6	913.8	1 002.0	1 005.0
Revenues and income from real estate	1 116.0	1 022.4	1 006.6	914.2	946.0	962.0
Fines, sanctions and penalty interest	262.9	269.5	275.3	275.0	280.0	285.0
Revenues from the sale of state-owned and municipal property	249.6	190.2	121.6	144.0	150.0	171.5
Revenues from concessions	17.7	26.8	29.4	30.0	35.0	48.0
Other non-tax revenues	94.6	82.1	49.7	67.9	71.1	72.0
Grants	311.3	454.6	520.1	679.9	778.7	661.8
External grants	297.3	439.9	505.3	670.2	768.7	646.9
Domestic grants	14.0	14.8	14.8	9.7	10.0	14.9
Total expenditures	14 068.8	15 198.9	16 461.4	17 666.7	18 853.4	20 158.6
<i>Non-interest expenditures -- total</i>	<i>13 344.9</i>	<i>14 501.5</i>	<i>15 666.8</i>	<i>16 930.7</i>	<i>18 115.5</i>	<i>19 472.1</i>
Current non-interest expenditures	12 103.6	12 945.2	13 541.3	14 568.6	15 395.6	16 370.7
Salaries and stipends	1 551.6	1 717.6	1 781.1	1 961.0	2 104.1	2 305.4
Salaries	1 506.1	1 671.5	1 735.3	1 913.6	2 053.1	2 251.4
Stipends	45.4	46.0	45.7	47.4	51.0	54.0
Social security contributions	569.8	641.6	618.9	622.7	624.8	637.7
Support	2 515.5	2 722.8	2 752.3	2 901.0	2 973.0	3 061.4
Defense and security	1 395.5	1 450.1	1 632.2	1 763.9	1 878.0	2 055.0
Subsidies - total	940.1	868.1	739.0	389.8	406.9	461.4
Subsidies	439.3	443.9	377.3	389.6	406.7	461.2
Subsidies for healthcare activities	500.8	424.2	361.7	0.2	0.2	0.2
Social assistance and welfare	5 131.1	5 545.1	6 017.8	6 930.3	7 408.8	7 849.9
Pensions	3 161.1	3 516.9	3 668.1	4 081.2	4 386.0	4 695.0
Allowances and household benefits	1 003.7	940.9	1 225.7	1 246.6	1 274.4	1 269.1
Health insurance payments	755.0	853.3	863.6	1 319.6	1 446.1	1 568.4
Other health insurance expenditures	211.3	234.0	260.4	282.8	302.4	317.4

CONSOLIDATED STATE BUDGET	2003	2004	2005	2006	2007	2008
BGN mln.	Reported	Reported	Program	Current prices	Current prices	Current prices
Acquisition of equity, shares, participation and other financial assets (net)			100.0	135.8	150.0	160.0
Fixed assets	1 195.0	1 505.2	1 605.9	1 933.2	2 245.7	2 608.7
Reserve for unpredictable and structural expenditures	46.2	51.1	419.6	293.1	324.2	332.7
- structural reform and other reserves			15.0	50.0	56.0	60.0
- budget			349.1	187.6	208.2	212.7
- natural disasters	46.2	51.1	55.5	55.5	60.0	60.0
Interest	723.9	697.4	794.7	736.0	737.9	686.5
External interest	560.8	516.7	565.9	530.3	556.3	520.9
Domestic interest	163.1	180.7	228.8	205.7	181.6	165.6
Balance	0.9	656.4	-195.6	0.0	364.1	384.2

NOTES:

1. The projections for 2007 and 2008 do not include the financial relationships (flows) from and to the European Union, which will introduce modifications to the structure, both by economic elements and by functions (sectors).
2. The data reported for 2003 and 2004 are presented according to the national methodology applied during the respective period.

Table: Consolidated fiscal program 2003-2008 (% of GDP)

CONSOLIDATED STATE BUDGET in % of GDP	2003	2004	2005	2006	2007	2008
	Reported	Reported	Program	Current prices	Current Prices	Current prices
Total revenues	40.7%	41.7%	39.3%	39.6%	39.4%	38.7%
Tax revenues	32.2%	33.6%	31.9%	32.5%	32.4%	32.3%
Direct taxes	17.0%	16.6%	15.6%	15.2%	15.8%	15.7%
Corporate taxes	3.1%	2.6%	2.4%	2.6%	2.8%	2.9%
from nonfinancial enterprises	2.8%	2.2%	2.1%	2.2%	2.4%	2.5%
from financial institutions	0.4%	0.3%	0.3%	0.3%	0.4%	0.4%
Natural persons income tax	3.3%	3.3%	2.9%	2.7%	2.8%	2.9%
Revenues of the social security and health insurance	10.6%	10.7%	10.2%	10.0%	10.3%	9.9%
Social security contributions	8.5%	8.5%	8.1%	7.7%	7.4%	7.2%
Health insurance contributions (for the NHIF)	2.1%	2.2%	2.1%	2.2%	2.8%	2.7%
Indirect taxes	14.1%	16.0%	15.5%	16.3%	15.7%	15.8%
Value-added tax	9.0%	10.2%	10.2%	10.7%	10.4%	10.4%
excise duties - total	4.5%	5.0%	4.7%	5.0%	5.0%	5.1%
Customs duties and customs levies	0.7%	0.8%	0.6%	0.6%	0.3%	0.2%
Other taxes	1.0%	1.1%	0.8%	0.9%	0.9%	0.8%
Non-tax revenues	7.7%	6.9%	6.2%	5.6%	5.5%	5.2%
Transfers from the BNB	0.4%	0.4%	0.4%	0.3%	0.4%	0.4%
Other	7.3%	6.4%	5.8%	5.3%	5.1%	4.8%
Revenues from levies	2.2%	2.3%	2.2%	2.0%	2.1%	1.9%
Revenues and income from real estate	3.2%	2.7%	2.4%	2.0%	1.9%	1.8%
Fines, sanctions and penalty interest	0.8%	0.7%	0.7%	0.6%	0.6%	0.5%
Revenues from the sale of state-owned and municipal property	0.7%	0.5%	0.3%	0.3%	0.3%	0.3%
Revenues from concessions	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Other non-tax revenues	0.3%	0.2%	0.1%	0.2%	0.1%	0.1%
Grants	0.9%	1.2%	1.3%	1.5%	1.6%	1.2%
external grants	0.9%	1.2%	1.2%	1.5%	1.6%	1.2%
domestic grants	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total expenditures	40.7%	40.0%	39.8%	39.6%	38.7%	38.0%
Non-interest expenditures -- total	38.6%	38.2%	37.9%	37.9%	37.2%	36.7%
Current non-interest expenditures	35.0%	34.1%	32.8%	32.6%	31.6%	30.9%
Salaries and stipends	4.5%	4.5%	4.3%	4.4%	4.3%	4.3%
Salaries	4.4%	4.4%	4.2%	4.3%	4.2%	4.2%
Stipends	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Social security contributions	1.6%	1.7%	1.5%	1.4%	1.3%	1.2%
Support	7.3%	7.2%	6.7%	6.5%	6.1%	5.8%
Defense and security	4.0%	3.8%	3.9%	4.0%	3.9%	3.88%
Subsidies - total	2.7%	2.3%	1.8%	0.9%	0.8%	0.9%
Subsidies	1.3%	1.2%	0.9%	0.9%	0.8%	0.9%
Subsidies for healthcare activities	1.4%	1.1%	0.9%	0.0%	0.0%	0.0%
Social assistance and welfare	14.9%	14.6%	14.6%	15.5%	15.2%	14.8%
Pensions	9.2%	9.3%	8.9%	9.1%	9.0%	8.9%
Allowances and household benefits	2.9%	2.5%	3.0%	2.8%	2.6%	2.4%
Health insurance payments	2.2%	2.2%	2.1%	3.0%	3.0%	3.0%
Other health insurance expenditures	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%
Acquisition of equity, shares, participation and other financial assets (net)			0.2%	0.3%	0.3%	0.3%
Fixed assets	3.5%	4.0%	3.9%	4.3%	4.6%	4.9%
Reserve for unpredictable and structural expenditures	0.1%	0.1%	1.0%	0.7%	0.7%	0.6%
- structural reform and other reserves			0.0%	0.1%	0.1%	0.1%
- budget			0.8%	0.4%	0.4%	0.4%
- natural disasters	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%

CONSOLIDATED STATE BUDGET in % of GDP	2003	2004	2005	2006	2007	2008
	Reported	Reported	Program	Current prices	Current prices	Current prices
<i>Interest</i>	<i>2.1%</i>	<i>1.8%</i>	<i>1.9%</i>	<i>1.6%</i>	<i>1.5%</i>	<i>1.3%</i>
External interest	1.6%	1.4%	1.4%	1.2%	1.1%	1.0%
Domestic interest	0.5%	0.5%	0.6%	0.5%	0.4%	0.3%
Balance	0.0%	1.7%	-0.5%	0.0%	0.7%	0.7%
GROSS DOMESTIC PRODUCT	34 546.6	38 008.4	41 343.0	44 655.4	48 761.5	53 021.2

Table: Distribution of the expenditures by functions 2003-2008

CONSOLIDATED STATE BUDGET BGN mln.	2003	2004	2005	2006	2007	2008
	Reported	Reported	Program	Current prices	Current prices	Current prices
DISTRIBUTION OF THE EXPENDITURES BY FUNCTIONS	14 068.5	15 198.7	16 461.5	17 666.7	18 853.4	20 158.6
Current expenditures	12 827.3	13 642.4	14 335.9	15 304.6	16 133.5	17 057.2
Capital expenditures	1 195.0	1 505.2	1 606.0	1 933.2	2 245.7	2 608.7
Acquisition of equity, shares, participation and other financial assets (net)			100.0	135.8	150.0	160.0
Reserve	46.2	51.1	419.6	293.1	324.2	332.7
% of GDP	40.7%	40.0%	39.8%	39.6%	38.7%	38.0%
% of Total Expenditures	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
% of Non-interest expenditures	105.4%	104.8%	105.1%	104.3%	104.1%	103.5%
Non-interest expenditures -- total	13 344.6	14 501.3	15 666.8	16 930.7	18 115.5	19 472.1
Current expenditures	12 103.4	12 945.0	13 541.2	14 568.6	15 395.6	16 370.7
Capital expenditures	1 195.0	1 505.2	1 606.0	1 933.2	2 245.7	2 608.7
Acquisition of equity, shares, participation and other financial assets (net)			100.0	135.8	150.0	160.0
Reserve	46.2	51.1	419.6	293.1	324.2	332.7
% of GDP	38.6%	38.2%	37.9%	37.9%	37.2%	36.7%
% of Total Expenditures	94.9%	95.4%	95.2%	95.8%	96.1%	96.6%
% of Non-interest expenditures	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
I. GENERAL GOVERNMENTAL SERVICES - TOTAL (A+B+C) + RESERVE	1 097.8	1 115.2	1 232.0	1 291.0	1 374.1	1 419.9
% of GDP	3.2%	2.9%	3.0%	2.9%	2.8%	2.7%
% of Total Expenditures	7.8%	7.3%	7.5%	7.3%	7.3%	7.0%
% of Non-interest expenditures	8.2%	7.7%	7.9%	7.6%	7.6%	7.3%
I. GENERAL GOVERNMENTAL SERVICES - TOTAL (A+B+C)	1 097.8	1 115.2	1 187.0	1 276.0	1 364.1	1 409.9
Current expenditures	942.6	968.8	1 017.3	1 084.3	1 166.5	1 214.3
Capital expenditures	155.2	146.4	169.7	191.7	197.6	195.6
% of GDP	3.2%	2.9%	2.9%	2.9%	2.8%	2.7%
% of Total Expenditures	7.8%	7.3%	7.2%	7.2%	7.2%	7.0%
% of Non-interest expenditures	8.2%	7.7%	7.6%	7.5%	7.5%	7.2%
A. EXECUTIVE AND LEGISLATIVE BODIES	823.9	918.8	996.4	1 074.4	1 149.5	1 168.3
Current expenditures	674.2	780.1	832.1	889.3	961.5	983.3
Capital expenditures	149.7	138.6	164.3	185.1	188.0	185.0
% of GDP	2.4%	2.4%	2.4%	2.4%	2.4%	2.2%
% of Total Expenditures	5.9%	6.0%	6.1%	6.1%	6.1%	5.8%
% of Non-interest expenditures	6.2%	6.3%	6.4%	6.3%	6.3%	6.0%
B. GENERAL SERVICES	154.3	66.7	57.9	62.5	68.5	71.5
Current expenditures	153.2	64.9	55.8	60.0	64.0	66.0
Capital expenditures	1.1	1.8	2.1	2.5	4.5	5.5
% of GDP	0.4%	0.2%	0.1%	0.1%	0.1%	0.1%
% of Total Expenditures	1.1%	0.4%	0.4%	0.4%	0.4%	0.4%
% of Non-interest expenditures	1.2%	0.5%	0.4%	0.4%	0.4%	0.4%
C. SCIENCE + RESERVE	119.6	129.7	177.7	154.1	156.1	180.1
% of GDP	0.3%	0.3%	0.4%	0.3%	0.3%	0.3%
% of Total Expenditures	0.9%	0.9%	1.1%	0.9%	0.8%	0.9%
% of Non-interest expenditures	0.9%	0.9%	1.1%	0.9%	0.9%	0.9%
C. SCIENCE	119.6	129.7	132.7	139.1	146.1	170.1
Current expenditures	115.2	123.7	129.4	135.0	141.0	165.0
Capital expenditures	4.4	6.0	3.3	4.1	5.1	5.1
% of GDP	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%

% of Total Expenditures	0.9%	0.9%	0.8%	0.8%	0.8%	0.8%
% of Non-interest expenditures	0.9%	0.9%	0.8%	0.8%	0.8%	0.9%
CONSOLIDATED STATE BUDGET						
BGN mln.	2003	2004	2005	2006	2007	2008
	Reported	Reported	Program	Current prices	Current prices	Current prices
II. DEFENSE AND SECURITY + RESERVE	1 787.7	1 946.4	2 086.8	2 226.5	2 440.0	2 667.7
% of GDP	5.2%	5.1%	5.0%	5.0%	5.0%	5.0%
% of Total Expenditures	12.7%	12.8%	12.7%	12.6%	12.9%	13.2%
% of Non-interest expenditures	13.4%	13.4%	13.3%	13.2%	13.5%	13.7%
II. DEFENSE AND SECURITY (A+B+C+D)	1 787.7	1 946.4	2 068.2	2 225.9	2 439.4	2 667.1
Current expenditures	1 612.5	1 723.9	1 935.3	2 083.9	2 210.9	2 407.0
Capital expenditures	175.2	222.5	132.9	142.0	228.5	260.1
% of GDP	5.2%	5.1%	5.0%	5.0%	5.0%	5.0%
% of Total Expenditures	12.7%	12.8%	12.6%	12.6%	12.9%	13.2%
% of Non-interest expenditures	13.4%	13.4%	13.2%	13.1%	13.5%	13.7%
A. DEFENSE + RESERVE	825.6	875.0	978.9	1 033.0	1 156.0	1 303.1
% of GDP	2.4%	2.3%	2.4%	2.3%	2.4%	2.5%
% of Total Expenditures	5.9%	5.8%	5.9%	5.8%	6.1%	6.5%
% of Non-interest expenditures	6.2%	6.0%	6.2%	6.1%	6.4%	6.7%
A. DEFENSE	825.6	875.0	960.9	1 033.0	1 156.0	1 303.1
Current expenditures	694.9	696.2	869.4	937.0	980.0	1 103.1
Capital expenditures	130.7	178.8	91.5	96.0	176.0	200.0
% of GDP	2.4%	2.3%	2.3%	2.3%	2.4%	2.5%
% of Total Expenditures	5.9%	5.8%	5.8%	5.8%	6.1%	6.5%
% of Non-interest expenditures	6.2%	6.0%	6.1%	6.1%	6.4%	6.7%
B. POLICE, INTERNAL OLDER AND SECURITY	726.5	780.3	784.8	851.9	923.0	982.9
Current expenditures	700.7	753.9	762.8	826.9	898.0	951.9
Capital expenditures	25.8	26.4	22.0	25.0	25.0	31.0
% of GDP	2.1%	2.1%	1.9%	1.9%	1.9%	1.9%
% of Total Expenditures	5.2%	5.1%	4.8%	4.8%	4.9%	4.9%
% of Non-interest expenditures	5.4%	5.4%	5.0%	5.0%	5.1%	5.0%
C. JUDICIAL SYSTEM + RESERVE	175.0	226.2	251.6	268.6	280.0	297.7
% of GDP	0.5%	0.6%	0.6%	0.6%	0.6%	0.6%
% of Total Expenditures	1.2%	1.5%	1.5%	1.5%	1.5%	1.5%
% of Non-interest expenditures	1.3%	1.6%	1.6%	1.6%	1.5%	1.5%
C. JUDICIAL SYSTEM	175.0	226.2	251.0	268.0	279.4	297.1
Current expenditures	156.7	209.7	232.5	248.0	255.9	273.0
Capital expenditures	18.3	16.5	18.5	20.0	23.5	24.1
% of GDP	0.5%	0.6%	0.6%	0.6%	0.6%	0.6%
% of Total Expenditures	1.2%	1.5%	1.5%	1.5%	1.5%	1.5%
% of Non-interest expenditures	1.3%	1.6%	1.6%	1.6%	1.5%	1.5%
D. PRISON ADMINISTRATION	60.6	64.9	71.6	73.0	81.0	84.0
Current expenditures	60.2	64.1	70.6	72.0	77.0	79.0
Capital expenditures	0.4	0.8	1.0	1.0	4.0	5.0
% of GDP	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
% of Total Expenditures	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%
% of Non-interest expenditures	0.5%	0.4%	0.5%	0.4%	0.4%	0.4%
III. EDUCATION + RESERVE	1 504.7	1 652.4	1 798.9	1 954.0	2 094.3	2 272.0
% of GDP	4.4%	4.3%	4.4%	4.4%	4.3%	4.3%
% of Total Expenditures	10.7%	10.9%	10.9%	11.1%	11.1%	11.3%
% of Non-interest expenditures	11.3%	11.4%	11.5%	11.5%	11.6%	11.7%
III. EDUCATION	1 504.7	1 652.4	1 708.9	1 954.0	2 094.3	2 272.0
Current expenditures	1 445.0	1 566.5	1 632.9	1 796.0	1 935.3	2 108.0
Capital expenditures	59.6	85.9	76.0	158.0	159.0	164.0
% of GDP	4.4%	4.3%	4.1%	4.4%	4.3%	4.3%

% of Total Expenditures	10.7%	10.9%	10.4%	11.1%	11.1%	11.3%
% of Non-interest expenditures	11.3%	11.4%	10.9%	11.5%	11.6%	11.7%
CONSOLIDATED STATE BUDGET	2003	2004	2005	2006	2007	2008
BGN mln.	Reported	Reported	Program	Current prices	Current prices	Current prices
IV. HEALTHCARE + RESERVE	1 697.7	1 769.1	1 777.7	1 922.0	2 109.5	2 289.1
% of GDP	4.9%	4.7%	4.3%	4.3%	4.3%	4.3%
% of Total Expenditures	12.1%	11.6%	10.8%	10.9%	11.2%	11.4%
% of Non-interest expenditures	12.7%	12.2%	11.3%	11.4%	11.6%	11.8%
IV. HEALTHCARE	1 697.7	1 769.1	1 677.2	1 810.0	1 971.9	2 147.0
Current expenditures	1 623.0	1 693.5	1 621.2	1 719.0	1 866.9	2 030.0
Capital expenditures	74.6	75.6	56.1	91.0	105.0	117.0
% of GDP	4.9%	4.7%	4.1%	4.1%	4.0%	4.0%
% of Total Expenditures	12.1%	11.6%	10.2%	10.2%	10.5%	10.7%
% of Non-interest expenditures	12.7%	12.2%	10.7%	10.7%	10.9%	11.0%
V. SOCIAL SECURITY + RESERVE	4 805.2	5 238.4	5 596.5	6 047.6	6 431.0	6 766.2
% of GDP	13.9%	13.8%	13.5%	13.5%	13.2%	12.8%
% of Total Expenditures	34.2%	34.5%	34.0%	34.2%	34.1%	33.6%
% of Non-interest expenditures	36.0%	36.1%	35.7%	35.7%	35.5%	34.7%
V. SOCIAL SECURITY, SOCIAL ASSISTANCE AND WELFARE	4 805.2	5 238.4	5 511.5	5 987.6	6 371.0	6 706.2
Current expenditures	4 788.0	5 198.6	5 491.9	5 965.6	6 345.0	6 678.2
Capital expenditures	17.2	39.8	19.6	22.0	26.0	28.0
% of GDP	13.9%	13.8%	13.3%	13.4%	13.1%	12.6%
% of Total Expenditures	34.2%	34.5%	33.5%	33.9%	33.8%	33.3%
% of Non-interest expenditures	36.0%	36.1%	35.2%	35.4%	35.2%	34.4%
A. PENSIONS + RESERVE	3 161.1	3 544.3	3 760.1	4 176.2	4 484.0	4 794.2
% of GDP	9.2%	9.3%	9.1%	9.4%	9.2%	9.0%
% of Total Expenditures	22.5%	23.3%	22.8%	23.6%	23.8%	23.8%
% of Non-interest expenditures	23.7%	24.4%	24.0%	24.7%	24.8%	24.6%
A. PENSIONS	3 161.1	3 544.3	3 700.1	4 116.2	4 424.0	4 734.2
incl. support		27.4	32.0	35.0	38.0	39.2
% of GDP	9.2%	9.3%	8.9%	9.2%	9.1%	8.9%
% of Total Expenditures	22.5%	23.3%	22.5%	23.3%	23.5%	23.5%
% of Non-interest expenditures	23.7%	24.4%	23.6%	24.3%	24.4%	24.3%
B. SOCIAL ASSISTANCE AND INDEMNITIES + RESERVE	1 215.0	1 162.9	1 512.0	1 530.4	1 577.9	1 588.0
% of GDP	3.5%	3.1%	3.7%	3.4%	3.2%	3.0%
% of Total Expenditures	8.6%	7.7%	9.2%	8.7%	8.4%	7.9%
% of Non-interest expenditures	9.1%	8.0%	9.7%	9.0%	8.7%	8.2%
B. SOCIAL ASSISTANCE AND INDEMNITIES	1 215.0	1 162.9	1 487.0	1 530.4	1 577.9	1 588.0
incl. support		1.1	0.9	1.0	1.1	1.5
% of GDP	3.5%	3.1%	3.6%	3.4%	3.2%	3.0%
% of Total Expenditures	8.6%	7.7%	9.0%	8.7%	8.4%	7.9%
% of Non-interest expenditures	9.1%	8.0%	9.5%	9.0%	8.7%	8.2%
C. PROGRAMS, ACTIVITIES AND SERVICES RELATED TO SOCIAL SECURITY, ASSISTANCE AND EMPLOYMENT	429.1	531.2	324.5	341.0	369.1	384.0
Current expenditures	411.9	491.4	304.9	319.0	343.1	356.0
Capital expenditures	17.2	39.8	19.6	22.0	26.0	28.0
% of GDP	1.2%	1.4%	0.8%	0.8%	0.8%	0.7%
% of Total Expenditures	3.1%	3.5%	2.0%	1.9%	2.0%	1.9%
% of Non-interest expenditures	3.2%	3.7%	2.1%	2.0%	2.0%	2.0%
VI. HOUSING CONSTRUCTION, PUBLIC WORKS, PUBLIC UTILITIES AND PROTECTION OF THE ENVIRONMENT (A+B)	497.3	586.3	946.8	1 024.0	1 106.0	1 209.8
Current expenditures	283.8	339.2	520.7	532.0	490.0	490.8
Capital expenditures	213.5	247.1	426.1	492.0	616.0	719.0
% of GDP	1.4%	1.5%	2.3%	2.3%	2.3%	2.3%

% of Total Expenditures	3.5%	3.9%	5.8%	5.8%	5.9%	6.0%
% of Non-interest expenditures	3.7%	4.0%	6.0%	6.0%	6.1%	6.2%
CONSOLIDATED STATE BUDGET	2003	2004	2005	2006	2007	2008
BGN mln.	Reported	Reported	Program	Current prices	Current prices	Current prices
A. HOUSING CONSTRUCTION, PUBLIC WORKS, PUBLIC UTILITIES		197.8	529.3	582.0	612.0	658.3
Current expenditures		90.3	400.3	411.0	365.0	363.3
Capital expenditures		107.6	129.0	171.0	247.0	295.0
% of GDP		0.5%	1.3%	1.3%	1.3%	1.2%
% of Total Expenditures		1.3%	3.2%	3.3%	3.2%	3.3%
% of Non-interest expenditures		1.4%	3.4%	3.4%	3.4%	3.4%
B. PROTECTION OF THE ENVIRONMENT		388.4	417.5	442.0	494.0	551.5
Current expenditures		248.9	120.4	121.0	125.0	127.5
Capital expenditures		139.5	297.0	321.0	369.0	424.0
% of GDP		1.0%	1.0%	1.0%	1.0%	1.0%
% of Total Expenditures		2.6%	2.5%	2.5%	2.6%	2.7%
% of Non-interest expenditures		2.7%	2.7%	2.6%	2.7%	2.8%
VII. RECREATION, CULTURE, RELIGIOUS ACTIVITIES	286.1	303.7	286.1	311.0	318.3	335.6
Current expenditures	262.0	265.6	268.0	286.9	292.3	307.0
Capital expenditures	24.1	38.2	18.2	24.1	26.0	28.6
% of GDP	0.8%	0.8%	0.7%	0.7%	0.7%	0.6%
% of Total Expenditures	2.0%	2.0%	1.7%	1.8%	1.7%	1.7%
% of Non-interest expenditures	2.1%	2.1%	1.8%	1.8%	1.8%	1.7%
A. RECREATION	9.3	9.2	6.5	9.1	9.2	8.8
Current expenditures	8.0	7.8	6.3	8.0	8.1	7.4
Capital expenditures	1.3	1.4	0.2	1.1	1.1	1.4
% of GDP	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
% of Total Expenditures	0.1%	0.1%	0.0%	0.1%	0.0%	0.0%
% of Non-interest expenditures	0.1%	0.1%	0.0%	0.1%	0.1%	0.0%
B. PHYSICAL CULTURE II SPORTS	23.3	24.5	10.3	16.2	16.4	17.7
Current expenditures	22.2	23.3	9.1	15.0	15.2	16.5
Capital expenditures	1.0	1.3	1.2	1.2	1.2	1.2
% of GDP	0.1%	0.1%	0.0%	0.0%	0.0%	0.0%
% of Total Expenditures	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%
% of Non-interest expenditures	0.2%	0.2%	0.1%	0.1%	0.1%	0.1%
C. TOURISM	3.3	11.3	7.5	12.8	13.3	14.0
Current expenditures	3.2	11.0	7.1	12.0	12.5	13.0
Capital expenditures	0.1	0.4	0.4	0.8	0.8	1.0
% of GDP	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
% of Total Expenditures	0.0%	0.1%	0.0%	0.1%	0.1%	0.1%
% of Non-interest expenditures	0.0%	0.1%	0.0%	0.1%	0.1%	0.1%
D. CULTURE	248.6	257.1	259.2	270.0	276.4	292.0
Current expenditures	227.0	221.9	242.7	249.0	253.5	267.0
Capital expenditures	21.6	35.1	16.4	21.0	22.9	25.0
% of GDP	0.7%	0.7%	0.6%	0.6%	0.6%	0.6%
% of Total Expenditures	1.8%	1.7%	1.6%	1.5%	1.5%	1.4%
% of Non-interest expenditures	1.9%	1.8%	1.7%	1.6%	1.5%	1.5%
E. RELIGIOUS ACTIVITIES	1.6	1.6	2.7	2.9	3.0	3.2
Current expenditures	1.6	1.6	2.7	2.9	3.0	3.2
Capital expenditures						
% of GDP	0.00%	0.00%	0.01%	0.01%	0.01%	0.01%
% of Total Expenditures	0.01%	0.01%	0.02%	0.02%	0.02%	0.02%
% of Non-interest expenditures	0.01%	0.01%	0.02%	0.02%	0.02%	0.02%
VIII. ECONOMIC ACTIVITIES AND SERVICES + RESERVE	1 621.8	1 838.5	1 786.4	1 963.3	2 032.3	2 291.8

% of GDP	4.7%	4.8%	4.3%	4.4%	4.2%	4.3%
% of Total Expenditures	11.5%	12.1%	10.9%	11.1%	10.8%	11.4%
% of Non-interest expenditures	12.2%	12.7%	11.4%	11.6%	11.2%	11.8%

CONSOLIDATED STATE BUDGET		2003	2004	2005	2006	2007	2008
BGN mln.		Reported	Reported	Program	Current prices	Current prices	Current prices
VIII. ECONOMIC ACTIVITIES AND SERVICES		1 621.8	1 838.5	1 761.4	1 913.3	1 976.3	2 231.8
Current expenditures		1 146.3	1 188.7	1 053.9	1 100.9	1 088.7	1 135.4
Capital expenditures		475.5	649.8	707.5	812.4	887.6	1 096.4
% of GDP		4.7%	4.8%	4.3%	4.3%	4.1%	4.2%
% of Total Expenditures		11.5%	12.1%	10.7%	10.8%	10.5%	11.1%
% of Non-interest expenditures		12.2%	12.7%	11.2%	11.3%	10.9%	11.5%
A. MINING, FUELS AND ENERGY		56.8	41.3	24.9	28.0	32.0	36.0
Current expenditures		55.9	39.3	16.3	19.0	20.0	21.0
Capital expenditures		0.8	2.0	8.6	9.0	12.0	15.0
% of GDP		0.2%	0.1%	0.1%	0.1%	0.1%	0.1%
% of Total Expenditures		0.4%	0.3%	0.2%	0.2%	0.2%	0.2%
% of Non-interest expenditures		0.4%	0.3%	0.2%	0.2%	0.2%	0.2%
B. AGRICULTURE, FORESTRY, HUNTING AND FISHING		370.5	382.2	543.7	594.0	634.9	750.0
Current expenditures		350.5	366.6	432.1	455.0	493.0	571.0
Capital expenditures		20.0	15.6	111.6	139.0	141.9	179.0
% of GDP		1.1%	1.0%	1.3%	1.3%	1.3%	1.4%
% of Total Expenditures		2.6%	2.5%	3.3%	3.4%	3.4%	3.7%
% of Non-interest expenditures		2.8%	2.6%	3.5%	3.5%	3.5%	3.9%
C. TRANSPORT AND TELECOMMUNICATIONS		692.3	774.7	953.3	1 049.2	1 099.5	1 232.0
Current expenditures		453.8	465.8	374.0	395.0	376.0	343.0
Capital expenditures		238.5	308.9	579.3	654.2	723.5	889.0
% of GDP		2.0%	2.0%	2.3%	2.3%	2.3%	2.3%
% of Total Expenditures		4.9%	5.1%	5.8%	5.9%	5.8%	6.1%
% of Non-interest expenditures		5.2%	5.3%	6.1%	6.2%	6.1%	6.3%
D. INDUSTRY AND CONSTRUCTION		0.5	2.4	3.0	3.1	2.1	2.5
Current expenditures		0.5	2.4	2.8	2.9	1.9	1.9
Capital expenditures		0.0	0.1	0.2	0.2	0.2	0.6
% of GDP		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
% of Total Expenditures		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
% of Non-interest expenditures		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
E. OTHER ECONOMIC ACTIVITIES		501.7	637.7	236.5	239.0	207.8	211.3
Current expenditures		285.6	314.6	228.7	229.0	197.8	198.5
Capital expenditures		216.2	323.1	7.8	10.0	10.0	12.8
% of GDP		1.5%	1.7%	0.6%	0.5%	0.4%	0.4%
% of Total Expenditures		3.6%	4.2%	1.4%	1.4%	1.1%	1.0%
% of Non-interest expenditures		3.8%	4.4%	1.5%	1.4%	1.1%	1.1%
IX. EXPENDITURES UNCLASSIFIED WITHIN THE OTHER FUNCTIONS		770.1	748.8	1 314.3	1 164.9	1 212.1	1 179.2
Current expenditures		723.9	697.7	794.7	736.0	737.9	686.5
Capital expenditures							
Acquisition of equity, shares, participation and other financial assets (net)				100.0	135.8	150.0	160.0
Reserve		46.2	51.1	419.6	293.1	324.2	332.7
% of GDP		2.2%	2.0%	3.2%	2.6%	2.5%	2.2%
% of Total Expenditures		5.5%	4.9%	8.0%	6.6%	6.4%	5.8%
% of Non-interest expenditures		5.8%	5.2%	8.4%	6.9%	6.7%	6.1%
Including:							
INTEREST - TOTAL		723.9	697.4	794.7	736.0	737.9	686.5
% of GDP		2.1%	1.8%	1.9%	1.6%	1.5%	1.3%
% of Total Expenditures		5.1%	4.6%	4.8%	4.2%	3.9%	3.4%

% of Non-interest expenditures 5.4% 4.8% 5.1% 4.3% 4.1% 3.5%

CONSOLIDATED STATE BUDGET	2003	2004	2005	2006	2007	2008
BGN mln.	Reported	Reported	Program	Current prices	Current prices	Current prices
ACQUISITION OF EQUITY, SHARES, PARTICIPATION, OTHER FINANCIAL ASSETS AND BORROWED FUNDING (NET)			100.0	135.8	150.0	160.0
% of GDP			0.2%	0.3%	0.3%	0.3%
% of Total Expenditures			0.6%	0.8%	0.8%	0.8%
% of Non-interest expenditures			0.6%	0.8%	0.8%	0.8%
RESERVE FOR UNPREDICTABLE AND STRUCTURAL EXPENDITURES	46.2	51.1	419.6	293.1	324.2	332.7
% of GDP	0.1%	0.1%	1.0%	0.7%	0.7%	0.6%
% of Total Expenditures	0.3%	0.3%	2.5%	1.7%	1.7%	1.7%
% of Non-interest expenditures	0.3%	0.4%	2.7%	1.7%	1.8%	1.7%

UPDATE OF THE GOVERNMENT DEBT MANAGEMENT STRATEGY

2005

The past year was relatively favourable with respect to the external environment and to the fiscal parameters from the perspective of government debt status and servicing. The budget balance was positive, whereas (as a result mainly of the overfulfillment of the revenue part) a surplus amounting to 1.5 percent of GDP was achieved. Correspondingly, this precluded the necessity to resort to a positive debt financing and resulted in an increase of the amount of the fiscal reserve. External interest rates remained at a low level, while the rate of exchange of the U.S. dollar against the Euro (and against the Bulgarian Lev) decreased significantly in comparison to 2003. In consideration of the structure of the government debt, these factors contributed substantially to the reduction of debt servicing expenditures.

The domestic market for government securities continued to develop in a foreseeable direction, while the most significant impact was made by the growth of lending in the banking sector. Up to a considerable extent, this influenced the banking system liquidity, but nevertheless demand for government securities remained high.

The year 2004 also saw the upgrading of the credit rating of Bulgaria up to investment grade by the agencies Standard & Poor's and FITCH. This rating was awarded because of the prudent fiscal policy, the development of the real sector and the progress of the country achieved in the process of accession to the European Union. The awarding of such a rating to Bulgaria puts the country into a different category of borrowers who can count on a much wider circle of investors and respectively on a lower cost of financing.

Within this environment, the pursued debt management policy resulted in a substantial improvement of the debt parameters. In nominal terms, the volume of debt went down by EUR 555 million, reaching EUR 7.96 billion, while as a ratio to GDP the debt decreased by 7.3 percentage points, down to 40.9 percent. This is the fifth consecutive year when a reduction of the debt-to-GDP ratio with more than 7 percentage points has been achieved and this is essentially due to two factors – the sustainable growth of the economy and the prudent fiscal policy.

In addition to the achieved reduction of the debt during the year, a number of other results can also be reported that comply with the objectives established by the Government Debt Management Strategy.

1. Gradual increase of fixed interest rate debt until achieving a balanced, risk-neutral structure (45-50 percent)

In 2004, the predominantly fixed interest rate borrowing policy continued. One single issuance with floating coupons only was launched on the domestic market. Interest payments on this issuance are linked to the three-month SOFIBOR index and the main objective of the issuance is to provide support for the development of the interbank money market.

External financing in 2004 has been from international financial institutions exclusively and debt has mainly been absorbed under existing operational loans and programs. In this respect, whenever the

creditors' terms have permitted it and the proposed parameters have been favourable, fixed interest rate coupons have been the preferred choice too.

In July, a repurchase operation was carried out for discounted Brady bonds with a floating interest rate at a nominal value of U.S. \$ 679.3 million. In addition to the significant decrease of the amount of government debt, this has also led to an improvement of its interest rate structure.

As result of the measures undertaken, the proportion of debt with fixed interest rates grew in 2004 by 5 percentage points up to 48.3 percent, and this result is already in line with the established objective to achieve a balanced debt structure.

2. Increase of the proportion of the debt denominated in Bulgarian Leva and in Euro

The constant strengthening of the linkage of our economy to that of the European Union emphasizes the necessity to reduce the state budget liabilities' dependence on exchange rate developments related to other currencies. Within this context, the last year was no exception for our borrowing policy, which was exclusively oriented towards the Bulgarian Lev and the Euro, with the exception of small disbursements under earlier government investment loans. The above-mentioned repurchasing of Brady bonds at a discount also influenced significantly the currency structure of the government debt.

The policy pursued, as well as the declining rate of exchange of the U.S. dollar against the Euro have led to a reduction of U.S. dollar denominated liabilities and correspondingly to an increase of the Bulgarian leva and Euro proportion of the debt from 35.0 percent to 40.7 percent in 2004.

3. Increase of the proportion of domestic debt at the expense of reduced external financing

The restrictive policy with respect to the conclusion of new external loans during the last few years taken in conjunction with the favourable macroeconomic environment created opportunities to achieve a positive net issuance on the domestic market. The demand for government securities remained high in 2004 too, which was mainly attributable to the growth of the pension funds' assets and to the growing liquidity resources within the banking system.

The growth of domestic debt in nominal terms during the last year was BGN 424 million, which as a proportion of total debt growth represents 3.7 percentage points. The volume of domestic debt reached 17.2 percent of the total government and government-guaranteed debt.

4. Creation of prerequisites for secondary market development

In 2004, the Ministry of Finance adhered to the already established practice of issuing open type medium-term and long-term securities, which enhanced the liquidity of the separate issuances through increasing their nominal amounts at subsequent auctions. The offering of government securities with different maturities that correspond to the pivot points of the charting of the benchmark yield curve was also one of the main priorities of the policies applied in the sphere of creation of favourable conditions for local secondary market development. Within this context, the proportion of short-term government securities (with three and twelve month maturities) issued during the year reached 28.02 percent, while the share of medium-term securities (with three and five year maturities) was 29.80 percent and the share of long-term government securities (with 7-, 10- и 15-year maturities) was 42.78 percent. The diversification of the offered government securities in a breakdown by maturities has been accompanied by a currency diversification. Auctions were used for the issuance during the year of 15-year Euro-denominated government securities for a total

nominal value of EUR 65.0 million or 18.94 percent of the total volume of issued government securities.

The essential points of emphasis that were noticeable throughout 2004 were furthermore accompanied by various other measures of different character aiming on the one hand to popularize the issuance policy of the International Monetary Fund and its timely communication to the stakeholders, while on the other hand, these measures were aimed at obtaining feedback with respect to the status and the development trends of the securities market. In support of this, the Ministry of Finance announced as early as the end of 2003 its intentions to issue government securities in 2004 and kept publishing a monthly issuance calendar 30 days in advance of the respective issuances. In addition, the Ministry of Finance maintains extensive and abundant information on its pages in the Internet and with the Reuters Agency; the Ministry takes part in meetings with the participants on the market, etc.

5. Development of the systems for auction holding and registration of government securities

In pursuance of the Government Debt Management Strategy, the Ministry of Finance and the Bulgarian National Bank (in its quality of government debt agent) undertook a number of measures for the development of new systems for the primary auction based sales of government securities and for their registration and servicing, as well as for trading in government securities on the secondary market in accordance with the best practices in this sphere. Consequently, the new auction holding system was implemented at the beginning of November 2004 and it allows the automatic holding of auctions, the use of standardized trading orders and of alternative communication channels (SWIFT and VPN), minimizing the duration for the holding of auctions, the simultaneous holding of several auctions at a time, etc. A new system for the registration, servicing and trading with government securities is envisaged to be introduced within the next few years. The system will secure the provision of the necessary modern infrastructure with respect to transactions with government securities on the secondary market.

6. Increasing the proportion of issues for small investors

The efforts to increase the proportion of issues for small investors, both local and foreign natural persons, continued throughout 2004. With this objective in mind, the Ministry of Finance on the one hand expanded the scope of offered instruments, issuing Euro-denominated instruments in addition to the Leva-denominated securities, while on the other hand the Ministry extended the bonds' maturity from three to five years. In this connection, in February 2004, five-year Euro-denominated government securities were offered for sale to private individuals for the first time. By the end of the announced deadline for the sale, a total of Euro 4.32 million of this issue was sold within the same month. Even in 2004, however, the proportion of government securities intended for individual investors within the general structure of domestic government debt remained within the confines observed during the previous year (between 1.80 and 1.90 percent).

In view of the objective pursued, which consist both in the expansion of the investor basis and in the achievement of an optimum price for the issued domestic debt, as well as in the securing of the access of the separate small investors to attractive and safe investing, such as the investment in government securities, the Ministry of Finance envisages the continuation of the monitoring of this specific market segment. On this basis, therefore, the current analysis of the market's development perspectives end of the opportunities for future growth of the proportion of non-institutional investors in domestic government debt will remain one of the general priorities.

7. Maintaining a fiscal reserve covering at least one-year debt payments (approximately EUR 1 billion)

According to the State Budget Act for 2004, the minimum amount of the fiscal reserve for 2004 is BGN 2.5 billion.

2004 was another year when the average amount of the maintained fiscal reserve was in considerable excess over the projected minimum. The fundamental factors for this were the surplus achieved during the execution of the State Budget and the revenues coming from privatization transactions. By the end of the year, the fiscal reserve funds amounted to BGN 4.6 billion, what was also their average annual level. The considerable surplus with respect to the established minimum limit provided the opportunity to repurchase Brady bonds during the year and to achieve a negative debt financing.

8. Maintaining an active dialogue with the rating agencies

The maintenance of the active dialogue with the rating agencies was one of the fundamental priorities of the Ministry of Finance also during the past year. Regular annual meetings were held with all the four institutions that have produced credit ratings for Bulgaria and an active communication was maintained with respect to the development of the country and of the economy. It must be pointed out that in 2004 the agencies Standard & Poor's and Fitch awarded an investment-grade rating (BBB) for the foreign currency denominated Bulgarian long-term debt.

9. Restrictive approach to financing public projects with government debt or government guarantees

In compliance with the presently valid Ordinance on the terms and conditions that must be satisfied by the investment projects financed with government debt and by the projects that apply for government-guaranteed financing, there were two projects that were approved in 2004. The total amount of the government guarantee is BGN 451 million. This conservative approach was preserved also with respect to the 2004 procedure for the 2005 projects approval: a single project only has been approved to be financed with a government loan for a value of BGN 76 million.

The experience accumulated during the last few years shows that the established procedure for the selection of projects to be financed with government debt or with government guarantees ensures a high degree of transparency and predictability, while it also provides an opportunity to prioritize the spheres where government support is necessary.

10. Facilitating the development of the money market

In accordance with the previously announced intentions of the Ministry of Finance, in February 2004 an open issuance was offered for government securities with a floating interest coupon linked to the three-month SOFIBOR⁹ index. The issuance has a three-year maturity and a total nominal amount of up to BGN 100 million.

There are several objectives involved in the introduction of this type of instrument. In the first place, the trading of the floating coupon issuance on a secondary market is an indicator of the market expectations about the movement of interest-rate levels, therefore it supports also the development of the domestic market for government securities. In the second place, the linking of state-issued

⁹ The SOFIBOR index is a daily averaged fixing of the selling quotations for non-collateralized deposits denominated in Bulgarian Leva offered on the Bulgarian interbank market by a representative group of banks.

securities to the SOFIBOR index contributes to the popularization of the index and its establishment on the market as an alternative to the basic interest rate.

The fundamental factors of influence for the identification of the measures to be undertaken in order to achieve the objectives set up in the Debt Management Strategy during the last stage of the three-year period will be as follows:

- **The State Budget perspectives:**
According to the three-year budgetary framework, no serious modification of the budgetary balance as compared to the last few years is envisaged. The accession to the European Union is expected to lead to a demand for additional funds during the first year of membership, due to which 2007 will be a year with a relatively more burdened expenditure part.
- **The necessity to co-finance projects related to the Eurointegration process:**
The securing of financing sources for the implementation of the projects will also be related to the assessment of the opportunities and of the benefits provided by the state guarantees for the execution of projects that are definitely important for the development of the country and of the economy. There will be a significant participation of the European Investment Bank (EIB) and of the European Bank for Reconstruction and Development (EBRD) too. The appropriate identification of the priorities and the assessment of the state capacity, from the points of view both of financing and of implementation, will be of extreme importance in order to avoid the unnecessary growth of the indebtedness of the state or the long-term freezing of expenditure resources.
- **Condition of the international markets:**
The development of international interest rates and of the exchange rate of the U.S. dollar against the European currency will continue to be important for the amount of interest expenditures of the State Budget. The expected long-term rise of interest rates needs to be taken into account during the formulation of the country's borrowing policy and the eventual early repayment of government debt. The imminent accession to the European Union will also lead to a modification of the price levels for contracting new debt and this will in its turn determine the types of instruments and the maturities during the financing selection.

In addition, the world economy's development perspectives will be taken into consideration, particularly those of the European economy as Bulgaria's principal trade partner and development motor. Domestic reforms in a number of sectors will also exercise an important influence on the decision-making process. Taken as a whole, however, the government debt management policy will adhere to the objectives set up by the Strategy. The efforts will continue towards the attainment of the objectives to decrease the relative proportion of debt; to achieve a balanced interest-rate structure; to curtail the influence of exchange rate fluctuations; to develop the domestic market and to prepare it for EU conditions; to decrease the share of direct financial participation of the state in large infrastructural projects at the expense of attracting private partners.

The activity related to the improvement of the government treasury's structure and organization will continue during this year too. The refinement of the interaction and the coordination, the introduction of accurate control procedures, as well as the limitation of operational risks and the improvement of the qualification of the personnel will create a favourable environment for the improvement of the work efficiency and for the application of the government's policy for the implementation of the approved Debt Management Strategy. In addition, a project will be started in 2005 for the introduction of a fully integrated government treasury, which is to be in compliance with the practices established in the EU member countries.
