

MINISTRY OF FINANCE



REPORT

ON THE 2004 STATE BUDGET ACT

EXECUTIVE SUMMARY	4
INTRODUCTION.....	8
CHAPTER 1: ECONOMIC DEVELOPMENT AND FISCAL STRATEGY	10
I. Economic review and outlook	10
1. World economy development	10
2. National economy development	12
2.1. Trends in the development of the national economy in 2003	12
2.2. Demographic profile of the population and the labor market.....	14
3. Macro framework of the 2004 State Budget.....	16
II. Implementation of the consolidated fiscal program for 2003	17
1. Review of the fiscal stance as of June 2003	18
2. Evaluation of the consolidated budget implementation by the end of 2003	19
III. Medium-term fiscal strategy	21
CHAPTER 2: REVENUES AND TAX POLICY	24
1. Corporate Taxes	25
2. Personal Income Taxation.....	27
3. Revenues from Payroll Taxation	28
4. Value Added Tax	29
5. Excise Duties	30
6. Customs Duties	31
7. Non-tax Revenues	32
8. Grants.....	33
CHAPTER 3: EXPENDITURE POLICIES AND EXPENDITURES	33
I. Public Expenditures by Economic Items.....	33
1. Current expenditures	34
1.1. Salaries and Remuneration in the Public Sector	34
1.2. Payroll Taxation.....	34
1.3. Maintenance.....	34
1.4. Subsidies	35
1.5. Social Security and Welfare.....	37
1.6. Interest Payments	40
1.7. Contingency	41
2. Public Investment.....	41
II. Public Expenditures by Function	43
1. General Review.....	43

2. Review of the Functional Groups	44
2.1. General Public Services	45
2.2. Defense and Security	48
2.3. Education	52
2.4. Health Care	53
2.5. Social security and welfare (pensions, social assistance and compensations), social security and employment works and services	56
2.6. Housing, Communal Amenities and Environment	60
2.7. Recreation, Culture, and Religion.....	62
2.8. Economic Affairs	65
2.9. Expenditures, not classified under the other functions	70
III. 2004 Budget by Responsibilities.....	71
1. The Republican Budget.....	71
2. Judiciary	72
3. Mandatory Social Security.....	73
4. National Health Insurance Fund (NHIF)	74
5. Municipal Budgets.....	76
6. Budget of National Fund at the Ministry of Finance	77
CHAPTER 4: DEBT POLICY / BUDGET 2004 FINANCING	79
I. Government Debt	79
II. Financing	82
CHAPTER 5: RISKS AND PERSPECTIVES.....	83
I. Risks to the 2004 Budget.....	83
1. Changes in the Economic Parameters.....	83
2. Realization of Undertaken Obligations and Arrears	84
II. Reforms and Perspectives	84
1. Budget Reform Implementation	84
2. Financial Decentralization	86
CONCLUSION.....	89
ANNEXES.....	90

EXECUTIVE SUMMARY

of the 2004 State Budget Act Report

The 2004 Budget accounts for the impact of both domestic and world macroeconomic developments. Bulgaria's projected GDP growth in 2004 is 5.3%. It will be gained by a real increase in income levels and household credit. During the next year the level of investments is expected to reach 21.5% of GDP. The rising growth rates of the world economy and the European Union in particular, in late 2003, as well as the enhanced productivity and competitiveness of Bulgarian manufacturers, following the investments made in recent years, will give an impetus to the export of goods and services. 2004 export is projected to grow in real terms by 5.5-6%, which will make it an important growth factor.

Under the conditions of the Currency Board Arrangement the fiscal policy is a major safeguard against changes in the macroeconomic environment arising from adverse domestic and external factors. Therefore the fiscal policy and budget performance are of particular importance. The Government has been pursuing a prudent and flexible policy with a view to maintain macroeconomic stability. This year's underlying budget position is likely to see some more tangible restrictions triggered by the change in the deficit target level. This will set in motion the arrangements meant to ensure flexible fiscal management should a less favourable economic scenario occur. That is why the following have been envisioned by way of a requirement to stay the course of a prudent fiscal policy and to cushion eventual risks: a certain level of the deficit, a non-declining balance of the fiscal reserves and extra budgetary structural reserves.

The 2004 budget deficit is 0.7 percent of GDP or BGN 284.2 million in consolidated terms. The intention to sustain a robust fiscal stance has been the key reason to set such a target deficit level. This is in accordance with the accelerated pace of structural and public sector reforms. Over the medium-term (by 2006) we strive at a fully-balanced budget. The low level of the budget deficit has been aligned with the negative balance of the current account.

The higher level of the fiscal reserve ensures economic stability and should be considered as a protection against the occurrence of possible risks to the yearly budget implementation.

The reserves planned in the consolidated fiscal program amount to BGN 223.7 million or approximately 78.7 percent of the deficit. They will be allocated only if necessary to cover contingent and pressing expenditures, as well as for the purposes of the structural reforms.

Tax policy represents a key element of the fiscal policy. Tax policy secures funding for government functions and is an important leverage which can impact investment activity and economic growth. In 2004 the rate of the corporate profit tax will be cut from 23.5% to 19.5%. Additionally, related with the new grouping of population centers the persons will pay a lower level of the presumptive tax ("patent tax") in real terms. Another change will occur in the arrangements governing VAT exemptions under international agreements, conventions, treaties, etc. endorsed by the National Assembly. These changes will exempt from taxation supplies made under projects directly financed from grants within the framework of international agreements.

Simplification of the taxation system and its efficient administration shall remain a key objective for the tax policy in 2004.

The Government has adopted an approach well established across developed economies. According to it the structure of the consolidated budget revenue should comprise a growing relative share of revenue raised from indirect taxes at the expense of direct ones.

Resulting from the tax policy to be conducted in 2004 the consolidated budget expects to receive BGN 14 361.7 million or 37.8% of GDP. Revenue from social security and health insurance contributions (26.8 percent), value added tax (23.2 percent) and the personal income tax (7.7 percent) account for the highest share in the total revenue.

With the revenue and deficit having their limitation parameters so set, total gross expenditures in 2004 amount to BGN 14 645.9 million. The levels, which have been proposed for the separate expenditure items, within the limits set, reflect the new focus the Bulgarian government policies are taking. They strive at resource allocation for state consumption, investments and transfers in a manner that is most efficient and socially acceptable, with due respect for the priority of pre-accession process support. All areas have incorporated the requirement for enhancing the efficiency of recurrent operating costs, i.e. improve the quality of work at lower costs. The following is an outline of the major government expenditures: social security, social assistance and welfare services 13.6% of GDP, (at 13.8% in 2003), education 4.1% of GDP (at 3.9% in 2003), healthcare 4.3% of GDP (at 4.0% in 2003), defense and security 4.9% of GDP (at 4.9% in 2003), public works 2.1% of GDP (at 1.9% in 2003)

As from the middle of the next year budgetary wages have been planned to grow by 8.5%. Pension benefits will be indexed as from June 1 by a factor of 5.8%. The Government has envisioned increasing the minimum monthly wage from BGN 110 to BGN 120. In 2004 the ceiling of pensions shall be raised to reach BGN 420. This is a step towards improving the situation of retired people. The State Budget has planned for BGN 204.2 million to go for active measures to reduce unemployment.

Operating and labor costs of the administration, as a share in GDP, are on the rise. This is mainly due to the establishment of new structures relating to the administrative capacity building necessitated by the "European integration" process, the introduction of a mandatory pre-school year, and 13th grade at vocational schools, the reform and the strengthening of the judiciary.

2004 subsidy costs as planned for the enterprise sector and for the non-profit organizations are at BGN 372.6 million. Substantial subsidies have been envisaged with a view to support farmers and tobacco growers.

Capital investments are projected to experience a significant growth in 2004. This represents an important trend underpinning the overall economic growth. The expenditures planned in the consolidated budget amount to BGN 1 330.2 million and represent 3.5 percent of the expected level of the gross domestic product. It has been planned that these funds should largely be channeled towards investment projects, which are of nationwide or regional significance. They will also be focused onto such projects whose implementation our country expects to be supported in substantial terms by the European Union Pre-Accession Funds. The respective funds have been secured in view of the country's anticipated accession to NATO.

Interest costs in 2004 are expected to be at BGN 788.2 million, which accounts for 2.1% of GDP. The expenditures for domestic debt interest are relatively predictable due to the fact that the predominant part of the securities have fixed interest coupons. Despite improvements in the interest structure of the external debt more than half of the external obligations are tied to the international interest rates. This makes that part of the interest payments highly dependent on the variations of these rates.

Looking at the functional profile of the expenditures it is obvious that healthcare and education represent an unquestionable priority. The funds envisioned for the restructuring of the health system with a simultaneous improvement in the quality of services rendered to citizens are at a significantly higher level relative to previous years. As from the beginning of 2004 there will be a switch to a new method of hospital financing, whereby a major portion of their operations shall be financed through the National Health Insurance Fund. Compared to 2003 health expenditures are growing by 14.6% in nominal terms, with their GDP share reaching 4.3%.

Education is the second area where a substantial nominal growth of expenditures has been secured (14.8% relative to 2003). This is done on a one-off basis in 2004 due to the introduction of the pre-school preparation and an extra grade in the vocational schools. By all means developments in the coming years should gear at the optimization of structures in accordance with the country-specific economic and demographic challenges. Reforms in the sector of education should continue at a fast pace, with the aim to provide incentives for private structures to enter the sector, and render cost-effective services. Total budget financing for this sector as a GDP share is 4.1% in 2004.

Defense and security spending in 2004 is projected to account for 12.8% of total expenditures or 4.9 percent of GDP. Defense system reforms are a key element of the new security policy pursued by the Republic of Bulgaria. These reforms have set it a priority to build modern, upgraded armed forces, which are able to respond to the strategic environment and the nature of current challenges. These reforms are meant to ensure defense-sufficient military capability, within the means that this country can afford, and are to support the integration effort for the accession to the Euro-Atlantic system of security. The 2004 Budget secures the finances required by the Schedule of Reforms and the obligations arising from the Republic of Bulgaria's accession to NATO.

The 2004 Budget secures the resources required to deliver measures towards improving the organization of police investigation and counteract the so-called "new security risks", like organized crime, corruption, terrorism, drug trafficking, etc. The measures are to ensure public order and security for citizens. These funds as planned in the budget exceed the 2003 level by 6.3%.

The Government deems it a key priority to further the reform of the judiciary, the objective being to build an efficient and viable justice system, which meets the European requirements and standards.

The Government holds the position that the budget has planned for all the financial, physical and personnel resources required for a normal functioning of the separate bodies of the judicial system and their interaction with the other participants in the judicial process. This position was presented by the Ministry of Finance at the consultations held in relation to the 2004 State Budget Draft Law of the Republic of Bulgaria where representatives of the Supreme Judicial Council were in attendance. Without signing a memorandum, like the case with other ministries and agencies, the positions of the two parties were brought much closer. Despite that, in adherence to the Judiciary Act and the Organic Budget Act the 2004 State Budget Draft Law of the Republic of Bulgaria has fully incorporated the draft of the Supreme Judicial Council. In the event that their proposal gets passed the consolidated budget deficit would soar by BGN 128.0 million and hit a level of 1.1% of GDP.

According to the Government the indicative judiciary costs in 2004 should stay at BGN 208.1 million, where the excess is BGN 63.5 million relative to the previous year (a 44% growth). These data unambiguously indicate that the normal functioning and the reform of the judiciary shall remain a key priority for the Bulgarian Government. The figures are even more impressive at the backdrop of the restructuring of the expenditures in some of the other sectors.

By way of a pilot project three ministries prepared their 2004 draft budget plans in a program format. The Ministry of Finance's effort to introduce the program-based and result-oriented budgeting will be sustained in 2005 by expanding the pool of ministries drawing up their budgets in this manner. This is going to lay the foundations for an optimal decision-making regarding fiscal parameters and a more efficient allocation and disbursement of budgetary resources in accordance with Government priorities. The ultimate goal is for the state to render public services at a most rational usage of the limited budgetary funds, and enhance their overall public value.

INTRODUCTION

In the past few years Bulgaria achieved macroeconomic stability and a sustainable economic growth. This is largely due to the Currency Board Arrangement, which was adopted and introduced in 1997. It resulted also from the implementation of a tight financial discipline and the prudent management of public finance.

The fiscal policy is a major tool to influence the economy under the conditions of a currency board arrangement. Therefore issues like the level and structure of public expenditures, taxation, the level and financing methods of the budget deficit become matters of overwhelming importance.

The Report under the 2004 State Budget Act was prepared by the Ministry of Finance. The Report provides the argumentation for the economic parameters, set in the consolidated fiscal program. It illustrates their optimum combination with a view to conduct an efficient Government policy, retain economic growth and implement national priorities. Likewise, this Report contributes to an enhanced transparency and accountability of Government policies before the public.

The body of the report starts with an analysis of the world and domestic economic setting. It also projects the levels of the major macroeconomic indicators for Bulgaria and the international arena. The above-mentioned factors have been taken into account when drafting the fiscal strategy, which presents the budget framework and the lines along which the fiscal policy will be pursued.

Chapter 2 outlines the major changes in the 2004 tax legislation. It makes an assessment of their impact on the budgetary revenue and economic activities.

Chapter 3 examines the expenditure side of the consolidated state budget by economic items and functions, with a separate presentation of the autonomous budgets of ministries and agencies, municipalities, the National Health Insurance Fund (NHIF), the National Social Security Institute (NSSI), and the extrabudgetary National Fund at the Ministry of Finance.

Chapter 4 deals with the level and the trends in the government debt, its currency and interest structure. It also presents the major lines to be observed in the debt management.

Chapter 5 draws the major risks and prospects in relation to the 2004 Budget. On the one hand, this part is a detailed study of the negative factors, which may materialize in the course of budget implementation. It also inquires into the possible options to minimize their impact. This chapter includes also a review of the public sector reforms in connection with the introduction of the program-based and result-oriented budgeting. This is going to lay the foundations for an optimal decision-making regarding fiscal parameters and a more efficient allocation and disbursement of budgetary resources in accordance with Government priorities. The ultimate goal is for the state to render public services at a most rational usage of the limited budgetary funds, and enhance their overall public value. Special attention is paid to the process of financial decentralization, aiming at the laying of a robust foundation for the new system of financial relations between the central and local government.

The Appendix to the State Budget Act Report shows the budgets of the first-level budget spending units alongside the rationale for the indicators they have incorporated.

It needs to be noted that this Report has been drawn up based on the Government priority of attaining a 0.7% of GDP deficit level. We note this because pursuant to Art. 196, paras 2 and 3 of the Judiciary Act it is the Supreme Judicial Council (SJC) which draws its own yearly budget. This budget is then

submitted to the Council of Ministers to be included in the State Budget Draft. The Council of Ministers may not amend the proposed budget of the judiciary. It may only come out with an opinion on it before the National Parliament. That is why it is for the first time that this year's Report has examined in greater detail the parameters of the judiciary budget plan, proposed by the SJC. And the 2004 State Budget Draft Law of the Republic of Bulgaria includes the proposal of the SJC. In the event that this proposal gets passed the consolidated budget deficit would soar by BGN 128.0 million and reach a level of 1.1% of GDP. The key parameters of the two options for a Judiciary Budget Draft are outlined in Chapter 3, Section III, item 2 under the heading of "Autonomous Budgets".

CHAPTER 1: Economic Development and Fiscal Strategy

I. Economic review and outlook

The analysis of the economic setting and the review of the trends in the domestic and the international environment provide one with the basis to derive the pre-conditions (constraints) facing the fiscal policy over the next three years and the desirable impacts the fiscal strategy should target.

1. World economy development

World economy growth continues to be depressed. For a third consecutive year it has scored a growth rate of approximately 2%, which is below its capacity. The optimistic expectations for its recovery in 2004 have become the reason to project a growth rate of around 3%. The pace of economic activities in late 2002 and early 2003 was unsteady due to a number of developments, which adversely affected consumer and investor confidence. These include the preparation for the war in Iraq, the rise in oil prices, tense international relations, the constant threat of terror, and the outbreak of the SARS.

In response to that many countries applied fiscal and monetary incentives trying to stimulate economic activities. Interest rates in the U.S. and Japan saw drastic cuts. At end of June 2003 the U.S. Federal Reserve cut the interest rates by 25 basis points to a level of 1%. The additional tax cuts by approximately USD 380 billion served as yet another solid incentive to the same end. The fast resolution of the Iraq conflict and the subsequent decrease in oil prices led to a partial recovery of consumer and investor confidence and a rise in equity prices. As a result, in 2003 the American economy is expected to register a growth of 2.2%, and for 2004 the growth rate projected is 3.6%. The key challenges lying before the future development of the U.S. remain the following: the deflation risk, excessively low interest rates, the enormous deficit (over USD 455 billion) and the increasingly restrictive conditions for maneuvers by the Federal Reserve. Nevertheless, it is the U.S.A., which is expected to become the driving force behind the global recovery because of the economies of Japan and the European Member States being highly dependent on the U.S.

In the Euro Area the pace of growth is slower than in the U.S. The European Central Bank adopted a more conservative approach in delivering the incentives for a quicker recovery from the stagnation. By cutting the interest rate from 4.75 % in late 2000 to the present level of 2% it provided also an opportunity for a subsequent reduction in the event of adverse developments arising from a continual future depreciation of the dollar against the euro and shrinkage in EU exports. Euro Area growth projections for 2003 and 2004, made by BNP Paribas, stand at respectively 0.3 and 1.3%. Germany registered a decline of 0.2 and 0.3% (on a quarterly basis) in each of the first two quarters of 2003. And projections of the 2003 GDP growth do not exceed 0.3%. The behavior and the prospects for the economies of Italy and France remain more comfortable compared to those for Germany. GDP growth in Italy is 0.8 and 0.4% for the same period, and the expected growth of the economy in 2003 is 0.4%. In France the growth rate is respectively 0.3 and 0.1% on a quarterly basis, and in 2003 the economy is expected to grow by 0.8%. The development of France, Germany and Portugal could be adversely affected by the registered deficits of over 3% of GDP in these countries. In 2004 Italy may well be expected to join this group too. Thus the number of EU countries, which are in breach of a key requirement of the Maastricht Treaty, will grow.

According to BNP Paribas the economies of Central and Eastern Europe have remained relatively unaffected by the economic decline in Europe. Despite that there exist a number of risks, the highest being those related to the slowed recovery of the European economy. This is going to impact the exports and the foreign direct investment inflows of these countries thereby affecting their growth prospects.

Table 1: Key economic indicators per selected countries

	Real GDP				Consumer Price Index				Current Account Balance as % of GDP			
	2001	2002	2003	2004	2001	2002	2003	2004	2001	2002	2003	2004
USA	0.3	2.4	2.6	3.9	2.8	1.6	2.1	1.3	-3.9	-4.6	-5.1	-4.7
Japan	0.4	0.2	2.0	1.4	-0.7	-0.9	-0.3	-0.6	2.1	2.8	2.9	2.9
Euro Area	1.5	0.9	0.5	1.9	2.4	2.3	2.0	1.6	0.2	0.9	0.8	0.8
Germany	0.8	0.2		1.5	1.9	1.3	1.0	0.6		2.3	2.4	2.1
France	2.1	1.2	0.5	2.0	1.8	1.9	1.9	1.7	1.7	1.8	1.2	1.6
Italy	1.8	0.4	0.4	1.7	2.7	2.6	2.8	2.0	-0.1	-0.6	-1.1	-0.9
Candidate countries		4.3	3.9	4.3	21.1	15.8	10.1	7.3	-2.8	-3.4	-4.1	-3.6
Turkey	-7.5	7.8	5.3	5.0	54.4	45.0	26.0	13.4	2.3	-0.9	-3.2	-1.9
Pre-accession	3.1	2.9	3.3	4.1	9.8	5.7	4.1	4.8	-4.5	-4.3	-4.5	-4.4
Baltic States	6.6	6.3	5.5	5.9	2.7	1.5	1.3	2.5	-6.6	-7.6	-7.5	-6.8
Estonia	5.0	5.8	5.0	5.1	5.8	3.6	1.7	2.0	-6.1	-12.4	-12.6	-9.2
Latvia	7.9	6.1	5.5	6.0	2.5	1.9	3.0	3.0	-9.6	-7.8	-7.3	-6.8
Lithuania	6.5	6.7	5.8	6.2	1.3	0.3		2.5	-4.8	-5.3	-5.7	-5.9
Central Europe	2.2	2.2	2.7	3.6	6.3	2.8	2.3	3.6	-4.2	-4.2	-4.2	-4.2
Czech Republic	3.1	2.0	1.7	2.6	4.8	1.8	0.6	3.5	-5.7	-6.5	-5.7	-5.1
Hungary	3.8	3.3	3.0	3.5	9.2	5.3	4.7	5.5	-3.4	-4	-5.7	-5.4
Poland	1.0	1.4	2.9	4.1	5.5	1.9	0.8	2.2	-3.9	-3.5	-3.3	-3.8
Slovakia	3.3	4.4	4.0	4.0	7.3	3.3	8.5	8.1	-8.6	-8.2	-6.3	-5.0
Slovenia	2.9	3.2	2.2	3.0	8.4	7.5	5.9	5.0	0.2	1.7	0.9	0.4
Mediterranean & SEE	5.1	4.6	4.6	5.0	25.1	16.9	11.2	9.5	-5.4	-4.0	-4.7	-4.7
Bulgaria ¹	4.1	4.8	5.0	5.3	7.4	5.8	2.5	4.1	-6.2	-4.4	-6.8	-6.1
Cyprus	4.1	2.2	2.0	3.8	2.0	2.8	3.6	3.5	-4.3	-5.6	-4.9	-4.7
Malta	-1.2	1.2	2.8	3.8	2.9	2.2	2.0	2.0	-4.5	-3.9	-3.4	-3.4
Romania	5.7	4.9	4.7	5.0	34.5	22.5	15.1	12.0	-5.5	-3.4	-4.8	-4.8

Source: World Economic Outlook, IMF, September 2003

In the period January through June 2003 the price of crude oil of the Brent type posted an upward trend. This contributed to a higher growth (of around 4%) of the oil exporting countries (Russia, Norway, Saudi Arabia). In the beginning of June the price of the Brent crude oil hit levels beyond USD 28 per barrel. It is still below the January levels (by 14.4%) but is by 15.7% higher year-on-year. The rise in prices is primarily due to the unremitting tension on the oil market preceding the June meeting of OPEC, as at end of May the oil reserves of the U.S. were at their lowest since 1973. Despite that, the resumption of a part of the Iraqi oil production will alleviate some of the tension because it is quite likely that the OPEC will undertake production-cutting measures. Oil prices are expected to gradually go down in the course of the year to levels like USD 26, 24 and USD 20 per

¹ Bulgaria data revised by the Ministry of Finance

barrel respectively in the second, third and fourth quarter of the year. According to World Bank projections oil prices in 2004 are expected to settle within the range of USD 20 – USD 22 per barrel. This is bound to have a positive effect on growth rates of the EU countries, which are net importers of oil.

The weakness of the U.S. currency prevailed in the first half of 2003 despite the successful end of the war in Iraq, despite reclaimed consumer and investor confidence and the surge in equity prices. Since the beginning of the year the American dollar has depreciated by 13% against the euro. Whereas in January 1 Euro traded per 1.06 USD, in June 1 Euro already traded per 1.17 USD. According to the expectations of international analysts the U.S. dollar is anticipated to go up beginning of next year, when the impact from the recovery of the global equity markets will be complete. However this will be short-term given the large current deficit of the U.S. and the change in the form of its financing. On the other hand, the stronger Euro will exert a negative influence on the growth prospects for European economies.

2. National economy development

2.1. Trends in the development of the national economy in 2003

The macroeconomic stability our country gained in the last few years was retained in the first half of 2003 too. The stability of the Bulgarian economy represents a key factor for the economic growth attained in the last five years, as well as for the gradual improvement in its standing conferred by international analysts and rating agencies.

Despite the slow pace of world economy recovery in 2002 and early 2003 the Bulgarian economy managed to realize an **economic growth** of 4.8% in 2002 and 4.1% in the first half of 2003. The 7.2% growth in individual consumption makes the biggest contribution to the real rise in the country-generated income in the first half-year. The gross formation of fixed capital in the first half-year of 2003 was up by 18% relative to the same period in the previous year. The high growth rate of the investment part of the GDP can be interpreted as an indicator of the future recovery of the investment activities of domestic and foreign entrepreneurs in the Bulgarian economy. The industrial sector experienced a 6.7% growth in the gross added value in the first half-year of 2003. The increase in the added value of the sector was anticipated because industrial output data indicated a similar positive trend (an increase by 14.4% in the first half-year relative to the same period of 2002). Industrial sales also posted a growth of 18.6%. The services sector, traditionally the most dynamic one in the Bulgarian economy, registered a 3.6% growth in the gross added value. It was only the agricultural sector that marked a drop of 0.7% and made a negative contribution to the total growth of the added value. Projected GDP growth in 2003 is 5%.

The process of growing the **real wage incomes** in the country has been sustained. In the first half-year of 2003 the country- average monthly wage stood at BGN 281.16 and is by 7.9% higher, in nominal terms, than the same period of the previous year. Expectations are that its monthly average value in 2003 will reach BGN 289.86, and a 4.0% real growth.

One of the key indicators of the macroeconomic stability attained in the country is the low **inflation** rate, based on a change in the Consumer Price Index (CPI). The inflation accumulated in the first nine months of 2003 remains low (at 1.2%), and inflation on a yearly basis (September 2002 –

September 2003) is 3.6%. 2003 cumulative inflation is expected to reach 3.9% mainly due to the higher prices of electricity, heat and telephone services as from July 2003.

The balance of payments current account ran a deficit in the period January through June 2003. It amounted to USD 982.2 million (5.2% of GDP) against USD 383.6 million (2.5% of GDP) in the same period of the previous year. The trade balance has largely contributed to the worsening of the current account (60.7%). The reasons include both the slow growth recovery across the major trade partners of Bulgaria and the rise in domestic credit. The balance of services is at USD 91.9 million. It has worsened by USD 57.6 million relative to the respective 2002 period. Net transport receipts are USD 114.3 million against USD 62.5 million in the respective period of the previous year. The balance of tourist services has improved to USD 271.7 million relative to USD 217.3 million in the preceding year, which is explained by the higher number of foreign tourists visiting the country. The significant contribution of the net income item towards the deterioration of the current account is due to a number of factors, including a rising share of private sector debt, operations for government debt restructuring, as well as dividends paid by a large foreign direct investment company to the foreign owners.

The trade volume trends in the first half of 2003 are expected to remain the same in the second half with the trade deficit rising to 11.1% of GDP. The deficit in the income account accumulated by June will add to the deterioration of the current account deficit, which is projected to reach 6.8% of GDP by the end of the year. Higher revenues from tourism and private transfers are expected to only partially offset the negative effects on the trade balance.

In the first seven months of 2003 money supply increased in nominal terms by BGN 1,006.6 million (7.2%), reaching BGN 14.97 billion. This growth is attributed mainly to the rise in the BGN-component of the money stock by 6.7% (BGN 581.4 million) while the foreign exchange component rose by 8.1% (BGN 425.2 million). High-powered money (M1) increased by 4.5% or BGN 246.7 million over the first seven months of 2003, and the quasi-money increased by 5.6% or BGN 452.3 million. All components of the quasi-money have increased. The foreign exchange component though posted a higher increase of 6.6% (BGN 334.3 million), while the BGN component rose by 4% (BGN 118 million). The components of the less liquid money also played a significant role in increasing the broad money (BGN 307.6 million) in the period of December 2002 through July 2003.

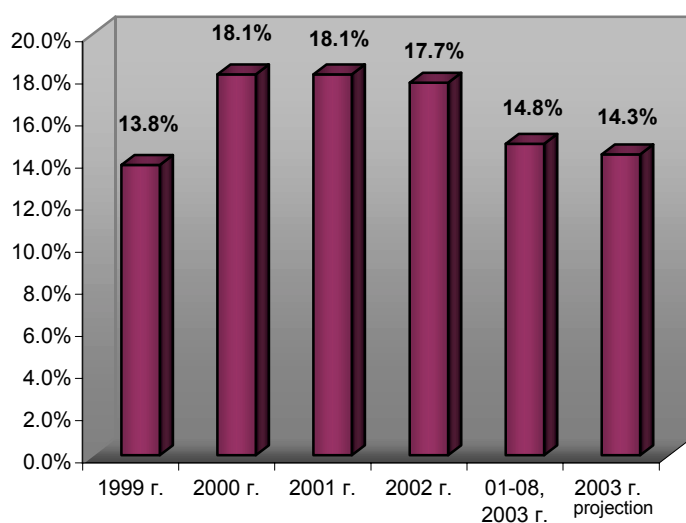
From the perspective of the **banking system** assets the increase in the money supply in the first seven months of 2003 is attributed to the increase in the net domestic assets, and the domestic credit in particular. Domestic credit rose by 8.1% (BGN 618.2 million) in the period between end-2002 and July 2003. The structure of bank assets is changing, which can be seen in the declining share of foreign assets and a growing share of credits to private enterprises and households. This is also associated with the large interest differential at home and abroad, even though there is a clear tendency of converging of interest rates in recent years.

Consumer credits have been growing rapidly and at August 31, 2003 they reached BGN 1,460 million, which is 18.25% of the total credits. **Corporate loans** account for approximately 80% of credits. A large portion of the borrowed resources is used for purchasing imported investment goods and equipment used in export-oriented sectors. The credit expansion is not accompanied by a growth in the doubtful and irregular exposures, which are fully provisioned. Cumulative profit in the banking sector has grown substantially and at August 31, 2003 it stood at BGN 267 million.

2.2. Demographic profile of the population and the labor market

In the last two years the unemployment rate saw a steady downward trend. According to the Employment Agency data the number of registered unemployed at end-August 2003 was 480 881. As can be seen from the chart below the unemployment has reached its lowest levels in the last four years, getting closer to the levels registered in the beginning of 1999 when the economic restructuring processes accelerated, followed by sharp rise in unemployment.

Chart: Annual average unemployment rates in Bulgaria in 1999 – 2003



In a year's time (July 2002 – July 2003) the number of registered unemployed decreased by 25.1 percent, which represents the largest annual drop registered by the Employment Agency so far. To a very large extent this is due to the expansion of the active labor market programs. In the first seven months of 2003 the number of people included in the active labor market programs is over four times higher than in the same period of 2002.

The decline in the registered unemployment is attributed to the higher demand for labor from entrepreneurs. According to the Employment Agency data the vacancies reported in the first seven months of 2003 (other than those offered under the active labor market programs) increased by 14% compared to the same period in 2002. It can be considered that the labor productivity of the Bulgarian economy has been growing, since the growth in employment is smaller than the growth in the economy's gross added value.

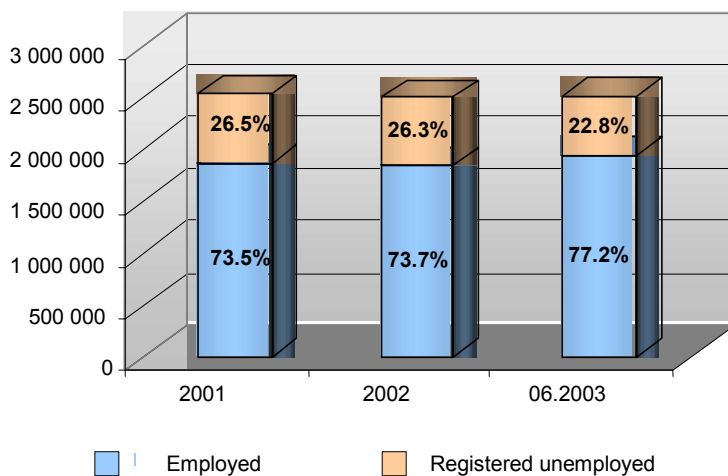
While examining the employment rate and the measures to encourage it one needs to account for the demographic structure of the population and the characteristics of the labor market. This is necessary because of the impact and importance of the demographic factor on the country's economic development, and on the redistribution processes. The worsening of the demographic profile of the population is constraining the government policy and requires high social spending.

Individuals outside the work force were 3 344.7 million at June 30, 2003. The number of pensioners, although declining due to the increased minimum retirement age and length of service, still remains at very high levels. The continued ageing of the population has become even more worrisome, with the number and share of population below 15 of age continuously declining. Conversely, the number and share of people aged above 65 is increasing. While in 1990 the relative share of young people below 15 was 20.1%, and the share of the elderly aged above 65 was 13.4% in the total population, in 1995 these shares are respectively 17.7% and 15.2%. In 2002 the relative share of the young was

14.6%, whereas the elderly already accounted for 17.0% of total population. There is the ongoing trend of a falling natural increase of the population. The birth rate is expected to remain at the levels of the recent years 8.6-9% and the mortality rate at 14-14.1%. Since 2004 the number of school-aged population in the country is projected to decline by 11 897 individuals.

The unemployed-to-vacant jobs ratio is the broad indicator for the tension on the labor market and the chance of finding a job (and this is without consideration for the need to match employers' requirements for work force quality with the professional and training profile of job-seekers). The average value of this indicator in the first quarter of 2003 is 13:1, against 27:1 in the same period of 2002. The trend at play is actually a result of the number of jobs offered and the number of unemployed. At the same time it is envisaged that the budgetary sector will provide another 51 thousand people with jobs under the program and measures set forth in the Employment Promotion Act. Employment is highest in the South-Western (860.9 thousand) and the South-central (711.6 thousand) regions. It is lowest in the North-Western part of Bulgaria - at 159.1 thousand individuals. Furthermore, 76% of the employed work in urban areas, and the remaining 24% in rural areas.

Chart: Level and structure of the work force:



3. Macro framework of the 2004 State Budget

Table: Key macroeconomic indicators

Macroeconomic indicators	2000	2001	2002	2003 projection	2004 plan	2005 plan	2006 plan
GDP in current prices (BGN million)	26 752.8	29 709.2	32 323.7	34 966.0	37 983.0	41 342.0	45 051.0
- real growth	5.4%	4.1%	4.8%	5.0%	5.3%	5.3%	5.5%
Inflation (%)							
- end- period	11.3%	4.8%	3.8%	3.9%	4.2%	3.1%	3.9%
- period average	10.3%	7.4%	5.8%	2.5%	4.0%	3.2%	3.9%
Exchange rate (BGN/USD) Annual average	2.1	2.2	2.1	1.8	1.8	1.8	1.8
Current account (USD million)	-703.7	-842.2	-679.3	-1 365.0	-1 337.2	-1 184.9	-1 155.0
% of GDP	-5.6%	-6.2%	-4.4%	-6.8%	-6.2%	-5.1%	-4.6%
o.w. trade balance (USD million)	-1 175.5	-1 580.5	-1 594.4	-2 211.0	-2 325.0	-2 219.0	-2 297.0
% of GDP	-9.3%	-11.6%	-10.3%	-11.1%	-10.7%	-9.5%	-9.1%

2003 projected **GDP growth rate** is approximately 5%. It will remain at this level in 2004 too (5.3%). This growth will be achieved both through a real increase in income, and an increase in the credit to households. During the next year the level of investments is expected to reach 21.5% of GDP. This increase will be financed mainly through domestic savings, which will reach 15.4% of GDP. In order for this scenario to materialize there needs to exist a robust financial system. Rising growth rates of the world economy and of the European Union at end of 2003, as well as the enhanced productivity and competitiveness of Bulgarian producers, following the investments made in recent years, will give an impetus to the export of goods and services during the period in question. The real growth in the exports in 2004 is expected to range between 5.5% and 6%, making it an important factor of growth.

The assumptions made in the macro framework about the BGN/USD exchange rate are based on IMF projections, which envisage a depreciation of the U.S. dollar, staying at an annual average of BGN 1.8 per dollar in 2003. The expectation being that it will remain at this level in the period 2004-2006. In 2004 it is expected that the yearly oil price per barrel will be at USD 25.

International interest rates are projected to stay at the current levels until the end of 2003. No substantial increase should be expected during the next year because of the slow recovery of the world economy. This significantly reduces the risks facing the balance of payments and relating to capital outflows in the shape of bank deposits. It also cushions the risk of deterioration in the current account caused by higher interest payments.

Preservation of the macroeconomic stability and the enhanced competitiveness of the Bulgarian economy are expected to contribute to a further decrease in **inflation**. In the period between December 2003 and December 2004 inflation is projected to stand at 4.2%. This rate, which is by 1-2% higher than the one in the Euro Area, is due to the steps endorsed 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 relation to the commitments made by this country at the EU accession negotiations.

It is supposed that in 2004 and in the following 2 years the **number of the individuals employed** in the economy will be growing at a rate between 1% and 2%. The major part of the economic growth will again be secured through labor productivity gains. The average wage income in 2004 is estimated to reach BGN 310 and mark a real growth of 2.7%.

Based on 2003 indicators and given the previously described expectations about the developments in the economic environment in 2004, the projection is that next year's **current account deficit** should be contained to 6.2% of GDP, and that of the trade balance should amount to 10.7% of GDP. Over the short-term it is highly possible that the trade deficit as percent of GDP should decrease resulting from an improved external demand and a higher competitiveness of the Bulgarian exports.

II. Implementation of the consolidated fiscal program for 2003

The results reported in connection with the hitherto execution of the consolidated budget present solid reasons to expect that the fiscal policy objectives set in the 2003 Budget shall be met in real terms. They include the requirement to maintain fiscal sustainability and macroeconomic stability, contribute to meet the objectives relating to NATO and EU membership and support the pre-accession process, finance priority expenditures, as approved by the State Budget Act, channel the positive outcomes from revenue overperformance and the expected savings towards certain spending items, mainly with a view to provide additional funds for to the commitments made in the Annual Budget Act in respect of the delegated state activities financed through the municipalities and to bail out the deficit in the budget of the National Health Insurance Fund.

1. Review of the fiscal stance as of June 2003

Table: Performance of key budget indicators in BGN million

Indicators	June 2002	2003 г. Program	June 2003	2003 г. estimate	Performance at June 2002	Performance per 2003 Program	Estimate per 2003 Program
Revenues, incl.:							
- taxes	6 067,1	13 372,6	6 828,8	13 570,8	112,6 %	51,1%	101,5%
- non-taxes and grants	4 633,4	10 662,4	5 314,2	10 838,0	114,7 %	49,8 %	101,7 %
	1 433,7	2 710,2	1 514,6	2 732,8	105,6 %	55,9 %	100,8 %
Expenditures, incl.:							
-current non-interest	5 796,0	13 635,4	6 206,7	13 833,6	107,1 %	45,5 %	101,5%
-capital	4 936,7	11 563,9	5 351,9	11 878,4	108,4 %	46,3 %	102,7 %
-interest	421,4	1 232,8	400,2	1 192,2	95,0 %	32,5 %	96,7 %
	437,9	838,7	454,6	763,0	103,8 %	54,2 %	91,0 %
Balance	271,1	-262,8	622,1	-262,8			

The data at June 30 provide a reason for a positive evaluation of the execution of the consolidated budget. In the first half-year the cash surplus amounts to BGN 622,1 million or an excess of BGN 351,0 relative to the same period of the previous year.

The accumulated revenues for the period is equivalent to BGN 6 828,8 million making 51,1 % of the program. Revenues from corporate income taxation are by 3,6 % higher than the respective period of 2002. This is primarily due to the sizable proceeds obtained in March and April of 2003 from taxes paid under annual tax returns reporting higher financial gains in 2002 relative to 2001. The administrative measures, which the tax and customs administrations undertook in order to enhance compliance of public receivables, have largely contributed to the achievement of revenue levels that are by 12,6 % higher than the respective period of 2002. Customs duties and taxes on imported goods register an increase across all categories of goods, resulting from the growth in the volume of imports, which is higher than the one planned for this period. Overall, the position of the personal income tax does not deviate from projected levels. This is largely helped by the measures relating to the mandatory registration of employment contracts with the NSSI, as well as the considerable growth in the number of employed individuals during the tourist season.

Half-year expenditures are at the level of BGN 6 206,7 million or 45,5 % of the program. These have been carried out in accordance with a previously endorsed schedule in compliance with the lawfully established limitations and priorities.

Budgetary systems' urgent and priority spendings have been regularly financed. At the same time, some of the systems, like health care, education and farming saw the application of the scheme of front-loading of financing with a view to support them when larger seasonal expenditures were incurred and to prevent the accumulation of arrears.

2. Evaluation of the consolidated budget implementation by the end of 2003

The review of the fiscal stance as well as the positive results achieved so far should be placed in the context of the trends and expectations for the development of the major macroeconomic determinants. The Government is ready to undertake countervailing measures in respect of the consolidated budget deficit target level, should the trend of a growing deficit remains in the balance of payments current account, resulting from the considerable depreciation of the U.S. dollar against the Euro.

Under the conditions of the Currency Board Arrangement the fiscal policy is a major safeguard against changes in the macroeconomic environment arising from adverse domestic and external factors. Therefore, the execution of the budget supports the Government in the conduct of a reasonable, flexible and prudent fiscal policy with a view to maintain macroeconomic stability.

As has already been mentioned, the positive assessment of budget execution, on the overall, makes a case for one to expect revenue overperformance in the consolidated budget by around 2% in excess of the program. Revenues as percent of GDP are expected to preserve the level attained in the previous two years. The overperformance of revenues is estimated to occur mainly in relation to the following items: corporate income tax, indirect taxes (including VAT, excise tax and customs duties) and non-tax revenues. The projection for revenues from corporate income taxation to be higher than planned are based on the growth gained in the 2002 profit compared to 2001 as reported by multiple financial and non-financial enterprises, as well as on receipts under larger tax audit acts. The trends observed with revenues from personal income taxation confirm the expectations for attainment of the planned level. A sizable overperformance of VAT in import of goods is expected to occur, explained by sharp increase in the volume of import.

A saving of interest expenses is expected to occur within the consolidated budget expenditures . This is mainly due to the exchange rate being lower than the one used for the estimates of interest payments in the budget framework. Performance of this indicator will be around 91 % of the annual estimate. Savings are expected to generate also at the item of capital investments, primarily connected with the implementation of EU funded program. Regarding the disbursement of EU pre-accession funds delays in the procurement procedures have been reported for the ISPA Program, where some large-scale projects have been planned for construction, requiring land expropriation procedures, etc. Adequate measures have been taken to speed up this process, like: amendments to the Spatial Planning Act, the required financial resources have been secured for the budgets of the respective agencies to proceed with expropriation procedures, etc. With a view to apply an integrated approach to water management in the ISPA environment sector the financial memoranda have been

revisited to include additional activities, which will be financed by EU funds (like sewerage system, collection units, etc.).

The positive impacts from the revenue overperformance and the expected savings on some expenditures will be carefully refocused onto some other spending priorities of the Government, with the macroeconomic stability being kept along with the possible countervailing measures relating to the target level of the budget deficit.

Municipalities

In connection with the commitments made in the State Budget Act for the delegated state activities, which are financed through the municipalities, the additional funds needed until the end of the year are provided. According the provisions of Art.9, para 4 of the 2003 State Budget Act of the Republic of Bulgaria BGN 155.8 million will be provided to cover by 100 percent the shortfall in the operating costs of the delegated state activities.

The municipalities are expected to overperform their own revenues by over BGN 100 million relative to the initial estimates under the 2003 consolidated program. This will make it easier to finance supplementary municipal expenditures of priority. Further, resulting from the joint effort being made on the part of the municipalities and the central authorities, arrears have tended to gradually decrease in respect of municipal and state activities.

Social security funds

Regarding the budget of the NSSI it is expected that both planned revenues and expenditures will attain a lower performance level, which does not change the overall budget balance. Efforts have been made to resolve outstanding internal and external issues, which had led to the lower level of revenue compliance. These took the shape of amendments to the social security regulations as from January 1, 2003. The Social Security Code also saw a number of measures made in order to develop and improve the insurance system in the country in compliance with the developments in the EU Acquis. The amendments are basically related to the level of the contributory earnings (“social security income”), the introduction of a minimum monthly threshold of contributory earnings per major economic activities and categories of occupations, social security collection enforcement, introduction of a higher administrative and penal liability for officials allowing payment of income without remittance of social security contributions. Apart from that, the matter of the supplementary social security has been rearranged. It provides the opportunity for a more efficient regulation and oversight by the state, as well as higher guarantees as to the financial sustainability of insurance companies, managing the supplementary social security funds.

Regarding the NHIF’s budget the projection for the execution of the expenditure side indicates that in case the average monthly spending on drugs is preserved at the same level, to date this spending is approximately BGN 19 to 20 million, another BGN 45 million will be needed until end of 2003. In order to secure the optimum minimum of the budgetary health insurance payments for 2003, NHIF’s reserve resources have been activated to an amount of BGN 73.2 million. The mentioned amount will be provided through an urgent adjustment of the NHIF’s budget. Alongside the measures envisaged so far efforts are being made with a view to optimize and enhance the efficiency of drug spending. Some additional cost-saving mechanisms have been triggered, the objective being to step up the

medical and financial oversight on drug prescriptions and reimbursements, make reporting timeframe clearer, clarify penalties to be levied where non-compliance is established.

Budgets of ministries and agencies

The evaluation of the expected execution of the expenditures of ministries and agencies is based on a careful analysis of the positive and negative budgetary impacts by the end of the year. It also reflects the desire for efficient disbursement of funds with a view to attain an optimum allocation of the limited budget resources. That is why there are many cases where opportunities are sought within the limits of the approved budget to secure the financing of priorities by internal reallocation and optimization of spending.

The health care system has undertaken certain measures in order to reduce liabilities of hospitals and enter into obligations on their behalf to pay off their arrears. With the new Framework Agreement the NHIF is going to focus on paying for the most resource-intensive part of hospital care – surgery, which is what generates the highest portion in the liabilities of hospitals.

With the better execution of the 2003 budget the Government will take the opportunity to channel additional resources across the respective sectors and priority areas to support the ongoing reforms and the fulfillment of its program.

III. Medium-term fiscal strategy

The medium term fiscal strategy of the Republic of Bulgaria is based on the Bulgaria's Government Program. The key objective is to maintain the macroeconomic stability and to create conditions for sustainable growth in the long term while improving the living standards of the population.

The improvement of the living standards is the social aspect of the economic objectives and is key for achieving sustainable long-term growth. In this context the efforts have been directed to promoting employment, raising income levels, enhancing labor market flexibility, and guaranteeing social protection to socially disadvantaged groups. The social dimension of the fiscal policy requires availability of resources for the active labor market programs and the maintenance of an equitable and efficient social security system targeted at the needy.

There are two important factors, which influence the choice of economic tools needed to achieve the above-mentioned goals.

- Retaining the Currency Board Arrangement.
- Current status and expected trends in the Bulgarian and the world economy.

The Currency Board Arrangement is in itself a source of stability and security for the economy, provided that the principles of this arrangement are duly applied. With an open economy like the Bulgarian one and given the insufficiently strong financial discipline, such a measure represents the strongest guarantee for the macroeconomic stability. On the other hand, under the conditions of the Currency Board, the fiscal policy is the only flexible tool for pursuing an active economic policy.

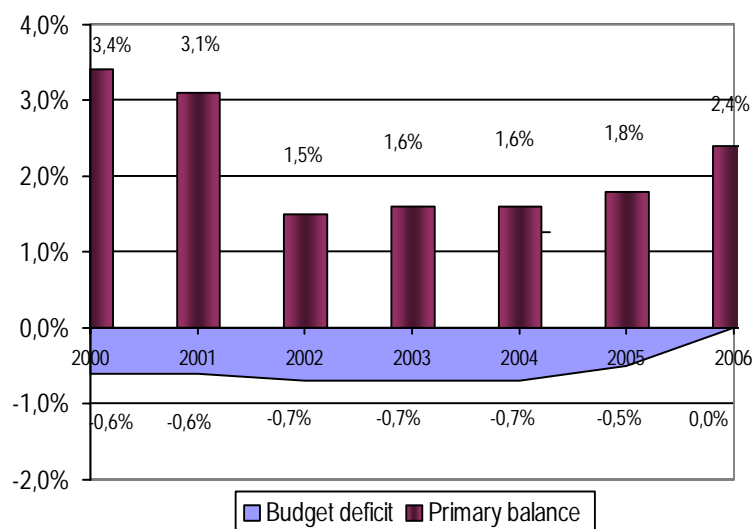
Usually the major threat to the Currency Board Arrangement is the continuing external current account and trade deficits as they lead to draw down of international reserves and put pressure to the local currency by depreciating it. The latest data on the current account for January-June 2003

indicate unfavorable trends in the trade balance of the country. Over the longer term export is projected to grow due to expected improvements in the international economic environment as a whole, and in the EU Member States in particular, as well as the improved investment activities of the Bulgarian entrepreneurs. These trends underlie the projection for a gradual contraction of the current account deficit.

The fiscal aspect of the economic measures in this context boils down to an avoidance of the twin deficit and attainment of a balanced budget.

Chart: Consolidated Fiscal Deficit and Primary Balance

2000-2006 (as % of GDP)



The fiscal framework for the period 2004-2006 envisions a gradual reduction of the budget deficit in the consolidated budget and attainment of a balanced budget under the following terms: 2004 – 0.7%, 2005 – 0.5%, 2006 – balanced budget. The inability to attain a zero budget deficit in the previous years is predetermined by the commitments made to ease the tax burden, utilize EU pre-accession funds and advance the on-going public sector reforms.

The low budget deficit is a sign of the commitment of the Bulgarian Government to curtail public spending approximately to the level of revenue raised in the budget. Thus it will relieve the debt burden for the future generations.

In theoretical terms there are two indicators, which need to be monitored for the purpose of pursuing a robust mid-term fiscal strategy.

- ✓ Positive levels of the primary surplus
- ✓ Declining government debt –to-GDP ratio.

The reporting data and the indicators incorporated in the mid-term fiscal strategy show that both criteria have been met. Over the period 2004-2006 the primary surplus is projected to be in the range of 1.6-2.5% of GDP. This is prompted by the expectations for lower interest rates, the national economy growth rate and the consistent public expenditure policy. The declining trend of government and government guaranteed debt as percent of GDP, as well as the achieved levels of below 60% of GDP show that the budget deficits have been kept low and that the economy is growing at a healthy rate.

Within the framework of the above-mentioned constraints, a key priority to the budget policy is to secure sufficient resources for the health system reform and to improve the services provided by this sector. For that purpose 4.3% of GDP have been allocated for health, which is by 14.6% higher than the health care resources in 2003. The education expenditures are also increasing significantly (4.1% of GDP) as compared to 2003 – an increase of 14.8% related to the introduction of a mandatory pre-

school education and a 13-th grade, coverage of the full per capita cost at municipal schools and the per capita costs for the first, second and third year of studies at higher schools. It is expected that in 2005-2006 these sectors will restructure and strive at increased private financing. A key priority in 2004-2006 will be the expenditures related with the accession to the European structures, including disbursement of pre-accession funds.

In the category of total non-interest expenditures for the period 2004-2006 the following is envisaged: around 36.8% for social security, social assistance and welfare services including contingency, over 13.5% for defense and security, approximately 10.9% for economic affairs.

As from the beginning of 2004 the ceiling for pensions has been planned to be raised from BGN 200 to 420. Substantial amounts have been allocated for other measures and program in the social sector, including a continuation of the active labor market programs. Salaries in the budgetary sector and the social transfers will be indexed on an annual basis.

The plan for the tax policy is to pursue an overall reduction in the tax burden. Beginning of next year the corporate profit tax rate has been planned to decrease from 23.5% in 2003 to 19.5% in 2004. The three-year period is to see a gradual reduction in the dividend rates collected from enterprises where the state holds interests. The level of the health insurance premiums are planned to stay at 6% in 2004 and rise to 8% in 2005.

The macroeconomic stability as ensured by the fiscal policy and the maintenance of the Currency Board Arrangement will stimulate the economic development. The state's withdrawal from the economy, the lowering of the tax burden and the broadly balanced budget will induce private investment growth. On the other hand, tax breaks have not been planned for any specific sector of the economy in order to avoid possible market mechanism distortion. The measures meant to encourage employment and economic growth will lead to a rise in employment, hence a rise in the living standards of people. The lower budget deficit and export incentives will gradually help settle the current account issues.

CHAPTER 2: Revenues and Tax Policy

The total budget revenues for 2004 are projected to be in the amount of BGN 14,361.7 million and will account for 37.8 percent of GDP.

The revenue estimates take into account the adjustments in the projected macro-framework indicators, including GDP and the US Dollar exchange rate, the 2003 revenues which are affected by a number of factors – changes in export volumes and structure, domestic consumption, privatization, legislative changes, etc.

Table: Revenues into the 2001-2004 Consolidated State Budget

Mill. BGN	2001		2002		2003		2004	
	Report	% GDP	Report	% GDP	Program	% GDP	Program	% GDP
Total revenues	11,837.5	39.8	12,523.3	38.7	13,373.8	37.9	14,361.7	37.8
Tax revenues	9,190.5	30.9	9,596.8	29.7	10,662.4	30.2	11,532.8	30.4
<i>Direct taxes</i>	5,198.1	17.5	5,103.8	15.8	5,23.8	16.2	5,901.5	15.5
Corporate taxes	1,150.3	3.9	975.8	3.0	947.0	2.7	937.0	2.5
- non-financial entities	811.6	2.7	871.3	2.7	838.5	2.4	814.6	2.1
- financial sector	338.7	1.1	104.5	0.3	108.5	0.3	122.3	0.3
Personal income tax	1,062.8	3.6	1,052.4	3.3	1,073.0	3.0	1,108.8	2.9
Revenues from insurance funds	2,984.9	10.0	3,075.7	9.5	3,703.9	10.5	3,855.7	10.2
- NSSI, UPF (Universal Pension Fund), and PTU (Professional Training & Unemployment)	2,399.5	8.1	2,459.9	7.6	2,971.4	8.4	3,099.3	8.2
- NHIF	585.5	2.0	615.8	1.9	732.5	2.1	756.4	2.0
<i>Indirect taxes</i>	3,756.6	12.6	4,190.3	13.0	4,624.6	13.1	5,287.7	13.9
VAT	2,454.4	8.3	2,688.0	8.3	2,943.2	8.3	3,336.4	8.8
Excise duties	1,106.8	3.7	1,313.9	4.1	1,501.3	4.3	1,747.0	4.6
Duties and customs charges	195.4	0.7	188.4	0.6	180.1	0.5	204.3	0.5
<i>Other taxes</i>	235.9	0.8	302.7	0.9	314.0	0.9	343.6	0.9
Non-tax revenues	2,283.7	7.7	2,624.8	8.1	2,210.6	6.3	2,363.5	6.2
<i>Transfers form BNB</i>	174.6	0.6	172.8	0.5	150.0	0.4	156.0	0.4
<i>Others</i>	2,109.2	7.1	2,452.0	7.6	2,060.6	5.8	2,207.5	5.8
Grants	363.2	1.2	301.8	0.9	500.8	1.4	465.4	1.2

In accordance with the 2003-2005 tax policy, the goal is to achieve sustainable economic growth and stability. In order to attain this goal provisions have been made for an annual reduction in direct tax rates.

Bulgaria's economic growth needs a higher level of investment, and the alleviation of the tax burden is conducive to such development. The comparative analysis shows that the corporate tax rates rank amongst the lowest levels in the countries of the region. Sustaining this advantage and its appropriate use in combination with the simplification of the administrative procedures for taxpayers will make the Bulgarian economy more attractive to foreign investors.

The priorities in the Government's tax policy are as follows:

- Overall reduction of the tax burden within the balanced budget;
- Maintaining the stability of the tax system;
- Development of the legislation in line with the requirements of the EU *acquis*;
- Clear definition of the rights and obligations of taxpayers and the tax administration in view of promoting the administration's capacity;
- Sector neutrality and equitable treatment of tax liable persons.

1. Corporate Taxes

The amendments to the Corporate Income Tax Act are aimed at boosting investment, strengthening the economy's capacity to ensure an increase in output, and, hence, higher employment and income levels.

Legislative Changes

- Reduce the corporate tax rate from 23.5 percent down to 19.5 percent.

This reduction in the corporate tax rate will "free" cash for the business, and will promote the economic opportunities for production and investment.

- Reduce the rate for the taxation of donations for the BRC (Bulgarian Red Cross), medical and health establishments, orphans, disabled people, etc. from 20 percent down to 15 percent.

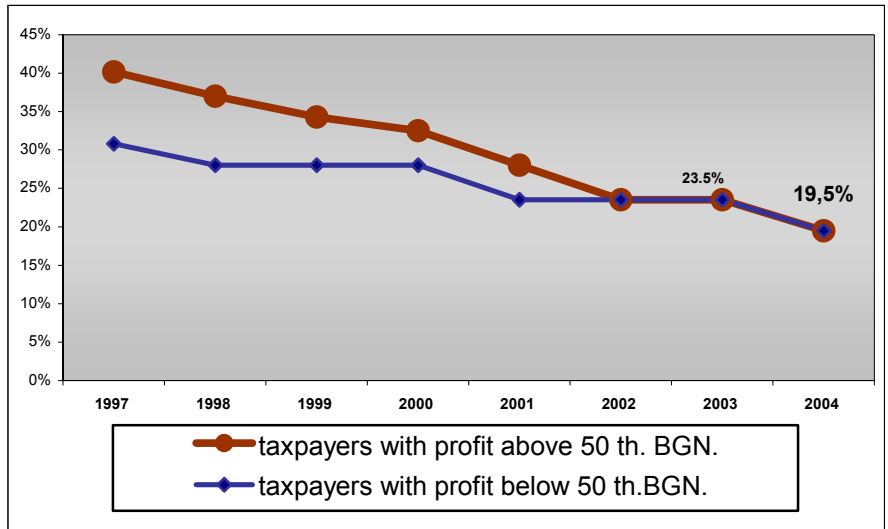
The purpose of the changes proposed is to encourage donations and support various organizations and socially disadvantaged individuals; it could be regarded as a follow-up of the policy along this line over recent years.²

- Change in the regime of budget-funded enterprises taxation for their business activity. A one-off tax on their revenues from business activity in the amount of 4 percent is introduced.
- A proposal with regard to a more favorable treatment of expenditures for staff transport.

² (See the Report on the 2003 State Budget Law, p. 29: Introduction of tax exemptions for donations from natural persons, working only on the basis of contracts of employment under the same conditions as for self-employed persons).

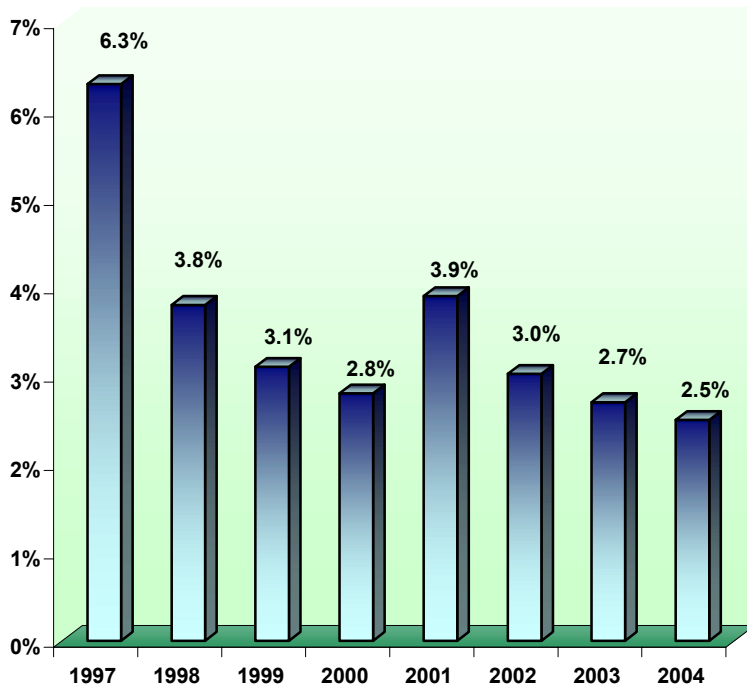
The lower corporate tax rate (19.5%) will improve the investment environment in the country, and will promote corporate profit and revenues.

Chart: Tax Rates for 1997 – 2004



Projected Revenues

Chart: Relative Share of Corporate Taxes of GDP for 1997 – 2004



The revenues from corporate taxes (including dividend and insurance premium taxes) for 2004 are estimated at BGN 937.1 mill. (2,5% of GDP).

Non-financial Institutions

The 2004 corporate tax from non-financial institutions (including non-for-profit organizations and budget-funded enterprises) is estimated at BGN 814.7 million, including the projected revenues from dividend and income taxes in the amount of BGN 61 million.

Financial Institutions

The corporate tax from financial institutions is estimated at approximately 122.3 mill. BGN, including the projected revenues from the insurance premium tax which is expected to be approx. 25.5 mill. BGN.

The above estimates take into account a one-off revenue as a result of the introduction of the international accounting standards into the banks' financial reports..

2. Personal Income Taxation

The table below contains the forecasts for the dynamics of the average salary, the nominal and the real income after taxation; all the three indicators show growth in 2004 compared to 2003.

Table: *Incomes of the Population*

Indicator	2003 Projection- BGN	2004 Program-BGN	2004 Growth
Average salary	301.6	322.4	6.9 %
Nominal income for consumption	236.8	252.9	6.8 %
Real income for consumption (2003 basis)	231.0	243.0	5.2 %

Taking into account the fact that no changes are planned for the 2004PIT scale, the growth in the nominal and real incomes for consumption is based mainly on the expected salary growth in 2004.

Table: *Monthly Taxation Scale for 2004*

Tax base	Tax due under the PITL
up to BGN 120	non-taxable
from 120 to BGN 150	BGN 0.0 + 12 % on the amount above BGN 120
from 150 to BGN 250	BGN 3.6 + 22 % on the amount above BGN 150
from 250 to BGN 600	BGN 25.6 + 26 % on the amount above BGN 250
above BGN 600	BGN 116.6 + 29 % on the amount above BGN 600

Legislative Changes

- A proposal to reduce the threshold, which is the condition for presumptive (patent) taxation from BGN 75 to 50 thousand.
- A proposal to regroup the settlements for the purpose of presumptive taxation, which will result in lowering the amount of the presumptive tax (patent tax) for the various businesses.

The findings of the settlement grouping show that there is lower demand in a number of settlements with lesser population. The current tax amount is high and is inconsistent with the business environment in these settlements. Therefore, a proposal has been put forward to transform certain towns into a lower tax group, which would be commensurate with the real turnover of goods and services consumption. A more fair tax level will result in improved collection.

- As presumptive taxation is to be applied to small local businesses, the production of foodstuffs and other mass consumption commodities is excluded from the scope of this tax.

Projected Revenues

The 2004 projected revenues under the PITL (Personal Income Tax Law) amount to BGN 1,108.8 mill.. The factors that determine this forecast are the average salary, the number of the employed and the expected presumptive tax.

3. Revenues from Payroll Taxation

The 2004 projected revenues from payroll taxation amount to BGN 3,855.7 mill., including BGN 756.4 mill. from health insurance contributions and BGN 3,099.3 mill. from social security contributions.

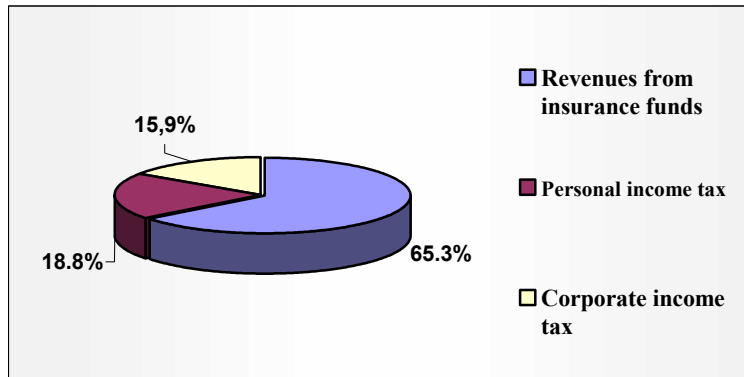
The planned revenues from **health insurance contributions** are calculated on the basis of the full coverage of the population across the country. The 2004 budget of the NHIF provides for maintaining the 6-percent contribution rate. A 3.3-percent growth on the 2003 budget is proposed. The main source of tax revenues from health insurance contributions comprises the contributions for employees made by employers. The contribution ratio employee/employer will also be maintained at the 75:25 level in the 2004 fiscal year.

The projections for **social security contributions** revenues are based on the following:

- Increasing the average social security income up to BGN 307.13 compared to BGN 290.50 in 2003.
- Keeping the 2003 level of minimum social security income for self-insured persons at BGN 200, and increasing the maximum social security income for all insured persons from 1,000 up to BGN 1,200.
- The social security contribution rate for mandatory supplementary pension insurance for individuals born after 12/31/1959 r. as from 2004 will be 3 percent compared to the current 2 percent rate.
- Maintaining the employer/employee ratio of 75/25 for the contributions to the Pension Fund, the General Sickness and Maternity Fund, and the Unemployment Fund.

- The increase in the number of the insured for 2004 – 2, 341,644 people (2,284,677 persons under the 2003 Budget Law).

Chart: *Relative Share of Direct Taxes*



The chart clearly shows that the contributions from insurance funds hold the biggest share (65.3%) of the 2004 revenues from direct taxes.

4. Value Added Tax

Legislative Changes

Changes have been proposed in respect of the exemption regime under international contracts, conventions, agreements, etc. approved by the National Assembly. This revision envisages tax exemption for supplies under projects with direct grant funding within the framework of international agreements to which the Republic of Bulgaria is a signatory, including those parts of the projects that are financed from the state budget and/or with funds from IFI loans with sovereign guarantee.

Projected Revenues

While the tax which will not flow into the budget as a result of the proposed change amounts to BGN 25.8 mill., the effect on the budget will be null, as the VAT due will contribute to downsizing the expenditure item of the state budget.

The main factors which affect the projection estimates regarding the value added tax are GDP and its structure by consumption items, the foreign exchange rate, the inflation rate.

- The US Dollar exchange rate has the strongest impact on the changes of the projections for the VAT on the 2004 import. The calculations show that the expected revenues from the VAT on the 2004 import amount to BGN 2,900 mill..
- The introduction of the scheme "active improvement" – non-reimbursement of tax credits for the export of products imported for reprocessing purposes – is taken into consideration in respect of the revenues from VAT for domestic transactions.
- The expectations are based on the improved tax collection as a result of the Government's measures.
- The introduction of new excise duties on fuel and tobacco items also affects the increase in the revenues from this tax

Table: Revenues from VAT for 2004

Factors with impact on VAT	2004 Project
<i>1. VAT from import</i>	<i>BGN 2,900.0 mill.</i>
<i>2. VAT from domestic transactions (net)</i>	<i>BGN 412.3 mill.</i>
<i>3. VAT from ministries and agencies</i>	<i>BGN 24.1 mill.</i>
<i>Total VAT projected</i>	<i>BGN 3,336.4 mill.</i>

5. Excise Duties

Legislative Changes

The amendments proposed to the Excise Duties Law are aimed mainly at aligning the Bulgarian legislation with the EU *acquis*.

The proposals are as follows:

1. The taxation of mineral oils (gas, gas oil, kerosene) is changed from BGN/ton into BGN/1,000 liters at 15° C. The change is related to the alignment of our legislation with the EU *acquis*.
2. Transformation of liquid fuel road and environmental taxes into excise ones.
3. Increase in the excise rates for fuel, as follows:
 - gas – by 41 BGN/ton. The effect on the retail price under equal other conditions is 4.6 percent;
 - gas oil – by 57 BGN/ton. The effect on the retail price under equal other conditions is 6.9 percent.
 - propane-butane – by 80 BGN/ton. The effect on the retail price under equal other conditions is 9.6 percent.
4. Increase in the excise rates for cigarettes, as follows:
 - filter cigarettes – 0.004 BGN/piece + 43.5 percent of the sale price (so far 0.002 BGN/piece + 40 percent of the sale price);
 - non-filter cigarettes – 0.002 BGN/piece + 20 percent of the sale price (so far 0.001 BGN/piece + 15 percent of the sale price).
5. Decrease in the excise rate, as follows:
 - cigars – from 1 BGN/piece + 10 percent of the sale price up to 270 BGN/1000 pcs.;
 - pures – from 0.20 BGN/piece + 10 percent of the sale price up to 270 BGN/1000 pcs.;
 - coffee extract – from 3.5 BGN/Kg up to 1.5 BGN/Kg.
 - powder mixtures with over 10% coffee extract – from 1,3 BGN/Kg up to 1 BGN/Kg.

The excise rate reduction under item 5 has been proposed due to the unjustified high rates of excise duties for these types of commodities in Bulgaria compared to the minimum EU levels, and in view of bringing the Bulgarian legislation into line with the EU *acquis*. The effect of these reductions on the budget is a loss that amounts to BGN 1.4 mill.

- for newly-manufactured automobiles
 - above 120 kw upon the DIN system – 700 BGN plus 90 BGN for 1 kw for the difference above 120 kw.
 - above 126 kw upon the SAE system – 700 BGN plus 85.7 BGN for 1kw for the difference above 126 kw.

Projected Revenues

The total excise revenues under the consolidated budget program are in the amount of **BGN 1,747 mill.**

The estimates for the excise revenues take into account the expected volume of consumption of the basic excise items – fuels and tobacco items, the dynamics of the import, legislative changes, and the potential shrinking in fuel consumption by approximately 10-15 percent as a result of the higher excise rates, which are expected to contribute to an increase in the prices of gas by 4,6 percent, gas oil– by 6,9 percent, and LNG– by 9,6 percent. The business policy of the major taxpayers – Lukoil Neftochim Bourgas AD and Bulgartabac-Holding AD – is crucial to the revenues from excise duties.

The 2004 projections for excise revenues are calculated on the basis of data regarding the quantities of excise goods manufactured and imported in 2002, and the expected volumes of excise commodities consumption in 2003. There is growth in liquid fuel production and import for 2003. The aggregate effect of the above factors is an excise growth in 2004 by BGN 245.7 mill. compared with the previous year.

6. Customs Duties

The 2004 revenues from customs duties are projected at BGN 204.3 mill., which accounts for 0.5 percent of GDP, i.e. the same relative share of GDP as in 2003.

In terms of the share of revenues from agricultural commodities import duties, the EU countries rank first, and in terms of the share of revenues from industrial commodities import duties – the members of the World Trade Organization or countries with which the Republic of Bulgaria has signed agreements containing the Most Favorable Nation tariff provision. In view of the forthcoming enlargement of the EU and further opening of the trade in processed agricultural items as from 5/01/2004, the tariff rates will gradually be reduced in 2004-2006 to reach the zero level by 01/01/2007. The 2003 and 2004 tariffs for the import of industrial goods from the EU, CEFTA, and Turkey are at the zero rate, and, therefore, no revenues from duties thereof are expected.

The import volume for 2005-2006 is expected to be on the increase as compared to the previous year, as the import from the zero-level tariff countries will be increasing at a faster pace than the one from countries with an above-the-zero-level tariff. Moreover, there are two factors, which will be taking effect in the opposite direction – the increased import volume and the improved control.

Other Taxes

The amendments proposed to the **Law on Local Taxes and Fees** target the improvement of administrative procedures with a view to minimizing the costs for the tax administration and the taxpayers. There are draft amendments to the base coefficient, which is used to calculate the tax on motor vehicles. The coefficient table has not been updated for the last two years, which has resulted in unrealistic high tax rates for certain vehicles (the ones over 7 years of use).

In connection with the introduction of the vignette system, an amendment provides for refunding a part of the road tax paid for the time period within the calendar year for which vignette charges have been paid for the motor vehicle.

7. Non-tax Revenues

Table: Non-tax Revenues into the Consolidated State Budget

BGN Million	2001		2002		2003		2004	
	Report	% GDP	Report	% GDP	Program	% GDP	Project	% GDP
Non-tax revenues	2,283.7	7.7	2,624.8	8.1	2,210.6	6.3	2 363.5	6.2
Transfers form BNB	174.6	0.6	172.8	0.5	150.0	0.4	156.0	0.4
Others	2,109.2	7.1	2,452.0	7.6	2,060.6	5.8	2 207.5	5.8
Revenues and income from property	1,031.7	3.5	1,173.4	3.6	1,119.5	3.2	1 034.4	2.7
Charges and fees	617.4	2.1	786.9	2.4	611.0	1.7	725.4	1.9
Fines and interest	296.0	1.0	327.2	1.0	219.1	0.6	269.6	0.7
Concessions	15.5	0.1	15.8	0.0	24.6	0.1	28.7	0.1
Disposal of state/public property	102.8	0.3	103.6	0.3	58.7	0.2	111.2	0.3
Others	45.8	0.2	45.1	0.1	27.7	0.1	38.2	0.1

The 2004 non-tax budget revenues are projected at BGN 2,363.5 mill.. This part of the revenues includes revenues and income from property; state, municipal, and legal charges; fines; sanctions and penalty interest; revenues from concessions, state dividends, etc.

The factors determining these proceeds are as follows:

- The 2004 proceeds from state dividends are estimated at BGN 191.1 mill.. The estimates take into account the fact that substantial state property is to be privatized in 2004, including Bulgartabak-Holding AD and BTC. The expected reduction in the 2003 profit of NEC and the Kozloduy power plant is also taken into account.
- The 2004 revenues from Bulgargaz are projected at BGN 75 mill..
- Interest revenues are estimated at BGN 128.5 mill..
- The expected revenues from fines and sanctions are calculated at BGN 269.6 mill..
- An important item includes state, legal, and municipal charges and fees – BGN 725.4 mill..

8. Grants

The revenues from grants from external and internal sources are projected at BGN 465.4 mill.. The 2004 projected revenues of the National Fund from the pre-accession EU funds are in the amount of BGN 450.1 mill..

CHAPTER 3: Expenditure Policies and Expenditures

I. Public Expenditures by Economic Items

Table: Expenditures under the 2001-2004 Consolidated Fiscal Program

BGN Million	2001		2002		2003		2004	
	Report	%GDP	Report	% GDP	Program	% GDP	Program	% GDP
Total expenditure	12,017.2	40.4	12,732.5	39.4	13,636.6	38.6	14 645.9	38.6
Total non-interest expenditure	10,911.5	36.7	12,019.7	37.2	12,796.3	36.3	13 857.7	36.5
<i>Current non-interest expenditure</i>	<i>9,714.6</i>	<i>32.7</i>	<i>10,854.1</i>	<i>33.6</i>	<i>11,360.4</i>	<i>32.2</i>	<i>12 303.7</i>	<i>32.4</i>
Salaries and scholarships	1,195.9	4.0	1,378.7	4.3	1,459.4	4.1	1 632.1	4.3
Insurance contributions	442.2	1.5	478.5	1.5	511.3	1.4	598.8	1.6
Maintenance	1,989.4	6.7	2,202.3	6.8	1,986.6	5.6	2 299.9	6.1
Defense and security	1,189.2	4.0	1,321.8	4.1	1,457.0	4.1	1 527.1	4.0
Subsidies	708.8	2.4	772.1	2.4	719.7	2.0	683.2	1.8
Payroll taxation and welfare	4,189.1	14.1	4,700.7	14.5	5,226.4	14.8	5 562.8	14.6
- Pensions	2,702.0	9.1	2,944.2	9.1	3,062.7	8.7	3 375.9	8.9
- Assistance and benefits	857.7	2.9	1,006.7	3.1	1,299.3	3.7	1 167.2	3.1
- Health insurance								
contributions to the NHIF	404.1	1.4	564.8	1.7	627.8	1.8	769.7	2.0
Other payroll tax expenditures	225.3	0.8	185.0	0.6	236.6	0.7	249.9	0.7
<i>Fixed assets</i>	<i>1,196.8</i>	<i>4.0</i>	<i>1,165.6</i>	<i>3.6</i>	<i>1,232.8</i>	<i>3.5</i>	<i>1 330.2</i>	<i>3.5</i>
<i>Contingencies</i>					<i>203.1</i>	<i>0.6</i>	<i>223.7</i>	<i>0.6</i>
<i>Interest payments</i>	<i>1,105.7</i>	<i>3.7</i>	<i>712.8</i>	<i>2.2</i>	<i>840.3</i>	<i>2.4</i>	<i>788.2</i>	<i>2.1</i>

1. Current expenditures

1.1. Salaries and Remuneration in the Public Sector

The expenditure planned by the Government for the next calendar year amounts to 1,588.9 mill. BGN for salaries in the public sector and BGN 43.2 mill. for scholarships. These funds are planned to secure the salaries due to 383, 000 people. A one-off increase by 8.5 percent as from July 1 is planned. The 2004 average salary in the public sector will be at BGN 326.7. By year-end it will reach BGN 340 compared to expected BGN 316.3 at the end of 2003. These values ensures a nominal growth of 7.5 percent at the end of 2004 and a real growth of 3.2 percent. The average salary, the out-of-budgetary sector included, is expected to reach approximately BGN 310, which is an increase by 6.9 percent in nominal values, and by 2.7 percent in real ones compared to the expected level for 2003. The 2004 personal insurance contribution burden will remain at 10.5 percent of the gross average salary. At the non-taxable minimum threshold of BGN 120, the personal tax burden marks a slight increase from 10.51 percent in 2003 up to 10.56 percent in 2004, whereas it decreases from 11.4 percent to 11.2 percent in the budgetary sector.

Taking into account the planned increase in the public sector salary, and related changes in the personal tax and insurance burden, the 2004 nominal salary-related income for consumption in the public sector will be up to BGN 255.79 on the 2003 level of BGN 243.41, which is an increase by 5.1 percent.

1.2. Payroll Taxation

The expenditures for payroll taxation, including social security and health insurance contributions, are calculated as a percentage of the salary expenditures depending on the insurance burden. The 2004 amount planned for this expenditure item is at BGN 598.8 mill..

As from 2004, the supplementary compulsory insurance contribution rate is increased by 1 percent and will be at 3 percent.

While there will also be an increase in the maximum insurance income from BGN 1,000 to 1,200, the minimum income threshold of BGN 200 will remain at the 2003 level.

The 6 percent rate of the health insurance contribution will be maintained throughout 2004.

The burden of sharing the insurance contribution remains in the ratio 75/25 between the employer and the ensured insured person.

1.3. Maintenance

Maintenance includes expenditures for food, medicines, bed linen and garments, business trips, materials, fuel and energy, outsourced services, current repair, training and research costs and books, other remuneration and payments to the staff, membership contributions for non-commercial entities, growth in the state reserve, and EU accession-related expenditures.

The increase in the costs for administration maintenance and salaries as a share of GDP is mainly due to the establishment of new structures in view of the European integration process; the introduction of compulsory pre-schooling, and a 13th grade in vocational schools; the reform and capacity strengthening in the judiciary.

1.4. Subsidies

Subsidies for the Real Sector and Non-for-profit Organizations

The subsidies for the real sector cover the following areas: energy sector; BDZ National Company (Railway company); Agriculture Fund; Tobacco Fund; National Fund to MOF; Bulgarian Posts – EOOD; Student Canteens and Hostels; city and intercity transport in scarcely populated mountain and border areas and municipalities.

The Government has committed to downsizing the subsidies, the trend being well tangible in the transport and energy sectors, and in their percentage of GDP over recent years. This policy is provided for in the Economic Policy Memorandum between the Government and BNB in conformity with the agreements with the IMF; the Government has committed to focusing the subsidies only in socially relevant areas and earmarking them for target groups of needy consumers. In parallel with the overall downsizing of subsidies, the reforms in the energy, health and transport sectors, enterprises with state-owned capital, etc. will continue.

Table: *Allocation of the Subsidies Planned for 2001-2004*

Year	Subsidies, in BGN Mill.
2001	292.1
2002	303.1
2003 Program	392.3
2004 Project	372.6

Subsidy expenditures reflect the needs put forward by the agencies with a slight reduction in the expenditure amounts.

The justification is to be found in the review of their allocation by sectors.

Energy

District heating companies:

- On the grounds of §14 of the Law on Energy and Energy Efficiency, the Council of Ministers determines lower (fixed) heat energy sales prices for household consumers than the priced set by the State Energy Regulation Committee;
- The schedule for the annual 10-percent price increase as from July 1 adopted by the State Energy Regulation Committee will achieve gradual downsizing of the subsidies and their phasing out by 2005.
- The 2003 subsidies are in the amount of BGN 45 mill. and are allocated for 13 district heating companies (DHCs) across the country which are on the list in Annex No 3 to Art.2, para 1 of the COM Decree No 259/99.

The subsidies planned for 2004 are in the amount of BGN 29.3 mill., being allocated for both DHCs and the coal production subsector. As for DHCs, there is a reduction from 45 mill. BGN for 2003 down to BGN 24.3 mill. for 2004. The subsidy amount is consistent with the guarantee agreement signed with the EBRD for the Rehabilitation of the Heat Transmission Network Project for DHC-Sofia and an identical one for DHC-Pernik.

The subsidies allocated for the coal production companies for 2003 amount to BGN 3 mill., and for 2004 the amount is up to BGN 5 mill.. The need for this increase is related to the arrangement under the above project for Open Coal Production Mines company to supply coal to DHC-Pernik at lower prices than the market ones.

There will be no subsidies planned following 2004, as the companies are slated for privatization in accordance with the Energy Strategy adopted by the National Assembly.

Transport

Under the Economic Policy Memorandum between the Government and BNB there is a commitment to limit the subsidies for the real sector and focus them on socially relevant areas. As regards the transport sector, such areas are city passenger transport and transport in scarcely populated mountain and border areas, as well as railroad passenger transport. In legal terms, the grounds for the provision of these subsidies are regulated in §4 of the Law on Road Carriers and Art.52 of the Railway Transport Law.

The purpose of state aid restructuring is to achieve the gradual phasing out of the current subsidizing arrangement which ensures the compensation of operational losses by means of financing the delivery of specific transport services that are defined as PSOs.

In view of the above, there is a planned decrease in the road transport subsidy for the next three-year period – from BGN 17 mill. in 2003 down to BGN 10.1 mill. in 2004; the subsidy arrangement will be applied only to transport services in scarcely populated areas at the end of this period.

As regards railway transport, the 2004 subsidy remains at the 2003 level of BGN 70 mill.. The challenges in the sector are as follows:

- liabilities for principal and interest payment on loans with sovereign guarantee in the amount of BGN 30 mill.;
- losses of up to 25 percent of operational revenues;
- repair works in default, which are a potential source of expenditure in forthcoming periods.

The reduction in the subsidy payment to the transport (road and railway) sector will result in a financial deficit in the companies' balance due to the slow pace of reforms and the social function which they perform. These companies need to further optimize their operations on market principles.

Social Subsidies

- The 2004 compensation for free-of-charge or discount-tariff transport is in the amount of BGN 55.1 mill. on the 2003 payment of BGN 45.5 mill..

The effective legislation entitles various social groups that account for 3.2 mill. people of the total population (40 percent) to using tariff discounts. As the budget capacity to ensure the funds for these transport arrangements on the basis of the current tariffs is insufficient, some amendments to the regulatory framework aimed at limiting the above entitlements have been drafted and put forward.

- Transport costs for bread delivery services for the population. BGN 2.6 mill. are secured for 2004.

Postal Services

In accordance with the Postal Services Law, the Bulgarian Post EAD is defined as the main postal operator, which has the obligation to provide the universal postal service across the country through its postal network, including at unfavorable economic conditions. This postal operator receives compensation from the state budget for the deficit incurred as a result of performing these services. The budget provides for a gradual decrease in this compensation. The 2004 payment, which is in the amount of BGN 1 mill. secures the compensation for the deficit suffered by Bulgarian Posts EAD.

Agriculture

The subsidy from the State Budget for the Agriculture State Fund for 2004 remains the same as the 2003 subsidy and amounts to BGN 40 mill.. There is inconsistency with the provisions of the Law on Agricultural Producers Support with regard to determining the amount of the central budget transfer to the Fund and the subsidy amount. The effective Law on Agricultural Producers Support needs to be revised in order to bring its financial parameters in line with the annual budget capacity.

The 2004 subsidy payment to the Tobacco Fund remains the same compared to 2003. The subsidies to be provided to tobacco producers by the Fund are in the total amount of BGN 101 mill..

1.5. Social Security and Welfare

The 2004 funds for the purpose of social security and welfare are planned at BGN 5,562.8 mill.. These include social security costs (pensions, social assistance and benefits, health insurance payments, and other health insurance expenditures), maintenance costs of social security offices, defense and mobilization preparation costs, and reform reserve funds.

Pensions

The 2004 pension allocations are planned at BGN 3,375.9 mill. and account for 8.9 percent of GDP. They hold the biggest share of 60.7 percent of the total social security and welfare expenditure. This amount includes pension costs together with postal charges and VAT, supplements to the war veteran pensions, and pensions under international agreements.

Over recent years the number of pensions has been on a steady increase, as shown on the table below.

Table: Average Annual Number of Pensions and Pensioners in Thousands for 1999–2004

Years	Nr. Pensions	Nr. Pensioners
1999	2,429	2,382
2000	2,440	2,379
2001	2,567	2,371
2002	2,622	2,351
Jan-June 2003	2,663	2,343
2003	2,674	2,338
2004 Project	2,702	2,321

The 2004 average number of pensioners is expected to decrease by 0.75 percent on 2003 and to amount to 2, 320,557 people. This is mainly due to the drop by approx. 55,240 in the number of pensioners eligible on old age grounds as a result of the provisions regulating a higher retirement age and the number of points under Art. 68 of the Social Security Code (SSC).

On the other hand, over recent years there has been an increase in the number of pensioners, receiving pensions on disability grounds due to general sickness, and pensions on old age grounds under Art.69 of the SSC (commissioned officers, officers and sergeants). There is a particular concern with the growing number of new pensioners eligible for disability pensions due to general sickness, their number accounting for 13.2 percent of the total number of pensioners projected for 2003. This unfavorable trend is due to the inefficient oversight on the medical expertise boards (both national and territorial). There has been a slight increase in the number of pensioners – officers and sergeants – from MOD and MOI (by approx. 4,900 people) as a result of the reform in the Bulgarian Army and MOI and the forthcoming NATO membership. There are also projections for an increase in the number of pensioners on military disability grounds and pensioners with personal pensions, as well as the ones with social pensions. As regards the remaining types of pensions, there is a declining trend.

The average number of benefits in 2004 will be approximately 2,702,000 at the projection of 2,674,169 for 2003, i.e. an increase in 2004 by 1.04 percent on 2003. This is mainly due to the provision of second, third and fourth social disability pensions under Art.101, para 3 of the SSC. Their average number is expected to reach 293,776 in 2003, and 339,717 – in 2004.

The 2004 average benefit per pensioner will be BGN 120.98. The nominal increase is by 12.6 percent, and the real one – by 9.9 percent at the expected 2003 average annual inflation rate of 2.5 percent, and by 8,3 percent at the expected 2004 average annual inflation rate of 4 percent. The average pension benefit per pensioner will be about 50.1 percent of the projected 2004 net insurance income (241.26 BGN) and 37.5 percent of the projected 2004 average salary (BGN 322.79). The 2003 average pension benefit per pensioner is expected to be BGN 107.49 and to be, respectively, 47.2 percent of the projected 2003 net insurance income (BGN 227.90) and 35.8 percent of the expected average salary (BGN 300.21).

The increase in the average pension benefit is mainly due to the following factors:

- The increase in the maximum benefit up to BGN 420 as from January 1,2004 as a result of which approx. 153,000 will be entitled to the real amounts of their benefits.
- The higher amount of the newly issued benefits in 2004 compared to the ones issued in 2003 (due to the revised Art. 70, para 2 of the SSC, which will be in force as from Jan.1, 2004), the lower amounts of the benefits terminated and the increase in the amount of certain benefits.
- The adjustment of benefits by the 1.058 coefficient as from June 1, 2004.
- The increase in the amount of the social benefit on old age grounds up to BGN 52,90, which is to be effective as from June 1, 2004.
- The increase in the number of social benefits on disability grounds in the amount of 25 percent as second, third and fourth pension benefits.
- The increase in the minimum benefit amounts as a result of the increase in the social benefit on old age grounds.
- The increase in the amount of the supplements to benefits, which are calculated as a percentage of the social benefit on old age grounds.

Social Assistance and Compensations

This expenditure category includes payments and benefits on the grounds of the Social Insurance Code (SIC), the Family Children Assistance Act (FCAA), the Law on the Protection, Rehabilitation and Social Integration of the Disabled (LPRSID), and the Social Assistance Law (SAL).

The expenditures for social assistance and benefits are the second most significant expenditure category; the 2004 expenditures, therefore, are projected at BGN 1167.2 mill. The total 2004 expenditure only for social assistance and benefits under the MSIC is projected at BGN 404.2 mill.. The above amount includes the costs of temporary incapacity payments and the costs of unemployment benefits. The expenditures for health insurance contributions for pensioners, unemployed persons and persons below the age of 18 amounts to BGN 214.6 mill..

In accordance with the planned amendments to the FCAA and the forthcoming amendments to the LPRSID, the benefits due for children under these payments are to be born by the social assistance offices as from 01/01/2004.

The benefit for raising a child up to age of 2 is in the amount of BGN 120.

The increase in the short-term benefits and grants under the MSIC are related to the following:

- the expansion of the range of insured persons in 2004;
- the increase in the average daily amount of the cash benefit;
- The employer's obligation to cover the payments of temporary incapacity has been reduced to 1 day. There is also an increase in the number of temporary incapacity days.

The total of BGN 10.9 mill. is planned for prevention and rehabilitation-related expenditures for insured persons. This amount is to cover the costs of basic medical services, accommodation at prices determined in contracts between the NSSI and the relevant legal entities, and partial cash aids for meals. This will allow the matching of prevention and rehabilitation expenditures incurred with the savings from temporary incapacity benefits due to these persons.

The 2004 **expenditures for unemployment benefits** are planned at BGN 128.3 mill.. The estimates are made on the basis of the projected number of 85,000 of the unemployed and the average monthly unemployment benefit of BGN 125.44. The minimum and the maximum amounts of the unemployment benefit are BGN 80 and BGN 140, respectively.

1.6. Interest Payments

The interest payments for public debt servicing are projected at BGN 788.2 mill. for 2004, which accounts for 2.1 percent of GDP. This ratio will remain relatively stable during next years, which is shown on the chart below.

Chart 1: *Dynamics of the Relative Share of Interest Payments of GDP*

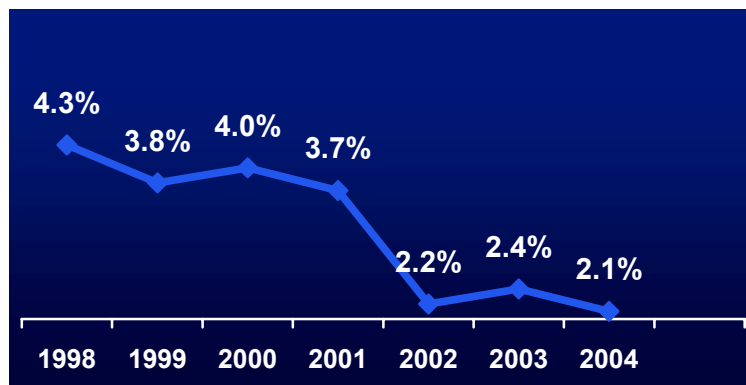
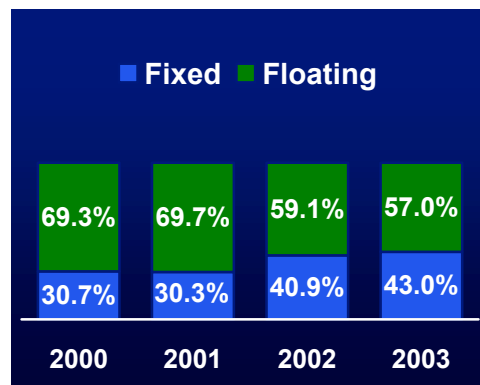


Chart 2: *Relative Share of Floating and Fixed Interest Rates*



The 2004 expenditures for interest payments on the **domestic debt** are expected to stand at approximately 194.5 mill. BGN. Out of this total, the share of interest payment due to BNB is approx. BGN 48.3 mill.. This amount of interest payments on the domestic debt is relatively predictable and stable, as the prevalent part thereof comprises fixed-interest coupon bonds. The payments on the debt to BNB and the state securities for the structural reform will be affected by international interest rates.

The 2004 expenditures for interest payments on **external loans** are projected to be at 593.7 mill. BGN. The main part of these payments is under state loans, and BGN 48.7 mill. – on state investment loans. While there has been a substantial improvement in the interest structure of the external debt achieved in 2002, more than half of the external liabilities are still interrelated to the international interest rates, which makes this part of the payments dependable on the fluctuations of these rates. The fluctuations in the foreign exchange rate also impact the amount of interest payments due to the prevailing share of payments in UD Dollars, SDRs and Japanese Yens.

1.7. Contingency

Table: Allocation of the Contingency in the 2004 Consolidated State Budget

BGN Million	2003 Program	%GDP	2004 Program	%GDP
Contingency, including	203.1	0.6	223.7	0.6
<i>For structural reform, including:</i>	<i>150.8</i>	<i>0.4</i>	<i>168.2</i>	<i>0.4</i>
- Healthcare	73.2	0.2	85.6	0.2
- Defense	0.0	0.0	22.0	0.1
- Pensions	60.0	0.2	60.0	0.2
- Judiciary	0.6	0.0	0.6	0.0
<i>For natural disasters</i>	<i>52.3</i>	<i>0.1</i>	<i>55.5</i>	<i>0.1</i>

The contingency planned under the consolidated fiscal program amounts to BGN 223.7 mill.. It will be allocated, if needed, for spendings related to the commitments of the Republic of Bulgaria to: the implementation of the Armed Forces Objectives, social and health insurance, the judiciary, and natural disasters prevention and post-crisis management.

2. Public Investment

A substantial growth in capital investments is planned for 2004, which will foster the overall economic growth in the country. The capital expenditures in the consolidated budget are projected at BGN 1,330.2 mill.. They account for 3.5 percent of the expected GDP, which means the same real level as for 2003. One of the main priorities in the 2004 budget is further improving the infrastructure in line with the requirements of a modern European economy. The capital investments to be made by the state in 2004 are restructured so as to target major objects of national importance.

The allocation of funds by sources for next year is planned to be as follows:

- external grants from the pre-accession EU funds and domestic co-financing for these grant funds – BGN 422.0 mill.
- state investment loans – BGN 287.7 mill.
- municipal external loan – BGN 78.0 mill.
- domestic sources:
 - central budget – BGN 85.7 mill.
 - own funds – BGN 456.8 mill.

The capital expenditures in the 2004 budget are allocated by taking into account the enhanced involvement of investment subsidies under the PHARE, ISPA and SAPARD programs. The funds disbursed under these programs are to be absorbed in order for our country to meet the higher

requirements of EU accession and execute social and economic cohesion measures. Substantial progress is expected along ISPA whose focus is on major infrastructure projects. The following projects are planned to start: Transit Roads III; electrification of the Plovdiv-Svilengrad railway line; expansion of Sofia Airport; completion of the Danube 2 bridge design and start-up of civil works; regional waste disposal depots and waste water treatment facilities.

The 2004 budget allocations related to the co-financing of projects under EU programs should be considered as the minimum financial provision of these projects.

The increased involvement of external grant and loan investment resources in the financing of investment programs and projects contributes to crowding out the funds from domestic sources – subsidies from the central budget and own budget funds of first-level spending units and municipalities.

The capital expenditures in the 2004 budget to be allocated among ministries and agencies amount to the total of BGN 592.3 mill.. First-level spending units will absorb most of the grant funds for investment purposes from the European Union. The expenditures related to these grants, and the domestic co-financing to them secured from the National Fund to the MOF fall outside the capital expenditures ceilings set in the current budgets of these first-level spending units.

Out of the total allocation in the central budget, BGN 69.6 mill. will be the amount of capital transfers to commercial companies and non-for-profit organizations. BGN 30 mill. out of that total are allocated to the Railway Infrastructure National Company; BGN 24.5 mill. – to projects for the expansion of Sofia Airport; and BGN 13.1 mill. for the expansion of Bourgas seaport; others – BGN 2 mill.

The capital expenditures of municipalities are projected at BGN 187 mill.. BGN 50 mill. out of that total are planned to be financed by the municipalities with their funds in accordance with the fiscal decentralization measures.

Moreover, the earmarked central budget subsidy for capital investment for municipalities also provides for further construction of environmental sites with high regional and national relevance (waste water treatment facilities, solid waste disposal depots, etc.).

The funds breakdown by investors is aimed at ensuring the concentration of financial resources for the execution of investment programs and projects which are on the national priorities list. The funds allocated for restructuring the defense system in line with NATO standards are an example of such a priority.

In the field of the technical and social infrastructure, the major task is to facilitate the absorption of the external resources agreed, and the implementation of the reforms which are already underway in a number of systems and activities. Therefore, there is priority allocation of funds for ensuring the domestic co-financing under external loans. These are investment programs and projects of the Ministry of Regional Development and Public Works, the Ministry of Transport and Communications, the Ministry of Agriculture and Forestry, the ministry of Labor and Social Policy, the Ministry of Health, the Ministry of Education and Science, and the Ministry of Finance.

II. Public Expenditures by Function

1. General Review

The allocation of government expenditures by functions is performed on the basis of the approved in the Three-Year Budget Prognosis expenditure ceilings, and indicates the direction of the expenditures in the nine primary functional areas, while providing additional analysis opportunities, as well.

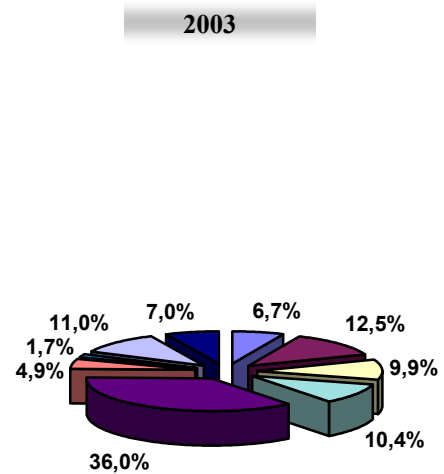
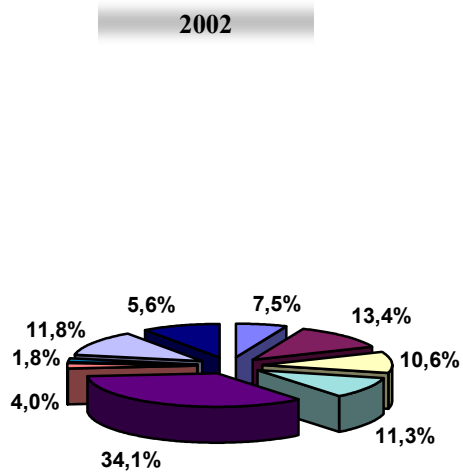
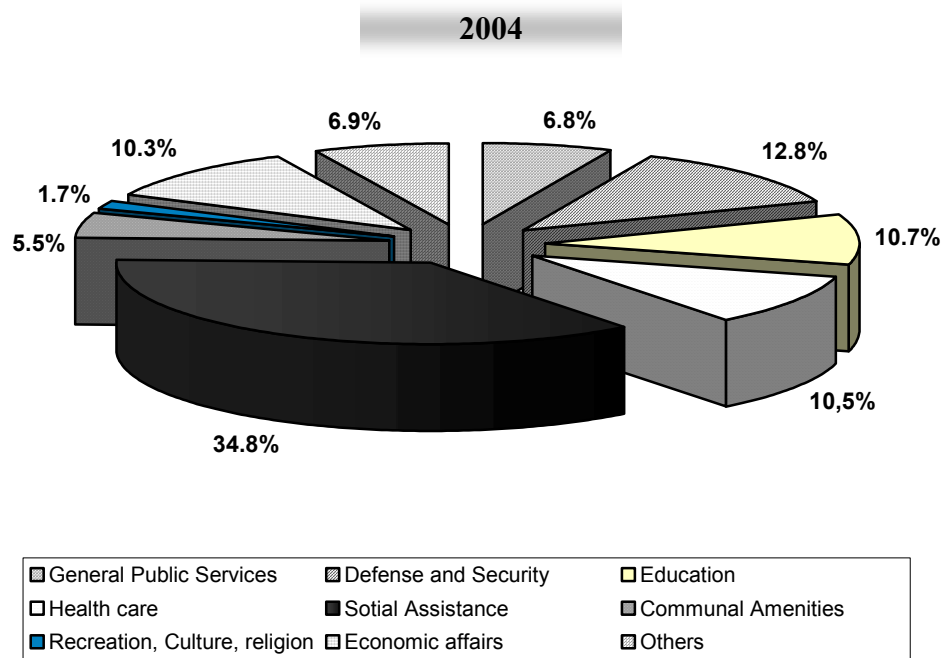
Thus, the policies of the state can be demonstrated, as well as its contribution in the specific areas. Some of these areas are entirely the responsibility of the state, like “General Public Services,” “Defense and Security,” whereas for others the state must provide a certain level of support, but in principle, they should be managed by the developing private initiative – these are areas like “Education or “Health Care,” for example.

Table: Allocation of the government expenditures by function

BGN Million	2001	2002	2003	2004
	Report	Report	Program	Program
ALLOCATION OF EXPENDITURES BY FUNCTION (in million BGN)	12 017.2	12 732.5	13 636.6	14 645.9
% of GDP	40.4	39.4	38.6	38.6
% of Total Expenditures	100.0	100.0	100.0	100.0
<i>Current</i>	<i>10 820.5</i>	<i>11 566.9</i>	<i>12 403.8</i>	<i>13 315.7</i>
<i>Capital</i>	<i>1 196.8</i>	<i>1 165.6</i>	<i>1 232.9</i>	<i>1 330.2</i>
TOTAL NON-INTEREST EXPENDITURES (in million BGN)	10 911.4	12 019.7	12 796.3	13 857.7
% of GDP	36.7	37.2	36.3	36.5
% of Total Expenditures	90.8	94.4	93.8	94.6

2. Review of the Functional Groups

Diagram: Shares of the primary functions, as part of the overall consolidated expenditures



2.1. General Public Services

Table: *Distribution of the budget expenditures for the general public services*

BGN Million	2001	2002	2003	2004
	Report	Report	Program	Program
GENERAL PUBLIC SERVICES - TOTAL (A+B+C)	952.0	950.7	918.1	1 002.1
% of GDP	3.2	2.9	2.6	2.6
% of Total Expenditures	7.9	7.5	6.7	6.8
% of Non-Interest Expenditures	8.7	7.9	7.2	7.2
<i>Current</i>	769.7	812.4	816.5	901.6
<i>Capital</i>	182.3	138.2	101.6	100.5
A. EXECUTIVE AND LEGISLATIVE BODIES	758.6	737.0	757.6	811.9
% of GDP	2.6	2.3	2.1	2.1
% of Total Expenditures	6.3	5.8	5.6	5.5
% of Non-Interest Expenditures	7.0	6.1	5.9	5.9
<i>Current</i>	586.7	605.4	657.8	715.9
<i>Capital</i>	171.9	131.5	99.8	95.9
B. GENERAL SERVICES	95.9	94.7	38.6	55.0
% of GDP	0.3	0.3	0.1	0.1
% of Total Expenditures	0.8	0.7	0.3	0.4
% of Non-Interest Expenditures	0.9	0.8	0.3	0.4
<i>Current</i>	89.3	91.8	38.3	52.6
<i>Capital</i>	6.6	2.9	0.3	2.4
C. SCIENCE	97.5	119.0	121.9	135.2
% of GDP	0.3	0.4	0.3	0.4
% of Total Expenditures	0.8	0.9	0.9	0.9
% of Non-Interest Expenditures	0.9	1.0	1.0	1.0
<i>Current</i>	93.7	115.2	120.4	133.1
<i>Capital</i>	3.8	3.8	1.5	2.1

This function reflects the funding of the entire public administration – central, local, and executive, and is divided into the following groups: Executive and legislative bodies, General Services, and Science. The expenditures for the General Services are primarily channeled into optimization of their structures and maintenance.

For the group of “**Executive and Legislative Bodies,**” the budget for 2004 provides a consolidated total amount of BGN 811.9 million, including:

- For the financial support of the activities and structures, under the central budget – central administration, state committees, executive agencies, regional administrations, commercial and trade representative agencies abroad, embassies and consular offices abroad, and other newly formed administrative structures, there are BGN 464.7 million provided.

The expenditure amounts thus calculated provide normal operating conditions for the central administrations, enabling them to perform the tasks and activities, set before them by the government, related both to the internal policies and the foreign policy of the Republic of Bulgaria in the area of negotiations and the execution of programs, which are part of the accession process of the Republic of Bulgaria to the EU and NATO, the chairing of the OSCE, the payments of the membership fees to the international institutions, as well as, for the execution of the primary functions of the President, the Vice-President, and the National Assembly.

The total number of state employees, on the basis of which the budget for the “**Executive and Legislative Bodies**” budget was drafted, is 29,506, out of which 28,784 working for the central administrations of the different ministries and other agencies, and 722 for those state bodies with budgets of their own. The above numbers include 36 individuals for the establishment of the new Economic Social Council and another 35 individuals, for the establishment of a new structure, responsible for the execution of the minority integration policies.

- The total amount of funds from the central budget during 2004 amount to BGN 68.7 million;
- Funds for the maintenance of the municipal administrations – BGN 174.6 million, out of which BGN 1.1 million for capital expenditures;
- BGN 90.3 million are projected in the National Fund at the Ministry of Finance, coming from EU funds

The consolidated amount of the budgeted funds for the “**General Services**” group for 2004 amount to BGN 55.0 million, out of which BGN 0.4 million are included in the central budget, and the remaining funds will be distributed among the different ministries and state agencies. They are designated for the execution of the National Statistical Research Program, the preservation of the Bulgarian ethnic-cultural identity, the preservation and proliferation of our cultural and historic heritage, protection of the rights of Bulgarians abroad, creation of suitable conditions of stay for the refugees in the Republic of Bulgaria, the acceptance, distribution, and control of the humanitarian aid, provided to Bulgaria by foreign states, the settlement of class-action labor disputes, attracting and facilitating foreign investment, as well as the priority investment projects in Bulgaria, supporting the Unified Foreign Investment Information System, conducting the foreign trade policy of Bulgarian exporters to the Russian markets, marketing and advertising campaigns for Bulgarian goods in Russia, accumulation, storage and utilization of the state and military contingency reserves, in accordance with the national security requirements, preparation of short-, medium-, and long-term forecasts for the economic development of Bulgaria, the concessions for activities, listed in the central register, the activities, related to the administrative services provided to the citizens and legal entities, civic protection of the population and the national economy during natural disasters, accidents, and catastrophes.

The increase 152.63% of the State Reserves, compared to the 2003 State Budget Act, will allow the restoration of the State Reserves, in accordance with the requirements of the Mandatory Quantities of Oil and Oil Products Act.

Group B – “General Services” includes: The National Statistical Institute, the Agency for Bulgarians Abroad, the Refugee Agency, the Foreign Aid Agency, the National Arbitration and Reconciliation Institute, the Bulgarian Foreign Investment Agency, the Center for Bulgarian Industry in Moscow, the State Agency “State Reserves and Military Contingency Reserves”, the Agency for Economic Analyses and Forecasting, the activities under the Concessions Act, the Central Register of Special Bids, and the Civic Protection Agency.

For the activities of group “General Services,” there are 2,975 individuals employed on pay-roll.

In group “**Science**,” despite the great needs and potential opportunities for development, the funding options are not rationally employed. This is one of the sectors, where an optimal combination between private and state sources of funding must be sought, in accordance with the services offered. The state has provided opportunities for utilization of EU funds for science and scientific research, but there is still a lack of good quality projects being developed, which can apply for such funding.

The funds for the “Science” group of activities amount to 0.4% of GDP, as provided in the 2004 Budget .

- The total amount of funds for scientific activities during 2004, provided to the autonomous budgets of the state higher education institutions and the Bulgarian Academy of Sciences, is BGN 81,284.3 million, as follows:

Bulgarian Academy of Sciences - BGN 67.8 million

State higher education institutions - BGN 13.5 million

- The budgeted funds for scientific activities, performed by the specialized units of the ministries and other state agencies, amount to BGN 42.4 million, including:

The National Assembly - BGN 0.2 million;

The Ministry of Interior - BGN 0.07 million;

The Ministry of Health - BGN 1.18 million;

The Ministry of Education and Science - BGN 4.9 million;

The Ministry of Economy - BGN 2.1 million;

The Ministry of Agriculture and Forestry - BGN 33.8 million

- The funds for scientific activities, planned for the National Fund at the Ministry of Finance, amount to BGN 11.6 million .

2.2. Defense and Security

Table: Distribution of the budget expenditures for Defense and Security

BGN Million	2001	2002	2003	2004
	Report	Report	Program	Program
II. DEFENSE AND SECURITY (A+B+C+D)	1 453.7	1 707.3	1 713.8	1 871.9
% of GDP	4.9	5.3	4.9	4.9
% of Total Expenditures	12.1	13.4	12.6	12.8
% of Non-Interest Expenditures	13.3	14.2	13.4	13.5
<i>Current</i>	<i>1 327.2</i>	<i>1 503.5</i>	<i>1 650.9</i>	<i>1 780.3</i>
<i>Capital</i>	<i>126.5</i>	<i>203.8</i>	<i>62.9</i>	<i>91.6</i>
<i>DEFENSE + CONTINGENCY</i>				898.9
% of GDP				2.37
% of Total Expenditures				6.1
% of Non-Interest Expenditures				6.5
A. DEFENSE	733.8	827.9	826.9	876.9
% of GDP	2.5	2.6	2.3	2.3
% of Total Expenditures	6.1	6.5	6.1	6.0
% of Non-Interest Expenditures	6.7	6.9	6.5	6.3
<i>Current</i>	<i>638.6</i>	<i>671.2</i>	<i>787.4</i>	<i>816.7</i>
<i>Capital</i>	<i>95.2</i>	<i>156.7</i>	<i>39.5</i>	<i>60.2</i>
B. POLICE, INTERNAL ORDER AND SECURITY	565.0	674.5	680.4	723.3
% of GDP	1.9	2.1	1.9	1.9
% of Total Expenditures	4.7	5.3	5.0	4.9
% of Non-Interest Expenditures	5.2	5.6	5.3	5.2
<i>Current</i>	<i>550.7</i>	<i>650.6</i>	<i>669.6</i>	<i>710.3</i>
<i>Capital</i>	<i>14.3</i>	<i>23.9</i>	<i>10.8</i>	<i>13.0</i>
<i>JUDICIARY + CONTINGENCY</i>			144.6	208.1
% of GDP			0.4	0.5
% of Total Expenditures			1.1	1.4
% of Non-Interest Expenditures			1.1	1.5
C. JUDICIARY	109.9	145.4	144.0	207.5
% of GDP	0.4	0.4	0.4	0.5
% of Total Expenditures	0.9	1.1	1.1	1.4
% of Non-Interest Expenditures	1.0	1.2	1.1	1.5
<i>Current</i>	<i>94.4</i>	<i>124.6</i>	<i>131.7</i>	<i>189.6</i>
<i>Capital</i>	<i>15.5</i>	<i>20.8</i>	<i>12.3</i>	<i>17.9</i>
D. CORRECTIONAL FACILITY ADMINISTRATION (PRISONS)	45.0	59.5	62.5	64.1
% of GDP	0.2	0.2	0.2	0.2
% of Total Expenditures	0.4	0.5	0.5	0.4
% of Non-Interest Expenditures	0.4	0.5	0.5	0.5
<i>Current</i>	<i>43.5</i>	<i>57.2</i>	<i>62.2</i>	<i>63.6</i>
<i>Capital</i>	<i>1.5</i>	<i>2.3</i>	<i>0.3</i>	<i>0.5</i>

This function includes all expenditures for defense, police, internal order and security, support and maintenance of the judiciary, and correctional facility administration. The consolidated expenditures for 2004 amount to BGN 1,894.5 million, including contingency BGN 22.0 for defense and BGN 0.6 million for the judiciary, which equals to 5.0% of GDP. The relative share of the defense expenditures remains the highest for next year as well, followed by the security-related expenditures.

The defense and security priorities are the consequence of the general political objectives of the government, and are based on the current reality in the international environment. The recent changes in the strategic environment, led to a shift in the character of the challenges, risks, and threats for the security of the Republic of Bulgaria.

An increased importance was gained by some non-traditional challenges, like the illegal proliferation of weapons and technologies for their production, international terrorism, organized crime, all of which are a serious risk factor, facing the emerging market economies in Southeastern Europe. The transnational character of the majority of these challenges, calls for the introduction of common approaches and joint actions, in order to neutralize them.

The defense and security objectives and priorities are realized through establishing optimal defense capabilities, through cooperation and integration.

The reform of the defense system is one of the key elements of the new security policy of the Republic of Bulgaria. The priority of this reform will continue to be the development of contemporary and state-of-the-art armed forces, adequate to the strategic environment of contemporary challenges, and ensuring a sufficient military potential, within the resource framework of the country, aimed towards supporting the integration efforts for joining the Euro-Atlantic security system, as well. The Army restructuring process is conducted under the condition of maintaining a relatively steady level of defense expenditures.

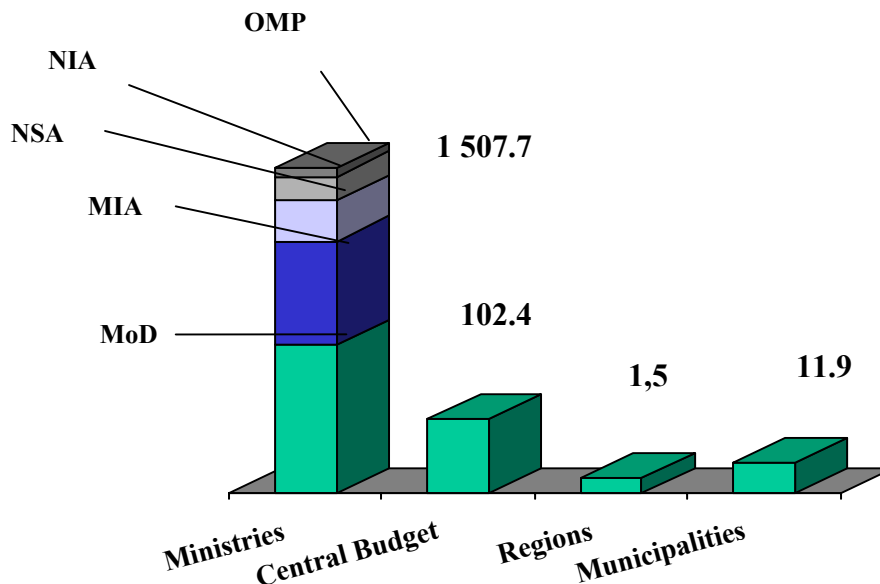
The primary measures, undertaken by the government and the law-enforcement agencies, in the area of public order and civic security, are aimed towards improving the organization of police investigations, in order to increase the level of solving crimes with a high level of public risk involved. In this respect, the work on improving the cooperation between the courts and the law-enforcement agencies will continue, as well as towards counteraction against the so-called “new security risks” – organized crime, corruption, terrorism, drug trafficking, etc.

The 2004 state budget provides BGN 1,622.2 million to the “Defense” and “Police, Internal Order and Security” groups, divided as follows:

- Through the Republican budget – BGN 1,610.1 million
- Budget credits to the municipalities - BGN 11,9 million

The funds for the expenditures of the ministries and other state agencies, provided through the republican budget amount to BGN 1,507.7 million, for the regional administrations – BGN 1,5 million, and from the central budget – BGN 102,4 million., including BGN 22.0 million as a contingency for defense.

Diagram: *Distribution of the expenditures for the “Defense and Security” function: Group A “Defense” and Group B “Police, Internal Order and Security,” in million BGN*



The defense and security expenditures (Group A “Defense” and Group B “Police, Internal Order and Security”) for 2004 amount to 4.3% of GDP. The financial backing of the activities, ensuring the defense and security of the country, including the NATO integration policies, is in accordance with the objective ability of the country to dedicate resources towards this goal. When compared to the other East-European states, the share of the defense expenditures in Bulgaria is still at a high level.

Information on the “Accession to NATO” priority and the expenditures, related to it

In the beginning of 2003, after receiving the invitation to join NATO in November 2002, two rounds of negotiations were held, during which the political, economic, defense-military, resource, and legal implications of the accession process were discussed. In accordance with NATO’s recommendations to the invited countries, a Schedule for the Implementation of the Reforms was drafted and approved – this was a unilateral act, through which Bulgaria undertakes the responsibility to reach the targets, detailed in it, and to implement the reforms according to the time tables in the Schedule.

The financial support of the Reform Schedule, as well as the obligations, ensuing from the accession of the Republic of Bulgaria to NATO, will be provided within the framework of the approved budgets of the respective state bodies and institutions, and the budgeted funds for the execution of the National Program for Preparation and Accession of the Republic of Bulgaria to the North Atlantic Alliance and the Annual National Program of the Action Plan for NATO membership. For 2004, the budgeted funds for supporting these programs amount to 74.0 million BGN, distributed over a number of key directions:

- Political preparation for membership and accelerated introduction of NATO standards in the areas of defense and security policy-making;

- Acceleration of the procedures for achieving operational compatibility between the armed forces of the Republic of Bulgaria and the armed forces of NATO and the member-states;
- Reaching NATO security standards, through introduction of legislative acts and institutional development of the system for protection of classified information;
- Foreign policy dialogue, consulting and other diplomatic means;
- Widening and refining the democratic and civic control over the armed forces and those institutions with authority, related to defense and security.

Judiciary

Table: 2004 budget of the Judiciary

In thousand BGN	SJC draft² 2004	Position of the CoM 2004
Total Expenditures	340 158.9	208 120.0
Current Expenditures	226 645.8	189 620.0
Capital Expenditure	82 913.1	17 900.0
Reserves	30 600.0	600.0

The expenditures for Group C “Judiciary” include the necessary financial resources, for the normal functioning of the different judiciary bodies.

According to the position of the government, the total amount for the expenses provided should be BGN 208.1 million, including the reserves of BGN 0.6 million, which represents an increase of 43.9%, when compared to the 2003 Budget.

The current expenditures, amounting to BGN 189,6 million (an increase of 43.9% compared to the 2003 Budget), have been calculated on the basis of the needs for salaries and labor remuneration, social security payments and maintenance of the individuals, employed by the judiciary. The calculations have taken into consideration the increase of the number of court proceedings, the involvement of an increased number of individuals in the judicial processes and, therefore, the increased needs for providing remuneration to experts, public defenders, court experts, jury members, and witnesses.

The capital expenditures amount to BGN 17.9 million, out of which BGN 2.9 million are transfers towards the “Court Buildings” and “Penitentiary Buildings” funds of the Ministry of Justice, and the remaining 15 million are for the budget of the Judiciary..

² The draft budget of the SJC is analyzed thoroughly in Part III of this Report.

Table: 2004 Budget of the Prison Administration

In thousands of BGN	2003 Budget Act	2004 Budget
Total Expenditures	62 539,5	64 113,0
Current Expenditures	62 239,5	63 593,0
Capital Expenditure	300,0	520,0

The expenditures for the “Judiciary” group include the necessary financial resources, for the execution of the primary tasks and activities of the “Execution of Punishments” Directorate of the Ministry of Justice, including all prisons and the detention facilities of the Investigation.

The total amount of the budgeted expenditures for the Correctional Facilities’ Administration Group for 2004 is BGN 64.1 million, divided as follows: 63.6 million BGN for current expenditures and BGN 0.5 million for capital expenditures. The priority in the maintenance expenditures is on the food, medication, and heating expenditures, in order to ensure normal living conditions for the prison inmates and the detained for investigation individuals.

The total number of pay-roll employees of the General Directorate “Execution of Punishments” is 4,588.

2.3. Education

BGN Million	2001	2002	2003	2004
	Report	Report	Program	Program
III. Education	1 192.3	1 353.4	1 363.2	1 565.1
% of GDP	4.0	4.2	3.9	4.1
% of Total Expenditures	9.9	10.6	10.0	10.7
% of Non-Interest Expenditures	10.9	11.3	10.7	11.3
<i>Current</i>	<i>1 163.2</i>	<i>1 301.3</i>	<i>1 287.2</i>	<i>1 523.4</i>
<i>Capital</i>	<i>29.1</i>	<i>52.1</i>	<i>76.0</i>	<i>41.6</i>

The consolidated amount in the 2004 budget for the “Education” function is BGN 1,565.1 million. The increase of the budgeted funds, when compared to the previous year is 14.8%. The budgeted funds are distributed among the following budgets:

- Ministries and other state agencies

The funds, budgeted for the “Education” function, which includes the secondary (high) schools of the Ministry of Education and Science, the Ministry of Agriculture and Forests, and the Ministry of Culture, are distributed among the following priority policies and programs:

- “Increasing the quality of education and training – Increasing of the efficiency and quality of the education and training in secondary schools, and improving the economic and social position of teachers” – **there are funds provided for the 0.9% of the time** served by teachers, and the additional 1,850 employees needed to cover

the requirements of the educational process of the students in the 13th grade, in accordance with the provisions of the Professional Education and Training Act.

- “Social assistance of the access to education” – funds have been provided for the student scholarships, the necessary funds for daily room and board in the dormitories and student canteens, as well as the medical insurance payments for regular and doctoral university students.
- “Funding of the educational process” – the support and maintenance expenditures are increased by 13.0%.

- Autonomous budgets – State Higher Educational Institutions

Through a budgetary subsidy, 100% of the standard normative support of the expenditures of first-, second-, and third-year university students has been provided, in accordance with the Higher Education Act (HEA) and Decree No. 162 of the Council of Ministers from July 20, 2001, establishing the differentiated standards for the calculation of the per capita expenditures for support of students in the different professional fields.

The subsidy for higher educational institutions, in addition to the support and maintenance expenditures, also provides funds for scientific and research activities, in accordance with the provisions of the HEA, funds for household/utility expenditures, including scholarships for regular and doctoral students, support and maintenance of the student dormitories and canteens, health insurance payments for the regular and doctoral students, and funds for capital expenditures.

- The funds provided to the central budget amount to BGN 62.8 million, to the municipal budgets – BGN 881.0 million, and for the National Fund at the Ministry of Finance, the budgeted amount is BGN 16.8 million, for covering of the membership fees for the “Leonardo da Vinci” and “Socrates” programs of the EC.

2.4. Health Care

BGN Million	2001	2002	2003	2004
	Report	Report	Program	Program
HEALTH CARE + CONTINGENCY			1 416.7	1 623.8
% of GDP			4.0	4.3
% of Total Expenditures			10.4	11.1
% of Non-Interest Expenditures			11.1	11.7
IV. HEALTH CARE	1 196.0	1 437.4	1 343.5	1 538.1
% of GDP	4.0	4.4	3.8	4.0
% of Total Expenditures	10.0	11.3	9.9	10.5
% of Non-Interest Expenditures	11.0	12.0	10.5	11.1
<i>Current</i>	1 114.0	1 380.0	1 290.2	1 480.1
<i>Capital</i>	82.0	57.4	53.3	58.0

The health care expenditures in the 2004 budget comply with the definition of health care as one of the main priorities of the budget policy, with the health care state policy, as well as the ongoing progress of the health care sector reform.

The radical changes in the funding mechanisms of health care will continue through 2004, in accordance with the readiness of the health care system and the approved steps of the medium-range projections for the development of the health care and health insurance sectors.

The responsibilities of the state, and the republican budget respectively, towards the funding of hospital care are preserved to a certain degree, through the subsidies of health care services, on the basis of a contract with the funding authority – Ministry of Health. BGN 280.2 million are projected to subsidize the hospital care through the budget of the Ministry of Health in the health establishments too, which have been transferred from the municipal budgets till 31 December, 2003. Of the total amount of expenditures for hospital care, 46.6% will be covered through the budget of the Ministry of Health and 53.4% through the budget of the NHIF.

- Ministries and other state agencies

In the 2004 Draft of the Republican Budget, there are BGN 609.3 million provided for the funding of the primary public health care systems and the activities of the medical institutions under the Ministry of Health, the Ministry of Transport and Communications, the Council of Ministers, the Ministry of Defense and the Ministry of Youth and Sport.

These expenditures are distributed as follows:

- Ministry of Health -	BGN 558.8 million
- Council of Ministers	BGN 13.5 million
- Ministry of Defense -	BGN 31.0 million
- Ministry of Transport and Communications	BGN 5.8 million
- Ministry of Youth -	BGN 0.2 million.

Through the budget of the Ministry of Health, the expensive life-saving and life-supporting medication and consumables will be provided, the priority national programs will be financed, approved by the Council of Ministers as part of the national health care policy (the National Program Against Cardio-Vascular Diseases; the National Cancer Screening Strategy; the National Transplant Program; the National Program for Prevention and Control of AIDS, etc.), emergency medical care, as well as all other activities, related to public health care.

- The National Health Insurance Fund – the health insurance payments calculated for 2004 amount to BGN 769.7 million. The increase of the expenditures by BGN 93.6 million, compared to the previous year, is expected to improve the reimbursement payments through the NHIF.

Thus, the distribution of the budget funds for health insurance payments guarantee:

- Defining the needs for primary outpatient medical care, on the basis of the regulatory standards introduced, providing equality of access to all health insured individuals in

emergency cases and full coverage of the specialized medical-diagnostic activities provided to individuals with chronic diseases;

- Taking into account those regional needs for medical care, excluded from the regulatory standards – on the basis of historically proven consumption and population age structure;
- Guaranteed equal volumes of medical care, provided in the different regions of the country, for one and the same range and type of medical services;
- Reflecting the actual medical care needs of the population.;
- Ensuring the provision of all types and specialties of medical services throughout the territory of the country;
- Providing for increased demand for the medical care services, offered by the university medical centers in the country.

In the 2004 budget of the NHIF, there are BGN 11.6 million provided to cover the salaries and labor remuneration of the 2,180 employees of the NHIF and RHIF, and BGN 13.3 million for current expenditures for maintenance and support of the structures of the Fund.

2.5. Social security and welfare (pensions, social assistance and compensations), social security and employment works and services

The budgeted expenditures for this function in 2004 are expected to be BGN 5,092.8 million, not including the amount of contingency. They include the payment of retirement pensions, social benefits and compensations, and the expenditures for support and maintenance of the social security agencies. The high level of the budgeted funds is retained, in accordance with the absolute priority, which they have in the budget.

BGN Million	2001	2002	2003	2004
	Report	Report	Program	Program
V. SOCIAL SECURITY AND WELFARE (A+B+C)	4 026.0	4 339.5	4 845.7	5 092.8
% of GDP	13.6	13.4	13.7	13.4
% of Total Expenditures	33.5	34.1	35.5	34.8
% of Non-Interest Expenditures	36.9	36.1	37.9	36.8
<i>Current</i>	<i>3 980.6</i>	<i>4 329.4</i>	<i>4 829.4</i>	<i>5 075.5</i>
<i>Capital</i>	<i>45.4</i>	<i>10.2</i>	<i>16.3</i>	<i>17.3</i>
PENSIONS + CONTINGENCY			3 122.7	3 435.9
% of GDP			8.8	9.0
% of Total Expenditures			22.9	23.5
% of Non-Interest Expenditures			24.4	24.8
A. PENSIONS	2 702.0	2 944.2	3 062.7	3 375.9
% of GDP	9.1	9.1	8.7	8.9
% of Total Expenditures	22.5	23.1	22.5	23.1
% of Non-Interest Expenditures	24.8	24.5	23.9	24.4
B. SOCIAL BENEFITS, COMPENSATIONS AND OTHER HEALTH INSURANCE EXPENDITURES	1 083.0	1 191.7	1 535.9	1 417.2
% of GDP	3.6	3.7	4.4	3.7
% of Total Expenditures	9.0	9.4	11.3	9.7
% of Non-Interest Expenditures	9.9	9.9	12.0	10.2
C. SOCIAL SECURITY AND EMPLOYMENT WORKS AND SERVICES	241.0	203.6	247.1	299.7
% of GDP	0.8	0.6	0.7	0.8
% of Total Expenditures	2.0	1.6	1.8	2.0
% of Non-Interest Expenditures	2.2	1.7	1.9	2.2
<i>Current</i>	<i>195.6</i>	<i>193.5</i>	<i>230.8</i>	<i>282.5</i>
<i>Capital</i>	<i>45.4</i>	<i>10.2</i>	<i>16.3</i>	<i>17.3</i>

Group “Pensions”

This group of expenditures includes the retirement pensions, paid out by the State Social Security Fund and the pensions, paid out by the teachers’ Retirement Fund, as well as the postal fee for the pension payments and the VAT on them.

- Pensions from the budget of the SSSF

For 2004, there are BGN 3,374.3 million provided, excluding the reserves for the social security system reform – BGN 60.0 million, so the increase, when compared to 2003, is approximately BGN 313 million. It has been planned to update the pensions, after July 1 2004, with 5.8%, while the expected inflation for 2004 is 4.2%. The removal of the pension ceiling after January 1, 2004 and pegging their maximum amount to the ceiling on the insurance income is taken into consideration. In relation to the above, and the forecasted increase of the maximum insurance income from BGN 1,000 in 2003 to BGN 1,200 in 2004, a ceiling on the retirement pensions, or the sum of pensions and other retirement benefits received by a retired individual up to BGN 420 a month has been planned for introduction.

- Pensions from the budget of the Teachers’ Retirement Fund

For 2004, there are BGN 1.62 million provided for the budget of the TRF, to be used for payment of additional retirement benefits to the pensions, as well as, to cover the early retirement pensions.

Group “Social Assistance and Compensations”

This group of expenditures includes the benefits and payments for citizens under the Social Assistance Act, the Law on Protection, Rehabilitation and Social Integration of the Disabled, the Social Insurance Code, the Family Assistance for Children Act, the Ministry of Interior Act, and the Defense and Armed Forces Act.

The social benefits and compensations will be distributed predominantly through the budgets of the MLSP, the SSSF budget, the budgets of the higher education institutions and the municipal budgets.

In order to be able to implement the overall social policy of the state through the MLSP, almost all social expenditures are transferred from the municipal budgets to the budget of the MLSP. A more detailed description of the distribution of these expenditures is given in the previous chapter.

- Ministries and other state agencies

The 2004 budget of the Ministry of Labor and Social Policy provides a total amount of BGN 719.0 million, compared to BGN 617.8 million for 2003, including:

- For the benefits under the Instructions for the Implementation of the Social Assistance Act there are BGN 104.9 million planned;
- Targeted energy benefits under the SAA – BGN 110. 0 million
- For 2004, the budgeted funds for the benefits under the Law on Protection, Rehabilitation and Social Integration of the Disabled, amount to BGN 16 million, which is the same as in 2003.

- The health insurance payments of the individuals, specified under Art. 40, par. 2, pts. 1, 4, and 8 of the Health Insurance Act, are minimally increased, in comparison with those in 2003, to BGN 20.9 million.
- The expenditures under the Family Children Assistance Act are increased by BGN 171 million, compared to those in 2003, which are transferred from the budget of the State Social Security Fund. This increase is a consequence of the provisions of the Family Children Assistance Act, according to which after January 1, 2004, all benefits provided under it will be paid out solely through the Social Assistance Agency of the MLSP. The amount of the monthly additional benefits is increased from BGN 15 to 18, while keeping the level of the per capita income in the family according to Art. 4 of the FCAA at BGN 200. This amount also includes 263 million BGN for benefits under Art 40 of the Law on Protection, Rehabilitation and Social Integration of the Disabled Individuals.
- This group of expenditures also includes a budgeted amount of BGN 204.2 million for active labor market measures, ensuring the continuous development of the policies for decreasing the level of unemployment, preservation and sustaining the labor force.

In the other ministries and state agencies, there are BGN 66.8 million budgeted, including:

- Health insurance payments for individuals, insured through the state budget: Council of Ministers – for refugees; Ministry of Justice – for prison inmates; MIA and MoD – for military personnel and individuals, recruited for mandatory military duty.
- Compensations under the Ministry of Interior Act, and the Defense and Armed Forces of the Republic of Bulgaria Act.

- State Social Security Fund Budget

This group of expenditures under the autonomous budget of the SSSF is related to the disbursement of payments for different compensations, under the Social Security Code. To cover these expenditures there are BGN 619.7 million provided for 2004, compared to BGN 778.5 million in 2003. The significant decrease in the absolute value of these expenditures in 2004 is due to benefits under the Family Children Assistance Act, which are now entirely included in the budget of the Ministry of Labor and Social Policy.

For 2004, the budgeted funds for compensation of the “Unemployment” risk are based on a minimum of BGN 80 and a maximum of 140 unemployment compensation.

- Teachers’ Retirement Fund Budget

In this group of expenditures, under the budget of the TRF there are BGN 83 million budgeted for health insurance payments of the retirees, exercising their early retirement rights through the fund.

- In the central budget there are funds provided to cover the expenditures for social benefits and compensations, amounting to BGN 1.8 million, and the budgets of the higher educational institutions provide BGN 10.7 million for compensations, benefits, and health insurance payments.

Group “Social Security and Employment Works and Services”

The 2004 consolidated expenditures for this group amount to BGN 299.7 million, which are distributed as parts of the central budget, the budgets of the ministries and other state agencies, the SSSF budget and the Teachers’ Retirement Fund, the municipalities, and the National Fund at the Ministry of Finance.

- Ministries and other state agencies

The expenditures under the budget of the MLSP include the support, maintenance, salaries and social security payments for: the Employment Agency, the Social Assistance Agency, the State Child Protection Agency, the Social Investment Fund, and the “Rehabilitation and Social Integration” Fund.

After the amendments in the Social Assistance Act in 2003, the Social Assistance Agency was established, and the number of its staff has reached 5,790 individuals (including the staff from the former National Social Assistance Service – 108 employees).

During 2004 the number of employees of the General Labor Inspectorate is planned to increase with another 40 individuals and the number of employees of the State Child Protection Agency with 30, following Resolution No. 564 from August 8, 2003, for the adoption of an Action Plan for the period July 1 – December 31, 2003, supporting the Strategy for Acceleration of the Negotiations for Accession of the Republic of Bulgaria to the European Union.

- State Social Security Fund

The expenditures of the State Social Security Fund for social assistance agencies and activities, insurance and employment amount to BGN 68.2 million. The SSSF budget expenditures for this group are related to providing sufficient maintenance and support, funds for salaries and labor remuneration for the NSSI system. It is planned for 2004 to increase the salaries and other remuneration, which is related to the equalization of the average salary level in the NSSI to that of the analogous state bodies – the General Tax Directorate and the NHIF. The support and maintenance funds for the NSSI, for 2004, have been increased to BGN 23.8 million, or by 18.5%, in comparison with 2003, following the new functions of the NSSI for registration of the labor contracts, and the strengthening of the control over the insurers (employers) and insured individuals. The number of pay-roll employees will be 3,978 in 2004.

- The budgeted expenditures from the central budget amount to BGN 47.8 million;
- The municipal budgets – BGN 90.0 million;
- The National Fund at the Ministry of Finance - BGN 11.1 million.

2.6. Housing, Communal Amenities and Environment

BGN Million	2001	2002	2003	2004
	Report	Report	Program	Program
VI. HOUSING COMMUNAL AMENITIES AND ENVIRONMENT	506.6	503.2	682.3	808.9
% of GDP	1.7	1.6	1.9	2.1
% of Total Expenditures	4.2	4.0	5.0	5.5
% of Non-Interest Expenditures	4.6	4.2	5.3	5.8
<i>Current</i>	<i>247.9</i>	<i>286.3</i>	<i>332.0</i>	<i>424.5</i>
<i>Capital</i>	<i>258.7</i>	<i>217.0</i>	<i>350.3</i>	<i>384.4</i>

The consolidated expenditures under this function amount to 808.9 million BGN. These funds are distributed to the different budgets as follows:

- Ministries and other state agencies

The funds, budgeted under this function, will be used by the ministries for the execution of the government program for this sector, through the implementation of the following policies:

1. Ministry of Regional Development and Public Works

Ensuring the continuity of the activities of the policy for creation of favorable conditions for a sustainable and balanced regional development; the policy for stimulation of the decentralization of state governance and creation of conditions for its implementation; the policy for efficient utilization of the pre-accession instruments for social and economic cohesion and harmonization with the acquis ; the policy for optimization of the management and disposal of the state-owned real estate properties – on the basis of the structural planning of the territorial distribution, and the creation and maintenance of the cadastre and the property register. Creation of conditions for maintenance of the existing housing facilities and providing incentives for construction of new reasonably priced ones; the policy for development of favorable conditions for efficient investment processes in the public utilities sector; completion and maintenance of the water supply systems. For the MRDPW, the budgeted funds amount to BGN 89.4 million. Through this function, the majority of the activities of the MRDPW, the budget structures of the National Construction Control Directorate, and the Cadastre Agency, are performed

2. The Ministry of Environment and Waters

Realization of the activities under the policies for: optimization of the water supply – sustaining and improving the quality of the underground and surface water sources; securing optimal quality and quantity of water for drinking/household and agricultural needs; the policy for improvement of waste management – construction of an integrated system of waste treatment facilities, as well as the establishment of mechanisms for differentiated waste collection, recycling and reprocessing; the policy for improvement of the quality of the **atmospheric** air in the “hot spot” regions, and reduction of the noxious emissions in the air; the biodiversity preservation policy; the security and public awareness policy; the integrated environmental protection policy – the development and introduction of the National Environmental Monitoring System; control and management of chemical substances and prevention of large-scale accidents; the geological information policies, the mineral and raw

material balance, and preservation of the earth entrails. The budgeted funds for the MEW amount to BGN 16.4 million.

3. The Council of Ministers

The expenditures are related to the activities of the Board of Directors of the National Compensatory Housing Fund. The budgeted funds amount to BGN 0.2 million.

4. Ministry of Labor and Social Policy

Under the temporary employment program, and the **professional retraining** in the construction and tourism sectors under the “Beautiful Bulgaria“ Project, the budgeted funds amount to BGN 20.7 million.

The number of pay-roll employees in this function is 2,233, distributed as follows:

-MRDPW -	896 employees
-MEW -	1,322 employees.
-Council of Ministers -	15 employees

A 50 individuals' increase of the number of pay-roll staff of the Cadastre Agency is planned , in relation to the implementation of the long-term program for the activities for the creation of the Cadastre and the Property Register, as provided by the Cadastre and Property Register Act. The number of pay-roll staff of the Ministry of Environment and Waters is planned to be increased by 61 employees.

The amount of support and maintenance funds is largely determined by the utilization and, respectively, co-financing the State Investment Loans (SIL), which are being serviced predominantly by the MRDPW. The majority of SIL by the MRDPW are concentrated under this function, which reflects the realization of the activities for implementation of the policies for establishing, preserving and sustaining public utilities' systems, construction, maintenance and repairs of the municipal road network; the policy towards integrated water management; and the policy for establishing the Cadastre and Property Register of the Republic of Bulgaria. The relative share of the funds from the State Investment Loans in this function amounts to 56.5% of all the funds in it.

- The budgeted funds for 2004, for the function under review, in the central budget amount to BGN 26.9 million;
- The municipal budgets – BGN 439.9 million;
- The National Fund at the Ministry of Finance - BGN 215.5 million.

2.7. Recreation, Culture, and Religion

BGN Million	2001	2002	2003	2004
	Report	Report	Program	Program
VII. RECREATION, CULTURE AND RELIGION	217.4	223.1	229.6	247.2
% of GDP	0.7	0.7	0.7	0.7
% of Total Expenditures	1.8	1.8	1.7	1.7
% of Non-Interest Expenditures	2.0	1.9	1.8	1.8
<i>Current</i>	202.5	211.2	220.6	236.8
<i>Capital</i>	14.9	11.9	9.0	10.4
CULTURE	196.3	198.9	206.5	226.6
% of GDP	0.7	0.6	0.6	0.6
% of Total Expenditures	1.6	1.6	1.5	1.5
% of Non-Interest Expenditures	1.8	1.7	1.6	1.6
<i>Current</i>	182.9	187.9	197.5	216.8
<i>Capital</i>	13.4	11.0	9.0	9.8
OTHER PUBLIC AND SOCIAL SERVICES (RECREATION, SPORTS, TOURISM, RELIGION)	21.1	24.2	23.1	20.6
% of GDP	0.1	0.1	0.1	0.1
% of Total Expenditures	0.2	0.2	0.2	0.1
% of Non-Interest Expenditures	0.2	0.2	0.2	0.1
<i>Current</i>	19.6	23.3	23.1	20.0
<i>Capital</i>	1.5	0.9	0.0	0.6

The consolidated amount of budgeted funds for the group “**Recreation** amounts to BGN 7.2 million.

- Ministries and other state agencies

The expenditures for recreation of the ministries and other state agencies amount to BGN 5.7 million, including BGN 0.55 million capital expenditures for maintenance and support of their facilities, of which: for the Council of Ministers – 4.2 million BGN; for the Ministry of Justice – BGN 0.67 million; for the Ministry of Labor and Social Policy – BGN 0.32 million; for the Ministry of Regional Development and Public Works – BGN 0.35 million; for the Ministry of Agriculture and Forestry – BGN 0.20 million

- Bulgarian National Television – the budgeted expenditures for 2004 amount to BGN 0.388 million;
- The municipal budgets provide BGN 1.0 million for expenditures under this group.

In the 2004 consolidated budget for group “Physical Culture and Sports,” there is a total amount of BGN 8.9 million provided

- Ministries and other state agencies

The state institution, responsible for the physical education and sports policies is the Ministry of Youth and Sports. In the budget of the Ministry there are targeted funds provided, amounting to BGN

3.25 million. These funds are aimed at facilitating physical education and sports, in accordance with the provisions under Art. 11, par. 3 of the Gambling Act and Art. 57a of the Physical Education and Sports Act, and represent the expected revenues during 2003 in the Republican Budget from the Bulgarian Sports Lottery, in accordance with the provisions of Art. 2a of the Corporate Income Tax Act.

There are funds provided for covering the expenses of the educational-training and sports-competition activities in the specialized sports schools, for funding of special target programs for the development of sports and social tourism for disabled individuals, and for support for talented children and teenagers. There are budgeted funds for the preparation and participation of Bulgarian athletes in the “Athens 2004” Olympic Games, for prizes to medallists and winners, as well as, the necessary funds for purchasing medication and reactive chemicals for illegal substance (doping) control.

In accordance with the provisions under Art. 9, par. 3 of the Gambling Act and Art. 59b of the Physical Education and Sports Act, the primary funding of the activities of the sports’ federations, clubs, and other national sport organizations, will be performed on the basis of contracts, which will guarantee the normal performance of the sports activities, despite the decreased amount of target funds provided in the budget of the Ministry for 2004.

In accordance with resolution No. 129 of the Council of Ministers from 2000, establishing the minimum differentiated amounts of financial resources for physical education and sports, in the central budget for 2004, the funds provided amount to BGN 2.0 million.

For funding of youth activities, the budget of the Ministry of Youth and Sports provides BGN 0.4 million.

- The central budget for 2004 provides funds, amounting to BGN 2.0 million, and the municipal budgets - BGN 3.6 million.

For 2004, the budgeted funds for group “**Tourism**” amount to BGN 2.9 million, which will ensure execution of the activities under this group, including the national tourist advertising campaign.

These funds will provide for execution of the activities in the tourism sector.

The state institution, responsible for the execution of the policies, related to tourism is the National Tourist Advertising and Information Executive Agency, which is a secondary level spending unit, under the Minister of Economy.

26 individuals are employed within the National Tourist Advertising and Information Executive Agency.

The total amount of expenditures in the consolidated budget of Group “**Culture**” amount to BGN 226.6 million, which will be distributed through the following budgets:

- Ministries and other state agencies

For the ministries and other state agencies for 2004, there are BGN 50.9 million budgeted for culture, which will be used for the following activities:

- For funding of the expenditures, related to the cultural institutes under the Ministry of Culture, for funding of creative projects and programs in the spheres of film productions, book publishing, theaters, museums, supporting the development of

culture, funds for conservation and restoration of real estate cultural monuments, with a total amount of BGN 44.0 million

- For the execution of the functions of the General Directorate of Archives of the CoM – BGN 4.3 million
- To the Ministry of Labor and Social Policy – BGN 2.5 million, for funding capital expenditures under culture-related projects;
- To the Ministry of Education and Science for support and maintenance of the Museum of Education – BGN 0.086 million

- Bulgarian National Television and Bulgarian National Radio

For funding the activities of the Bulgarian National Television and the Bulgarian National Radio, and in accordance with the issued program licenses for national and regional radio-television programs under the Radio and Television Act the budgeted funds amount to BGN 100.2 million, including BGN 3.2 million for capital expenditures.

For the preparation, creation and broadcasting of 73,566 hours of radio programs, a subsidy, amounting to BGN 30.7 million is provided, for the broadcasting of:

- Program “Horizont” – 24-hour radio broadcasting;
- Program “Hristo Botev” – 24-hour radio broadcasting;;
- Program “Radio Bulgaria” – 57 hours of average daily radio broadcasting, in Bulgarian and nine foreign languages;
- Regional programs;
- Radio Varna – 24 hours a day, Radio Plovdiv – 18 hours a day, Radio Stara Zagora – 18 hours a day, Radio Shoumen – 18 hours a day, Radio Blagoevgrad – 18 hours a day.

For the preparation, creation and broadcasting of 18,788 hours of television programs, a subsidy, amounting to BGN 47.1 million is provided, for the broadcasting of:

- “Channel 1” – 24-hour TV broadcasting;
- Satellite program “TV Bulgaria” – 12-hour TV broadcasting;
- Regional programs – 4 programs – 3 hours 50 minutes each.

- The expenditures for “Culture” provided in the central budget amount to BGN 5.1 million, and those in the municipal budgets amount to BGN 70.3 million.

For the Group “**Religion,**” the 2004 budget provides BGN 1.2 million through the budgets of the respective ministries for facilitating the officially registered religions, and the expenditures, provided in the central budget amount to BGN 0.4 million.

2.8. Economic Affairs

BGN Million	2001 Report	2002 Report	2003 Program	2004 Program
VIII. ECONOMIC AFFAIRS	1 367.5	1 505.2	1 497.0	1 508.0
% of GDP	4.6	4.7	4.2	4.0
% of Total Expenditures	11.4	11.8	11.0	10.3
% of Non-Interest Expenditures	12.5	12.5	11.7	10.9
<i>Current</i>	909.6	1,030.0	933.4	881.5
<i>Capital</i>	457.9	475.1	563.5	626.5

This function reflects the relationship between the budget and the real sector, as well as the commitment of the government to the completion of the structural reforms. The function reflects the economic relations between the public sector and the real sector, while funding of the different managing state agencies is presented in General Public Services function. The main mechanisms underlying these relations are the funding programs and the subsidies for the different sub-sectors.

Group “Mining, Fuels and Energy”:

In the 2004 budget, the consolidated amount of funds provided, on the basis of the expected expenditures for the “Mining, Fuels, and Energy” group, amount to BGN 51.3 million, including current expenditures – BGN 43.8 million, and capital expenditures – BGN 7.4 million. The funds are distributed into the following budgets:

- Ministries and other state agencies

From the budgeted funds for Group “Mining, Fuels, and Energy,” BGN 15.6 million are provided for technical liquidation and rehabilitation of old geological surveying works, performed by the Ministry of Environment and Waters, support and maintenance of the activities of the “Center for Energy Efficiency of the Industry,” under the Ministry of Economy, support and realization of the tasks of the two funds - “Dismantling of Nuclear Facilities” and “Safe Storage of Nuclear Waste,” under the Ministry of Energy and Energy Resources.

There are 41 individuals employed within the Group “Mining, Fuels, and Energy.”

For the technical liquidation and rehabilitation of old geological surveying works, through the budget of the Ministry of Environment and Waters there are BGN 1,018.6 thousand provided, out of which BGN 1,008.6 thousand for capital expenditures, and BGN 10.0 thousand for current expenditures. For the support and maintenance of the activities of the “Center for Energy Efficiency of the Industry,” under the Ministry of Economy, related to preparation of expert analyses and surveys of energy users, development of measures for reduction of industrial energy consumption, etc., there are BGN 113.3 thousand provided, out of which BGN 5 thousand for capital expenditures. For the support and realization of the tasks of the two funds - “Dismantling of Nuclear Facilities” and “Safe Storage of Nuclear Waste,” under the Ministry of Energy and Energy Resources, which include the expenditures and remuneration for the Boards of Directors of the two funds, and the support and

maintenance of the State Enterprise for Radioactive Waste Management, there are BGN 14,445.1 thousand provided.

- In the central budget for 2004, the provided funds amount to BGN 29.3 million, and in the National Fund at the Ministry of Finance, the funds amount to BGN 6.4 million

Group “Agriculture, Forestry, Hunting and Fisheries”:

The consolidated expenditures for this group amount to BGN 439.3 million. They are distributed as follows:

- Ministries and other state agencies

The budgeted funds for Group “Agriculture, Forestry, Hunting and Fisheries” amount to BGN 280.7 million, out of which, BGN 84.9 million will be used for salaries and other remuneration of the staff, and related expenditures.

This group includes the expenditures of the Ministry of Agriculture and Forestry, for combating contagious and parasitic diseases; collection and disposal of high-risk waste materials; purchasing of vaccines and diagnostic kits; purchasing of anti-hail missiles for the 8 firing ranges and the 200 missile launch sites in the agricultural system; forest protection and reproduction; support and maintenance of forest-guarding , for protection of woods and wild game; protection, reproduction, and improvement of soil fertility , and the environmental functions of the soil layers; for the development of the vineyards and wine-producing sectors, in accordance with the EU requirements; protecting the cattle selection, and improving quality of breeds; grain and forage control; protection and reproduction of the fisheries and other aquatic cultures; preservation and enrichment of the fishery resources of the country; testing, surveying, and certification of agricultural and forestry equipment; sort testing and certification of the planting and sowing materials; protection of the country from influx and proliferation of pests on the plants and agricultural products; price subsidies for the irrigation water supplies.

For premiums to the tobacco producers there are BGN 101.0 million provided, and for support and maintenance of the “Tobacco” Fund, and targeted financial aid - BGN 30.0 million.

BGN 18.4 million are provided for capital expenditures – for construction of forest roads for logging, repairs and refurbishment of the game control stations, laboratory equipment for testing plant and animal products, wine and vineyard testing laboratories; construction and equipment of border control stations, etc.

There are 14,493 pay-roll employees, working in this group..

- The central budget provides BGN 4.0 million, the municipal budgets – BGN 1.6 million;
- The National Fund at the Ministry of Finance provides BGN 105.5 million for financing the activities in this group;
- The state fund “Agriculture” – BGN 47.6 million.

The consolidated budget for 2004 provides BGN 759.5 million to cover the expenditures of the “**Transport and Communications**” group. The activities of this group are performed through:

- Ministries and other state agencies

The budgeted funds for the “Transport and Communications” group, amounting to BGN 407.7 million, are aimed at ensuring the realization of the objectives of the government in the transport and communication sectors, namely: completing the construction of an efficient transport system and infrastructure; achieving a high level of safety and environmental sustainability for all types of transport; development of the communication services; development of communication and information technologies; providing society with efficient, safe, and accessible information services, and improvement of the transport infrastructure.

There are 4,760 pay-roll employees in the different transport and communication activities.

- **The Ministry of Regional Development and Public Works** – In this group of functions, the Ministry executes activities, related to its policy for creation of conditions, facilitating efficient investment processes in the sphere of public works, completion and maintenance of the road infrastructure. Some of the major programs, for which funds are budgeted, include: the program for completion of the highways in the Republic of Bulgaria; the program for equalization of the main road network in the country; the program for border-crossing passage; the program for the Balkan range mountain road passes; the program for maintenance and reconstruction of the road network, as well as the continuous maintenance and repairs of the road network.

The budgeted funds, for the execution of the programs, listed above, amount to BGN 272.8 million, including: BGN 96.1 million for current expenditures, and BGN 176.7 million for capital expenditures.

Of the total amount of the funds, budgeted for the “Transport and Communications” group, 63% are coming from the following state investment loans: Transit Roads I; Transit Roads II; Transit Roads III; Border-Crossing Points on the Trans-European Road Network; Transit Roads and “Trakia” Highway.

- **The Ministry of Transport and Communications** - The budgeted funds for this group, amounting to 124.6 million BGN, provide the necessary funding of expenditures, related to: the development of the railroad infrastructure and combined transport; development of the air and water transport infrastructure; surveying and maintaining the water routes and port aquatories; control and standards for safety and environmental sustainability for the road, railroad, air, and marine transport; development and maintenance of traffic management and information services for marine transport and the national emergency and security system; ensuring the route-navigation conditions and maintenance of the shipping route along the Danube river; the removal of pollution, caused by spillages of oil and oil derivatives; control over the navigation equipment for air traffic management; funding of long-distance communication and postal projects and those in the fields of information and communication technologies, while adhering to the principles of loyal competition; funding of scientific research and marketing activities for the needs of long-distance communications, information and communication technologies.

BGN 4.2 million are provided for the construction of a winter storage facility, where 39 ships from the Danube river fleet can be stored during the winter.

In addition, there are funds provided from external funding, amounting to BGN 38.5 million for “Reconstruction and electrification of the railroad line Plovdiv-Svilengrad,” and the construction of “Danube Bridge II”.

There are BGN 13.4 million provided for capital expenditures for: ensuring safety and more efficient utilization of the ports; public transportation and marine safety; airfield repairs and maintenance, and completing the technical equipment of airport, etc.

There are 1,643 pay-roll employees involved the transport and communication group of activities, under the Ministry of Transport and Communications.

The Communications Regulatory Commission – out of the budgeted funds for the “Transport and Communications” group, BGN 10.3 million are provided for: regulation of the long-distance communications sector in the Republic of Bulgaria; regulation and control of postal services; regulation and control over electronic documents and electronic signatures; ensuring the security of the electronic messaging and transactions.

There are 237 pay-roll employees in the communications activities.

- There are BGN 147.0 million provided in the central budget;
- BGN 99.1 million - in the municipal budgets;
- BGN 105.8 million are provided in the National Fund at the Ministry of Finance.

Group “Industry and Construction”:

The budgeted funds for the “Industry and Construction” group for 2004 amount to BGN 0.4 million.

In the “Industry and Construction” group there are 31 pay-roll employees, and it includes only the expenditures of the Agency for Small and Medium Enterprises, which is a second level spending unit, under the Minister of Economy.

The funds provided will cover the expenditures of the agency, which it has to perform according to the provisions of the Small and Medium Enterprises Act, aimed at stimulating small and medium business ventures.

Group “Other Economic Affairs“:

The 2004 state budget provides a consolidated amount of BGN 257.5 million, for the expenditures under the “Other Economic Affairs” group.

- Ministries and other state agencies

The funds provided during the year of 2004 in support of activities from group “Other Economic Activities” amount to BGN 60.6 million, financially securing any activities furnished by ministries and other agencies related to publishing, implementation of metrology and technical supervising, standardization, certification and testing, privatization and post-privatization control, patent services, accreditation of laboratories and authorities, activities leading to trade promotion (financing the participation in international exhibitions and fairs, etc.). BGN 10 million are provided for subsidizing

water price for the irrigation agriculture, which is a state responsibility up to Dec. 31, 2004, in accordance with Art. 58, par. 3 of the Irrigation Associations Act. Funds are provided for construction of infrastructure projects (hydro-melioration/irrigation equipment). There are funds provided to stimulate the controlling authorities of the Ministry of Finance and for issuing securities, as well.

The funds provided in the 2004 Budget secure a normal functioning of the administrations in the “Other Economic Affairs” group.

The following administrations are incorporated in the group “Other Economic Affairs”:

1. Under the National Assembly – the Food Supply Complex, the “*State Gazette*” publishing house and editorial staff;
2. Under the Council of Ministers – palaces, residential properties and **industries**, the Center for Translations and Editing, and editorial office “Legal Acts”;
3. Under the Ministry of Labor and Social Policy – training center “Manastirski Livadi”;
4. Under the Ministry of Education and Science – “*Az Buki*” and Editor-in-Chief’s Office “*Pedagogicheski Izdania*” (“Pedagogical Editions”);
5. Under the Ministry of Economy – State Agency of Metrology and Technical Supervision, Bulgarian Standardization Institute, Executive Agency “Certification & Testing,” Privatization Agency, Post-Privatization Control Agency, Patents Administration of the Republic of Bulgaria, Executive Agency “Bulgarian Office of Accreditation,” and Executive Agency for Trade Promotion.
6. Under the Ministry of Finance – publishing center of the Tax Administration.

In the “Other Economic Affairs” group, 2,374 pay-roll employees are engaged.

- There are BGN 125.0 million provided in the 2004 central budget on this group;
- BGN 15.0 million - in the municipal budgets;
- BGN 34.8 million in the National Fund at the Ministry of Finance;
- BGN 22.1 million - in the Privatization Expenditure Fund.

2.9. Expenditures, not classified under the other functions

BGN Million	2001	2002	2003	2004
	Report	Report	Program	Program
IX. EXPENDITURES, NOT CLASSIFIED UNDER THE OTHER FUNCTIONS	1 105.8	712.8	1 043.5	1 011.9
% of GDP	3.7	2.2	3.0	2.7
% of Total Expenditures	9.2	5.6	7.7	6.9
% of Non-Interest Expenditures	10.1	5.9	8.2	7.3

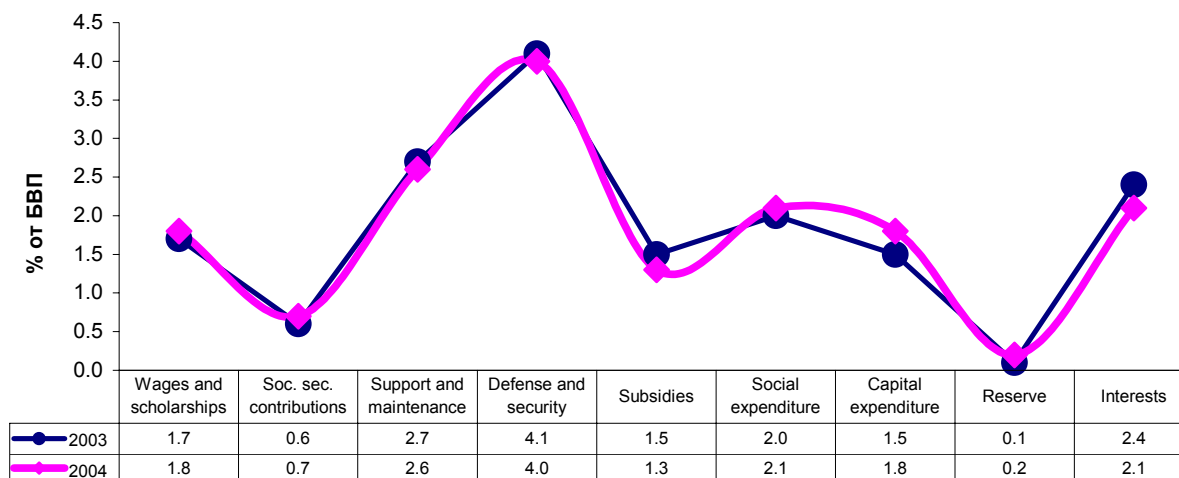
The expenditures under this function, on a consolidated basis amount to BGN 1,011.9 million. This function includes the contingencies of the National Health Insurance Fund (BGN 75.6 million), the National Social Security Institute (BGN 60.0 million) and the Supreme Judiciary Council (BGN 0.6 million), the contingency for defense (BGN 22.0 million), the contingency for prevention and compensation of the consequences from natural disasters and large scale industrial accidents (BGN 55.5 million), and the contingency for structural reforms, under the central budget (BGN 32 million).

The expenditures planned for interest payments during 2004, amount to BGN 788.2 million, out of which BGN 593.7 million for external debt payments, and BGN 194.5 million for the internal debt. According to their distribution by ministries (out of the total amount of BGN 47.7 million), the biggest share of them belongs to the Ministry of Regional Development and Public Works - BGN 23.9 million, and to the Ministry of Transport and Communications - BGN 13.1 million.

III. 2004³ Budget by Responsibilities

1. The Republican Budget

Diagram: Comparison between the different expenditures, divided by main category 2003-2004



³ In Annex 1 of the Report, the policies and the budget indicators, according to IRBC are described.

Republican Budget, million BGN	2003	%GDP	2004	%GDP
Revenues	7,660.3	21.7	9 052.5	23.8
Tax revenues	6,093.0	17.3	7 485.9	19.7
Non-tax revenues	1,565.7	4.4	1 565.2	4.1
Grants	1.6	0.0	1.5	0.0
Total Expenditures	5,918.8	16.8	6 322.5	16.6
Current non-interest expenditures	4,463.6	14.4	4 755.4	12.5
Salaries and scholarships	598.8	1.7	701.8	1.8
Social security contributions	219.4	0.6	253.1	0.7
Operations and maintenance	952.9	2.7	991.0	2.6
Defense and security	1 446.8	4.1	1 515.1	4.0
Subsidies	522.4	1.5	506.7	1.3
Social expenditures	723.3	2.0	787.6	2.1
Capital expenditure	537.8	1.5	678.9	1.8
Increase of the state reserve	9.5	0.0	14.5	0.0
Reserve	69.3	0.1	87.5	0.2
Interest payments	838.6	2.4	786.2	2.1
Transfers (net)	-2,102.9	-5.9	-2 967.1	-7.9
Deficit / Surplus	-361.3	-1.0	-237.0	-0.6

The projected deficit in the 2004 Republican Budget amounts to BGN 137 million, or 0.4% of GDP. This represents an improvement of the budget balance, in comparison with 2003, by BGN 224.3 million, or 0.6% of GDP.

The increase in the revenues amounts to 2.3% of GDP, predominantly as a result of the more stringent control, the increased collection rate, and the improved macroeconomic environment.

The greatest decrease can be seen in the amount of expenditures for subsidies – 0.4% of GDP, due to the changes in the mechanism for hospital funding through the NHIF.

2. Judiciary

The position of the Council of Ministers on the issue of Budget for the Judiciary for 2004 is developed by the government in order to secure the financial, material and personnel resources necessary for the normal functioning of the legal system in this country. The expenditures provided for 2004 amount to BGN 205.2 million, including BGN 189.6 million current expenditures, capital expenditures BGN 15.0 million and BGN 0.6 million reserve funds. In comparison to the other budgetary systems, there is a considerable growth of expenditures for the system of the legal authority. They are BGN 63.3 million more than the previous year, which is a 44.6 per cent growth, provided by a central budget subsidy increase by 53.6 %.

In the budget, proposed by the Supreme Court Council (SCC), the total expenditures included, amount to BGN 340.2 million, from which:

- current - BGN 226.7 million,
- capital - BGN 82.9 million, out of which BGN 15 million subsidy from the central budget for the “Court Buildings” and “Penitentiary Buildings” funds, under the Ministry of Justice, and
- reserves - BGN 30.6 million, out of which BGN 30.0 million from the central budget for the reform of the legal system.

The expenditures defined by the SJC for the judiciary exceed by 116.8 % the expenditures, approved by the National Assembly for 2003.

The draft budget, proposed by SJC for the judiciary leads to a violation of the target level of the deficit included in the consolidated fiscal program by BGN 128.0 million, or by 0.34 % from GDP, while preserving the present levels of the revenues and expenditures under the other budget systems.

In conclusion, the Council of Ministers considers, that the calculated funds under the individual indicators, incorporated in the position statement concerning the draft budget of judiciary for the year of 2004, provide the necessary funds for the normal functioning of the constitutionally established independent institutions, securing the jurisdiction in this country.

3. Mandatory Social Security

The MSS budget for 2004 is based on the treasury execution of the budget for the first half of 2003, on the demographic projections for the development of the population until the year of 2020 of the National Social Security Institute (NSSI), and on the assumption for the dynamics of the number of insured persons.

The NSSI executes the following policies, related to functional direction “social security and welfare”:

1. Guaranteeing the functioning of financially sustainable retirement system;
2. Management of social-insurance risks defined by the Mandatory Social Insurance Code;
3. Sustaining the administrative capacity of NSSI.

For the execution of its basic policy of pensions payment during 2004, BGN 3,374.3 million are provided, excluding the reserves for the social security system reform – BGN 60.0 million, so the increase, when compared to 2003, is approximately BGN 313 million. It has been planned to update the pensions, after July 1 2004, with 5.8%, while the estimated inflation for 2004 is 4.%. The removal of the pension ceiling after January 1, 2004 and the pegging their maximum amount to the maximum ceiling of the insurance income. In this respect and with the forecasted increase of the maximum insurance income from BGN 1,000 in 2003 to BGN 1,200 in 2004, an implied ceiling up to BGN 420 a month on the retirement pensions or the sum of pensions and other retirement benefits which one retired individual can receive is planned for introduction, .

The management of social-insurance risks is related to the compensatory payments, based on different provisions from the Mandatory Social Insurance Code. For this purpose, in 2004 BGN 404.2 million are provided, compared to BGN 578.1 million for 2003. The significant decrease in the absolute value of these expenditures in 2004 is due to benefits under the Family Children Assistance Act, which are now entirely included in the budget of the Ministry of Labor and Social Policy.

For 2004, the budgeted funds for compensation of the “Unemployment” risk are based on a calculation of a minimum of BGN 80 and a maximum of 140 for unemployment compensation.

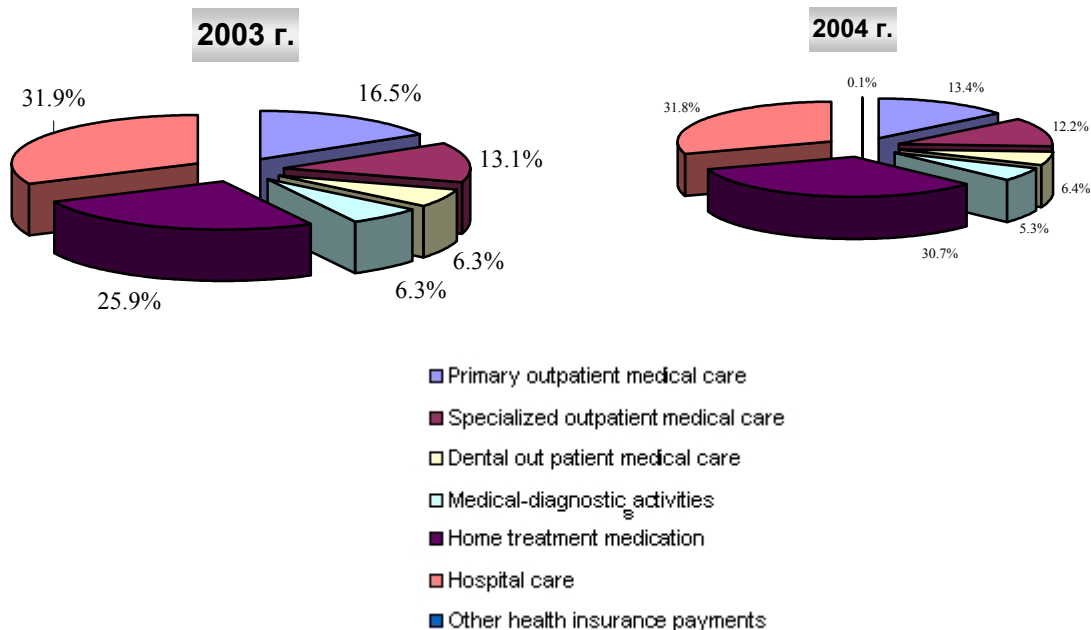
NSSI Administrative capacity maintenance is related to securing sufficient resources, equipment, and funds for salaries within the system. The support and maintenance funds for the NSSI, for 2004, have been increased to BGN 23.8 million, or by 18.5%, in comparison with 2003, following the new functions of the NSSI for registration of the labor contracts, and the strengthening of the control over the insurers (employers) and insured individuals. The number of pay-roll employees in 2004 will be 3,978.

4. National Health Insurance Fund (NHIF)

In the 2004 draft, the following parameters are provided for the National Health Insurance Fund budget: 795.3 million BGN - revenues, BGN 878.1 million - expenditures, out of which 769.7 are health insurance expenditures. The major part of these payments are for outpatient medical care (BGN 287.5 million), for medical drugs for home treatment (BGN 236.5 million) and for hospital care (BGN 245.1 million), as demonstrated in the table below:

Table: Allocation of the health insurance payments of the NHIF for 2003 and 2004

Indicator	2003 Budget	2004 budget
Total (BGN thousand)	627 752.9	769 705.2
Primary outpatient medical care	103 500.0	103 500.0
Specialized outpatient medical care	82 400.0	94 000.0
Dental outpatient medical care	39 800.0	49 000.0
Medical-diagnostic activities	39 300.0	41 000.0
Home treatment medication	162 752.9	236 500.0
Hospital care	200 000.0	245 105.2
Other health insurance payments		600.0



The strategy for drafting the 2004 NHIF budget is founded on two main principles:

1. The budget is an element of the macro-economic allocation of the expenditures, performed by the state and particularly those for the “Health Care” sector.
2. The budget is elaborated in correspondence to the health care policy for 2004, and the preservation the mechanisms achieved, ensuring the health care services in the country.

In 2004 the National Health Insurance Fund will carry out the following policies related to the “Health Care” function:

- strengthening of the functions of the General Practitioners, the specialized outpatient medical care, and the medical-diagnostic tests;
- Improving the access of the healthcare insured individuals to the primary specialized outpatient medical care;
- Widening the scope and improvement of the system and methodology of hospital care financing;
- Introducing a reliable system for monitoring and quality control of the medical services, and assessment of the responsibility of providers;

The main priority in the activity of the National Health Insurance Fund the execution of health insurance payments, satisfying to an adequate degree the real needs of the insured individuals.

In the 2004 budget of the National Health Insurance Fund, the revenues provided amount to BGN 795.3 million, out of which BGN 756.4 million revenues from health insurance payments, and BGN 38.9 million non-tax revenues.

The budgeted expenditures amount to BGN 879.4 million, including BGN 11.6 million expenditures for remuneration of the 2,180 employees on pay-roll. The number of the personnel is increased by 70 employees, reflecting the increased responsibilities of the NHIF related to hospital care funding and in compliance with the controlling functions, under the Health Insurance Act, over the execution of the National Framework Agreement.

There are BGN 13.3 million provided for current support and maintenance expenditures of the Central Management office of the NHIF and the Regional Health Insurance Fund offices.

BGN 769.7 million are provided in the budget for covering of expenditures for health insurance reimbursements, distributed as follows::

- Primary outpatient medical care – BGN 103.5 million
- Specialized outpatient medical care - BGN 94 million
- Dental outpatient medical care - BGN 49.0 million
- Medical diagnostic activities – BGN 41.0 million
- Hospital care – BGN 245.1 million
- Home treatment medication – BGN 236.5 million
- Other health insurance payments – BGN 0.6 million

The distribution of the budget funds for healthcare payments into separate directions aim to guarantee:

- Defining the necessities from primary non-hospital aid on the basis of the regulative standards introduced which implies an equal access to all health insured persons for the acute cases and complete health insurance for the provision of specialized and medical diagnostic activities for the dispensary treatment of diseased persons;
- Financial securing for guaranteed medical aid packs;
- Guarantee of equal in volume medical aid for all the regions in this country;
- Reflecting the medical aid necessities of the population;
- Introducing of incentives for better quality of the medical care provided.

During 2004 the NHIF is planned to finance the municipal hospitals not only by way of “clinical pathways,” but also using a specific mechanism for financing their overall activities, on the basis of actually performed activities.

A reserve fund is provided in the 2004 budget of NHIF, in accordance with Art. 26, par. 1 of the Health Insurance Act, amounting of 75.6 million BGN.

With these parameters of the 2004 National Health Insurance Fund budget, deficit is expected to reach BGN 84.1 million. The deficit will be covered from the existing cash funds of the NHIF at the BNB.

5. Municipal Budgets

The expenditure part of the budgets of the municipalities, as part of the consolidated state budget for 2004, is expected to reach BGN 1,909.9 million, compared to BGN 1,641.8 million in 2003, or an increase of BGN 268.1 million, which expressed in percent equals to 16.3 per cent. The budget for 2004 provides a complete funding of the delegated state activities, funded through the municipal budgets.

By the proposed for approval updated standards for 2004, current expenditures for state activities, funded though the municipal budgets will reach BGN 1,722.9 million, excluding capital expenditures, as compared to BGN 1,476.0 million for 2003, or by BGN 246.9 million more. Expressed in percent, the increase is 16.7 per cent.

By applying the standards for 2004 and preserving the condition, that the state transactions can be used only for funding of the delegated state activities, conditions for regular funding of schools, social assistance centers, government cultural institutions such as community libraries, regional libraries, art galleries, etc. are created.

In 2004 the expenditures for the delegated state activities, including capital expenditures, will amount to BGN 1,207.1 million and will be financed by state transfers, including remised taxes –personal income tax, amounting to BGN 726.1 million, general supplementary subsidy for state-delegated activities, amounting to BGN 309.1 million, target subsidy for capital expenditures, amounting to BGN 59.0 million, out of which 32.0 million BGN for environmental projects and general equalizing subsidy for local activities of BGN 35.0 million. In case the calculated remised tax is higher than the expenditures, established according to the standards, a contribution to the central budget is formed. In order to introduce guarantees for protecting the interests of the central budget and for strengthening the financial discipline, it is proposed to reduce the amount of the personal income tax remise to the respective municipality by the amount of contribution to the budget. Thus, in practice, there will be

no municipality contributing to the central budget, when municipal budgets are approved. Supplementing the funding for the state delegated activities with funds from local revenues like taxes and other non-tax revenues, is provided as an option, at the discretion of the municipal council.

The responsibility of local authorities is raised – that of mayors, municipal administration and municipal councils, when defining local financial policy and organization of the revenues and expenditures in the municipal budgets as far as municipal revenues and local activities are concerned. The expected municipal revenues for funding of municipal expenditures for local activities for 2004, amount to BGN 667.8 million. About BGN 190.8 million are expected to be received from property taxes BGN, 474.9 million – from fees and other non-tax incomes, and an equalizing subsidy amounting to BGN 35.0 million for compensation of insufficient tax capacity in some of the municipalities.

In view of the discontinuation of deductions from local taxes, fees, charges and other non-tax revenues from municipal budgets, the investment activity of the municipalities has increased, at the expense of the additional resources provided. In 2004 this activity is expected to amount to no less than 50.0 million BGN. The act for the state budget of the Republic of Bulgaria for 2004, creates conditions for the development and implementation of a realistic budget. This statement is also grounded on the efforts which the government and the Ministry of Finance produce aiming at the realization of the updated Financial Decentralization Program for the period 2002-2005.

For the successful realization of the financial decentralization and stimulation the investment activity of municipalities, a Municipal Credits Act is under development, whose provisions will regulate the authority of municipalities to issue debt securities, and procedures for their collateralization .

The 2004 budget continues the consolidation of financial decentralization and development of local self-government in the Republic of Bulgaria, the solving of specific problems by the municipal citizens themselves, and the creation of conditions for concurring the interests of local communities and the country as a whole.

6. Budget of National Fund at the Ministry of Finance

The National Fund is an extra-budgetary fund under the Ministry of Finance. It is responsible for the financial management of the foreign aid, granted to our country by the European Community. Its activity is related to mobilization and management of the funds, granted through the PHARE, ISPA, and SAPARD programs, the pre-accession funds, along with Bulgarian financial resources from the state budget, etc.

The National Fund also manages the funds, granted by the EC, related to the financial decentralization.

The process of European integration is one of the major priorities of the Bulgarian government. The budget expenditures, arising in this respect, are divided into two main groups:

- budget expenditures for co-financing the various financial instruments of the European Union for Bulgaria.
- current expenditures and more specifically, those related to the execution of the national programme of the Republic of Bulgaria for adoption of *acquis*, meeting the membership criteria, and participation in the discussions for integration of the country into the EU.

Table : 2004 Budget of the National Fund at the MoF

<i>Indicators</i>	<i>million BGN</i>
I. Own Revenues and Grants	454.0
Non-tax revenues	3.9
Grants	450.1
II. Expenditures	597.6
Current Expenditures	98.2
Subsidies	77.4
Capital Expenditure	422.0
III. Transfers	149.9
Deficit (I – II + III)	6.3

The expected funds, in the revenue section of the National Fund Budget, amount to BGN 454 million. The majority share of them is expected to come from abroad - BGN 450 million.

The 2004 expenditures are budgeted to be BGN 597.6 million, out of which the greatest share represent the capital expenditures which amount to BGN 422 million. These expenditures basically incorporate the resources, provided through the PHARE, ISPA, and SAPARD programs.

The expenditures provided for membership fees and the participation in non-profit organizations is for the educational programs “Socrates” and “Leonardo da Vinci,” and amount to BGN 16.76 million.

The 2004 budget deficit of the National Fund is expected to be BGN 6.3 million.

CHAPTER 4: Debt Policy / Budget 2004 Financing

I. Government Debt

Up to June 30, 2003, the amount of the state and state guaranteed debt was EUR 8,878.5 million, including foreign debt - 7,736.4 million Eur and internal debt – EUR 1,142.2 million. The government debt-to-GDP ratio towards the said period amounts to 49.2 %, where only for the foreign debt referring to the GDP, it is 42.9 %, respectively. In comparison with the end of 2002, as an absolute value, the state debt has been decreased by EUR 355.2 million, and in terms of relative value referring to GDP by 6.4 points. The expenses for servicing the debt, towards the end of June of the current year, amount to BGN 453.1 million, which is less than the preliminary calculations, due to the lower than expected international interest rates.

The amount of **the external debt** towards June 30, 2003 was EUR 7,736.4 million, which represents a decrease of EUR 417.7 million, in comparison to the end of 2002. For the same period respectively, as part of GDP, the foreign debt is reduced by 6.2 %, and as part of the total amount of the debt, it is reduced by 1.2 %.

In order to optimise the currency and interest rate structure of the foreign debt, in 2002 a series of measures were undertaken, aiming to overcome the existing debt-related risk.

The implemented restructuring of part of the Brady debt by means of replacing it with new global bonds in Euro and in USD, the considerable drop of USD exchange rate relative to the Eur and the continuing trend of borrowing resources mostly in EUR, are the major reasons predetermining the achievement of a considerably optimised currency structure of the foreign debt. The share of the debt denominated in USD from 66.19% at the end of 2001, was reduced to 54.03% by the end of 2002, and during the current year, its relative weight continued to decrease, reaching 50.96 % by June 30, 2003. At the account of the reductions, realized in the USD component and in the debt share denominated in other currencies, the foreign debt presented in Euro is increasing – respectively from 17.41% up to 30.49 % for the period December 2001 – December 2002.

The interest rate structure of the foreign debt also experienced a positive change during 2002, which was preserved as a trend throughout the current year, as well. This change resulted from the swap operations performed, exchanging Brady bonds with floating interest rates with global fixed coupon bonds and is a result of the consistent policy of borrowing new foreign credits with fixed interests rates. By the end of 2002, the debt share of floating interests had been reduced down to 62.80% from 88.80% at the end of January 2002. The higher share of fixed coupons in the interest structure of the foreign debt, led to a better predictability of the interest expenses for the budget and to a reduced necessity of reserve funds to cover the interest risk.

In spite of the considerable improvement achieved in the interest structure of the foreign debt during the past 2002, there are still more than half of the foreign debt linked to the international interest rates, which makes that part of the payments dependable upon their movement. By the end of 2003, the forecasted amount of the foreign debt amounts to EUR 8,400 million, and the payments on it to BGN 1,122.9 million, the principles of which amount to BGN 536.1 million, and interests to the amount of BGN 611.2 million. The expected execution of the interest payments is about 95 %. The deviation of the parameters,

included in the State Budget Act (SBA) for 2003 is due to the ongoing trend for gradual interest reduction by the European Central Bank and the American Federal Reserve – on the one hand, and the devaluation of the USD in comparison to the remaining currencies at international markets, on the other.

The domestic debt towards the end of 2003 is expected to mark an increase of about BGN 180 million, as compared to 2002, but as part of the GDP it will remain within the limits of 6.5% of GDP. The effected policy of gradual increase of net issues of Treasury Bonds, targets to overcome the misbalance between the internal and external debt of the country, and follows priority financing from local markets, which is the practice in the EU member countries. The latter is realized in accordance with the state of the debt market, the liquidity in the financial system, the preferences of the investors towards specific securities, payments to and from the budget, the debt amortization schedule, seasonal disbalance occurrences, external factors, etc. Thus, crowding out of private financing by state financing is eliminated, as well as increased rate of return through Treasury Bonds auctions is realized. In this sense, the flexible issuing policy applied, is mainly directed towards improvement of the structure of the internal debt. In this context, it is expected that in 2003, the share of the newly emitted long-term TB will reach a dominating share of over 50%. For the first six months of the current year only, the maturity date of the TB, issued for financing of the budget deficit has increased by nine months, and is now 5 years and two months keeping relatively steady levels of rate of return in the various debt instruments. Meanwhile, in view of improving the secondary trade of the TB in circulation, buy-back operations for old illiquid BGN issues were carried out. The auctions gave an opportunity for receiving the face value and the interests on them or to replace them by newly issued TB. Thus, the reduction of part of the forthcoming interests payment has been done, taking into consideration the fact that the back-purchased TB have been issued at interest coupons, exceeding the existing ones. In order to harmonize the internal market with the European markets, and to provide possibilities for attracting foreign investors in the beginning of 2003, 7-year treasury bills, denominated into euro, were issued. They received particular interest, since 55 % of the bank deposits are in foreign currency, half of which are in euro. In order to improve the quality parameters of the internal debt, the execution and the regular swap operations of Settlement of Non-performing Debts Act bonds, denominated in USD, with Settlement of Non-performing Debts Act bonds, denominated into Euro still continues. The currency composition of the debt is entirely constructed in favor of the Bulgarian BGN component, whose share towards the end of the month of June this year amounted to 66.3%. Parallel to this, a diversification of the currency structure is observed, resulting from the increase of the debt share, denominated into the reserve currency of the Currency Board in the country – the euro. In particular, from 11.8% at the end of 2002, by mid-2003 the share of the debt in euro increased to 20.0%.

The interest structure of the domestic debt also indicates a positive development, expressed in a continuous growth of the fixed rate debt. Accordingly, their share rose from 69.3% at the end of the previous year, to 74.2% by the end of the first six months of 2003. The same is due both to the fact that the domestic debt is issued only at fixed interests coupons, as well as, because of the regular amortization of the debt by the floating interests.

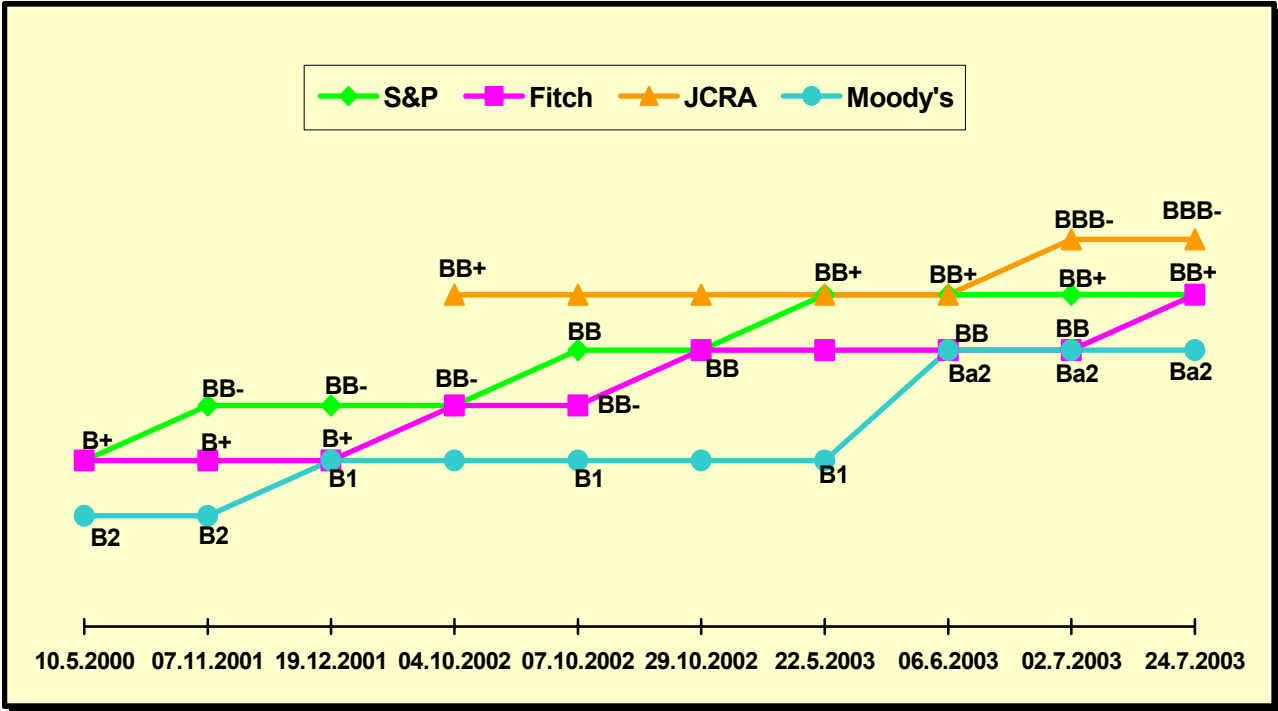
And last but not least, we have debt portfolio diversification, represented by TB issued on a free market, covering a time range of 3 months up to 10 years, which shows an absolute superiority of the medium- and long-term securities.

The 2003 domestic debt year-end forecast is for EUR 1,176 million, and the payments are expected to reach a total sum of EUR 1,012.4 million, out of which EUR 839.2 million – principles, and EUR 173.2 million – interest payments.

By the end of 2004 the foreign debt will remain at approximately the same level in absolute value as compared to 2003, and in terms of the ratio to GDP, it is expected to diminish to 42.7%. The domestic debt is expected to grow with about BGN 350 million, thus reaching BGN 2,650 million. The increase follows the current policy for insuring a priority financing of the budget deficit from the internal market, as well as in the context of a smooth balancing of the structure of the country’s national debt. This will be achieved through preserving the relative constant levels of the domestic debt, compared to GDP.

During the period of 2004-2006 our foreign debt payments will be between EUR 600 and 850 million and, for the domestic debt – between EUR 350 and 700 million, accordingly. Referring to the external debt, an influence upon those parameters will be produced by the fluctuations of the international interest rates, as well as by the USD/EUR exchange rate. The foreign debt will keep on growing, as a result of the acquisition of already agreed upon state investment and state-guaranteed loans, but its ratio to GDP is expected to decrease. In view of the fact, that the volume of the state-guaranteed debt and of the debt on state-investment loans shows some tendencies of increasing, the process of approval of new state guarantees and state investment loans shall be strictly controlled, subjected to specific criteria, and linked to the budget risk. The amount of the domestic debt will be influenced towards increasing in the coming years, by the volume of positive financing, which will be determined on the basis of the current market conditions, and the needs to guarantee the funding of the budget deficit.

Diagram: Dynamics of the Credit Rating for the Period 2000 – 2003



II. Financing

The external financing of the CRB in 2004 will be negative to the amount of BGN 162.9 million, while expecting approval and utilization of new loans, supporting of the balance of payments, amounting to BGN 270 million. The provisioned utilization of state investment loans exceeds the volume of the regular payments, according to the agreed amortization schedules. As a result, the expected net volume of the external financing from them for 2004 will be about BGN 246 million.

Domestic financing is going to compensate the low external financing of the CRB through realization of a positive balance of approximately 299.4 million BGN. For this purpose, the increase in volume of the newly issued long-term TB will continue, taking into consideration the increased participation of retirement/pension funds in this market. In order to encourage savings, the market of saving bonds designed for citizens, will be developed further, whose return will slightly exceed those of the regular auctions.

The revenues from the **privatization** for 2004 amount to BGN 550 million.

CHAPTER 5: Risks and Perspectives

I. Risks to the 2004 Budget

This Chapter is aimed at increasing the security during the implementation of the budget, by outlining the risks to the budget implementation and the measures to overcome them, as early as its planning stage.

Good knowledge of the factors, which can effect the actual implementation of next year's budget, and the establishment of an approach for prompt reaction in case of their eventual occurrence, is of great importance for securing the stability of the budget process.

1. Changes in the Economic Parameters

The fluctuations in the economic parameters can influence the revenue and expenditure parts of the budget, as well as, the debt. In order to increase certainty in the execution of the budget, it is necessary to identify the risk factors, and to outline the measures for overcoming them, which presumes defining an approach for prompt reaction in case of their eventual occurrence, and incorporating buffers into the budget, in order to limit the effect of unfavorable sequences.

Exchange Rate. The macroeconomic framework of the budget is developed at a presumed average exchange rate of BGN 1.8 for USD 1, for the period. On the one hand, the devaluation of the dollar has a positive effect on the foreign debt payments of the Republic of Bulgaria, since the predominant part of it is denominated in USD. On the other hand, if this tendency persists it will adversely affect the trade balance. The reduced revenues from exports will lead to a deterioration in the financial state of the companies and, hence, to lower tax revenues.

At present, the **international interest rates** are at one of their lowest levels. The expectations are for preservation of these levels during 2004, which will reduce the risk from outflow of capitals in the form of bank deposits and from higher interest payments on the foreign debt. The relatively higher interest rates in the country favor the shift of capitals back home, having flown out during recent years. The favorable fact is that the hypothesis for the increase of the interest rates is contradictory to the hypothesis for a low currency rate of the dollar, and for the slower restoration of foreign demand.

Internal Interest Rates. The hypothesis, when creating the macro-frame was that the interest rates will not increase substantially, and will vary around their present level of 2.5 – 3 %. With a budget deficit of 0.7 % of GDP, the possibility for an increase in domestic interest rates, is minimal. The low interest rates will stimulate the investment process and the long-term growth of the economy, which is presently estimated at 5.5 %.

Fiscal Risks

When preparing the calculations of the 2004 budget, a sensitivity analysis was conducted, investigating the effect of an eventual change in the levels of the basic risk parameters upon the expenses for servicing government debt (both principle and interest payments). Towards

June 30, 2003, the share of the debt with fixed interest rates comprised 41.6 %, versus 58.4 % for the part with floating interest coupons.

The results from the analysis demonstrate, that for 2004 the deviation of 50 basis points in the values of LIBOR of the USD and Eur, from fixed basis levels of the same interest rates, lead to an increase in the debt payments between EUR 20 and EUR 22 million. Following the target for a gradual reduction of the part of the floating interest rates debt, in favor of the part with fixed interest rates, outlined by the “Government Debt Management Strategy” in the 2003, and as a result of the particular measures undertaken by the MoF in this aspect, the dependence of expenditures on the changes of international interest rates for the next few years, would be reduced gradually.

The predominant share of the government debt, denominated in USD (46.2 % towards June 30, 2003) defines the stronger influence of the fluctuations in the values of this currency, on servicing of the country’s obligations. The devaluation of the USD by 5%, compared to the Eur, under the conditions of a gradually increasing share of payments in American currency for the period 2004-2007, leads to their additional increase – from EUR 50 to 70 million by the end-period.

2. Realization of Undertaken Obligations and Arrears

Municipalities and the accrued arrears overdue in their budgets, are a risky expenditure part of the budget. The accumulation of arrears has turned into an annual practice, which needs to be overcome. Municipalities, that are contributing to the budget, do not meet their obligations, which is another potential risk for the execution of the budget.

Health Care. Weak financial management and ineffective structures led to the accumulation of considerable arrears by hospitals – which are registered as commercial companies, at the end of each year and the government is eventually forced to cover them. This creates a bad precedent and weakens the financial discipline in the budget system. The present budget practice makes it difficult to limit the accumulation of hidden arrears by budget organizations.

In view of the above, the risks for the execution of the state budget for 2004, are minimized. The reported data towards August 31, 2003 disclose evidence of a large surplus in the consolidated budget, which will be sufficient for covering of unforeseen liabilities, arising as a consequence of some risk factors. This means that the 2004 budget will start free of any additional burden of liabilities and overdue payments, transferred from the present year 2003.

II. Reforms and Perspectives

1. Budget Reform Implementation

The efforts of the Ministry of Finance to introduce program and result-oriented budgeting, continued throughout the current year, as well. By tabling the pilot program budget of the Ministry of Environment and Waters (MEW) to the Council of Ministers and presenting it to the National Assembly as an Appendix to the 2003 State Budget Act, following Resolution No. 87 of the Council of Ministers from February 11, 2003, two more line ministries have been included as pilot ministries, namely: the Ministry of Labor and Social Policy and the Ministry of Transport and Communications. Thus, the Ministry of Finance and the pilot line ministries faced new challenges.

- On the basis of the experience, accumulated during the first pilot program budget, the Ministry of Finance developed instructions for formulating strategic targets, operational targets and programs, constituting the structure of the program budget and they have been actually put into practice by the Ministry of Labor and Social Policy and by the Ministry Transport and Communications (MTC), while developing their budgets in a programme format for the year 2004.
- The Ministry of Finance, in cooperation with the Ministry of Environment and Waters, has developed the instructions and guidelines for reporting on the performance of the first pilot program budget for 2003.
- Currently, methodological instructions are being prepared for identification and formulation the indicators for the performance of a program budget (in the first place, indicators for measuring the commodity/service provided, and secondly – indicators for evaluation of its benefits to society).

The budget of the MEW presented the mid-term aspects of the strategic and operational targets, which have to be developed, for the period 2003-2005, as well as, the necessary financial support for their realization.

According to the obligations, undertaken by the Government, under the PAL 2 Loan, the pilot development of program budgets will be expanded during the coming years. It is anticipated, that by 2005, the system will include not only the MEW, the MTC, the MLSP, and the MES, but two other ministries, as well. It is expected that by 2007, all line ministries will develop their budgets in this way. To achieve the strategic targets of the program approach to budgeting, the line ministries should build up the necessary capacity and optimize their organizational structures. It is of special importance, to guarantee effective coordination between the structural units, responsible for the policies of the respective ministry and of those, responsible for drafting of the budget.

The introduction of program and result-oriented budgeting will create conditions for optimization of the decision-making, related to fiscal parameters and a more efficient allocation and utilization of budget funds, in compliance with the priorities of the government. The final goal is public services provided through the most rational utilization of the limited budget resources, thus extending the benefits from them to the entire society.

The new approach to budgeting suggests a redistribution of the tasks and responsibilities among the primary participants in the budget process, and replacement of the existing responsibilities with new ones. It will allow for a better coordination of the tasks, performed by the various institutions, within the frameworks of the entire sector, and will ensure a better interaction between them. A substantial new element in the program approach to budgeting is, that it not only facilitates the prioritization between the separate programs of a specific ministry, but also helps for a prioritization at a national level between the separate sectors. The development of the program approach will lead to a more active participation of the line ministries in the process of budgeting, and will increase their role and responsibility for the efficient use of the resources, during the implementation of the strategic priorities, and as a final result – improvement of the quality indicators, related to the public services of the individual budget sectors.

The basic principles of program budgeting are: transparency of the drafted budgets, and the ability to measure the results and the benefits from the various social programs, through the development of quantitative and qualitative indicators. The consistent application of this principles, creates a possibility to monitor the effect from the programs on the budget for many years, the flexibility of the expenditures, the obligations, assumed for the coming years, the results expected by the society, how beneficial the results actually are, and whether this is what we need most, within the framework of our limited resources. The discussion and approval of the budget by the National Assembly separately for each program, will provide the necessary guarantees that the political decisions will be effective within a medium-term period.

2. Financial Decentralization

The Financial Decentralization Program, already realized in the country as part of the process of implementation of the overall reform in the budget sphere, has achieved a substantial advance. The working group on financial decentralization (WGFD), formed following the Council of Ministers' Resolution No. 138, dated March 11, 2002, has elaborated the long-term tasks and the necessary legislative reform, which is in progress, although not completed yet. In its present form, the financial decentralization does assume that the municipal expenditures can be covered by local revenues.

The expenditure standards, approved by the WGFD, define the minimal level funding for the delegated services in four sectors: education, health care, culture, and social welfare.

The starting point in the Financial Decentralization Concept and the detailed Program for its realization, approved by the government, is to clarify the expenditure responsibilities assigned to municipalities. It was agreed, that the municipal expenditures shall be treated either as "Delegated by Central Authorities," or provided at the discretion of municipalities, i.e. as a local choice – in order to build up a stable foundation of the new system of financial relations between central and local authorities.

Fiscal decentralization is truing to achieve financial independence of the municipalities, by delegating each municipality decision-making rights, regarding the method for calculation of local taxes and charges, as well as, their volume. Thus, municipal administrations are given an opportunity to take independent decisions, and to form and implement their own policy, in accordance with the specific priorities for the region.

The basic principles of financial decentralization are:

- Creating an incentive system, directed at increasing local revenues, enhancing the capacity in the financial management sphere, and a maximum degree of local autonomy, in defining the character and content of municipal services;
- A simplified structure of financial relations;
- Strict financial discipline by central and local authorities;
- Ability of the central authority to monitor and evaluate the process of decentralization;

- The decentralized system of financial relations, reflects the differences between the municipalities, in terms of their financial resources, management competence, and provides the municipalities of different potential with an opportunity to develop, according to their own specifics;
- Conditions for effective civil control.

The implementation of the above mentioned principles, as well as those, incorporated into the Governance Program of the Government of the Republic of Bulgaria, is being monitored by the WGFD.

The following steps were undertaken, for the execution of the Programme for realization of the basic principles:

1. Division of the revenue responsibilities between the state and the municipalities on the basis of the agreements with the National Association of Municipalities in the Republic of Bulgaria (NAMRB).
2. Division of expenditure responsibilities between the state and the municipalities, through a separation of the activities, financed through municipal budgets into: “State activities” and “Municipal activities.”
3. Defining the standards for the number of personnel for the “state activities” for education, financed through the municipal budgets.
4. Defining the standards for support and maintenance of the “state activities,” financed through the municipal budgets, for the spheres of education, health care, social services, and culture, and quantitative criteria for their application.
5. Liberation of the volume of local taxes, which are determined by municipal councils.
6. Funding of the “state activities,” as defined in items 3 and 4 by state transfers – remised state revenues (personal income tax), and general supplementary subsidy.
7. Introduction of a transparent mechanism for defining the budget relations of the central budget with the municipal budgets.
8. Funding of “municipal activities” with municipal revenues from local taxes, charges and other non-tax revenues, as well as, an equalizing subsidy in cases of insufficient tax capacity within the municipalities.
9. Introduction of control over the spending of state transfers, for funding of “state activities” only.
10. Giving freedom to local authorities for spending their of own revenues, collected from local taxes charges, and other non-tax revenues, and from the equalizing subsidy, in accordance with their needs and the requirements of the population.
11. Removal of the revenues from municipal tax and municipal profit tax as balancing revenue.

12. Enactment of amendments in the State and Municipal Properties Act.

For the successful realization of the financial decentralization and stimulation of the investment activity of the municipalities, a Municipal Credits Act is being drafted, and a project for monitoring the realization of the financial decentralization is in progress.

The realization of the Financial Decentralization Programme is making a serious step towards the approbation of local self-government in our country. It helps the citizens of the municipality to solve their own specific problems, to create conditions for unifying the interests of local communities and the country, as a whole.

CONCLUSION

After achieving and maintaining macroeconomic stability over a period of six years, the economic policy of Bulgaria is faced with a new challenge – achieving sustainable economic growth, until the realization of the full potential of the Bulgarian economy, at the current resource level. This relates to the fast development of the process of globalization, and the real perspective for Bulgaria to become part of the European Union's Common Market in the nearest future.

All the above, becomes meaningful, only if it is linked to a real improvement of the population living standards, improved health care, education and increased employment. Modern world governments should find the complex balance between the implementation of market mechanisms and polishing off market imperfection, widely present in the new market economies. Parallel to that, enterprising activity incentives should be increased, in order to provide an honorable living for those Bulgarian citizens who, for various reasons, happen to fall outside of the scope of the labor market.

A low level of budget deficit is planned for the 2004 Budget, which will contribute to the improvement of financial discipline, stability of public finance, neutralization of external inequilibriums, and non-aggravation of the coming generations with burdens of debt. The deficit, calculated on a consolidated basis, is 0.7 per cent of GDP, and it will be brought down to a zero level, in accordance with the medium-term fiscal strategy.

In 2004, the general tax and insurance burden will be reduced, and changes in the tax system will be implemented, towards its simplification. The tax policy of the government is based on a sound compromise between providing the necessary resources for the implementation of the expenditure policies, and the creation of conditions, stimulating investments and economic growth. Following the policy of the developed market economies, tax burdens need to shift from direct to indirect taxes, and as a first priority, corporate tax is reduced from 23.5 % to 19.5%.

The volume and structure of the expenditures, on a consolidated basis, outline the basic priorities, incorporated into the government programme and the fiscal policy. In the 2004 Budget, the biggest growth in comparison to the previous year is planned in the expenditures for the health care, education and reform of the legal system.

The introduction of program and result-oriented budgeting shall create prerequisites for optimization of the decision-making, related to all fiscal parameters, and the more efficient distribution and use of budget funds, in compliance with the government priorities. The final goal of the state is to provide public services, through the most rational utilization of the limited budget funds, under the conditions of clear transparency, while increasing the benefits from them to the whole society.

ANNEXES

1. Budget 2004 by Responsibilities
2. Consolidated Fiscal Program for 2004
3. Consolidated Fiscal Program for 2004 by Functions