



REPUBLIC OF BULGARIA
Ministry of Finance

CONVERGENCE PROGRAMME

(2015–2018)

April 2015
Sofia, Bulgaria

CONVERGENCE PROGRAMME

OF THE REPUBLIC OF BULGARIA
2015–2018

Table of contents

1. Overall Policy Framework and Objectives	7
2. Economic Outlook.....	9
2.1 World economy/technical assumptions	9
2.2 Cyclical developments and current prospects	9
2.3 Medium-term scenario	10
2.4 Sectoral Balances	12
3. Government Balance and Debt	27
3.1 Policy strategy	27
3.2 Medium-term objectives	28
3.3 Actual balances and updated budgetary plans for the current year	29
3.4 Medium-term perspectives, including description and quantification of the strategic policy effects	37
3.5 Structural balance (cyclical components of the balance, one-off and temporary measures) and fiscal stance, including expenditure benchmark	40
3.6 Debt levels and developments	42
3.7 Budgetary implications of major structural reforms	44
4. Sensitivity Analysis and Comparison with the Previous Update	55
4.1 Alternative scenario: higher growth of the European economy	55
4.2 Sensitivity of budgetary projections to different scenarios	57
4.3 Comparison with the previous programme	57
5. Sustainability of Public Finance	59
5.1 Policy Strategy	59
5.2 Long-term budgetary prospects, including the implications of ageing populations	60
4.3 Proposals for improvement of the pension model and development of the pension system	63
5.3 Contingent Liabilities	65
6. Quality of Public Finances	67
6.1 Policy Strategy	67
6.2 Composition, efficiency and effectiveness of expenditure –COFOG	68
6.3 Structure and Efficiency of Revenue Systems	69
7. Institutional Features of Public Finances	79
7.1 National budgetary rules	79
7.2 Budgetary procedures	79
7.3 Other institutional developments in relation to public finances	81
8. Annex A	84
Table 1a: Macroeconomic prospects	84
Table 1b: Price developments	85
Table 1c: Labour market developments	85
Table 1d: Sectoral balances	86
Table 2a: General government budgetary prospects	86
Table 2b: No-policy change projections	88
Table 2c: Amounts to be excluded from the expenditure benchmark	88
Table 3: General government expenditure by function	88
Table 4: General government debt	89
Table 5: Cyclical developments	90
Table 6: Divergence from previous update	90
Table 7: Long-term sustainability of public finances	91
Table 7a: Contingent Liabilities	92
Table 8: Basic assumptions	92

List of abbreviations

GDP	Gross Domestic Product
GVA	Gross Value Added
NAWRU	Non-accelerating wage rate of unemployment
BNB	Bulgarian National Bank
VAT	Value Added Tax
PSS	Public Social Security
GS	Government Securities
EBRD	European Bank for Reconstruction and Development
EIB	European Investment Bank
EC	European Commission
EU	European Union
ESA'2010	European System of Accounts'2010
ECB	European Central Bank
LSB	Law on the State Budget
LSBRB	Law on the State Budget of the Republic of Bulgaria
PFL	Public Finances Law
CP	Convergence Programme
SGP	Stability and Growth Pact
FDI	Foreign Direct Investments
RIEDTWA	Rules for Implementation of the Excise Duties and Tax Warehouses Act
HICP	Harmonised Index of Consumer Prices
SSC	Social Security Code
CFP	Consolidated Fiscal Programme
IMF	International Monetary Fund
MF	Ministry of Finance
NHIF	National Health Insurance Fund
NRA	National Revenue Agency
NSI	National Statistical Institute
NSSI	National Social Security Institute
NRP	National Reform Programme
TFP	Transitional and Final Provisions
ULC	Unit Labour Costs
MTO	Medium-term budgetary objective
MSTI	Medium-sized Taxpayers and Insurers
SSF	Social Security Funds
GDMS	Government Debt Management Strategy
CB	Central Budget
BGN	Bulgarian lev
EDP	Excessive Deficit Procedure
EUR	Euro
LIBOR	London Interbank Offered Rate
USD	US dollar

1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

The Convergence Programme of the Republic of Bulgaria (2015–2018) outlines the key policy priorities in support of economic growth within a framework of sustained macroeconomic and fiscal stability.

With regard to public finances, major policy goal is to keep fiscal sustainability by overcoming budgetary imbalances through comprehensive, growth friendly fiscal consolidation, supported by accelerated EU funds absorption.

As pointed out in the National reform programme, speeding up structural reforms, enhancing the institutional capacity and improving further the business environment are also among the leading priorities of the current government. They are aimed at increasing productivity and competitiveness of the economy in order to achieve a balanced growth, sustainable convergence and higher living standards in the long run. In this regard, policies to improve the quality of education, reduce the administrative burden, ensure transparent absorption of EU funds, promote infrastructure investment as well as pro-active participation in common projects of European and regional importance, including in the context of the Investment Plan for Europe (the so called “Juncker” Plan), are of high priority.

In the medium-term, fiscal policy goals are for maintaining the sustainable budgetary framework in the context of Bulgaria’s commitments both under the Stability and Growth Pact, and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. In this regard, strict budgetary discipline is a fundamental commitment of the government. Fiscal parameters are prepared based on a realistic forecast of the key macroeconomic indicators, a conservative assessment of revenues, and more restrictive planning of expenditures.

Medium- and long-term fiscal sustainability will enhance confidence and create a predictable investment and business environment. In this update of the Convergence Programme Bulgaria retains its medium-term objective for a structural deficit of 1%.

Tax and social security policies are supportive to investment, employment and economic growth. The implementation of a policy aimed at increasing tax collection, lowering tax compliance cost, reducing the share of the shadow economy, combat against tax fraud and tax evasion is also important.

In the context of preserving macroeconomic stability, Bulgaria keeps its firm commitment to maintain the Currency Board Arrangement at the existing fixed exchange rate of BGN 1.95583 to EUR 1 until the country joins the Euro area.

This Convergence Programme (CP) has been approved by the CoM on April 29. Following this, it will be submitted for information to the National Assembly. It comprises seven chapters.

The first chapter contains the overall framework of the government economic policies and objectives. The second one presents an analysis of the key macroeconomic developments and medium term forecast.

The third chapter makes an overview of strategic fiscal policy objectives with regard to the budget balance and government debt. This chapter outlines the current budgetary position and the expected developments during the reference period, with emphasis on the structural and cyclically-adjusted balance. Major trends in the debt development over the programme period are also outlined. The main policy actions provided for in the medium-term government programme and their quantitative effects are also presented.

The fourth chapter presents a sensitivity analysis of the forecasts, including debt sensitivity. Special attention is paid to the sensitivity of budgetary projections to the alternative scenario.

Chapter five is dedicated to the sustainability of public finances. The main focus here is on the long-term budgetary outlook with a view to the impact of ageing population.

The sixth chapter deals with the quality of public finances. It presents the government policy strategy in this area, the composition of expenditure and the structure and efficiency of revenue systems.

The seventh chapter provides an overview of the institutional characteristics of public finances in Bulgaria – budgetary procedures and national fiscal rules. This chapter of the Programme also focuses on the key legislative changes relevant to public finances and in particular the setting up of an independent fiscal council and automatic correction mechanisms.

The current Convergence Programme presents measures and developments addressing the first out of the seven CSRs of 08 July 2014 on the 2014 National Reform Programme of Bulgaria, containing the Council Opinion on the 2014 Convergence Programme of Bulgaria¹, namely:

Country Specific Recommendation 1: Reinforce the budgetary measures for 2014 in the light of the emerging gap relative to the preventive arm of the Stability and Growth Pact requirements. In 2015, strengthen the budgetary strategy to ensure that the medium-term objective is reached and, thereafter, maintained. Ensure the capacity of the new fiscal council to fulfil its mandate. Implement a comprehensive tax strategy to strengthen tax collection, tackle the shadow economy and reduce compliance costs. ▼

¹ OJ C 247, 29.07.2014

2. ECONOMIC OUTLOOK

2.1 World economy/technical assumptions

The current Convergence Programme is based on the macroeconomic framework for the period 2015–2018, developed using the medium-term macroeconomic model of the Ministry of Finance with key assumptions for the external environment as of mid-March 2015, provided by the International Monetary Fund, the World bank and the European Commission.

Fig. 2-1: Assumptions on Key Macroeconomic Indicators

	2015	2016	2017	2018
Global economy (real growth, %)	3.5	3.7	3.8	3.8
EU GDP (real growth, %)	1.6	1.8	1.9	1.9
USD/EUR Exchange rate, annual average	1.11	1.10	1.10	1.10
International commodity prices (dollar-denominated, %)				
Oil Brent (USD/barrel)	-37.8	11.9	8.2	4.6
Non-energy goods	-5.0	0.8	0.8	0.9
Food	-4.3	0.2	0.2	0.3
Beverages	-5.6	-1.4	-1.4	-1.4
Agricultural raw materials	-6.1	2.1	2.2	2.2
Metals	-5.3	1.1	1.2	1.3
Six-month LIBOR on USD-denominated deposits	0.67	1.91	3.27	4.05
Six-month LIBOR on EUR-denominated deposits	0.01	0.03	0.14	0.31

Source: IMF, EC, WB, MF

2.2 Cyclical developments and current prospects

– Economic growth

In 2014 the Bulgarian GDP growth accelerated to 1.7% compared to 1.1% in 2013. Changes in the main components contributing to the GDP dynamics were registered during the year. While in 2013 export had a positive contribution, in 2014 domestic demand was the main growth driver.

Final consumption increased by 2.4% compared to a 1.3% decline in 2013. Its growth comprised the increase, in real terms, in household expenditure by 2% and of public consumption by 3.8%. The key factors contributing to the dynamics of consumer expenditure were the increase in the real disposable income of households, the higher number of people employed and the higher consumer confidence at the beginning of the year.

The 2.8% growth in fixed capital investment was formed of public capital expenditure. Like in 2013, in 2014 the latter grew steadily, with a real increase of 25.1%. The funds disbursed under EU Operational Programmes, including from national co-financing, were the main contributors to this increase. Private investment² decline slowed down in 2014, and during the second quarter even registered a 3.5% increase.

The improved domestic demand was the leading reason for the growth in import of 3.8% during the year. The growth of export slowed down to 2.2%. As a result, net export had a negative contribution to the growth of the economy.

The economic activity in the country also accelerated on the supply side. The gross value added growth was 1.6% in 2014 compared to 1.2% in 2013. Unlike the previous year, when the dynamics of services was determinant for the growth of GVA, in 2014 all sectors contributed to the reported growth. Services again were the largest contributor (0.8 pp), followed by industry (0.6 pp) and agriculture (0.3 pp). Following five consecutive years of decline in construction, in 2014 GVA in the sector increased by 1.4%. The reported growth was mainly due to recovery in civil engineering.

– Cyclical position³

According to the Ministry of Finance estimates, the potential GDP growth in 2014 was 1.8% and is expected to reach 1.9% in 2015. The gradual increase in total factor productivity will contribute to the progressive acceleration of growth throughout the period of the projection, and in 2018 the growth is expected to reach 2.2%. The positive dynamics of the labour market observed in 2014 resulted in a decline in NAWRU. Its gradual decline, along with an increase in the participation rate, will compensate for the reduction in the working age population and will lead to a positive contribution of labour as a factor of potential growth over the period of the projection. In 2015 the contribution of capital to the potential GDP growth will be 1.1 pp. The projected slowdown in investments in 2016 will slightly reduce the contribution of capital, but it will continue to lead the dynamics of potential growth.

During the period 2015–2016, a lower growth of potential output compared to the actual one is expected, and, as a result, the negative output gap will increase from 0.5% to 0.8%, respectively. In 2017 the economy will come closer to its potential, but the deceleration in actual growth in 2018, as a result of the challenges of an ageing population, will again lead to an increase of the negative output gap to 0.7%.

2.3 Medium-term scenario

In 2015 the growth of the Bulgarian economy is expected to slow down to 1.4% in real terms compared to a 1.7% growth in 2014. The lower increase in public consumption and investments will be the main contributors to the lower domestic demand compared to 2014. At the

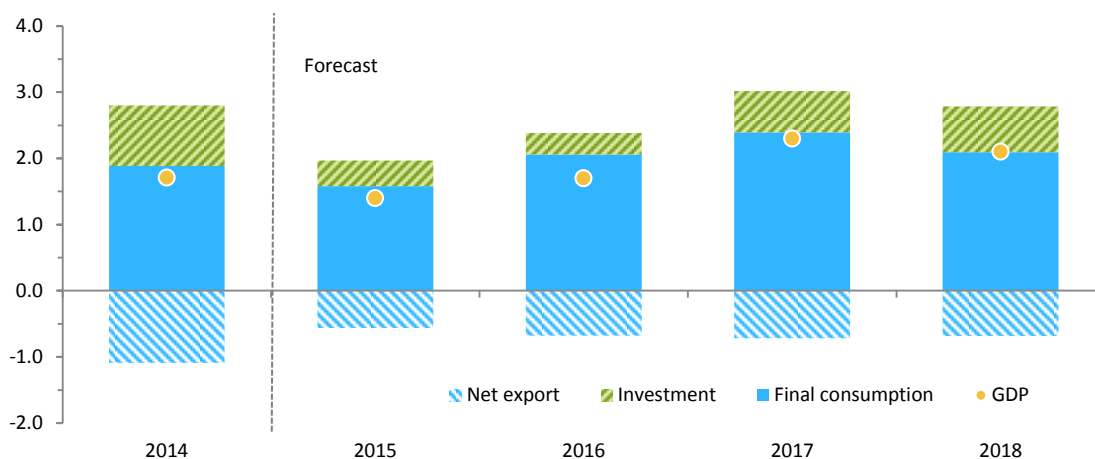
² Private investments are measured as a difference between investments in fixed capital for the whole economy and those for State Government sector.

³ Cyclical development of the economy is measured by the output gap indicator. It is calculated as the difference between the actual output of an economy and its potential output. The potential GDP of the Bulgarian economy was calculated using the production function based on a methodology developed by the EC. Karel Havik & Kieran Mc Morrow & Fabrice Orlandi & Christophe Planas & Rafal Raciborski & Werner Roeger & Alessandro Rossi & Anna Thum-Thysen & Valerie Vandermeulen, 2014. "The Production Function Methodology for Calculating Potential Growth Rates & Output Gaps", European Economy – Economic Papers 535

same time, the favourable dynamics of employment in 2014, the increase in the real disposable income of households and the observed stabilising of the domestic environment lead to a higher than expected growth of private consumption and contributed to the improved values of the consumer confidence indicator at the beginning of 2015. The positive development of private consumption will continue, and the growth will accelerate to 2.4% in 2015 compared to 2% in 2014. Stabilisation of private investment, which will be positively affected by the ongoing process of remediation of residential buildings in the country, is envisaged. We assume that the decline in prices of housing properties has already been overcome, and expect that during the period of the projection their growth will stimulate investments in this sector.

The acceleration of the growth of the European and global economy, will lead to an increase of the export of goods and services by 2.8%. The slowdown of domestic demand will have an opposite effect on import, limiting its growth to 3.6%. As a result, the negative contribution of net export will decline to 0.6 pp compared to 1.1 pp in 2014.

Fig. 2-2: Contributions to GDP growth, by component (pp.)



Source: NSI, MF

During the period 2016–2017 the economic growth will gradually accelerate to 2.3%, with private consumption and investment being the main contributors. They are expected to be positively affected by the improved business climate in the country and the increased credit activity. The favourable development of the external environment will lead to increased export of goods and services, which, coupled with the increased domestic demand, will result in higher import growth and, hence, a slight increase of the negative contribution of net export to 0.7 pp.

The unfavourable demographic trends in the country are expected to slow down the long-term growth. This has been taken into account in the development of the medium and long-term macroeconomic forecast, resulting in lower growth in 2018. The trend of acceleration of employment growth will be interrupted. We expect that the weaker development of the labour market will also result in lower growth of private consumption compared to 2017.

2.4 Sectoral Balances

– Labour market, incomes and labour productivity

In 2014, the labour market in Bulgaria showed first signs of recovery since the beginning of the economic crisis in 2009. Unlike most of the years after 2009, when the main source of growth of the newly created value added in the economy was external demand, in 2014 economic growth was based on domestic demand, which is of crucial importance for the dynamics of employment in the country.

The average number of people employed in 2014 increased by 0.4%⁴ compared to 2013, mainly supported by agriculture and services. The increase in employment in the services sector was limited by the reduced scope of subsidised employment programmes compared to a year earlier. Export orientated industries of the Bulgarian economy also increased their economic activity compared to 2013, and the number of people employed in manufacturing went up by over 1% in the second half of 2014, for the first time after a five-year decline.

The positive developments of employment were at the basis of the decreased unemployment rate by 1.5 pp to 11.4%⁵ on average for the year. The downward trend in unemployment was also confirmed by the data on registered unemployed people. According to the latter, a decline was reported in the group of people who have started work, but this was related to the lower number of people included in labour market programmes and measures, while with regard to people who started work in the primary market the upward trend from the previous two years was maintained. This, together with the decline in newly-registered unemployed people, observed for the first time since 2012, proves a subsiding in the employment shedding processes and increased demand of labour in the real sector of the economy. However, it should be noted that despite the decrease in discouraged workers returning to the economically active population, in 2014 the workforce decreased compared to 2013, unlike the trend of increase in the previous two years.

The recovery in the positive dynamics of the labour market which started in 2014 is expected to continue in 2015. Such expectations are confirmed by the short-term business statistics of the expectations of entrepreneurs on the recruitment of personnel, which increased in the first three months of the year in all observed sectors of the economy. Furthermore, in January consumer expectations for unemployment in the next 12 months showed improvement. Current data on registered unemployment in January and February confirmed that the downward trend in the annual dynamics of unemployed continues.

In 2015 the average number of people employed is expected to increase by 0.3%⁶ compared to 2014, supported both by the positive trends reported in 2014 and the beginning of 2015, and by the expectations of further recovery of demand of labour in the private sector of the economy. The envisaged cutting down of personnel costs in the public sector is expected to hold back the growth of employment in services, while expectations for improved external demand support the already ongoing recovery of employment in industry. The average annual unemployment rate in 2015 is expected to decline by 0.6 pp compared to 2014, and to reach 10.8%⁷.

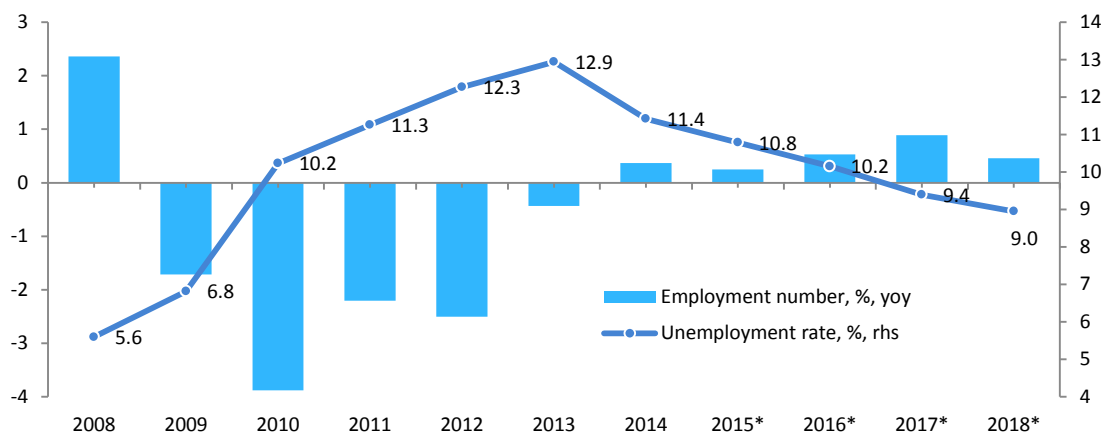
⁴ According to ESA 2010 data.

⁵ Based on Labour Force Survey data.

⁶ According to ESA 2010 data.

⁷ As defined in the Labour Force Survey.

Fig. 2-3: Employment growth and unemployment rate, %



* Forecast

Source: NSI (ESA, LFS), MF

With the gradual acceleration of growth in domestic demand and strengthening the positive impact of the external environment on the economic activity in the country, in 2016 and 2017 employment growth is expected to accelerate to 0.5% and 0.9% respectively, before slowing down to 0.5% in 2018 under the influence of the unfavourable demographic developments in the country. The unemployment rate follows a downward trend and is expected to reach 9% at the end of the forecast horizon.

Along with the employment recovery in the country, the compensation per employee was characterised by a significantly lower growth rate of 1.5% in 2014 as compared to previous years. The main contributor to the growth was the service sector, where the indicator reported a decrease of 0.8%. For the first time since the onset of the crisis, in many of the activities in the services sector the optimisation of labour cost was achieved through a reduction in compensation per employee, while employment in these activities followed an upward trend. Unlike services, wage growth in industry came at a considerably higher rate of 5.7% in nominal terms. In the processing industries, the leading contributions to the upward development in salaries had the activities characterised with the highest increase of turnover for the external market⁸.

In line with increased demand for labour, which started in the beginning of 2014, real labour productivity grew by 1.3%. Both productivity and income developments had a favourable impact on the cost and price competitiveness of the economy. During the period under consideration, the unit labour costs reported a 0.5% decline in real terms, and their nominal growth rate decelerated considerably to 0.2%, down from 7.2% in 2013.

In 2015 the growth of compensation per employee will slightly accelerate and will remain close to the growth rate reported in 2014. The continuing recovery of the employment in some services sector activities is likely to restrain income dynamics there. A similar effect could be expected along the planned budget sector consolidation of labour costs. On the other hand, the growth rate of the compensation per employee in industry will exceed the average for the economy, following the higher external demand and the upward dynamics of the

⁸ The comparison is based on short-term statistics of labour costs and people employed, and data about the turnover for the external market in industry.

value added in the sector. A more substantial increase in labour incomes could be expected during the period 2016–2018, in line with expectations of increased economic activity in the country. Income development will be preconditioned both by the accelerated rate of real growth in labour productivity and by the upward trend in consumer prices in the country. Thus the share of the compensation of employees in the gross value added will be characterised by a gradual increase, and the increase in unit labour costs will remain limited and will not have a negative impact on the competitive position of the economy.

Fig. 2-4: Real Unit Labour Costs (RULC)



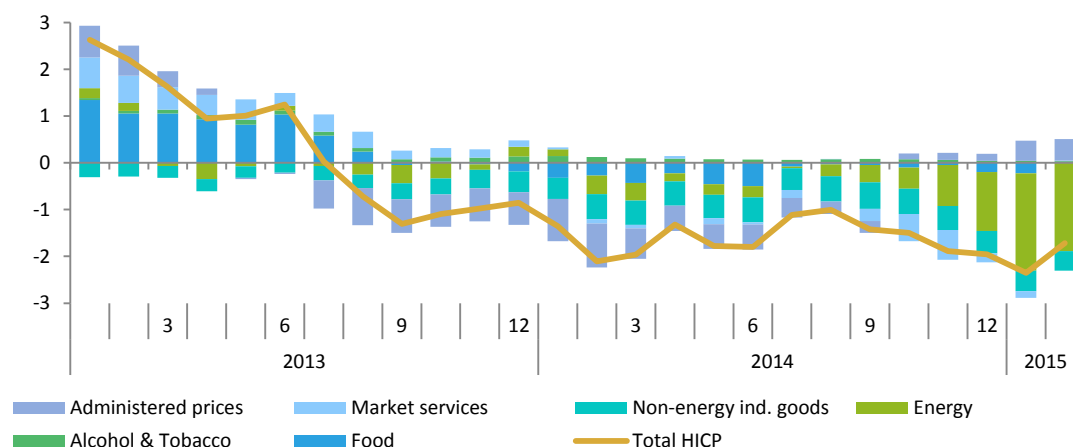
* Forecast

Source: MF

— Inflation

During the past year and a half the dynamics of consumer prices in the country followed a stable process of deflation. After inflation became negative in August 2013, the decline in consumer prices on an annual basis accelerated in 2014, and the decrease in HICP at the year-end amounted to 2%. The average annual inflation rate was also negative at -1.6%.

Fig. 2-5: Inflation rate (%) and contributions (pp.) by main HICP component (compared to the corresponding month of the previous year)



Source: NSI, MF

The decline in international prices of food and energy commodities had a major influence on deflation in the country in 2014. On one hand, the downward dynamics of international prices and the lower producer prices in the food processing industry largely accounted for the registered decrease in domestic food prices which stood at -0.8% on an annual basis as of December.

Crude oil prices on global markets, on the other hand, had a significant impact on the acceleration of deflation in the second half of the year. After reaching its highest point in 2014 of an average of USD 111.9 per barrel in June, as of December the Brent price registered a 43.7% decline in USD terms compared to the same month of the previous year. Domestic prices of **transport fuels** followed this dynamics and decreased by 14.7%, with a direct contribution of 1.25 pp to the deflation reported at the year-end.

The prices of **non-energy industrial goods** (excluding administered prices) continued on the decrease in 2014. The latter began in 2010 and followed a gradual acceleration in the last five years, reaching -2.4% at the end of 2014. In terms of main components, durable consumer goods, which are traditionally imported, had the largest impact for the observed developments. The market for cars, especially second-hand cars, had an impact on the depreciation in the past few years.

The change in prices of **market services** (excluding administered prices) was negative on an annual basis for most of the year, with an acceleration of their negative rate of change in the period September-November. The cut of price caps on roaming services in the EU, enacted in July, had a significant impact in this respect. Consecutively, prices of mobile phone services decreased by 10.2% as of December and their contribution to the deflation reported at the year-end was 0.31 pp. No significant secondary effects in road transport prices in line with lower fuel prices were observed.

The negative change in **administered prices**⁹ accelerated at the beginning of the year after the fees paid by pensioners for examinations by GPs, specialists and dental services under the contract with the National Health Insurance Fund were reduced by almost 66% in January. Increases in heating prices by 4.8% in July and of electricity in July and October by a cumulative 11.9% led to a positive change in administered prices during the last three months of 2014, reaching 0.9% in December. During the year pharmaceutical products reported 2% decline on average compared to the end of 2013.

In January 2015 the decrease in the overall HICP widened to 2.4% compared to the corresponding month of the previous year due to the accelerated depreciation of automotive fuels. In February, however, deflation slowed down as a result of the shrinking of the negative contributions of both energy and food products. This was influenced, on the one hand, by the reversal in the downward trend in crude oil prices on the global markets and, on the other hand, by the reported significant depreciation of the Euro against the US dollar.

⁹ The index of the administered prices is estimated by measuring the relevant elementary aggregates of the consumer basket.

Negative annual inflation is expected to continue slowing down throughout 2015. As of December consumer prices will report a positive change of 0.8% compared to the end of 2014. Nevertheless, the average annual inflation will remain negative (-0.6%) due to the reported acceleration in the negative inflation rate at the end of 2014 and the beginning of 2015.

The expected slowing down in the deflation rate and the reversal of the trend during the last quarter of the year will be due to the higher international prices in EUR (BGN) terms, as a result of the significant depreciation of the Euro against the US dollar. This will compensate for the expected price decrease of the main groups of commodities in dollars. Crude oil prices' developments will be the only exception. The average price for Brent in 2015 is expected to be 61.5 USD/barrel, which is a 37.8% decline in dollar terms or 25.6% in EUR (BGN) terms compared to 2014. In this respect, the prices of automotive fuels will remain much lower throughout the year, but their decrease will slow down considerably and will reach -4.1% in December (from -14.7% in December 2014). Prices of food products will register a 2.1% increase at the year-end as a result of the higher international prices, estimated in EUR. The change in prices of non-energy industrial goods will remain negative, but is expected to slow down to -0.2% due to the depreciation of the Euro and the higher import prices of some durable consumer goods. The impact of one-off effects on the depreciation of services will wane in the second half of the year, and they will report a positive change of 1.2% at the year-end, also supported by stronger domestic demand.

During the period 2016–2018 the average annual inflation is expected to accelerate to 1.8–2.0%, assuming higher international oil prices in the coming years and the expected recovery in domestic demand.

Fig. 2-6: HICP forecast for the 2015–2018 period

	2015	2016	2017	2018
Annual average inflation (%)	-0.6	1.8	1.9	2.0
End-of-period inflation (%)	0.8	1.7	2.0	2.0

Source: MF

The contribution of administered prices and tax policies to the overall inflation during the period 2016–2018 is expected to be low. The planned hike in excise duties on cigarettes is expected to lead to an increase in their prices by an average of 3.4% at the end of 2016 and 3.6% at end-2017, and their contribution to the increase in the total index is estimated at 0.11 pp and 0.12 pp, respectively. The change in the excise duties at the beginning of 2018 will be smaller and will result in a hike in cigarettes' prices by an average of 1.8% and a contribution of 0.06 pp at the year-end.

The main risks to the inflation forecast relate mainly to developments in international prices and the rate of economic growth in Bulgaria. International crude oil prices could increase more significantly as a result of supply shocks, although global demand remains relatively low against the background of the increased yield. The limited supply of some agricultural goods, especially food, on a global scale as a result of adverse weather conditions could further trigger

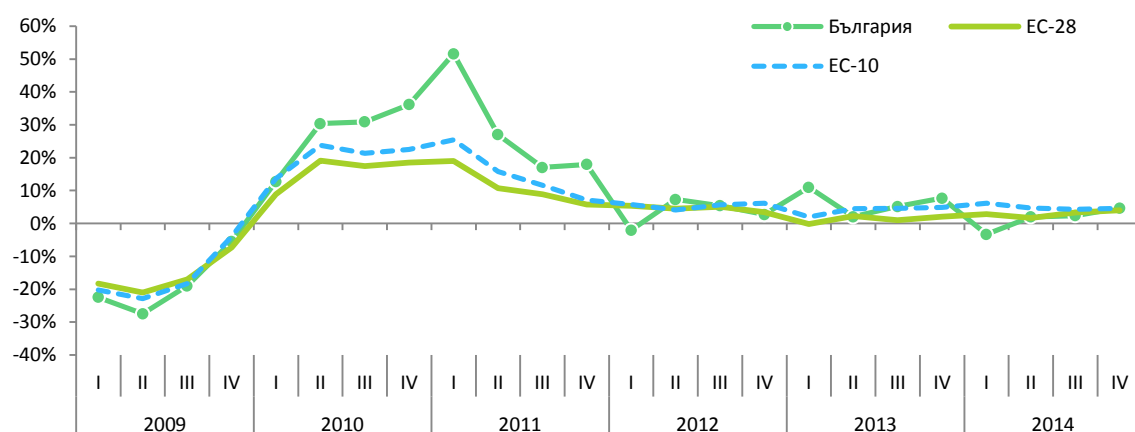
higher inflation in Bulgaria. At the same time, a lower economic growth of the Bulgarian economy and a delayed recovery of domestic demand will limit increases in prices of non-food goods and services.

– External Sector

In 2014 the overall balance of the current and the capital accounts improved. The balance reached a surplus of EUR 1 billion (2.4% of GDP) compared to EUR 878 million (2.1% of GDP) in 2013.

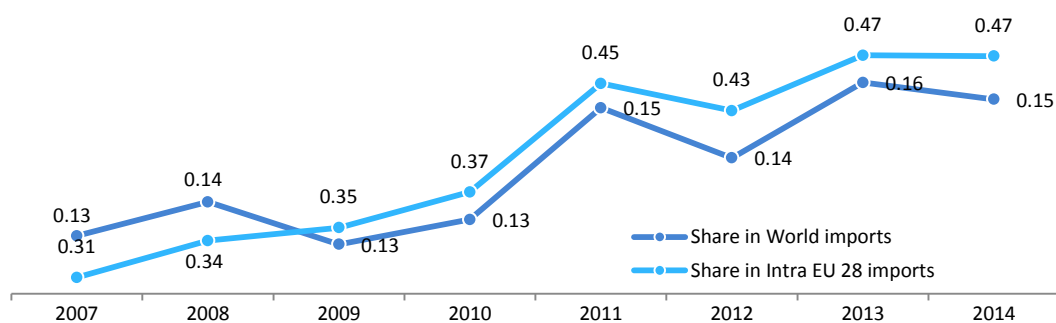
Services and Capital Transfers, which traditionally have positive balances, were critical to this development. The increased surplus in services was driven by accelerated increase in export of transport and other business services. Despite the unfavourable weather conditions during the summer tourist season and the tension between Russia and Ukraine, which resulted in a small number of foreign tourists from these countries, revenues from travel continued to grow during the year. Capital transfers inflow came mainly from EU Funds. A decrease in the Income account deficit was reported.

Fig. 2-7: Export of goods and services (nominal annual evolution)



Source: Eurostat

Fig. 2-8: Bulgaria's share in international trade



Source: MF staff estimates based on WTO and Eurostat data

The growth in consumption and investments in 2014 led to increase in demand for import goods. Real import growth resulted in import increase of 1.5% in nominal terms, in spite of the falling international prices. The dynamic was the opposite in the export of goods. The decline in prices was not offset by the real increase in exported production and nominal export declined by 0.7%.

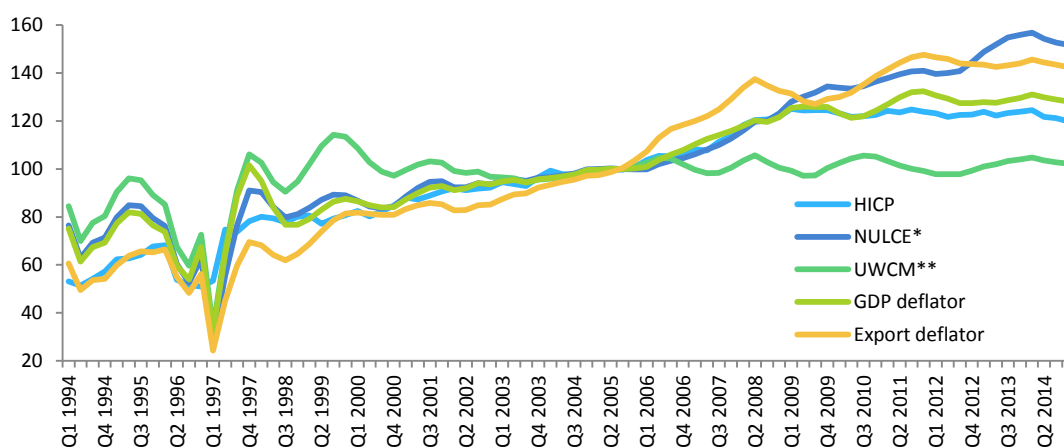
The dynamics of export did not result in a significant loss of Bulgaria's market shares. The share of Bulgaria's export in intra-EU import remained unchanged. The overall export growth, however, was lower than the growth of global import.

The development of the real effective exchange rate (REER) based on different deflators showed that the indicator has considerably slowed down its growth rate in the post-crisis period and has even registered separate periods of decline compared to the same quarter a year earlier. Only REER based on nominal labour costs for the total economy reported a more accelerated growth in 2013, and this growth resulted mainly from the accelerated increase in unit labour costs. There was also an influence, though not as significant, coming from the observed appreciation of the Euro in the second half of 2013 and the first half of 2014 and the related increase in the nominal effective exchange rate. Since mid-2014, however, an adjustment was observed, and REER with this deflator reported a decrease on an annual basis during the last two quarters of the year.

REER based on the share of labour costs in manufacturing is considered as a more reliable measure of competitiveness as it compares the increase in labour costs in the tradable sector of the economy with that in Bulgaria's main trade partners. The lowest accumulated increase compared to the base year 2005 is observed exactly with this indicator.

In the medium term, REER of the Bulgarian lev is expected to continue appreciating as a result of the positive differential of labour productivity growth and the pace of economic convergence towards the more advanced EU Member States.

Fig. 2-9: Real effective exchange rate, Bulgaria vis-a-vis 36 industrial countries, 2005=100



* Nominal unit labour cost in total economy; ** Unit wage cost in manufacturing (EC methodology)

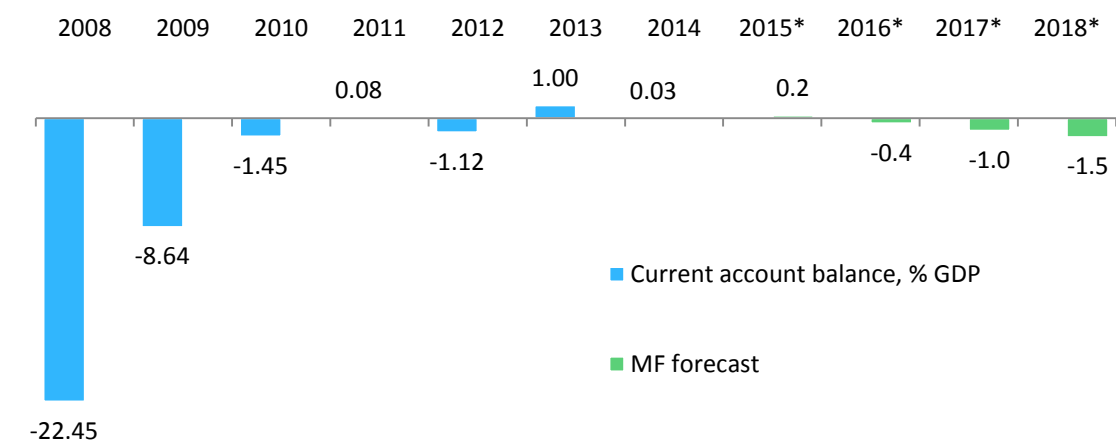
Source: EC, MF

The gradual recovery of domestic demand in 2015 is expected to affect positively the export growth. The continuing stabilisation of the European economies will have a key positive impact on the forecast acceleration while third countries' contribution will be limited. The dynamics of export will also result in increased import of raw materials for the export orientated sectors. The expected slowdown in the growth of consumption and investments will have a more mod-

erate deterrent effect on import. The depreciation of the Euro will offset the decline in international prices in USD, and in 2015 we expect low positive deflators. The export price deflator will outpace the import price deflator. The current account balance will be slightly positive in 2015, with the surplus in services almost entirely offsetting the trade deficit, and the balance of revenues and transfers will remain practically unchanged as relative share of GDP.

With the acceleration of consumption and investment activities as from 2016, we expect a gradual increase in the trade deficit. Current account balance will, from a balanced position, become slightly negative and the deficit will moderately increase in the medium term, reaching 1.5% of GDP at the end of the projection period. The negative trade balance will be fully offset by the surplus in *services*, which will amount to 7.7–8% of GDP throughout the projection period, and by the positive balance of transfers, mainly from the EU. Expectations are for moderate growth in revenues from tourism and strengthening the trade in other services.

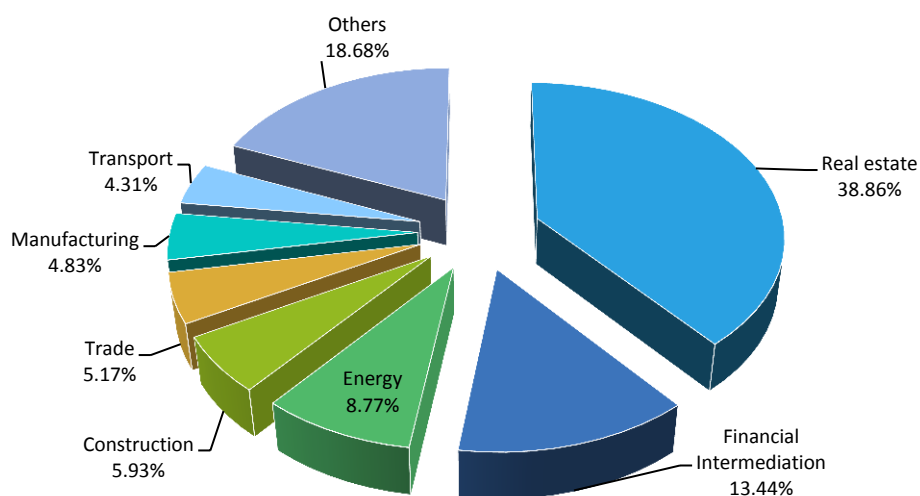
Fig. 2-10: Current account balance, % of GDP



* Forecast

Source: BNB, NSI, MF

Fig. 2-11: Industry structure of FDI attracted in 2014 (relative share, %)

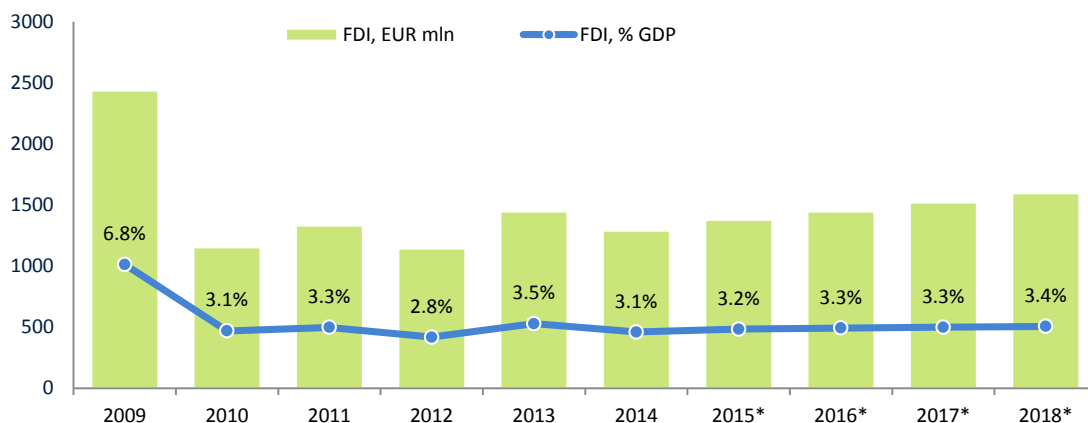


Source: BNB

The financial account balance in 2014 was EUR 2.1 billion compared to a deficit of EUR 962.2 million in 2013. The Eurobond issue by the government in June 2014 and the bridge loan obtained in December were among the main financial inflows in the country. Other significant inflows into the financial account were the foreign direct investments.. They amounted to EUR 1.29 billion, or 3.1% of GDP, and registered a 10.9% decline compared to 2013. Investments were mainly focused in real estate transactions, financial intermediation, generation and distribution of energy, and construction. At the same time, the Bulgarian banks continued increasing their assets abroad, mainly in the form of short-term loans.

It is expected that FDI levels in the country will remain slightly above 3% of GDP for the period 2015–2018, due to the relatively high liquidity maintained by banks, and that there will be no financial inflows in the sector in the medium term. The contribution of the net portfolio investments to the financial account will be determined by the assuming of new debt by the government and the repayment of principal under the government debt in global bonds maturing in 2015 and 2017.

Fig. 2-12: FDI dynamics



* Forecast

Source: BNB, MF

– Monetary Sector

The main objective of the monetary policy in Bulgaria is to maintain price stability through securing the stability of the national currency. This objective is achieved within the framework of the Currency Board Arrangement and a fixed exchange rate of the national currency to the Euro.

As of February 2015 Bulgaria's international foreign currency reserves reached EUR 17.2 billion, registering an increase of EUR 3.6 billion compared to the same period of the previous year. The increase in the banks' deposits at the BNB as a result of the growth in their excess reserves¹⁰ was a main contributor to the dynamics of foreign currency reserves. In a context of weak demand for loans in the country, the ECB policy of low interest rates on refinancing op-

¹⁰ Excess reserves of banks, estimated as the amount with which the funds, kept by banks in accounts with BNB for the purposes of compliance with minimum required reserves (MRM), exceed the required minimum reserves under Ordinance No. 21, amounted to a daily average of 92.8% of MRR on average in February 2015 compared to 56.5% in December 2014 (9.1% in December 2013).

erations, the introduction of a negative interest rate on the deposit facility and the non-standard measures to increase liquidity in the Euro area have limited investment options for banks and impacted the growth of their excess reserves kept at BNB. As of January 2015 Bulgaria's international foreign currency reserves covered 6.5 months of import of goods and non-factor services, and the reserves to short-term external debt ratio amounted to 157.6%.

In 2014 the dynamics of monetary and credit aggregates was influenced by the action of divergent factors. The continuing high rate of household savings continued to determine the growth of attracted funds in the banking system. During the first five months of the year, the weakening effect of the personal income tax on interest from term deposits, introduced from the beginning of 2013, and the reduction of the tax rate from 10% to 8% in January 2014, which led to a significant slowdown in the growth of overnight deposits and some acceleration in the growth of quasi-money, had an additional impact on the structure of monetary aggregates.

During the second half of June 2014 the fourth largest bank in the country – “Corporate Commercial Bank” AD (CCB) – was subjected to a liquidity pressure that also affected its subsidiary Commercial Bank “Victoria” EAD. As a result of depletion of the liquidity of the two banks and on the grounds of requests from their management, they were placed under special supervision. By the end of June liquidity pressures began to spread to other credit institutions. The situation was quickly brought under control thanks to the substantial liquidity buffers required by the BNB and accumulated in the banking system in previous periods, the measures taken by the BNB and the government, and the timely negotiating of a liquidity support scheme for the banking sector between the government and the European Commission. Pursuant to the statutory requirements of the European Commission, liquidity support can be provided only to solvent and viable banks.

The liquidity pressure on the banking system in the second half of June 2014 was short-lived, but affected the dynamics of monetary aggregates at the end of this month, as part of the term deposits were withdrawn from the banking system, thus increasing the money in circulation, and another part was transformed into overnight deposits. These developments caused a downward dynamics of quasi-money and accelerated the pace of growth of overnight deposits and currency outside monetary financial institutions at the end of the first half of 2014. As a result of measures taken, depositor confidence in the system was quickly restored and deposits started returning to the banking system as early as in July. The banking system restored its normal operation, and by the end of September household deposits exceeded the level at the end of May 2014.

The revocation of the CCB's licence for banking activities in November 2014 and its exclusion as a reporting unit from the scope of monetary statistics¹¹ lead to changes in the statistical information on credit institutions and, as a result, in November the main monetary, deposit and credit indicators decreased. The payment of guaranteed deposits in CCB which started in the beginning of December and the preference of economic agents to leave them in the banking system contributed to the growth of monetary and deposit indicators to levels close to

¹¹ As a result of the withdrawing of the CCB's licence for banking activities and in compliance with the requirements of the ECB in the field of statistics, CCB was excluded as a reporting unit from the *Other monetary financial institutions* sector (S.122 according to ESA'95) and was reclassified in institutional sector *Other financial intermediaries, except insurance corporations and pension funds* (S.123 according to ESA'95).

those prior to the withdrawal of the bank' licence and the exclusion of the deposits in it from the monetary statistics, and to a positive growth of broad money at the end of 2014 on an annual basis.¹² In the structure of broad money at the end of December compared to November, an increase was observed in the level of deposits redeemable at notice up to 3 months and those with agreed maturity up to two years. The non-guaranteed deposits in CCB and the unpaid guaranteed deposits remained outside the scope of monetary statistics. The fact that the guaranteed deposits in CCB, paid by the Bulgarian Deposit Insurance Fund (BDIF) in December, remained in the banking system, and only 2% were withdrawn in cash, demonstrates the recovered confidence in the banking system. As of February the rate of increase in broad money accelerated, and an increase on the December levels was observed in all types of deposits.

Since the beginning of 2014 till June the annual growth of claims on the non-government sector followed an acceleration trend, reaching 2.4% in the middle of the year. This dynamics was mostly determined by the positive developments in lending to non-financial corporations, while loans to households recorded a low positive growth after the slight decline at the end of 2013. The liquidity pressure, to which the banking sector was subjected in the middle of the year, and the placing of CCB and Commercial Bank "Victoria" EAD under special supervision had some impact on the dynamics of claims on the non-government sector, which mostly involved discontinuing a trend of acceleration while maintaining the positive growth rate in the period from July till October. No significant changes were observed in the stock of the claims on non-financial corporations and households, which remained at levels close to those before June. As CCB had extended loans mainly to non-financial corporations, excluding it as a reporting unit from the scope of monetary statistics in November 2014 resulted in a significant decline of the claims on non-financial corporations and, accordingly, in a substantial decrease on an annual basis in the claims on the non-government sector in the period till the end of the year and during the first two months of 2015. During the same period, a lower decrease in accounts receivable from households on an annual basis was reported compared to that of businesses.

To finance their lending operations, banks continued to rely mainly on resources raised from residents. As of the end of February 2015 household deposits registered an increase by BGN 1,751 million compared to the same period of the previous year, and the total increase in deposits of residents amounted to BGN 1,095 million as a result of the decline in deposits of other monetary financial institutions and financial corporations.

In 2014 banks used a considerable portion of their liquidity to increase their foreign assets and their claims on the general government sector, and to continue repaying liabilities to foreign institutions (mainly to parent banks). As a result of this dynamics, the net foreign assets of banks followed an upward trend throughout the year. In February 2015 this indicator had a value of BGN 3.3 billion. As from the second half of 2014, banks started increasing their excess reserves with the BNB, and a more considerable increase was observed at the end of 2014 and the beginning of 2015.

¹² Commercial Bank "Victoria" EAD was reopened on 12 December 2014 and continued operating as a credit institution.

According to the data of the quarterly Bank lending survey conducted by the BNB, during the first three quarters of 2014 easing of the lending standards was observed on loans to households, while standards for loans to enterprises remained almost unchanged. During the fourth quarter banks tightened their lending standards for granting financial resources of enterprises. With regard to household lending, the credit policy was tightened for consumer loans and remained unchanged for loans for housing needs. The main factors, which, according to banks, have contributed to the easing of the credit policy during the year, are related to the competition from other banks and the lower cost of attracted funds. At the same time banks report that the tightening of the lending standards was mainly influenced by the macroeconomic environment, the credit risk and the collateral risk.

Interest rates on newly contracted fixed-term deposits for households and non-financial corporations followed a downward trend throughout 2014, and during the second half of the year the trend intensified. This dynamics was preconditioned by the high liquidity of the banking system, the relatively low demand for bank loans and the low, even negative in some segments, interest rates in the Euro area. As of February 2015 the weighted average interest rate on new¹³ fixed-term deposits¹⁴, presented as a weighted average on a 12-month basis, declined to 2.3% compared to 3.2% a year earlier. The decline in the cost of attracted funds of banks contributed to a downward trend in interest rates on loans. As of February 2015 the weighted average interest rate on new loan agreements¹⁵ decreased by 0.7 pp on an annual basis to 7.7%. The decline in interest rates on new loans granted to non-financial corporations (by 0.9 percentage points to 7.2%) was more significant, while interest rates on newly contracted loans to households fell by 0.3 percentage points on an annual basis to 9.4%.

In 2014 the ongoing increase in resources attracted from residents and the additional macroprudential measures to strengthen the liquidity of credit institutions contributed to the increase in the liquid assets to total liabilities ratio to 30.1% in December 2014 compared to 27.0% at the end of 2013. In January 2015 the liquidity position of the banking system continued strengthening, and the liquid assets ratio increased further to 31.8%. The increased liquidity in the banking sector at the end of 2014 and the beginning of 2015 was also affected by the payment of guaranteed deposits to depositors of CCB, which started at the beginning of December.

In 2014 the Bulgarian banking sector continued reporting stable financial indicators. The audited profits of the banking sector as of 31 December amounted to BGN 711 million, and this financial result ensured a return on assets of 0.85%. The total capital adequacy of the banking system remained high, at a level of 21.95% as of December 2014, including the Tier 1 capital adequacy ratio of 19.97%.¹⁶

¹³ The terms “new” deposit agreements and “new” loan agreements refer to the statistic category “new business”.

¹⁴ Weighted average interest rate on term deposits for the household and non-financial corporations sectors, weighted in terms of currency and term.

¹⁵ Weighted average interest rate on loans for the household and non-financial corporations sectors, weighted in terms of currency and term.

¹⁶ The total capital adequacy and Tier 1 capital adequacy indicators, as well as the Tier 1 common equity ratio have been brought in line with Directive 2013/36/EU and Regulation (EU) No 575/2013 on capital requirements. The repealing of Ordinance No. 8 of BNB on the Capital Adequacy of Credit Institutions and Ordinance No. 9 of BNB on the Evaluation and Classification of Risk Exposures of Banks and the Allocation of Specific Provisions for

In 2014 the Bulgarian National Bank continued applying the best practices in regulating banks' activities. In March 2014 the amendments to the Law on Credit Institutions were passed. They aimed at bringing the law in compliance with Directive 2013/36/EU of the European Parliament and of the Council on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms. Essentially, with these changes and with the entry into force of Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms (i.e. the CRD IV/CRR Package), the European version of the rules of the new Basel agreement on capital, the so called Basel III, was introduced. The new framework imposed a change in the supervisory approach of BNB in order to keep the buffers in the banking system accumulated over the years.

In April 2014 at a meeting of the Governing Council of the BNB amendments and supplements were adopted to several main ordinances of the BNB in the field of banking supervision and new ordinances on capital buffers and risk management in banks were adopted. As a result of these changes the Bulgarian legislation was brought in line with the new legal framework of the European Union on the activities of credit institutions, established by the adoption of the CRD IV/CRR package and the amendments made to the Law on Credit Institutions, promulgated in the State Gazette, No. 27 of 2014.

The new Ordinance No 7 of BNB on the Organisation and Management of Risks in Banks introduced provisions regarding the requirements for the structure and organisation of risk management, the setting up of a risk committee and the expanding of already existing requirements for technical criteria for the treatment of individual risk types. The new Ordinance No. 8 on Capital Buffers of Banks introduced statutory requirements related to the establishment of a methodology for maintaining a capital conservation buffer, countercyclical capital buffer specific for each bank, buffer for global systemically important institution, buffer for another systemically important institution, and buffer for systemic risk. The BNB set the level of the capital conservation buffer at 2.5% (effective as of May 2014) and of the systemic risk buffer at 3% for all credit institutions in the country. In mid-November all affected European partners were informed of the activation of the systemic risk buffer, thus meeting the formal requirements and obligations of the BNB and the "Banking Supervision" Department. With this, the capital buffer for systemic risk was officially activated as from the middle of December and become applicable to all exposures of banks to Bulgarian clients.

In 2014 a standardised supervisory reporting framework, covering all reporting by banks under the CRD IV/CRR package, became operational in the EU. In order to facilitate the process of introduction of the new requirements, active communication was conducted with banks regarding Regulation (EU) No 575/2013 and all efforts were made to ensure uniform practice in the interpretation of the key issues in the implementation of the framework. In addition, during the second half of 2014, different issues relating to the practical introduction of the new reporting forms and templates and of some related Implementing Regulations were solved.

According to the MF's forecast the annual growth rate of money supply is expected to reach 5.1% at the end of 2015. Over the next years broad money growth will gradually accelerate from 5.7% yoy at the end of 2016 to 6.9% at the end of 2018. Net foreign assets of the banking

Credit Risk, imposed by the new European regulatory framework, has an impact on the scope, frequency and content of the data disclosed with regard to the banking system and individual banks.

system will continue their upward trend till 2017, after which, in 2018, they will decrease slightly. Their dynamics will be determined mainly by the expectations that deposits raised from residents will significantly exceed the amount of loans extended during the period.

Credit to the Private sector I will increase at a relatively slower pace during the period 2015–2018. At the end of 2015 its growth on an annual basis will be 1.9%, and by 2018 it will accelerate to 3.7%. During the entire period a trend of gradual increase of the contribution of Loans to Households will be observed , especially consumer loans, which will follow the increasing private consumption contribution to economic growth. ▼

3. GOVERNMENT BALANCE AND DEBT

3.1 Policy strategy

The ambition to preserve the stability of public finances remains a main priority of the fiscal policy in the coming years. It is to be achieved by smooth and gradual fiscal consolidation steps within the annual range of 0.4%-0.6% for the General Government deficit under ESA 2010 and 0.5% annual improvement of the structural deficit for 2016-2018 period. This is essential for complying with the reference value for the General Government budget deficit under the Stability and Growth Pact requirements. In this regard, during the preparation of the forecast for the development of the main budget indicators in medium term, the impact of the factors, which could influence negatively the public finances was taken into account, including a better definition and management of the fiscal risks. The main fiscal parameters of the budgetary framework indicate the continuation of the trend of prudent fiscal policy through implementation of fiscal consolidation measures.

In view of the stability of public finances, the setting of realistic targets for key budgetary parameters and the compliance with the established fiscal rules and restrictions are relevant for the Consolidated Fiscal Programme (CFP) and the national budget as well as for the General Government sector.

The Government Debt management policy, implemented by the Ministry of Finance, is crucial for the dynamics and structure of the consolidated debt of the General Government sector due to the fact that central government debt accounts comprise around 96% of the latter. The main goal of the borrowing policy is to ensure the resources needed to finance the state budget, to refinance outstanding debt and to ensure the sustainability of the fiscal reserve account at optimal cost and reasonable risk level.

New government debt will be issued within the debt limitations envisaged in the State Budget Law for the corresponding year and taking into account the effects of the adopted borrowing strategy, on the risk parameters and the cost of servicing the government debt. The main priorities in sovereign debt management during the period under consideration include performing an optimal selection of different alternatives to provide a wide range of debt financing and maintain maximum flexibility in choosing the structure of funding in terms of markets, placement, instruments, currencies, etc. Efforts will be focused on providing options for market-based financing, and during the period Bulgaria will maintain its role of a regular issuer of government securities by establishing a *medium-term programme for issuing debt on international capital markets*. In parallel, when the specific requirements of the loan financing are identified, the special developments of the macroeconomic environment, investors' interest and the cost of financing, and the need for a more even distribution of the maturities of outstanding debt will be taken into account.

Taking into account government priorities in various policy areas, the selection of projects with an investment focus, which will be funded by government and/or government guaranteed

loans, will be made by using a consistent analytical and restrictive approach in exact compliance with the statutory conditions and procedures, and with high degree of transparency.

The forthcoming Government Debt Management Strategy (GDMS) for the period 2015–2017 will outline the basic tools as well as will implement an approach of continuity and consistency of the government debt management policy and the achievement of its primary objectives.

3.2 Medium-term objectives

The fiscal consolidation process will continue in the medium-term. The targets for the General Government sector deficit for the period 2015–2018 are as following: 2.8% for 2015, 2.4% for 2016, 1.8% for 2017 and 1.3% for 2018.

The deficit target of the General Government sector for the period 2015–2018 will be achieved through decrease in the share of expenditures as a percentage of GDP (from 38.8% in 2015 to 37.5% of GDP in 2018), and an increase in tax revenues in 2016 and 2017 compared to 2015, while maintaining the overall level of revenues at around 36% of GDP. The increase of tax revenues in 2016 y-o-y basis is due both to improved macroeconomic indicators (growth of consumption, growth of import, the inflation, growth of the average salary and improved employment rate, etc.) and to measures taken by revenue agencies to increase revenues collection rate. The impact of the improved macroeconomic indicators is estimated at about BGN 820 million. – mainly due to increasing VAT revenues as well as due to the higher consumption and the growth of import in 2016. When the revenues from VAT are forecast, it is took into account the expected higher implementation of these revenues in 2015 - based on better than expected tax revenues as of the beginning of this year (2015). When it is estimated the excise duties revenues in the next year, it has been taken into account the envisaged increase in the excise duty for cigarettes that has a positive budgetary effect of BGN 55.6 million for year 2016, as well as the base effect of the increased tax revenues within the current year¹⁷.

Consolidation on expenditure side is most significant in intermediate consumption – mostly in the maintenance costs. They register a decline of 0.1 pp of GDP in 2015 compared to 2014, and by 0.2 pp of GDP in 2016 compared to 2015. In addition to this, Gross Fixed Capital Formation is also expected to decrease by 0.4 pp of GDP in 2016 compared to 2015. This decline is related mainly to the start of the new programming period for the EU funds and the expected lower absorption rate of European funds in its first years resulting also in lower expenditures for national co-financing.

The government policy in the area of wage expenditure remains unchanged and its aim is preserving their level. The estimates for the 2016 State budget are made under the assumption that the nominal growth is due only to the reflected effects of the increase in the minimal wage, including the standards for financing of the activities delegated by the state. The increase in compensation of employees expenses can be seen in some autonomous budgets, as the municipalities' budgets, over which the government cannot put limits directly. These expenditures in the municipalities in 2016 reflect the real parameters and level of salaries in the municipality administration achieved during the previous years. In practice, an internal restruc-

¹⁷ The data in table 2a in the Annex present the provisions in the State Budget Law for 2015 and do not take into account the updated estimates of the revenue agencies for better than projected revenues.

turing of the expenditure was implemented through decrease in the maintenance costs and increase in the compensation of employees.

Furthermore, in view of the horizontal nature of the envisaged limits on expenditure in the public sector, the implementation of the measures shall be linked to the implementation of programmes for structural and functional reforms in the respective sectors.

3.3 Actual balances and updated budgetary plans for the current year

The 2014 was marked by serious challenges in the course of the budget execution, which made it necessary to update the fiscal framework and revise in a negative direction the budgetary targets for annual deficit and debt. In addition to this optimistic estimates at the stage of revenues planning, a number of internal and external factors, which could not be fully assessed at the planning stage, had a negative fiscal effect. The main internal factors were the deteriorated political environment in the country, the problems in two leading banks in June 2014, the deflationary pressure, the serious damage caused by natural disasters, the sustainable shortage of funds for the health sector, and others. In terms of external factors, the escalating crisis in Ukraine and the subsequent sanctions and counter-sanctions by the EU and Russia, the significant deviations from the forecast of the energy prices and fuel prices on international markets, and others stood out. Under the influence of these factors, and due to the too optimistic assumptions at the planning stage, the need became clear to update the fiscal framework as a result of serious underperformance in revenues from some taxes compared to the projections set in the 2014 State Budget Law. The postponement of the adoption of the revised budget after the elections in October strongly limited the opportunity to realise cost savings due to serious risks of rise in liabilities at the end of the year in areas where commitments for expenditure have already been made. For these reasons it was objectively impossible for the 2014 deficit to remain within the target initially set in the previous Convergence Programme – a deficit of 1.8% of GDP. As a result, in the October deficit and debt notification tables the estimated deficit of the General Government sector for 2014 was deteriorated to 3.5% of the projected GDP, and this deficit was also set in the updated fiscal framework under the Law Amending and Supplementing the 2014 Law on the State Budget of the Republic of Bulgaria, passed by the 43rd National Assembly in November. Based on the data in the April EDP notification tables regarding the General Government sector for 2015, the deficit for 2014 remained within the requirements of the Stability and Growth Pact of 2.8% of GDP.

The comparison between the estimates made in September 2014 and the assessments relating to the April EDP notification tables for 2015 shows an improvement of the General Government sector deficit for 2014 by 0.7 pp of GDP. The key improvement from the assumptions in the September estimate are in the assessments of the accounts receivable and accounts payable in the balances of budget spending units, and the effects of reporting taxes according to the “Time adjusted cash” method. When temporarily suspended Operational Programmes were unblocked, most of the accounts payable to contractors were effectively disbursed during the year, which resulted in reduction of liabilities. In addition, taxes subject to reimbursement were reimbursed within the deadlines in order to support businesses. The active actions of the current government, even in the short period until the end of the year, gave positive results.

– Budgetary developments in 2014

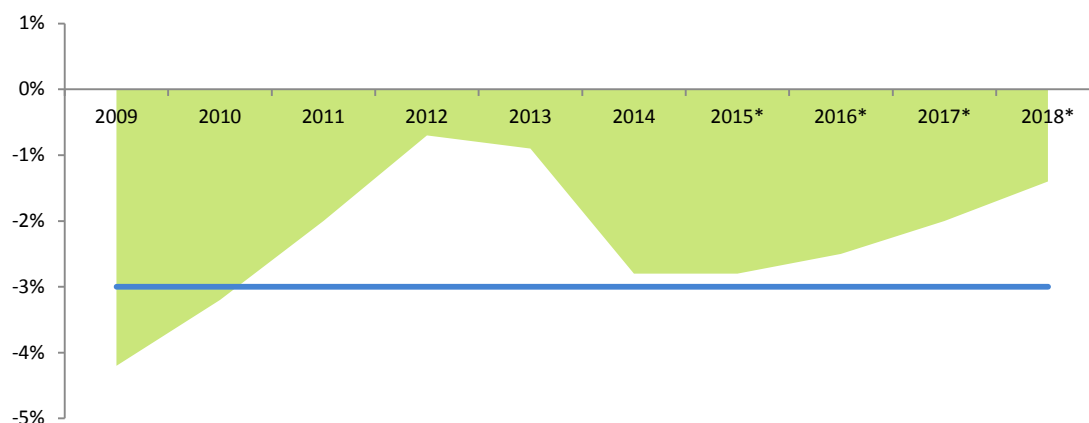
In 2014, the total revenues as a ratio of GDP reached 36.4%, which is 1 pp. decline compared to 2013. The revenues of the General Government sector were by 1.6 pp lower than the projection in the previous Convergence Programme. The external and internal factors described above and the too optimistic assumptions at the revenue planning stage were in the basis of the more pessimistic performance against the forecast in the last year's Convergence Programme.

Negative effects were observed in the highest extent in taxes on production and import, as well as other current revenues. They registered a decline of 0.5 pp (and 1.6 pp compared to the estimate in the previous Convergence Programme) and 0.7 pp. in the previous year. In terms of taxes revenues, the most significant drop was reported in VAT revenues. For these revenues, the most tangible negative effects came from the deflationary pressure in the country, the situation on international markets, the lower crude oil prices and the EUR/USD exchange rate, the domestic consumption and the dynamics of import and export. Political instability and the problems in the banking sector acted as deterrents that suppress consumer activity. The decline in energy raw materials prices and other imported raw materials also contributed to the lower revenues. The reduction of non-refunded tax credit to its lowest level in the past eight years had a significant impact on the level of VAT receipts. This was related to the measures taken to speed up the refund of VAT to companies and reflected the government's efforts to maintain correct relations with the business. A slight decline was observed in the excise duties' revenues. It was determined both by the decline in volumes in the trade of fuels, and the reduced consumption of certain excise goods.

Compared to 2013, the ratio of taxes on income and wealth to GDP registered a minimal increase of 0.1 pp. The corporate taxes revenues reported an increase as a result from the observed increase in the 2013 financial statements of the companies and respectively the higher advance payments in 2014. An improvement in personal income tax' receipts was also observed. The main factors behind this development were the decline in unemployment rate, the raising of the average salary level and the reported positive results from the measures taken to collect the overdue tax liabilities.

The social security and health insurance revenues increased by 0.3 pp compared to the previous year. The factors specified above as influencing the personal income tax, the increase in the maximum monthly insurance income from BGN 2.200 to BGN 2.400, the increase in the minimum thresholds for social security contributions, the increase in employment/decrease in unemployment rate and other factors contributed to this. The amount of capital transfers received, including the main portion of the funds received under the EU Funds and programmes, exceeded the its values for the previous year. This resulted from the accelerated absorption of EU funds in connection with the final stage of the implementation of projects during the 2007–2013 programming period.

Fig. 3-1: Budget balance (ESA'2010, % of GDP)



* Forecast

Source: Eurostat, MF

Total expenditure for 2014 amounted to 39.2% of GDP which was an increase by 0.9 pp. compared to the previous year. Expenditure policy during the year was focused on accelerating the public investment to support economic growth, strengthening the social commitment of the state to the most vulnerable groups of the population, and ensuring the normal functioning of the budgetary systems in accordance with the fiscal framework approved at the end of 2013. This framework, however, was planned under the assumption of sustainable political environment, accelerated growth, non-deflationary developments in the economy and positive expectations regarding the external environment, which did not materialise. During the budget year tensions occurred in some budget systems (mainly in the healthcare and public order and security), and there was pressure to provide resources for overcoming the consequences of natural disasters, coping with the increased flow of fugitives and other issues, all of which exerted pressure on the expenditure side of the budget. The temporary suspension of payments by the EC under two Operational Programmes, which made it necessary to provide national resources for the projects' implementation until the suspended payments were unblocked, also had a negative impact on expenditure side of the budget. These factors, together with the postponement of the revision of the budget after the elections in October 2014, made it impossible to undertake sufficient measures to shrink expenditure within the budget year in order to compensate for the revenues lagging behind. Nevertheless, expenditure remained by 0.7 pp. lower than these planned in the previous Convergence Programme¹⁸, and the shortage of funds for the budget systems mentioned above was provided by restructuring, prioritising and streamlining of expenditure in other systems, while preventing the rise in liabilities at the end of the year.

Investment policy was a main priority during the year - increase in gross fixed capital formation by 0.9 pp. compared to the previous year. This was related to the advanced implementation of projects in their final phase under the operational programmes, and the public investment programme "Growth and Sustainable Development of the Regions". Transport infrastructure projects, environmental protection infrastructure projects and other aspects of regional development had the largest share of the European funds absorption. In 2014 the

¹⁸ It should be taken into account the effect from moving from ESA 95 to ESA 2010, which increased the GDP by 2 billion BGN in 2014.

amount of payments under projects supporting competitiveness of the economy and human resource development was also considerable.

A 0.8 pp. increase compared to 2013 was also observed in social transfers, including these in kind, which comprised of pensions, compensations and benefits for households, and health insurance payments. Funds for pensions increased both due to the payment from the beginning of the year of the amounts indexed in April 2013, and due to the indexing of pensions by 2.7% under the “Golden Swiss rule” and increasing in the amount of the maximum pension from July 2014. Funds for social benefits also increased as a result of the increase in the individual amount of certain payments from July 2013, and also because of the increased energy benefits from the autumn of 2014. The shortage of financing in healthcare emerged as one of the most critical problems in 2014, which required updating of the resources provided in this direction, and the amount of spending for the year was by 15.5% greater than in the previous year.

The minimal increase in expenditure on compensation of employees was reported, in comparison to the previous year (by 0.1 pp.). It was related to a growth of salaries within the systems of some independent budgets (mainly municipalities), which have autonomy in managing their budgets, and to the increase in funds absorbed under EU Funds and programmes and comprising compensations to employees.

Interest expenditure, 0.7% of GDP, registered a 0.1 pp. decline on y-o-y basis. The other two categories of expenditure, where a decline from its 2013 level was observed in 2014, were the intermediate consumption of the government and subsidies – by 0.2 and 0.1 pp. respectively.

– 2015 Budgetary Focus

In 2014 the deficit reached 2.8% of GDP and thus measures have been envisaged to ensure fiscal consolidation and shrink of the deficit by 0.7 pp from 3.7% of GDP in 2014 to 3.0% of GDP in 2015 under the national methodology on cash basis, and to keep the deficit of the General Government sector within the requirements of the Stability and Growth Pact. The deficit of the General Government Sector in 2015, using the ESA 2010 methodology, is envisaged to be close to that for the previous year, and to amount to 2.8% of GDP. This target takes into account the changed economic environment and the entry of the projects under the Operational Programmes and funds for the 2007–2013 programming period in their final phase, while also reflecting measures to ensure financial stability, restore confidence and limit potential negative impacts on the economy.

The **revenue** policy is orientated at supporting economic growth, improving the business environment, fight against tax fraud, and overall increase in fiscal sustainability in the long term. The programme for the year provides for retaining the tax burden of the main taxes, and the revenue framework is planned conservatively, taking into account the negative factors in the projections for 2014.

The **public expenditure** policy is orientated at ensuring the proper functioning of the budgetary systems and, at the same time, restructuring of costs in order to ensure funding for the priority policies of the government and limit inefficient costs and structures. Measures concerning expenditure are aimed at their restricting by optimising inefficient spending, and a balance was sought between the need to reduce cost and risk of liabilities in individual budget systems occurring.

Main fiscal consolidation measures for 2015

The implementation of the measures to which the government committed itself at the end of 2014 is presented below. The budget effect of their implementation was updated based on latest assessments and is measured on an annual basis.

➤ *Measures on the Revenue Side:*

- To expand the scope of taxable interest income on all bank accounts, except interest income on children's saving accounts. The expected positive effect on revenues will be BGN 27.5 million (0.03% of the projected GDP). **The measure is implemented.**
- As of 1 January 2015 the maximum monthly insurance income was increased from BGN 2.400 to BGN 2.600 for all individuals, and the plans are to remain unchanged till 2018. The expected positive effect on revenues will be BGN 43.1 million. The measure will affect about 74.157 insured individuals, 10.801 of which with income between BGN 2.400 and BGN 2.600 and 63.356 individuals with income at the amount above BGN 2.600. **The measure is implemented.**
- As of 1 January 2015 the minimum insurance income of agricultural producers was increased – from BGN 240 to BGN 300. The expected effect of this measure is about BGN 4.2 million. About 25 500 agricultural and tobacco producers are affected by this measure. **The measure is implemented.**
- The tax relief on personal income not exceeding 12 minimum salaries was abolished – expected positive effect on an accrual basis of up to BGN 20 million. **The measure is implemented.**
- Two new preferences were introduced for families with children, which will be used in 2015 with the filing of the annual tax return under Article 50 of the LPIT – expected negative effect on an accrual basis of up to BGN 25 million. **The measure is implemented.**
- In order to enhance the control and the collection rate of current and outstanding liabilities, a requirement was introduced according to which payments under contracts with the public sector above a specified amount shall be executed after the tax authorities confirm that the recipient of the funds has no liabilities to the state budget. **The measure is implemented.**

This measure results in enhanced control and streamlining of expenditure on collection of public receivables, and will ensure better reporting and transparency of the actions of the public sector in accordance with the principles, standards and best practices in the EU. The expected positive effect in 2015 in the amount of BGN 80 million.

- The minimum thresholds for social security contributions for the main economic activities and occupational groups will be increased on average by 4.4% in 2015 compared to 2014, with estimated positive effect on revenue at around BGN 35.4 million (0.04% of the projected GDP). **The measure is implemented.**

➤ *Measures on the Expenditure Side:*

- The length of insurance service for retirement under Article 68(2) of the SSC is increased by 4 months as of 1 January 2015, and the age under paragraph 1 remains at the 2014 level. The positive effect on expenditure will be about BGN 18.5 million. **The**

measure is implemented.

- Abolishing as of 1 January 2015 of the second social disability pension under Article 101(3a) of the Social Security Code – reducing the pension expenditure by about BGN 7.3 million. **The measure is implemented.**
- Reducing the “personnel funds” in the public sector by 10% – expected decrease in expenditure by about BGN 300 million. The 10% decrease in the personnel expenditure for 2015 compared to the updated 2014 budget law covers all ministries, departments, the National Social Security Institute, the National Health Insurance Fund. This cost reduction does not include activities delegated by the state in education and culture sectors. In addition, the independent budgets of the National Assembly, the Supreme Judicial Council and the centers for emergency medical care, the state psychiatric hospitals and the centers for transfusion hematology within the system of the Ministry of Health are also excluded. In the event of direct reduction based on reducing the resources for staff by 10%, about 16,800 positions are expected to be cut down, of which around 6,000 are vacancies. When the occupied positions in the staff are cut, the compensations payable under the Labour Code, the Law on Civil Servants, Law on Defense and Armed Forces of the Republic of Bulgaria and the Law on the Ministry of the Interior shall be paid. The measures to comply with the parameters of the reduced personnel costs, including the date on which the reduction of staff will take effect and exactly what staff and in which structures will be laid off, will be defined by the first-level spending units. The success of the policy for streamlining personnel costs, unlike that of previous similar policies in this area, is guaranteed by the fact that personnel costs for first-level spending units have been streamlined at the level of law and can only be changed with an update of the 2015 Law on the State Budget of the Republic of Bulgaria. In previous policies in this area, the government was empowered to increase personnel costs, if deemed necessary, while now it has no such powers, thus ensuring the actual implementation of this policy. **The measure is implemented.**
- Adoption of measures and legislative changes to optimize cost control in the health sector and reduce the cost of health insurance payments – savings of over BGN 80 million. With regard to the reduction of the expenditure of the National Health Insurance Fund in 2015 compared to 2014 it shall be borne in mind that in 2014 the cash expenditure incurred by the National Health Insurance Fund included the payment of outstanding liabilities from 2013 in the amount of BGN 110 million, in particular:
 - Activities carried out by medical services providers above the limits in October and November 2013 – BGN 67 million.
 - Activities carried out by medical services providers within the limits in November 2013 – BGN 26 million.
 - Medication for treatment at home for the period 01–15 November 2013 – BGN 17 million.

This expenditure was a one-off payment made in 2014 and will not be incurred in 2015. No legislative changes are necessary to further streamline the expenditure of the National Health Insurance Fund in 2015. However, it is necessary to amend and supplement some ordinances of the Minister of Health on the basic package of medical services, and medical standards, which involves actions on the part of the executive. **In the process of implementation.**

- The “Growth and Sustainable Development of Regions” programme was terminated

due to its inefficiency – expenditure will be reduced by about BGN 100 million. **The measure is implemented.**

Interim assessment of the implementation of the above mentioned measures will be made in the report on the execution of the Consolidated Fiscal Programme for the first half of the year, which the Ministry of Finance publishes on its internet site and submits to the National Assembly by 15 September. Furthermore, such assessment will be provided in the report, accompanying the 2016 State Budget Law.

Other features of the fiscal policy for 2015:

➤ Measures concerning wages:

As of January 2015 the minimum salary was increased from BGN 340 to BGN 360. A further increase is envisaged during the year – as of July 2015 the minimum salary is planned to become BGN 380. The net effect of the measure on the budget balance is neutral, as the expected higher expenditure resulting from the increase in the minimum salary of public sector employees will be largely offset by the expected revenues from taxes and social security contributions on the increased salaries for all employees in the other sectors of the economy, whose remuneration is equal to the minimum salary.

➤ Measures concerning pensions and social assistance:

In 2015 the implementation of the so called “Swiss rule” will continue (i.e. updating the pensions as of 1 July of the corresponding year by a percentage, equal to the sum total of 50 percent of the increase in the insurance income and 50 percent of the consumer price index during the previous calendar year). The planned percentage of the increase for 2015 is 1.9%. The total effect on expenditure is estimated at BGN 94.1 million (0.1% of the projected GDP).

It is also envisaged to increase as of 1 July the maximum level pension received from BGN 840 to BGN 910. This is a consequence of the increase in the maximum insurance income. This will result in further increase in expenditure by BGN 18.2 million (0.02% of the projected GDP).

The length of insurance service required for entitlement to pension for the third category of labour was increased by 4 months, and the expected effect is BGN 18.5 million (0.02% of the projected GDP).

To support the pensioners with the lowest pensions, in April 2015 a one-off additional payment was granted to all pensioners with pensions below the poverty line – BGN 286. The total amount of these payments – BGN 50 million, will increase expenditure by 0.06% of the projected GDP.

In the field of social and family benefits and compensations, the parameters of the extant legislation will not change in 2015: the period of payment of cash benefits for pregnancy and maternity and the amount of compensation for raising a child aged from one to two years will remain unchanged; the arrangements for granting compensation for temporary disability remains unchanged; the period based on which short-term benefits for temporary disability and unemployment are calculated remains unchanged, while the period for calculating the benefits for pregnancy and maternity is increased; the size of the lump-sum benefit in case of death remains unchanged; the maximum amount of the guaranteed claims of workers and employees from the “Guaranteed Claims of Workers and Employees” Fund for unpaid wages in the

event of bankruptcy of the enterprise remains unchanged; the minimum amount of unemployment benefits also remain unchanged. The social protection of vulnerable groups through better targeting of social benefits, increased effectiveness of programmes, implementation of a differentiated approach, improvement of legislation in the field of social assistance and streamlining the institutional structure related to social protection of the lowest income groups and groups at risk remains a priority of the spending policy. The funds earmarked for social benefits in 2015 increase by BGN 39 million in nominal terms (0.04% of the projected GDP), as the number of beneficiaries of social protection is expected to increase, and the thresholds for granting heating aid are increased.

➤ ***Measures concerning education:***

In the field of pre-school and school education, a priority is to ensure equal access to quality education and vocational training in all regions. Efforts are directed at expanding the delegated responsibilities of managers of the units within the system, and the additional funds provided are allocated into the budgets of the corresponding spenders. Measures to increase the attractiveness of the teaching profession are envisaged, and for 2015 the funds necessary to ensure the implementation of the policies in relation to the income of those employed in the public education system and measures to support teaching staff have been provided. Funding for the full-day organisation of the school day for the pupils from first to fifth grade and means for funding focal point schools have been provided. For the increased amounts of the standard for financing the activities in secondary education, further BGN 27 million (0.03% of the projected GDP) were ensured.

In the field of higher education efforts are directed at encouraging autonomous higher education institutions to continuously increase the quality of the higher education offered. To this end, educational institutions are supported in the introduction, development and improvement of internal systems for assessment and maintaining the quality of education. The state also improves the credit conditions for students and postgraduates by increasing the size of the government guarantee for bank lending to the university students. The placements of students in a real work environment, which will improve the link between education and the business for the purpose of quick and effective realisation of graduates in the labour market and successful career start, have a key role for achieving the priority for improved quality of higher education.

The resources envisaged under the Operational Programmes for the implementation of projects in the “Education” sector will shrink by BGN 62.3 million (0.07% of the projected GDP), as the 2007–2013 programming period comes to its end, and the projects under the Operational Programme for the new programming period 2014–2020 have not been launched yet. At the same time, the expenditure allocated for financing of projects under the Erasmus+ Programme is increased by BGN 28.3 million (0.03% of the projected GDP for 2015) compared to the previous year.

In 2015 all operative programmes co-financed by the SCF 2007–2013 will enter into the final phase of implementation of the projects funded, and therefore intensive payments under the programmes are envisaged. For 2015 alone, the estimated amount of disbursed funds exceeds 16% of the budget for the whole programming period. The expenditure under each programme takes into account the unspent portion of the budget and the ability to complete projects already contracted. Increased capital expenditure under European programmes offsets to some extent the envisaged decline in capital expenditure in the national budget. The expected

net effect is a decrease in capital expenditure by about BGN 100 million (0.12% of the projected GDP).

3.4 Medium-term perspectives, including description and quantification of the strategic policy effects

The medium-term government strategy is set out in detail in the medium-term budgetary framework, the National Reform Programme and the three-year action plan for implementing the National Development Programme: Bulgaria 2020 during the period 2015–2017. It provides for the implementation of a number of measures, grouped in several key priority areas, which are expected to lead to more balanced regional development, enhanced quality of human capital, promoting innovation, higher quality of infrastructure and, generally, enhance the competitiveness of the economy, employment and income. The finance will be provided mainly through EU funds, which will complement the expenditures from the national budget.

– Improved access to and enhanced quality of education and training and quality of the workforce – earmarked funds in the amount of BGN 3.1 billion

The policy is focused on shaping and improving the quality of human capital in all its dimensions. Activities are envisaged for modernising the education system in the country, managing the quality of education and youth activities, including upgrading of existing facilities and equipment, and improving the creativity and innovation oriented at individuals. The policy aimed at enhancing the quality of the workforce will be implemented by adapting lifelong learning and mobility to the needs of the labour market, strengthening the links between educational institutions and the labour market, acquisition of competencies in accordance with the requirements of the labour market, promoting the introduction of modern forms of work organisation, introducing a dual system of education and increasing the quality of education. Measures aimed at increasing the financial culture of the population will also be implemented.

Increasing the social role and relevance of research, development of scientific potential through integration into the European Research Area, as well as development of research through programme-competitive funding are envisaged. In terms of improving the quality of healthcare, innovations for sustainable and effective health system, as well as improved quality of health services and ensuring access of all citizens to healthcare and services are planned.

– Reducing poverty and promoting social inclusion – envisaged funds of BGN 2.9 billion

The emphasis is laid on guarantees for adequate participation of vulnerable groups of the population in all spheres of public life through a set of measures covering areas such as possibilities for employment and own business, better quality of social services, deinstitutionalisation of care for children and elderly and disabled people, and a number of legislative amendments. The activities planned include improving the qualification of the unemployed, enhancing the quality of intermediary services in order to better meet the needs of the labour force, as well as measures for more flexible employment so as to improve the possibilities for combining personal and professional life. Measures for tackling the shadow economy on the labour market through better protection of labour rights and reduction of undeclared employment are also envisaged.

– **Achieving sustainable integrated regional development and use of local potential – envisaged funds of BGN 7.4 billion**

The country's regional development is targeted at development of the potential of the Bulgarian regions, decrease of inter-regional disparities and turning all regions into an attractive place for living and doing business. The key areas of government intervention will be: strategic planning and regional management through strengthening the capacity of local authorities, urging town development and better integration of the Bulgarian regions through integrated sustainable urban development and strengthening of the polycentric network of towns, improving urban labour mobility, development of and improving the access to cultural services and sports in the regions and building broadband infrastructure, support for effective and sustainable absorption of the regions' tourist potential through development of the infrastructure for specialised forms of tourism and marketing of the tourist regions and forming regional tourist products, support for the development of regions that lag behind and improving the quality of life in rural areas, creating conditions for environmental protection and better environment in the regions through enhancing the quality and effectiveness of water supply services for the businesses and the population and building and modernising the sewerage systems and waste water treatment for sustainable water resource management, as well as enhancing territorial cohesion through the development of cross-border, inter-regional and transnational cooperation.

– **Supporting innovation and investment activities to enhance the competitiveness of the economy – envisaged funds of BGN 0.3 billion**

The key priority directions in the three-year period will be building of innovation and scientific infrastructure to improve the connections between business, science and education, and implementation of measures under the Investment Promotion Law. There will be comprehensive measures for promoting the investment in industry and high-tech manufacturing and services, such as support for building infrastructure, education, job creation and financing of innovation products. The National Reindustrialisation Programme will promote the development of sectors and sub-sectors of the Bulgarian industry that are competitive or have a development potential. A pro-active marketing will help support the attraction of targeted investment in the economy, as well as promotion of the country as a tourist destination. SMEs will be supported through activities for improving the conditions for starting up business, as well as introduction of good practices, including wider use of ICT and support for R&D projects. EU funds will be used to finance the building and the further construction of a different type of innovation and scientific infrastructure across the country, while national budget funds will ensure the participation of Bulgarian enterprises in EU programmes such as Eureka, Eurostars 2 and the Enterprise Europe Network.

– **Strengthening the institutional environment for greater effectiveness of public services for citizens and businesses – envisaged funds of BGN 191 million**

There are plans for a reduction in the administrative burden for businesses, regular review of laws with a view to avoiding its increase, as well as better coordination among the territorial units of the central administration that deliver services. The impact assessment will be institutionalised, the insolvency procedures will be alleviated and the application of the tacit consent principle will be expanded. The quality of the judiciary is expected to be improved through better interaction among the individual units within the structure and extensive application of ICT. Some pilot initiatives will also be launched that will lead to strengthening of the control of

law enforcement and limitation of any non-regulated and corruption practices. With a view to a more effective administration, a mechanism for assessment and planning of the need for experts will be devised, the methods of selection will be updated, the internship programmes will be used more actively and the mobility options will be improved. The activities related to improving the dialogue with the society when formulating and monitoring state policies will continue.

– **Energy security and enhancing resource efficiency – envisaged funds of BGN 0.5 billion**

Government efforts will be targeted at enhancing energy security, independence and effectiveness of the economy, as well as at improving the environment. In order to guarantee the country's energy security, conditions will be provided for diversification of the sources and the routes for natural gas supply through the building of gas interconnections with the neighbouring countries and supporting the construction of gas pipelines along the main European gas corridors, as well as promoting the keeping of reasonable balance between the energy resources available in the country and the EU objectives for clean energy. The reduction in the use of electricity in everyday life by replacing it with natural gas will result in a more effective use of resources, lower costs and more qualitative and healthier environment. As to the effective use of resources, actions will be taken to promote the introduction of low-carbon, energy-efficient and low-waste technologies, as well as to increase the share of recycled and utilised waste.

– **Improving transport connectivity and access to markets – envisaged funds of BGN 9.2 billion**

In the period up to 2017, the key focus of the policies aimed at creating optimal conditions for development of the economy, improving the access to markets and limiting environmental pollution will be on the effective maintenance, modernisation and development of transport infrastructure, sustainable development of public transport and reform in the railway transport system. A number of projects along the trans-European corridors crossing the country are planned. The most large-scale ones are the further construction of the Struma motorway, Hemus motorway, Kalotina motorway, modernisation of the Sofia-Plovdiv railway, modernisation of the Sofia-Pernik-Radomir railway, modernisation of the Vidin-Sofia railway, recovery of the project parameters of the Ruse-Varna railway and modernisation of the Mezdra-Gorna Oryahovitsa railway. In order to have a sustainable development of public transport, efforts are mainly focused on the construction and development of smart networks and public transport services. The extension of the subway in Sofia is of paramount importance here. Concerning the reform in the railway transport system, the efforts will be focused on the better management of the railway sector, as well as on the restructuring of BDZ Holding EAD and National Railway Infrastructure Company.

– **Ex-ante impact assessment**

The table below presents the anticipated effects from the implementation of the measures planned. The SIBILA (Simulation model of Bulgaria's Investment in Long-term Advance) model

has been used to this end. Effects¹⁹ defined as changes in the levels of key macroeconomic indicators have been assessed.

Fig. 3-2: Effects from the implementation of the measures planned

Macroeconomic indicator	Effect as of 2017
GDP	10.7%
Export of goods and services	3.5%
Current account balance (% of GDP)	-11.3 pp
Employment (15-64 years), thousands	7.0%
Unemployment rate (15-64 years)	-2.6 pp
HICP inflation	3.6 pp
Budget balance (% of GDP)	3.0 pp

Source: MoF, SIBILA.

Resulting from the interventions expected, as of end-2017 there will be a positive change concerning the employment (an increase by 7% over the baseline scenario) and the unemployment rate (a drop by 2.6 pp). This is due to the direct effects of investing funds in the economy (opening new jobs) and to indirect effects (reflecting in enhancement of the quality of the employed and the labour force as a whole).

According to the analysis, the country's fiscal stance would improve by 3 pp. as a result of the implementation of the measures planned. As a whole, the overall effect is a combination of several opposite influences – increasing government expenditure and higher income and better economic conditions leading to an increase in budget revenues.

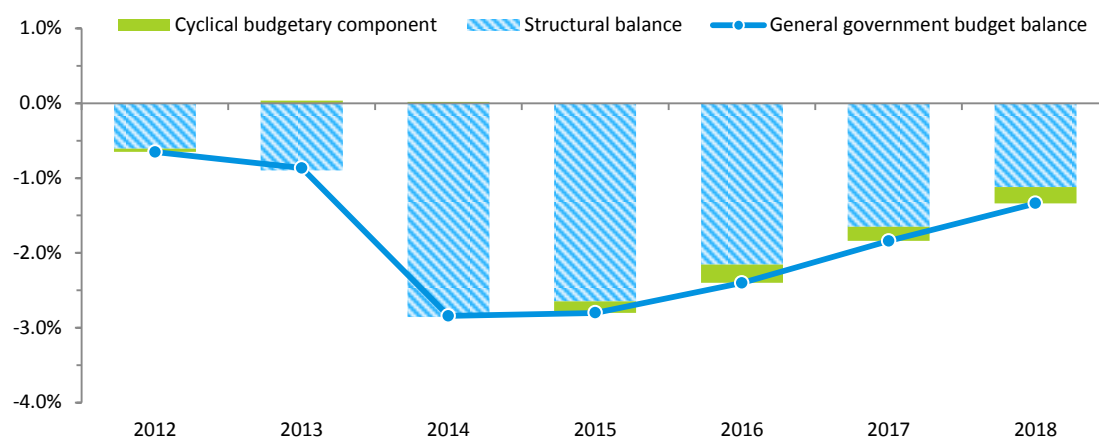
The country's production output and GDP will grow smoothly in the period under consideration, thus allowing gradual convergence with the EU. The implementation of the measures planned will play a significant role in this regard, with simulations showing that their effect for GDP would be 10.7% higher than the baseline scenario as of 2017. The inflation rate will remain at relatively low levels but will yet accelerate by 3.6 pp. compared to the baseline scenario. The export of goods and non-factor services will also grow more quickly than the baseline scenario (3.5%) as a result of the interventions planned.

3.5 Structural balance (cyclical components of the balance, one-off and temporary measures) and fiscal stance, including expenditure benchmark

The structural budget balance is estimated at -2.9% of GDP in 2014 and at -2.7% of GDP in 2015. During the period 2016-2018 the following of a restrictive fiscal policy is envisaged that will contribute to retaining the country's macroeconomic stability and maintaining long-term sustainability of public finance. An adjustment of the structural deficit by 0.5 pp is planned for each year, expecting it to reach -1.1% of GDP in 2018. At the end of the forecast period the structural balance will thus be close to the medium-term budgetary objective of -1.0% of GDP.

¹⁹ The overall effects from the implementation of measures for the economy are the difference between two scenarios – a baseline scenario (scenario 0) which simulates economic development without action plan interventions, and a hypothetical alternative scenario (scenario 1) which takes account of the implementation of measures in the deadlines set in the action plan and with the resources planned for this purpose.

Fig. 3-3: General government balance, % of GDP



Source: MoF

According to the MF's estimates, the corrected expenditure aggregate net of discretionary revenue measures (expenditure benchmark) decrease respectively by 0.8%, 1.9% and 0.5% in real terms for the years of 2015, 2017 and 2018. The estimate for 2016 shows a real increase of the net expenditures by 2.8%. due to the fact that the structural deficit is higher than the MTO of -1% of GDP for each of the years 2015-2018, the lower reference rate (medium-term reference rate of potential growth reduced by convergence margin) should be applied to the real growth of the net expenditures.

For 2015 and 2016 the comparison is conducted by implementing the benchmark reference rates of potential growth from 2013 estimates – namely 2.1% and margin of 1.38 (fixed for 3 years). For the next years, the updated reference rate, based on the Commission's winter 2015 forecast, is used. Namely, average growth rate of the potential GDP of 1% and margin of 1.26. Therefore the real growth of the modified government expenditures should not exceed 0.7% in 2015 and 2016. For the next two years, in order to comply with the expenditure benchmark, an annual reduction of the net expenditures with minimum 0.3% in real terms is needed.

Based on the above-mentioned, with the exception of 2016, the decrease of the expenditures, corrected by the discretionary revenues measures, is higher compared to the minimum requirement of 0.3% reduction in real terms.

Within the context of the investment clause, implemented by the European Commission in the period 2013-2014, applicable only to the Member States within the preventive arm of the SGP, Bulgaria presents below two tables with data for the national co-financing under the Operational programmes.

Table for 2013, BGN

Operational programme²⁰	Ex-ante application	Outturn data
OP "Transport" ²¹	205 725 000,00	90 215 507,11
OP "Environment"	177 060 319,95	167 501 841,84
OP "Regional Development"	106 741 900,00	103 862 984,56
OP "Human Resources Development"	97 879 968,31	103 272 130,17
OP "Development of the Competitiveness of the Bulgarian Economy"	63 489 690,00	50 200 042,44
OP "Administrative Capacity"	8 229 380,00	9 201 700,56
OP "Technical Assistance"	2 550 000,00	3 761 111,29
Structural and Cohesion fund (total):	661 676 258,26	528 015 317,97

Table for 2014, BGN

Operational programme	Ex-ante application	Outturn data
Operational programme	Ex-ante application	Outturn data
OP "Transport"	115 944 954,89	109 182 892,99
OP "Environment"	127 547 298,91	216 306 214,11
OP "Regional Development"	102 632 923,30	89 776 497,17
OP "Human Resources Development"	82 180 069,79	87 344 154,74
OP "Development of the Competitiveness of the Bulgarian Economy"	70 196 299,26	69 299 076,21
OP "Administrative Capacity"	12 152 574,13	13 172 934,75
OP "Technical Assistance"	3 108 786,40	3 463 741,79
Structural and Cohesion fund (total):	513 762 906,68	588 545 511,76

Source: MF

3.6 Debt levels and developments

The government debt management policy pursued in 2014 has been entirely compliant with the need to secure financial resources to refinance the outstanding debt, to cover the budget deficit, to provide a liquid support and to ensure the stability of the fiscal reserve. The policy of issuing new government debt carried out upon taking account of both the current size, structure and parameters of debt and of the forecast levels and rates of change has remained of paramount importance when securing the required financing.

According to the Eurostat data for 2014, the consolidated general government debt-to-GDP indicator amounts to 27.6% as of end-2014 as against 18.3% for 2013, while the levels of this indicator remaining below the reference value of the Maastricht convergence criterion of 60%. The reasons for the reported considerable rise in this indicator within a year originate from the

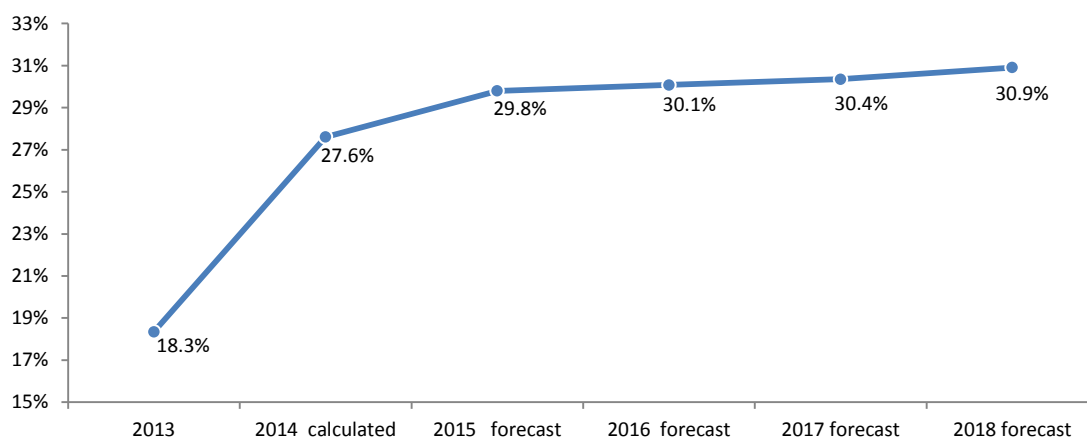
²⁰ There is no expenditure under Connecting Europe Facility as of 31.12.2014.

²¹ Trans-European Networks projects within the Cohesion fund are part of the OP "Transport".

higher budget deficit generated in 2014, the need for liquid support and the securing of funds to refinance the global bonds maturing in January 2015.

The budget policy carried out by the Government, the forecasts for moderate GDP growth and the need for maintaining adequate liquid buffers in the budget, as well as the needs for refinancing of the outstanding government debt in the period 2015 – 2018 will result in a consolidated general government debt of around 30-31% of GDP.

Fig. 3-4: Consolidated general government debt/GDP ratio



Source: MF

The main sources of debt financing in 2014 (around 72%) are secured through government security issues, one third of which on the international capital markets and the rest issued on the domestic market. The remaining 28% are absorption of investment project financing loans, including such financed by government investment loans from international financial institutions and funded under the Structured Programming Loan Agreement of EUR 700 million "Bulgaria – co-financing of the EU Funds 2007-2013". Around 51% of the transactions were conducted on the international markets and around 47% on the domestic market. The operations that had most considerable influence on the size and the structure of government debt as of end-2014 are the issue of 10-year benchmark Eurobonds amounting to EUR 1.493 billion, the conclusion of a short-term *bridge-to-bond loan* to the amount of EUR 1.500 billion and, last but not least, the issuing of EUR 2 784.2 million on the domestic market, of which short-term government securities of around EUR 2.180 billion. The assumption of this debt allowed maintaining of the country's financial stability. Funds were secured in the form of a loan extended to the Bulgarian Deposit Insurance Fund to cover the shortage of funds needed to pay the guaranteed deposits of depositors with CCB AD (the licence of which has been withdrawn) of up to BGN 2.0 billion, and liquid support in the form of state aid was granted to FIB under a scheme approved by the European Commission.

The volume of the short-term debt maturing in 2015, the high concentration of debt payments in the long run, as well as the need for securing sources for budget deficit financing and maintaining certain fiscal reserve levels in the coming years have required the taking of actions to draft a Global Medium-Term Note Programme of the Republic of Bulgaria (GMTN). The total volume of the tranches issued under the Programme in each of the following years will be up to the government debt limits as determined in the annual laws on the state budget of the Republic of Bulgaria. The Programme will allow conducting predictable and flexible government lending policies and will provide access to financial resources at favourable market conditions.

Within the debt limits of the Law on the State Budget of the Republic of Bulgaria for 2015 and as per the Programme's conditions, new benchmark Euro bonds amounting to EUR 3.1 billion were issued at end-March 2015 with a maturity of 7, 12 and 20 years respectively which is conducive to improving the government debt repayment profile. The investor interest in the bonds offered by the Republic of Bulgaria shows the options for the state to finance itself on a market basis and is a sign of the international investors' trust in the economic policies pursued.

The following debt limits have been regulated in the Law on the State Budget of the Republic of Bulgaria for 2015 in order to support the efforts to control the government debt level:

- The maximum amount of the government debt as of the end of 2015 shall not exceed BGN 24.5 billion (EUR 12.5 billion);
- The maximum amount of the new government debt that could be issued under the Government Debt Law is BGN 8.1 billion (EUR 4.1 billion).

The sizeable volumes of financing both through MTN on the international markets and through the domestic market issues are aimed to provide the resources needed to cover the large volume of maturing debt repayments of BGN 7.1 billion throughout the year. The net increment of the outstanding debt in 2015, however, is expected to be within BGN 2.2 billion, which results from the need to find financial resources to cover the 2015 budget deficit.

Local government debt, which forms around 4% of the Consolidated General Government Debt, will not change in the period under consideration and will remain at its level of around BGN 1.0 billion, as a result of the limits set in the Public Finance Law which envisage that the annual amount of municipal debt payments for each municipality in each year shall not exceed 15 per cent of the average annual amount of its own revenue and the general equalising subsidy for the last three years calculated on the basis of the annual report data on the budget execution of the relevant municipality. In addition, the Municipal Debt Law bans the assumption of new financial liabilities before the conducting of local elections which are forthcoming at end-2015.

The debt of the Social Security Funds sector (below 1% of consolidated general government debt), which will be repaid entirely in 2016, and the financial assets accumulated in the form of government securities issued by the central government sub-sector (around BGN 600 million for 2014) determine its slight influence on the amount of general government debt in the period 2015-2018.

The level of Local government debt and of the Social security funds sector debt will not increase and will not influence on the state's indebtedness. In the presence of circumstances that could result in a risk of breaching the 60% threshold of the consolidated general government debt-to-GDP ratio, there is a statutory possibility in the State Budget Law for the respective year to plan additional limitations for the assumption of municipal and social security funds debt. Such a restriction allows preventing a considerable negative influence from the excessive increase in the amount of debt.

3.7 Budgetary implications of major structural reforms

This item describes the implications for public finance of the measures taken for implementing strategic government policies.

– Implications for the Expenditure Side of the Budget

The *pension reform* undertaken recently aims at ensuring stable revenues in the pension system, as well as to make pensions more adequate in view of the demographic challenges ahead for the country. The further increase in the retirement age will be subordinate to enhancing the stability of the pension system in the long run, solidarity among generations and reducing the poverty risk for elderly pensioners. Furthermore, the reform will have a positive impact on the public finances in view of the reduction in the public expenditure and transfers related to pension fund' financing. In addition, the pension reform will have a positive impact on the structural deficit indicator by meeting the condition for long-term sustainable fiscal policy in the meantime.

The pension expenditure' forecast for the period takes into account of the provisions of the Social Security Code and the assumptions in the Government's medium-term fiscal framework as follows:

- As from 1 January 2015, there is an increase in the length of insurance service by 4 months, while the retirement age remains at its 2014 levels . The most wide-spread third labor category will thus require 60 years and 8 months years of age for women and 63 years and 8 months for men respectively. The required insurance length of service for 2015 is 35 years for women and 38 years for men accordingly. A final decision on the further increase in the retirement age and in the length of service for all labor categories has to be taken by the mid- 2015.
- The maximum monthly amount of the pensions received by one person will increase from BGN 840 to BGN 910 as from 1 July 2015 and will remain at this level by the end of 2018.

The pension projections foresee an increase in pensions as from 1 July every year by a percentage equal to the sum of 50 per cent of the insurance income increase and 50 per cent of the consumer price index for the previous calendar year.

As displayed in the table below, pension fund expenditure and transfers in the medium-term will remain around 10% of GDP over the entire period.

Fig. 3-5: Estimated pension expenditures²²

Year	Pension expenditures	
	BGN Mln	% of GDP
2015	8 349.8	10.0
2016	8 603.6	10.0
2017	8 863.2	9.9
2018	9 154.3	9.9

Source: NSSI

²² Data up to 2018 are based on the forecast of revenue and expenditure of the consolidated PSI budget for 2016-2018 dated March 2015.

– Implications for the Revenue Side of the Budget

I. Legislative Amendments in the Tax Policy

Fig. 3-6: Estimated effects on the budget from discretionary revenue measures:

Discretionary measures in BGN M	2015	2016
Increase in the excise duty rates for cigarettes		55.6
Positive implications for VAT revenues in accordance with the scheduled increase of excise duty rates for cigarettes set in the Excise Duties and Tax Warehouses Law.		11.0
The reduced excise duty rate for gas oil used in primary agricultural production through the fuel voucher system in the form of state aid	-34.0	
1. On-going monitoring of debtors with overdue liabilities of over BGN 100 thousand (BGN 200 thousand for Sofia City Territorial Office) for taxes and social insurance contributions; 2. Implementing an affirmed plan of conducting phone campaigns according to schedule; 3. Introducing a mechanism for public liability repayment of persons with claims from municipalities, other institutions or state-owned enterprises under public procurement contracts or under EU-funded projects	104.5	108.0
Exercising fiscal control of border check-points and across the country, of the points of receiving/unloading of goods of high fiscal risk.	74.6	80.0
The effect of the introduction of the reverse charge mechanism for VAT on supplies of cereals and technical crops will continue in 2015 and in 2016.	34.0	40.0
Expanding the scope of taxation of deposit interest earnings for all deposit accounts under PITL	27.5	
Repealing a tax relief of income from labour relations not exceeding the minimum wage for the previous calendar year	20	
Amendments to legislation regulating the procedure for establishment and payment of profit allowance to the state. Reducing the allowance rate for the period 2015-2017 from 70 to 60 per cent, and from 60 to 50 per cent for 2016	7.5	-39.9
Tax allowance for children and disabled children under PITL	-25.0	
Introducing a tax of 10% on additional expenses of members of parliament pursuant to Article 217a of CITL	0.6	
Impact of increasing the minimum insurance income of farmers from BGN 240 to BGN 300 as from 1 January 2015;	4.2	
Increasing the maximum insurance income from BGN 2,400 to BGN 2,600 per month	43.1	
Increasing the monthly minimum wage for the country: BGN 360 as from 1 January 2015 BGN 380 as from 01 July 2015	8	
Increasing the monthly minimum wage for the country to BGN 420 as from 1 January 2016		12.3
Changes in the minimum insurance income by main economic activities	35.4	
Total	300.4	267.0

➤ *Corporate Tax*

The forecast for corporate tax revenues (including taxes on dividends, liquidation quotas and income of resident and non-resident legal persons) is based on retaining the basic tax rate of 10 per cent, the forecast development of macroeconomic indicators, the data about losses from previous years declared by taxable persons that are subject to deduction in subsequent accounting periods, as well as on some legislative amendments.

In order to establish a uniform tax regime with regard to the income of non-resident legal persons, there is a withholding tax exemption for interest on bonds or other debt securities issued by the state and by the municipality and eligible for trading on a regulated market in the coun-

try or in an EU member, or in another EEA state, as analogous to the interest on the instruments issued by resident companies. The scope of tax exemption for deposit interest earnings has been expanded to include the earnings of non-resident legal persons from loan interest where no bonds are issued and where the state or the municipalities are borrowers.

In view of the amendments to EU competition legislation, there is an alignment of the tax relief in the form of state regional development aid and state aid for farmers, as well as of the tax relief in the form of “*de minimis aid*”. In connection to the tax relief in the form of state aid, a requirement has been introduced to apply the latter only after a positive decision of the European Commission regarding the tax relief in the form of state regional development aid or after having received a receipt from the European Commission with an identification number for the aid- for the tax relief in the form of state aid for farmers.

A tax on additional expenses of the members of parliament is introduced as from 1 January 2015. These additional expenses are regulated in the Rule of Organisation and Procedure of the National Assembly. The tax rate is 10 per cent. The members of National Assembly shall declare and remit the tax until 31 December of the relevant financial year. (Anticipated positive budgetary impact – BGN 0.6 million for 2015)

➤ **Personal Income Tax**

The forecast of the revenue under the Personal Income Tax Law (PITL) for 2015-2018 has been made upon preserving the single tax rate of 10% (with no tax-free threshold) for all taxpayers, except for the income from economic activities of sole owners for which the tax rate is 15%. It also takes into account the expected average wage growth, the projected number of employed persons, the statutory tax relief, the expected better collection of PITL taxes, as well as some legislative amendments. Personal income tax revenues also include patent tax proceeds in the municipal budgets.

As to tax relief, legislative amendments include, on the one hand, repealing of the tax relief for income from labour contracts not exceeding the minimum wage for the country that was effective in 2014, and, on the other hand, the introduction of two new forms of tax relief for children. Child allowances and disabled child allowances enable taxable persons that meet the statutory requirements to deduct an amount determined according to the number of children or a disabled child allowance from the amount of the annual tax base (Anticipated negative impact on the budget on accrual basis – (BGN -25 million) for 2015). Resulting from the repealed legislation regulating the tax relief of income from labour relations not exceeding 12 monthly minimum wages for the relevant year, the budgetary impact on accrual basis is positive, amounting to BGN 20 million in 2015.

The tax base for deposit earnings taxation of resident persons has been expanded as of 1 January 2015. Tax is already due for deposit interest earnings for all types of bank accounts, not only for deposit (term) accounts. The rate for this tax is 8 per cent for 2015, i.e. it remains unchanged according to the one effective in 2014 but is higher than the rate of 6 per cent for the period set in the law in force by the end of 2014 - anticipated positive impact on the budget amounting to a total of BGN 27.5 million for 2015.

An amendment has been passed according to which earnings from interest on bonds or other debt securities issued by the state and by the municipalities from a source in Bulgaria assessed/paid in favour of non-resident natural persons established in a third country for tax purposes where they are not realised through a given base in the country, and the bonds or

the other debt securities are issued by the state or by the municipalities and are eligible for trading on a regulated market in the country or in an EU member, or in another EEA state, shall not be subject to final tax.

➤ ***Value Added Tax (VAT)***

The forecast of VAT revenues includes an assumption for preserving the relative share of VAT proceeds in consumption. It takes account of the macroeconomic variables forecasts and the positive impact of the fiscal control of the circulation of goods of high fiscal risk on the territory of the Republic of Bulgaria and the VAT reverse charge mechanism for the supplies of cereals and technical crops introduced in the previous year. It also takes account of the amendments to the tax law.

Amendments to Article 118 of the VAT Law have been made in view of having effective control exercised by the revenue agencies on the entire process of supplies and circulation of liquid fuels from producers and importers to final consumers, preventing tax evasion and non-payment of taxes and avoiding the appearance of unjustified liquid fuels at petrol stations and at other fuel storage sites. The order of registering and reporting of refuelling already covers taxable persons (different from a budget organisation within the meaning of the Public Finance Law and a municipal enterprise not selling liquid fuels) that refuel liquid fuels for their own needs.

The major amendments to the VAT Law aim to align national legislation with the requirements of Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services (Directive 2008/8/EC). According to the requirements of this Directive, as from 1 January 2015, the supplies of telecommunications services, radio and television broadcasting services and electronically supplied services delivered from taxable persons to non-taxable persons established in the European Union shall be subject to tax in the state where the recipient is established, has his permanent address or usually resides. The amendments to the law regulate two servicing regimes of the mini one-stop-shop type for suppliers aiming to alleviate taxable persons in fulfilling their VAT obligations. These regimes enable the persons to determine a state, called member state of identification, through which they will fulfil, in an electronic way, all their obligations of registration, declaration and remittance of value added tax due for their supplies. These regimes are not obligatory and it is up to the supplier to choose whether to apply them or not.

The part of the VAT Law regulating the special regime referring to investment projects complies with the requirements of Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid (Regulation (EU) No1407/2013). The higher requirements to persons in some cases may appear to be an obstacle to using the special order, which would mean assessment and payment of the tax as early as at the time of import rather than through a subsequent inclusion in the VAT returns.

A positive impact is projected for 2016 for VAT revenues from the increase in excise duty rates for cigarettes in accordance with the schedule set in the Excise Duties and Tax Warehouses Law. (Anticipated positive impact on the budget - BGN 11 million for 2016)

➤ *Excise Duties*

When making the excise duty revenue forecasts, the positive impact of the enhanced control over trading in excisable goods has been taken into account in addition to the macroeconomic indicators.

In accordance with Council Directive 2011/64/EU of 21 June 2011 on the structure and rates of excise duty applied to manufactured tobacco, from 1 January 2014 the overall excise duty on cigarettes shall represent at least 60% of the weighted average retail selling price of cigarettes released for consumption. This excise duty may not be lower than EUR 90 per 1,000 items, regardless of the weighted average retail selling price. Council Directive 2011/64/EU specifies that Bulgaria shall be allowed a transitional period until 31 December 2017 in order to reach the minimum excise duty on cigarettes by being recommended to gradually increase excise duties. In this connection, a provision has been adopted containing the relevant schedule of increasing the excise duty on cigarettes in the period 2016-2018 to reach, as from 1 January 2018, the minimum level of EUR 90 per 1,000 items (BGN 177 per 1,000 items or BGN 3.52 per box). (Anticipated positive impact on the budget - BGN 55.6 million for 2016)

➤ *Tax on Insurance Premiums*

The forecast of the amount of revenue from tax on insurance premiums takes account of the preserved rate of 2% and of the trend of expanding and enriching of insurance products, as well as of the dynamics of increasing gross premium proceeds in general insurance. The amendment to the law referring to the regime of declaration and remittance of the tax on insurance premiums has been taken into account. The tax shall be declared by submission of a quarterly return and shall be paid by the end of the month following the calendar quarter. In accordance with the provisions effective until 31 December 2014, the tax on insurance premiums shall be declared by the submission of a monthly return and shall be paid by the end of the following month.

II. Measures for Improving Collection and Addressing Shadow Economy

In the context of implementation of the specific Council recommendations to Bulgaria, the following legislative and administrative measures have been taken:

➤ *Measures taken by NRA to increase revenues:*

- 1. Measures in the area of collection of overdue liabilities are described in details in item 6.3 of the Convergence programme 2015-2018 r**
- 2. Fiscal control measures.**

The fiscal control over goods of high fiscal risk that has been introduced since the start of 2014 aims to protect the fiscal stance and to prevent evasion of VAT, corporate taxes and personal income taxes, as well as to limit unfair competition and to protect Bulgarian manufacturers of goods of high fiscal risk. The circulation of all goods of high fiscal risk, regardless of the place of receiving/unloading of goods, i.e. the territory of the country, the territory of another EU member state or of a third country, is subject to fiscal control, i.e. fiscal control covers intra-Community acquisitions, intra-Community supplies, goods crossing the territory of the country from one EU member to another and domestic supplies.

As a result of the fiscal control exercised, there is a growth by 11.7% for 2014 compared to 2013 of collaterals imposed on tax and social insurance contributions, the trend for 2015 being

to increase the direct effect from this activity. There are plans for opening in 2015 new fiscal points at border check points, as well as for adding new goods to the list of goods of high fiscal risk. The long-term benefits are increasing VAT revenues, limiting unfair competition and a corrective to the domestic market of goods of high fiscal risk.

The fiscal control over goods of high fiscal risk that has been introduced since the start of 2014 aims to protect the fiscal stance and to prevent evasion of VAT, corporate taxes and personal income taxes, as well as to limit unfair competition and to protect Bulgarian manufacturers of goods of high fiscal risk. The circulation of all goods of high fiscal risk, regardless of the place of receiving/unloading of goods, i.e. the territory of the country, the territory of another EU member state or of a third country, is subject to fiscal control, i.e. fiscal control covers intra-Community acquisitions, intra-Community supplies, goods crossing the territory of the country from one EU member to another and domestic supplies.

The overall assessment of the establishment of NRA's Fiscal Control Directorate and of exercising fiscal control is a growth in the declared tax base for intra-Community acquisitions by 20.07% for 2014, or BGN 373 million more than the previous year, 2013. An additional net effect of BGN 74.6 million is expected for 2015 and of BGN 80.0 million for 2016.

3. VAT reverse charge mechanism

The effect of the introduction of the reverse charge mechanism for supplies of cereals and technical crops will continue in 2015 and in 2016. The anticipated positive impact on the budget amounts to around BGN 34.0 million for 2015 and around BGN 40.0 million for 2016.

The overall additional net impact of the above measures for the revenues is BGN 213.1 million for 2015 and BGN 228.0 million for 2016. These additional impacts have been included in the anticipated performance of revenues collected by NRA for 2015 and in the 2016 revenue estimate.

In addition, the underlying measures taken to increase revenues from mandatory social insurance contributions are as follows:

- ▶ binding data from template 1 and template 6 returns (from 2014) – anticipated annual impact of BGN 200 million;
- ▶ criminalising the failure to pay social insurance contributions (from 2015).-09-HQ

Managing the risk of non-compliance of tax and social security legislation

NRA works on the implementation of a *Compliance and Risk Minimisation Programme for 2015*, with a total of 14 risks being subject to treatment according to the endorsed programme of control actions²³. Joint actions with some bodies of the National Customs Agency are planned in connection with the following three risks: 1) Incomplete accounting of revenues from sales by traders in solid, liquid and gaseous fuels; 2) Incomplete accounting of revenues from selling tobacco products by liable persons carrying out activities of whole sales and retail sales of tobacco products and 3) Decreasing tax liabilities by failing to account the full amount of income generated in pubs.

²³ There are plans for sending 11,400 letters, making 1,660 audits, 1,415 operational observation inspections, 375 inventories, 1,210 operational checks and 255 fact-and-circumstance-finding inspections in connection to the risks identified.

A total of 13 specific risks were subject to NRA treatment in 2014. At tactical level (risks manifested in a certain way for all or for a very large group of persons), the effect achieved as a result of treatment over the last 7 years is BGN 159 million, which is a 25% drop from the damage that would have occurred in 2014, if the risks had not been treated in the prior periods. The difference between the number of persons at risk in case no treatment had been administered and when reporting the treatment is 48 thousand persons, which accounts for 27% of the total number of persons at risk that would have existed over the period under assessment in case no treatment had been administered. At operational level (a specific group of persons), the effect achieved as a result of treatment over the last 7 years is BGN 291 million, or a 36% drop from the damage in 2014 compared to the damage that would have occurred in the same period, if the risks had not been treated. The difference between the number of persons at risk in case no treatment had been administered and when reporting the treatment is 12 thousand persons, which accounts for 12% of the total number of persons at risk that would have been active in the period under assessment in case no treatment had been administered.

4. Prevention and counteraction to tax and social insurance fraud

- ▶ Continued monitoring of liable persons with considerable contribution to the revenue side of the budget or with considerable influence on the country's economic growth in order to achieve effective dialogue between representatives of the revenue administration and the businesses so as to make corrections to some inaccurate behaviour by giving guidance and making clarifications of possible negative consequences;
- ▶ Continued monitoring of the behaviour of large foodstuff retailers to prevent the risk from engagement into tax fraud and abuse schemes aimed at gaining illegal competitive advantage through lower prices of mass foodstuffs, as well as timely taking of preventive measures against them when finding clues for departure from normal commercial practice; and
- ▶ Regular monitoring, information analysis and performing of control actions, including jointly with the Fiscal Control Directorate and other control bodies, such as the Bulgarian Food Safety Agency, the Directorate for National Construction Control, the National Security Agency, the Ministry of Interior, the Public Prosecutor's Office, for the following industries: meat, sugar, fuels, construction and manufacturing and processing of ferrous and non-ferrous metals.

▶ *National Customs Agency*

The improvement of the Bulgarian Excise Centralized Information System (BECIS), aimed at automated control of persons producing and selling excisable goods continued in the past year. The interaction between the National Customs Agency (NCA) and the National Revenue Agency (NRA) has been strengthened with regard to the control of persons performing activities with excisable goods on the basis of the information in BECIS and in NRA's Fuel Control Information System. The Central Customs Directorate of NCA and the NRA Headquarters organised joint inspections of persons trading in manufactured and unmanufactured tobacco, as well as in tobacco refuse supposed to be participating in tax fraud schemes. NCA and NRA officers enhanced their joint control in the sites for trading in liquid fuels and, as a result, violations within the competence of both administrations have been found, as well as over 350 thousand litres of fuels of unknown origin and with unpaid excise duty. The unit dealing with excise control within the structure of the Customs Intelligence and Investigation Directorate of

the Central Customs Office has played a significant role in the organisation and coordination of joint inspections, in the risk analysis and in the selection of sites for inspection. The customs mobile team officers have had major contribution to the physical control and efficiency of inspections.

The official tests and introduction of the *System for Exchange of Risky Information (SERI)* are forthcoming. The system has been set up to automatize the process of collecting and processing of risky information. The basic modules of SERI are the Risky Information module, the Inspections module and the Pre-Trial Proceedings module. The information from the System for Registration of Physical Inspection Protocols of the National Customs Agency has been transferred to SERI and it incorporates the data available from the system for combating drug trafficking, SERI 1 (first iteration) and the administrative violation acts. After the system is finally introduced, it will accumulate, store and exchange information for the purposes of risk analysis, will document the results from the control activities and will support the work of the operational control units.

The performance of regular activities is of utmost importance for ensuring the uninterrupted working capacity of the national systems, as well as of the systems ensuring connection with the EU - Communication Centre for Connection with the EU Systems, New Computerised Transit System (NCTS), Export Control System Phase 2, Import Control System Phase 1, System for Economic Operators Registration and Identification System, Integrated Tariff Management System and Excise Movement and Control System.

Changes have been carried out to the Calculation Module of *TARIC* in connection to the entry into force of legislative amendments at EU level. The New Computerised Transit System (NCTS), the Export Control System and the Import Control System have been improved in accordance with the latest amendments to the Commission's Functional Specifications. The amendments were put in real operation with the versions from December 2014.

The functionality of BECIS was upgraded in 2014 by elaborating and putting into operation of a module for processing of vouchers for agricultural producers, the exchange of information with the NRA system was improved, as well as the integration with the other systems of NCA. A new version of the System for Exchange of Excise Data (SEED) was implemented in December 2014.

With the successful closure of OPAC projects three new modules of the Bulgarian Integrated Customs Information System (BICIS) were implemented, i.e. Automated Information System for Monitoring of Administrative Proceedings and Tracking of Court Appeals (MAP), Decisions for Taxation Elements and Post-clearance Control. The projects aim to improving the services delivered to citizens and business and to enhancing their trust in the customs authorities through upgrading of BICIS, refining of information systems, introducing of e-government principles and improving organisation of the working processes.

The MAP module will assist in implementing of the fundamental business processes, such as registration of individual administrative acts, appeals to a decisive body, appeals to a court of first instance, appeals to the instance of cassation, monitoring of files (text search, search of individual administrative acts, queries, tracking of deadlines), handling of documents in the court phase (handling of file documents, participation in hearings, registration of representatives), suspension of provisional enforcement, registration of new ruling of a competitive body.

The purpose of the Solutions for Taxation Elements module is to optimise and improve the quality and efficiency of the administrative processes in the National Customs Agency by enabling the real-time tracking of changes and to strengthen the administrative capacity of the Bulgarian customs administration. The module ensures the maintenance of up-to-date data in BICIS for the purposes of making queries and submission of correct information to the information systems integrated by BICIS.

The introduction of the Post-clearance Control module allows the automation of activities performed by the specialised units of the National Customs Agency that carry out post-clearance inspections. The efficiency of planning and inspections of the post-clearance control units will thus improve and the receipt of full and trustworthy information will thus be optimised.

The electronic gateway of the National Customs Agency has been refined - the basic e-services have been integrated into a single gateway on a single technological platform with a single point of entry for economic operators.

Automated Information System for Document Management and Administrative Activities has been realised, which automated processes of the Agency's document turnover, with a gateway for administrative e-services for citizens and businesses. Expansion of the administrative e-services delivered and the upgrading of the Automated Information System for Document Management and Administrative Activities continues with the implementation of 13 new administrative e-services for citizens and businesses that are to be implemented by the middle of 2015.

The National Customs Agency will implement the single information and communication platform for exchange of data with other government institutions under an OPAC-funded project. The outcome of this project is to implement the platform and to apply in practice the exchange of data with the Bulgarian Food Safety Agency. The project will be finalised in the middle of 2015.

The National Customs Agency has started preparing the development of information systems related to the application of the Customs Code of the EU. An important stage of this preparation is the implementation of a project funded by OPAC, the key results of which are the development and introduction of an architecture of information and technological services, processes and infrastructure of the National Customs Agency and development and introduction of a Customs Exporting Information System in line with the corporate architecture developed. The implementation of this project will lay the basis for the development of new systems and will result in the refinement of the existing ones in accordance with EU requirements. ▼

4. SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS UPDATE

4.1 Alternative scenario: higher growth of the European economy

The alternative scenario has been prepared on the assumption of a higher growth of the European economy in 2015 and to a higher degree in 2016 as a result of the measures taken in the EU, such as the announced by the ECB expanded asset purchase programme (the so-called quantitative easing), introduction of an EU investment plan and successful implementation of structural reforms. In its winter forecast the European Commission also increased its expectations of the GDP growth of the EU as a result of the impact of the above-mentioned measures.

Fig. 4-1: Comparison between the baseline and the alternative assumptions

	2015		2016		2017		2018	
	Alternative scenario	Difference compared to the baseline scenario, pp.	Alternative scenario	Difference compared to the baseline scenario, pp.	Alternative scenario	Difference compared to the baseline scenario, pp.	Alternative scenario	Difference compared to the baseline scenario, pp.
EU GDP (real growth, %)	1.8	0.2	2.2	0.4	2.3	0.4	2.3	0.4

Source: MoF

With the stronger acceleration in the economic activity in the EU, a more substantial improvement in the external demand is expected and an increase in the Bulgarian export to EU Member States, respectively, as against the baseline scenario. The overall export of goods will accelerate to 3.4% in real terms (nominal growth of 4.8%) in 2015. There will be a stronger impact in 2016 and the growth rates will reach respectively 4.2% and 6.6% in real and nominal terms. The improved external environment and the rising export revenues will have a positive influence on domestic demand. The improved consumer confidence and higher employment will contribute to an accelerated growth of final consumption by 0.1 pp in 2015 and 0.5 pp in 2016 as compared to the baseline scenario. As a result, the growth of the Bulgarian economy is expected to speed up by 0.1 pp and by 0.3 pp in 2015 and 2016 respectively, as compared to the baseline scenario.

The more raw materials required for the export-oriented sectors along with the accelerated growth of domestic demand will result in higher import of goods, the growth of which will rise

to 4.3% in real terms and 4.8% in nominal terms in 2015 and to 5.2% and 7.4% in 2016, respectively. As to the services, an increase in the growth rates of all items is expected but this will not have a considerable impact on the net balance. The influence on the income and current transfers balances will be negligible. As a result, the more favourable dynamics of the external environment will lead to a minimal improvement in the current account to 0.3% of GDP in 2015. In 2016, when the impact of domestic demand on import will be more sizable, the current account deficit will deteriorate to 0.5% of GDP.

Fig. 4-2: Effects on the main macroeconomic indicators

Real growth rates	2015		2016		2017		2018	
	Alternative scenario, %	Difference compared to the baseline scenario, pp	Alternative scenario, %	Difference compared to the baseline scenario, pp	Alternative scenario, %	Difference compared to the baseline scenario, pp	Alternative scenario, %	Difference compared to the baseline scenario, pp
GDP	1.5	0.1	2.0	0.3	2.5	0.2	2.3	0.2
Final consumption	2.1	0.1	3.1	0.5	3.2	0.2	2.8	0.2
Export of goods	3.4	0.4	4.2	0.7	4.5	0.7	4.7	0.7
Import of goods	4.3	0.3	5.2	0.8	5.4	0.6	5.4	0.6
Current account balance (% of GDP)	0.3	0.03	-0.5	0.1	-1.0	0.02	-1.5	0.0
Harmonised inflation, annual average	-0.6	0.02	1.9	0.13	1.9	0.06	2.0	0.06
Employed, %	0.3	0.0	0.7	0.2	1.0	0.1	0.5	0.0

Source: MoF

Due to the still slow recovery of the labour market, the expected positive influence of the higher external demand on the overall domestic economic activity in 2015 will not contribute substantially to improving the situation on the labour market, as compared to the baseline scenario. With the gradual strengthening of the impact of higher export on the domestic environment and the more rapid increase in the domestic demand, the improvement in the employment dynamics is expected to be more tangible in 2016 and 2017, with the differences being 0.2 and 0.1 pp for the two years.

The higher domestic demand, on its turn, will result in a higher inflation rate, with a more tangible impact expected in 2016.

4.2 Sensitivity of budgetary projections to different scenarios

– Sensitivity of the budgetary projections to the alternative scenario

The changes in the structure and pace of economic recovery of the Bulgarian economy significantly affect the fulfilment of the planned medium-term fiscal objectives and parameters. Despite the fact that in the alternative scenario of accelerated growth of the economic activity of the EU the impact comes mainly from export dynamics, the growth rate of almost all GDP components is higher than the baseline scenario. The domestic demand dynamics, particularly final consumption, has a considerable impact on the revenue side of the budget taking into account the high share of indirect taxes in the overall tax proceeds.

With the alternative scenario, the positive impact on consumer confidence and import of goods and services is limited in 2015, but is expected to be more sizable in 2016. Therefore the improvement in the indirect tax dynamics as compared to the baseline scenario is higher in 2016, while the impact in 2015 is rather small. An increase in comparison to the baseline scenario is also expected in the revenues from direct taxes and social security contributions as a result of the positive impact of higher economic activity on the labour market, with a more considerable rise in proceeds again expected in 2016 and in the subsequent years.

Upon preserving the overall budget expenditures at the level of the baseline scenario no changes are expected in 2015 in the general government deficit of 2.8% of GDP, while in the coming years the higher budget revenues will allow an acceleration of the process of fiscal consolidation and a decrease of the budget deficit to 2.2% of GDP in 2016 and 1.5% of GDP in 2017.

– Sensitivity of debt upon any changes in the levels of exchange rates and interest rates on international markets

The current structure of the consolidated general government debt in terms of its composition with regard to market indicator levels (*exchange and interest rates*), does not imply any significant influence of both its nominal value and of the amount of funds required for debt service. Based on estimate data, the share of debt denominated in currencies other than EUR and BGN is expected to be within 1% over the 2015-2018 period. The share of debt with floating interest rates is also expected to remain comparatively low in the period under consideration, varying between 3.5-1.7%, which, in turn, results in a minimum interest rate risk in case the leading central banks raise the interest rates. In this respect, the expected increase in the basic interest rate from the US Central Bank will not affect government debt interest payments due to its negligible part, the share of which is calculated in USD on the basis of the 6-M LIBOR.

4.3 Comparison with the previous programme

The growth of the Bulgarian economy in 2014 was lower than the one expected in the previous Convergence Programme as a result of the weaker export of goods and services, mainly export to third countries. At the same time, both consumption and investment performed better than expected, which exerted pressure towards increasing import. The fiscal stimuli through increased budget expenditures for social and health insurance payments and the co-financing costs in connection to the accelerated absorption of EU funds contributed to the stronger domestic demand. Weak export and the favourable domestic demand dynamics resulted in a negative contribution of net import of 1.1 pp, against a positive contribution of 0.3 pp project-

ed in the previous Convergence Programme. The reported development of the Bulgarian economy in 2014, as well as the modified assumptions for the development of the external environment, the international prices and the exchange rate required a revision of the medium-term macroeconomic forecast of the Ministry of Finance.

The weaker GDP growth in 2015 and 2016 as compared to the previous Convergence Programme is due to the lower private consumption and investment, as well as to the planned weaker increase in public consumption and investment for the purposes of having lower budget deficits over the forecast period. Despite the change in the levels of export and import growth as a result of the data reported for 2014, the negative contribution of net export remains at levels close to those expected in the previous forecast.

Fig. 4-3: Main macroeconomic indicators

Real growth rates	2014			2015			2016		
	CP 2015	CP 2014	Difference, pp	CP 2015	CP 2014	Difference, pp	CP 2015	CP 2014	Difference, pp
GDP	1.7%	2.1%	-0.4	1.4%	2.6%	-1.2	1.7%	3.4%	-1.7
Final consumption	2.4%	1.5%	0.9	2.0%	2.9%	-0.9	2.6%	3.9%	-1.3
Gross fixed capital formation	2.8%	2.1%	0.7	1.8%	4.3%	-2.5	1.5%	5.4%	-4.0
Export of goods and services	2.2%	6.9%	-4.6	2.8%	5.9%	-3.0	3.1%	6.1%	-3.0
Import of goods and services	3.8%	6.3%	-2.5	3.6%	6.6%	-3.0	4.0%	7.1%	-3.1

Source: MF



5. SUSTAINABILITY OF PUBLIC FINANCE

5.1 Policy Strategy

This chapter is analysing the fiscal position by evaluating the current status of public finance by taking into account the future increase in age-related public expenditures. The sustainability indicators S1 и S2, calculated under the methodology elaborated by the Commission, are used for this purpose²⁴. The medium-term fiscal sustainability indicator (S1) shows the adjustment to the primary structural budget balance ensuring a level of government debt of up to 60% of GDP in 2030. The long-term fiscal sustainability indicator (S2) shows the adjustment to the current primary balance so as to preserve the intertemporal budget constraint (the discounted value of the future primary structural balances should cover the current debt level) over infinite horizon including additional age-related costs. The positive value of the indicators means a need for fiscal consolidation or structural reforms to reduce the burden of the ageing population on public finance.

Fig. 5-1: Comparison between sustainability indicators under the old and the new Programme scenario

	Programme scenario 2014		Programme scenario 2015 ²⁵	
	S1	S2	S1	S2
Value	-1.97	0.99	-1.0	3.1
of which:				
Initial budgetary position	-0.5	-0.01	1.6	2.3
Debt ceiling	-0.83	-	-2.0	
Future changes in the budgetary position	-0.62	1.00	-0.6	0.8

Source: MoF

The estimates of the Ministry of Finance show that the value of the S1 indicator for 2015 is negative, which according to the Commission's reference values²⁶ means low fiscal sustainabil-

²⁴ Chapter 8 of Fiscal Sustainability Report 2012. EUROPEAN ECONOMY. 8/2012

²⁵ The assessment of fiscal policy sustainability is strongly dependent on the prospects for long-term development of the economy. The basic parameters used in this scenario are shown on Table 7 of Annex A. They have been developed by the Ministry of Finance on the basis of the long-term assumptions and methodology set in The 2015 Ageing Report. The existence of differences between the long-term macroeconomic scenario released in the Report and in the present Convergence Programme is justified by the different medium-term forecasts used to start calculations. The MoF scenario is based on the forecast in this Convergence Programme (2015-2018), while the one in the Report is based on the Commission's 2014 Spring Forecast.

²⁶ Reference values set in the Fiscal Sustainability Report 2012 that show the level of risk for public finance sustainability: S1<0 - low risk; 0<S1<3 – moderate risk; S1>3 – high risk; S2<2 – low risk; 2<S2<6 – moderate risk; S2>6 – high risk.

ity risk in the medium term. The only component with negative impact on the indicator is the initial budgetary position but government policies are aimed at a reduction in the negative budget balance which will ensure public finance sustainability and debt level below 60%. As far as the S2 indicator is concerned, its value of 3.1% corresponds to a medium fiscal sustainability risk and shows that a policy of budget surpluses in the long run is needed. An adjustment to both the initial budgetary position (2.3 pp) and to the ageing expenditure component (0.8 pp) is required. The demographic changes related to a drop in the working-age population represent a main challenge for public finance in the long run and in order to reach a more optimal sustainability, consistent and constructive measures in the area of social security, healthcare and education need to be taken.

5.2 Long-term budgetary prospects, including the implications of ageing populations

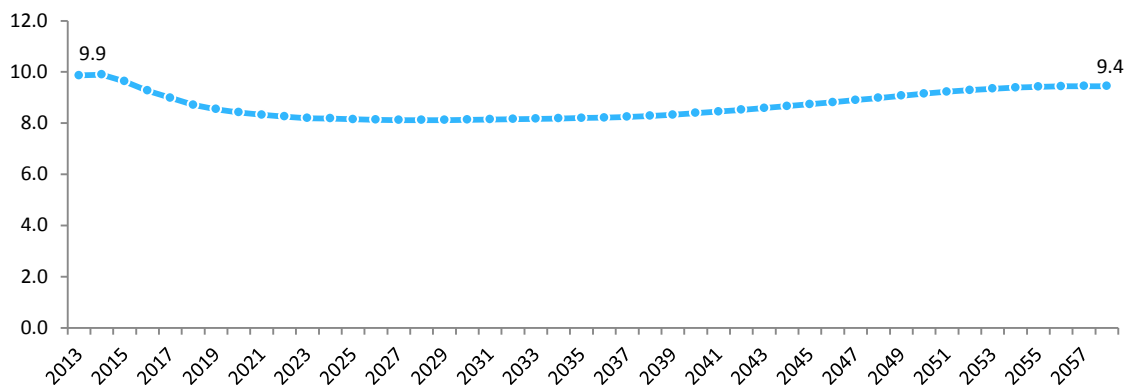
The long-term budgetary forecast for the development of the pension system is based on the following assumptions and policies in the area of pensions:

- From 2014 the so-called “Swiss rule” on pensions’ indexation is re-introduced, according to which from 1 July each year pensions will be indexed by a percentage equal to the sum of 50% of the CPI and 50% of the growth of the average insurance income for the previous calendar year;
- In 2015 the requirements for retirement age for entitlement to length-of-service pension and the age will be kept at the levels reached in 2014. The required years of service for men and women increase by 4 months;
- In 2015 a final decision is to be taken on the further increase of the retirement age;
- In 2015 a decision is to be taken on the possibilities and conditions for early retirement;
- In 2015 a decision is to be taken on the social security contribution and the social security contribution to the second pillar of the pension system (universal pension funds).

The long-term budgetary forecast of the development of the pension system is based on current (2015) pension legislation and on the provisions of the Social Insurance Code. When preparing the pension expenditure forecast, the latest Eurostat demographic projections EUROPOP 2013 and the macroeconomic forecast developed by the Ageing Working Group (AWG) to the Economic Policy Committee of the European Commission in connection with the 2012 update of the Ageing Report (“2015 Ageing Report”) were used. The NSSI actuarial model for long-term forecasting of PSI funds was used as a tool.

The figure below shows the estimated results in terms of the public pension expenditures as a share of GDP in the period 2015–2060.

Fig. 5-2: Figure Pension expenditures as % of GDP, 2013 - 2060

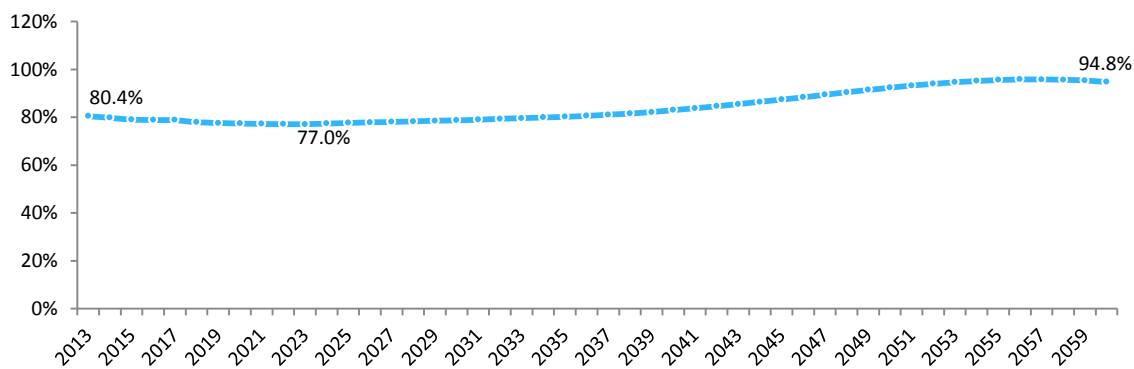


Source: NSSI

The estimated results on the basis of the latest amendments to pension legislation show a certain constraint of pension expenditure as a share of GDP in the first half of the forecast period, reaching its lowest levels of 8.1% in the period 2026 –2030. In the second half of the period, as a result of the ageing population and the increasing life expectancy in Bulgaria, the fiscal pressure on the Bulgarian pension system increases again, with the share of pension expenditures in GDP reaching 9.4% in 2060²⁷.

The ageing population and the increasing life expectancy, on the one hand, and the decreasing number of working age population, on the other hand, significantly affect the public social security system in the long term. In 2013 a hundred socially insured individuals corresponded to 80 pensioners. There is an improvement in the dependency ratio in the next couple of years²⁸, because of the projected lower number of newly granted pensions in those years due to the increase in the retirement age and in the length of service, the limitation of early retirement, as well as due to the existence of incentives for longer presence of older workers on the labour market. There is an upward trend of the dependency ratio after 2023 due to the ageing population, the increasing average life expectancy and the decreasing number of employed persons, with 95 pensioners expected to correspond to 100 insured persons in 2060.

Fig. 5-3: Number of pensioners to number of socially insured individuals (dependency ratio) 2013-2060



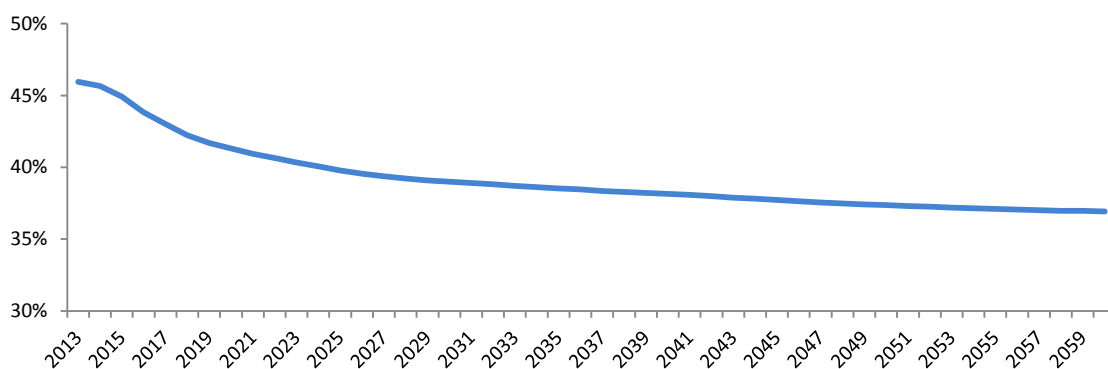
Source: NSSI

²⁷ The results are from the 2015 Ageing report.

²⁸ The ratio between the number of pensioners and the number of socially insured people

The upward trend of the dependency ratio is accompanied by a long-term downward trend of the replacement rate²⁹. The replacement rates for the first pillar are expected to decline due to the gradual linking of the amount of the pension with the contribution over the whole working life, not only in the last years. Another reason for the lower replacement rate for the first pillar in the long term is the decrease in the amount of the pension for the individuals insured in the second pillar as well. The amount of this decrease depends on the insured period in both pillars and the amount of the social security contribution which is transferred from the first to the second pillar.

Fig. 5-4: Average pension to average insurance income (replacement rate), 2013-2060



Source: NSSI

The recovery of the so-called “Swiss rule” on pensions’ indexation from 2014 has a favourable effect on the replacement rate – in the long run it increases the latter by about 2.5 pp compared to an indexation only with inflation. However, the gross replacement rate decreases from 46% in 2014 to around 37.0% in 2060.

As in Bulgaria pensions are not subject to taxation, a clearer idea of how much income they replace is given by the net replacement rate (the ratio between the average pension and the average net insurance income) which is higher by about 12 pp – 57.9% is the reported net replacement rate for 2014 and until 2060 the value of this indicator decreases to about 49%.

In the long term, factors such as an increased average life expectancy, ageing population and a reduced number of employed persons would exert an increasingly stronger impact on the public pension system and put the financial stability of the Bulgarian social security system to a test. At the same time, the above factors lead to a significant decrease in the replacement rate under the first pillar. The three-pillar pension model favours the improvement in the replacement rate. The future adequacy of pensions, in this sense, would largely depend on the extent to which the second and the third pillar would be able to improve the income of the future pensioners.

²⁹ The ratio between the average pension and the average contributory income for the country

4.3 Proposals for improvement of the pension model and development of the pension system

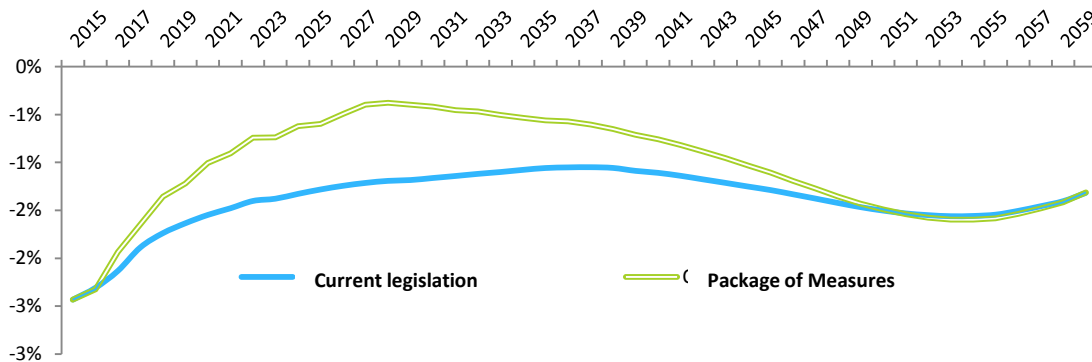
On 31 March 2015 the Vice Prime Minister and Minister of Labour submitted proposals developed by a working group for improvement of the pension model and development of the pension system. The key aim of the proposed changes is to increase the financial stability of the pension system and to improve the adequacy of pensions. At this stage the proposals are under discussion and the government has set the summer of 2015 as a deadline for their adoption. The changes in the pension system are described in detail in the National Reform Programme.

The table below summarizes the main financial effects of some changes on the PSS budget for the year in which those are to enter into force.

Proposal	In force from	Financial effect in comparison with the current legislation for the respective year
The persons short of up to 12 months of the required age to be granted a reduced pension, with the pension being reduced by 0.4% for each month of insufficient age	01.01.2016	An increase of pension expenditures by around BGN 32.0 million for 2016
The amount of the minimum insurance income for farmers to be gradually made equal to the minimum insurance income for self-insured persons from BGN 300 to BGN 420	01.01.2016	An increase of revenues by BGN 5.6 million for 2016
A smooth increase of the insurance contributions for the Pension Fund by 3.5 pp. and for the Unemployment Fund by 1 pp. from 01.01.2017 to 2028.	01.01.2017	The accumulated effect of the increase of PSS revenue for the whole period is around BGN 10.2 billion.

The figure below shows the impact of the package of proposals on the balance of PSS Funds for the period 2015 – 2060.

Fig. 5-5: Balance of PSS Funds as a % of GDP for the period 2015–2060



The baseline scenario is prepared according to the parameters of the current legislation (in force as of April 2015). The option “Package of Measures” shows the cumulative effect of the following proposals for changes in the pension insurance legislation:

- Gradual increase of the social security contribution for the “Pension Fund” and the “Unemployment Fund” in the period 2017- 2026 by 4.5 pp. totally.
- Gradual increase and equalization of the standard retirement age of men and women in 2037 at the age of 65 and then introduction of an automatic mechanism to changes in life expectancy.
- Increase of the insured length of service for retirement under the normal labour conditions by 2 months annually till reaching the age of 40 for men and 37 for women in 2027.
- Gradual increase of the retirement age in case of shortage of insured length of service for men and women to the age of 67 and increase in the required insured length of service till reaching 15 years actual length of service for men and women.
- Introduction of possibility for granting a reduced pension for persons short of up to 12 months of retirement age, with the pension being reduced for the lifetime by 0.4% for each month of insufficient age.
- Gradual increase of the retirement age for the category workers till the age of 57 for workers in first category and the age of 62 for workers in second category ;
- As of January 2016 introduction of a minimum retirement age for the military personnel and the state officials under the Law on Interior of the age of 52 and 10 months and its gradual increase by 2 months annually till the age of 55.
- As of January 2017 increase of the weight of 1 year insured length of service in the pension formula (as for the newly granted pensions as well as for those already granted), till reaching the coefficient of 1.5%.

The results of the long-term forecast show that in both cases the system will have a deficit during the whole period 2015-2060, which in the beginning of the period is estimated to be 2.4% of GDP. After 2015 the implementation of the proposed measures for improving the pension model and development of the pension system is expected to result in significant improvement of the balance of PSS Funds, which will continue till 2029 when the deficit will reach its lowest level of around 0.4% of GDP. In the period 2027-2033 the deficit remains below 0.5% of GDP, after which it will start to increase reaching around 1.5% of GDP at the end of the forecast period.

The most significant positive impact on the expenditures for pensions and thus on the balance of PSS Funds will come from the increased insurance contributions and the limited opportunities for early retirement of workers in first and second category, as well as the requirement for completed age for the retirement of the personnel of the Ministry of Defence and Ministry of Interior.

Factors as the longer average life expectancy, aging of the population and decrease in the number of employees will influence stronger the state pension system in a long term period. In spite of the positive effect of the proposed package of measures on the balance of the PPS

Funds at the end of the period the results from both options coincide. This is due to the higher amount of pensions provided by the package of measures, where the weight of each year of length service in the pension formula reaches 1.5 and is applicable to all pensions (both newly granted pensions and pensions already granted), while in the Current Legislation Option the weight goes up from 1.1 to 1.2 in 2017 only for the newly granted pensions.

5.3 Contingent Liabilities

The government guaranteed debt of the general government sector as of end-2014 was 0.6% of GDP. The sector of “Energy” has a dominating share of 81% in the government guarantees’ structure by sectors. As regards the currency composition of the government guaranteed debt, the share of BGN- and EUR-denominated loans is 63.5%, of YEN-denominated ones – 35.5%, and of USD-denominated debts – 1%.

The 2015 State Budget Law provides for the possibility of issuing government guarantees to the maximum amount of BGN 3.157 billion. These reflect the government priorities in key areas such as the provision of support to the financial sector and the promotion of investments in the economy through the Bulgarian Development Bank, namely:

- In accordance with the Bank Deposits Guarantee Law under loans from foreign lenders, in a total amount of up to EUR 900 million (BGN 1.76 billion) under the condition of subsequent ratification;
- During the current fiscal year the Council of Ministers may approve and propose to the National Assembly the issuing of government guarantees for new external loan agreements of the Bulgarian Development Bank under the Bulgarian Development Bank Law up to the equivalent of BGN 1.0 billion in foreign currency while observing the legislation in the field of state aid.

The other funds for provision of government guarantees are envisaged for loans extended under the Crediting of Undergraduate and PhD Students Law, for funding the “Gas Interconnection Greece-Bulgaria” project, etc.

As regards the issuing of new government guarantees, in the medium term the government will continue to pursue a consistent analytical approach and to take into account the level of their effectiveness and importance for the economic development of the country, while exercising constant monitoring of both the servicing of government guaranteed loans, and the financial condition of borrowers. ▼

6. QUALITY OF PUBLIC FINANCES

6.1 Policy Strategy

The policy strategy in the area of the quality of public finances is related on the one hand to strengthening the practices of implementation of the Public Finance law (PFL), and on the other hand - to the continuing process of improvement programme-oriented budgeting. The key objectives are to increase the quality of public finance management by executing the budgetary process in accordance with the Public Finance Law, adhering to the fiscal rules and limitations, exercising constant monitoring of the impact of the budgetary legislation and its improvement, as well as implementing the best budgetary practices.

In this connection one of the key challenges will be the establishment of a system of applicable budgetary practices and standards for PFL implementation and the preparation of standards and unified forms of documents and acts of the relevant authorities related to the application of specific provisions of the PFL.

In view of improving the efficiency of public expenditures, the Ministers responsible for the relevant sector policies should commit to implement programmes for structural and functional reforms in the relevant sectors, covering the period until 2017, in accordance with the expenditure ceilings approved with the last medium-term budgetary framework for the period 2016-2018. The programmes should also include a system of performance indicators which are to measure and assess the level of achievement of the planned target values under the efficiency indicators.

In order to improve the processes of strategic planning and development of the national policies in line with the government priorities and the possibilities for their funding, there is a legal requirement for establishment of a sustainable classification of expenditures by areas of policies and budget programmes. The first-level spending units that apply programme budgeting (Council of Ministers, Ministries, state agencies and State Fund "Agriculture") should prepare their budgetary forecasts for the period 2016-2018 on the basis of the adopted by a Council of Ministers' Decision classifier of expenditures by areas of policies and budget programmes within the competence and under the responsibility of the relevant first-level spending unit, thus ensuring continuity and consistency of the policies and budget programmes implemented by them.

6.2 Composition, efficiency and effectiveness of expenditure – COFOG

Figure 6-1: Budget expenditure by function - % of GDP

	% of GDP		% of the total budget expenditure	
	2013	2018	2013	2018
1. General public services	4.2	4.4	11.1	11.9
2. Defence	1.2	1.0	3.2	2.6
3. Public order and security	2.7	2.2	7.0	6.0
4. Economic activities	5.0	5.5	13.1	14.8
5. Environmental protection	1.0	1.5	2.6	3.9
6. Housing and community amenities	1.3	1.2	3.5	3.1
7. Health care	4.6	4.6	12.1	12.3
8. Recreation, culture and religion	0.8	0.6	2.0	1.6
9. Education	3.8	3.3	9.8	8.9
10. Social protection	13.7	13.1	35.7	35.1
11. Total expenditure	38.3	37.5	100.0	100.0

The increase of the expenditures for the **General public services** function reflects the increase of interest expenditures from 0.9% of GDP in 2013 to 1.1% of GDP in 2018. Bulgaria’s contribution to the EU budget of 1.2% of GDP in 2013 and 2018 is also included in the function. Without the impact of these elements the expenditures for function 1 – General public services, decrease from 2.3% in 2013 to 2.1% in 2018 which corresponds to the measures taken for structural and functional reforms in the public sector.

The expenditures for the “Healthcare” function preserve their share of 4.6% of GDP in 2018.

This function also includes institutional units from the healthcare sector which provide non-market production for individual consumption and form part of the general government sector. The expenditures for the function include the measures for optimization of the activities and improvement of the control over expenditures in the healthcare system, aimed at limiting the expenditures for health insurance payments, which were initiated in 2015 and their effect will continue in the medium run, too.

The expenditures for the **“Economic activities”** function increased from 5% to 5.5% of GDP. Their dynamics corresponds to the planned increase under the function according to the medium-term budget framework. The function includes the state-owned enterprises which form part of the general government sector and excludes the expenditures covered by EU funds which, according to ESA 2010 methodology, do not have any impact on revenues and expenditures in the general government sector.

The reduction of the expenditures for the “**Social protection**” function from 13.7% to 13.1 % of GDP in 2018 reflects the decrease of the social security and social assistance benefits due to the expected improvement of the economic environment and the lower level of unemployment. Pension expenditures are expected to slightly increase – by 0.2 pp.. of GDP compared to their level of 2013. The forecast for pension expenditures has been prepared while preserving the parameters of the current legislation in the Social Security Code and the 2015 PSS Budget Law. The expenditures for the function do not include the changes to the pension system which are under discussion.

The expenditures for active measures on the labour market retain their nominal value. The current fiscal governance policy envisages the potential new policy decisions to be implemented by either changing the priorities within the fiscal framework of the current provisions included in the medium-term fiscal projections.

The expenditures for the other functions reflect the dynamics of the indicators by functions in the medium-term budget framework.

6.3 Structure and Efficiency of Revenue Systems

A high level task force operates to the Prime Minister of the Republic of Bulgaria and is charged with increasing revenue collection, fighting smuggling, tax crimes and shadow economy. At its weekly meetings the actions of the Interior Ministry, State Agency for National Security, Prosecutor's Office, Customs Agency, NRA and MF are discussed and coordinated in order to improve the efficiency of the revenue systems.

– Institutional Changes and Legislative Amendments Related to Public Finances and Improving the Collection Rate of Tax Revenues

This part of the Programme outlines policies and measures for increasing revenue collection, fight against smuggling, tax crimes, shadow economy, etc.

Tax Policy and Legislation

Tax policy is aimed at ensuring macroeconomic and budgetary stability in the medium and long term, providing the financial resources needed for implementation of the government's fiscal policy, and improving the business environment in order to encourage economic growth and employment. Tax policy development in this period complies with the requirements of the European Union law, as well as with the international agreements whereto the Republic of Bulgaria is a party. Some of the major priorities in the area of tax policy correspond to the 2014 country specific recommendations to Bulgaria, namely:

- increase of budget revenues and legalization of shadow economy;
- reduction of the administrative burden and costs for doing business and costs for the citizens.

The Excise Duties and Tax Warehouses Law and the Value Added Tax Law were amended in view to increasing budget revenues and legalizing the shadow economy.

- An obligation has been introduced for the taxable persons under the Excise Duties and Tax Warehouses Law to use measuring and control devices which are to meet certain

legal requirements. All data from the measuring and control devices are to be recorded and, if technically possible, the data are to be submitted electronically via the automated reporting systems of the entities. The data from the measuring and control devices, which are of material importance for exercising effective control and determining the excise liabilities, are to be sent to the Customs Head Office. There is a legal possibility the customs authorities to use the data from the measuring and control devices to determine the tax base for excise duty and public state receivables.

- Limited is the possibility of illegally using fuel oils and marked oils not according to their purpose as a heating fuel but as a motor fuel where the excise duty rate is higher and the fuel is in the fuel tanks of motor vehicles, automotive machines and all other vehicles.
- With the purpose of enabling revenue agencies to exercise more effective control on the overall process related to the supplies and movement of liquid fuels from producers and importers to the end consumer and in order to prevent the tax evasion and non-payment there are amendments to the Value Added Tax Law according to which all tax liable persons who supply vehicles, machines, facilities or other equipment with liquid fuels to meet their own needs are obligated to register and report the fuelling according to the procedure of Ordinance No H-18 of 13.12.2006 on the registration and reporting of sales at commercial outlets via fiscal devices.
- Information about tax assessment acts issued by the customs authorities is to be sent on a monthly basis to the National Revenue Agency. NRA revenue authorities can use the received information to make risk analysis and assessment and to take actions as regards the performance of tax audits and assessments of economic operators carrying high risk in view to determining liabilities under other types of taxes.

Another group of amendments to the tax laws is related to the achievement of results under the second priority - reduction of the administrative burden and costs for businesses and citizens:

- Repealed is the requirement under the Excise Duties and Tax Warehouses Law the persons applying for a license for management of tax warehouse to submit annual financial statements for the past three years.
- The amendments to the Tax and Social Insurance Procedure Code provide a possibility documents to be submitted electronically with a personal identification code (PIC) issued by NRA upon request. At the same time, the benefiting from a discount of the tax under the Personal Income Tax Law is bound to the submission of the annual tax return by electronic means. There is also a possibility the tax liable persons under the Local Taxes and Fees Law to submit electronically the tax returns under it.
- As from 1 January 2015 there is a new regime of declaring transport vehicles and determining the tax thereon. The new regime is implemented by means of using electronic services for automatic daily exchange of information from the Ministry of Interior to the Ministry of Finance about the road transport vehicles that are registered, de-registered and decommissioned, including information about their environmental category. The amendment is aimed not only to reduce the administrative burden, the costs for businesses and citizens and the administrative costs of municipalities, but also to increase the revenues to municipal budgets by means of preventing the possibil-

ity of non-declaring any acquired transport vehicles and evading the tax on transport vehicles.

- As from the beginning of 2015 there is also an electronic exchange of information between the municipalities and the Ministry of Finance. It will be used as a basis to create a national database for local taxes and fees, with information about the tax liable persons, the subjects of taxation, the tax reliefs and exemptions, the amount of the public receivables related to local taxes, including the overdue liabilities, the enforcement measures, etc. The development of a centralized module at the Ministry of Finance will allow the persons having a PIC issued by NRA to check the status of their tax account in terms of local taxes and fees – liabilities, payments, unpaid liabilities, etc.
- According to the adopted change to the regime of declaring and paying the tax on insurance premiums under the Tax on Insurance Premiums Law, the tax is to be declared by submitting a quarterly return and is to be paid by the end of the month following the calendar quarter. Until 31 December 2014 the tax on insurance premiums was to be declared and paid on a monthly basis.

Within the context of implementation of the Council's country specific recommendation No 1 for 2014, a *unified „ **National strategy for strengthening the tax collection, tackling the shadow economy and reducing the compliance costs** “* is being developed. The strategy is aimed at improving the collection of budget revenues, preventing and combatting tax and social security insurance frauds and evasion, and not least – reducing the administrative burden for doing business and costs for the citizens. The Council of Ministers is expected to adopt the document by the end of 2015.

The strategy will integrate measures which fall within the competence of a broad range of institutions. The document will contain a clear vision and action plan. It will include specific measures, based on a comprehensive integrated model of operation. The Strategy will be implemented by means of:

- strengthening inter-institutional cooperation and coordination;
- specific legislative and administrative measures;
- assessment of the effects of the planned measures;
- improved electronic exchange of information on national level – more effective utilization of the existing information technologies and resources at the institutions, their development, upgrading and coordinated use.

Customs Agency

1. Draft Law Amending the Customs Law

The draft has been prepared with the purpose of bringing the national legislation in line with the EU customs legislation and defining more precisely the provisions in order to make easier their implementation in practice. The proposed text changes the type of the administrative act determining obligations for public state receivables established by the customs authorities; defines more precisely the provision related to charging interest for late payment; repeals some provisions of the law because of the direct applicability of provisions of EU legal acts; envisages an exchange of information between the Ministry of Interior and the Customs Agency as well as an increase of the sanctions in case of repeated smuggling of goods; and defines more precisely the provision for confiscation in favour of the state of goods subject to customs violation.

The 2012 provision for performance of detention as an administrative measure authorizes the customs authorities to detain individuals in cases explicitly specified in the law where the respective individual has committed a criminal offence under Articles 234, 242, 242a and 251 of the Criminal Code. No rights of the arrested individual, other than the right to freedom of movement, may be restricted and the arrest period may not exceed 24 hours. In view of the greater efficiency in crimes' investigation, the draft law envisages the customs authorities to be able to escort on the territory of the country the individuals detained under the procedure of Article 16a and the accused individuals in relation to whom a detention for up to 72 hours has been ruled under the procedure of the Criminal Procedure Code. The provision of the customs authorities with such powers will also fill in the gap in the legislation by regulating the authority charged with the escorting of the individuals detained by the customs authorities under the procedure of Article 16a of the Customs Law as well as the individuals accused of committing a crime under the above Articles, in relation to whom a detention for up to 72 hours has been ruled under the procedure of the Criminal Procedure Code. The conditions and procedure for performance of an escorting activity will be defined in an instruction of the Minister of Finance.

The draft law envisages the customs authorities to carry out operative and investigative activity for prevention, detection and neutralization of crimes under Articles 234, 242, 242a, 251 and 255 of the Criminal Code, which will lead to faster and more effective detection of crimes. *The current absence of such powers creates an obstacle to charging the customs authorities with the establishment of the identity of the perpetrator in the pre-trial proceedings against unknown perpetrator.*

2. Amendments to the Excise Duties and Tax Warehouses Law as (EDTWL) from 01.01.2014

The new provisions have increased the excise duty rates on natural gas used as fuel for heating and on heavy fuel oil. The amendments fulfil the requirements of Council Directive 2003/96/EC restructuring the Community framework for the taxation of energy products and electricity and the commitments taken under the Treaty of Accession to the European Union to increase excise duty rates in order to reach the minimum levels of the Community. Preserved is the excise duty rate on natural gas used as motor fuel, which will be increased in the event that the European Commission passes an act for non-compliance with the rules on state aid.

The provision of Article 12 of EDTWL has been amended with the purpose of clearly defining the characteristics of the term "tobacco refuse" (remnants of tobacco leaves) as refuse of tobacco leaves does not fall within the scope of EDTWL until it is established that they are marketed for retail sale. In view of this and in order to prevent fraud and evasion of excise duties, a procedure is provided for the persons dealing with those goods.

Supplemented is Article 20, para. 2, item 1a of the law in view of ensuring equality of tax liable persons, enabling small wine producers when sending excisable goods to a licensed warehouse keeper in the country also to apply the excise duty suspension arrangement and the goods not to be accompanied by an electronic administrative document. The goods may be accompanied by the accompanying document referred to in Council Regulation № 436 of 26 May 2009 as regards the vineyard register, the mandatory declarations and the gathering of information

with the purpose to monitor the market, the documents accompanying the consignments of products and the records that are to be kept in the vineyard and wine sector.

A new section "IIa" "Licensing in special cases" according to which the State Agency "*State Reserve and Wartime Stocks*" is provided with the opportunity to obtain a license under EDTWL to implement the specific activities of management of state reserves and wartime stocks, their creation, storage, preservation, renewal, maintenance, release, use, recording, financing and controlling. In this way, the Agency will be able to store in the warehouses, provided to it for management, excisable goods under excise duty suspension arrangement.

Amendments have been made in relation to the guarantee under the excise duty suspension arrangement, and Article 77 of EDTWL envisages the amount of guarantee to be determined in such a way that it covers at any time the amount of excise duty which has been incurred or may be incurred, or has been established during the application of an excise duty suspension arrangement. Reduced is also the amount of guarantee under Article 78 of EDTWL, with the amount used as a basis to determine the amount of the guarantee being reduced from 30 to 20 per cent of the amount of excise duty on the monthly average quantity of goods stored, from 10 to 0 per cent of the amount of excise duty on the monthly average quantity of goods stored as regards the quantities of stored distillate or the statutory quantities under the Statutory Reserves of Petroleum and Petroleum Products Law, stored in a licensed warehouse, and from 150 to 100 per cent of the amount of excise duty on the monthly average quantity of the excisable goods released for consumption.

In execution of the Plan for reduction of the regulatory burden for businesses an amendment has been made to Article 90d of EDTWL as a result of which the time periods for issuing permits for trade in tobacco products will be shortened. When the submitted documents meet the requirements of the law and the submitted information is sufficient, the customs authorities are to issue the permit within 14 days from receipt of the request, compared to the one-month period before that.

Amendments and supplements have been made to Article 104 of EDTWL in connection with the powers of the customs authorities as revenue authorities in the proceedings under Articles 77 and 78 of the Tax and Social Insurance Procedure Code (TSIPC) – upon institution of proceedings for dissolution, transfer, transformation, liquidation and bankruptcy of an enterprise, the tax liable person is to inform them, too. The customs authorities need this information in order to take timely actions under the procedure of Chapter 15 of TSIPC.

In connection with the entry into operation of the state aid scheme in 2014, amendments have been made to the national legislation – the Excise Duties and Tax Warehouses Law and the Support to Farmers Law. The measure constitutes a scheme to support farmers registered under the Support to Farmers Law and aims to create relieved conditions for the fuel used by them in the production of primary agricultural products through the application of a reduced excise duty rate for gas oil through fuel vouchers. The aid will be provided in the form of fuel vouchers with pre-determined quantity of fuel and nominal value to farmers for cultivated agricultural land, used meadows and bred animals.

The scope of application of "direct supply" has been extended. There is a possibility, under certain conditions, for movement of excisable goods under an excise duty suspension arrangement to a place of direct supply located on the territory of a Member State when this

place has been specified by the authorised warehousekeeper in the Member State of receipt or by the registered consignee. It is estimated that the change will affect directly 24 tax liable persons. The adoption of this optional measure will enable these persons to increase the volume of their supplies regardless of the limitations they may have in relation to the warehouse capacity at the place of receipt. As an additional effect, we can expect an increase of the number of persons registered under the EDTWL as registered consignees in view of the fact that the place of direct supply can be specified as a place of receipt and the persons do not need to maintain storage facilities. As regards the chain of supply of liquid fuels for motor vehicles, the petrol stations – facilities intended for sale of fuels to final consumers, could also be specified as places of direct supply. As regards the functioning of the “Information system for control over liquid fuels” which ensures online information exchange between the Customs Agency and the National Revenue Agency, there are possibilities of exercising control at the place of direct supply – petrol stations, and this in turn guarantees the lawful end of the movement of energy products under an excise duty suspension arrangement and the issuance of an electronic excise tax document.

Simplified procedures are established in respect of movements of excise goods under an excise duty suspension arrangement which take place entirely on the territory of a Member State, including the possibility to waive the requirement of electronic supervision of such movements. The measure aims to provide a legislative solution for simplification of the formalities upon import of excisable goods by means of simultaneously placing under an excise duty suspension arrangement also the export of excisable goods under an excise duty suspension arrangement when the competent customs office in charge of placing the goods under the relevant arrangement coincides with or is part of the competent customs office by location of the tax warehouse and on the conditions that there is no physical movement of the excisable goods within the meaning of Article 73a, para. 1, items 3 and 4 of EDTWL. *The application of this measure will significantly reduce the administrative burden for businesses and at the same time will simplify the process of data processing by the customs administration.*

There is a possibility of dividing the movement of energy products under an excise duty suspension arrangement into two or more movements. The consignor is allowed to divide the movement of energy products under an excise duty suspension arrangement into two or more movements provided that the total quantity of excisable goods is not changed, the division is performed on the territory of a Member State which permits such procedure, and the competent authorities of that Member State are informed about the place where such division is performed. *This measure is aimed at the persons carrying out activities of heavy fuels supply (bunkering) and is intended to provide a legislative solution in the cases where the ordered heavy fuel, removed from a tax warehouse under an excise duty suspension arrangement and placed under export procedure, cannot be received by the recipient ship because of lack of tonnage. The regulation of this possibility will ensure the required level of legal certainty and predictability of the business environment for the economic operators.*

In connection with the need to eliminate any inconsistencies between the Bulgarian excise law and the EU one and in view of the opinion of the European Commission on the implementation of the provisions of Article 14, para. 1, letters b) and c) of Directive 2003/96/EC as regards the excise duty exemption of energy products, the definition of “private pleasure flying and sailing” has been made more precise.

In order to clearly define the measuring and control devices to be used by the persons in connection with the measurement of all types of excisable goods, to establish the types of data from the measuring and control devices to be transmitted to the automated reporting systems of the persons and the types of data to be transmitted to the information system of the Customs Agency, and to exercise control over these measuring and control devices, EDTWL contains a definition of “measuring and control devices” as well as amendments to Articles 103 and 103a, and a new Article 103b.

The changes related to the measuring and control devices will enter into force within 6 months after the delivery of a positive decision of the European Commission under a notification procedure initiated by the Ministry of Finance.

An amendment has been introduced to Article 39 for a gradual increase of the excise duty rate on cigarettes and a time period for reaching the minimum excise level of EUR 90 per 1 000 pieces until 31 December 2017.

There is a new requirement the tax documents within the meaning of EDTWL to indicate the package capacity and the number of packages in connection with the need for clear differentiation of the goods and their identification upon the exercising of control by the customs authorities.

An amendment has been introduced to Article 94, limiting the possibility of unlawful use of heavy and marked fuels as a motor fuel and not according to their intended purpose as a heating fuel.

Article 124, para. 8 has been changed, providing a possibility the energy products confiscated in favour of the state to be provided gratuitously to medical establishments, schools and social institutions, as well as to people with disabilities or people in dire straits.

3. Draft Rules amending the Rules for Implementation of the Excise Duties and Tax Warehouses Law

The proposed amendments envisage a specific procedure for the movement of and transactions in tobacco refuse as well as their destruction in view of the established risk of their use for illegal production of tobacco products.

4. Ordinance on the specific requirements and the control exercised by the customs authorities on the devices for measurement and control of excisable goods

In 2014 Ordinance № 3 of 19.02.2010 on the specific requirements and control exercised by the customs authorities on the devices for measurement of excisable goods was replaced by entirely new legal act - Ordinance № H-1 of 22.01.2014 on the specific requirements and control exercised by the customs authorities on the devices for measurement and control of excisable goods. *This change was driven by the economic situation in the country and the political decision to reduce the administrative burden on businesses as a whole.*

National Revenue Agency (NRA)

NRA takes measures and pursues policies to decrease the shadow economy, to improve the collection of tax and social-security liabilities, to reduce the administrative burden, including by means of developing the e-services, etc. In this connection it should be noted that in 2014

the NRA simplified 10 tax and social-security returns, including under PITL, CITL, Sample Form 1, LTFL, and implemented 9 new e-services:

- ▶ Submission of a Request for registration for application of the VAT cash accounting special regime;
- ▶ Submission of a Request for termination of the application of the VAT cash accounting special regime;
- ▶ Simultaneous submission of declaration Sample Form 1 – data on the social-insured person, and declaration Sample Form 6 – liabilities for mandatory social insurance contributions, under Ordinance H-8 to SIC;
- ▶ Submission of the return under Article 252 of CITL;
- ▶ Submission of the return under Article 246 of CITL;
- ▶ Submission of the return under Article 14, paragraph 1 of TIPL;
- ▶ Submission of the return under Article 14, paragraph 2 of TIPL;
- ▶ Reference on the actual status under the submitted Sample Form 1 – data on the social insured person, under Ordinance H-8 to SIC;
- ▶ Reference on the actual status under the submitted Sample Form 6 – liabilities for mandatory social insurance contributions, under Ordinance H-8 to SIC.

In addition to the above, another three e-services have been successfully implemented since the beginning of 2015:

- ▶ Submission of an annual return related to personal income taxation via Internet, using a personal identification code (PIC). The latter allows every person to see at any time the information kept in his/ her tax and social insurance account, including his/ her liabilities and payments, as well as the data on his/ her employment contract, social insured income or contributions for additional mandatory pension. Using PICs, persons are able to request a certificate or another tax and social insurance document to be issued by NRA.
- ▶ The other two new services for persons with PIC include reference on the actual status of the data declared by declaration Sample Form No 1/ Sample Form No 5 by social insurer, and reference on the actual status of the data declared by declaration Sample Form No 6/ Application for allocation of social insurance contributions.

In 2014, NRA also provided a possibility for certain officials from other administrations to receive electronic information about the liabilities of a person, thus achieving higher efficiency and interaction of public administration structures and reducing the number of forgeries of the certificates issued by NRA.

It should be noted that according to NRA estimates the use of the Agency's e-services saves businesses and citizens more than BGN 300 million a year.

In the area of enforced collection of public receivables, NRA continues to apply measures to increase the efficiency:

- ▶ ***Measures aimed at encouraging voluntary execution:***
 - ▶ Making phone calls to persons who do not pay within the statutory deadlines their declared liabilities;

- ▶ Sending e-notifications to persons registered under VATL to pay their VAT liabilities;
 - ▶ Sending notices of withdrawal of permits for urgent payments;
 - ▶ Sending notifications of a forthcoming foreclosure sale to debtors that have a property over which the NRA has imposed a collateral;
 - ▶ Sending notices of initiation of bankruptcy proceedings.
- ▶ ***Target campaigns for enforced collection of receivables from incorrect debtors:***
- ▶ Carrying out permanent monitoring in regard to the debtors having overdue liabilities with high fiscal effect over BGN 100.000 (BGN 200.000 for the Sofia Revenue Directorate) for taxes and social security contributions, categorised as receivable and partially – receivable;
 - ▶ Targeting the enforcement to budget debtors’ receivables from third parties – commercial chains;
 - ▶ Enforcement targeted at the cash in the cash registers of traders having unpaid public liabilities;
 - ▶ Targeting the enforcement to contractor debtors’ receivables from third parties – spending units. There is a mechanism for sending notifications to NRA and the Customs Agency of any forthcoming payments by spending units under contracts which exceed BGN 100 thousand. The measure is implemented in execution of one of the main government priorities to improve budget revenue collection. According to data from mid-March 2015, the receivables thus secured amount to over BGN 92 million, out of which the amounts actually paid to NRA accounts are BGN 54 million. Together with the direct fiscal effect, this measure also strengthens interinstitutional cooperation and coordination.
- ▶ ***Measures for collection of overdue liabilities, 2014-2015***
- ▶ Preparation of proposals for legislative changes aimed at shortening time periods and simplifying procedures in the process of enforced collection of public receivables;
 - ▶ Expansion of the electronic exchange of documents and data with public creditors as well as with institutions that keep information about debtors’ property/ assets;
 - ▶ Development and implementation of a software covering all activities related to public receivables’ collection;
 - ▶ Development of a functionality for automated identification of the debtor’s profile in view to determining adequate measures for debt collection;
 - ▶ Preparation of a Strategy for development of a “Collection” function at NRA.

The measures in the area of arrears collection are expected to have an additional net effect on the revenues collected by NRA to the amount of BGN 104.5 million for 2015 and BGN 108.0 million for 2016. ▼

7. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

7.1 National budgetary rules

With the adoption of the Public Finance Law (PFL) the determination of targets under various indicators, relevant to the fiscal policy is bound to a set of fiscal rules. The presence of a legal framework that determines rules, restrictions and procedures for action upon any deviations from the targets set for a certain indicator, is a precondition for increasing the predictability of the fiscal policy in view to ensuring public finance sustainability. The Law defines both restrictions/maximum limits and parameters of certain indicators, and mechanisms that are triggered in the case of negative fiscal trends and/ or established significant deviations from the set fiscal targets. The Public Finance Law preserves the structure of three fiscal rules (balance, debt and expenditure).

The different rules and restrictions are applicable to the general government sector and its sub-sectors, the consolidated fiscal programme and the local level (municipalities/budgets of municipalities).

The fiscal rules and restrictions comprise the indicators under the national methodology on the budget balance and the expenditures under the consolidated fiscal programme (on a cash basis) and the state debt, as well as indicators of the general government sector (for some rules and for the relevant subsectors) on the medium-term objective for the structural deficit, the budget balance and the consolidated debt of the general government sector.

The rules are further developed with the inclusion of specific provisions for cases of deviation from the target (the rule on the balance under the consolidated fiscal programme) and correction mechanisms for returning to the limit specified with the rule (the rule on the nominal amount of the consolidated debt of the general government sector as a percentage of GDP).

The availability of fiscal rules and restrictions that indicate the state of public finances is a mechanism for prevention of adverse fiscal trends and for taking prompt and adequate solutions, based also on the views and recommendations of the Fiscal Council, which is to be established soon.

7.2 Budgetary procedures

Sound public finance management requires observance of the budgetary procedure. The active involvement of all budget organizations in the budgetary process is a precondition for the overall success of the procedure as well as for the achievement of the predefined goals.

In connection with the extension of the scope of the budgetary framework, the budgetary procedures from the past years helped to gain experience in the institutionalization of the processes and practices of coordination and monitoring of the general government sector. The involvement of the budget organizations and legal entities controlled by the state and/ or the municipalities, which are not part of the Consolidated Fiscal Programme but fall within the scope of the general government sector, is a positive step in the development of the budgetary process.

The budgetary procedure for 2015 was organized and carried out in accordance with PFL rules and requirements and, similarly to the previous one, the individual stages were implemented under three governments. The planned stages and deadlines for the preparation of the 2015 budget were affected by the political environment and the related financial and economic consequences, which called for taking measures, including legislative ones, for revision of the budget for the 2014, giving rise to changes in the basis for preparation of the 2015 budget and the deadlines for implementation of the second stage of the budgetary procedure. Despite the reported delay ensuing from the needed time for the new government to start working after the special parliamentary elections in October 2014 and the required second revision of the 2014 budget, the administration timely developed the draft 2015 State Budget Law (and the update of the medium-term budgetary framework for the period 2015-2017 as motives there-to) which was adopted by the 43rd National Assembly on 19 December 2014. The process of preparation of the 2015 budget was also affected by the amendments to the 2014 State Budget Law made at the end of the pre-terminated mandate of the 42nd National Assembly, ensuing from an amendment to the 2014 NHIF budget (related to the approval of additional expenditures for health insurance payments at the expense of a reduction of budget organizations' budgets beyond the already planned expenditure cushion).

In order to guarantee the financial stability of the country and to ensure more realistic basis for the preparation of the 2015 budget, a draft law amending the 2014 State Budget Law was prepared and adopted, reflecting the revised macroeconomic forecasts for 2014, the under-performance of revenues to the state budget, the serious pressure of expenditures in a number of budgetary systems, the shortage of funding for expenditures under EU Funds and the potential threats of losing funds, the problems in the banking sector, etc.

Despite the short deadlines after the parliamentary elections and the formation of the government, the draft 2015 State Budget Law and the updated medium-term budgetary framework for the period 2015-2017 were approved by Council of Ministers' Decision No. 791 of 1 December 2014.

The beginning of the preparations for the 2016 Budget was marked by the adoption on 30 January 2015 of the Council of Ministers' Decision on the 2016 budgetary procedure. This procedure is based entirely on the Public Finance Law, while adhering to its requirements to the structure and content of key budgetary documents and deadlines for their adoption. The 2016 budgetary procedure continues the practice from recent years, which ensures the sustainability of the budgetary process.

The procedure creates a good organization and ensures the necessary coordination among the individual spending units in the process of budgetary planning and preparation of the 2016-2018 medium-term budgetary framework and the draft 2016 state budget.

The budgetary procedure for 2016 complies with the time periods relating to the application of the mechanisms and measures laid down in the main stages of the European Semester. Ensured is the attainment of the required by the Semester coordination among the key budgetary documents of the government and the commitments related to Council's opinion and recommendations on the implementation of the measures laid down in the National Reform Programme in the framework of "Europe 2020" Strategy as well as in the Convergence Programme.

7.3 Other institutional developments in relation to public finances

On 8 April 2015 the National Assembly adopted the *Law on the Fiscal Council and Automatic Correction Mechanisms*. Its adoption was delayed because of the early termination of the mandate of the previous 42nd National Assembly in the summer of 2014.

The Law on the Fiscal Council and Automatic Correction Mechanisms has been prepared in fulfilment of the requirement for establishment of an independent institution for fiscal surveillance laid down in Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States as well as in line with the commitments of the Republic of Bulgaria under the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

The Law fully transposes Directive 2011/85/EU to the Bulgarian legislation, whose requirements have already been implemented with the Public Finance Law and the Statistics Law. It should be pointed out that the adoption of the Law creates conditions for termination of the infringement procedure against Bulgaria № 2014/0025 in connection with the country's failure to notify the national measures transposing Council Directive 2011/85/EC of 8 November 2011.

The adoption of the Law on the Fiscal Council and Automatic Correction Mechanisms also fulfils the Council Recommendation of 9 July 2013 on the National Reform Programme 2013 of Bulgaria and delivering a Council opinion on the Convergence Programme of Bulgaria, 2012–2016, where Bulgaria was recommended to "establish an independent institution to monitor fiscal policy and provide analysis and advice", as well as creates conditions for fulfilment of Council Recommendation of 8 July 2014 on the National Reform Programme 2014 of Bulgaria and delivering a Council opinion on the Convergence Programme of Bulgaria, 2014, where Bulgaria was recommended to "ensure the capacity of the new fiscal council to fulfil its mandate".

The Law on the Fiscal Council and Automatic Correction Mechanisms sets up an independent advisory body on fiscal governance issues called Fiscal Council.

The objectives of the Fiscal Council are to independently monitor and analyse the budgetary framework with a view to preserving sustainable public finances, as well as to increase the quality of the official macroeconomic forecasts and budgetary frameworks. Together with these objectives, the Fiscal Council should also constitute a mechanism for improving transparency and public awareness of the fiscal governance of the country.

The main function of the Council is to monitor the compliance with the numerical fiscal rules provided for in the Public Finance Law relevant to the general government sector and the consolidated fiscal programme. The Council will prepare reasoned opinions regarding the spring and autumn macroeconomic forecasts of the Minister of Finance and the based on them draft medium-term budgetary framework, the Draft State Budget Law and the draft laws amending the latter, and the draft laws on the public social insurance budget and the National Health Insurance Fund budget. The Council will also prepare a reasoned opinion on the reports on the implementation of the state budget, the budgets of the public social insurance and the other social insurance funds administered by the National Social Security Institute, and the National Health Insurance Fund budget. In addition, the Fiscal Council will, on detecting significant bias affecting macroeconomic forecasts from the reported data within a period of at least four consecutive years, recommend to the Minister of Finance to take necessary measures to correct the bias. The Council will also monitor the implementation of the automatic correction mechanisms under Article 3, paragraph 1, letter “e” of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

The Fiscal Council will comprise 5 members, including a Chairperson, to be elected by the National Assembly on the basis of a preliminary public discussion, with a term of office of 6 years. The members shall be persons of high morals with at least a Master’s degree in Economics and not less than 10 years of professional experience in the field of economic analysis and/or public finance management. The members of the Council may also have foreign citizenship.

The Law envisages the opinions and recommendations of the Council to be published on its website, thus ensuring the transparency of its activity. The reasoned opinions and recommendations are not binding, but where the government disagrees therewith it should provide the reasons therefor in writing. The reasons for the non-agreement shall be published on the websites of the Council of Ministers and of the Ministry of Finance.

The organizational, technical and expert support of the Council activities will be provided by three experts within the administration of the National Assembly. The requirements to the three experts will be described in detail in the Rules of Procedure of the Council which the latter is to adopt and publish on its website.

The resources needed for the functioning of the Council will be planned in the budget of the National Assembly, specified in a separate expenditure heading.

The Fiscal Council and Automatic Correction Mechanisms Law also regulates the establishment and application of automatic correction mechanisms aimed at correcting significant deviations from the medium-term budgetary objective for the structural deficit or the adjustment path towards it according to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies.

The Law envisages that in case of identifying any significant deviation from the medium-term budgetary objective in structural terms the Minister of Finance shall prepare a correction plan with the main purpose of bringing the fiscal position back to the medium-term budgetary objective or the adjustment path towards it within a maximum of two years after the year of occurrence of the deviation. There is a requirement the average annual improvement of the structural balance to be in the amount of at least 0.5% of GDP for the timeline of correction.

The existence of a deviation from the medium-term budgetary objective can be identified by the European Commission, the Minister of Finance and/ or the Fiscal Council.

The Law envisages that the correction plan may be temporarily suspended in case of exceptional circumstances within the meaning of Article 9 of Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies. When the exceptional circumstances cease to exist, the Minister of Finance, if necessary, shall prepare a revised correction plan.

The Law is promulgated in State gazette, issue 29 of 21.04.2015 and is in force as of the same day. Now the National Assembly shall elect the members of the Fiscal Council following a public procedure according to Article 89 of the *Rules of Organization and Procedure of the National Assembly*³⁰. The funds for the functioning of the Fiscal Council for the current year are planned in the 2015 state budget. ▼

³⁰ <http://www.parliament.bg/bg/rulesoftheorganisations>

8. ANNEX A

Table 1a: Macroeconomic prospects

		2014	2014	2015	2016	2017	2018
	ESA code	Level MBGN	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
Real GDP (at previous year prices)	B1*g	81 651	1.7	1.4	1.7	2.3	2.1
Nominal GDP	B1*g	82 164	2.3	1.7	2.9	3.7	3.6
Components of real GDP							
Private consumption	P.3	51 223	2.0	2.4	2.9	3.2	2.7
Government consumption expenditure	P.3	13 758	3.8	0.5	1.4	2.1	2.1
Gross fixed capital formation	P.51	17 584	2.8	1.8	1.5	2.9	3.2
Change in inventories and net acquisition of valuables (% of GDP)	P.52+ P.53	427	0.5	0.5	0.5	0.5	0.5
Export of goods and services	P.6	56 140	2.2	2.8	3.1	3.4	3.6
Import of goods and services	P.7	57 481	3.8	3.6	4.0	4.4	4.4
Contributions to real GDP growth (In percentage points)							
Final domestic demand	-	-	2.5	2.0	2.4	3.0	2.8
Change in inventories and net acquisition of valuables	P.52+ P.53	-	0.3	0.0	0.0	0.0	0.0
External balance of goods and services	B.11	-	-1.1	-0.6	-0.7	-0.7	-0.7

Table 1b: Price developments

	ESA code	2014	2014	2015	2016	2017	2018
		Level	Rate of change ³¹	Rate of change	Rate of change	Rate of change	Rate of change
GDP deflator		100	0.6	0.3	1.2	1.4	1.5
Private consumption deflator		100	-0.4	-0.1	1.1	1.4	1.5
HICP ³²		100	-1.6	-0.6	1.8	1.9	2.0
Public consumption deflator		100	1.9	0.2	0.9	1.2	1.3
Investments deflator		100	-1.7	-0.1	1.2	1.3	1.4
Export price deflator (goods and services)		100	-0.6	1.2	2.2	2.7	2.9
Import price deflator (goods and services)		100	-1.9	0.6	2.0	2.6	2.8

Table 1c: Labour market developments

	ESA code	2014	2014	2015	2016	2017	2018
		Level	Rate of change	Rate of change	Rate of change	Rate of change	Rate of change
Employment (thousand persons) ³³		3 434.2	0.4	0.3	0.5	0.9	0.5
Employment (millions of hours worked) ³⁴		5 646.0	0.3	0.3	0.5	0.8	0.4
Unemployment rate ³⁵		11.4	11.4	10.8	10.2	9.4	9.0
Labour productivity (BGN per person employed) ³⁶		23 776.0	1.3	1.1	1.2	1.4	1.6
Labour Productivity (BGN per hour worked) ³⁷		14.5	1.4	1.1	1.2	1.4	1.7
Compensation of employees (MBGN) ³⁸	D.1	32 892.3	1.3	2.1	3.5	4.5	3.8
Compensation per employee		13 124.2	1.5	1.8	2.8	3.5	3.3

³¹ Percentage change as compared to the previous year.

³² Optional for Stability Programmes.

³³ Occupied population, national accounts definition.

³⁴ National accounts definition.

³⁵ Harmonised definition, Eurostat; levels.

³⁶ Real GDP per one person employed.

³⁷ Real GDP per one hour worked.

³⁸ In MBGN.

Table 1d: Sectoral balances

% of GDP	ESA code	2014 ³⁹	2015	2016	2017	2018
Net lending/borrowing vis-à-vis the rest of the world	B.9		1.6	0.8	0.2	-0.3
of which:			-0.9	-1.4	-2.0	-2.6
–Balance of goods and services			1.1	1.0	1.0	1.1
–Balance of primary incomes and transfers			1.4	1.2	1.2	1.2
–Capital account						
Net lending/borrowing of the private sector	B.9		4.4	3.2	2.0	1.0
Net lending/borrowing of the general government	EDP B.9		-2.8	-2.4	-1.8	-1.3
Statistical discrepancy						

Table 2a: General government budgetary prospects

	ESA 95	2014	2014	2015	2016	2017	2018
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-2 336.5	-2.8	-2.8	-2.4	-1.8	-1.3
2. Central government	S.1311	-2 517.2	-3.1	-3.0	-2.6	-2.1	-1.6
3. State government	S.1312		0.0	0.0	0.0	0.0	0.0
4. Local government	S.1313	119.0	0.1	0.1	0.2	0.2	0.2
5. Social security funds	S.1314	61.8	0.1	0.1	0.1	0.0	0.0
General government (S13)							
6. Total revenue	TR	29 906.7	36.4	35.9	36.0	36.1	36.1
7. Total expenditure	TE	32 243.2	39.2	38.8	38.4	37.9	37.5
8. Net lending / borrowing	EDP B.9	-2 336.5	-2.8	-2.8	-2.4	-1.8	-1.3
9. Interest expenditure	EDP D.41	596.2	0.7	1.0	1.0	1.2	1.1
10. Primary balance		-1 740.3	-2.1	-1.8	-1.4	-0.7	-0.2
11. One-off and other temporary measures							
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		16 776.3	20.4	20.5	21.2	21.2	21.2
12a. Taxes on production and import	D.2	12 178.9	14.8	14.8	15.5	15.5	15.5

³⁹ For the purposes of the forecast the data on trade in goods and services were technically adjusted from the 5th to the 6th edition of the Balance of Payments and International Investment Position Manual, while using data under ESA 2010. No amounts are presented for the current account and the trade balance because there are no official data under the 6th edition of the Manual.

	ESA 95	2014	2014	2015	2016	2017	2018
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
12b. Current taxes on income, wealth, etc.	D.5	4 388.5	5.3	5.5	5.5	5.5	5.4
12c. Capital taxes	D.91	208.9	0.3	0.3	0.2	0.2	0.2
13. Social contributions	D.61	6 448.8	7.8	8.0	7.8	7.7	7.5
14. Property income	D.4	564.2	0.7	0.4	0.3	0.3	0.4
15. Other		6 117.4	7.4	7.2	6.8	6.9	7.1
16=6. Total revenue	TR	29 906.7	36.4	36.0	36.0	36.1	36.1
Tax burden (D.2+D.5+D.61+D.91-D.995)		23 225.1	28.3	28.4	29.0	28.9	28.7
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	12 597.8	15.3	14.6	14.4	13.9	13.6
17a. Compensation of employees	D.1	7 956.0	9.7	9.1	9.1	8.9	8.7
17b. Intermediate consumption	P.2	4 641.8	5.6	5.5	5.3	5.0	4.9
18. Total social transfers (18=18a+18b)		12 264.2	14.9	15.0	14.9	14.7	14.5
<i>of which Unemployment benefits</i>	D.621. D.624	340.2	0.4	0.4	0.4	0.4	0.3
18a. Social transfers in kind	D.6311. D.63121 .	2 031.0	2.5	2.4	2.3	2.4	2.3
18b. Social transfers other than in kind	D.62	10 233.1	12.5	12.5	12.5	12.3	12.2
19=9. Interest expenditure	EDP D.41	596.2	0.7	1.0	1.0	1.2	1.1
20. Subsidies	D.3	970.8	1.2	1.0	1.0	1.0	1.0
21. Gross fixed capital formation	P.51	4 096.6	5.0	5.0	4.6	4.8	4.9
22. Capital transfers	D.9	359.1	0.4	0.7	1.0	0.9	0.8
23. Other		1 358.5	1.7	1.5	1.5	1.5	1.5
24=7. Total expenditure	TE1	32 243.2	39.2	38.8	38.4	37.9	37.5
Government consumption (nominal)	P.3	14 025.9	17.1	16.9	16.8	16.7	16.7

Table 2b: No-policy change projections

	2014	2014	2015	2016	2017	2018
	Level	of GDP	of GDP	of GDP	of GDP	of GDP
1. Total revenue at unchanged policies	29 906.7	36.40	35.55	35.76	35.96	35.93
2. Total expenditure at unchanged policies	32 198.5	39.19	39.00	38.44	37.92	37.44

Table 2c: Amounts to be excluded from the expenditure benchmark

	2014	2014	2015	2016	2017	2018
	Level	of GDP	of GDP	of GDP	of GDP	of GDP
1. Expenditure on EU programmes fully matched by EU funds revenue	2 490.0	3.0	3.0	2.7	3.1	3.2
2. Unemployment benefit expenditure at unchanged policies	-9.0	-0.01	-0.01	0.00	0.00	0.01
3. Effect of discretionary revenue measures	0.0	0.0	0.4	0.3	0.2	0.2
4. Revenue increases mandated by law	0	0	0	0	0	0

Table 3: General government expenditure by function

of GDP	ESA code	2013	2018
1. General public services	1	4.2	4.4
2. Defence	2	1.2	1.0
3. Public order and security	3	2.7	2.2
4. Economic activities	4	5.0	5.5
5. Environmental protection	5	1.0	1.5
6. Housing and community amenities	6	1.3	1.2
7. Health care	7	4.6	4.6
8. Recreation, culture and religion	8	0.8	0.6
9. Education	9	3.8	3.3
10. Social protection	10	13.7	13.1
11. Total expenditure (=item 7=24 in Table 2)	TE1	38.3	37.5

Table 4: General government debt

of GDP	ESA code	2014	2015	2016	2017	2018
1. Gross debt ⁴⁰		27.6	29.8	30.1	30.4	30.9
2. Change in gross debt ratio		9.3	2.2	0.3	0.3	0.5
Contributions to changes in the gross debt to GDP ratio						
3. Primary balance ⁴¹		-2.1	-1.8	-1.4	-0.7	-0.2
4. Interest expenditure ⁴²	EDP D.41	0.7	1.0	1.0	1.2	1.1
5. Stock-flow adjustment						
of which:						
Differences between cash and accruals ⁴³						
Net accumulation of financial assets ⁴⁴						
of which: privatisation proceeds		0.00	0.07	0.03	0.04	0.02
Valuation effects and other ⁴⁵		0.1	0.1	0.1	0.1	0.1
Implicit interest rate on debt ⁴⁶		4.4	3.7	3.2	3.7	3.8
Other relevant variables						
6. Liquid financial assets ⁴⁷						
7. Net financial debt (7=1-6)						
8. Debt amortization since the end of the previous year		9.2	16.7	6.7	8.0	3.7
9. Percentage of debt denominated in foreign currency		79.5	78.1	77.1	77.4	78.6
10. Average maturity		5.6	7.9	6.9	7.1	6.7

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

⁴¹ Cf. item 10 in Table 2.

⁴² Cf. item 9 in Table 2.

⁴³ The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.

⁴⁴ Including liquid assets, government securities, assets in third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.

⁴⁵ Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant or in case the debt-to-GDP ratio is above the reference value.

⁴⁶ Proxied by interest expenditure divided by the debt level of the previous year.

⁴⁷ AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5: Cyclical developments

of GDP	ESA code	2014	2015	2016	2017	2018
1. GDP growth ()		1.7	1.4	1.7	2.3	2.1
2. Net lending of general government	EDP B.9	-2.8	-2.8	-2.4	-1.8	-1.3
3. Interest expenditure	EDP D.41	0.7	1.0	1.0	1.2	1.1
4. One-off and other temporary measures		0.0	0.0	0.0	0.0	0.0
5. Potential GDP growth ()		1.8	1.9	2.0	2.1	2.2
contributions:						
labour		0.1	0.3	0.4	0.4	0.3
capital		1.1	1.1	1.0	1.0	1.0
total factor productivity		0.5	0.6	0.6	0.7	0.8
6. Output gap		0.0	-0.5	-0.8	-0.6	-0.7
7. Cyclical budgetary component		0.0	-0.2	-0.2	-0.2	-0.2
8. Cyclically-adjusted balance (2 – 7)		-2.9	-2.7	-2.2	-1.6	-1.1
9. Cyclically-adjusted primary balance (8 + 3)		-2.1	-1.7	-1.1	-0.5	0.0
10. Structural balance (8 – 4)		-2.9	-2.7	-2.2	-1.6	-1.1

Table 6: Divergence from previous update

	ESA code	2014	2015	2016	2017	2018
Real GDP growth ()						
Previous update		2.1	2.6	3.4	3.4	
Current update		1.7	1.4	1.7	2.3	2.1
Difference(pp.)		-0.4	-1.2	-1.7	-1.1	
General government net lending (of GDP)						
Previous update	EDP B.9	-1.8	-1.5	-1.1	-0.9	
Current update		-2.8	-2.8	-2.4	-1.8	-1.3
Difference(pp.)		-1	-1.3	-1.3	-0.9	
General government gross debt (of GDP)						
Previous update		22.8	22.2	23.3	20.6	
Current update		27.6	29.8	30.1	30.4	30.9
Difference(pp.)		+4.8	+7.6	+6.8	+9.8	

Table 7: Long-term sustainability of public finances

of GDP	2007	2010	2020	2030	2040	2050	2060
Total expenditure	38.2	37.4	37.0	37.8	38.6	40.3	40.9
Of which: age-related expenditures	15.2	18.5	18.1	18.9	19.6	21.4	22.0
Pension expenditures	7.5	9.7	9.2	9.5	9.9	10.8	11.2
Social security pension	7.2	9.4	8.9	9.2	9.6	10.4	10.8
Old-age and early pensions	5.7	7.8	6.9	6.8	7.0	8.0	8.6
Other pensions (disability, survivors)	1.6	1.6	2.0	2.4	2.6	2.4	2.1
Occupational pensions (if in general government)							
Health care	4.0	4.6	4.7	5.0	5.4	5.9	5.9
Long-term care							
Education expenditure	3.7	3.7	3.9	4.1	4.0	4.4	4.7
Other aging-related expenditures	0.1	0.4	0.3	0.3	0.3	0.3	0.3
Interest expenditure	1.1	0.7	1.1	1.1	1.3	1.9	2.8
Total revenue	39.4	34.1	36.1	36.1	36.1	36.1	36.1
Of which: property income	1.3	1.2					
Of which: from pensions contributions (or social contributions if appropriate)	5.8	7.3					
Pension reserve fund assets							
Of which: consolidated public pension fund assets (assets other than government bonds)							
Social contributions diverted to mandatory private pension scheme 48	0.8	1.0					
Pension expenditure paid by mandatory private pension scheme 49	0.0	0.0					
Labour productivity growth	3.6	4.7	2.4	2.0	2.3	2.0	1.5
Real GDP growth	6.9	0.7	1.4	1.0	1.1	0.9	1.4
Participation rate males (aged 20-64)	78.3	77.3	79.6	80.0	79.1	79.4	80.7
Participation rate females (aged 20-64)	68.3	68.0	70.7	70.4	68.4	68.2	70.2
Total participation rates (aged 20-64)	73.3	72.6	75.2	75.3	73.8	73.8	75.5
Unemployment rate (. people aged 15-64)	6.9	10.2	8.8	8.0	7.3	7.3	7.3
Population aged 65+ over total population	17.3	17.5	21.5	24.3	27.1	30.1	31.8

⁴⁸ Revenue from social security contributions or other revenue for the mandatory additional pension insurance, with which the accounts payable can be covered.

⁴⁹ Pension expenditure or other social benefits paid by the mandatory additional pension insurance.

Table 7a: Contingent Liabilities

of GDP	2014	2015
Government guaranteed debt	0.6	0.6
Of which: linked to the financial sector	0.2	0.1

Table 8: Basic assumptions

	2014	2015	2016	2017	2018
Short-term interest rate (annual average) 6-month LIBOR in EUR.	0.21	0.01	0.03	0.14	0.31
Short-term interest rate (annual average) 6-month LIBOR in USD.	0.33	0.67	1.91	3.27	4.05
Long-term interest rate (annual average).	3.35	2.36	2.40	2.48	2.56
USD/EUR exchange rate (annual average)	1.33	1.11	1.10	1.10	1.10
Nominal effective exchange rate. percentage change. previous year = 100 ⁵⁰					
EUR/BGN exchange rate (annual average)	1.95583	1.95583	1.95583	1.95583	1.95583
World economy (excluding EU). GDP growth.	3.3	3.5	3.7	3.8	3.8
EU GDP growth.	1.3	1.6	1.8	1.9	1.9
Growth of relevant foreign markets.					
World import volumes. excluding EU.					
Oil Brent (USD/barrel)	98.9	61.5	68.8	74.4	77.8
International prices of non-energy goods.	-4.6	-5.0	0.8	0.8	0.9
International prices of food products.	-7.1	-4.3	0.2	0.2	0.3
International prices of agricultural raw materials.	-3.6	-6.1	2.1	2.2	2.2
International prices of metals.	-6.6	-5.3	1.1	1.2	1.3



⁵⁰ The positive values reflect appreciation, the negative – depreciation.