



## Bulgaria: Staff Concluding Statement of the 2019 Article IV Mission

February 1, 2019

*Bulgaria delivered a robust economic performance in 2018, supported by sound macroeconomic policies. Translating this positive momentum into faster per capita income convergence toward the advanced EU partners continues to be the key policy challenge. Deeper integration into the EU through the newly agreed ERM II preparation process will be helpful in this regard. Beyond that, the task is to push ahead with broad-based reforms to strengthen institutions and public goods provision, to improve education and healthcare sectors, and to address labor market bottlenecks. Sustained reforms in these areas will help slow emigration and stimulate productivity growth.*

1. Economic performance remains robust, making this a good time for pushing ahead with reforms. Output is estimated to have grown by 3.2 percent in 2018, unemployment to have fallen to close to 5 percent, and the current account to have recorded another sizable surplus. Prospects for 2019 are for more of the same—we are projecting real GDP growth of 3.3 percent. However, the downside risks to this outlook have recently risen, owing to a sharper-than-anticipated slowdown in global trade and unsettled financial markets.
2. Bulgaria's integration with the EU continues to deepen, this year through the preparations for ERM II entry. The Bulgarian authorities and ERM II parties have agreed that Bulgaria will join ERM II and the banking union simultaneously. The agreement on ERM II preparation includes several additional commitments, which will help support financial sector supervision, improve SOE governance, and strengthen the anti-money laundering (AML) framework. Completing these commitments and joining ERM II and the banking union would further underpin the credibility of policies, in addition to many benefits that the EU membership has brought.
3. Translating these positive developments into sustained faster income convergence over the medium run requires continued broad-based reforms. Bulgaria has seen good growth and income convergence since the global financial crisis, albeit at a slower pace than before, and faces medium- to long-term growth and fiscal challenges due to persistent emigration and population aging. The main areas for improvement are the quality of institutions, including government efficiency and governance; infrastructure; education and health; and labor supply. A resilient financial sector and prudent fiscal policy provide fertile ground for reforms in these areas to take root, even as global risks have risen.

4. Government policy's focus on fiscal prudence and more spending on human and physical capital is appropriate. The 2018 fiscal balance recorded a small surplus (0.1 percent of GDP) exceeding the budget target, on account of revenue overperformance and capital under-spending. The small deficit (-0.5 percent of GDP) budgeted in 2019 reflects a projected increase in EU funds absorption and spending in critical areas (education, health, and infrastructure). A balanced budget is envisaged starting in 2020, to be achieved through a moderate rise of spending on non-wage items. These targets are consistent with the need to preserve buffers in light of more volatile external demand prospects and the currency board arrangement. Considering further Bulgaria's low level of public debt, there is ample space for allowing automatic stabilizers to operate freely in response to unexpected shortfalls in external demand or other shocks.

5. Bulgaria's relatively small public sector puts a premium on enhancing the efficiency in revenue administration and expenditure management.

- We support measures undertaken by the government and consider that further efforts are needed to strengthen revenue mobilization. We advise assessing the capacity of revenue administration with a view to developing a comprehensive strategy to improve efficiency. One area will be to reduce the sizable VAT compliance gap.
- There is scope for increasing public spending efficiency, particularly in public investment management, given that the quality of public infrastructure is viewed to be lagging in several areas. To this end, among others, we advise establishing guidelines for project appraisal and developing selection criteria for nationally funded investment projects. We support the ongoing project to adopt an E-procurement system, which would help address the loopholes in the procurement process.
- Functional review of public sector employment and wages would improve the expenditure management.

6. Governance reforms are critical means for strengthening the quality of institutions. While progress has been made, there still is a need for simultaneous progress and steadfast implementation on various fronts.

- The government has advanced reforms under the Cooperation and Verification Mechanism (CVM), including by establishing the unified anti-corruption commission and strengthening the independence between judges and prosecutors. Appreciating the progress made, the latest CVM report suggested the possibility of concluding the CVM in 2019. Pending recommendations include implementing the newly-adopted anti-corruption framework and improving the reporting of progress.

- Greater efficiency and transparency in public investment management would enhance the quality of investment and improve governance in the utilization of public resources.
- The forthcoming alignment of state-owned enterprise (SOE) legislation with OECD guidelines would help strengthen SOE governance. The guidelines recommend, among other things, developing a unified ownership policy, appointing well-qualified board members, and adopting high-quality accounting and disclosure standards.
- Strengthening the AML framework, including by transposing the fifth EU AML Directive into national legislation, should also contribute to stronger governance.

7. Sustaining education reform would improve labor productivity and support vulnerable groups. Strong government finances provide room to allocate additional resources with a view to closing the gap with peers in educational outcomes. We support ongoing efforts in this direction, including to ensure equal access to quality education; reduce the high rate of early leavers from education and training; update curricula to better reflect evolving work demand; and attract young teachers given the fastest-aging teachers among EU countries.

8. Many welcome policies are in operation to address structural bottlenecks and ease labor shortages. The government supports training and qualification programs for the skilled to complement a tertiary education upgrading, runs the Youth Guarantee program to support training and job search, is making efforts to bring back overseas Bulgarians, and has signed worker import agreements with neighboring countries. We encourage deepening the collaboration between education institutions and businesses and expanding the coverage of the Youth Guarantee program.

9. There is scope to improve the public health system, including coverage and spending efficiency. Healthcare is expensive for the outcomes and out-of-pocket payment remains high. The government is taking steps to enhance public health spending efficiency, including implementing a plan to optimize medicine spending and establish E-healthcare system. In this context, we see a need for further efforts to strengthen primary and preventive care.

10. The Bulgarian National Bank (BNB) has made steady progress with strengthening banking sector oversight. The BNB has vested decision making authority on banking supervision in the Governing Council. Consistent with the recommendations of the 2017 Financial Sector Stability Assessment, the BNB strengthened the legislation for related-party lending and formalized the supervisory review and evaluation process (SREP). The BNB is also supporting the ECB's comprehensive assessment of the banking sector. Joining the banking union thereafter at the same time as ERM II will further strengthen banking supervision. Given that non-performing loans (NPLs) have declined but remain well above

the EU average, the BNB should maintain its vigilance on NPLs. The implementation of the SREP should ensure that banks with high NPLs have sufficient capital buffers.

*The mission would like to thank the authorities and other counterparts for the constructive dialogue and kind hospitality.*

*An IMF mission, led by Jaewoo Lee, visited Sofia from January 21 to February 1 to conduct the 2019 Article IV consultation discussions.*

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or ‘mission’), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under [Article IV](#) of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.