

**FOR
AGENDA**

SM/11/124
Supplement 1

June 16, 2011

To: Members of the Executive Board

From: The Secretary

Subject: **Bulgaria—Staff Report for the 2011 Article IV Consultation—
Informational Annex**

The attached informational annex is being issued as a supplement to the staff report for the 2011 Article IV consultation with Bulgaria (SM/11/124, 6/16/11), which will be brought to the agenda for discussion on **a date to be announced**. The Secretary's Department has been notified by the authorities of Bulgaria that their explicit consent is required prior to the publication of Board documents on Bulgaria. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities indicating that they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper. Any requests for modifications for publications are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Ms. Purfield (ext. 34093), Ms. Mitra (ext. 39523), and Mr. Pouvelle (ext. 39904) in EUR.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the European Central Bank and the WTO Secretariat on Friday, June 24, 2011; and to the European Bank for Reconstruction and Development, the European Commission, the European Investment Bank, and the Organisation for Economic Cooperation and Development, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. This supplement is not being distributed in hard copy. It can be accessed in the Institutional Repository. A link to this document can be found in the daily list (<http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm>) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

BULGARIA

Staff Report for the 2011 Article IV Consultation—Informational Annex

Prepared by the European Department

June 15, 2011

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I. BULGARIA: FINANCIAL POSITION IN THE FUND

(As of April 30, 2011)

I. Membership Status: Joined: September 25, 1990;

Article VIII

II. General Resources Account:	SDR Million	%Quota
<u>Quota</u>	640.20	100.00
<u>Fund holdings of currency (Exchange Rate)</u>	606.22	94.69
<u>Reserve Tranche Position</u>	34.01	5.31
III. SDR Department:	SDR Million	%Allocation
<u>Net cumulative allocation</u>	610.88	100.00
<u>Holdings</u>	610.89	100.00

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

<u>Type</u>	<u>Date of Arrangement</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
Stand-By	Aug 06, 2004	Mar 31, 2007	100.00	0.00
Stand-By	Feb 27, 2002	Mar 15, 2004	240.00	240.00
EFF	Sep 25, 1998	Sep 24, 2001	627.62	627.62

VI. Projected Payments to Fund ^{1/}

(SDR Million; based on existing use of resources and present holdings of SDRs):

	<u>Forthcoming</u>				
	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Principal					
Charges/Interest	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>
Total	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>	<u>0.01</u>

^{1/} When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

VII. Implementation of HIPC Initiative: Not Applicable

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI): Not Applicable

IX. Exchange Arrangements

The currency of Bulgaria is the lev. Since July 1, 1997, the Bulgarian National Bank has operated a currency board arrangement. From July 1, 1997 to December 31, 1998, the lev was pegged to the Deutsche Mark at BGN 1000 per Deutsche Mark. Since January 1, 1999 the lev has been pegged to the euro at BGN 1.95583 per euro. Bulgaria joined the European Union (EU) on January 1, 2007. Bulgaria has accepted the obligations of Article VIII, Sections 2–4, and maintains an exchange system free of restriction on the making of payments and transfers for current international transfers.

X. Resident Representative

Mr. Lybek is the Regional Resident Representative, based in Bucharest. He took up the position on March 31, 2009.

II. BULGARIA: IMF-WORLD BANK RELATIONS

A. Partnership in Bulgaria's Development Strategy

1. The World Bank has been leading the policy dialogue in structural and institutional reforms aimed at Bulgaria's successful EU integration and convergence. On May 17, 2011 the Board of Directors discussed the Country Partnership Strategy (CPS) of the Bank which outlined the roadmap for the Bank's country support for the period 2011-2013. The CPS maintains a strong focus on Bulgaria making the most of its EU membership. It aims to partner with Bulgaria in strengthening national institutions and capacity to meet EU targets and in accelerating the absorption of EU grant funds. The objective of the CPS is to support Bulgaria in strengthening institutions and policies to achieve smart, sustainable, and inclusive growth. The CPS proposes a program dominated by knowledge and advisory services complemented by a modest lending program. World Bank knowledge and advisory services would focus on policy reforms, sector strategies and strengthening institutional capacity for increased EU funds absorption. Activities within the ongoing lending portfolio from the previous CPS are being also realigned to support Bulgaria's EU funds absorption priority. A railway reform support financing package composed of a series of three DPLs and an investment loan complementary to EU funding are included in the indicative lending program. World Bank potential financial support will be discussed upon the Government's request, with priority given to results based lending. The Bank will continue to undertake substantial knowledge and advisory services on policy reforms in select sectors and themes of Bulgaria's National Reform Program 2011-2015 such as innovation, education, business regulation, transport, and water, green growth, and social inclusion.

B. IMF-World Bank Collaboration in Specific Areas

2. The Fund team led by Ms. Purfield (mission chief) met with the World Bank Bulgaria team led by Mr. Harrold (Country Director of Central/South Europe and Baltics) in October 2010, to identify macro-critical structural reforms and to coordinate the two teams' work for the period October 2010 – September 2011. A meeting was also held with the WB country manager, Mr. Repnik (October 1) in Bulgaria. This memo has been updated in the context of discussions for the Article IV consultation

3. Bulgaria's main macroeconomic challenges are to maintain confidence in the currency board arrangement by pursuing prudent fiscal policies, ensuring financial system stability, and shifting growth towards the tradable sector. Fiscal discipline will be key to supporting the currency board arrangement. Continued prudent regulation and adequate capital buffers will help maintain financial system stability, while improvements in the business climate will facilitate more sustainable tradable-based growth.

4. Based on this shared assessment, the teams identified five structural reform areas as macrocritical in view of their central role in achieving fiscal consolidation and enhancing growth.

- **EU funds absorption.** Increased absorption of EU funds through improvements of administrative capacity and upgrading planning, execution, and monitoring systems will play a vital role. Rationalization of public administration through elimination of unnecessary or duplicated units and restructuring staff will also be important.
- **Pension reform.** The combination of large pension increases and reductions in social security contributions rates in the past has widened the gap between pension contributions and expenditures. Key elements of reform are: (i) slowing of pension increases; (ii) adjustment of pension parameters; (iii) addressing underreporting of insurable income.
- **Healthcare reform.** Mispricing and other distorted incentives have created financing pressures for the public health insurance fund, calling for a comprehensive reform focusing on efficiency and quality of the system – including through rationalizing in-patient care.
- **Education reform.** Building on past achievement, education reforms should focus on improving results. The areas of reform include measures to enhance the quality of student learning and to improve access to education.
- **Shifting growth towards the tradable sector.** With the end of the domestic demand boom, the engine of Bulgaria's growth will need to shift towards exports. Moderate wage growth, improved labor market flexibility, and strengthening the business environment by cutting red tape and reducing the regulatory costs for doing business are called for to facilitate the shift.
- **Development of basic infrastructure and energy.** Sustaining development of basic infrastructure and energy are a high priority to reduce costs of the transport network, to strengthen energy security, and hence improve competitiveness of the economy.

5. **The teams agreed that the Bank and the Fund share responsibility on financial sector issues, revenue administration, and pension reforms, while the Bank will lead EU funds absorption, basic infrastructure, business environment, education reforms, and social inclusion.** Both teams will keep the other apprised of upcoming missions and assessments. World Bank country economists participated in both the October 2010 IMF Staff Visit and the May 2011 Article IV Consultation and the IMF have assisted with World Bank work on competitiveness.

Appendix 1. Bulgaria: Bank and Fund activities in macro-critical structural reform areas, May 2010- June 2011.

Work Program	Products	Delivery Date
Bank	Gas Sector Policy Issues (analytic work)	Implementation through September 2011
	Poverty & Social Policy Monitoring (analytic work)	June 2011
	Water Sector Strategy (advisory)	May 2011
	Education Sector (analytic work)	June 2011
	Competitiveness Through Innovation (analytic work)	Implementation through November 2011
	Technical assistance on pensions (analytic work and workshops)	April 2011
	MAC-Public Finance for Growth and Competitiveness (analytic work)	June 2011
	Railway Sector Development Policy Loan (lending)	Mandate for negotiations expected in June 2011
Fund	Staff visit to provide input for 2011 budget	September 23 -October 4, 2010
	TA provision on pension reform - 'Bulgaria- Reforming the pension system' report issued in November 2010	October 13-26, 2010
	Article IV Consultation- Board meeting scheduled on July 1, 2011	May 10-20, 2011

C. The World Bank Group Strategy and Lending Operations

6. The Country Partnership Strategy (CPS) for Bulgaria¹, discussed by the Bank's Board on May 17, 2011, is anchored in Bulgaria's National Reform Program to implement the Europe 2020 Strategy and focused on three main pillars: (i) policy reforms for National Reform Program to implement Europe 2020 Strategy, (ii) strategies and institutions to accelerate EU funds absorption, and (iii) complementing EU financing.

7. The current active Bank portfolio in Bulgaria consists of 4 operations at the total amount of US\$ 353 equivalent. The World Bank's lending program in Bulgaria to date comprises 46 IBRD operations with a total original commitment of US\$3,003 million equivalent, consisting of 15 adjustment loans (US\$1,725.8 million), 24 investment projects (US\$1123 million), one debt reduction loan (US\$125 million), four Bank-managed Global Environmental Fund (GEF) grants, and two Bank-managed Prototype Carbon Fund (PCF) operations. Of these 46 operations, 42 have been completed, of which 13 have been fully or partially cancelled during implementation, and 4 operations are currently under implementation (Table 1).

Table 1. Bulgaria: Active World Bank Operations (Net of Cancellations)

Operation	US\$ million	Board Date
1. Second Trade and Transport Facilitation in Southeast Europe (TTFSE 2)	52.8	2007
2. Road Infrastructure Rehabilitation Project	122.5	2007
3. Social Inclusion Project	59.0	2008
4. Municipal Infrastructure Development Project	118.7	2009

8. Economic and Sector Work. The country diagnostic work recently completed by the Bank focuses on assessing the quality of education in Bulgaria and review of the Bulgaria's school autonomy reform, long-term care policies for older populations, and better regulation topical studies on: (i) administrative and regulatory barriers to business, (ii) ex-post impact assessment of the Act on Limiting Administrative Regulation and Administrative Control on Economic Activity, and (iii) reforming the regime of state fees.

9. As of April 30, 2011, IFC has 30 projects (completed and ongoing) in Bulgaria with total commitments of over US\$ 660 million. The single biggest investment of IFC in the country is in the field of renewable energy in the form of a loan for the construction of the largest wind park in Bulgaria. IFC is also involved in the development of the *Galata* gas field near the Black sea coast. In line with IFC's strategic goals for Bulgaria, IFC has supported a company investing in agricultural land and promoting land consolidation. In the financial sector, IFC is supporting two specialized SME banks; it established Bulgaria's first micro-lending bank and has invested in a venture fund, which is also targeting the SME sector. In other industries, IFC had contributed to key manufacturing projects in the country—it has supported the modernization and expansion of an electronics producer, a large steel

¹ International Bank for Reconstruction And Development and International Finance Corporation Country Partnership Strategy for Bulgaria for the period 2011-2013, April 20, 2011.

mill, and two glass processing plants. Some IFC projects entail an important environmental component. One of the manufacturing plants, for example, is purchasing equipment which would reduce its GHG emissions and the electronics producing company is making sensors for cars that monitor the emission of polluting gases and improve fuel efficiency.

Questions may be referred to Ms. Stella Ilieva (322-504-0998) and Ms. Sylvia Stoyanova (3592-9697-220).

III. BULGARIA: STATISTICAL ISSUES

Data provision is generally adequate for surveillance purposes. Bulgaria participates in the SDDS since 2003.

Real sector

1. The National Statistical Institute (NSI) is responsible for compiling national accounts, based on a system consistent with the *System of National Accounts 1993 (SNA 1993)* and the *European System of Accounts 1995*. GDP data by activity and expenditure categories are compiled and reconciled within an annual supply and use framework. However, government output and final consumption are estimated on a cash basis. In addition, published national accounts include current and capital accounts for the five main domestic sectors (general government and its sub-sectors, financial corporations, nonfinancial corporations, nonprofit institutions serving households, and households). Financial accounts and balance sheets by institutional sectors and sub-sectors are compiled on annual basis since 2006. Quarterly financial accounts and balance sheets are prepared by Bulgarian National Bank.
2. The NSI has compiled estimates of quarterly GDP by the production and expenditure approaches in current and constant prices since 1994. The preliminary flash estimates of GDP and its components by production and expenditure side are produced and disseminated 45 days after the reference period. The quarterly updates are disseminated 70 days after the end of the reference quarter with final figures disseminated after approximately 5 quarters. The annual data are disseminated about 5 quarters after the end of the reference year. The estimates at constant prices, which follow international standards, use chain-linked indices. Problems remain in the coverage of private sector activities as well as regarding constant price estimates of capital formation and external trade, although progress has been made in the development of export and import deflators.
3. On price data, the NSI produces a domestic consumer price index (CPI), a harmonized consumer price index (HICP) according to Eurostat methods, and a producer price index (PPI). All are updated monthly. The CPI series begins in 1995, the PPI in 2000 and the HCPI in 2005 (for earlier years it is set equal to the CPI). The coverage of the CPIs was extended, although they still exclude some important sectors, mainly owner-occupied housing and health and life insurance. Since 2004, financial services are included. Currently, work has started on inclusion of owner-occupied housing in CPI within a Eurostat project. The geographical coverage of the index is restricted to 27 urban areas that account for an estimated 65 percent of sales.
4. The flow of customs data has improved significantly in recent years and a new system for processing customs records is near completion. The development of export and import unit value indices is progressing smoothly and additional support is expected from Eurostat in this area. The current indices are used as deflators for the import and export components of the national accounts. The Import and Export Division of the NSI meets monthly with the

BNB to review data issues and ensure consistency between the NSI export and import data and the balance of payments data.

5. The national account data on employment and hours worked are compiled by the NSI based on Labor Force Survey and adjusted according to the ESA'95 methodology. The NSI also obtains current monthly estimates from a quarterly survey of establishments using all public enterprises and a sample of private employers that excludes establishments with less than five employees. The sample included 14,500 private employers out of approximately 142,000 qualifying private enterprises. The NSI household labor force survey is an alternative source of data, but improvements are needed to make it more consistent with the establishment survey, especially regarding agricultural employment. The survey is conducted four times a year.

6. The NSI also compiles and publishes wage data for various economic sectors. The main shortcomings include: (i) under-reporting of private sector wages; and (ii) reporting of average gross earnings only, not wages for time worked and wages by occupation. Since 2002, every four years a survey on earnings is conducted which provides information about average monthly and hourly earnings by economic activity, by occupation, by gender and by education. The National Social Security Institute (NSSI) administrative data are currently used to estimate wages by occupation and age (as well as the number of self-employed and employment in small firms). The household budget survey could provide an alternative source of data for private sector wages.

7. A Population Census was conducted in early 2001 and is a source for redesigning the household surveys conducted by the NSI, particularly the household budget survey and the labor force survey.

Government finance

8. In recent years, following the recommendations of a combined STA/FAD mission and within the framework of fiscal reporting requirements for EU accession, the authorities have made significant progress on implementing accrual accounting for government, budgetary and statistical systems. Consolidated data on a cash basis, covering general and central government operations, are routinely reported for publication in the *GFS Yearbook/Annual CD-ROM* and in *IFS*. In addition, quarterly accrual GFS data are reported on a quarterly basis for publication in *IFS*, through Eurostat. Since September 2008, the Ministry of Finance (MOF) prepares and submits the SDDS indicators for the central government finances in the IMF's GFSM 2001 format. The same indicators are published on the MOF's website on a monthly and quarterly basis.

9. The Ministry of Finance prepares data on the execution of the consolidated government budget on a monthly basis, following the national presentation. These data are not according to *GFS* standards. Aggregate data on revenue, expenditure, balance of the general government and composition of the financing (in national formats) are published in the monthly bulletin and posted on the MOF's website, in addition to the GFSM 2001 data.

The authorities have made progress in presenting data on a disaggregated basis, including expenditure by functional classification. In addition, a full economic classification of expenditure is now available, and the authorities have provided such data on an annual basis back to 1998.

Money and banking statistics

10. BNB reports monetary data for publication in *IFS* based on the ECB framework for the collection and compilation of monetary data.

Balance of payments

11. Bulgaria provides quarterly balance of payments (BOP) statistics for dissemination in the *IFS* on a timely basis. Yearly BOP data are disseminated in the Balance of Payments Statistics Yearbook up to 2008. The BNB derives other sectors investment income data on reinvested earnings, (debit) from the annual direct investment surveys of the NSI, as well as through surveys of the largest foreign-owned enterprises, used for preliminary estimates. Starting from 2002, data series on freight were revised according to a new methodology introduced jointly by the BNB and the NSI. Since joining the EU in January 2007, the trade data with EU countries are being collected following the INTRASTAT system. Data collection for imports and exports with non-EU member states and the movement of goods within the EU are still recorded through customs declaration.

Table 1. Bulgaria: Common Indicators Required for Surveillance
As of May 23, 2011

	Date of latest observation	Date received	Frequency of data ⁶	Frequency of reporting ⁶	Frequency of publication ⁶	Memo Items:	
						Data Quality – Methodological soundness ⁷	Data Quality Accuracy and reliability ⁸
Exchange Rates	May 2011	05/19/2011	M	M	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	April 2011	05/20/2011	M	M	M		
Reserve/Base Money	March 2011	04/27/2011	M	M	M	O, O, LO, LO	O, O, O, O, O
Broad Money	March 2011	04/27/2011	M	M	M		
Central Bank Balance Sheet	April 2011	04/27/2011	M	M	M		
Consolidated Balance Sheet of the Banking System	March 2011	04/27/2011	M	M	M		
Interest Rates ²	March 2011	04/29/2011	M	M	M		
Consumer Price Index	April 2011	05/12/2011	M	M	M	O, LO, O, O	LO, LO, O, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	Dec 2010	04/26/2011	A	A	A	O, LO, O, LO	LO, O, O, O, NO
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	Dec 2010	04/26/2011	M	M	M		
Stocks of General Government and General Government-Guaranteed Debt ⁵	Dec 2010	04/26/2011	M	M	M		
External Current Account Balance	2010 Q4	04/12/2011	Q	Q	Q	LNO, LO, O, LO	LNO, LNO, LNO, LO, LO
Exports and Imports of Goods and Services	2010 Q4	04/12/2011	Q	Q	Q		
GDP	2011 Q1 (flash estimate)	05/13/2011	Q	Q	Q	O, LO, O, LO	O, O, O, O, O
Gross External Debt	2010 Q4	04/12/2011	Q	Q	Q		

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions. ² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds. ³ Foreign, domestic bank, and domestic nonbank financing. ⁴ On a gross cash basis. The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and local governments. ⁵ Including currency and maturity composition. ⁶ Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA). ⁷ Reflects the assessment provided in the data ROSC published in December 2003, which is based on the findings of the mission that took place during January 15-30, 2003 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO). ⁸ Same as footnote 7, except referring to international standards concerning (respectively) source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.