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January 25, 2021

Statement by Mr. Huh and Mr. Becker on Bulgaria
(Preliminary)
Executive Board Meeting
January 27, 2021

We thank staff for the comprehensive papers and Mr. Hilbers and Mr. Manchev for the helpful Buff statement. We broadly agree with the findings of the staff report and their policy recommendations for Bulgaria.

The COVID-19 pandemic has severely impeded economic activity in Bulgaria, as it has in most other countries. It is, however, fortunate that the authorities had created the fiscal space that is now necessary to respond to the crisis without placing undue pressure on debt sustainability. It is encouraging to note that the initial lockdown helped contain the virus and that subsequent responses remain flexible with respect to delivery of care, eligibility and addressing administrative bottlenecks. We acknowledge the importance of the impact felt in the tourism industry and on remittances, in part because many countries in our own constituency are exposed in a similar manner. The health response is appropriately targeted at individuals, with around two-thirds of spending targeted at households, job retention and health care.

We agree that it is appropriate to allow the fiscal position to temporarily deteriorate to contain the pandemic. The starting point was strong and there are plans to return spending to a more sustainable level once the health emergency becomes less severe. It is notable that the projected deterioration in the public accounts, relative to the pre-COVID estimate, is entirely on the expenditure side. This is a little surprising given the impact on economic activity. Our prior would have been that, with slower economic activity and the associated impact on unemployment and company profits, the revenue base would also be eroded. *Could staff please elaborate on why revenue remains almost entirely unaffected in the forward projections?* We also concur that improvements in the efficiency of public spending and investment should always be encouraged.

Structural reform and infrastructure improvements are important in maintaining the momentum of the recovery, closing the existing output gap and maximizing the benefits from accession to the euro area. There is a striking shortfall in education and training and the authorities are to be commended for recognizing this and planning to address rising inequality through education reform. It is notable that in recent years Bulgaria has made significant progress in reducing the most severe aspects of poverty and deprivation. With respect to public investment in much needed infrastructure it is interesting to call out the Annex which gives examples of 'crowding in' private investment. *With this in mind, and given the relatively sound fiscal position, could staff elaborate on the possibility of providing further fiscal stimulus by bringing forward planned infrastructure projects?* This would aid the recovery, invest in the future and further develop relationships with EU partners.

The financial system is stable but the increase in non-performing loans should be carefully monitored. Banks have adequate capital buffers to absorb losses for now but there is a high degree of uncertainty about how long and severe the fallout from the pandemic will be. Attempting to raise new capital in an environment when existing buffers are depleted would be difficult and costly.

A more digital and greener economy would advance prospects for Bulgaria. The efficiencies conferred by adoption of digital forms of payments in the financial sector, retail, distribution and trade would significantly free up resources and help restructure to a more dynamic and flexible economy. The long-term prospects for the country would also be aided by planning a transition toward greener forms of electricity generation. We understand that the authorities are awaiting guidance from the EU but perhaps developing a domestic plan would be prudent.

The external sector is assessed by staff to be resilient but temporarily impacted by the COVID-19 pandemic. We note the reference to possible policy gaps affecting the current account. *Could staff elaborate on the structural factors that are impeding investment and encouraging saving in a manner that raises the current account by a significant margin (3.7 per cent of GDP) above its estimated fundamentals?*