




BULGARIAN ECONOMY

IN THE SECOND QUARTER OF 2003

REPORT BY
**THE CENTER
FOR ECONOMIC
DEVELOPMENT**

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ABBREVIATIONS USED

ABSSI.....	ACT ON THE BUDGET OF STATE SOCIAL INSURANCE	MRF.....	MOVEMENT FOR RIGHTS AND FREEDOMS
AEE.....	ACT ON ENERGY EFFICIENCY	MSIC.....	MANDATORY SOCIAL INSURANCE CODE
ASME.....	AGENCY FOR SMALL AND MEDIUM-SIZED ENTERPRISES	MTC.....	MINISTRY OF TRANSPORT AND COMMUNICATIONS
BAIT.....	BULGARIAN ASSOCIATION FOR INFORMATION TECHNOLOGIES	NB.....	NATIONAL BUDGET
BAS.....	BULGARIAN ACADEMY OF SCIENCE	NEC.....	NATIONAL ELECTRIC COMPANY
BASSCOM..	BULGARIAN ASSOCIATION OF SOFTWARE COMPANIES	NFA.....	NATIONAL FRAMEWORK AGREEMENT
BATA.....	BULGARIAN ASSOCIATION OF TOURIST AGENCIES	NHIF.....	NATIONAL HEALTH INSURANCE FUND
BCC.....	BANK CONSOLIDATION COMPANY	NMEC.....	NATIONAL MEDICAL EXAMINATION COMMITTEE
BCCI.....	BULGARIAN CHAMBER OF COMMERCE AND INDUSTRY	NMSS.....	NATIONAL MOVEMENT SIMEON 2ND
BIA.....	BULGARIAN INDUSTRIAL ASSOCIATION	NSI.....	NATIONAL STATISTICS INSTITUTE
BIBA.....	BULGARIAN INTERNATIONAL BUSINESS ASSOCIATION	NSSI.....	NATIONAL SOCIAL SECURITY INSTITUTE
BNB.....	BULGARIAN NATIONAL BANK	OECD.....	ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT
BNR.....	BULGARIAN NATIONAL RADIO	PA.....	PRIVATIZATION AGENCY
BNT.....	BULGARIAN NATIONAL TELEVISION	PIA.....	PERSONAL INCOME TAX
BRS.....	BULGARIAN RIVER SHIPPING	PPCA.....	PRIVATIZATION AND POST-PRIVATIZATION CONTROL ACT
BSE.....	BULGARIAN STOCK EXCHANGE	PPF.....	PROFESSIONAL PENSION FUND
BTC.....	BULGARIAN TELECOMMUNICATION COMPANY	R & D.....	RESEARCH AND DEVELOPMENT
CEFTA.....	CENTRAL EUROPEAN FREE TRADE ASSOCIATION	RES.....	RENEWABLE ENERGY SOURCES
CEP.....	COMMON ECONOMIC POLICY	RHIF.....	REGIONAL HEALTH INSURANCE FUND
CHPP.....	COMBINED HEAT AND POWER PLANT	RMEC.....	REGIONAL MEDICAL EXAMINATION COMMITTEE
CoM.....	COUNCIL OF MINISTERS	SAC.....	SUPREME ADMINISTRATIVE COURT
CPC.....	COMMISSION FOR PROTECTION OF COMPETITION	SCC.....	SUPREME COURT OF CASSATION
DTAA.....	DOUBLE TAXATION AVOIDANCE AGREEMENT	SERC.....	STATE ENERGY REGULATORY COMMISSION
EA.....	EMPLOYMENT AGENCY	SJC.....	SUPREME JUDICIAL COUNCIL
EC.....	EUROPEAN COMMISSION	SME.....	SMALL AND MEDIUM-SIZED ENTERPRISES
EDC.....	ELECTRICITY DISTRIBUTION COMPANY	SSI.....	STATE SOCIAL INSURANCE
EEA.....	ENERGY EFFICIENCY AGENCY	SU.....	STATE UNIVERSITIES
EPA.....	ENVIRONMENTAL PROTECTION ACT	UNDP.....	UNITED NATIONS DEVELOPMENT PROGRAM
EU.....	EUROPEAN UNION	UPF.....	UNIVERSAL PENSION FUND
FR.....	FISCAL RESERVE	VAT.....	VALUE ADDED TAX
GDP.....	GROSS DOMESTIC PRODUCT	VATA.....	VALUE ADDED TAX ACT
GLI.....	GENERAL LABOR INSPECTORATE	VPF.....	VOLUNTARY PENSION FUND
GMO.....	GENETICALLY MODIFIED ORGANISM		
GS.....	GOVERNMENT SECURITIES		
GVA.....	GROSS VALUE ADDED		
HPP.....	HYDRO-POWER PLANT		
ICT.....	INFORMATION AND COMMUNICATION TECHNOLOGIES		
IT.....	INFORMATION TECHNOLOGIES		
JSC.....	JOINT-STOCK COMPANY		
MAF.....	MINISTRY OF AGRICULTURE AND FORESTS		
MEER.....	MINISTRY OF ENERGY AND ENERGY RESOURCES		
MES.....	MINISTRY OF EDUCATION AND SCIENCE		
MLSP.....	MINISTRY OF LABOR AND SOCIAL POLICY		
MNB.....	MARITIME NAVIGATION BULGARE		
MoE.....	MINISTRY OF ECONOMY		
MoF.....	MINISTRY OF FINANCE		
MoH.....	MINISTRY OF HEALTH		

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Bulgarian economic development in the second quarter of 2003 can be given a positive assessment in terms of the dynamics of some macroeconomic and sector indicators.

Tourism, foreign trade, capital market and banking system indicators, as well as some macroeconomic indicators like GDP growth, inflation and unemployment level register improvement. Some revival is also observed in the sector policy for energy and high technologies and communications, although real changes in the regulatory framework lie ahead. An important step has been made in the areas of transport and environmental policy with the temporary closing of the corresponding chapters of the negotiations with the European Union, yet there is a need of serious efforts to fulfill commitments. Social security regulations also register improvement during the quarter.

At the same time, clear government policy steps towards continuing structural reforms and solving major problems of the business were not observed. The delay in the processes of privatization and attraction of sizable foreign investments persists. The functioning of the judiciary system and the fight against corruption did not register notable improvement.

The Estat index of business climate in Bulgaria registers some improvement as a result of the higher investment activity of companies, despite the growing discontent with the burden of social security and health insurance contributions, and the existing unfair competition. The lack of confidence in the Government economic policy reached peak values.

Business climate in Bulgaria is evaluated employing a summarized estimate of the indicator by the representatives of some 400 interviewed enterprises. The latest survey was conducted in mid July. In July **the Estat index of business climate** integrated estimate improved to **+1.377** (compared to -0.61 for the first quarter), which is the highest value

registered since April 2002. Despite the reported growth, the assessment of the economic environment remains neutral and the positive value of the index should not be interpreted as real improvement of the environment. Managers' optimistic expectations about the future somewhat contradict the declared absence of competitive advantages and the lower assessments of the quality of company resources. The tendency to introduce new technologies registers increase and so does the tendency to take investment loans. The basic problems of managers in the second quarter of 2003 include: high social security burden, unfair competition, inequality of market subjects in terms of the legislation basis and the absence of adequate government policy for the promotion of business development.

In the second quarter of 2003 **NSI's general business climate indicator** registers generally lower levels compared to the previous quarter and also to the second quarter of last year. The dynamics of the business climate in industry indicator registers the best comparison characteristics of the four component indicators, which form the general business climate indicator. Business surveys in construction also outline a strong second quarter for the sector. The business climate in retail trade indicator registers a lower average level compared to the same quarter of 2002. According to NSI's surveys again, the business climate indicator in the services sector registers slight improvement and stabilization, having registered in March the lowest level since the start of NSI's business surveys in this sector.

In the second quarter of 2003 **GDP growth** taken on an annual basis is expected to reach lower levels compared to the same period of 2002 (5.6 per cent). There are two reasons for such expectations - the delayed production growth in industry and the more unfavorable business climate in the services sector (trade excluded) compared to May and June 2002. The negligible monthly increase of consumer prices from January to April turned into **deflation** in May and June and since December last year deflation of 1.4 per cent instead of accumulated inflation

was registered in June. The accelerated decrease of the number of registered **unemployed** observed since the beginning of 2003 continued in the second quarter. The economic effect of the decrease of unemployment and the increase of employment is now reflected in higher income, however it is not yet accompanied by higher economic productivity.

Overall, the second quarter of 2003 witnessed rather good execution of the **budget** according to the consolidated fiscal program, with surplus registering double increase compared to the second quarter of 2002 and amounting to BGN 627.1 m. At the end of June **fiscal reserve** registers slight increase and amounts to BGN 4 299.7 m, of which funds in BNB deposits amount to BGN 3 747.4 m, and funds in foreign exchange assets amount to BGN 2 219.7 m.

On 22 May 2003, Standard & Poor's increased the rating of Bulgarian government securities denominated in local currency and Bulgaria reached for the first time investment grade rating. At the end of the second quarter of 2003, total **state and state-guaranteed debt** amounted to BGN 17 364.8 m, recalculated at BNB's central exchange rate of the lev for 30 June 2003. Total debt registered a decrease of BGN 195.2 m compared to the first quarter of 2003. According to comparable data, the debt/GDP ratio decreased from 49.8 per cent at the end of March to 49.2 per cent at the end of June 2003. But in USD equivalent terms, total state and state guaranteed debt increased by USD 363.4 m in the period end of first quarter - end of second quarter. As at end of June total **foreign debt** amounted to EUR 7 736.4 m (compared to EUR 7 807.3 m at the end of the first quarter of 2003). Mostly owing to exchange rate fluctuations in the period end of March - end of June, total debt expressed in USD terms registered an increase of USD 81 m. As of 30 June 2003, total **domestic debt** amounted to BGN 2 233.9 m, registering a decrease of BGN 56.7 m, compared to the first quarter of 2003.

In the second quarter of 2003 the pace of **privatization** in the state sector remains highly unsatisfactory

again. Only 20 transactions for sale of companies with majority state interest and 5 for detached parts were made. Consequently, the Annual Privatization Plan is fulfilled at 22 per cent in terms of the sale of majority blocks of shares. Non-fulfillment in terms of the sale of minority blocks of shares is even higher. Only 29 transactions have been made and the annual program is fulfilled at only 5.8 per cent. Thus, halfway through the Government's mandate, the privatization process had negative effect on the overall activity of the ruling coalition NMSS-MRF. For the two years of their government they manifested apparent inability to take clear political decisions for the sale of "the big companies" BTC EAD and Bulgartabac Holding AD. Political infirmity, poor administrative capacity, heavy-handed lobbying and intervention in PA's work are at the heart of the international conflicts Bulgaria was dragged in upon the privatization of the two companies. Foreign financial analysts now report a high degree of risk of political instability in the country. This undermines the confidence in the Bulgarian Government and puts off investors. Bulgaria again missed its chance to offer good investment environment and to attract big international companies.

In the second quarter of 2003 the public space focus in the area of **small and medium-sized enterprises** was placed on the bill on the promotion of investments in small and medium-sized enterprises, introduced by ruling majority MPs, which envisaged development of a scheme to promote the venture capital in the SME sector. The established in the last six months tendency of the Agency for Small and Medium-sized Enterprises to organize information seminars and round tables with the participation of employers with a view to identify small and medium-sized business problems continued in the quarter under review, however it is not clear whether the agency has the administrative capacity and the political support to solve these problems. The financing sources of SMEs increased in the second quarter, with major small and medium-sized business problems including again the absence of well-directed tax and social security policy; the still high collateral for bank

loans, the absence of quality business ideas and plans, the rather poor corporate management, and the absence of credit history. Bulgaria is expected to change the definitions of micro, small, and medium-sized enterprises applied in the country, with a view to comply with the new EU definition of these notions approved in May 2003, which will take effect as of 1 January 2005.

In the second quarter of 2003 Bulgarian **foreign trade** continues to develop at accelerated pace. Export growth rates (3.3 per cent compared to the previous quarter and 34.6 per cent compared to the second quarter of 2002) are remarkable but remain notably lower than import growth rates (23.1 per cent and 43.9 per cent accordingly), which leads, of course, to further increase of the negative trade balance. Such trade development is indicative of a functioning economy with products selling well at the foreign markets (despite the continuing depression in the economy of major trade partners) and with ability to absorb the quickly growing import. We cannot but note as another reason for the higher import the low US Dollar exchange rate, which encourages importers to make profitable purchases, expecting to calculate prime and raw material expenses at the new rate upon possible subsequent appreciation of the dollar. The European Union remains a major partner with increasingly higher share in both export (nearly 58 per cent in the second quarter of 2003) and import (more than 50 per cent), and the development of the relationship with this market becomes determinant of the general trade dynamics. Export to EU growth rates (only 7.1 per cent compared to the first quarter of 2003) are considerably lower than import growth rates (27.9 per cent). This is a result of many factors, some concerning current problems of European economy and others - the needs of the Bulgarian economy and the specifics of Bulgarian production, a large portion of which is under processing agreements.

The amount of **foreign direct investments** attracted in the second quarter of 2003 is double compared to the second quarter of 2002. In the first six months of the year the volume of investments amounted to USD 526.9 m, registering an increase of 50 per

cent compared to the volume for the same period of 2002 and amounting to only USD 72.8 m less than the volume for the whole 2002, which was USD 599.7 m according to revised BNB data. Given that reinvested profit data are included at a later stage, the final volume of investments for the first six months can reach USD 550 m. On one hand, this is a good attestation of Bulgarian economy and indicates higher national demand, but on the other hand, the absence of sizeable green field investments and sustainable inputs by strategic investors remains a major economic policy problem.

Reforms in the **energy sector** continued in the second quarter of 2003. The first phase of the liberalization of Bulgaria's electricity market was completed, with SERC granting a eligible consumer status to 10 companies. A strategy for the privatization of the electricity distribution companies was prepared and, parallel to that, a start was given to the tender procedures for the construction of the gas distribution network and the gas supply of two of a total of eight Bulgarian regions. An energy efficiency bill was presented in the public space. It is to play an important role in promoting the more efficient use of energy resources by all national consumers. The terminated electricity export to Turkey, which became a fact in April, will also have a decisive role for the future development of the Bulgarian energy sector.

The international oil market conjuncture and the cheaper dollar compared to the lev resulted in minimum fuel price fluctuations and had minimum effect on the energy expenses of Bulgarian enterprises accordingly.

In the second quarter of 2003 the **transport sector** did not witness any development towards substantially improved quality of the transport services. Infrastructure projects did not register any noticeable progress and remain at the financing negotiation stage. The processes concerning the penetration of private operators in the railway sector and the management of airport and port infrastructures did not yield any specific results, either. MTC's announced strategic visions on the

SUMMARY

concessioning of Varna and Burgas airports promise by the end of the year more particular steps to attract the private sector in infrastructure management. The agreements reached between Bulgaria and the European Union in the negotiations on the Transport Policy Chapter, which was closed in the quarter under review, will have serious impact on transport sector development.

The second quarter of 2003 was rich in events concerning the development of the Bulgarian **high technologies and telecommunications** sector - a number of conferences, seminars and meetings on the problems and challenges in this field were organized. At the same time, notable changes resulting in real and qualitative improvement of the current situation in the sector were not registered. The Strategic Plan for the Development of Bulgaria's IT Industry Competitiveness prepared by business representatives was one of the most important events targeting improvement of the ICT situation in the country. The objective of the plan is to present a vision for development of ICT companies competitiveness and to provide guidelines for improved consumer culture in terms of ICT. The approval of such a document is a necessary step with a view to achieve desired results regarding the introduction of e-Government and the development of information society, as well as to establish Bulgarian ICT companies as quality partners and suppliers of high-tech solutions in a global aspect.

In the second half of 2003 the indicators of **tourism** sector development were good. According to NSI's data, the number of foreign tourists who visited Bulgaria in the first six months of the year was 1 234 960, registering an increase of 9.59 per cent compared to the same period of the previous year. Greece, Germany, Macedonia, Great Britain, etc., account for the highest number of tourists. The number of visitors from Hungary and the Czech Republic registered the highest increase, which signals gradual return of Central Europe tourists. In the second quarter of 2003 revenues from international tourism amounted to USD 401.7 m, compared to USD 333 m for the same period of the previous year. In the first half

of 2003 revenues from tourism reached USD 574 m. These figures register notable improvement compared to the USD 485.6 m for the period January - June 2002. In the first six months of 2003 revenues from international tourism registered an increase of about 18 per cent. In the second quarter Bulgarians' spending on travels abroad amounted to USD 165.7 m. For the period January - June 2003 it exceeded USD 302 m, registering an increase of USD 34 m compared to the same period of the previous year. In the first six months of 2003 net revenues from tourism reached USD 271.7 m.

Active work to rehabilitate and renovate the specialized infrastructure along the Bulgarian Black Sea coast continued. At the same time, persisting major problems are a result of the poor quality of the basic infrastructure. Problems related to the quality of human resources emerged in the beginning of the summer season. The requirement for minimum number of tour operator's personnel was eliminated in the second quarter of 2003. The Ordinance on Categorization of Tourist Sites was also amended. The objective of the amendments is to support in the first place the alternative forms of tourism in regions where the tourism sector is only beginning to develop.

In the **agriculture sector**, despite some revival of the land market, supply is still higher than demand and farm land prices remain rather low. The implemented pilot census of farms and the real census to be taken in the period 1 July – 30 November will make it possible to establish the size and the structure of farms and the trends in their development, which will enable more precise formulation of the national agrarian policy and the specific measures to support farm producers. An agreement on reform of EU's CAP was reached at the end of June. The reform does not have yet direct effect on the financing of Bulgarian agriculture, but it should be taken into account in the development of the sector policy in the near future. The operation of the Agriculture Fund and the increased financing opportunities under the SAPARD Program can be given positive assessment in terms of agricultural producers' needs.

The role of the **capital market** in Bulgaria's financial sector remains insignificant - at the end of June the total market capitalization of the Bulgarian Stock Exchange was 4.89 percent of the adjusted GDP forecast for 2003. In the second quarter the stock-exchange trade in compensatory instruments was active despite the negligible decrease as a result of the delayed privatization against compensatory instruments and the disclosures about the so-called problem lots. The SOFIX index generally preserved its upward trend during the period. Market capitalization increased again against a decreased trade turnover (excluding the sale via the stock exchange of the majority state block of shares in Bulgartabac Holding AD) and an improved liquidity compared to the first quarter. Liquidity remains a major problem of the market despite the positive trends observed in the quarter under review. The number of issues registered for trade remains high, but the number of liquid positions is low. The dependence of the prices of traded companies on the publicly announced corporate events for the Bulgarian market remains contradictory, although the market expects and needs such information. There were changes in terms of the legal and regulatory environment, which can be given a general positive assessment. The Act on the Companies with Special Investment Purpose was passed on second reading in the second quarter. Netting of cash settlements between stock-exchange members was introduced at the end of May and the settlement period was reduced to two days.

In Bulgaria financial intermediation is provided mainly through the **banking system**. The condition of banks in Bulgaria remains stable, with excellent capital adequacy and liquidity indicators and parallel well-functioning banking supervision. Foreign participation in the banking system of Bulgaria is definitely predominant in both equity control and assets under management. Most important events in the quarter under review included: the new option for commercial banks to debit their EUR accounts with BNB with value date on the same working day (and to sell Euro for levs to BNB with the same value date). Along with that, the beginning of June marked the successful start of the Real Time Gross

Settlement System (RINGS). As of end of June 2003 banking system assets amounted to BGN 15 359 751 thousand, total deposits amounted to BGN 11 810 265 thousand, and the June current profit amounted to BGN 218 487 thousand. Generally the banking system marks continuing increase of assets, deposits and current profit in the quarter under review. Loans to the non-government sector also register an upward trend. Despite the intensified lending activity and the good indicators, there are still unutilized opportunities for development and improvement of the banking sector's efficiency. BNB's Banking Supervision Division changed the commercial banks' grouping (explicitly stating, as hitherto, that the grouping does not contain rating elements and should not be interpreted as assessment of the financial condition of banks).

In the **social security** area, the new Social Security Code was finally passed in the second quarter of 2003. The discussion of social security legislation changes, which continued for more than a year, resulted in a uniform and improved legal system regulating public relationships in the social security area, however the presidential veto of early July reveals that disputable points do still exist and need to be clarified. NSSI's data for the first six months of the year concerning the mandatory registration of labor contracts and the introduction of minimum social security thresholds since the beginning of 2003 reveal that the pessimistic forecast of mass layoffs and reappointment of workers and employees under contracts for work done, on positions of lower pay and under part-time contracts did not come true, which generates optimistic expectations about future lowering of the social security burden and possible increase of the pension income. Labor and social security legislation problems were discussed at a working meeting of business and social ministry representatives and at a Conference on the Pitfalls of Labor and Social Security Legislation. Legislative initiative along these lines is expected.

In the second quarter of 2003 unemployment registered the lowest level since the start of transition with parallel increase of employment in an environment

of positive economic dynamics and low inflation. The successful implementation of active government policy on the **labor market** continues, with excellent institutional preconditions in place. Mid-term actions to increase employment and to improve labor force employability through professional development are envisaged parallel with 2003 specific projects. Thereby, conditions to find permanent solutions to overcome unemployment will be created.

Data about the real increase of the **income** of Bulgarians contradict the information in the regular labor force survey conducted by NSI in April 2003. The consumer trust indicator registered a decrease of 1.9 percentage points for the period January - April 2003. The negative change in consumers' opinions about the changes in the financial situation of households in the last 12 months, about the general economic situation in the country, and about unemployment in the next year is a warning signal, which suggests economic and social policy failures.

The isolated manifestations of social discontent and tension in some enterprises continued in the second quarter of 2003. Protesters' demands concerned mainly the delayed payment of wages and social allowances; stretched out negotiations of collective labor contracts; and the absence of social adaptation programs in the event of layoffs owing to future privatization. Despite that, none of the above cases generated serious industrial conflicts and little by little the dialogue and **social partnership** mechanisms become firmly established in Bulgaria on sector and enterprise level too.

In the **healthcare** sector, the Government approved a new health map of Bulgaria, which states the number of medical institutions, doctors and dentists with whom NHIF should sign contracts with a view to provide normal health care for Bulgarians. But the map generated a conflict between the Ministry of Health and NHIF. After the appointment of NHIF's director, competition for new NHIF directors was started in the second quarter of 2003 and current directors were re-appointed under fixed-term contracts. A new list of medicines payable in full or in part by NHIF took

effect in May with a view to solve the problem of the shortage of funds for medicines. Eighty-six previously payable medicines were eliminated. Despite the implemented measures, the budget for medicines was exhausted and new funds to the amount of BGN 73 m were requested from NHIF's operational reserve. In mid June the Government approved the health care bill developed by the Ministry of Health Care as early as the previous year. The bill regulates for the first time the rights and obligations of patients in accordance with the modern legal concepts of European legislation and the moral and ethic values of modern society. It is expected to repeal the Public Health Care Act passed as early as 1972 and to take effect since 2005. Three health insurance funds voiced their interests in the voluntary health insurance system, the development of which would certainly be promoted by clear definition of the basic package of health services guaranteed by the mandatory public health insurance system.

In the second quarter of 2003 the focus in the **environmental policy** area was placed on the completed negotiations and the temporary closing of the Environment Chapter. This fact can be conditionally accepted as the finish of a period of well-directed government administration actions to achieve national legal and administrative framework comparable with the basic principles of the European common environmental policy. Against the increasingly intensifying public debate on the priorities of the national environmental policy and the price of their realization, the second quarter was also a period in which the foundations of the public-private partnership on environmental issues and on sustainable consumption of natural resources were laid. With the closing of the Environment Chapter reformulation of priorities towards the development of adequate administrative and management framework and expert potential for environmental policy development at national, regional and local level can be expected. Expectations at company level concern higher investment activity in environmental projects and notable revival of the environment-friendly equipment and technologies market.

After the end of the military operations in Iraq, the Government focused again on the negotiations for **Bulgaria's accession to the EU**. In April Bulgaria presented in Brussels its request that the negotiations on the financial chapters should not be bound to the next Community budget for the period 2007 - 2012. To this date Bulgaria has closed 25 out of 30 negotiation chapters, but it has a lot more to do by the end of the year, despite that comparison is now possible only with Romania, which has completed the negotiations on 19 chapters. Bulgaria must increase its efforts to complete the negotiations with the European Union by the end of 2004 when the term of office of the present European Commission expires. The new commission may choose to reopen now closed negotiation chapters, which will delay Bulgaria's accession.

Legislative initiatives targeting improvement of **other elements of the business environment** continued in the second quarter of 2003. The National Assembly passed the Act on the Restriction of Administrative Regulation and Administrative Control of Economic Activity, which is a decisive step towards facilitated licensing arrangements and limited state intervention in business activities. The expected positive effects of the introduction of this act include higher transparency and predictability of the business environment, clearer rules and less corruption. The Council of Ministers prepared and approved a new public procurement bill. Positive aspects of this bill include higher conformity with EU directives, optimized public procurement appeal procedures and implementation opportunities, incentives for SMEs, higher flexibility of public procurement assignment, setting up of a public procurement agency with coordinating functions and keeping a public procurement register. However, various institutional representatives and experts criticize some provisions of the bill. The National Assembly passed the bill on first reading in early September.

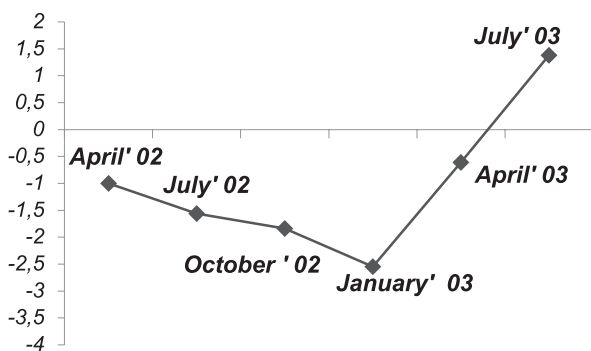
The judiciary system remains subject of severe criticism. Reforms are implemented along several lines with the most urgent task concerning the amendments to the Constitution. After a significant delay, in the second half of July the work of the

Commission on Amendments to the Constitution intensified, largely under external pressure. During the past quarter the results were reported from surveys conducted by a number of organizations on the spread of corruption in the country. Coalition 2000 reports sustainable, although negligible decrease of the corruption level in Bulgaria. Transparency without Borders' reports contain similar findings - Bulgaria now strikes the happy medium in terms of corruption level. Overall, achievements in this area remain insufficient - despite the adopted measures, there is yet a lack of vision and determination to take active anti-corruption steps.

The Estat Index of Business Climate

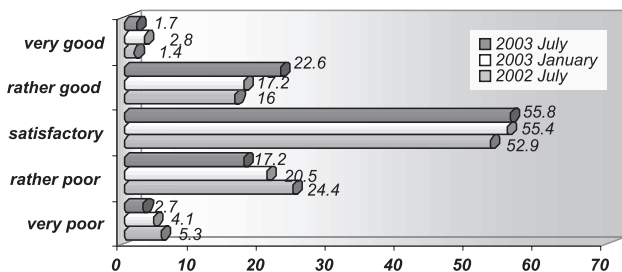
The integrated value of the **Estat index¹ of business climate** grows in July up to **1.377** – the highest value registered since April 2002 to date (Figure 1). This increase is due on the one hand to the higher assessment of companies' condition at the moment and their more optimistic future expectations, and on the other hand, to the higher aptitude to investments and business development. However, overall the assessment of the economic environment remains in the range of the index that characterizes it as **"neither favorable, nor unfavorable"**.

Figure 1. Business climate dynamics



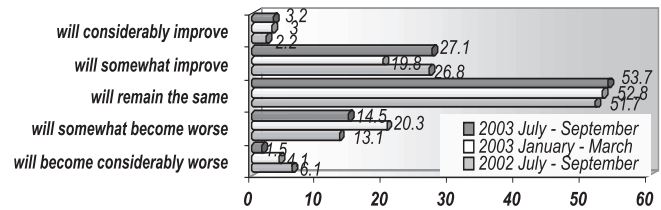
Almost $\frac{3}{4}$ of interviewed managers assess their business condition as very good, good or satisfactory (Figure 2). Their expectations to the future are rather optimistic (about $\frac{1}{3}$ are of the opinion that their business will develop over the next quarter (Figure 3).

Figure 2. Assessment of the current condition of companies



¹ The study was conducted in the period 7th-18th July, 2003 among managers of 407 companies and is representative at the level of going concerns. Criteria for selection of the companies in the sample are the region, sector, number of employed and type of ownership. The index methodology and the mathematical model are developed by the **ESTAT Agency for Market and Social Studies**. The integrated index comprises three components. Component I is "General condition of the company", Component II – "Investment attitudes and company strategies", and Component III – "Business environment"

Figure 3. Expectations of companies' condition over the next quarter



Management teams state competitive advantages are lacking – their share remains fairly high in July, too, over 28 per cent (Table 1), and give lower assessment of company's resources quality – financial resources, computer equipment, information and human resources, Internet.

Table 1. Companies position compared to competitors, %

Number of competitive advantages	2002			2003		
	April	July	October	January	April	July
None	19.5	28.3	32.5	33.1	27.1	28.5
1	19.8	13.1	16.3	17.0	16.6	16.0
2	18.8	24.2	17.6	18.3	22.1	17.9
3	16.5	14.4	13.9	12.0	11.6	10.8
4	13.2	7.8	10.8	10.3	9.5	11.5
5	7.1	6.9	3.7	4.0	6.0	7.9
6	5.1	5.3	5.2	5.3	7.0	7.4

A certain growth is observed in Component II of the **Estat index** of business climate – "Investment attitudes" which accounts to the largest extent for the growth of the integrated value in July. However, the tendency to invest excessive cash can not still reach the levels of April and July of last year (54 and 52 per cent, respectively) and though it is slightly going up, it reaches 45 per cent.

The study registers growth in another three indicators, directly related to business's capacity to develop. First, growing tendency towards introduction of new technologies in production, regardless of whether this has direct impact on company's profit – the share of those who agree to that statement grows from 77 per cent in April to 83 per cent in July 2003. Second, increased readiness to borrow a bank loan to invest. The clear drop registered in the share of those who agree to the statement "I would borrow a bank loan

to invest” in April, July and October of last year has been changing since the beginning of 2003 and a trend of increase is observed. Activity of financial institutions in lending, increased popularity of these services and, at the same time, higher number of extended loans, probably creates perceptions with the business that this is a good alternative that offsets the lack of financial resources – the third factor related to companies development. The share of managers who share that they experience shortage of funds remains high throughout the past year, and in July 2003 it reaches its highest value – nearly 73 per cent.

The basic problems faced by companies’ managers, as registered in the July study of business climate, can be summarized in three areas – difficulties directly related to work, legislation and government policies. Table 2 shows the shares movements in July 2002, April 2003 and July 2003.

Table 2. Statements related to some of the major problems faced by managers

Statements about the business environment	Share of those who agree, %		
	2002	2003	
	July	April	July
Social and health insurance contributions are a serious burden to business	67.3	65.7	72.7
Unfair competition hinders the development of most businesses in Bulgaria	85.1	82.7	87.3
The legislative framework creates equal conditions for all actors	19.2	14.0	13.9
The government encourages business development	16.6	11.0	8.8

More about business environment according to ESTAT Agency surveys

Overall, the results from the survey conducted among businesses in July are a bit more favorable compared to the previous survey, conducted in April 2003.

This applies to indicators of business environment condition by means of which we evaluate the role of administrative barriers, opportunities to start-up a business, consistency in legislative initiatives of the government, etc. At the same time, some important indicators evolve negatively, like unfair competition,

burden of social and health insurance contributions, overall policy in support to the business, etc.

With some other indicators, in practice there is no change – these are property rights protection, affordability of profit tax, intellectual property protection, impartiality and efficiency of the judiciary system and public procurement bidding procedures.

What is striking when comparing the results with the ones from the first survey of April 2002 is the positive move, i.e. certain positive trends are outlined in several areas. The first one is related to the tax system – tax rates are not to such an extent the reason to evade taxes, the patent tax is not such a grave problem for some of the companies, and generally, the tax system creates equal conditions for all entrepreneurs in the country.

The second area where certain though slight improvement is observed is the start-up of a new business and the spread of administrative barriers. Confidence in the banking system grows – from 35 per cent who trusted its stability and reliability in April 2002, up to over 40 per cent in July 2003. Similar conclusions can be drawn also with regard to property rights and intellectual property protection.

According to entrepreneurs, however, negative changes occur in several important areas over this period. First, this is protection of competition. While at the start of conducting such surveys 79 per cent of respondents considered unfair competition a hindrance, now this share grows to 87 per cent. A similar unfavorable development compared to the first survey is observed also with regard to tolerance to corruption and inclination to give bribes – here the growth is from 78 to 82 per cent. Also growing are the doubts in the consistency and efficiency of the legislative initiative and activity of the government, and the low efficiency of measures in support of research and development.

There is no significant change in assessments of transparency in public procurement bidding and the role of harmonization of Bulgarian law with acquis

communautaire. These two circumstances are not a good sign. It is well known that amendments were made in 2002 to the Public Procurement Act aimed at higher transparency. Apparently, however, these do not result in a real change in the practices and conduct in public procurement procedures, i.e. the legislative changes made do not reach at this stage the desired effects.

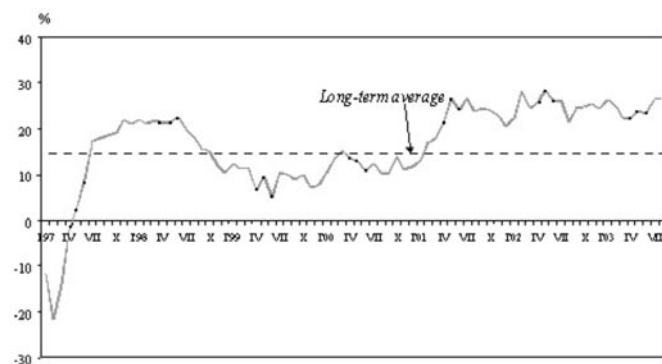
The same applies to European integration – regardless of the progress in approximation of legislation, this does not have an adequately efficient impact on companies' activities. Problems persist, ensuing from the lack of adequate information on what is going on and entrepreneurs can hardly assess its positive impact on activities and practices.

NSI business surveys

General indicator of business climate²

In the second quarter of 2003 general business climate indicator levels are in general lower compared to the previous quarter, as well as to the respective period of last year, mainly due to the sharper decline in the levels of the composite indicator of business climate in the services sector³. Yet, with the absence of abrupt fluctuations in the levels of the general business climate indicator during the quarter, the economic situation in the country remains relatively favorable.

Figure 4. Business climate, general (NSI)



Source: NSI

Industry

The dynamics of the business climate indicator in industry is remarkable for the best comparative characteristics among the four composite indicators comprising the general business climate indicator; only its levels in the second quarter of 2003 are higher compared to the second quarter of 2002 and, in addition, in April and May these come close to the historic maximum for the period from January 1994 to date, reached in August 2001.

Compared to the first quarter, a positive trend is to be noted of increased provision of production with regard to orders (mainly from abroad) - measured in number of months, this provision raises from 5.1 months in January to 8.0 months in April, and this is at almost equal levels of the business climate indicator in industry for January and April.

In June, however, the business climate indicator in industry drops down by 3.1 points below the May level due to lower assessment of both the current and anticipated business condition of companies. Among the hardships in activities in June it is only competitive import that has an enhanced negative impact, as indicated by 27.5 per cent of respondents versus 25.7 in May. However, highest remains the share of enterprises experiencing difficulties in their production activities due to insufficient demand on the domestic market (43.7 per cent).

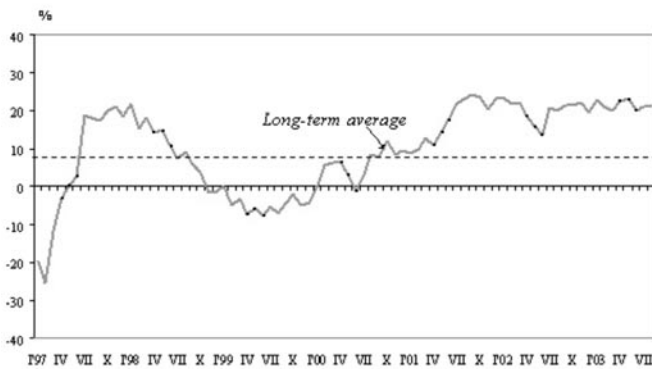
In June expectations to industrial activity for the third quarter are shaped based on increased share (compared to May) of expectations of preserving the same level of activity versus decreased share of expectations of higher activity.

² The general indicator of the business climate that we shall discuss in 2003 presents a weighted average arithmetic value of four sector indicators of the business climate - in industry, construction, retail trade and services sectors, and the indicator of business climate in the services sector is included in the general series May 2002. NSI started as of January 2003 to report the general index of business climate by including values available as of May 2002 of the business climate indicator in the sector of services. NSI conducts business observations in accordance with the EU harmonized program. Responses to the questions of the survey are presented in a three-category scale of the type: "increase", "no change", "decrease" or "above normal", "normal", "below normal". Balances of assessments are calculated as a difference of relative shares by extreme options of a response. **The indicator of business climate** is an average geometric value of balances of assessments of the current business situation and the expected business situation in enterprises for the next six months.

³ With the agreement that in April 2002 the general business climate indicator does not cover the services sector. What is striking is that in May 2003 the business climate indicator in the services sector is about 30 percentage points below the level of May 2002, and in June the difference exceeds 15 points.

In all the three months of the second quarter business surveys in industry register absence of expectations of higher selling prices.

Figure 5. Business climate in industry (NSI)



Source: NSI

Construction

Business surveys in construction outline a strong quarter for the sector. Although in April the business climate indicator in construction drops by 9.3 points due to a shift of the expectations of construction entrepreneurs from “better” to preserving “the same” business condition, in May it is recovered, and in June remains at the same level.

Among the hardships to construction activity, the highest share of enterprises (over 70 per cent) point out clients’ insolvency.

Yet, what is striking in the second quarter is the continuing growth since the beginning of the year in the curve of current construction activity. In May versus April the balance of assessments of this indicator goes up by about 20 points, and in June it is by 32 points higher than the May level, thus reaching the maximum level in the curve since January 1997.

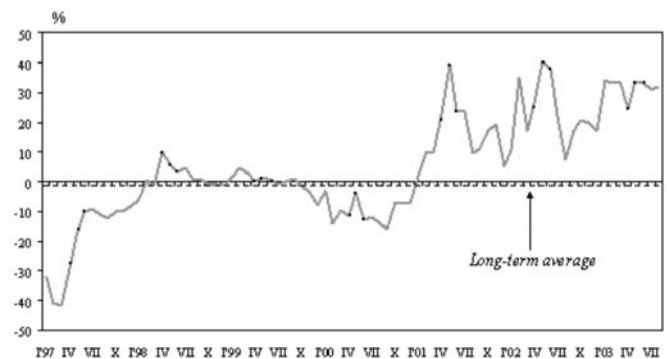
Prevailing for the third quarter are the expectations of preserving the June levels of construction activity and employment. By June there is no indication of anticipated rise of selling prices in construction.

Retail trade

Since the end of 2002 the business climate indicator

in retail trade has been sustainable, keeping almost the same levels, however, more than 10 points below the long-term average of the indicator. For the second quarter of 2003 the indicator is generally at a lower average level compared to the same period of last year.

Figure 6. Business climate in construction (NSI)

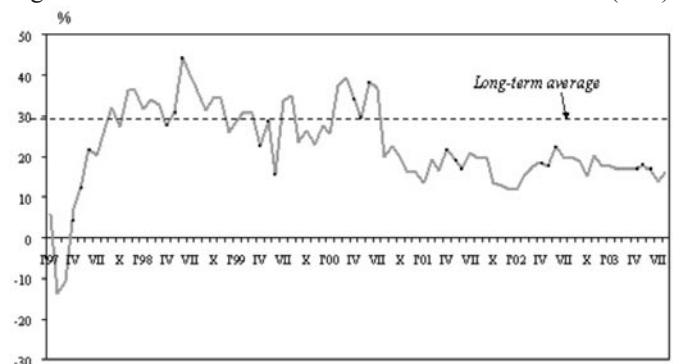


Source: NSI

There is better dynamics of expectations with regard to sales and orders to suppliers for the following three months, and their balance has had an upward trend since the beginning of the year and over the three months of the second quarter it is stabilized at level already exceeding the long-term average, though slightly, and compared to the respective period of last year it fluctuates in smaller amplitudes.

As most significant difficulties in retail trade business people continue to point out insufficient demand and competition in the sector. As regards selling prices in retail trade, business surveys do not record inflation expectations.

Figure 7. Business climate in retail trade (NSI)



Source: NSI

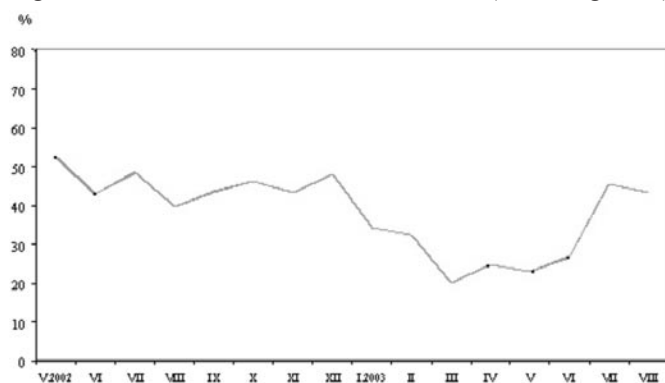
Services (excluding trade)

In the second quarter of 2003 the business climate indicator in the sector of services slightly raises and becomes stable, after it had reached its lowest level in March since the start of NSI business surveys in this sector in May 2002. Compared to the same months of last year the level of the indicator in May and June of the second quarter of 2003 is significantly lower. For May 2003 the business climate indicator in the services sector is by about 30 points below the level of May 2002, and for June the difference exceeds 15 points.

Assessments of the current and expected demand for services, expressed in individual months of the second quarter, are unstable.

In June business people in the area of services do not expect further increase of demand for services and do not intend to hire additional labour force over the next three months. Business surveys in June do not register expectations of price rises in the sector of services.

Figure 8. Business climate in services (excluding trade)



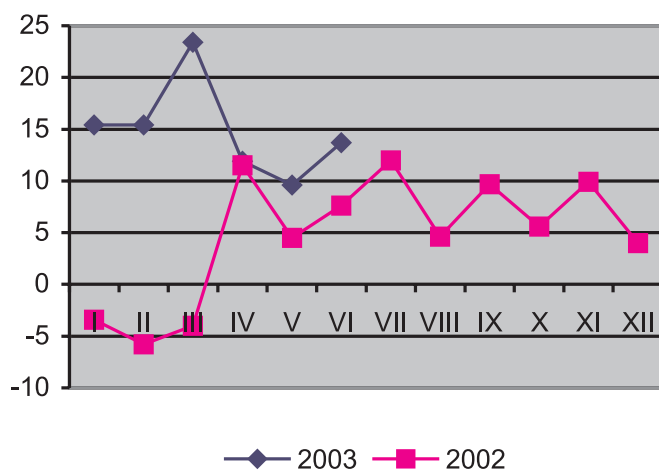
Source: NSI

Gross Domestic Product

Economic growth in the second quarter of 2003 will be probably lower than the growth on an annual basis for the same period of last year, i.e. 5.6 per cent.

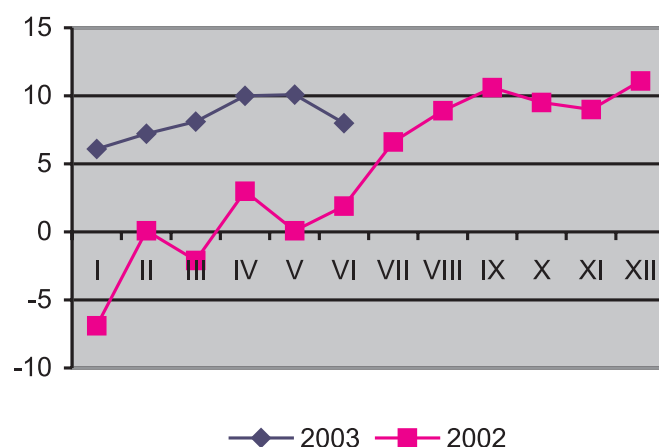
As regards the gross domestic product by production side, the reasons for such expectations are two: delay of industrial production growth in industry and deteriorated business climate in the sector of services (excluding trade) compared to May and June 2002. Yet, with the steep trend of the current construction activity during the months of the second quarter, as registered through the NSI business surveys, it can be suggested that the value added growth of the whole industrial sector will exceed the one for the same period of last year which was 4.8 per cent. Sales in domestic trade have been constantly growing since the beginning of the year and, despite the delay in June on an annual basis, trade will contribute to accelerating the growth rate of the services sector as a whole.

Figure 9. Industrial production growth rate, corresponding month of the previous year = 100, %



Source: NSI

Figure 10. Domestic trade sales growth rate, corresponding month of the previous year = 100, %



Source: NSI

In the first quarter of 2003 the contribution of the sectors of industry and services to the 3.8 per cent GDP growth on an annual basis is the same – by 1.8 percentage points. However, industrial sector value added, with a share in GDP a little over one fourth, has increased on an annual basis by 6.6 per cent, i.e. by twice a higher rate than the services sector (3.3 per cent rate, with a share in GDP over 50 per cent).

Our expectations of economic growth with regard to the gross domestic product by expenditure side are decomposed into expectations of a relatively high growth of end consumption (due to preserved high rate of growth of household income) and of declining rate of growth of investments in fixed assets, while a negative effect to growth is expected from the exceeding rate of imports over exports of goods and services (in the second quarter the nominal BGN growth of imports is nearly twice higher than exports growth, in addition import prices decline faster than export prices).

An indirect indication of delay in investments growth in the second quarter, perhaps with implications for the annual growth, is the reduced investment activity of private industrial companies. According to the investment business survey of NSI of April, what is notable in the investment plans for the current year is the higher growth of investments in the public sector compared to last year, and shrinkage of the

investment programs in the private industry sector (both compared to last year and to the intentions of six months ago).

Public sector industrial companies are expected to have a growth of investments in 2003 of 76 per cent, mainly due to the energy sector. The share of the public sector in the total volume of expected expenditure for acquisition of long-term tangible and intangible assets in 2003 reaches 47 per cent, i.e. by 19.5 points higher versus the share in 2002.

Expectations of the private sector of a more favorable investment climate in 2003 are evidently not being justified, as shrinkage is envisaged in private investment programs in industry by about 25 per cent versus 2002. Thus, at the end of April the expected total increase (in nominal terms) in 2003 versus the previous year is hardly 3.2 per cent.

In June NSI business surveys signalled a stall of economic activity growth over the next three months – expectations in industry are shaped with increased share (versus May) of the expectations of preserving the same level of activity against decreased share of expectations of increasing activity and employment; there is a slight increase in the sector of trade of the expectations towards sales and orders to suppliers, in the sector of services (excluding trade) no further increase is expected of demand for services and no additional hiring of labour force is envisaged over the following three months.

Inflation

The insignificant monthly rise of consumer prices from January till April turns into deflation in May and June, and thus in June instead of accumulated inflation since the beginning of the year, an accumulated deflation is in place amounting to 1.4 per cent since the start of the year. The relative rise of consumer prices from June 2002 till June 2003 is hardly 1.2 per cent. Deflationary processes emerge as early as in April with a drop of 3.6 per cent of industrial producer's prices in industry on the domestic market versus March and this continues in May (a drop of 1.1

per cent). The rise in June restores April's industrial price levels on the domestic market but over the second quarter as a whole industrial producers' prices on the domestic market are lower compared to the previous quarter. The drop of industrial producer's prices for the domestic market can be explained with the increasing acute pressure by cheaper competitive imports and less profitable exports. So far, industry as a whole counters such a pressure fairly successfully, as evident from the high rates of total sales in industry. However, fast growing of imports over the recent months alerts on mounting problems in the competitiveness of Bulgarian industry.

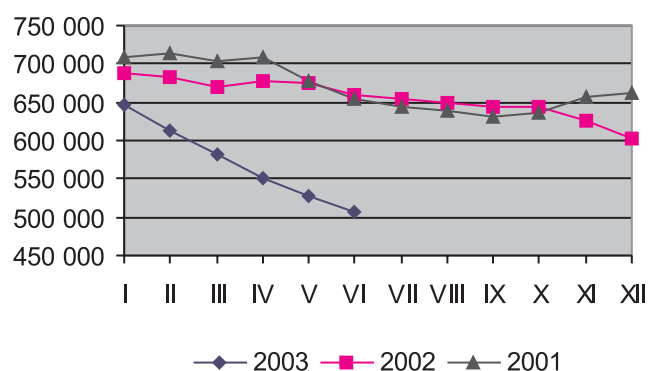
NSI business surveys in the months of the second quarter do not register increased inflationary expectations on behalf of the real sector.

Labor Market

The accelerated reduction of the number of registered unemployed that started in the beginning of the year, continues in the second quarter, too. As a result, at the end of June 2003 the number of registered unemployed is by 153 thousand lower than in June 2002 (as a comparison, in June 2002 the number of unemployed slightly increased versus June 2001).

The average monthly number of unemployed registered at labor offices in the first half of 2003 is 571 174, or by more than 104 thousand smaller than the average number for the six months of 2002.

Figure 11. Number of registered unemployed



Source: EA

Respectively, the average rate of registered unemployment in the first half of 2003 is 15.42 per cent, or by 2.81 percentage points lower than the corresponding period of 2002. Long-term unemployed for over 1 year amount to 300 585 average monthly, or 52.6 per cent of registered unemployed. Compared to the first six months of 2002 they decreased by almost 37 thousand. Jobless youngsters registered in labor offices of an age up to 29 have decreased by 33 683 people or by 17.2 per cent versus the same period of last year. From the beginning of 2003 till the end of June 89 thousand individuals have been covered by the ministry's program "From Social Assistance to Employment", and 6 400 refused to participate.

According to estimates of the General Labor Inspectorate over 300 thousand employed have been taken out of the grey economy in the first half of the year. As of mid of June 2.2 million individuals are being insured at the NSSI, and in December 2002 their number was 1.89 m. GLI expects that 100 thousand people more will be employed in the sector of tourism and services in the summer season.

The economic effect of reduction of the number of unemployed and increase of employed is already reflected in the growth of household income, but it does not seem yet to be accompanied by improved productivity of the economy.

Execution of the budget during the second quarter of 2003

Consolidated budget (covers the national budget and all autonomous budgets – those of local governments, insurance funds, state universities, Bulgarian Academy of Science, Bulgarian National Radio, Bulgarian National Television, Supreme Judicial Council, as well as extra-budgetary funds and accounts on central and local level).

Overall, relatively good execution of the consolidated fiscal program is observed during the second quarter of 2003, and some items show positive execution compared to the same period of last year. According to data from the Ministry of Finance, as of 31 June 2003 the **excess under the consolidated fiscal program** has increased twice compared to the second quarter of 2002 (BGN 309.1 m) and amounts to BGN 627.1 m. At the end of the first quarter of the year an excess of BGN 110.7 m was registered under the consolidated fiscal program.

Revenues and aids by the end of June 2003 amount to BGN 6 830.5 m, or a little over 51 per cent of the total annual amount planned in the consolidated budget program (BGN 13 373.8 m). As a comparison, in the second quarter of 2002 revenues under the consolidated budget amount to BGN 6 086.9 m or 48.8 per cent of the planned total annual amount, and 48.6 per cent of realized revenues. **Expenditures** for the period amount to a total of BGN 6 203.4 m, or 45.5 per cent of the annual amount of expenditures under Budget 2003 (BGN 13 636.6 m). As a comparison, for the same period of last year these were BGN 5 777.7 m (45.42 per cent versus budget estimates and 45.4 per cent of revenues realized during the year).

National budget (comprising the central budget, budgets of ministries and agencies and the budget of the Audit Office)

An **excess** is reported under the national budget at the amount of BGN 582 m. Revenues into this budget amount to BGN 4 221.2 (55.1 per cent of those planned for the year), and expenditures – BGN

3 639.2 m (45.4 per cent of the annual amount versus 2003 budget estimates). Compared to last year, these values were respectively BGN 3 556.7 m of revenues (50.94 per cent of the planned and 48.8 per cent of reported revenues) and BGN 3 365.7 m of expenditures (53.62 per cent of the program and 44.3 per cent of the total amount of expenditures realized over the year). The national budget excess is expected to go down considerably in the third quarter of the year due to the July payments under the foreign debt and the commitment of the Ministry of Finance under the Act on the State Budget, following 30 June 2003, to cover as a priority the deficit in municipal budgets up to BGN 130.1 m to complement the budgeted funds for current funding of delegated state activities.

Central national budget

The **excess** under the central national budget amounts to BGN 339.4 m, revenues being BGN 3 415.3 m, and expenditures – BGN 598.5 m.

Fiscal reserve

The fiscal reserve at the end of June 2003 marks a slight increase by BGN 7.7 m versus the previous month and amounts to BGN 4 299.7 m, out of which deposits at BNB are BGN 3 747.7 m, and foreign exchange assets are BGN 2 219.7 m. Table 3 illustrates the dynamics of the fiscal reserve over the period under review.

Table 3. Data on the fiscal reserve (FR) according to the Agreement with IMF (BGN m)

	As of 31 March 2003	As of 30 April 2003	As of 31 May 2003	As of 30 June 2003
Total amount of FR	3 442.1	4 035.1	4 292.0	4 299.7
FR funds in BNB deposits	3 027.5	3 632.7	3 873.1	3 747.4
FR funds in foreign currency assets	1 689.2	1 872.8	2 171.5	2 219.7

Source: according to MoF

At the beginning of June the Ministry of Finance placed BGN 185 m of the fiscal reserve as deposits

in five Bulgarian banks (United Bulgarian Bank, Bulbank, Hebrosbank, Post Bank and DSK Bank). According to MoF the goal of the transaction was efficient management of the fiscal reserve and realization of maximum yield at an optimal rate of risk and liquidity. The following criteria were applied in the selection of banks: their assets should exceed BGN 300 m, they should realize operational profit, and the amount of the deposit from the fiscal reserve could not exceed 50 per cent of bank's equity and should be fully secured with government securities. Interest rates achieved were in the range of 5.4 and 6.2 per cent per annum. This transaction provoked serious public discussions concerning its transparency and macro-economic effects (increased money supply, inflation pressure, increased deficit in the current account of the balance of payments) which will probably result in some changes in the following quarter in the Act on the State Budget Structure, stipulating maintenance of minimum amounts in the fiscal reserve to guarantee foreign debt payments for a year ahead and procedures of investing the remaining funds in the fiscal reserve.

Municipal finance and fiscal decentralization

As of 30 June 2003 municipal budgets register an excess of BGN 46.6 m with revenues of BGN 679.7 m, net transfers of BGN 258.5 m and expenditures of BGN 891.6 m.

On 14 May 2003 a meeting was held of the Task Force of the Ministry of Finance and the National Association of Municipalities in Bulgaria. It was agreed to:

- Make a joint proposal for up-dating of the Program for fiscal decentralization and work for its implementation, by setting up a working group to develop state standards on staffing and funding of municipal administration;
- Develop a Program for liquidation of unsettled expenditures of municipalities as of a certain date (to be specified) which should also include a compensatory mechanism for municipalities with a significant reduction of the 2003 budget;
- To use the mechanism of allocation of over-

fulfilment under DDFL estimates for financing of capital expenditures for state activities for 2003;

- A consensus was reached concerning funding of kindergartens - a proposal should be submitted to the working group for development of standards of coverage of a part of the subsistence of a child as a state responsibility;
- In the area of health care it was agreed that proposals should be made to the working group for development of standards of coverage of a part of the subsistence of a child in nurseries as a state responsibility, for defining students' health care as a state responsibility and developing standards of subsistence based on expenditures for servicing of one child.

Revenue part of the national budget

Tax revenues in the national budget as of 30 June 2003 amount to BGN 3 177 m versus BGN 2 614 m at the end of the second quarter of last year. Their execution by July 2003 is 52.1 per cent versus the annual estimates in the Act on the State Budget. As of the end of June 2002 execution of tax revenues to the national budget was 50.8 per cent.

Among tax revenues, highest relative share is accounted for by **VAT** – 46.3 per cent of total revenues versus 46.8 per cent for the same period of 2002. VAT execution for the first six months of 2003 is BGN 1 471.8 m versus BGN 1 222.3 m in the second quarter of last year. The slight decline in the relative share of revenues from VAT in the total tax revenues compared to last year may be explained with the introduction of VAT accounts as of 1 January 2003. The drop in crude oil and oil gas imports in the first six months of the year also has a negative impact. On the other hand, the growth in imports of machinery, clothes and raw materials has an effect of increase of VAT revenues.

High relative share have the revenues from **excise duties and charges on liquid fuels** – BGN 684.1 m or 21.5 per cent of total tax revenues. Execution of the tax compared to annual estimates as of end of June is 45.6 per cent versus 44.6 per cent at the

end of June 2002. As a result of higher excise duties on fuels (effective as of 1 January 2003) a trend is observed of reduction of quantities for the domestic market resulting in reduced budget revenues.

The relative share of revenues from **the profit tax** by 30 June 2003 (BGN 588.7 m) is 18.5 per cent of tax revenues versus 12.2 per cent in the previous year (BGN 319.7 m). Their execution compared to the annual estimates is 67.5 per cent. This good execution in the examined period is due to significant proceeds in March and April under the annual tax returns of 2002.

The share of revenues from **personal income tax (PIT)** by the end of June is 6 per cent of the tax revenues versus 9.9 per cent for the same period of last year. The execution of PIT on a net basis is BGN 190.5 m or 50.8 per cent compared to the annual estimates. For the same period of last year collected revenues amount to BGN 285.8 m or 46.4 per cent of the estimates for the year.

Revenues from **customs duties and taxes** amount to BGN 107.6 or 59.8 per cent compared to annual estimates. Their increase versus the same period of 2002 is BGN 19.2 m. In his comments to the data published in the third quarter about the revenues collected by the Customs Agency the minister of finance predicts over-fulfilment of duties revenues versus the amounts planned under the Act on the 2003 State Budget by about 17 per cent, as well as a slight over-fulfilment of VAT revenues.

Table 4. Revenues in the Republic of Bulgaria from the Customs Agency (BGN m)

	January	February	March	April	May	June	Total
2001	179.1	181.9	221.9	200.3	198.1	209.8	1191.1
2002	174.6	197.6	234.9	223.5	221.2	204.9	1256.7
2003	231.4	217.5	262.9	259.8	262.4	248.8	1482.8

Source: according to MoF

The end of May witnessed the end of the 21-month project **Reform and Modernization of Bulgarian**

Tax Administration under the PHARE program of a value of EUR 2 m, under the leadership of the Dutch tax and customs administration. Project activities provided for expert assistance from the participating countries in some of the major operational functions of the tax administration - registration and servicing of tax payers, tax audits and control, internal and external communications, tax methodology, appeals, etc.

In the second quarter of 2003 the new web-based version of **BICIS (Bulgarian Integrated Customs Information System)** was implemented and commissioned. It allows obtaining of information in real time in the central server of the Customs Administration and in local customs offices throughout the country on the movement of goods.

Non-tax revenues in the national budget at the end of the second quarter of 2003 amount to BGN 1 035.2 or 66.1 per cent versus the annual estimates. This increase is partially due to the one-time annual contribution from the excess of revenues over expenditures of BNB at the amount of BGN 132.6 m (versus a total annual estimate of BGN 150 m). A fairly good execution is observed of revenues from fines, sanctions and penal interest (62.1 per cent of annual estimates) thanks to the automated calculated of interest on overdue receivables, introduced by the tax administration.

Expenditure part of the national budget

Running costs have the highest relative share of 40 per cent of total expenditures – BGN 1 045.6 m. These include costs for medicines, fuel and energy, hired services, current repairs, as well as defense and security expenditures.

Interest paid for servicing of the foreign and domestic debt by the end of June amounts to BGN 453 m, out of which BGN 88.9 m on domestic loans and BGN 364.1 m on foreign loans. The relative share of expenditures for interest payments for the period presents 17.4 per cent of the total budget

expenditures (versus 17.9 per cent in the first half of 2002).

The share of **expenditures for wages and other payments to the employees** (BGN 261.9 m) is 10 per cent of total expenditures in the national budget. The fairly high share of these expenses is due to the increase by 3.5 per cent of salaries in the budget-supported sector as of 1 January 2003.

Increased is also the share of **social expenditures and such for scholarships** in the total expenses (10.2 per cent). This is explained with the amendments to the Social Assistance Act in the first quarter of the year. According to these changes, payment of unemployment compensations and benefits and payments under other programs, after 1 January 2003, are made by the newly established Social Assistance Council at the Ministry of Labor and Social Policy.

Transfers (subsidies/contributions) from the national budget to other budgets amount to BGN 1 033 m. The national budget has allocated to municipalities BGN 250.8 m or 59.6 per cent of the total annual amount. Under the budget of NSI transfers are made from the central budget at the amount of BGN 489.5 m or 51.8 per cent of the annual amount. The central budget subsidy to the judiciary is BGN 44.5 m or 46.4 per cent of the annual amount.

On 5 June the Council of Ministers passed **an updated version of the National plan for economic development of the Republic of Bulgaria for the period 2000 – 2006**. In the area of public finance one of the most important changes is the transition from an expenditure-based budget to a program-based multi-annual budget, stressing on the result from execution of programs and not on the expenses for funding of certain activities. In the mid-term the Government relies on conservative fiscal policy, planning for gradual reduction of the budget deficit and accomplishing a balanced state budget in 2005. The share of GDP reallocated from the state sector is expected to be reduced – gradual decrease of revenues under the consolidated budget

as a percentage of GDP with parallel optimization of the expenditures structure and limitation of budget subsidies. Due to the forthcoming local election and the political pressure towards increased budget expenditures in the next year it is possible that the Ministry of Finance be forced to agree to trade-offs with regard to the amount of the state deficit and the declared intention to decrease the share of budget revenues and expenditures versus GDP by 2005.

Foreign and domestic debt

On 22 May 2003 Standard and Poor's raised the rating of Bulgarian government securities in local currency and thus **Bulgaria reached for the first time investment rating** that will allow the country in future debt financing at lower cost and will attract the interest of large foreign institutional investors to Bulgarian government bonds.

In the beginning of June Moody' also raised Bulgaria's credit rating for long-term bonds denominated in foreign currency from B1 to Ba2, and for long-term bank deposits in foreign currency from B2 to Ba3. Government's rating for long-term government securities in local currency was also raised from B1 to Ba2. Rating's prospects are stable. Moody's major motivation to increase the credit rating is the trade, financial and institutional integration of Bulgaria with the European Union and the sharp decline of the share of government debt versus GDP and budget revenues as a result of the higher exchange rate of the Euro, declining international interest rates, considerable economic development, limited need for government borrowing and more active debt management. Recommendations are related to keeping the trend of reduction of the budget deficit and accelerating public institutions reform. The raising of the credit rating by the two rating institutions in the second quarter was followed by up-dated rating by the remaining agencies in the following months.

At the end of the second quarter of 2003 **the total amount of state and state-guaranteed debt** is BGN 17 364.8 m at BNB exchange rate of BGN as of 30 June 2003. Compared to the first quarter of the year

the total amount of the debt is reduced by BGN 195.2 m. At comparable data the Debt/GDP ratio drops down from 49.8 per cent at the end of March to 49.2 per cent at the end of June 2003. Compared to the same period of last year total debt is decreased by BGN 1 490.2 m due to the cheaper US dollar versus the Euro and the repayment of principals and interests made during the quarter.

In dollar terms, however, state and state-guaranteed debt has increased by USD 363.4 m over the period from the end of the first to the end of the second quarter of the year (from USD 9 782 m to USD 10 145.4 m according to BNB exchange rates as of the respective dates). This is due to the more expensive Euro versus the US dollar, as well as to the change of the currency structure of the debt. As of the end of March 2003 dollar-denominated debt was 49.79 per cent of the total amount of the state and state-guaranteed debt, while at the end of June dollar-denominated debt was already 46.16 per cent. As a comparison, the share of Euro-denominated debt increased from 29.9 per cent of the total amount at the end of March to 32.1 per cent at the end of June 2003 (BGN debt marked a decline in the debt structure – from 8.66 per cent at the end of March to 8.53 per cent at the end of June 2003).

In the following quarter the amount of the debt will probably be predetermined again by the dynamics of the exchange rate of Euro against US dollar and the changes in the currency structure. In all cases, however, an important indicator remains the ratio of total debt to GDP that will stay within the criteria of Maastricht and will probably keep its trend of gradual decline.

Foreign debt

According to data from the Ministry of Finance at the end of June the foreign debt amounts to EUR 7 736.4 m (versus EUR 7 807.3 at the end of the first quarter of 2003), the state debt being EUR 7 363.8 (versus EUR 7 425.4 m at the end of March) and state-guaranteed debt - EUR 372.6 m (EUR 381 as of 31 March 2003). As a result mainly of the changes in the

exchange rates over the period from the end of March to the end of June 2003, the total amount of the debt in dollar terms marks an increase of USD 81 m. In BGN terms a trend is observed towards reduction of the amount of foreign debt by BGN 137.9 m. The total foreign debt at the end of June amounts to USD 8 840.4 m or BGN 15 131.9 m, recalculated at the BNB rate of BGN to USD as of 30 June 2003.

There are slight changes in the debt structure compared to the previous quarter. The Euro-denominated debt accounts for 33.89 per cent (versus 31.46 per cent at the end of March), and the debt in USD and other currencies is 50.96 per cent (53.01 per cent as of 31 March 2003) and 15.16 per cent (15.53 per cent at the end of March), respectively. The interest structure is also subject to a very slight change. The ratio between floating interest rate debt and fixed interest rate debt is 63.2 per cent to 36.8 per cent. The average residual period of the debt is 10 years and 3 months, and at the end of the period a small reduction of the debt is observed in the range of 5 to 10 years and an increase of the debt over 10 years. Highest is the share of the debt on Brady bonds (amounting to 27.6 per cent) and other bonds (27.6 per cent). The share of the debt to IMF slightly declines to reach 12.3 per cent. Payables to the World Bank account for 11.9 per cent, to EU – 5 per cent, on state-guaranteed borrowings – 4.8 per cent, and to the Paris club – 3.1 per cent .

Domestic debt

As of 30 June 2003, according to data from the Ministry of Finance, the domestic debt equals the state debt and amounts to BGN 2 233.9 m (there are no liabilities on domestic state guarantees). Compared to the end of the first quarter of the year a reduction is observed of the total amount of domestic debt by BGN 56.7 m.

Within the structure of domestic debt at the end of June 2003, the share of government securities issued for financing of the budget deficit is 74.2 per cent (versus 74.04 per cent at the end of March) of the total amount of the foreign debt. At the end of June,

the share of the debt on government securities issued for the structural reform is 25.8 per cent (versus 25.91 per cent at the end of the first quarter) of the total domestic debt. Table 5 shows the dynamics of the total domestic debt structure.

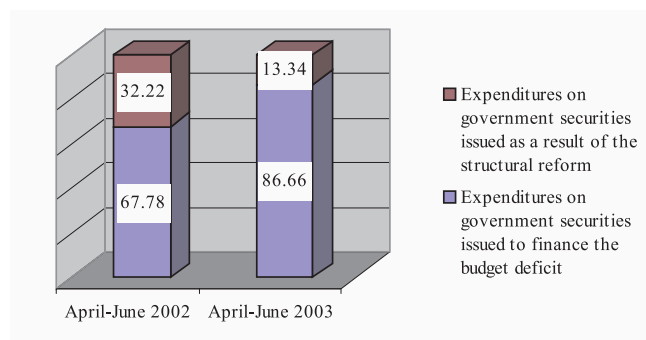
Table 5. Total domestic debt structure (%)

Debt structure	As of 30 June 2002	As of 31 March 2003	As of 30 June 2003
Debt on government securities issued to finance deficit	65.08	74.04	74.2
Debt on government securities issued for the structure reform	34.72	25.91	25.8
Domestic state guarantees	0.20	0.05	0.00

Source: according to MoF data, State Debt monthly bulletins

Total expenditures on the domestic debt (interest and discounts) at the end of the second quarter of 2003 amount to BGN 65.3 m (versus BGN 54.8 m for the respective period of the previous year). Among these expenditures, the share of expenditures on government securities for financing of the budget deficit is 86.7 per cent (versus 67.78 per cent at the end of June 2002). Highest is the relative share of expenditures on 5-year bonds (42.5 per cent), followed by those on 3-year ones (19 per cent). The share of expenses on government securities issued for the structural reform is 13.3 per cent (versus 32.22 per cent in the same period of 2002). Figure 12 illustrates the dynamics of the structure of expenditures on the domestic debt in 2002 and 2003.

Figure 12. Expenditures structure of domestic debt (%)



Source: according to MoF data, State Debt monthly bulletins

According to BNB data (Government Securities bulletin of Fiscal Services Department) during the months April – June the achieved average yield in the primary market of newly issued government securities for financing of the budget deficit was 2.81 per cent on an annual basis with three-month bonds (three auctions for the period), 4.36 per cent on an annual basis with twelve-month treasury bills (one auction for the period), 5.13 per cent with three-year treasury bills (one auction for the period), 5.53 per cent with five-year bonds (one auction for the period) and 6.15 per cent with seven-year bonds (two auctions for the period). No ten-year government bonds were issued during the quarter.

Thus, with regard to the domestic debt market, the second quarter marks a growth of the yield of all newly issued government securities compared to the previous quarter and a drop down compared to the second quarter of 2002. In comparison to the end of the first quarter the share of securities issued for financing of the budget deficit continues to increase at the expense of the share of securities issued for the structural reform. In comparison to the first six months of last year, the share of expenditures on government securities issued for financing of the deficit goes up, while the share of expenditures on securities related to the structural reform marks a drop down as a consequence of the changed structure of domestic debt.

New financing

During the first six months of the year new loans are received at a total value of BGN 541.4, with total payments made on the foreign debt being BGN 802.3 m. These payments include repayment of principals at the amount of BGN 391.3 m., and interest payments of BGN 411 m.

Within the new external financing, in the beginning of May Bulgaria received the funds under the first Program loan for restructuring (PAL) in support of the balance of payments from the International Bank for Reconstruction and Development. The loan of 16-year maturity (including 6-year grace period) at the

amount of EUR 151.2 m is extended in the context of implemented measures and actions planned in the three year program of the Bulgarian government for restructuring (PAL Program) which provides for support at a total amount of USD 750 m over a three-year period, as well as a package of analytical and consulting services.

This is the first loan under the PAL Program which ensures the unified framework of reforms in various sectors of Bulgarian economy. The strategic direction of this first loan is to encourage structural, regulatory and institutional reforms in the real sector with the purpose of improving business environment and facilitating private investments.

In the middle of June an agreement was signed between the Ministry of Finance and the World Bank for a loan of EUR 31.9 m for a Project for Reform in the Revenue Administration. The new system is expected to encourage civil society involvement and to enhance transparency and create equal conditions for the businesses, thus reducing to the minimum the possibilities for corruption. The system is also aimed at creating opportunities for cutting down direct taxes and insurance contributions in compliance with the government policy towards economic growth and opening of new jobs.

An agreement was also signed for the Project for District Heating, financed by the World Bank, in accordance with the adopted Development Strategy of Central Heat Supply for the period 2000 – 2005. Under this project, a loan will be made to Toploficatzia-Sofia at the amount of EUR 29 m, and Toploficatzia-Pernik will receive a loan of EUR 7 m. The project aims to support the extremely urgent rehabilitation activities in heating companies that would result in reduction of energy and water losses, thus strengthening the financial position of the companies.

The projects for reform in the revenue administration and district heating companies present a part of the World Bank Strategy for assistance to Bulgaria under which USD 750 m are envisaged in support of the reform programs by the end of 2004. To date, the

total amount of funds committed by the World Bank to Bulgaria reaches approximately USD 1.784 m and cover 33 projects.

Regulatory framework development

In the second quarter of 2003 amendments were passed in the **Tax Procedure Code, VAT Act, Corporate Income Taxation Act and Personal Income Taxation Act**. Overall, changes made are of partial nature and will hardly eliminate the need for large-scale amendments to the taxation laws in the fall with regard to elaboration and adoption of the state budget for the next year.

The objective of the changes adopted in the Tax Procedure Code is to improve efficiency of enforcement collection by strengthening measures of the administration in the fight against grey economy. The most significant changes concern the procedures and order of application of Double Taxation Avoidance Agreements (DTAA) signed by Bulgaria on foreigners' income and property. A positive aspect of the changes is the precise and clear definition of the grounds to use tax reliefs under DTAA and the way of their certifying. At the same time, criticism is directed towards the introduction of excessive control by the tax administration which may burden and bureaucratise DDTA procedures.

The main changes in the VAT Act are related to the definition of concepts concerning ferrous and non-ferrous metals scrap in compliance with the Act on curtailing harmful impact of waste on the environment and activities for their obtaining, processing and handling. The amended provisions of art. 52b exempt scrap supplies from VAT. In practice this means that investments in these activities are deprived of tax credits and this will have a negative impact on exports and the price competitiveness of Bulgarian manufacturers in the world market. Amendments are made to the conditions for use of the special order of charging VAT at import and accelerated 10-day period of VAT refund under art. 58b, para 1, and for deduction, netting and refunding of the tax within 45-day period under art. 77, para 2 and para 3. In the

area of administrative measures a definition is given to the concept of "thorough and documented search". In addition, secondary registration of bankrupt companies upon their privatization is stipulated.

The amendments to the Corporate Income Taxation Act and the Personal Income Taxation Act in their parts related to priority application of international agreements to avoid double taxation put an end to the practice of issuing government decrees to determine the order of application of DDA.

On 19 June 2003 the National Assembly of the Republic of Bulgaria approved the **Draft Law on Amendments to the Act on the State Budget of the Republic of Bulgaria in 2003** in its part on the Supreme Court of Cassation, in fulfillment of Decision No. 4 of 4 April 2003 of the Constitutional Court, which determines as anti-constitutional the provision of art. 2, para 2, it. 2 of the Act on the State Budget of the Republic of Bulgaria for 2003 with the motive that the funds budgeted to the Supreme Court of Cassation (SCC) for 2003 are less compared to those in the previous year (BGN 10 000 thousand) and do not ensure its normal functioning. The Act on Amendment of the Act on the State Budget of the Republic of Bulgaria for 2003 increases the budget of the judiciary for 2003 in its part on the SCC by BGN 3 000 thousand (from BGN 7 121.3 thousand to BGN 10 121.3 thousand). He required additional funds for the budget of the judiciary (for SCC) for 2003 will be provided from the funds for structural reforms, contingent reserves, within the defined parameters, and will not result in changing the deficit approved for 2003.

At the end of April a **draft law was developed for the amendment of the Act on the Audit Office**. It envisages that the Audit Office be given powers of control over arising and management of state-guaranteed debt and municipal debt, the objective of the change being to improve budget discipline.

At the beginning of April an exposure draft of the **Act on Amendment of the Act on Municipal Budgets** was submitted to the Local Self-government Commission

with the National Assembly. This draft defines the responsibilities of the state and municipalities and the sources of their financing in compliance with the principles of fiscal decentralization. Possibilities for civil control are enhanced, clear and simple rules are introduced in defining budget relations and full freedom is given to municipalities in spending funds raised from local taxes and charges and from other non-tax revenues. Amendments to the Act on Municipal Budgets were adopted in the second quarter of 2003.

Government Program

Fast and transparent privatization was one of the pillars of the government's economic program in 2001. It had to ensure sufficient funds in the fiscal reserve, to be the foundation of the structural reform in sectors like energy, transport and telecommunications. Privatization had to attract foreign investments and to generate confidence in government's capacity to successfully continue the reforms started by previous governments.

At the mid of government's term of office the privatization process burdened with negative aspect the overall activity of the governing coalition NMSS-MRF. For the two years in government they demonstrated evident inability to make political decisions on the sale of "the large companies" BTC EAD and Bulgartabac Holding AD. The political feebleness, weak management capacity and lack of expertise underlie the international conflicts in which our country was involved with the privatization of the two companies.

Political differences hinder also the privatization of Maritime Navigation Bulgare (NMB) and Bulgarian River Shipping (BRS). Neither the Council of Ministers, nor the Privatization Agency state publicly when the privatization strategies for these two companies will be adopted. The fate of Balkancar Holding also remains unclear while the company is in bankruptcy procedures complicated by endless lawsuits. Gaps in the secondary legislation impede the privatization of companies in the military industrial complex.

Privatization of electricity distribution companies started without a strategy passed by the Parliament and accompanied with trade union protests. Over the 10 past year the Bulgarian privatization model implanted in itself all the known methods of privatization – cash, voucher, via the stock exchange. All payment instruments were used, too. But with the privatization of EDCs in which in addition to the parliament, the government and the Privatization Agency, trade unions will take active part, and this is a doubtless "contribution" of our country in the

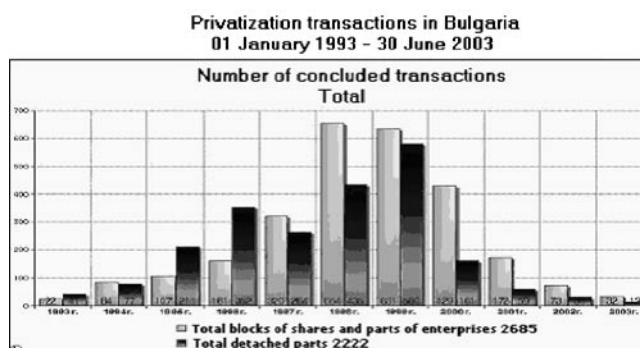
economic theory and practice.

The negative aspects of the privatization process listed so far brought to the active intervention of international institutions. At the beginning of March 2003 the Bulgarian government undertook a commitment to the World Bank to privatize by the end of 2003 Bulgartabac Holding AD, DSK Bank, MNB, BRS and Balkancar Holding. Added to this commitment of the government is the privatization of 20 small HPPs, as well as the privatization by the end of September 2003 of at least half of small and medium-size enterprises still remaining state ownership. The letter to the World Bank expressed an expectation that the privatization of BTC EAD would be completed by the end of the current year.

Commitments undertaken by the government are the condition for extension of the second trench of PAL loan. The only fulfilled commitment was the sale of DSK bank for EUR 311 m. This transaction completed the privatization in the banking sector.

Evidently, the Bulgarian government does not fulfill its commitments. It is little probable that for the remaining months of 2003 so many privatization transactions can be finalized.

Figure 13. Privatization in Bulgaria



Source: Privatization Agency

Foreign financial analysts already report higher levels of risk of political instability in the country. **This undermines the confidence to the Bulgarian government and repels investors.** Bulgaria missed again its chance to offer a good investment environment and to attract large foreign companies.

Implementation of the privatization program

The pace of privatization in the public sector in the second quarter of 2003 continued to be very unsatisfactory. Only 20 transactions were concluded for the sale of companies with majority state interest (over 50 per cent) and 5 for detached parts. Thus, in the middle of the year the execution of the Annual Privatization Plan for the sale of majority blocks of shares is 22 per cent. Even higher is the non-execution in the part of sales of minority blocks of shares. 29 transactions were realized and the execution of the annual program is only 5.8 per cent.

Table 6. Execution of the Annual privatization plan

	Annual Plan	1 st Quarter	2 nd Quarter
Parts and blocks of shares of companies with over 50 % state interest	145	12	20
Detached parts	60	7	5
Parts and blocks of shares of companies with less than 50 % state interest	900	25	29

In the second quarter of 2003 the public space focus in the area of small and medium-sized enterprises was placed on the introduced by deputies of the ruling majority on 23 May 2003 **Bill on the promotion of investments in small and medium-sized enterprises**, which envisaged development of a scheme to promote the venture capital in the SME sector. The established in the last six months tendency of the Agency for Small and Medium-sized Enterprises (ASME) to organize **information seminars and round tables** with the participation of employers with a view to identify small and medium-sized business problems, find solutions, and last but not the least, to promote the Government - business dialogue, persisted in the quarter under review. With a view to facilitate the demand and supply of investment projects in the country, the Bulgarian Chamber of Commerce and Industry (BCCI) offered a new service targeting companies and bankers - **e-market of investment projects**. **In the second quarter of 2003 the financing sources of small and medium-sized enterprises increased**, with major problems before small and medium-sized enterprises involving again the lack of well-directed tax and security policy, the high collateral for bank loans, the absence of quality business ideas and plans, the rather poor corporate management, and the absence of credit history.

Bulgaria is expected to change the definitions of micro, small, and medium-sized enterprises applied in the country, with a view to comply with the new EU definition of these notions approved in May 2003, which will take effect as of 1 January 2005.

ASME and GLI Information Seminars

In the second quarter of 2003 the Agency for Small and Medium-sized Enterprises (ASME) and the General Labor Inspectorate (GLI) organized a couple of information seminars with employers with a view to promote the Government-employers dialogue and to inform employers about the ways to get access to financial resources and to improve the working conditions. **On 12 and 16 May 2003**

experts from ASME and GLI organized meetings with employers, owners and managers of small and medium-sized enterprises in the regions of Pazardzhik and Lovech, the events being part of the coordination and cooperation agreement between the Agency for Small and Medium-sized Enterprises and the General Labor Inspectorate.

The Fourth Round Table of Banking Institutions and SMEs was organized on 8 and 9 May 2003 in Sofia on the initiative of ASME, which is the national program coordinator of EU's Multiannual Program of Enterprises and Entrepreneurship Development, Particularly Small and Medium-sized Enterprises (2001-2005). Experts from the European Investment Fund (EIF), the Directorate General on Enterprises of the European Commission, bankers and SME representatives took part in the event. The forum is organized on a regular basis by the Directorate General on Enterprises with a view to disseminate among EU candidate countries the good practices of improving SMEs' access to financing, and to provoke a dialogue on their problems and on the opportunities to create a favorable fiscal environment.

The National Conference on Business Incubators and their Future in Bulgaria was organized on 9 May 2003 by the JOBS Project. The JOBS Project draws on the Bulgarian experience of UNDP, which introduced a pilot model of a business center and incubator in Bulgaria six years ago. The project's incubators helped more than 100 companies to develop their own production and these companies have employed more than 350 people. So far, JOBS Project implementation results reveal that the wide network of business centers and business incubators created in 26 Bulgarian municipalities is a successful measure to fight unemployment and to promote the development of the national small and medium-sized business.

New SME Projects

Bulgarian high-tech small enterprises, which are a source of innovations improving the competitiveness of the economy at micro level and its capacity to cope

with the competitive pressure of market forces in the single market of the European Union, are expected to get support for their development through the construction of **an European virtual incubator** to be financed by the European Commission under the Leonardo da Vinci Program. The European virtual incubator is a portal site offering a package of services to:

- start-up entrepreneurs;
- operating small high-tech companies;
- training centers;
- business centers and incubators;
- technological parks.

The project for promotion of the technological and research developments transfer from Bulgarian technical universities to the industry, financed by the German Society for Technical Cooperation (GTZ), was launched in June 2003. Its objective is to identify four areas of vital importance to the national economy, which have traditionally good research developments with possible practical application. The objective of the project is to contribute to an intensified transfer of R&D results from Bulgarian technical universities to the small and medium-sized enterprises in the industry, with a view to commercialize R&D, on one hand, and on the other hand, to improve the technological level and the competitiveness of Bulgarian SMEs.

An international Doing Business Together in the Danube-East Euroregion project was launched in the second quarter of 2003 as well. It targets SME development in Silistra, Dobrich and the Romanian town Kukurash. The basic objective of the project financed under the PHARE Cross-border Cooperation Program is to improve the conditions for SME development along the two banks of the Danube.

A program for employment of micro-business consultants in the labor offices of 15 pilot regions was launched in June on the initiative of the Micro-credit Guarantee Fund at MLSP, the Employment Agency and UNDP. Their task is to consult citizens on

the opportunities to take loans from the Micro-credit Guarantee Fund, as well as on the other programs MLSP is involved in, with a view to promote the entrepreneurial spirit and initiative.

E-Market of Investment Projects

With a view to facilitate the demand and supply of investment projects, **BCCI provides a new service targeting companies and bankers - e-market of investment projects**, with Cooperative Bank being the key project implementing partner. The e-market of investment projects is an Internet-based database of entrepreneurial projects presented in Bulgarian and in English and freely accessible till the end of 2003. The observations that many companies have problems with the financing of their projects mostly as a result of the inability to develop investors' interest attractive projects, which were confirmed by a survey of Bulgarian companies, are at the heart of the initiative for the development of this service.

The objective of the new service is to enable entrepreneurs to test their project's value in a real market competition environment, because the product's functions involve financing supply and demand via Internet, and to improve their approach in investment projects. The new point in the service is the automatically generated rating of each project following its entry in the database. Rating generating indicators have been developed on the basis of indicators used by the World Bank in project rating, thereby targeting maximum objectivity based on uniform and worldly recognized standards. Rated projects are expected to get publicity beyond the Internet space through the annual publication of a Top 100 Investment Projects brochure in Bulgarian and in English, to be presented at international forums.

The e-market of investment projects is expected to improve the investment project development skills of Bulgarian companies; to guarantee more efficient transformation of savings into investments by way of project competition guaranteeing increasingly higher project quality; and last but not least, to provide through a transparent and objective procedure

an alternative financing source for the small and medium-sized enterprises.

New Financing Sources for SMEs

The tendency of **higher number of financing sources for small and medium-sized enterprises** persisted in the second quarter of 2003. In May Post Bank began to provide loans to small and medium-sized enterprises under its Partners Program. The automatically renewed credit line option allows to avoid additional expenses. At the end of April it became clear that Union Bank will support the small and medium-sized business by a bond issue at a total nominal value of BGN 5 m.

On 22 May 2003 ProCredit Bank signed with the Ministry of Finance and the German State Bank for Development a Bulgarian small business financing agreement amounting to EUR 4.1 m. Financing barriers to Bulgarian SMEs persist, but this agreement is a decisive step towards facilitating the SMEs' access to financial resources. The funds, which are not non-repayable, will be provided within the Bulgarian-German cooperation, which also involves support for Bulgaria in the process of EU accession.

In addition, the PHARE Program is expected to provide EUR 2.4 m, most of which for direct investments in enterprises with higher occupational safety risk.

The European Bank for Reconstruction and Development (EBRD) is setting up a risk investment fund for Bulgarian and Romanian SMEs and for support of the economic growth of the less developed candidate countries for EU accession. The fund called Global Bulgaria and Rumania Growth Fund is expected to start up with an initial capital of EUR 16.25 m with a possibility for increase up to EUR 20 m. The new fund is expected to invest an average of EUR 800 thousand per year, purchasing minority or majority shares in companies having annual turnover of up to EUR 40 m and employing up to 250 people.

Legislative Initiative

A bill developed by deputies of NMSS and introduced in the National Assembly in May envisages set up of a venture capital encouraging scheme targeting Bulgarian small and medium-sized enterprises, to be employed to promote national economic development in a short-term and long-term aspect. **The bill on the promotion of investments in small and medium-sized enterprises** aims at providing an alternative financing source for the small business by means of special joint stock companies investing through equity participation, long-term loans or convertible bonds and called "risk investment companies". The proposal includes state participation in the form of state guarantees for the bonds issued by the company, and licensing and control of these companies by the Financial Supervision Commission. The proposed bill on the promotion of investments in small and medium-sized enterprises is a clear indication of the government intentions to support Bulgarian SMEs, however the State should support those promising companies with growth potential, which will be able in the future to attract alone private investments to improve their competitiveness.

In the middle of June **ASME and the Indonesian Ministry of Cooperatives, Small and Medium-sized Enterprises** signed a **Memorandum for Cooperation**.

New EU's Definition of Micro, Small and Medium-sized Enterprises

Bulgaria is expected to change its **criteria of micro, small and medium-sized enterprises**, with a view to comply with the new EU's definition of these notions, which will take effect as of 1 January 2005. According to European Commission's Recommendation adopted in May 2003, the definition criteria for small and medium-sized enterprises, that is, personnel number and annual turnover or long-term assets amount, are preserved, but new higher thresholds are introduced with a view to prevent possible disturbance of the market competition balance and to avoid too much preferences for selected market actors. The new

definition describes the micro enterprise by means of its personnel number, as hitherto, but introduces also the annual turnover and long-term assets amount.

According to the new definition, the micro enterprise has a personnel of up to 10 people, a turnover of up to EUR 2 m and long-term assets up to EUR 2 m. The small enterprise has up to 50 employees, a turnover of up to EUR 10 m and long-term assets up to EUR 10 m. According to EU's criteria, the medium-sized enterprise now has up to 250 employees, a turnover of up to EUR 50 m and long-term assets up to EUR 43 m.

Foreign economic relations

During the second quarter of the year **the foreign trade commodities exchange of Bulgaria continues to develop at accelerated pace.** Its value exceeds by over 14 per cent the volume of trade in the first quarter, and realized commodities exchange for the first half of the year is by 40 per cent higher than the one in the first half of 2002. Growth rates of exports (3.3 per cent versus the previous quarter and 34.6 per cent versus the second quarter of 2002) are impressive but still remaining far behind those of imports (23.1 per cent and 43.9 per cent, respectively) and this naturally leads to a further increase of the negative trade balance. Yet, the basic conclusion to be drawn from such a development of trade is the one of a working national economy with well-accepted output on foreign markets (despite the continuing depression in the economy of the basic trading partners), capable of absorbing fast growing imports. Besides other reasons for growing imports, we should mention the low exchange rate of US dollar encouraging importers to make beneficial purchases with the anticipation of subsequent appreciation and then recalculate raw materials and inputs costs at the new rate.

Imported goods value (FOB) for the period April – June 2003 amounts to USD 1 782.9 m and for the half of the year it exceeds USD 3 508 m. The monthly average volume of exports comes already close to USD 600 m (versus USD 500 m at the end of 2002), and the second quarter is usually not the strongest one. Imports (CIF) in each of the three months are kept at a fairly constant level of about USD 900 m, at a total amount of USD 2 711.1 m for the quarter and USD 4 913.8 m for the six months. The negative trade balance in the second quarter amounts to USD 928.2 m – almost twice higher than the one in the first quarter and exceeds by 29 m the maximum reached so far in the fourth quarter of 2002. By itself this negative balance does not pose a threat to economy, provided revenues from other activities and investment are enough to cover it.

A major partner with an ever increasing share in

both exports (almost 58 per cent in the second quarter of 2003) and in imports (over 50 per cent) remains the European Union and the development of trade with the EU now determines the dynamics of commodities exchange as a whole. Concerning is the fact that exports to EU increase by only 7.1 per cent versus the first quarter of 2003 to reach USD 1 029.4 m, while at the same time imports grow by 27.9 per cent reaching USD 1 361.1 m. This results from a number of factors, some of which related to the hardships suffered by European economy, and others – to the needs of Bulgarian economy and the specific features of its production, a significant part of it being under processing agreements. Quite different seems to be the picture when comparing the results of the second quarter versus the same period of the previous 2002 – exports mark an increase of 36.3 per cent, and imports – of 39.6 per cent. The basic consumer of Bulgarian exported output is Italy, accounting for 28 per cent of exports to EU, and basic suppliers – Germany and Italy, accounting for 50 per cent of imports from EU.

Other countries from OECD (US, Turkey, Canada, Japan) account for 13.6 per cent of exports and for about 12 per cent of imports. Turkey is quite of a surprise in this area as it accounts for 8.8 per cent of exports and 6.5 per cent of imports. It is for the first time that exports to this country decline by 7.3 per cent compared to the first quarter, while imports grow by 44 per cent. What is more, in the months of April and May a negative commodity exchange balance is realized, which is not typical of bilateral trade. An important partner with increasing share in commodity exchange (6.2 per cent of exports and 7.3 per cent of imports) is CEFTA. In the second quarter of 2003 exports to these countries grow by 13.6 per cent versus the first quarter while imports grow by 18.8 per cent. Growth compared to the second quarter of 2002, however, is in favor of exports – by 54.1 per cent versus imports – by 47.6 per cent. However, this is not enough to overcome the traditionally negative trade balance with this group of countries.

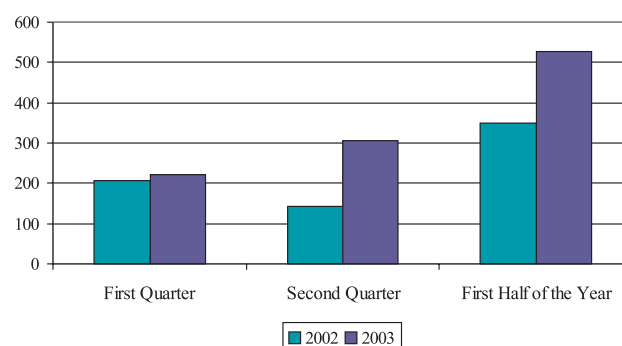
Some changes are observed in the commodity structure of the exchange. Exports of consumer

goods increase by 7.8 per cent compared to the previous quarter and their share is already by 36.6 per cent of total exports. Highest growth in this group is observed with foods. Raw materials and inputs mark an insignificant growth (1.5 per cent) and their share is kept at 41.2 per cent. The strong first quarter in the export of investment goods allows reaching a growth of 44.2 per cent for the half year compared to the same period of 2002 but in practice a decline is registered in the exports in this group of commodities in the second quarter. Certain changes occur in the structure of imports, too, the most significant of which is the continuous increase of the share of investment goods (reaching 25.7 per cent) and this of raw materials and inputs (36.4 per cent) at the expense of the decreasing share of energy resources (17.6 per cent) and consumer goods (19 per cent).

Foreign investments

Foreign direct investments attracted in the second quarter amount to USD 305.4 m (by 38 per cent more than the first quarter and over twice more than the second quarter of 2002). This proves that the trend of investing not big amounts of money in various companies with foreign participation operating on the Bulgarian market continues. Thus, for the first half of the year the volume of investments reaches USD 526.9 m which is twice as much as the realized volume for the same period of 2002 and by only 72.8 m less than the one for the whole 2002 (amounting to USD 599.7 m according to revised BNB data). Having in mind that data of re-invested profit are incorporated at a later stage, the final volume of investments for the first half of the year may reach USD 550 m. On the one hand, this is a rather good attestation for the Bulgarian economy and indicative of the enhanced demand in the country, and on the other hand – the absence of large green-field investments and stable investments by strategic investors remains an important problem for the economic policy.

Figure 14. Direct foreign investment in Bulgaria (USD m)



Source: BNB

With the absence of large privatization transactions, the share of equity interest investments continues to drop down to 29.4 per cent (USD 187.9 m) at the expense of loans growth (the change in the net liabilities between companies with foreign participation and direct foreign investors) which now exceeds 70 per cent (USD 317.3 m) of the foreign investments in the country in the second quarter. In the second quarter of the previous year the ratio between these two items is 30:60, and in the first quarter of 2003 attracted investments in equity interest and other forms of capital are almost equal. Thus, in the first half of 2003 the relative share of loans from foreign investors already exceeds 60 per cent of all attracted investments versus 52 per cent for the first half of 2002. This means that companies with foreign participation are currently focused on developing their operations and leave possible expansion and diversification of operations to the future.

In the second quarter of 2003 Bulgaria made an important step forward in the reforms of the energy sector, providing a possibility for liberalization of 15 per cent of the national electricity market, developed a strategy for privatization of electricity distribution companies and started the bidding procedures for construction of a gas distribution network and implementation of gas supply in two of all the eight regions in the country. The draft of the Energy Efficiency Act was presented to the public. It has an important role to play in encouraging more rational use of energy resources by all users in the country. World oil markets situation and low levels of the US dollar to the Bulgarian lev resulted in minimum fluctuations in fuel prices and in energy costs of Bulgarian companies, respectively.

Government Policy

The draft of the Act on Energy Efficiency (AEE) was presented in this quarter. The need for such a law is dictated by the strive for adopting and applying European legislation, as well as by the need for higher energy efficiency of Bulgarian enterprises as a mandatory condition for building up competitive advantages in regional and global terms.

The AEE draft proposes regulation of public relations concerning the government policy towards enhanced energy efficiency and use of renewable energy sources (RES). The draft law envisages the use of tax and financial instruments to encourage activities in support of energy efficiency, which by rule are costly.

Directions of the government policy on energy efficiency will be specified in long-term national programs and short-term programs developed on national, regional, local and industry levels. The government policy will be implemented by the minister of energy with the support of the Energy Efficiency Agency (EEA).

For the financial support of energy efficiency measures and activities the draft law provides for the establishment of Energy Efficiency Fund. The regulation and structuring of the fund is marked with

ambiguities and lack of concrete commitment which makes questionable its functionality and capacity to accomplish the goals it is set up for. It is not made clear in what way financing from the fund will be different from and will be more appealing than bank financing of similar projects⁴. The draft does not provide any certainty that the fund will raise adequate monies in order to encourage tangibly energy efficiency in the country.

Some of the incentives envisaged in the draft law aimed at encouraging activities in support to energy efficiency are related to the formulation of companies' financial result for taxation purposes and include:

- Accelerated straight-line depreciation of fixed assets directly related to energy efficiency
- Deduction from the end financial result of expenses for research, development and implementation of measures towards reduction of energy consumption and energy generation from RES
- Exemption from VAT of all goods, activities and financing servicing energy efficiency and reduction of harmful impact on the environment.
- Exemption from state and local taxes of donations for development of energy efficiency under approved projects.

The draft encourages the involvement of the central and regional bodies of the executive branch in the implementation of energy saving projects through the provided possibility to use budget savings resulting from application of energy efficiency measures as a subsidy for the usual activity and this will not lead to cutting the annual amount of the received subsidy. The positive effect of these incentives depends on the compliance with the proposed scheme of savings allocation. Under the conditions of increasing requirements for revenues to cut budget deficit and insufficiency of sources of financing the expenditure part of the budget, a real threat exists that subsidies for the usual activities of central and regional bodies

⁴ Thus, for instance, even now the United Bulgarian Bank offers financing for energy efficiency projects within a joint program with the US Agency for International Development (USAID). The US Agency provides guarantee coverage of 50 per cent of net losses on principals arising from non-execution of loan obligations. http://www.ubb.bg/bg/small_and_medium/p4.htm

will be reduced and the thus created financial vacuum will be filled-in with the savings resulting from energy efficiency activities. This would eliminate the economic incentives for active involvement of government bodies in similar projects.

Incentives towards improved efficiency of energy consumption according to the **proposed amendments to the Act on Local Taxes and Charges** are related to local tax exemption of rehabilitated and heat-insulated buildings constructed after 1990, for a period of 10 years as from the date of upgrading. It is envisaged that upon rehabilitation and heat-insulation the taxable value of the buildings will be reduced by including the expenses incurred with a negative sign in the adjustment coefficient of the physical condition of the property. It is proposed that improvement resulting in more efficient use of energy (PVC window frames, heat insulation) not to be taken into account in the taxable value of the property. So far, such improvements increased property's taxable value and, hence, tax liabilities. In other words, investment aimed at more efficient use of limited energy resources by end users were sanctioned.

Measures for encouragement of project implementation in the area of energy efficiency and building up of RES may bring to positive results in the social area, too, by including individuals from programs for the unemployed in the energy efficiency projects.

Another positive effect on employment will result from the requirement that every project on building up, reconstruction and upgrading be subject to energy efficiency evaluation, as this opens a new niche in the Bulgarian business space. On the other hand, this means emergence of a new regulatory burden and additional costs to construction developers.

Another measure that will burden the business is the envisaged mandatory elaboration of energy saving programs by all economic and municipal energy users. This will force all companies, including those of insignificant energy use, to spare time and money for development of such programs. Such a measure

will also have a strong negative impact on small businesses which do not have adequate capacity for the elaboration of similar programs. Therefore, when similar measures are to be imposed a careful analysis should be made of the final effect on economic and municipal entities to avoid possible unprofitable expenses.

EEA draft is still in the stage of expert discussion. It is indisputable that if Bulgaria wants to have a working and efficient legal regime to encourage energy efficiency the proposed wording of the draft needs better clarity and specification.

In the second quarter of the year **Bulgaria made its first step towards liberalization of the energy market**. SERC assigned the status of eligible user for the second half of 2003 to 10 companies which together account for 15 per cent of total electricity consumption in the country. Independent producers that can take part in the liberalized market segment are Maritza Iztok 2 CHPP, Varna CHPP, Bobov Dol CHPP, Rousse CHPP and Maritza 3 CHPP. These plants will have to offer to privileged users about 9 per cent of their annual available capacity.

Table 7. Companies that acquired the status of eligible electricity users in Bulgaria

Company	Consumption in 2002 GWh
Mini Martza-Iztok EAD	562
Stomana Industry AD	423
The Non-ferrous Metals Smelter (KCM AD)	340
Asarel Medet AD	324
Elatzite Med AD	302
Umicor Med AD	284
Devnia Cement AD	168
Agropolichim AD	134
Neochim AD	125
Sviloza	147
Total:	4811

SERC's decision provides legal grounds to eligible users to seek better trading conditions of electricity supply. If this opportunity is realized it will facilitate these companies to reach higher competitiveness, since most of them export the bulk of their products.

Since horizontal or vertical links exist among individual eligible users, the better conditions of electricity supplies will have a multiplying effect within individual clusters, like for instance the cluster in the chemical industry or extraction and processing of non-ferrous metals.

Implementation of this opportunity may be seriously hindered by the inadequate in-company capacity of eligible users to operate under the conditions of a liberalized electricity market. Since the liberalized market offers a new, unknown to Bulgarian enterprises, format of trade relations in electricity supplies, most of the users have not still gained sufficient knowledge of the processes in the electricity market and do not have adequately trained staff to manage company's participation in the liberalized market. The lack of adequate capacity may result in passive behavior on behalf of eligible users or to limit the benefits they can derive from free negotiations. In this respect one of the most critical aspects of free negotiations is the ability of privileged users to properly estimate and order in advance the required quantities of electric power. In the cases when such quantities are higher or lower than the actually used electricity the respective user must take part in the so-called balancing market. Within this balancing market the National Electric Company (NEC) buys out excessive quantities at prices considerably lower than those at which the companies have purchased the power and covers their shortages at prices higher than the selling prices to industrial customers on the regulated market. In case of poor estimates of required quantities, it may prove in the end that the privileged user suffers financial losses from the free negotiations unlike preliminary expectations.

The initial liberalization of the Bulgarian electricity market is a positive step towards country's European integration. Aiming at creation of a single internal energy market the European Union places before its Member States specific requirements concerning users that should have the right to choose independently their electricity supplier. Following several years of debates on the time limits for opening the market the European Union approved in the last

quarter a schedule according to which as of 1 July 2004 all non-household users should have obtained the right to choose freely their electricity supplier, and by July 2007 this possibility will have to be provided to households, too. This means that at the time of its EU accession Bulgaria should practically be at the threshold of full liberalization of the electricity sector. Currently, MEER plans for gradual reduction of consumption limits for eligible users each year, so that to achieve full liberalization of the market by 2007. Fulfilment of these intentions that would result in compliance with European requirements within envisaged time-limits depends exclusively on the success of initial opening of the market and mostly on the capacity of controlling bodies to monitor carefully the results of liberalization and timely correct occurring defects.

The major concern is related to the future effect on the regulated segment of the market. In order to sell the fixed quantities on the liberalized market independent producers need to offer to eligible users sufficiently attractive prices. Aiming at a lower price, independent producers may introduce the practice of cross-subsidizing by transferring costs for the liberalized sector onto the regulated one (e.g. to include fixed costs completely in the price they present for approval to SERC). Avoidance of similar practices requires high level of competence of the regulatory body as it finally approves individual items in the structure of selling prices of the producers.

Bulgaria has a longer road to go compared to EU Members State and candidate countries with regard to implementation of European requirements to market liberalization. The last report⁵ of the European Commission on the implementation of directives on the internal electricity and gas market indicates that currently Bulgaria lags behind most of the present and future EU Member States with regard to the degree of liberalization of the market⁶. In addition,

⁵ Commission of the European Communities, *Second Benchmarking Report On the Implementation of the Internal Electricity and Gas Market*, Commission Staff Working Paper (updated report incorporating the candidate countries), Brussels, April, 2003

⁶ Still behind Bulgaria are Latvia (11 per cent market liberalization), Estonia (10 per cent), Cyprus (0 per cent) and Malta (0 per cent)

European countries have a longer history of market liberalization. EU countries were obliged to open 26 per cent of their markets as early as 1999⁷. On the one hand, this situation places Bulgaria in an unfavorable position as it has to open its market at faster pace than the remaining countries. At the same time it provides possibilities to government institutions and market players to study the experience of other countries and to avoid as much as possible the errors made and unfavorable development.

During the quarter under review **the Council of Ministers adopted a Privatization Strategy for Electricity Distribution Companies (EDC)**. The strategy envisages grouping of the seven state-owned EDCs in three packages of similar parameters with regard to their financial position, customer base, level of sales, territory of operations and structure of consumers. The three packages will be offered for sale at the same time, and not one after the other as previously planned in last year's Energy Development Strategy. The change is justified with the higher probability of finding buyers for all the three packages when offered simultaneously as this will encourage to the highest degree investors' interest and the competition among potential investors.

Privatization is viewed upon as an instrument for the companies to improve their efficiency, creditworthiness and quality of services they provide to end users, and thus to get prepared to take part in the liberalization of the market. Accomplishment of these results depends on the quality of investors and regulatory requirements to their performance. In order to ensure investor's capacity the Strategy envisages setting of initial objective requirement to candidates like annual electricity sales above a certain threshold, a defined amount of equity, certain credit rating and experience and a certain share of liberalized electricity market.

The strategy proposes a good model of EDCs privatization taking into account realities and strategic benchmarks in the country's development and the

energy sector in particular, investors' interests and competition of similar deals in Central and Eastern Europe. There are two major factors at present that may influence negatively strategy's implementation. The first one is related to the long expected new legal and regulatory framework in the energy sector. The absence of clear rules under which future owners will carry out distribution and supply of electric power will probably limit the interest of serious investors. The second factor is related to the possible interest of investors to the three packages. Initial requirements considerably limit the number of potential candidates, especially in view of their past performance in a liberalized environment. Over the last two years a decline is observed in the interest of foreign companies in purchasing new electric companies after their extremely high activity in 1999 – 2000.

SERC opened the bidding procedures for gasification of two out of the eight regions identified in the List of new gas distribution networks to be constructed in distinct regions of the territory of the Republic of Bulgaria of 2001. The new gas distribution network will provide access to households, public, commercial and industrial users to a more efficient energy source. The implementation of such infrastructure projects will create preconditions for reduction of harmful gas emissions from the energy sector and opening of new jobs both in the course of building up the networks and in their subsequent operation.

The bidding procedures in Mizia and Trakia regions are launched before the adoption of the new legal and regulatory framework in energy and the gas sector in particular. This creates uncertainty for potential investors and may limit investors' interest to the biddings because when submitting their offers there will be no clarity as to the rules governing their operations as holders of the right to build and then operate the gas distribution networks.

In April 2003 **Turkey terminated electricity import from Bulgaria** negotiated by an inter-government agreement of 1998. The motivation for such termination referred to the lack of progress in the

⁷ Regulatory requirements and the first result of opening the electricity market in the European Union are presented in the publication of the Center for Economic Development "The Road to a Single Electricity Market in the European Union" (2001)

construction of infrastructure projects in Bulgaria included in this agreement, reduced electricity requirements in the European part of Turkey resulting from delayed economic growth and the attempt of Turkish authorities to curtail the stable trend of rising electricity prices for household and industrial users.

Having a share of about 10 per cent of NEC sales and over 50 per cent of electricity exports of Bulgaria, Turkey is a substantial user of Bulgarian electric power and problems with the sales in its market have inevitable impact on the Bulgarian electricity sector as a whole. Termination of export shrinks the profits of NEC and electricity generating companies, especially those of Maritza Iztok complex and this will have a negative impact on the investment and repair programs of these companies.

Restricted possibilities of electricity sales shrank the demand of lignite coal from Maritza Iztok mining complex which influenced negatively the production process being close to the break-even point. Last but not least, the unfavorable effect on the trading balance should also be noted, since electricity exports to Turkey ensure about 1.4 per cent of the total revenues from exports to the country.

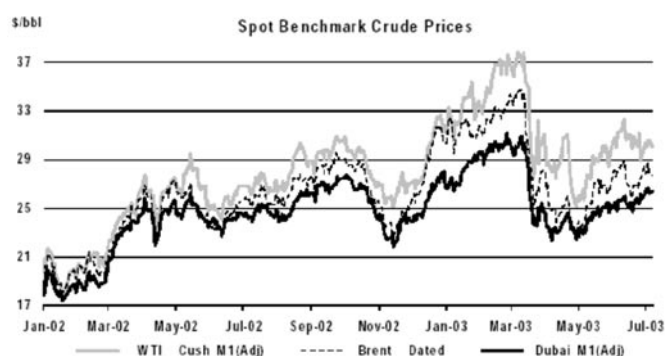
As of the mid of 2003 inter-state negotiations to restore electricity exports to Turkey continued in search of a satisfactory solution to both countries.

Energy resources prices

International markets situation in the second quarter of 2003 was again marked by unstable oil quotations which, having reached levels of about USD 24 per barrel for Brent in April, gradually raised to levels of USD 26-27 per barrel in June. Decisive factors for the price of crude oil were again the news from the Middle East, levels of oil extraction in the North Sea and the levels of oil and oil products production and stocks in USA. The fast solution of military actions in Iraq brought to a significant drop down of fuel prices starting at the end of the first quarter of 2003. Another pressure on quotations was exerted by the spreading SARS epidemics which had a strong impact on the

transport business forcing many of the air lines to cut down their transatlantic flights. Counteracting to this serious drop was OPEC's decision to lower oil extraction.

Figure 15. Dynamics of Crude Oil Spot Prices, WTI, Brent and Dubai



Source: Monthly Report on Crude Oil Prices, International Energy Agency, July 2003, <http://www.iea.org/omrep/11july03pri.pdf>

The situation in the international oil market has a bearing on the Bulgarian economy, too, since the country satisfies almost completely its import needs under trading conditions following world market dynamics. Due to the relative stability of international oil markets and due to the persistent low rate of the US dollar, there were no distinct trends of oil and oil product prices in the Bulgarian market during the reviewed quarter. Accordingly, there were no significant changes in the costs of businesses and households for oil and oil products.

Higher quotations of alternative fuel⁸ in the international markets in the first quarter, influencing import prices of natural gas in Bulgaria, and reduced gas supplies resulted in the beginning of April in a 2.5 per cent rise of natural gas prices for users connected to the transmission and distribution network of Bulgargaz EAD. The low exchange rate of US dollar to Bulgarian lev had a suppressing role to a further price increase. The increase did not have a considerable impact on major users like fertilizers, glass, oil, cement and ceramics industries. Natural gas price changes did not significantly affect heating companies, either, as

⁸ Heavy oil with sulphur content of 1 per cent, heavy oil with sulphur content of 3.5 per cent and gas oil with sulphur content of 0.2 per cent.

these operate at minimum capacity in the spring and summer season and purchase and use only minimum quantities of natural gas.

Lower international prices of natural gas and alternative fuels in the second quarter created conditions for SERC to cut down the selling prices of Bulgargaz by 8 per cent as an average in the beginning of the second half of the year. Lower prices will ease operational expenses of large customers of the state-owned company and will improve their market position.

SERC increased electricity and heat prices to households by 15 per cent and 10 per cent, respectively, in accordance with the adopted indicative plan of 2001. SERC undertook its third step towards rendering household electricity prices in accordance with the costs of supply to users of low voltage.

The extent to which electricity price changes will impact household costs depends on the quantity of power consumed. The costs of households with higher consumption levels will increase more than of those of low energy consumption. This results from the existing two-bracket scale of household electricity prices and the higher tariff increase in the second bracket.

The effect of increased prices of electricity and heat will be gradually assimilated by household budgets due to lower expenses for basic needs in summer. Households do not need heating due to the higher temperatures. Other factors mitigating new prices impact on household budgets are also the lower prices of fruit and vegetables during the season. The negative effect of higher electricity prices may be amplified by the possible speculative increase of the prices of some goods.

Reaching levels of electricity prices that cover the costs of electricity distribution companies is an important step forward to a further liberalization of the sector, as well as to providing possibilities to the energy sector to operate at a profit which is

a mandatory condition for attracting more stable investors in the course of privatization.

With regard to industrial and commercial enterprises these measures can be characterized as positive, since price increase will put an end to cross-subsidizing from enterprises to households. Thus, conditions will be created both for continuation of electricity market liberalization and gradual easing of the price burden to industrial entities which in the end of the day will improve their competitiveness.

In the second quarter of 2003 the transport sector did not witness any development towards substantially improved quality of the transport services. Infrastructure projects did not register any noticeable progress and remain at the financing negotiation stage. No significant improvement was registered in terms of the penetration of private operators in the railway sector and the management of airport and port infrastructures, either. MTC's announced strategic visions on the concessioning of Varna and Burgas airports promise by the end of the year more particular steps to attract the private sector in infrastructure management. The agreements reached between Bulgaria and the European Union in the negotiations on the Transport Policy Chapter, which was closed in the quarter under review, will have serious impact on transport sector development.

Temporarily closing Chapter 9: Transport Policy in early June, Bulgaria made a step forward in the negotiation process with the EU. Negotiations on this chapter are one of the most difficult for all candidate countries because the question is about transposing about 10 per cent of the entire European legislation.⁹ Besides, the future candidate countries must also start to apply the legal norms, and the building of adequate administrative capacity is part of that process. The fact that out of the 10 new Member States only Slovenia closed the negotiations without transitional periods, and Romania has not closed this chapter yet despite that its EU negotiations continue for more than two years, proves the complexity of the Transport Chapter.

Bulgaria's position in the negotiation process was developed with a view to the current situation in the transport sector and the ongoing transformation processes therein, as well as against European and global transport market trends. Consequently, transitional periods were requested for the road, air and railway transport with a view to provide enough time for these sectors to adapt to the European

requirements and to the new competitive working environment within the EU.

Regarding the wide range of social, fiscal, technical and environmental requirements towards the road transport, Bulgaria requested and managed to negotiate three transitional periods. These concern the access of foreign carriers to the national road transport market, the financial stability of the Bulgarian carriers, and the axle load on the road network.

With respect to the transport services offered in Bulgaria, the limitation on the operation of foreign carriers on the domestic market will have the strongest effect. It should be noted that EU provides such an opportunity to all candidate countries with a view to guarantee their smoother integration into the single market.¹⁰ The limitation is favorable for the national carriers as the latter will avoid the strong competitive pressure of the European road transport operators for a longer period of time. But if they fail to make use of the transitional period to prepare for operation under new conditions, they may prove in a marginal situation on Bulgaria's domestic road transport market after the elapse of that period. Bulgaria's economic sectors making the most intensive use of road transport operators' services will prove the major victim of limited competition, because the latter will have weaker influence on the quality of services and on the price levels. This transitional period will also have negative effect on the opportunities of Bulgarian transport companies for domestic transport operations within the EU Member States, because the limitation is of a reciprocal nature.

Regarding the railroad transport, Bulgaria insisted on transitional periods for enforcement of the directives concerning railway development, infrastructure capacity distribution and the imposition of infrastructure charges. The request for a transitional period is a result of the poor financial situation of the two state railway companies, the need to essentially improve the quality of their services, and the ongoing structural changes in the sub-sector. EU did not provide to Bulgaria the requested transitional periods and consequently there is a need to accelerate the

⁹ Transport legislation issues are generally regulated in art. 70 - 80 of the EC Treaty and are specified in the secondary legislation containing several hundreds of ordinances, directives, and resolutions.

¹⁰ Cyprus, Malta, and Slovenia will not apply transitional periods, notwithstanding the opportunity provided.

pace of reforms and the adaptation of BDZ and the Railway Infrastructure Company to operation under market conditions.

With respect to the air transport, the European legislation sets requirements concerning the security, the infrastructure and the establishment of market conditions. The European Open Sky Agreement, which will take full effect for Bulgaria since the beginning of 2006, is among the most significant points for the Bulgarian air transport with a view to the European integration. From that time onward all air companies will be able to fly to the destinations. That will result in elimination of the monopoly of the still state-owned air company Bulgaria Air on some destinations, which it serves on the strength of bilateral agreements. MTC insists that upon privatization of the company not less than 51 per cent should remain Bulgarian property with a view to preserve the right of the company to carry out flights under the bilateral agreements. The expected market loss as a result of the monopoly elimination in a little more than two years, as well as the need to adapt the company to operation in a highly competitive environment may prove important factors, which could reduce the investors' interest in the privatization of the state company.

EU water transport legislation is one of the most difficult to enforce in the future membership candidates due to a need to make sizable investments to observe the requirements for higher security of vessels and to improve the condition of the infrastructure. It is interesting that none of the countries which have completed the negotiation on the Transport Policy Chapter has requested a transitional period. This situation is largely a result of the firm position of the European Commission for the need of timely harmonization of national with European legislation and building an adequate administrative capacity for the water transport. The major water transport related challenge for Bulgaria will be to overcome the poor technical condition of the vessels under Bulgarian flag. It should be noted that coping with this problem will not only facilitate Bulgaria's integration in the EU but will also support the development of the national maritime and river business as it will restore

customers' confidence in the technical capacity of carriers to ensure quality performance of the transport tasks they are assigned.

In the second quarter of 2003 **the idea to concession Bulgarian airports** launched by MTC before the international business community as early as the beginning of the previous year **was further developed in strategic visions for the participation of the private sector in the management of Varna Airport and Burgas Airport**. The two complexes are the most attractive Bulgarian airport infrastructures subject to concessioning¹¹ because they serve the tourist flow to the Bulgarian Black Sea coast. In recent years the two airports report sustainable increase of the passengers and cargoes served. The expectations about growing interest of foreign investors in the Bulgarian Black Sea complexes reveal good perspectives for the years to come.

The basic reason, which makes necessary to attract the private sector in airports management, is the need of sizable investments and know-how to improve the physical infrastructure and the quality of services, as well as the absence of enough government funds for such activities. The service level indicators of the two airports are below the standards set by the International Air Transport Association (IATA). In the last three years investments in the two airports amounted to BGN 4 m only, which covered the minimum infrastructure support needs. Given the strong airport complexes - tourist business interrelation on the Black Sea coast, the improved infrastructure quality will increase the competitiveness of both the airports and the tourist clusters.

MTC plans to base the development of the two airports on state - private business partnership by way of a 35 year concession. Thereby the infrastructure will remain under state ownership, and the responsibility for the airport complexes investments, management and operation will be transferred to the concessionaire. The State will regulate and control

¹¹ Given that there exist international agreements to finance the reconstruction of Sofia Airport, the latter is not envisaged for concessioning, at least not before the validity of the financial agreements expires.

the quality of services, the investments level and the charges the operator imposes on its customers. To guarantee the interests of the customers - passengers and shippers, as well as air carriers - under private monopoly conditions, the State must have and exceptionally good regulatory capacity. Bulgaria does not have such yet because the private sector has only started to penetrate as infrastructure projects operator. Besides, the protection of airport customers' interests requires that the State guarantee sufficient independence to the regulatory authority. That is a result of the fact that the concession payment shall be determined as a percentage of the proceeds and, consequently, under political pressure the regulatory may unjustifiably increase the airport charges to generate higher proceeds.

Similar to the information memorandum and the call for declaration of interest in the concessioning of Bulgarian airports and ports circulated in 2002, the presented visions on the future development of Varna and Burgas airport complexes will possibly intensify again the attention of potential investors. To prevent those visions from remaining a single action that will not hold for long the investors' interest, there is a need to take quick steps to clarify all concessioning conditions and to organize the tender procedures.

The second quarter of 2003 was quiet and did not bring significant changes in the information and communication technologies sector. The problems and uncertainties around the privatization of the state telecom continued in the period under review, accompanied by lack of development in the passing of a new telecommunications act. On the other hand, the private sector continued its active participation in the now liberalized telecommunication market.

In early May the **Commission for Protection of Competition (CPC) authorized the purchase of 100 per cent of the shares in Cable Bulgaria AD, Sofia by Bulgaria Broadband, Luxembourg (a majority owner also of Eurocom Cable)**. Rumors about the transaction went long before CPC's authorization. If effected, the deal will be another proof of the Bulgarian telecommunication market consolidation. The purpose of the planned concentration is to upgrade the available infrastructure of Cable Bulgaria AD, to raise the standards and to improve the quality of the cable services offered.

A workshop to discuss the initial text of a **Strategic Plan for the Development of Bulgaria's IT Industry Competitiveness** was organized in the middle of May. The document is a result of the joint efforts of experts from the Bulgarian Association of Information Technologies (BAIT, www.bait.bg), BIBA (www.biba.bg) and the Bulgarian Association of Software Companies (BASSCOM, www.basscom.org) with the support of the United States Agency for International Development (USAID) Reforms Popularization and Support Project.

The objective of the strategic plan is to present the joint vision, concern and commitment of the business and the Bulgarian Government for development of the national ICT industry competitiveness. The main points of the proposed plan focus on the following subjects: establishment of public-private partnerships; improving the market environment, improving the infrastructure and making efficient use of the information resources; improving the human resources education and development; branding and positioning the Bulgarian ICT industry on the international market.

Specific time limits and implementing agencies for each proposed project and task, which should have been an integral part of the presented draft document, were absent. Without those specifications the above actions may well remain desirable, which will make the implementation of the goals set more difficult to achieve.

Four business associations in the Bulgarian ICT sector - BAIT, the Bulgarian Trade Chamber of Electronic Industry and Informatics, the Telecommunications Association, and the Bulgarian Internet Association - signed a memorandum at the end of June. It concerns the development of common positions and joint steps to protect the interests of the Bulgarian information society, as well as Bulgaria's future accession to the European Union.

One of the resolutions adopted with the document involves the set up of a consultative council called Bulgarian Information Society Forum, to be a working consultative body comprising representatives of the associations which have signed and joined the memorandum and coordinating the interests of the individual associations, developing their common positions and opinions before the Bulgarian government and local authorities and the European institutions and organizations, and making recommendations for joint actions concerning vital interests of the Bulgarian information society. BAIT will coordinate the joint actions under the memorandum.

A change in the prices of the services provided by BTC was approved at the end of June to everybody's surprise. Higher local call prices and charges had been commented for quite some time, but nobody expected that the new prices will become a fact without prior comment. Thus, since July 1, 2003 local call prices increased by 14.3 per cent (from 7 stotinki to 8 stotinki, VAT excluded) at the expense of lower long distance calls (by an average of 12 per cent) and international calls (15.62 per cent). The recent telephone installation charge of BGN 100 was decreased by 20 per cent and the monthly rate was increased to BGN 8.50.

A European Software Institute (ESI) Regional Center for Bulgaria was opened at the end of June in Sofia. The new software center is the fourth in the world and the first in Eastern Europe. It was made possible as a result of a joint project of the Ministry of Transport and Communications and the UN Development Program, the implementing agencies are the Communications and Information and Communication Technologies Development Agency at MTC and BASSCOM.

The Institute was established in 1993 by the European Commission with the support of the Basque government, its head office is in Zimudio, Biscay, Spain. The basic goal of the institute is to contribute for the development of the European industry competitiveness by way of promoting the continuous improvement of the information and communication technologies and the knowledge in this field.

The European Software Institute's center in Bulgaria will have the task to develop the information technologies sector competitiveness by way of know-how and expertise transfer and to contribute for the adaptation in Bulgaria of established technological and quality standards. The fact that there are only six centers of this kind in the world is an exceptional advantage for Bulgaria. It is also an acknowledgment of the potential of the national software industry and recognition by the world software society.

The second quarter of 2003 was also full of events in the field of information technologies. **The traditional Internet Expo** organized by BAIT was held in mid April. Similar to previous years, this event attracted a significant number of the companies operating in the national ICT field. A conference on "Liberalization and then what?", hosted by the Telecommunications Association was organized within the exhibition. The topics discussed at the conference included the sorest points of the Bulgarian communications sector - the development of the market and the regulatory framework, the penetration of technological innovation, the investments in the sector and the effect of the global crisis.

An international scientific and technical conference on Technological Innovation in Education and Vocational Training was organized in Sofia in the middle of May. The event was organized by the Center for European Education and Multicultural Communications, Edimit OOD, BAIT, MES and the Agency for Development of Information and Communication Technologies at MTC. The objective of the conference was to acquaint the participants with the national and the European practices and trends in the development, implementation and dissemination of technological innovation in education and vocational training. Major topics of discussion included:

- Government's policy to modernize education;
- Implementation of technological innovation in education - methodological and technological challenges;
- Technological innovation in vocational training - trends and practices;
- Social aspects of the implementation of technological innovation in education;
- European standards in the field of IT training;
- European programs in the field of IT implementation in education and training.

Placing the priority on the quality of Bulgarian IT education is vital for improving Bulgaria's positions in terms of ICT use and implementation. Therefore the organization of such forums and the discussion of the problems of the educational system and process should not be neglected. The fact that there is now initiative along these lines is positive, but one should not forget that good intentions alone cannot change the current situation.

The Third Discussion Forum on Government Administration Reform and e-Government - e-Municipality Cooperation, organized by IDG, Bulgaria with the support of the Minister of Government Administration, was held at the end of May. Major problems and opportunities of Bulgarian e-Government development were discussed at the conference and the international experience along these lines was presented. Government administration representatives expressed their strong

support to this initiative at the conference and earlier, with the adoption of the e-Government strategy, but it is a fact that particular plan with measures and actions to guarantee pursuit of the goals set in the strategy has not been approved yet. And that is actually the more important and reasonable part of the efforts required to successfully implement the e-Government.

Along with the above important events, **the second quarter witnessed also a considerable number of conferences on digital divide, information security and safety, selection of technological solutions, etc.** This is indicative of the private sector's desire and capacity to get actively involved in the ICT spread in Bulgaria, so it is perhaps the government administration again that should make more efforts to achieve good results in this field.

The data provided by the national card operator BORICA for the quarter under review also indicate a positive change (Tables 8 and 9). The total number of automatic teller machines and POS terminals installed and of bank cards issued for the months of April, May, and June increased by more than 10 per cent (14 per cent for cards). Almost 10 m transactions (an increase of 21.5 per cent compared to the previous quarter) to the amount of about BGN 839.6 m (an increase of 19.4 per cent) have been executed for the same period. The interesting point is that despite the higher absolute number of the transactions via Internet, ATM and telephone, the total amount paid under these transactions registered a decrease.

But the important fact in this case is that Bulgarians pay increasingly higher attention to the opportunities provided by non-cash settlements, which is a prerequisite for intensified spread of e-trade and a successful start of the e-Government in the next few years. Along with that, the number of services payable in this way also registers an increase (in April the second GSM operator Globul introduced the payment via ATM option, and in most towns public utilities are payable via ATM for a long time).

Table 8. Automatic teller machines, POS terminals and bank cards

Installed automatic teller machines, POS terminals, and bank cards issued	31.12.2002	01.04.2003	01.07.2003	Growth for the II quarter (first half-year)
Total installed automatic teller machines	829	912	1 027	12.61% (23.88)
Total installed POS terminals	2 554	2 728	3 007	10.23% (17.74)
Total bank cards issued	1 614 105	1 802 675	2 055 190	14.01% (27.33)

Source: BORICA, www.borica.bg

Table 9. Transactions via Internet, ATM and telephone

Total transactions for the period	2003, first quarter	2003, second quarter	Change, II quarter compared to I quarter
Total transactions	8 210 354	9 976 119	21.51%
Total transactions via Internet (ePay.bg system)	11 557	13 178	14.03%
Total payment of services transactions via ATM	18 619	22 727	22.06%
Total payment of services transactions via telephone	3 320	3 428	3.25%
Total amount, transactions in BGN for the period	2003, first quarter	2003, second quarter	Change, II quarter compared to I quarter
Total amount, transactions in BGN	702 995 149.85	839 555 096.22	19.43%
Total amount, payments via Internet	601 579.77	524 639.24	-12.79%
Total amount, payment of services via ATM	676 923.72	720 789.04	6.48%
Total amount, payment of services via telephone	168 608.11	125 907.12	-25.33%

Source: BORICA, www.borica.bg

Number of Tourists and Revenues from Tourism

According to NSI's data, the number of **foreign tourists** who visited Bulgaria in the first six months of the year was 1 234 960, registering an increase of 9.59 per cent compared to the same period of the previous year. In June 2003 alone this number registered an increase of 23.6 per cent compared to June 2002. Greece, Germany, Macedonia and Great Britain account for the highest number of tourists. Visitors from Hungary (90 per cent), Cyprus (58 per cent) and the Czech Republic (63 per cent) registered the highest increase. In the first half-year the number of Bulgarians who traveled abroad for tourism reached 400 630 people. The highest number of Bulgarians preferred to visit Turkey, Germany, Greece, Macedonia, Serbia, and Montenegro.

In the second quarter of 2003 **revenues** from international tourism amounted to USD 401.7 m, compared to USD 333 m for the same period of the previous year. In the first half of 2003 revenues from tourism reached USD 574 m. These figures register slight improvement compared to the USD 485.6 m for the period January - June 2002. In the first six months of 2003 revenues from international tourism registered an increase of about 18 per cent.

In the second quarter Bulgarians' **spending** on travels abroad amounted to USD 165.7 m. For the period January - June 2003 it exceeded USD 302 m, registering an increase of USD 34 m compared to the same period of the previous year. In the first six months of 2003 **net revenues** from tourism reached USD 271.7 m (compared to USD 217 m for the same period of 2002).

Environment for Development of Tourism

The summer tourist season was officially opened in the beginning of June in the Sunny Beach resort complex. Expectations for the current season are optimistic - according to data by major tour operators, the number of tourists will register an increase, with most significant growth of the number of tourists from Great Britain (about 60 per cent) and Germany (about

20 per cent). Change in the category of tourists is also expected - according to MoE's the share of tourists able to pay registers an increase. Experts recommend smooth increase of lodging prices while preserving the price competitiveness of the Bulgarian tourist product.

Active work **to rehabilitate and renovate the specialized infrastructure** along the Bulgarian Black Sea coast will continue in the second quarter of 2003. For example, the Sunny Beach resort complex started the new season with new investments amounting to EUR 70 m, with total investments in the complex for the last three years amounting to EUR 250 m. Fifteen new hotels, including a new 5-star one, will be opened in this season alone. The total number of hotels in the resort reached 112, with the number of beds therein exceeding 32 000 and registering an increase of 4 000 beds compared to the previous year. Owing to the efforts to expand the material resources, in April and May 2003 the number of foreign tourists in Sunny Beach registered an increase of 28 per cent compared to the same period of 2002. In the new season the total number of tourists in the resort is expected to exceed 305 000 people, registering an increase of 90 000 people compared to the previous year.

The biggest aqua-park on the Balkans was opened in the beginning of the summer tourist season in the Golden Sands complex. Investments in this park, which is the first of its kind for Bulgaria, amount to BGN 10 m, with the water facilities supplied by a Spanish company. The park is expected to attract more tourists, mostly by compensating the absence of enough attractions and sport facilities on the Bulgarian Black Sea coast.

Basic infrastructure related problems persist in a number of Black Sea resorts. There is still lack of a clear strategy for the privatization of the state company, which owns the infrastructure in Sunny Beach. Most likely, there will be no haste with this process with a view to avoid the serious conflicts, which originated some time ago in Golden Sands.

Problems related to the quality of human resources emerged in the beginning of the summer season. The tourism sector begins to suffer from shortage of qualified personnel, mostly as a result of labor flight. Major reasons include low pay and the seasonal character of the jobs. At the same time there is heavy demand of qualified tourist personnel on an international scale and, given that in many countries the pay is much higher compared to Bulgaria, such labor drain is normal.

According to data by the Bulgarian Association of Tourist Agencies (BATA) presented in June, tourism accounts for 6 per cent of the employed in Bulgaria, with twice higher number of seasonal employees. But the problems concerning the social security contributions of seasonal employees have not been solved, thereby generating tension and uncertainty.

The personnel shortage problem is expected to get aggravated in the years to come owing to the expanded specialized infrastructure mostly in the sea resorts. It is a fact that Bulgaria's material resources are registering dynamic growth, but the process is not accompanied by active training and increase of the number of qualified personnel in this field.

The problems are complex and a possible way out of the situation is to increase the pay in tourism with a view to make the personnel who have left the country come back. But there is also a need to make changes in the educational system - for example updated curriculums in the area of tourism and organization of practice training and probation in Bulgarian tourist sites. Another possible solution is the active involvement of the tourist business in personnel training. The latter is already under way - a project for construction of a tourist personnel qualification and training center in Sunny Beach has been developed.

BATA is particularly active in personnel training - two BATA's projects were announced in the recent months: one for foreign language teaching of tourist personnel and another for the implementation of European practices in tourism.

Regarding **the alternative forms of tourism** (rural, eco, cultural, historical, etc.), the new biannual cooperation agreement signed between the Government of the Confederation of Switzerland and the Stara Planina Regional Tourist Association in the second quarter of 2003 is of paramount importance. The Swiss Government's support for tourism started in 2001. The new agreement is actually a step further of this cooperation. Forty projects have been implemented so far, with total financing by the Swiss Government expected to reach BGN 142 thousand in 2003.

Another tourism partnership trend concerns **the active cooperation between Southeast Europe countries** and the presentation of common tourist products. This is particularly positive on the eve of the 2004 Summer Olympic Games in Athens. The investment forum with a focus on the tourist cooperation of Bulgarian and Greek partners, organized in May in Serres, North Greece, is a step towards the realization of such cooperation. The initiative for a framework agreement between business centers from Southwest Bulgaria and the Chamber of Commerce and Industry of Serres (announced at the forum) contributes for intensified transfrontier cooperation.

In June the Bulgarian Association of Hotel and Restaurant Running celebrated its 10th anniversary. It is one of the most active associations in the sector. The event confirmed again that tourism is a sector characterized by good partnership between companies.

Regulatory Framework

The Ordinance on Licensing of Tour Operators and Tour Agents was amended in the second quarter of 2003. The requirement for minimum number of tour operator's personnel was eliminated. The ordinance required tour operators to have not less than five specialists employed under labor contracts; tour operators licensed as tourist agents - not less than six, and tourist agents - not less than two.

These texts were among the most disputed and

discussed ones during the passing of this Ordinance in October last year, because they were interpreted as a protection of the big tour operators by MoE. According to the latest amendments, the owner or the manager of the company is free to employ as many people as he needs. The requirement for air tickets sale agencies to have not less than two employees is preserved as it corresponds to the international standards.

The requirement for minimum office area of 16 square meters for tour operators was also eliminated.

The Ordinance on Categorization of Tourist Sites was also amended. Higher requirements to high category hotels (in terms of parking areas, garages, entrances, lifts, etc.) will be applied only to sites designed after 1 July, 2003 and shall not be valid for older sites.

Fast food places with up to 12 seats will not be subject to categorization where they are on the territory of cultural institutions, shops, car washes, service centers, service shops, etc. This is based on the presumption that the sale of hot snacks and drinks is not their basic but accompanying activity.

It should be noted that the amendments are a result of the dialogue and the agreement reached between MoE and the tourism trade organizations. The objective of the amendments is to support in the first place the alternative forms of tourism in regions where the tourism sector is only beginning to develop.

Condition of the Sector

The share of agriculture in GAV and GDP preserves its intensive downward trend. In the first quarter of 2003 alone this share dropped down to 6.5 and 5.6 per cent, accordingly (compared to 7.5 and 6.5 per cent for the first quarter of 2001). Taking account of the seasonal growth, a share of 9.5-10 percent of GAV and 8.5-9 per cent of GDP can be projected for the second quarter of 2003. Despite some revival at the land market, supply is still higher than demand and farm land prices remain rather low. The introduced incentives for uncultivated land do not have effect yet and the need of consolidation problem remains unsolved.

A pilot **census of farms** was taken at the end of March and in early April. Its objective was to outline possible oversights and mistakes in the mechanism with a view to remove these by the start of the regular census to be taken in the period 1 July - 30 November. The census is expected to cover over 900 000 farms throughout the country. That will make possible to establish the size and the structure of farms and the trends in their development, which will enable more precise formulation of the national agrarian policy and the specific measures to support farm producers.

The unfavorable weather conditions during the winter and the spring will not allow to achieve the **expected cereal yield**, but the production (about 2.2-2.3 m tons) will be sufficient to cover national needs. According to MAF's data, the average wheat yield is projected at about 290 kg per decare, and that of barley - at 240 kg. In some regions of Northeast Bulgaria, which were highly affected by the winter frost and the prolonged drought, the yield will be much lower compared to both the normal and the average for the country. Implemented measures to provide quality and certified seeds for the autumn sowing resulted in grain crop of higher quality compared to the previous year and the yield in the regions unaffected by the drought is expected to exceed the average one. The assistance in support of this year's harvest started as early as 20 June, which will allow timely and efficient spending of funds for the purposes they have been earmarked for.

The higher area of sown land and the expected higher yield allow to project sunflower yield of over 710 thousand tons, which represents an increase of 10 per cent compared to 2002. The complete utilization of the limit under the target financial line of the Agriculture Fund for direct subsidies to purchase quality seeds and fertilizers for the production of sunflower seeds also contributes to the increase.

Environment for Development

Having closed the veterinary and phytosanitary issues section of the Agriculture Chapter, MAF works on the second section - Common Agricultural Policy (CAP) and rural development policy, with the ambition to complete the negotiations in 2003. The agreement on reform of EU's CAP reached at the end of June envisages payment of subsidies in the sector as a fixed single payment decreasing with each consecutive year, and not on the basis of the produced output. Funds saved thereby will go back to the sector in the form of another type of target support. They will be redistributed by the individual member states to finance activities promoting rural development, improving production quality and targeting environment protection. These changes do not have yet direct effect on the financing of Bulgarian agriculture, but they should be taken into account in the negotiations with the EU.

Important for the development of national agriculture are also **some normative acts of the European Council and the European Commission**, such as the Council's Decision of 8 April 2003 on new mutual farm concessions and their inclusion in the European Agreement; the amendment to Regulation No. 834/14 May 2003 of the European Commission amending the rules for implementation of the European Agreement measures in the meat and eggs from domestic birds sectors; and the Regulation of 3 June 2003 concerning the concessions in the form of Community tariff quotas for certain cereals originating in the Republic of Bulgaria.¹²

¹² Official Journal of the European Union, www.europa.eu.int/eur-lex/en/archive/index_2003.html

MAF's collegium approved **draft Regulation on the terms and procedure of export licensing**. It envisages payment of export subsidies to the Agriculture Fund only on the basis of the export licenses issued. The aim is to support farm producers by promoting the production of high quality Bulgarian agricultural products capable to cope with foreign markets competition. By 1 March each year the Agriculture Fund will propose to CoM a list of the products to be subsidized, the subsidy amount, and the export direction. The objective of this Regulation is to create the necessary mechanism and capacity for export subsidizing which is a fundamental measure of EU's CAP.

The newly passed Apiculture Act is expected to promote the sector's development. A pilot project for special spring prophylaxis and registration of the bee families with a view to guarantee the quality and harmlessness of bee honey and bee products was started for the purpose. Project implementation funds represent a target subsidy granted by the Agriculture Fund under the Stock-Breeding Program. All that will allow to extend the production of quality products and to increase export by about 25 per cent up to 5 thousand tons.

A Bulgarian Rose Production bill was introduced in the National Assembly at the end of June. The objective is to regulate the path from the creation of quality propagating material and the planting of rose gardens to the processing of the rose blossom according to a Bulgarian technology and the marketing of the end product - the attar of roses, with a single quality certificate, which will allow to preserve and establish the Bulgarian Attar of Roses brand. With that end in view, the bill envisages mandatory issuance of quality certificates by state-accredited laboratories with a view to limit unfair competition and prevent the loss of foreign markets. The attar of roses produced amounts to 900 kg and realization on the international markets at a price of over USD 4 thousand/kg is expected.

The Agriculture Fund gets further established as a financing and intervention agency by expanding

its activity and building its administrative capacity. In the first half of 2003, 523 projects amounting to a total of BGN 24.4 m were approved under the three investment programs: Stock-Breeding, Crop Production, and Technical Equipment. Over BGN 7 m were utilized in April and May alone. In the event of purchase of new technical equipment with the financial assistance of the Fund and on a resolution by the Management Board, one may take loans under preferential conditions from the commercial banks with which the Fund has signed refinancing agreements. That will expand the volume of the purchased technical equipment, increase the number of projects refinanced by the commercial banks and enable more farmers to make use of the program.

The work on the specification and expansion of the options for farmers to get financial assistance under **the SAPARD Program** continues. The objective of the agreed amendments to now effective measures is to facilitate the access of farmers to the Program funds. Funds for investments in the Eggs and Egg Products Sector will be granted under Measure 1.1.: Investments in Farms. The conditions for granting funds under Measure 1.2.: Processing and Marketing Improvement are facilitated by reducing the minimum required output. Measure 2.1.: Development and Diversification of Economic Activities, now includes projects in mountain regions and projects for the set up or rehabilitation of small production units for storage, production and packaging of agricultural products.

Despite the continuous improvement of the conditions for access to the program and the higher number of approved projects, the general opinion of EU's Monitoring Commission is that Bulgaria was the first to start program implementation, but it is now lagging far behind the other countries in the utilization of SAPARD funds for the financing of national agriculture. The major reason lies in the problems encountered by farmers in the development of sufficiently reliable projects, in the rather difficult application conditions, and in the inability to provide own financing.

In the second quarter of 2003 the stock exchange trading in compensatory instruments was active despite the insignificant decline caused by the delay of privatization against compensatory instruments and disclosures on the so-called problem lots. The SOFIX index was increasing over most of the period and reached record values in its history. Market capitalization grew again in this quarter with a lower turnover (not taking into account the sale via the stock exchange of the state-owned minority block of Bulgartabac Holding AD) but at a higher liquidity compared to the first quarter.

Yet, the role of the capital market in the financial sector of Bulgaria is still insignificant – as of the end of June 2003 the total market capitalization of the Bulgarian Stock Exchange – Sofia AD was at 4.89 per cent of the up-dated GDP estimates (source MoF) for 2003. Underdevelopment of the capital market is explained with both the conditions and prospects to the Bulgarian economy as a whole, and the circumstance that financing mechanisms via such an alternative non-banking environment remain unknown or non-preferred even with the availability of respective projects. **Overall liquidity remains low, market incentives are insufficient to establish good practices of corporate governance even in public companies. Investment alternatives remain limited and financial mediation is still provided mainly through the banking sector.**

The capital market through the indicators of Bulgarian Stock Exchange – Sofia AD (excl. the market of compensatory instruments)

As of 30 June 2003 market capitalization based on data from the exchange amounted to a total of BGN 1 726 335 740 (out of these BGN 318 675 205 on official markets) while at the end of the first quarter market capitalization amounted to a total of BGN 1 426 888 968 (out of these BGN 242 948 638 on official markets). Turnover in the second quarter of 2003 was BGN 55 733 714 with 15 176 085 traded securities. This turnover and volume of trade does not include the sale of 12.838 per cent (or 945 803 shares) of the capital of Bulgartabac Holding AD,

neither compensatory instruments and rights traded on the exchange, but include block deals again without compensatory instruments. This presents an insignificant drop in turnover but with more traded securities compared to the previous quarter. The SOFIX index in the beginning of April declined but then started to rise again to reach in June one of its highest values since the start of its calculation – 279.63 (following 229.14 at the end of March and 183.08 at the end of December 2002).

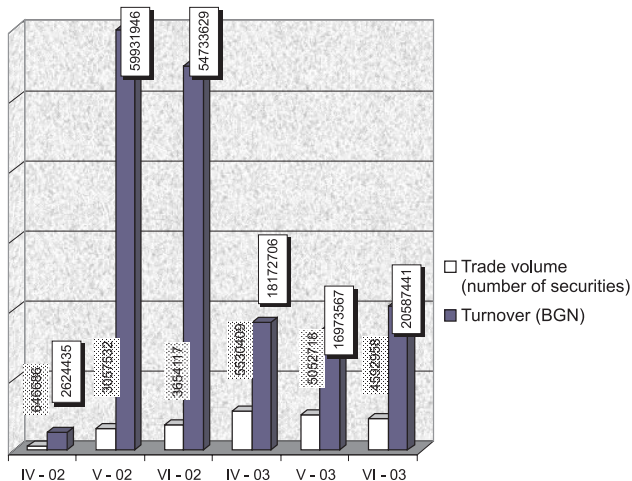
Thus, the second quarter of the year was marked by a diverse development of the major indicators characterizing the condition of Bulgarian capital market (understood and measured traditionally through the indicators of the Bulgarian Stock Exchange – Sofia AD). Excluding compensatory instruments but including block deals, the exchange turnover dropped down in this quarter but the volume of trade grew versus the previous quarter (the sale of Bulgartabac Holding is not accounted for in this case, otherwise turnover and volume are considerably increased). Market capitalization and the SOFIX index exceed their end-of-March values.

Capital market in Bulgaria remains underdeveloped. Low liquidity remains among the major problems irrespective of the positive trends of last quarter. The number of issues registered for trading continues to be high but liquid positions are few (these are most of the securities included in SOFIX plus some of the former privatization funds).

Yet, as whole a positive development is in place if compared to the corresponding period of 2002. With regard to the volumes of trade on the Bulgarian Stock Exchange – Sofia AD in the second quarter of 2003 a significant growth is observed compared to the same period of last year (Figure 16). At the same time the turnover marks a decline; however, it should be taken into account that in the second quarter of 2002 a one-time transfer of blocks of Sheraton Sofia Balkan AD was made. In addition, if we add to the second quarter of this year the turnover of the sale of the state-owned minority block of Bulgartabac Holding AD, the two quarters become comparable with regard

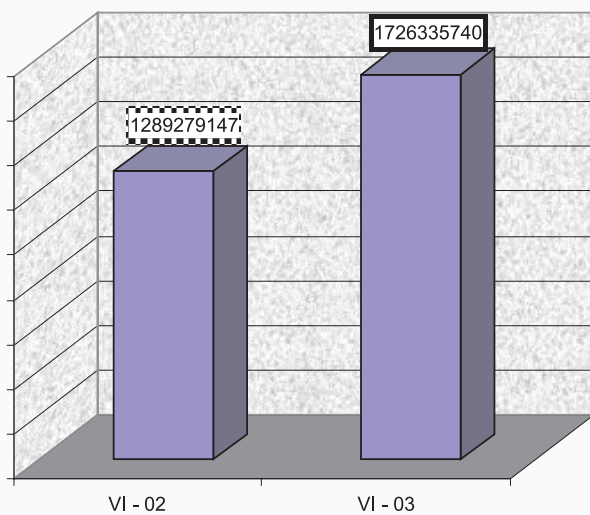
to turnover at a nearly doubled volume of trade in the period April – June 2003. Market capitalization grows, too (Figure 17).

Figure 16 . Trading on the Bulgarian Stock Exchange – Sofia AD (second quarters of 2002 and 2003 , excluding the sale of 12.838 % of Bulgartabac Holding AD)



Source: According to data from the Bulgarian Stock Exchange – Sofia AD, monthly bulletins

Figure 17. Total capitalization of the markets of the Bulgarian Stock Exchange – Sofia AD at the end of period (BGN)



Source: According to data from the Bulgarian Stock Exchange – Sofia AD, monthly bulletins

During this quarter the audited financial statements of public companies for the first quarter of 2003 were to be published in accordance with the last legislative amendments, as well as the audited financial statements for 2002. Like in previous reporting periods many of the companies did not

again submit their statements in time. Among those who did not submit their financial statements in time for both the previous year and for previous quarter were even two companies included in the calculation of the SOFIX index (Bulgartabac Holding AD and Blagoevgrad BT AD). In addition, the audited version of financial statements sometime presented results considerably differing from those disclosed earlier in the year (and this happened again even with companies within SOFIX, like Petrol AD and Neochim AD). All this reconfirmed the problem of **corporate governance practices in Bulgaria that still need improvement**. This again brings us to the conclusion that **dependence of prices of traded companies on public disclosure of corporate events remains contradictory for the Bulgarian market, although the market expects and needs such information**.

In the second quarter of the year **there was no particular revival of the market of bonds** on the Bulgarian Stock Exchange – Sofia AD. A total of 62 deals of corporate bonds were concluded for the quarter on the official markets of the Bulgarian Stock Exchange – Sofia AD (following 43 deals in the first quarter) with a total turnover of a little over BGN 6 m (versus BGN 14 m in the first quarter). Corporate bonds deals on the non-official markets of the stock exchange amount to a total of 35 (following 18 in the first quarter with a total turnover of BGN 3.8 m (versus over BGN 1 m in the first quarter).

In the first quarter registered for secondary trading on the stock exchange were the mortgage bonds of Central Co-operative Bank AD (first issue of this bank, and it was registered on the official market of corporate bonds) and Bulgarian-American Credit Bank AD (third issue of this bank). Registered for secondary trading on the stock exchange were also the bonds of TBI Credit EAD (a company that holds a large share of the domestic market of consumer leases of household electronic and kitchen appliances). All the three issues had been privately placed and fully executed before that.

Private placement and subsequent registration on the exchange is the preferred strategy by issuers with the

purpose of lowering the risk of placement failure but ensuring higher liquidity for investors. In confirmation to this we can point out that only three transactions with bonds were concluded on the primary market of the stock exchange during the quarter. It is quite probable that many of the privately placed issues in the period April – June will soon join the above three issues registered for secondary trading on the Bulgarian Stock Exchange – Sofia AD. These are the issues of Post Bank AD, Kaolin AD - Senovo, Bulgaria Invest Bank AD, ProCredit Bank AD and Unionbank AD. What should be noted is that most of the issues are of mortgage bonds by banks which is undoubtedly related to the increased demand for mortgage loans in recent months.

It should be specially noted that in the second quarter of 2003 an attempt was made for **the first for Bulgaria Euro-bond corporate issue** – this of First Investment Bank AD. The initial idea was to make one or two issues of about EUR 50 m, but after the issue was presented in Frankfurt and London and following the advise of the issue manager J. P. Morgan, a decision was made in May to postpone the issue until the end of the year and to raise the nominal value up to EUR 100 m with the purpose of attracting investors with more liquidity (though a small volume was already placed privately). A subsequent registration at Luxembourg Stock Exchange is envisaged.

Compensatory instruments trading

The start of compensatory instruments trading on the Bulgarian Stock Exchange – Sofia AD was among the leading events in the area of the capital market in 2002. The positive expectations of investors and participants in privatization against compensatory instruments resulted in initial price rise of the securities and later on to continuous preservation of prices at levels close to one fourth of the nominal value. Interest to compensatory instruments trading remains high even today and it is in direct dependence on the progress of privatization via the stock exchange (especially the sale of larger blocks of more attractive enterprises) where payment is planned to be effected in compensatory

instruments.

However, the positive news around compensatory instruments trading on the Bulgarian Stock Exchange – Sofia AD in the second quarter stepped back to the disclosures about the **so-called problem lots**. A part of these lots, which were or still are the subject of litigation with regard to the lawfulness of their issue, proved to have been used already in privatization transactions and thus a discussion arose on possible problems in two directions – with their acquisition by persons in good faith on the secondary market and with the use of such compensatory instruments in privatization transactions. In May the Privatization Agency announced 355 similar problem lots, two thirds of these being issued by the regional governors of Montana and Vidin.

At the end of June The Supreme Administrative Court confirmed by a decision the revocation of compensatory warrants of a nominal value of BGN 142 m and this accelerated the amendments of the Act on Compensatory Instruments Transactions discussed earlier. According to the statutory amendments adopted later in July, “problem lots” which were not registered in the Central Depository shall be blocked in the Central Register of Compensatory Instruments. If already registered in the Central Depository such blocking shall be done there, however, the instruments that have been subject of a transaction on the regulated market are not subject to blocking (these are acquired by a third person in good faith like the acquirers of compensatory instruments on the stock exchange). Such instruments cannot be invalidated and in the case when a court makes a determination that they were issued without legal grounds or on legal grounds eliminated later, a person who has enriched himself without such grounds by their issue shall return the same quantity and nominal value of compensatory instruments. All these changes in the Act on Compensatory Instruments Transactions, though somewhat delayed, are aimed at regaining certainty among actors on the capital and privatization market.

Compensatory instruments trading statistics for

the period April – June 2003 are as follows: a total of 5 067 deals with compensatory instruments have been concluded (versus 4 121 in the first quarter) with a turnover of BGN 23 076 858 (versus BGN 17 534 456 in the first quarter) which marks a certain increase compared to the first quarter. In addition, however, block transactions with compensatory instruments are registered on the exchange – 42 deals with a total turnover of BGN 13 219 464 which is a two times drop down of the turnover with an almost unchanged number of deals compared to the first quarter of 2003. During the quarter compensatory instruments were traded at a price of 22 to 25 per cent of the nominal value, i.e. almost like in the previous quarter.

Legal and regulatory environment

As regards legal and regulatory environment, the second quarter of the year brought to **changes that can generally be assessed as positive**. In April the Financial Supervision Commission issued instructions for the cases when calculation of the liquidation value of a company is obligatory when making a tender offer. The objective of this measure is the better protection of interests of minority shareholders, so that they have the possibility to obtain a “fairer” price in the cases when the actual condition of the company significantly differs from the one shown on its balance sheet.

In April, following long discussions with representatives of investment intermediaries **amendments were adopted in the rules of the Bulgarian Stock Exchange – Sofia AD and the Central Depository**. According to these a minimum threshold of BGN 5 000 was introduced above which all transactions should be finalized through a bank. At the end of May, in connection with the commissioning of the system for real time gross settlement (RINGS) netting of cash payments was introduced between the members and the time period for settlement was reduced to two days.

After a part of the parliamentary opposition attacked the newly passed **Act on the Financial Supervision Commission in front of the Constitutional Court**,

in April the Court admitted for examination this constitutional case. The disputed provisions were related to the impossibility for the decisions of the Financial Supervision Commission to be appealed to the court, and together with that – to the annual fees to be paid by the persons - subject to supervision to the financial regulator. At the beginning of July the Constitutional Court rejected by a decision the request on determination of anti-constitutional nature of the provisions of the act.

In the second quarter of 2003 the **Act on Companies with a Special Investment Purpose was passed at second reading**. The hopes are that it will make a serious break-through in the environment for development of the capital market in our country, both with regard to the opportunity for emergence of the companies with a special investment purpose and generally with the introduction of mile stone norms in Bulgaria of assets securitization. Creation of investment alternatives and encouragement of collective investment schemes are among the expected additional effects from this new law.

During the elapsed quarter a **draft law on encouragement of investments in small and medium-sized enterprises** was introduced into Parliament. This law is aimed at encouraging investments in small and medium-sized enterprises through new entities – companies for venture capital investment in such enterprises. The companies in question shall be subject to licensing and control by the Financial Supervision Commission. Companies for venture capital investment are envisaged to be able to issue dematerialized bonds guaranteed by the state.

The condition of banks in Bulgaria continues to be stable with excellent indicators of capital adequacy and liquidity and a well functioning bank supervision. At the end of the second quarter in Bulgaria there are 34 banks, out of which 27 are the banks licensed to perform transactions in the country and abroad, there is one bank with a license to conduct transactions only in the country and there are six branches of foreign companies.

Statistics of the banking system

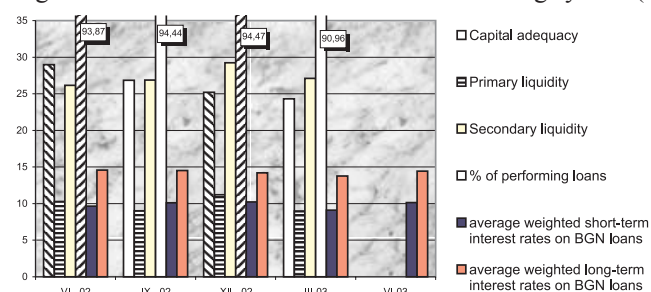
As of 1 January 2003 International Accounting Standards became effective for commercial banks which imposed a **change in the format and structure of their balance sheets and income statements.**

As of April the Banking Supervision Department of BNB **modified the grouping of commercial banks** (like before with the special condition, that grouping does not at all contain any elements of rating and should not be interpreted as a valuation of the financial condition of the banks). Bank's location in the groups depends on the amount of its assets. Group One always comprises 10 banks, Group Two - the remaining ones, and Group Three consists of the branches of foreign banks in Bulgaria.

According to BNB data at the end of June the banking system has assets at the amount of BGN 15 359 751 thousand while at the end of March these were BGN 14 976 602 thousand (which presents an increase of BGN 383 149 thousand in the second quarter). At the end of June deposits amounted to BGN 11 810 265 thousand while at the end of March these were BGN 11 158 984 (an increase of BGN 651 281 thousand in the second quarter). In June the current profit of the banking system was BGN 218 487 thousand while in March it was BGN 125 420 thousand. According to the last available data from BNB the total capital adequacy of the banking system at the end of March 2003 was 24.32 (excluding group five) while this indicator was 25.22 per cent three months earlier (and 31.32 at the end of 2001). At the end of March 2003 the total primary liquidity of the

banking system was 8.99 per cent, and the secondary liquidity was 27.12 per cent (the respective figures for the end of 2002 were 11.2 and 29.25 per cent, and for the end of 2001 – 13.47 and 25.47 per cent). Some of these indicators are shown in Figure 18.

Figure 18. Selected indicators of the banking system (%)



Source: according to BNB data, monthly information bulletins

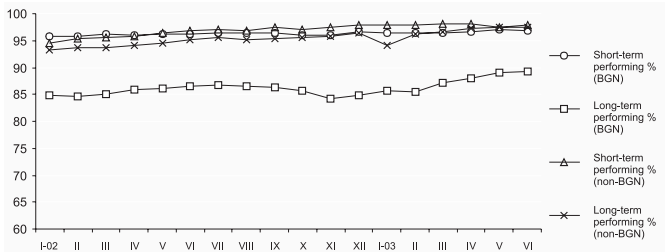
Thus, the banking system generally continued in the last quarter to increase its assets, deposits and current profit. The current profit of the banking system at the end of the quarter exceeds the one of June 2002. The ratio net interest income/other non-interest income is preserved at high levels despite the insignificant drop over the quarter (having been 2.18, 2.30 and 2.25 at the end of 2000, 2001 and 2002 respectively, at the end of March it reaches 2.54, and for June it is 2.42) suggesting the underdevelopment and inadequate diversification of banking. The ratio of capital adequacy at the end of March is lower than the one at the end of 2002 or the end of March 2002 but it is still relatively very high and certifies the stability of the system. Liquidity ratios of the banking system as a total in March show multi-directional movements compared to March 2002 (primary liquidity ratio goes down but the secondary one goes up) but they are again relatively high. All this can again be interpreted as a sign that **stability is in place in the banking system of Bulgaria but there is unutilized capacity for development and improvement of its efficiency.**

Lending to the non-government sector shows a trend of increase (under the Currency Board arrangements these are the loans from commercial banks that include loans to non-financial state-owned enterprises, private companies, households and non-banking financial institutions). From BGN 4 374 627 thousand at the end of 2001 receivables on

loans to the non-government sector reached BGN 6 250 741 thousand at the end of December 2002. At the end of June 2003 receivables on loans to the non-government sector amounted already to BGN 7 603 463 thousand.

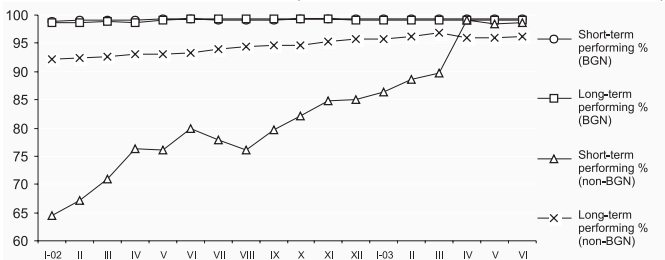
Newly contracted loans from commercial banks for the first six months of 2002 were a total of BGN 2 561 m while for the first six months of 2003 newly contracted loans amounted to a total of BGN 3 006 m (a growth of 17 per cent). **The condition of the loan portfolio is good** – if 93.87 per cent were classified as performing loans in all categories of loans in the banking system at the end of June 2002, then at the end of 2002 performing loans accounted for 94.47 per cent. At the end of March the percentage of performing loans declines but this is more probably a seasonal deviation and this indicator is expected to improve over the year (Figure 18). The general conclusion of the condition of the loan portfolio applies in particular to receivables on loans from private enterprises and households – the percentage of performing loans there increases or remains at a high level in the second quarter of 2003, too (Figures 19 and 20).

Figure 19. Condition of the loan portfolio: private enterprises (revised data after December 2002)



Source: BNB data, monetary report and own calculations

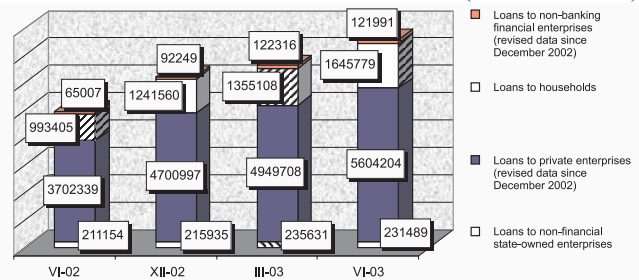
Figure 20. Condition of the loan portfolio: households (revised data after December 2002)



Source: BNB data, monetary report and own calculations

Interest rates on short-term and long-term loans in BGN in June are higher than those in March (ref. again Figure 18). **The dynamics of loans reveals some more interesting short-term trends** (according to currency, term and borrowers). Thus, for instance, the review of receivables on loans to the non-government sector illustrates an increase of lending exposure both to private enterprises and households but their relative share remains almost unchanged (Figure 21).

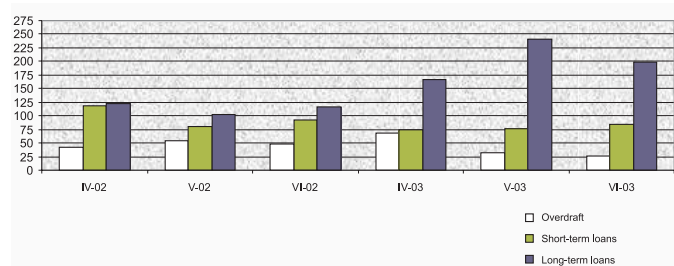
Figure 21. Receivables on loans to the non-government sector (BGN thousand)



Source: BNB data, monthly information bulletins

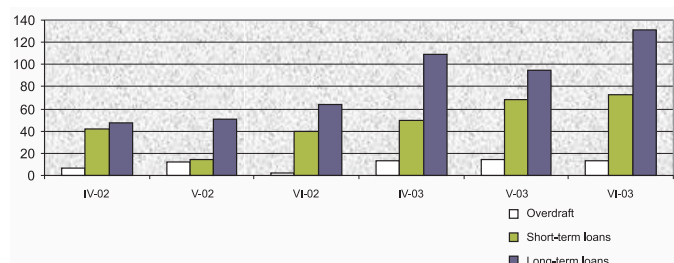
Figure 22, 23 and 24 present the dynamics of newly contracted loans for 2002 and 2003. The second three months of 2003 show increased lending activity compared to the same period of 2002. As regards terms and currency the trend is preserved of a higher share of long-term versus short-term loans in BGN and Euro while with USD loans short-term loans prevail again. All this is a manifestation not that much of interest rates dynamics but of increased investment activity in the country and taking into account the currency risk (under Currency Board arrangements and the Euro as the reserve currency for Bulgaria). However, expectations for a further cheaper US dollar in the short-term horizon seem to be overcome and this is probably the major reason for the almost unchanged volume of newly contracted loans in US dollars in the second quarter of 2003 compared to the same period of 2002.

Figure 22. Newly contracted loans from commercial banks (BGN m)



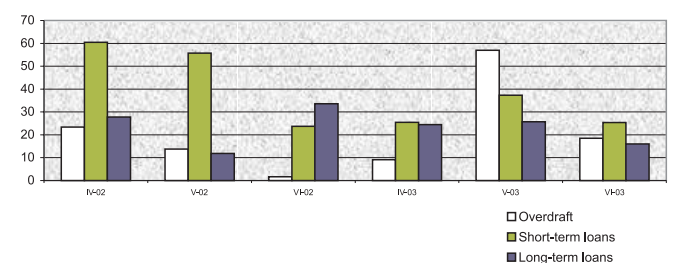
Source: BNB data, monthly information bulletins

Figure 23. Newly contracted loans from commercial banks in EUR (BGN m equivalent)



Source: BNB data, monthly information bulletins

Figure 24. Newly contracted loans from commercial banks in USD (BGN m equivalent)



Source: BNB data, monthly information bulletins

Restructuring and other events in the sector

Via various channels like privatization, opening of representation offices, branches and newly established banks **foreign participation in the banking system of Bulgaria is already predominant both with regard to control over equity and managed assets.** According to the last quoted data from BNB¹³ 83.4 per cent of the total assets of the banking system are owned by private persons at the end of 2002. At the same time foreign banks and investors control 72 per cent of banking

assets.

During the first months of 2003 the last large state-owned bank remained **DSK Bank AD** which together with Encouragement Bank accounted for the last 14.2 per cent of the state-owned share in banking assets (the municipal share is 2.4 per cent). As early as July 2002 five potential candidates were selected for consultants to the privatization of DSK Bank. Later, on the grounds of additional presentations J. P. Morgan was selected among them as the final consultant. In October 2002 the state interest of 75 per cent in DSK Bank AD was transferred to the Bank Consolidation Company and thus the sale of the bank could now be finalized. Officially, the procedure for the bank's privatization started on 9 December 2002 with the publication of an invitation to potential investors in the Financial Times and in a Bulgarian daily.

At the end of January 2003 the time limit for submission of indicative offers by candidate buyers expired. Within the time limit offers were filed by the Austrian Erstebank, the Hungarian OTP and the Greek Pyreus. Up to 100 per cent but not less than 80 per cent of the capital of the DSK Bank were offered for sale. Since all the three potential buyers promised to give a better price if offered 100 per cent of DSK Bank, BCC decided to offer for sale the whole block of shares. BCC admitted all the three candidate-buyers to the due diligence of DSK Bank.

At the end of March it was formally announced that final offers for the purchase of DSK Bank would be accepted until 10 April. Within the time limit, however, offers were submitted only by the Austrian Erstebank and the Hungarian OTP. Ranking according to "proposed price" was headed by OTP which offered EUR 311 m while Erstebank offered EUR 293 m. In April BCC delayed the choice of the preferred buyer which provoked discussions and activated candidates lobbying. One of the supposed impediments pointed out by a part of the parliamentary opposition was the question to what extent the sale of the bank should be made under the terms and conditions of the PPCA. Therefore the National Assembly adopted an amendment of the law explicitly indicating that banks

¹³ Source: BNB Annual Report 2002

shall not be privatized by the Privatization Agency. The amendment became effective retrospectively (as of the date of coming into effect of PPCA).

In the middle of May BCC selected OTP as the preferred buyer of DSK Bank. Soon after that the contract was signed. The Hungarian bank is to remit EUR 31.1 m in BCC account equal to 10 per cent of the offered price for DSK Bank. The remaining amount will be remitted after the transfer of shares in favor of OTP. A period followed during which the Hungarian institution had to obtain the required permits from supervisory authorities and from anti-monopoly regulators. OTP expressed their intentions to invest BGN 600 m over the next five year, to complete DSK Bank's restructuring, to improve its information technology and upgrade its branch network. In July the Bulgarian Commission for Protection of Competition and the Hungarian financial supervision body issued their permits and following the expected permit from BNB the transaction is to be finalized in September.

Among the remaining more important events during the quarter, it was the **liquidity crisis on the BGN money market in the middle of April** that provoked interest. This crisis (according to comments, the largest one in the banking system after the introduction of the Currency Board arrangements) was overcome after MoF organized an auction for the repurchase of securities by which BGN 25 m were extended to banks with about 11 per cent average yield. Some of the actors and analysts in the market expressed their concerns that only certain banks have benefited from the cheaper resource but this was categorically denied by MoF. Other comments focused on what the causes and nature of the emerged crisis were. Most observers united around the conclusion that the crisis results from poor management and projection of cash flows (on behalf of the banks but probably MoF, too).

The probability of reoccurrence of such crises was eliminated to a considerable extent in the beginning of June when two important innovations of BNB became a fact. First, BNB provided a possibility to commercial banks to debit their Euro accounts with BNB with a

value date on the same working day (and with the same value date to sell Euro for BGN to BNB).

Second, in the beginning of June the **RINGS system was successfully launched (the system for real time gross settlement)**. All system-important transactions go through it, i.e. transactions between commercial banks and between BNB and banks. "System-important" are also considered to be payments on government securities transactions, as well as transfers of amounts equal to or exceeding BGN 100 thousand. Payments explicitly ordered by customers will also go through RINGS. The system is compatible with the payment system of the European Central Bank TARGET and will allow processing of international payments and payments in Euro upon the country's accession to EU.

Social Security

In the second quarter of 2003 major social security topics of discussion included: future Labor Code amendments; the new Social Security Code, which, after a nearly half-year of discussions following its first reading in Parliament on 20 December 2002, got passed on second reading only at the end of June (26 June 2003) and was returned for re-examination by the president in early July; as well as the labor and social security legislation problems discussed at the working meeting of business and social ministry representatives organized by MLSP and BIA on 9 April 2003 and at the Conference on the Pitfalls of Labor and Social Security Legislation organized by the Kapital Karieri weekly in cooperation with BIA on 24 June 2003.

Labor Contracts and Minimum Social Security Thresholds

NSSI's data for the first six months of the year concerning the **mandatory registration of labor contracts and the introduction of minimum social security thresholds** since the beginning of 2003 reveal that the pessimistic forecast of mass layoffs and reappointment of workers and employees under contracts for work done, on positions of lower pay and under part-time contracts did not come true. In the first six months of 2003, more than 300 thousand people were taken out of the shadow economy and NSSI's revenues increased by BGN 200 m compared to the same period of 2002. As a result of the administrative measure concerning the mandatory registration of labor contracts at the NSSI, about 25 thousand company owners "emerged from the dark" and in the beginning of May official employers were already about 250 thousand. The higher collection of social security contributions at NSSI in the first six months of the year generates optimistic expectations about future lowering of the social security burden and possible increase of the pension income. Owing to the introduced mandatory minimum social security thresholds by branches and professions, the revenues from social, health and pension insurance contributions increased by BGN 20-30 m per month. That allowed to have the old-age

social pension increased by 7.2 per cent instead of the envisaged in the Act on the Budget of the State Social Security (ABSS) 6.2 per cent and as of 1 June 2003 this pension amounts to BGN 50.

According to the envisaged amendments to the Labor Code, which were approved by the National Council for Trilateral Cooperation in early May, **labor contracts** are expected to **contain two new obligatory elements**, namely terms of the regular annual leave and the additional rest periods, if any, and term of the advance notice for termination of the agreement between the employer and the employee. These new labor contract conditions are expected to take effect by the end of the year; existing contracts will have to be rewritten or supplemented, which will place additional burden on the personnel departments, particularly those in small enterprises, which have additional functions. The objective of these amendments is to improve the regulation of the employer-employee contractual relationship, but there is a need to take appropriate measures to avoid the burden for the small business, which is the major national source of employment.

The amendments to the Labor Code, which should conform to International Labor Organization's and European Union's requirements, have to be negotiated between the employers and the syndicates only, without any intervention by the State, in line with the European Commission's recommendation; however the employers and the syndicates failed to present a general agreement by the end of April 2003 - the time limit set by the social ministry for that purpose, which means that this year again the amendments to the most disputed normative document, which has not been revised for decades, can remain unapproved. The bureaucratic procedures of the labor contracts registration and the labor office relationship, the large number of forged sick-lists, the obligation to employ people subject to labor readjustment, are but a few of the problems put up by the employers before the social ministry and representatives of NSSI, the Employment Agency and the Labor Inspectorate at a public discussion. On 24 June 2003, in Sofia, Kapital Karieri weekly organized in cooperation with BIA a **Conference on the Pitfalls of Labor and Social**

Security Legislation. Major focus points of the conference included: amendments to the Labor Code, additional pay, employment regulation, termination of labor contracts, the new Social Security Code, sick-lists and disability resolutions control, out-of-court settlement of collective labor contracts. The public discussion on the labor and social security legislation outlined the problems and solutions in these areas, which should be supported with legislative initiative.

Social Security Code

The new Social Security Code, which was passed on first reading in the plenary hall in December 2002, generated intensive discussions in the public space in the first half of 2003 and was passed on second reading in Parliament at the end of June. But the President's veto of early July revealed that there are still disputable points, which have to be clarified.

The pension insurance company - custodian bank relatedness, or absence thereof, was the most widely discussed case, but, in the long run, the principles of international practice were laid down in the new code. The final version contains a text to the effect that where the custodian bank is a shareholder in the pension insurance company or a related person, where it is a lender or creditor of the company, or where it is one and the same person or a related person to an investment broker having contractual relationship with the company, the bank cannot sign a custodian service contract with the pension insurance company. There was a provision to the effect that the pension company had to necessarily sign a custodian service contract with one custodian bank only for each supplementary pension insurance fund managed by the company, however the text saying that the company can sign contracts with more than one bank remained in the final version.

With a view to solve the problem of the five occupational funds, which did not manage to attract **the minimum required number of insured persons**, this requirement was eliminated for the occupational funds as well as for the universal funds, despite that the latter did not have that problem. According to

the big pension companies, the elimination of the minimum number of insured persons requirement for these funds can result in a large number of small pension companies on the insurance market, which will not be to the benefit of the insured persons. The stability of a pension fund is determined by both the pension company assets and the number of insured persons, but only time can tell whether the course of legislative initiative is the right one.

Within nine months after the date on which the Social Security Code takes effect, the pension companies must bring their activity to conformity with its provisions and submit the required documents to the Financial Supervision Commission. The licenses of those companies, which fail to fulfill their obligations, will be withdrawn and a procedure for their compulsory dissolution will be initiated.

Within a year the pension companies must also bring their capital to conformity with legal requirements. **The minimum capital requirement under the new code is BGN 5 m.** In recently effective legislation the amount was BGN 3 m. To guarantee the assets of the insured persons, the pension company must always dispose of equity capital to the amount of not less than 50 percent of the minimum requirement, and until the lapse of the one-year term the equity capital cannot be less than BGN 1.5 m.

According to the passed Social Security Code, **the pension companies must set up with own funds a reserve for each supplementary mandatory pension insurance fund they manage, to the amount of not less than 1 per cent and not more than 3 per cent of the pension fund assets.** The 2003 percentage cannot be less than 0.2 per cent, gradually increasing to 0.4 per cent in 2004, 0.6 per cent in 2005, and 0.7 per cent in 2006, to reach 1 per cent in 2007. The assets in this fund shall be used to cover the difference, where the universal and the occupational fund yield is below the guaranteed minimum and the reserve assets of the corresponding fund are insufficient.

In the interest of the insured persons, as of 1 July 2004 **the accumulated savings in the individual**

lots of the insured persons in supplementary pension insurance funds will be measured both as an absolute sum and in shares, whereby the value of a share will give information about the result of the invested assets of the insured persons. The latter will be able to make comparison with the yield of other funds, as well as with the yield of government securities and the interest on bank deposits, and judge the effect of inflation on savings.

The control of social security contributions is stricter in the new code, **with NSSI's control authorities having warning functions**. They must inform the prosecution authorities, where they establish misrepresented documents made to avoid payment of the due state social security, health insurance and supplementary mandatory pension insurance contributions at an amount of more than BGN 3 000. The control also involves administrative and penal liability - an official, who authorizes the payment of remunerations for which the due social security contributions have not been made, will be punished with a fine amounting to BGN 20 000.

The new Social Security Code liberalizes in part the investment regime for the assets accumulated in pension funds, but it does not allow pension funds to make portfolios of different risk and yield in the supplementary voluntary pension insurance funds, which could allow the insured persons to just choose the risk and yield combination they prefer. This reveals that for the time being the legislative initiative places the focus on guaranteeing higher security of the social security assets in the voluntary pension insurance rather than on creating incentives to expand the scope of the insured persons within the voluntary pension insurance system by the introduction of various pension products offering different combinations of risk and yield on the invested social insurance assets.

The attempt to introduce equality of the insured persons did not meet with success. The amendments to the Mandatory Social Security Code approved in 2000 created the so-called "privileged groups" insured on the state budget. In 2002 government officials were joined by a new large

group of persons insured on the state budget like the professional military personnel under the Act on the Defense and the Armed Forces of the Republic of Bulgaria; the government officials under the Ministry of Interior Act and the Punishment Execution Act, as well as judges, prosecutors, investigators, executive magistrates, registration judges and judicial officers, whereby the pension system fairness was ruined. The plan is to include professional military personnel and Mol officers and sergeants in the supplementary mandatory pension insurance since 1 January 2004.

The new Social Security Code granted to the deputy-chairman of the Financial Supervision Commission, who heads the Social Security Supervision Department, **the right to withdraw the license for supplementary pension insurance fund management where the interests of the insured persons are threatened**. He can temporarily prohibit: a shareholder from exercising his right to vote; the payment of dividends, or the signing of new insurance contracts for a given period of time. The objective of all these powers is to guarantee the rights of the insured persons.

As of 1 January 2004, the average national monthly social security income for the last 12 months preceding the month in which the pension is granted will be taken into account upon the calculation of pensions. The objective is to guarantee higher income to pensioners and to calculate pensions on the basis of an updated average monthly social security income.

The good position of the State Social Security Budget allowed to **eliminate as of 1 January 2004 the ceiling on pensions**, which will improve the income of pensioners and their standard of living, accordingly.

The new Social Security Code **envisages calculation of a penalty interest to the amount of BNB's basic interest rate plus 20 per cent on overdue obligations towards NSSI** (in the last six months the basic interest rate varied between 2.5 and 3 per cent). The penalty is expected to take effect in the beginning of 2004, whereby companies

are provided with an opportunity to repay or reduce their obligations towards NSSI. Thus the interest on obligations towards SSS will be less favorable than the interest on bank loans and unfair insurers who use the failure to make social security contributions as a form of crediting will be punished.

NSSI's examination revealed that 1574 pensioners must refund over BGN 500 thousand of written up pensions owing to intentional misrepresentation of their income data. NSSI opposed to the President's idea about financial amnesty of unfair pensioners, because it would place them in a privileged position against 2.4 million people, who stated correct data about their income, and against those who voluntarily repaid the excess amounts. The social ministry is expected to propose a guaranteed minimum income of BGN 40 for the pensioners who broke the law. At this stage deductions for excess pensions can be not more than one sixth of the minimum wage, and the social ministry is expected to propose that the amount paid be not less than the officially determined minimum income of BGN 40.

By a decree of 9 July 2003 the head of state exercised his constitutional powers and returned for reconsideration some texts of the amendments to the social code, which he found unconstitutional. Major disagreements concern the fact that according to the President the code has not been developed as a consolidated act, it does not contain general principles and does not guarantee in full the social security of the citizens. The President considers some texts unclear and difficult to understand by the insured persons and the employers. In his opinion the fact that that too many areas require issuance of special ordinances and decrees is a weak point of the code. The President particularly objects to citizens' having the right to early pension from universal pension funds, where they have accumulated assets in their lot, which constitutes violation of the insured persons' rights in the view of experts. The President also attacks the norm, which eliminates the minimum number of insured persons requirement, with the argument that it would result in an influx of insurers that could threaten the interests of the consumers. Similar to supplementary social insurance violations,

mandatory social security violations should also involve enforcement of coercive administrative measures with a view to guarantee equality of the social insurance system. The new Social Security Code restored the option for military personnel, secret section personnel excluded, to get insured in universal pension funds, and the President objected to the exclusion of the secret section personnel with the argument that it violates the principle of equality of the citizens. The texts, which entitle NSSI to enforce collection of their receivables by way of distraint upon the accounts of both their debtors and related persons, also await re-examination. The last criticism of the President is towards the provision whereby NSSI seizes the constitutional presidential powers to excuse bad public debts up to BGN 1 000. The presidential veto on the new Social Security Code reveals that there are still disputable texts, which require discussion in the near future with a view to have a more precise new Social Security Code affecting all social groups.

The European Commission is expected to analyze by 2007 the need to introduce mandatory social security contributions for the self-employed, and to prepare a general directive. In the European countries the self-employed are taught to take care of the safety of their work as facts show that labor accident costs are two times higher compared to the investment in improved working conditions. According to GLI's data, about 15 per cent of the economically active Bulgarians are self-employed, but are not covered by health and safety at work measures and for that reason GLI and the social ministry propose mandatory accident and occupational disease insurance of the self-employed.

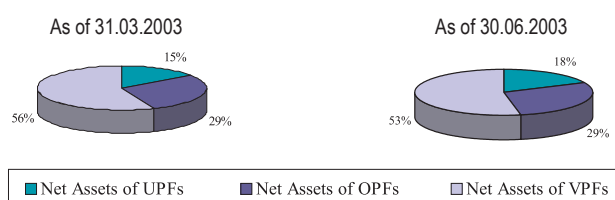
The working meeting of business and MLSP representatives on labor and social insurance legislation problems, employment and personnel training incentives for employers, organized by MLSP and BIA, was held on 9 April 2003. It revealed that in 2003 MLSP will focus on labor pay, because the artificial maintenance of low wages discourages the labor force and results in lower labor productivity. The social minister supported the business representatives' proposal to include Territorial

Medical Examination Commissions and the National Medical Examination Commission in the NSSI system with a view to improve the control of sick-lists and of TMEC's and NMEC's resolutions. The social ministry is expected to present draft normative amendment to solve the problem of the electronic signature and the electronic filing of documents with NSSI.

Supplementary Pension Insurance

The tables below contain data about the dynamics of the number of insured persons in UPF, OPF and VPF in the second quarter of 2003; the dynamics of the available net assets of the three types of pension funds in the second quarter of the year; the distribution of pension assets by funds; as well as information about pension funds' investments in different financial instruments as at end of the second quarter of 2003. It is interesting to note that in the second quarter of the year the number of insured persons in UPFs and the amount of the available net assets in UPFs registered the highest growth (by 9.41 per cent and 37.19 per cent, accordingly). As at end of the second quarter of 2003 the relative share of pension assets in UPFs registered an increase by 3 percentage points (from 15 per cent as at end of the first quarter to 18 per cent as at end of the second quarter) at the expense of the share of pension assets in VPFs, which is mainly a result of the higher number of insured persons in UPFs in the second quarter. As of 30 June 2003, the tendency to have pension fund assets invested predominantly in government issued or government guaranteed securities and in bank deposits in the country persists. The share of investments in foreign securities remains low, owing to both the high as yet legal limitations on UPF's and OPF's investments abroad and the lack of investment experience in the pension funds. Investments in foreign securities are expected to increase in the future, which will result in a better risk/return ratio for the insured persons.

Figure 25. Relative share of pension assets by funds



Source: Social Security Supervision Department, FSC

Table 10. Insured persons in pension funds

	Number as of 31.03.2003	Number as of 30.06.2003	Change, in %
Total insured persons in supplementary pension insurance funds	1 894 678	2 019 369	+6.58
Total insured persons in UPFs	1 250 325	1 367 939	+9.41
Total insured persons in OPFs	157 541	158 312	+0.49
Total insured persons in VPFs	486 812	493 118	+1.30

Source: Social Security Supervision Department, FSC

Table 11. Available net assets of pension funds

	As of 31.03.2003	As of 30.06.2003	Change, in %
Total available net assets in supplementary pension insurance funds, thousand BGN	350 416	408 753	+13.41
Available net assets in UPFs, thousand BGN	54 370	74 589	+37.19
Available net assets in OPFs, thousand BGN	103 684	119 389	+15.15
Available net assets in VPFs, thousand BGN	202 362	214 775	+6.13

Source: Social Security Supervision Department, FSC

Table 12. Pension funds' investments in different financial instruments as of 30 June 2003

	UPF	OPF	VPF
Government issued or government guaranteed securities, % of total investments	73.40	68.39	52.46
Securities accepted for trading at regulated securities markets, % of total investments	6.43	9.64	5.89
Municipal bonds, % of total investments	0.19	0.66	0.52
Bank deposits, % of total investments*	19.74	20.53	37.12
Real estate, % of total investments**	0.33	0.76	3.68
Investments abroad, % of total investments	0.01	0.02	0.02
Other investments, % of total investments	-	-	0.32

Notes: *Investments in mortgage bonds are included for VPFs.

** Investment in mortgages are included for UPFs.

Source: Social Security Supervision Department, FSC

Employment, Unemployment and Labor Market Policy

The positive downward trend in the number of unemployed registered at the labor offices was preserved in the second quarter of 2003. In March the unemployment level was 15.69 percent according to this indicator, dropping down to 13.67 percent in June and registering the lowest level since the start of transition. NSI's regular labor force survey registers similar dynamics of the number of unemployed and the unemployment coefficient indicators against the first quarter of 2003. The number of "discouraged persons" registers a decrease.

On the other hand, the number of employed registers an increase of 171.7 thousand people compared to the previous quarter. **Employment growth** is manifested mostly in the agriculture, construction, transport and communications, hotels and restaurants sectors, with new jobs opened in the real economy registering an increase at the expense of the number of employed under MLSP's programs.

In April the Council of Ministers approved the **National Action Plan on Employment**. This is the basic employment policy instrument, which defines the projects, the programs, and the measures; the incentives for employers; the number of people included in subsidized employment programs; and the financial resources for the implementation of its goals. The 2003 plan envisages provision of jobs to more than 150 000 unemployed and training and qualification of another 72 648 unemployed.

The basic course of action targets control of the unemployment of young people and cut down of the number of long-term unemployment. Special efforts are made to facilitate the social and economic integration of the Roma people and the other minority groups, of the disabled and the other underprivileged groups on the labor market. Mid-term actions to increase employment and to improve the labor force employability are envisaged parallel with the 2003 specific projects. Thereby, conditions to find permanent solutions to overcome unemployment will

be created.

The successful implementation of **already approved projects and programs to reduce unemployment** continued in the second quarter of 2003. The most important characteristics of these measures is the strictly differentiated approach to the specific social group. For example, the 2003 plan is to provide public administration employment to 1 001 unemployed young people of age up to 29 years, who have university education and no professional time record. By 2005 the program will cover 4 089 unemployed university graduates. MLSP's special program will also provide employment to 1 400 disabled people, with BGN 3 m earmarked to subsidize the employers and to provide training to the disabled people. As of the beginning of May the number of the registered unemployed disabled people was 15 579 people. Other employment programs and active measures are gathering speed, with new activities added to some of them - for example, training of illiterate people. It should be pointed out that all bodies and institutions responsible for the implementation of the programs demonstrate capacity and skills to cope with a multitude of different programs and to work with a wide circle of actors.

The new Ordinance on the Terms and Procedure of Carrying out Agency Activity for Employment, approved by the Council of Ministers in May, is another prerequisite for improved labor market dynamics. The most important aspect of the ordinance is the facilitated regime for such services, which has been transformed from a licensing to a registration one.

Income and Living Standards

The second quarter of 2003 proves again **the permanent upward trend of the real income of Bulgarians**. In an environment of positive economic dynamics and low inflation, the real increase in the incomes of Bulgarians, registered by NSI on the basis of data for wages and household budgets, has the following values: average quarterly increase of 5.4 per cent for the average monthly wage of the employed, and 8.9 per cent for the total monthly

income per household member, compared to the same period of the previous year.

In accordance with the 2003 budget plan, as of 1 June 2003 pensions increased at an average of 6.2 per cent, whereas the minimum pension and the related disability and survivor's pensions increased by 7.2 per cent.

On the other hand, income statistics data contrast with those registered by NSI's regular consumer survey conducted in April 2003. The consumer trust indicator registered a decrease of 1.9 percentage points for the period January - April 2003. Overall, the April survey registers higher pessimism in consumers' assessments and expectations. The negative change in consumers' opinions about the changes in the financial situation of households in the last 12 months, about the general economic situation in the country, and about unemployment in the next year are a warning signal, which suggests economic and social policy failures.

Social Assistance

The basic element of the new social policy strategy - the differentiated social assistance approach, was also employed in the heating assistance system. **The Ordinance on the Target Benefits for Heating** was amended in the period under review. The heating benefits are the most frequent type of social assistance, covering 700 thousand households in the heating season 2002-2003. According to the latest regulatory amendments, priority social groups in the heating assistance system include old people, children and disabled people, and the conditions for access to the system have been changed accordingly.

Social Partnership

The isolated manifestations of social discontent and tension in some enterprises like BDZ; Himko, Vratsa; Kremikovtsi; Madara, Shumen; BTC, etc., continued in the second quarter of 2003. Protesters' demands concerned mainly the delayed payment of wages and social allowances; stretched out negotiations of

collective labor contracts; and the absence of social adaptation programs in the event of layoffs owing to future privatization. Despite that, none of the above cases generated serious industrial conflicts and little by little the dialogue and social partnership mechanisms become firmly established on sector and enterprise level as well.

The regular national level meetings and consultations of business, syndicate and government representatives on labor and social security legislation and on the employment and labor force retraining policy also contribute to that process.

The National Institute for Conciliation and Arbitration was set up in the period under review in accordance with the European Social Charter and the Act on the Settlement of Collective Labor Disputes. It will contribute to the voluntary settlement of collective labor disputes between workers and employees before the dispute grows into a strike or is referred to the court. The National Institute for Conciliation and Arbitration is set up on a tripartite principle. It is a legal person at the Minister of Labor and Social Policy with the status of an executive agency. The objective is to create an efficient disputes settlement system which will be trilaterally bound, independent, fair, competent, transparent and much more expedient than legal procedures.

The new health map of Bulgaria to be valid till 2006; the agreements signed between NHIF and doctors, dentists, and hospitals; the started competition for appointment of RHIF directors; the new medicines list, which took effect as of 16 May 2003; as well as the bills amending the Medical Institutions Act and the Health Bill introduced by the Council of Ministers and MRF's parliamentary group representatives were the most debated health insurance topics in the second quarter of 2003. The topic concerning the closing of medicine production shops in relation to the new Good Manufacturing Practices standards which took effect in April also received due comment. The problem with the shortage of funds for medicines brought forward the question about the use of a portion of NHIF's reserve, which currently forms the basis of the national fiscal reserve. A couple of new funds voiced their interests in the area of voluntary health insurance, which could be promoted by a clearly defined basic package of health services.

The National Health Map of Bulgaria was not updated without scandal. The amended health map approved by the Government in early June generated a conflict between the Ministry of Health and NHIF. The new document states the number of medical institutions, doctors and dentists with whom NHIF should sign agreements with a view to guarantee normal health service provision for the people. The conflict burst out when the director of NHIF stated that the institution had not been involved in the new health map development, which provoked the Ministry of Health to officially state that the health map had been prepared in accordance with legal requirements - with the participation of the regional health care centers, the regional health insurance funds and the regional collegiums of the Bulgarian Doctors Union (BDU). The minimum number of hospitals which must necessarily sign agreements with the health insurance fund is defined on the basis of regional needs, however MoH has determined a sanitary minimum. **NHIF must sign agreements with not less than 102 out of the total 145 multiple-discipline hospitals and with 165 out of the 225 currently existing medical institutions.** The health map also states that patients need 4

910 general practitioners, 6 046 dentists and 4 987 specialists. According to the new health map, not less than 28 out of the total 36 after-care hospitals must work with NHIF. All dispensaries must also sign agreements with NHIF to cover the medical care needs of Bulgarians. The law says that the national health map must be updated every third year and must reflect the real needs of the people in the different regions, yet at this stage the bed capacity of the Bulgarian medical institutions is used at about 60-65 percent, whereas it should be used at 90-95 per cent.

Under the 2003 National Framework Agreement, **NHIF signed more than 15 500 agreements with general practitioners from the outpatient treatment system, with medical institutions, with dentists and pharmacies.** 14 603 agreements were signed in 2002. In 2003 the number of general practitioners who signed agreements with NHIF dropped down to 4 617 people, compared to 5 276 people in 2002. **NHIF signed inpatient care agreements with 249 Bulgarian medical institutions** (31 private included). The number of medical institutions in the hospital care sector increased by 56 compared to 2002, owing to the inclusion of a large number of new diagnoses developed into clinical paths. Medical institutions will work on 81 clinical paths, including 45 new ones. For the first time the 2003 NFA allows out-patient care structures to work on clinical paths. **The number of 2003 dental care agreements is 5 507, registering an increase of 417 compared to 2002,** which shows that the higher demand of dental services by the health insured persons motivates dentists to become contractual partners with NHIF. 5 443 out of the total 5 507 dental care agreements are for primary dental care and 64 are for special dental care. For the first time the 2003 NFA enables the dentists to get higher pay where they work in problem regions. 2 120 pharmacies signed agreements with NHIF. The highest number of pharmacies is in Sofia and the lowest - in Silistra.

According to the amended Health Insurance Act, within a month after the appointment of NHIF's director, rules should be developed and a date

should be fixed for **competitions for RHIF directors**. The competition for the director's positions in the 28 RHIFs was announced on 5 June 2003. The Managing Board of NHIF resolved on organizing the competition according to schedule from 22 July to 28 July in NHIF's central office. Candidates for the three year term of office of RHIF directors must satisfy the following requirements: minimum three year professional managerial experience in health care, banking, insurance or social security; university education with a master's degree, as well as a master's degree, speciality or qualification in health management. Candidates must also submit a paper on Priority and Risk Management by RHIF in the Specific Environment of the Corresponding Health Region.

A total of 81 people filed documents for the competitions by the deadline on 7 July 2003, of which 60 candidates continue their participation in the competitions for RHIF directors. **To avoid violation of the Labor Code which prohibits competitions for non-vacant positions, current directors were re-employed under fixed-term contracts.** Only time will show whether the replacement of current RHIF directors will improve the work of RHIFs, which have to develop their coordination with the new NHIF management.

The current reimbursement level effective as of 16 February 2003 was preserved with the new list of medicines payable in full or in part by NHIF effective as of 16 May 2003. 86 medicines were eliminated from the new NHIF list, under which NHIF pays in full 381 medicinal products and in part - 956 products for a total of 133 diagnoses. Bulgarian medicines on the list are 267, and foreign ones - 1070. According to the new amendments, NHIF will not pay for medicines under programs requiring in full hospital monitoring of the treatment. NHIF's provision preventing prescription of more than three medicines payable in full or in part by NHIF for one diagnosis took effect as of 16 April 2003. Besides, as of 16 April 2003, people who have failed to make their health insurance contributions for more than three months will not be entitled to expensive medicines given with

a protocol. The problem with the shortage of funds for medicines makes NHIF frequently amend the positive list of medicines and take inconsistent, hasty and half-baked measures. It is true that the 2003 NHIF budget for medicines amounting to BGN 162.7 m is absolutely insufficient to cover the medicines payable in full or in part by NHIF. Out of that budget NHIF paid about BGN 50 m to cover unsettled medicine expenses for November and December 2002. From the beginning of 2002 till November of the same year NHIF spent about BGN 240 m for medicines. Towards the end of 2002 NHIF was spending about BGN 28 m per month for medicines. In February 2003, owing to the enforced restriction measures, monthly medicine expenses dropped down to BGN 24 m, and in May NHIF spent for medicines about BGN 19 m. Despite the implemented measures to limit the expenses for medicines payable in full or in part by NHIF, the budget for medicines for 2003 is expected to be insufficient. The National Assembly may well allow NHIF to spend by year end about BGN 40-50 m of its reserve, which currently forms the basis of the country's fiscal reserve.

On 30 May 2003 a representative of NMSS's parliamentary group introduced in the National Assembly a bill amending the Human Medicine Drugs and Pharmacies Act, which was unanimously approved on first reading by the Health Care Commission on 2 July 2003. The amendment proposed in the bill aims at providing medical institutions (psychiatric or oncological dispensaries having no hospital sections) with the right to open pharmacies to meet their own needs, thereby facilitating the procedure of free medicines provision, prescription and use-up and improving the control of this activity as well.

On 21 April 2003 the Council of Ministers introduced in the National Assembly **a bill amending the Medical Institutions Act. The bill sets forth facilitated arrangements for the medical care provided by hospital care medical institutions, dispensaries, dialysis centers and residential and nursing care homes.** Thereby people who file with the Minister of Health applications to provide medical care will not

have to submit sanitary assessment decisions issued by the state sanitary control bodies and certificates issued by the regional health care centers. The bill also proposes **facilitated arrangements for registration of out-patient care medical institutions and hospices**. Another important amendment concerns the medical institution accreditation process. Amendments envisage withdrawal of the medical care licenses where the medical institutions have failed to take the necessary accreditation steps, have not been given positive accreditation assessment, or have been given the lowest possible positive accreditation assessments under two consecutive accreditation procedures. The objective of the amendments is to guarantee the quality of the medical care provided by medical institutions and to promote the competition of those citizens who want to provide medical care.

On 13 June 2003 **MRF's parliamentary group representatives also introduced in Parliament a bill amending the Medical Institutions Act**. The objective of the amendments proposed therein is **to enable the set up of medical institutions as non-profit public benefit legal persons** registered in the Central Register at the Ministry of Justice and to allow these institutions to get financing from NHIF as well as from local and foreign donor organizations under programs and projects granting target aid for health care, in line with the universal practice in the European Union and the USA. Proposed amendments allow to facilitate the State in the performance of its social functions and responsibilities, which will be assumed by non-profit organizations.

In the middle of June **the Government approved the health bill developed by the Ministry of Health as early as the previous year**. It is expected to repeal the Public Health Act passed as early as 1972. The new act is expected to take effect since 2005 and within a year thereafter approval of more than 50 ordinances and regulations is expected. The bill regulates for the first time the rights and obligations of patients in accordance with the modern legal concepts of European legislation and the moral and ethic values of modern society. The bill envisages restoration of school and kindergarten consulting

rooms, which will provide children's health prevention and promotion services instead of treatment and will be financed from the health ministry budget. The bill also makes provision for free access of children to a pediatrician, as well as for free access of pregnant women to an obstetrician-gynecologist from a special out-patient care medical institution, with no warrant by their GPs required. The bill also envisages registration treatment of alternative medicine and prohibits its advertising. Severe penalties are envisaged for doctors who issue false sick-lists.

The legal term under the Human Medicine Drugs and Pharmacies Act, within which Bulgarian pharmaceutical companies had to bring their products to conformity with the requirements of the international standards of Good Manufacturing Practices, lapsed on 18 April 2003.

Pharmaceutical companies were granted 8 years to implement the standards of Good Manufacturing Practices. The term was extended twice, but the companies proved unprepared again, mainly because of the need to make sizable investments in new equipment. About 10 Bulgarian pharmaceutical producers have fulfilled the Good Manufacturing Practices requirements according to the Bulgarian standards and can come out on the international markets, provided that they also get a permission from the corresponding EU Member State. A total of 34 workshops of 23 producers are closing, but according to data by the Medicines Executive Agency the large-scale restructuring of the sector with a view to achieve the standards of Good pManufacturing Practices reveals that about 50 per cent of the production facilities are not operating but are not stopped forever. The objective is to concentrate the production of a company's medicine in one place with a view to achieve economies of scale and guarantee the quality of Bulgarian medicines.

In the second quarter of 2003 three health insurance funds filed with the Financial Supervision Commission applications for voluntary health insurance licenses - Bulgaria AD Health Insurance Company, Bulgarska Zdravna Kompania Health Insurance Company, and Medika

21 AD Health Insurance Fund. According to the transient and final provisions of the Act Amending the Health Insurance Act, unlicensed physical or legal persons who provide voluntary health insurance must apply for licenses or terminate their activity within 6 months after the act is passed. The term expired on 19 May 2003. Four Bulgarian companies are currently providing voluntary health insurance - Doverie United Health Insurance Fund, Zakrila AD Bulgarian Health Insurance Company, DZI Health Insurance Joint-Stock Company AD and Bulstrad-Health Insurance AD. Development of Bulgarian voluntary health insurance requires more precise regulation of the basic package of services and their NHIF-guaranteed volume, with a view to specify the health care services which the voluntary health insurance could offer.

European Environmental Regulations

On 30 June 2003 the Bulgarian Government announced **the official completion of the negotiations on the Environment Chapter within the general negotiation process for Bulgaria's EU accession.** Closing ahead of term Chapter 22: Environment, Bulgaria demonstrated accelerated progress in the transposition of European environmental regulations in national legislation (Table 13).

The negotiation position on this chapter started with the legislation, which was adopted by the European Union and took effect by the end of 1999. In 2002 Bulgaria stated in a declaration that it accepted EU's environmental legislation adopted in 2000, 2001 and 2002, and would apply it as of the date of accession, except for the directives for which transitional periods were mutually agreed. As of the temporary closing of the Environment Chapter, the EU framework directives in nearly all segments of the sector have been transposed in the national legislation, which allows adoption by year end of additional laws and regulations concerning the introduction of "daughter directives" under the individual segments.

Changes of national legislation as a result of the transposition of the *acquis communautaire* are also amplified by Bulgaria's commitments under a number of international conventions (for example, in the area of cross-border pollution, climatic changes, and public access to environmental information). Together they form the broad legal framework for implementation of modern and efficient environmental policy.

Table 13. Transposition of European environmental regulations

Environment Sector	Changes of Bulgarian Legislation
Horizontal legislation	Environment Protection Act
Quality of air	Act on Atmospheric Air Cleanness
Waste management	Act on the Restriction of Harmful Waste Impact on the Environment; Waste Management Act (to be passed by the end of 2003)
Quality of water	Water Act
Nature protection	Protected Territories Act; Biodiversity Act

Industrial pollution control and risk management	Environment Protection Act; Ordinance on the terms and procedure of issuing integrated permits for the construction and use of new and for the use of operating industrial plants and facilities in which systems for prevention of big accidents with dangerous substances or for restriction of their effect are introduced
Chemicals and genetically modified organisms	Act on Restriction of the Harmful Effect of Chemical Substances and Preparation; GMO Act (to be passed by the end of 2003)
Noise of machinery and equipment	-
Nuclear safety and radiation protection	Act on the Safe Use of Nuclear Energy

In a national perspective, completed negotiations on the Environment Chapter will have two basic effects:

- Higher expectations for decisive improvement of the environmental characteristics and the quality of life of populated regions through implementation of the sustainable development principles and practices;
- Achieving better national and regional indicators through more intensive and result-oriented utilization of the financial resources from the EU pre-accession/cohesion funds.

According to projections of the Ministry of Environment and Water, in the period till 2006 Bulgaria will receive grants at the amount of BGN 100-140 m per year and after the EU accession this amount will increase more than five times. With efficient government policy and good cooperation of central and local authorities in place, this actually means higher volume of public investments targeting improved way and quality of life by preserving the biodiversity and improving the environmental indicators in a situation of higher economic activity.

Legislative Process

In the quarter under review, the legislative control of economic activities in terms of their environmental impact was regulated in a couple of normative documents.

The painful for the Bulgarian companies range of problems concerning the **responsibility of the State for environmental damages as a result of passed actions or failure to act until**

the moment of privatization (except for the privatization agreements signed by 1 February 1999) was regulated in the Ordinance on the terms and procedure of determining the responsibility of the State upon privatization for environmental damages as a result of past actions or failure to act. According to its provisions, after a preliminary assessment of the environmental damages in accordance with the Environment Protection Act, **the State shall provide financing for their removal with funds planned in the state budget for the corresponding year and target funds from donors intended for Bulgarian environment protection.** The ordinance also stipulates the terms and procedure of environmental assessments, underscoring that the fixed tangible and intangible assets, acquired by privatized companies upon implementation of a company-developed program for removal of past environmental damages through state financing, shall remain company property and shall be used for environment protection even after the term for implementation of the activities set forth in the company environmental program. The program for removal of past environmental damages and bringing the operation of the privatized project, shall be developed by the buyer under the privatization contract and shall be submitted to the Ministry of Environment and Water in accordance with environmental regulations requirements.

A system for issuing integrated permits for the construction of new and for the use of operating industrial plants and facilities in accordance with the provisions of art. 103 and art. 104 of EPA was introduced with a view to prevent serious accidents with dangerous chemical substances or to restrict their effect on human life and health and on the environment. The ordinance, approved in April, regulates the specific obligations of the enterprises which have introduced a system for prevention of serious accidents with dangerous chemical substances or for restriction of their effect on human life and health and on the environment. After 1 January 2004 (when the ordinance requirements will take effect), after 1 January 2006 for operating plants and facilities accordingly, with a view to assess the serious accident risk, the enterprises covered

by the ordinance (assessed as possible serious accident risk sources) must submit to the Ministry of Environment and Water the required information, including description of:

- basic engineering procedures, material balance included;
- type and quantity of dangerous chemical substances in the company and in the facility;
- storage facilities;
- in-plant transport, including by pipelines (transport of prime and raw materials, intermediate and end products and wastes, personnel, etc.);
- safety important facilities and apparatuses (year of putting into operation; year of putting into operation after capital or partial repair; reconstruction; operation; maintenance);
- past accidents in the plant or the facility.

The permit under art. 104 of EPA and the cited ordinance is issued by the Minister of Environment and Water following coordination with the President of the State Civil Protection Agency, the Minister of Interior, the Director of the National Fire and Accident Prevention Service, the Minister of Health Care, the President of the State Agency for Metrology and Technical Supervision, and the district governors and local self-government bodies at the location of the corresponding plant or facility.

A National Eco-labeling Scheme (NELS) was approved in May. It regulates a very important environmental policy instruments having effect on the whole product life cycle.

The national eco-labeling scheme covers products, which have or could have material impact on the environment in a global or regional aspect and/or on nature as a whole within one or more of their product life cycle phases. Eco-label can be given to a product with characteristics, which enable its significant contribution for improvement of key environmental aspects by identification of the impacts the tested product yields, in terms of the life cycle, for environmental improvement. Labels for hotels and other tourist sites, for shoes, marble, terracotta, parquet and textile products are prepared

in 2003. Requirements for another 22 product groups, including electric appliances, detergents, lighting fixtures, paper, dyes, etc., should be developed by 2007. Food and beverages will be regulated in the ordinance on biological plant growing and stock breeding. At this stage about 35 per cent of the Bulgarian producers will be able to satisfy eco-labeling requirements, which include requirements for environmentally friendly production conditions, package recycling conditions, waste separation measures, energy efficient production practices, etc.

The practical implementation of eco-labeling creates opportunities for substantial environmental improvement as a result of consumer's choice and opportunities to encourage producers and traders to seek competitive advantages in offering goods and services from this group. A voluntary mechanism like eco-labeling will improve companies' opportunities to participate on the European market, as well as their potential in the area of public procurement, which has a significant share in Bulgarian companies' activity and income.

Financing of Environmental Activities

The implementation of **a project for the set up of Bulgarian environment protection donorship fund (a trust eco-fund)** is a new aspect of the national environmental activities financing system. The fund envisages to accumulate assets to the amount of BGN 12.5 m from the Bulgarian Government, BGN 8 m from donorship organizations, BGN 2 m from foundations, and BGN 2.5 m from the Bulgarian private sector. The Protected Territories Fund, which will operate within the trust eco-fund, has already accumulated BGN 4 m received from the Global Eco Fund.

Table 14. Monitoring of negotiations for Bulgaria's accession to EU

Chapter	Status (30 June, 2003)
1 Free Movement of Goods	Temporarily closed
2 Free Movement of Persons	Temporarily closed
3 Freedom to Provide Services	Temporarily closed
4 Free Movement of Capital	Temporarily closed
5 Company Law	Temporarily closed
6 Competition Policy	Open
7 Agriculture	Open
8 Fishery	Temporarily closed
9 Transport Policy	Temporarily closed
10 Tax Policy	Temporarily closed
11 Economic and Monetary Union	Temporarily closed
12 Statistics	Temporarily closed
13 Social Policy	Temporarily closed
14 Energy	Temporarily closed
15 Industrial Policy	Temporarily closed
16 Small and Medium-Sized Enterprises	Temporarily closed
17 Science and Research	Temporarily closed
18 Education and Training	Temporarily closed
19 Telecommunications	Temporarily closed
20 Culture and Audiovision	Temporarily closed
21 Regional Policy	Open
22 Environment	Closed
23 Consumer Protection	Temporarily closed
24 Justice and Home Affairs	Open
25 Customs Union	Temporarily closed
26 Foreign Relations	Temporarily closed
27 Common Foreign and Security Policy	Temporarily closed
28 Fiscal Control	Temporarily closed
29 Fiscal and Budgetary Issues	Open
30 Institutions	Temporarily closed
Total chapters closed	25

The war in Iraq made Bulgaria take important and hard decisions in a difficult situation, which delayed the EU accession negotiations. However, when the conflict ended, the situation allowed to proceed with the activities for Bulgaria's integration in the European structures.

In the beginning of April 2003, in its latest report on the economic situation and perspectives of the candidate countries for EU accession, the European Commission gave positive assessment of their development. The opinion of the Commission was that the aggravated international economic situation as a result of the conflict in Iraq did not have serious

effect on the economic growth of these countries. Projections for Bulgaria and Romania are promising. The European Commission projects their 2003-2004 growth at 4.5-5 per cent. Certain risk owing to the geopolitical situation is stated and the exceptionally high foreign debt is added for Bulgaria. Projections for Bulgaria include: inflation rate of 4.5 per cent for 2003 and 4 per cent for 2004, slight drop down of unemployment levels, 5 per cent GDP growth in 2003 and slightly lower 2004 growth rate.

At a meeting in Brussels on 22 April 2003 with EU's Commissioner for Budgetary Issues Mihale Schreyer, the Bulgarian ministers of foreign and of European affairs presented Bulgaria's request that the negotiations on the financial chapters should not be bound to the next Community budget for the period 2007 - 2012, when Bulgaria is expected to become a full member of the European Union. Our country expressed its desire to have EU's decision on the financial package for Bulgaria separated from the discussions on the next Community financial framework. Such an approach would guarantee timely completion of the negotiations for accession by 1 January 2007.

Meanwhile, at the meeting with the Bulgarian foreign minister the head of the Delegation of the European Commission Dimitris Kurkulas did not bind himself with the promise that Bulgaria's negotiations with the European Union will be completed on 1 May 2004. "I cannot say whether 1 May 2004 is an achievable date; this is an ambitious goal; but I do not rule out the possibility that you achieve it ... It is early to think yet what will happen and whether financial chapters will be closed. The financial support for Bulgaria upon EU accession will be much higher and, therefore, negotiations must be very careful with a view to achieve mutual benefit.

To this day Bulgaria has closed 25 out of 30 negotiation chapters. The chapters, on which the negotiations for accession have not been completed and directly concern the next Community budget include: Chapter 7: Agriculture; Chapter 21: Regional Policy; Chapter 29: Fiscal and Budgetary Issues. The

present EU budget expires at the end of 2006; the next budget will be for five years and will regulate general finances up to 2012. It may be difficult to draw it up as 25 Member States will then vote it.

On 2 June 2003 Bulgaria closed Chapter 9: Transport Policy. EU's transport legislation covers social, technical, fiscal and environmental norms and safety requirements. The objective is to have candidate countries develop and improve their transport infrastructure with a view to become full part of the Trans-European transport network.

The head of the Delegation of the European Commission Dimitris Kurkulas is optimistic that the schedule for Bulgaria's accession to the European Union will be fulfilled and the 2007 full membership term is achievable. In his opinion, there is no problem to complete by the end of 2004 the negotiations on the financial chapters Chapter 7: Agriculture, Chapter 21: Regional Policy, and Chapter 29: Fiscal and Budgetary Issues. "The concern is not about the negotiations but rather about the preparation for Bulgaria's accession to the European Union", which involves administrative capacity building and judiciary system reforms.

The Minister of European Affairs assesses the Greek Presidency, which expired at the end of June, as successful for Bulgaria. In her opinion "a good pace in the eurointegration process means that by the end of 2003 Bulgaria should complete the negotiations on the technical chapters and on that portion of the financial chapters, which does not involve fiscal aspects, like, for example, agriculture."

Despite the continued negotiation process and the closing of Chapter 9: Transport Policy, some problems did arise. The Council of Europe produced 24 pages of remarks on the Religions Act. The basic reason for the set up of such a commission is the fact that some texts of the act are in conflict with the European Convention on Human Rights and with Bulgaria's commitments for accession to the European Union. Problems concern basically the privileges created by the act for the Bulgarian Orthodox Church, and the

absence of equality. European democrats' proposal to appoint a reporter is also based on the fact that the new Religions Act was passed without its prior submission to Strasbourg for expert opinion.

During their visit in April 2003, representatives of the third mission of the European Commission discussed with the Ministry of Regional Development and Public Works the priorities and projects for cross-border cooperation between Bulgaria and its neighbor countries. This year the European Commission provides within PHARE additional EUR 3 000 000 for the Facilitation along the External Borders of the European Union Program, which will support the Bulgaria-Turkey, Bulgaria-Serbia and Bulgaria-Macedonia cross-border cooperation. An amount of EUR 500 000 of the funds is allocated through the Small Projects Fund for the People to People projects within the Bulgaria-Turkey cross-border cooperation program. Development of the joint program documents for cross-border cooperation between Bulgaria and Turkey, Serbia and Macedonia in the period 2004-2006 will begin this year. Documents should be signed by mid 2004.

A start was given to the PHARE grant scheme for cultural tourism projects. Support will be provided to projects, which contribute for the development of a complete tourist product, involving along with cultural monuments reconstruction also popularization of the folklore and crafts, improvement of the infrastructure (roads, parking lots, communications); the hotel base and the catering and entertainment places; the service sector (tourist guiding, transport, health services); and of the cultural tourism information support (signs, information centers and materials).

In May 2003 the National Assembly ratified the 2002 Annual Financial Agreement between the European Commission on the part of the European Union and Bulgaria under the SAPARD Program, signed on 4 April 2003.

The 2002 Annual Financial Agreement determines the financial commitment of the European Union to Bulgaria at the amount of EUR 55 582 227. It is only

valid for implementation of the SAPARD Program, in accordance with the Multiannual Financial Agreement between the European Commission and Bulgaria. The term of commitment undertaken by the European Commission expires on 31 December 2004. The annual agreement amends the text of the Multiannual Financial Agreement on extreme natural disasters. Provision is made that the European Commission can increase the amount of the financial support from the European Union, but in any event at not more than 85 per cent, where Bulgaria has made a reasoned request for projects for regions affected by natural and for a definite period.

On **30 June 2003**, at a meeting of the European Commission in Brussels, **Bulgaria completed the negotiations on Chapter 22: Environment**. A special release of the Ministry of Environment and Waters says that the direct effect of the changes in Bulgaria as a result of the adoption and implementation of European environmental law and the accession to the European union will be improved quality and way of life and convenience for the people. The indirect effect of the implementation of European environmental standards will be lower number of unemployed, who will be provided temporary employment for the construction of sewerage systems and waste water treatment plants, of sewerage depots and infrastructure environmental projects and permanent employment after these are put into operation. The implementation of European environmental norms and legislation will also have favorable effect on the development of tourism and agriculture. All this means that the European standards for control and quality of the environment will be introduced and applied.

The Government has negotiated extended periods for adaptation of the business to some EU requirements. Transitional periods have been granted for:

- Directive concerning the lower sulfur content of some liquid fuels;
- Directive concerning the emissions of volatile organic compounds during storage, transportation and distribution of gasoline;
- Directive concerning the deposit of waste;

- Directive concerning the lead and treatment of urban waste water;
- Directive concerning the integrated prevention and control of industrial pollution;
- Directive concerning the reduction of the emissions of certain pollutants discharged in the atmospheric air by bid combustion installations.

The Greek Presidency was rather successful for Bulgaria. A special European Union - the Balkans Meeting on the Balkan countries, Bulgaria and Romania in the first place, was organized in Thessaloniki. The conclusions of the Declaration state that "The future of the Balkans is in the European Union". Every country will be assessed on the basis of its own successes, insofar as it fulfills the Copenhagen criteria. The European Union also adopted a Thessaloniki Agenda for the Western Balkans: Moving towards European Integration, which describes in detail, with a focus on the financial aspects, the policies to be implemented and approved simultaneously by the EU and the Balkan countries with a view to support the latter in their accession to the structures of the European Union.

Despite the successes achieved in the period April - June 2003, Bulgaria has still a lot to do by the end of the year. Twenty-five negotiation chapters have been closed. Comparison is now possible only with Romania, which has completed the negotiations on 19 chapters. Bulgaria must increase its efforts to complete the negotiations with the European Union by the end of 2004 when the term of office of the present European Commission expires. The new commission may choose to reopen now closed negotiation chapters, which will delay Bulgaria's accession. Hope remains that the Government will manage to fulfill its tasks and to refute the skepticism of the European Commissioner for Enlargement Guenter Ferheugen, who gave in an interview of 20 May 2003 the following answer to the question how realistic is Bulgaria's and Romania's accession to the EU in 2007: "Everything depends on the efforts these two countries will make to fulfill the accession criteria and to implement the necessary reforms. Yet 2007 is certainly a very ambitious goal."

Licensing Regimes

The Act on the Restriction of Administrative Regulation and Administrative Control of Economic Activity was passed in the second quarter of 2003. It preserves the number (39) of economic activities subject to licensing arrangements, which are specified in a list to the act.

This act is a decisive step towards facilitated licensing arrangements and limited state intervention in business activities. That is also one of the basic entrepreneurship promotion measures announced by the Vice Premier and Minister of Economy Nikolay Vassilev in October 2002. The act is actually a new social compact between the business and the Government.

The most important aspects of the act include introduction of the tacit agreement and the one-stop shop principles. The activities, which require licensing are specified - banking and insurance, pension insurance and some activities in the production; transport and trade; foreign trade in arms and ammunitions and in goods of possible double use; compact disk production and other sectors. The act also makes provision for licensing of the hospitals' business, the trade in medicines, the radio and television business and the communication business. All types of activities shall only be licensed by a central administrative body.

The objective of the tacit agreement institution is to reduce corruption opportunities and to accelerate the procedures for start-up and performance of the corresponding activity. The principle is introduced for the licensing and certification of single transactions or actions and shall only be applied where the corresponding act does not provide otherwise.

Tacit agreement exists where the administrative body has failed to express an opinion within the statutory period. The interested person must then inform the administration that he begins to perform the corresponding activity. A new 14-day period, within which the administration can express an

opinion, starts to count from that moment. Where the administration remains tacit, the transaction can be realized. This provision applies to any type of economic activity, transactions requiring licensing and registration excluded (see above). The act makes provision for subsequent administrative response under certain conditions, while suspension is only applied until the violations are removed and is appealable before an administrative court.

The act makes provision that in exercising their powers, administrative bodies must organize their activity so that they serve the interested persons on one place and in one service room. This is the one-stop shop principle - the other important aspect of the act, which also targets time saving and reduced corruption opportunities.

Another aspect, which is totally new for Bulgarian legal history, is the introduction of a text providing for preliminary assessment of the impact of bills on the economic environment. When a bill making provision for introduction of licensing or registration arrangements is planned or developed, the body, which proposes its inclusion in CoM's legislative program, must prepare reasoned opinion about the need to introduce the corresponding regulation. This reasoned opinion must be accompanied by detailed economic analysis and assessment of the impact the arrangement would have on the economic activity. The persons for whom obligations or restrictions arise under the new regulation must be informed before the act is passed, with a view to hear their proposals and objections.

Business circles and experts give a very positive assessment of this provision as it improves the transparency and, in the first place, the predictability of business behavior, and allows activity planning. To that effect was also one of EC's requirements which legislators conformed to.

The act contains provision on administrative charges. The administration should provide information about these charges and about the methods of their calculation.

Within 6 months after the act is promulgated, all administrative bodies and local self-government authorities must amend all existing regulations which contain provisions in conflict with the new act.

Finally, the act prohibits the introduction of regimes by regulations without authorization by the National Assembly, which is also a very positive aspect. In summary, major positive aspects of the act include:

- Licensing, registration and authorization regimes shall only be introduced by acts;
- A list of the economic activities subject to licensing arrangements is approved (these economic activities are 39 in number);
- Mandatory preliminary analysis of the impact of proposed bills on the business environment;
- The tacit agreement principle is introduced for single transactions;
- The one-stop shop service is introduced;
- The administration must present detailed and complete information about time limits, charges due and the methods of their calculation, and must provide assistance for completion of documents.

The expected positive effects of the introduction of this act include higher transparency and predictability of the business environment, clearer rules and less corruption.

Public Procurement Regulation

The Council of Ministers prepared and approved a **new public procurement bill**. Major aspects of the bill include:

- Conformity of the act with EU directives concerning public procurement.
- Supplies, services and construction are specified as objects of public procurement.
- Public procurement contracting authorities - new subjects (public organizations, public companies, traders holding special or exclusive rights in the water-supply, energy, transport, and communication sectors) are added to the existing ones (government bodies, mayors of municipalities and urban districts, higher

education institutions and medical institutions).

- Three times higher thresholds for the different types of public procurement are introduced.
- New options are added to the public procurement assignment procedures - for example, negotiation procedures without publication of public procurement notices; project competitions.
- Set up of a public procurement agency - this decision is in line with EC's recommendations. The agency will provide coordination and issue methodological instructions on the implementation of the act and mandatory instructions for contractors where violations are established.
- Keeping the public procurement register - the necessary content of this register is specified in detail.
- General assignment rules - the contracting authority is required to announce by 1 March of the corresponding year the public procurement plan for the next 12 months.
- Price preferences are introduced for offers by of candidates registered under the Small and Medium-sized Enterprises Act and provision is made for elimination of this preference as of January 2007. There are two assessment criteria for the offers - low price and economic benefit.

The following aspects of the act can be given utterly positive assessment:

- Conformity with EU directives concerning public procurement.
- Optimized appeal procedures and public procurement implementation opportunities.
- Incentives for SMEs by way of price preferences.
- Higher flexibility of public procurement assignment.

However, some institutional representatives and experts criticize certain provisions of the act. Criticism is along the following lines:

- There is lack of clarity in the introduced criteria for the higher public procurement thresholds above which the requirements of the act are applicable. The possible negative effects of this

circumstance include lower transparency for smaller public procurement orders, conditions for corruption, etc.

- Absence of information about unsuccessful candidates and their offers and about appeal procedures for the quality of provided services and supplies, etc., in the public procurement register.
- According to BIA experts, such information would enable sector analyses on the utilization efficiency of budgetary funds.
- There is also a need to reflect in the register subsequent amendments to signed agreements.
- Introduction of arbitral justice on the basis of a separate act is proposed. That could be done with the view of expedient and efficient resolution of disputes, which block public procurement orders.
- The need of accelerated introduction of e-government in its public procurement section is emphasized.

The bill was passed on first reading in early September.

Reform of the Judiciary System

The judiciary system remains object of severe criticism. There are several areas of amendments.

The most urgent task, which needs to be fulfilled as soon as possible, is **the amendment of the Constitution**. Amendments concern three basic points: magistrates' irremovability, mandateness and immunity. This is also a condition laid down by the European Commission, and failure to fulfill it could delay Bulgaria's accession to the EU. In the second quarter of 2003, the work of the set up interim commission for amendments to the Constitution was delayed as a result of conflicting interests in the judiciary system. Consequently, the amendment decisions were delayed, yet they have to be taken in September to enable the EC to come up by the end of 2003 with a conclusion that Bulgaria is able to complete the negotiations in the next year.

In the second half of July the Commission registered significant progress in its work, mostly as a result of external pressure. The questions of magistrates' functional immunity, their irremovability, the grounds for their dismissal, etc. were discussed.

In the end, the Commission approved unanimously the proposals for amendments to the fundamental national law, concerning the magistrates' irremovability and mandateness. These amendments include:

- Judges, prosecutors and investigators shall not be criminally and civilly liable for their official actions and for the acts they rule, except where they deliberately commit indictable offense.
- No accusation shall be brought against magistrates without authorization by SJC and magistrates shall not be arrested except for grave crime and only with authorization by SJC,
- Magistrates shall become irremovable after 5-year length of service and following attestation by a decision of SJC. Irremovability shall only lapse at the age of 65, upon resignation, absolute verdict of imprisonment for deliberate offense, regular failure to perform their duty of service, or actions discrediting the judiciary.

In early September the deputies passed on first reading the bill amending the Constitution of the Republic of Bulgaria.

The second reading of **the bill amending the Judiciary System Act** continued in the second quarter of 2003. One of the proposals concerns the appointment of the presidents of the Supreme Administrative Court, the Supreme Court of Cassation, and the Chief Prosecutor. It was resolved on their appointment by a majority of two thirds of the supreme judicial council members. Proposals for these top three positions in the judiciary system will be made not earlier than three months and not later than one month before the term of offices of the corresponding magistrate expires. The terms of office will start to count as of office assuming date. According to that provision, the current president of SAC will have to resign at year end and not in the summer as some interpretations envisage.

Fight Against Corruption

In the quarter under review a number of organizations published the results of their surveys of the corruption level in the country. Coalition 2000' reports register sustainable, although negligible decrease of the corruption level. The reports of Transparency International contain similar findings - Bulgaria now strikes the happy medium in terms of corruption level. The World Economic Forum Report contained similar conclusions, as noted in the report on the previous quarter. On the other hand, a World Bank's survey stating that the corruption level in Bulgaria remains unchanged became known some time ago. The survey also gives some optimistic results - part of the economy is gradually "coming out of the dark", the business environment has improved, time spent for work with the government administration has registered notable decrease. At the same time, the business becomes more uncertain about the fairness of the judiciary system and the respectability of the political parties and the political figures. Tolerance towards corruption registers a decrease.

Overall, results are not encouraging - despite the adopted anti-corruption measures, there is generally lack of vision and determination to take active anti-corruption steps.

ANNEX 1: MAIN INDICATORS FOR THE SECOND QUARTER OF 2003

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Economic dynamics														
Industry														
Industrial production, volume index, previous month =100, %														
2003	86.5	96.7	116.7	91.8	94.6	110.1								
2002	81.5	99.7	109.2	101.6	96.5	106.3	105.2	95.8	103.9	100.4	105.3	101.6	-	-
Industrial production, volume index, corresponding month of the previous year = 100, %														
2003	115.4	115.4	123.4	111.9	109.6	113.7								
2002	96.6	94.2	96.0	111.5	104.5	107.6	112.0	104.6	109.7	105.6	109.9	104.0	-	-
Industrial production, from the beginning of the year, volume index, corresponding period of the previous year = 100, %														
2003	115.4	115.4	118.2	116.4	115.0	114.7								
2002	96.6	95.4	95.6	99.3	100.3	101.5	103.0	103.2	104.0	104.1	104.7	104.6	-	-
Industrial sales, total, volume index, previous month =100, %														
2003	86.2	96.8	119.6	92.6	98.5	108.3								
2002	82.3	97.9	106.8	108.4	93.0	108.4	107.0	95.5	101.9	99.0	104.3	104.7	-	-
Industrial sales, total, corresponding month of the previous year = 100, %														
2003	117.7	116.4	130.4	111.3	117.8	117.8								
2002	90.7	89.7	90.5	108.9	96.3	104.0	110.0	105.1	108.9	100.3	105.8	105.6	-	-
Industrial sales, total, A43, volume index, corresponding period of the previous year = 100, %														
2003	117.8	117.1	121.6	118.8	118.6	118.5								
2002	90.7	90.2	90.3	94.7	95.0	96.5	98.5	99.3	100.4	100.4	100.9	101.3	-	-
Domestic trade														
Trade and repairing activities, total, net receipts from sales, volume index, previous month =100, %														
2003	71.0	102.7	107.1	101.7	102.6	102.9								
2002	-	113.3	111.7	98.9	98.2	101.6	111.6	102.4	101.4	108.3	96.6	109.5	-	-
Trade of motor vehicles and motorcycles, repair of motor, retail trade of automotive fuel, net receipts from sales, volume index, previous month =100, %														
2003	76.7	98.0	107.3	102.7	103.4	107.0								
2002	-	99.7	116.9	95.4	99.6	107.7	106.7	97.0	102.7	107.9	101.6	102.4	-	-
Wholesale and commission trade, net receipts from sales, volume index, previous month =100, %														
2003	70.2	104.1	106.7	101.2	102.2	102.2								
2002	-	118.3	112.0	99.1	97.3	100.5	113.7	103.0	100.9	109.3	95.4	109.9	-	-
Retail trade, repair of personal and household goods, net receipts from sales, volume index, previous month =100, %														
2003	71.0	98.9	109.4	104.1	104.3	103.4								
2002	-	100.8	106.4	100.1	101.7	102.6	105.1	103.3	102.9	103.7	99.6	112.6	-	-

ANNEX 1: MAIN INDICATORS FOR THE SECOND QUARTER OF 2003

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Trade and repairing activities, total, net receipts from sales, volume index, corresponding month of the previous year = 100, %														
2003	106.1	107.2	108.1	110.0	110.1	108.0								
2002	93.1	100.1	97.9	103.0	100.1	101.9	106.6	108.9	110.6	109.5	109.0	111.1	-	-
Trade of motor vehicles and motorcycles, repair of motor; retail trade of automotive fuel, net receipts from sales, volume index, corresponding month of the previous year = 100, %														
2003	103.5	98.8	100.6	101.2	102.5	104.1								
2002	97.3	106.7	103.1	103.1	98.4	98.5	98.7	98.9	101.4	102.9	105.3	104.7	-	-
Wholesale and commission trade, net receipts from sales, volume index, corresponding month of the previous year = 100, %														
2003	107.5	109.5	109.8	112.0	112.2	109.0								
2002	90.9	98.7	96.4	103.2	100.3	102.6	108.3	110.9	113.5	111.6	110.8	113.4	-	-
Retail trade, repair of personal and household goods, net receipts from sales, volume index, corresponding month of the previous year = 100, %														
2003	102.0	102.1	104.4	106.4	105.5	105.9								
2002	101.0	103.4	101.6	101.9	100.2	101.1	104.5	106.2	104.1	103.7	103.3	104.9	-	-
Trade and repairing activities, total, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %														
2003	106.1	107.8	108.0	108.7	109.0	108.8								
2002	93.1	96.7	95.4	97.3	97.9	98.5	99.8	101.0	102.1	102.9	103.5	104.3	-	-
Trade of motor vehicles and motorcycles, repair of motor; retail trade of automotive fuel, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %														
2003	103.5	101.5	101.2	101.3	101.6	102.1								
2002	97.3	101.8	102.3	102.5	101.6	101.0	100.7	100.4	100.5	100.8	101.3	101.7	-	-
Wholesale and commission trade, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %														
2003	107.5	109.7	110.0	110.7	111.0	110.7								
2002	90.9	94.9	93.2	95.7	96.6	97.6	99.2	100.7	102.2	103.2	104.0	104.9	-	-
Retail trade, repair of personal and household goods, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %														
2003	102.0	102.6	103.3	104.0	104.3	104.6								
2002	101.0	102.3	102.1	102.1	101.7	101.6	102.0	102.6	102.8	102.9	102.9	103.2	-	-
Inflation														
Inflation (Consumer price index - 100), previous month =100, %														
2003	0.6	0.1	0.4	0.3	-0.6	-2.2	0.9							
2002	2.7	1.6	0.8	-0.1	-2.1	-1.7	0.1	-0.7	0.8	1.0	0.2	1.2	-	-
Inflation (Consumer price index - 100), December of the previous year = 100, %														
2003	0.6	0.8	1.2	1.5	0.8	-1.4	-0.5							
2002	2.7	4.4	5.2	5.1	2.9	1.1	1.2	0.6	1.4	2.4	2.5	3.8	-	-

ANNEX 1: MAIN INDICATORS FOR THE SECOND QUARTER OF 2003

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Inflation (Consumer price index - 100), corresponding period of the previous year = 100, %														
2003	1.7	0.2	-0.2	0.2	1.7	1.2	2.0	4.5	4.0	3.2	3.2	3.8	0.6	1.1
2002	7.0	8.4	9.2	9.2	6.9	5.2	5.5	4.5	4.0	3.2	3.2	3.8	8.2	7.1
Employment and unemployment														
Unemployed persons registered, total, end of the period, number														
2003	646 757	611 727	581 350	552 068	528 718	506 424	489 343						581 350	506 424
2002	687 805	683 894	668 972	678 637	673 803	659 032	653 329	650 018	644 718	644 298	624 946	602 524	668 972	659 032
Unemployment (Employment Agency, ratio to the economically active population from the population census in 2001), end of the period, %														
2003	17.46	16.51	15.69	14.90	14.27	13.67	13.21	17.55	17.40	17.39	16.87	16.27	15.69	13.67
2002	18.57	18.46	18.06	18.32	18.19	17.79	17.64	17.55	17.40	17.39	16.87	16.27	18.06	17.79
Newly opened vacant jobs, end of the period, number														
2003	1 759	2 024	2 136	2 480	2 349	6 076	3 890						2 136	6 076
2002	1 588	4 177	3 284	3 420	2 437	2 055	2 011	3 272	2 802	2 270	2 651	1 926	3 284	2 055
Employed person, total, end of the period, number														
2003	1 939 285	1 987 936	2 013 227	2 048 568	2 061 979	2 078 861	1 917 999	1 914 477	1 925 092	1 917 214	1 918 643	1 911 216	2 013 227	2 078 861
2002	1 878 628	1 883 392	1 890 173	1 895 911	1 905 823	1 913 121	1 917 999	1 914 477	1 925 092	1 917 214	1 918 643	1 911 216	1 890 173	1 913 121
Employed person, public sector, end of the period, number														
2003	735 719	761 917	770 504	774 021	774 571	778 131	737 200	735 424	740 543	735 825	747 422	756 733	770 504	778 131
2002	761 630	762 192	760 562	749 826	745 729	743 092	737 200	735 424	740 543	735 825	747 422	756 733	760 562	743 092
Employed person, private sector, end of the period, number														
2003	1 203 566	1 226 019	1 242 723	1 274 547	1 287 408	1 300 730	1 180 799	1 179 053	1 184 549	1 181 389	1 171 221	1 154 483	1 242 723	1 300 730
2002	1 116 998	1 121 200	1 129 611	1 146 085	1 160 094	1 170 029	1 180 799	1 179 053	1 184 549	1 181 389	1 171 221	1 154 483	1 129 611	1 170 029
Fiscal review														
State budget														
Revenues of the Consolidated State Budget, total, BGN million														
2003	1 029.2	1 944.8	3 220.6	4 631.2	5 813.3	6 830.5	7 247.7	8 194.7	9 180.6	10 312.3	11 315.3	12 524.8	3 220.6	6 830.5
2002	889.1	1 752.7	2 782.3	4 040.8	5 156.1	6 064.4	7 247.7	8 194.7	9 180.6	10 312.3	11 315.3	12 524.8	2 782.3	6 064.4
Expenditures of the Consolidated State Budget, total, BGN million														
2003	1 130.6	2 105.4	3 109.8	4 221.5	5 195.0	6 203.4	6 843.6	7 778.0	8 688.8	9 667.1	10 789.5	12 743.1	3 109.8	6 203.4
2002	1 020.3	1 905.9	2 821.1	3 928.6	4 816.5	5 733.6	6 843.6	7 778.0	8 688.8	9 667.1	10 789.5	12 743.1	2 821.1	5 733.6
Consolidated State Budget deficit (-)/surplus (+), BGN million														
2003	-101.5	-160.6	110.8	409.7	618.3	627.1	404.1	416.7	491.8	645.2	525.8	-218.3	110.8	627.1
2002	-131.2	-153.2	-38.8	112.2	339.6	330.8	404.1	416.7	491.8	645.2	525.8	-218.3	-38.8	330.8

ANNEX 1: MAIN INDICATORS FOR THE SECOND QUARTER OF 2003

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Revenues of the Republican Budget, total, BGN million														
2003	651.3	908.4	1 937.0	2 878.1	3 626.4	4 221.2	4 242.3	4 783.1	5 355.4	6 076.4	6 647.0	7 289.4	1 937.0	4 221.2
2002	521.9	985.5	1 585.0	2 364.3	3 042.6	3 540.5	4 242.3	4 783.1	5 355.4	6 076.4	6 647.0	7 289.4	1 585.0	3 540.5
Expenditures of the Republican Budget, total, BGN million														
2003	737.0	1 195.6	1 846.2	2 594.1	3 016.6	3 639.2	3 718.5	4 205.2	4 697.0	5 252.8	5 949.2	7 286.0	1 846.2	3 639.2
2002	367.7	869.5	1 376.1	2 113.1	2 531.4	3 018.5	3 718.5	4 205.2	4 697.0	5 252.8	5 949.2	7 286.0	1 376.1	3 018.5
Republican Budget cash deficit (-) / surplus (+), BGN million														
2003	-85.7	-287.2	90.8	284.0	609.7	582.0	523.8	577.9	658.4	823.5	697.8	3.4	90.8	582.0
2002	154.2	116.0	208.9	251.3	511.1	521.9	523.8	577.9	658.4	823.5	697.8	3.4	208.9	521.9
Government and government guaranteed debt														
Government and government guaranteed debt, BGN million														
2003	17 548	17 639	17 560	17 680	17 062	17 365	18 993	18 964	18 929	18 667	18 627	18 180	17 560	17 365
2002	20 993	20 917	20 859	20 103	19 502	18 855	18 993	18 964	18 929	18 667	18 627	18 180	20 859	18 855
Domestic government and government guaranteed debt, BGN million														
2003	2 114	1 129	2 291	2 246	2 226	2 234	1 973	1 988	2 030	2 042	2 088	2 112	2 291	2 234
2002	1 897	1 890	1 917	1 927	1 908	1 949	1 973	1 988	2 030	2 042	2 088	2 112	1 917	1 949
Foreign government and government guaranteed debt, BGN million														
2003	15 434	15 431	15 270	15 434	14 836	15 131	17 020	16 976	16 899	16 625	16 539	16 069	15 270	15 131
2002	19 096	19 027	18 942	18 177	17 594	16 906	17 020	16 976	16 899	16 625	16 539	16 069	18 942	16 906
Government and government guaranteed debt, ratio to the annual GDP, %														
2003	49.7	50.0	49.8	50.1	48.4	49.2	61.8	61.6	61.5	60.6	60.5	56.0	49.8	49.2
2002	68.2	68.0	67.6	65.3	63.4	61.3	61.8	61.6	61.5	60.6	60.5	56.0	67.6	61.3
Domestic government and government guaranteed debt, ratio to the annual GDP, %														
2003	6.0	6.3	6.5	6.4	6.3	6.3	6.4	6.5	6.6	6.6	6.8	6.5	6.5	6.3
2002	6.2	6.1	6.2	6.3	6.2	6.3	6.4	6.5	6.6	6.6	6.8	6.5	6.2	6.3
Foreign government and government guaranteed debt, ratio to the annual GDP, %														
2003	43.7	43.7	43.3	43.7	42.0	42.8	55.4	55.2	54.9	54.0	53.7	49.5	43.3	42.8
2002	62.0	61.8	61.4	59.0	57.2	55.0	55.4	55.2	54.9	54.0	53.7	49.5	61.4	55.0
Domestic government debt, total, BGN million														
2003	2 112	2 206	2 289	2 245	2 225	2 234	1 973	1 988	2 027	2 039	2 085	2 110	2 289	2 234
2002	1 891	1 884	1 912	1 922	1 903	1 945	1 973	1 988	2 027	2 039	2 085	2 110	1 912	1 945

ANNEX 1: MAIN INDICATORS FOR THE SECOND QUARTER OF 2003

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Debt on Government Securities issued for budget deficit financing, BGN million														
2003	1 515	1 609	1 696	1 659	1 659	1 658	1 286	1 307	1 351	1 369	1 418	1 462	1 696	1 658
2002	1 144	1 139	1 172	1 198	1 201	1 269	684	677	676	670	667	648	1 172	1 269
Debt on Government Securities issued for structural reform, BGN million														
2003	596	597	593	586	567	576	576	576	576	576	576	576	593	576
2002	746	745	740	724	702	677	684	677	676	670	667	648	740	677
Domestic government guarantees, BGN million														
2003	1.8	1.5	1.2	0.9	0.5	0.0	3.7	3.3	3.0	2.6	2.3	1.9	1.2	0.0
2002	6.4	6.0	5.6	5.1	4.5	3.9	3.7	3.3	3.0	2.6	2.3	1.9	5.6	3.9
Foreign government debt, USD million														
2003	8 109	8 092	8 090	8 356	8 536	8 415	7 997	7 997	7 967	7 849	7 862	7 978	8 090	8 415
2002	7 925	7 921	7 921	7 840	7 936	8 103	7 997	7 997	7 967	7 849	7 862	7 978	7 921	8 103
Foreign government guaranteed debt, USD million														
2003	426	415	416	428	432	426	524	538	541	536	533	546	416	426
2002	508	496	503	505	509	529	524	538	541	536	533	546	503	529
Foreign economic relations and foreign investments														
Balance of Payments														
Current account, million USD														
2003	-164.7	-155.6	-91.6	-381.7	-217.7	29.1	116.2	160.6	50.8	-141.7	-180.4	-301.2	-411.9	-570.3
2002	-130.5	-51.9	-55.2	-137.4	-101.5	92.8	116.2	160.6	50.8	-141.7	-180.4	-301.2	-237.6	-146.1
Trade balance, (FOB), million USD														
2003	-71.1	-121.4	-117.5	-267.0	-287.0	-163.9	-82.4	-56.4	-81.9	-174.4	-209.9	-325.0	-310.0	-717.9
2002	-82.5	-75.3	-94.2	-148.5	-190.0	-74.0	-82.4	-56.4	-81.9	-174.4	-209.9	-325.0	-252.0	-412.5
Exports (FOB), million USD														
2003	544.2	538.6	642.9	570.4	568.0	644.5	586.3	525.8	527.8	520.5	527.8	478.4	1 725.7	1 782.9
2002	383.8	408.8	408.1	425.5	402.9	496.4	586.3	525.8	527.8	520.5	527.8	478.4	1 200.7	1 324.8
Imports (FOB), million USD														
2003	615.3	660.0	760.4	837.4	855.0	808.4	668.7	582.2	609.7	694.9	737.7	803.4	2 035.7	2 500.8
2002	466.3	484.1	502.3	574.0	592.9	570.4	668.7	582.2	609.7	694.9	737.7	803.4	1 452.7	1 737.3
Services, net, million USD														
2003	-21.5	-14.0	-24.2	-35.0	29.7	156.9	202.1	194.3	103.3	-11.4	-23.0	-21.1	-59.7	151.6
2002	-8.4	5.2	-1.2	-34.9	48.0	140.8	202.1	194.3	103.3	-11.4	-23.0	-21.1	-4.4	153.9

ANNEX 1: MAIN INDICATORS FOR THE SECOND QUARTER OF 2003

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Income, net, million USD														
2003	-113.4	-48.1	-18.2	-126.7	-5.6	-14.2	-89.1	-5.7	-11.4	-7.3	4.0	-23.6	-179.7	-146.5
2002	-63.9	-8.3	2.7	7.6	-11.3	-21.7							-69.5	-25.4
Current transfers, net, million USD														
2003	41.3	27.8	68.2	47.0	45.2	50.2	85.5	28.4	40.9	51.4	48.4	68.6	137.3	142.4
2002	24.2	26.5	37.5	38.5	51.8	47.7							88.2	138.0
Capital account, million USD														
2003	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2002	0.0	0.0	0.0	0.0	0.0	0.0							0.0	0.0
Financial account, million USD														
2003	-40.4	63.2	123.2	509.6	222.9	187.8	-145.3	3.0	121.9	189.2	200.9	194.8	146.0	920.3
2002	73.1	38.2	82.4	287.2	234.3	141.2							193.7	662.7
Direct investment abroad, million USD														
2003	-0.5	-0.4	-1.6	-2.6	0.7	-2.2	-0.9	-1.9	-0.2	-1.3	-0.2	-22.6	-2.5	-4.1
2002	-0.1	-0.2	-0.2	-0.3	-0.1	-0.6							-0.5	-1.0
Direct investment in Bulgaria, million USD														
2003	42.6	50.6	128.2	96.1	110.3	99.0	-23.4	23.4	24.7	116.3	42.3	66.2	221.4	305.4
2002	47.3	56.7	103.3	96.7	49.4	-3.0							207.3	143.1
Portfolio investment assets, million USD														
2003	13.0	10.0	-19.9	10.5	86.5	-36.6	16.2	-17.4	7.5	-34.2	88.7	15.7	3.1	60.4
2002	44.3	-71.6	-73.2	81.3	65.6	102.2							-100.5	249.1
Portfolio investment liabilities, million USD														
2003	-32.0	-3.3	-29.8	0.4	30.2	4.7	-85.5	14.7	18.0	-17.3	29.8	-16.3	-65.1	25.9
2002	-18.8	-15.8	-36.8	-100.7	-23.1	-50.2							-71.4	-174.0
Other investment assets, million USD														
2003	-1.4	34.7	-60.0	256.7	-140.0	1.5							-26.7	118.2
2002	4.4	90.8	15.4	183.5	71.1	-18.5	-98.6	-25.7	10.1	107.3	7.5	-64.4	110.6	236.1
Other investment liabilities, million USD														
2003	-61.9	-28.4	106.4	148.4	135.2	130.9	46.9	9.9	61.8	18.5	32.7	216.3	16.1	414.5
2002	-4.1	-21.7	73.8	26.7	71.4	111.3							48.0	209.4
Net Errors and Omissions (BP), million USD														
2003	-94.7	137.5	50.7	47.2	99.7	-149.1	66.9	-66.5	-28.9	93.1	90.2	149.6	93.5	-2.2
2002	-174.4	3.3	-94.8	-9.7	-34.6	-20.4							-265.9	-64.7

ANNEX 1: MAIN INDICATORS FOR THE SECOND QUARTER OF 2003

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Overall balance (BP), million USD														
2003	-299.8	45.1	82.3	175.1	104.9	67.8	37.8	97.0	143.8	140.7	110.6	43.3	-172.4	347.8
2002	-231.8	-10.4	-67.7	140.1	98.2	213.6	213.6	213.6	143.8	140.7	110.6	43.3	-309.9	451.9
Reserves and Related Items, million USD														
2003	299.8	-45.1	-82.3	-175.1	-104.9	-67.8	-37.8	-97.0	-143.8	-140.7	-110.6	-43.3	172.4	-347.8
2002	231.8	10.4	67.7	-140.1	-98.2	-213.6	-213.6	-213.6	-143.8	-140.7	-110.6	-43.3	309.9	-451.9
Finance														
Financial indicators														
Exchange rate BGN / USD, average for the period														
2003	1.84170	1.81554	1.81026	1.80353	1.68361	1.67717	1.72003	2.00039	1.99537	1.99354	1.95327	1.92447	1.82250	1.72144
2002	2.21474	2.24804	2.23369	2.20959	2.13121	2.04781	1.97152	2.00039	1.99537	1.99354	1.95327	1.92447	2.23216	2.12954
Exchange rate BGN / USD, end of the period														
2003	1.80827	1.81393	1.79516	1.75710	1.65440	1.71159	1.72807	1.98905	1.98360	1.98280	1.97021	1.88496	1.79516	1.71159
2002	2.26448	2.26081	2.24190	2.17121	2.08355	1.96073	1.99921	1.98905	1.98360	1.98280	1.97021	1.88496	2.24190	1.96073
Basic interest rate, effective annual, average for the period														
2003	3.27	2.53	2.55	2.60	2.98	2.92	2.54	3.82	3.81	3.76	3.76	3.39	2.78	2.83
2002	4.86	4.66	4.52	4.16	3.98	3.79	3.72	3.82	3.81	3.76	3.76	3.39	4.68	3.98
Money (M1), BGN million														
2003	5 141.2	5 235.0	5 087.1	5 272.3	5 371.4	5 583.0	4 589.0	4 750.4	4 804.9	4 804.1	4 936.0	5 542.7	5 087.1	5 583.0
2002	4 651.4	4 584.3	4 594.2	4 602.9	4 474.8	4 402.9	4 589.0	4 750.4	4 804.9	4 804.1	4 936.0	5 542.7	4 594.2	4 402.9
Money (M2), BGN million														
2003	13 239.4	13 388.3	13 156.3	13 401.7	13 415.1	13 867.7	12 243.5	12 521.5	12 589.7	12 703.6	12 929.4	13 581.3	13 156.3	13 867.7
2002	12 035.3	12 068.5	12 088.1	12 136.0	11 902.6	11 875.7	12 243.5	12 521.5	12 589.7	12 703.6	12 929.4	13 581.3	12 088.1	11 875.7
International reserves of BNB, BGN million														
2003	8 363.2	8 472.8	8 602.7	9 233.3	9 315.7	9 451.3	8 034.3	8 231.8	8 496.2	8 750.6	8 923.6	8 947.5	8 602.7	9 451.3
2002	7 372.4	7 373.0	7 196.2	7 427.8	7 546.3	7 908.4	8 034.3	8 231.8	8 496.2	8 750.6	8 923.6	8 947.5	7 196.2	7 908.4
Fiscal reserves at the Issue Department of BNB, BGN million														
2003	2 793.2	2 803.8	3 027.5	3 632.7	3 873.1	3 747.4	3 065.5	3 108.2	3 238.9	3 482.0	3 685.8	3 034.7	3 027.5	3 747.4
2002	2 276.2	2 260.4	2 106.5	2 358.9	2 803.3	3 020.8	3 065.5	3 108.2	3 238.9	3 482.0	3 685.8	3 034.7	2 106.5	3 020.8
Banking system														
Claims on credits granted by the Commercial Banks, total, BGN thousand														
2003	6 444 818	6 563 094	6 816 766	7 167 024	7 424 452	7 727 590	5 352 435	5 512 677	5 765 237	5 923 656	6 126 486	6 409 070	6 816 766	7 727 590
2002	4 520 277	4 543 750	4 609 974	4 796 653	4 944 889	5 065 015	5 352 435	5 512 677	5 765 237	5 923 656	6 126 486	6 409 070	4 609 974	5 065 015

ANNEX 1: MAIN INDICATORS FOR THE SECOND QUARTER OF 2003

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Credits to Resident Sector, total														
2003	6 356 088	6 489 685	6 745 467	7 094 504	7 355 881	7 657 439	5 300 222	5 453 859	5 689 755	5 822 181	6 016 990	6 316 911	6 745 467	7 657 439
2002	4 472 243	4 507 846	4 573 470	4 760 548	4 893 417	5 016 555	5 300 222	5 453 859	5 689 755	5 822 181	6 016 990	6 316 911	4 573 470	5 016 555
Credits to Government Sector														
2003	8 673	8 947	9 494	9 380	9 406	9 561	6 196	9 203	9 404	9 391	9 536	8 486	9 494	9 561
2002	5 066	6 350	6 932	6 669	6 933	6 512	6 196	9 203	9 404	9 391	9 536	8 486	6 932	6 512
Credits to Non-government Sector														
2003	6 291 902	6 444 224	6 662 763	7 014 528	7 280 799	7 603 463	5 256 205	5 399 240	5 639 343	5 772 922	5 977 063	6 250 741	6 662 763	7 603 463
2002	4 439 405	4 487 627	4 552 367	4 736 963	4 857 929	4 971 905	5 256 205	5 399 240	5 639 343	5 772 922	5 977 063	6 250 741	4 552 367	4 971 905
Credits to Non-financial Public Corporations														
2003	219 215	229 954	235 631	246 234	245 746	231 489	211 675	208 075	195 975	202 831	207 660	215 935	235 631	231 489
2002	183 596	175 571	180 510	225 524	222 297	211 154	211 675	208 075	195 975	202 831	207 660	215 935	180 510	211 154
Credits to Non-financial Private Corporations														
2003	4 715 900	4 800 569	4 949 708	5 202 209	5 377 904	5 604 204	3 941 157	4 040 047	4 235 802	4 315 476	4 459 918	4 700 997	4 949 708	5 604 204
2002	3 339 231	3 380 809	3 416 763	3 521 944	3 614 751	3 702 339	3 941 157	4 040 047	4 235 802	4 315 476	4 459 918	4 700 997	3 416 763	3 702 339
Credits to Households														
2003	1 260 492	1 300 495	1 355 108	1 438 127	1 532 501	1 645 779	1 035 501	1 079 306	1 126 596	1 172 289	1 214 409	1 241 560	1 355 108	1 645 779
2002	864 317	879 057	900 932	933 388	955 478	993 405	1 035 501	1 079 306	1 126 596	1 172 289	1 214 409	1 241 560	900 932	993 405
Credits to Non-bank Financial Institutions														
2003	96 295	113 206	122 316	127 958	124 648	121 991	67 872	71 812	80 970	82 326	95 076	92 249	122 316	121 991
2002	52 261	52 190	54 162	56 107	65 403	65 007	67 872	71 812	80 970	82 326	95 076	92 249	54 162	65 007
Credits to Resident Banks														
2003	55 513	36 514	73 210	70 596	65 676	44 415	37 821	45 416	41 008	39 868	30 391	57 684	73 210	44 415
2002	27 772	13 869	14 171	16 916	28 555	38 138	37 821	45 416	41 008	39 868	30 391	57 684	14 171	38 138
Credits to Non-resident Sector														
2003	88 730	73 409	71 299	72 520	68 571	70 151	52 213	58 818	75 482	101 475	109 496	92 159	71 299	70 151
2002	48 034	35 904	36 504	36 105	51 472	48 460	52 213	58 818	75 482	101 475	109 496	92 159	36 504	48 460
Total assets, end of the period, BGN thousand														
2003	14 470 798	14 527 980	14 976 602	14 754 441	14 752 332	15 359 751	12 924 968	13 225 015	13 475 455	13 503 015	13 901 329	14 557 124	14 976 602	15 359 751
2002	12 340 044	12 286 166	12 710 381	12 722 090	12 473 976	12 394 798	12 924 968	13 225 015	13 475 455	13 503 015	13 901 329	14 557 124	12 710 381	12 394 798
Total liabilities, end of the period, BGN thousand														
2003	12 413 277	12 474 347	12 882 639	12 702 089	12 694 628	13 252 494	11 197 870	11 455 975	11 681 572	11 674 854	12 053 348	12 621 459	12 882 639	13 252 494
2002	10 676 646	10 602 225	11 014 662	11 040 181	10 782 330	10 682 602	11 197 870	11 455 975	11 681 572	11 674 854	12 053 348	12 621 459	11 014 662	10 682 602

ANNEX 1: MAIN INDICATORS FOR THE SECOND QUARTER OF 2003

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Interest revenues, BGN thousand														
2003	74 730	145 393	223 314	302 382	385 403	465 864	405 735	468 644	533 137	600 091	672 166	738 092	223 314	465 864
2002	56 711	110 773	168 685	224 465	283 518	342 850	148 229	182 185	201 740	240 089	258 199	266 625	168 685	342 850
Current profit/loss, BGN thousand														
2003	98 482	122 770	125 420	148 232	180 278	218 487	148 229	182 185	201 740	240 089	258 199	266 625	125 420	218 487
2002	25 913	47 270	56 996	80 116	112 082	132 715	148 229	182 185	201 740	240 089	258 199	266 625	56 996	132 715
Social policy and industrial relations														
Wage & Salary 1)														
Average Monthly Wage & Salary of employees under labor contract, total, nominal, BGN														
2003	270	265	280	280	287	281	267	265	272	271	272	282	272	283
2002	251	252	265	262	269	265	267	265	272	271	272	282	256	265
Average Monthly Wage & Salary of employees under labor contract, public sector, nominal, BGN														
2003	308	298	324	317	340	327	309	312	328	321	319	332	310	328
2002	282	285	304	298	318	311	309	312	328	321	319	332	290	309
Average Monthly Wage & Salary of employees under labor contract, private sector, nominal, BGN														
2003	247	244	253	256	254	253	240	236	237	240	241	249	248	254
2002	229	229	238	238	236	235	240	236	237	240	241	249	232	236
Real Average Monthly Wage & Salary of employees under labor contract, total, growth, corresponding period of the previous year =100, %														
2003	5.7	4.9	5.8	6.6	4.9	4.7	1.6	2.3	2.2	3.8	3.4	0.6	5.5	5.4
2002	1.6	2.0	1.6	-3.3	-0.9	-0.8	1.6	2.3	2.2	3.8	3.4	0.6	1.7	-1.7
Real Average Monthly Wage & Salary of employees under labor contract, public sector, growth, corresponding period of the previous year =100, %														
2003	7.3	4.3	6.7	6.1	5.1	3.8	2.1	5.2	2.8	8.3	5.5	1.2	6.1	5.0
2002	2.6	3.5	2.8	-2.9	-0.8	0.2	2.1	5.2	2.8	8.3	5.5	1.2	3.0	-1.2
Real Average Monthly Wage & Salary of employees under labor contract, private sector, growth, corresponding period of the previous year =100, %														
2003	6.0	6.3	6.5	7.3	5.8	6.3	2.5	0.8	3.1	1.1	2.0	0.8	6.3	6.5
2002	1.4	1.6	1.9	-2.3	-0.6	-0.7	2.5	0.8	3.1	1.1	2.0	0.8	1.6	-1.2
Income and consumption of the households 1)														
Total income, monthly, average per person, nominal, BGN														
2003	128.8	122.4	135.8	142.4	146.6	152.3	137.3	142.7	148.5	146.7	144.1	195.5	129.0	147.1
2002	113.4	113.2	126.5	130.6	136.6	135.3	137.3	142.7	148.5	146.7	144.1	195.5	117.7	134.2
Cash income, monthly, average per person, nominal, BGN														
2003	124.5	118.3	130.2	132.5	134.2	139.1	124.8	128.7	135.5	132.2	126.3	157.0	124.3	135.3
2002	109.3	109.6	120.9	122.0	123.1	123.5	124.8	128.7	135.5	132.2	126.3	157.0	113.3	122.9

ANNEX 1: MAIN INDICATORS FOR THE SECOND QUARTER OF 2003

(Continued and end)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2
Total expenditure, monthly, average per person, nominal, BGN														
2003	125.2	116.0	130.1	135.5	143.2	141.9	133.6	140.8	147.6	143.6	141.6	183.8	123.8	140.2
2002	109.4	112.0	120.3	124.1	136.4	130.6		140.8	147.6	143.6	141.6	183.8	113.9	130.4
Cash expenditure, monthly, average per person, nominal, BGN														
2003	121.1	112.3	124.9	126.0	131.4	129.7	121.2	127.0	134.9	129.8	124.2	146.3	119.4	129.0
2002	105.5	108.6	114.9	115.6	123.2	118.9		127.0	134.9	129.8	124.2	146.3	109.7	119.3
Real total income, monthly, average per person, growth, corresponding period of the previous year =100, %														
2003	11.6	7.9	7.5	8.7	5.5	11.1	5.2	8.5	12.6	12.7	10.2	23.4	8.9	8.5
2002	0.1	5.3	3.3	1.7	4.5	5.2		8.5	12.6	12.7	10.2	23.4	2.9	3.8
Real cash income, monthly, average per person, growth, corresponding period of the previous year =100, %														
2003	11.9	7.7	7.8	8.3	7.1	11.2	5.3	8.5	13.5	12.1	9.2	20.3	9.1	8.9
2002	0.6	5.2	3.7	2.5	3.8	5.0		8.5	13.5	12.1	9.2	20.3	3.2	3.7
Real total expenditure, monthly, average per person, growth, corresponding period of the previous year =100, %														
2003	12.4	3.3	8.3	8.9	3.1	7.3	5.5	9.8	12.3	11.5	12.5	20.2	8.0	6.4
2002	-2.5	8.3	2.9	-0.3	5.3	7.7		9.8	12.3	11.5	12.5	20.2	2.8	4.2
Real cash expenditure, monthly, average per person, growth, corresponding period of the previous year =100, %														
2003	12.8	3.1	8.9	8.6	4.8	7.7	5.9	9.9	13.3	11.2	12.1	16.9	8.2	7.0
2002	-2.1	8.5	3.4	0.4	4.5	7.8		9.9	13.3	11.2	12.1	16.9	3.1	4.2

1) Average monthly values by quarter are calculated as simple average of monthly per capita values.

Sources: Employment Agency, Bulgarian National Bank, Ministry of Finance, National Statistical Institute and own calculations.

Acronyms:

GDP = Gross domestic product

"-" = Not applicable or missing data

ANNEX 2: REGULATORY DOCUMENTS PROMULGATED IN THE SECOND QUARTER OF 2003

Title	Status	Official Gazette
Banking ACT	Amended	№. 31/4.04.2003
State Internal Financial Control ACT	Amended	№. 31/4.04.2003
Classified Information Protection ACT	Amended	№. 31/4.04.2003
Financial Supervision Commission ACT	Amended	№. 31/4.04.2003
Measures against Money Laundering ACT	Amended	№. 31/4.04.2003
Privatization and Post-Privatization Control ACT	Amended	№. 31/4.04.2003
Public Offering of Securities ACT	Amended	№. 31/4.04.2003
Commercial CODE	Amended	№. 31/4.04.2003
ORDINANCE on the terms and procedure of determining, upon privatization, of State's responsibility for environmental damages as a result of past actions or failure to act	New	№. 33/11.04.2003
Excise Duty ACT	Amended	№. 37/22.04.2003
Value Added Tax ACT	Amended	№. 37/22.04.2003
Customs Office ACT	Amended	№. 37/22.04.2003
2003 State Budget of the Republic of Bulgaria ACT	Decision of the Constitutional Court	№. 37/22.04.2003
ORDINANCE on the terms and procedure of issuing integrated permits for construction and use of new and for use of operating industrial plants and facilities in which systems for prevention of big accidents with dangerous substances or for restriction of their effect are introduced	New	№. 38/23.04.2003
Privatization and Post-Privatization Control Act	Decision of the Constitutional Court	№. 39/25.04.2003
Tariff on fees to be collected by the Customs Agency under art. 12 of the Customs Act	New	№. 39/25.04.2003
Rules on the application of the Social Assistance Act	Amended	№. 40/29.04.2003
Ordinance on the terms and procedure of determining State's liability for damages incurred on the environment resulting from past actions or lack of action in case of privatization	Amended	№. 40/29.04.2003
Tax Procedure Act	Amended	№. 42/09.05.2003
Mandatory Social Security Code	Amended	№. 42/09.05.2003
Act on Water	Amended	№. 42/09/05/2003
Value Added Tax Act	Amended	№. 42/09/05/2003
Corporate Income Taxation Act	Amended	№. 42/09/05/2003
Personal Income Taxation Act	Amended	№. 42/09/05/2003
Act on companies with special investment purposes	New	№. 46/25.05.2003
Privatization and Post-Privatization Control	Decision of the Constitutional Court	№. 46/20.05.2003
Act on the Ombudsman	New	№. 48/23.05.2003
Ordinance on the terms and procedure of exercising market supervision	New	№. 49/27.05.2003
Rules of Procedure of the National Health Insurance Fund	Amended	№. 49/27.05.2003
Ordinance No. 3 of 15.05.2003 on the National Scheme of Environmental Marking	New	№. 49/27.05.2003
Health Insurance Act	Amended	№. 50/30.05.2003
Rules on the terms and procedure of exercising the rights of the State in companies with state participation in their capital	New	№. 51/03.06.2003
ORDINANCE on Tenders	Amended	№. 51/03.06.2003
CoM's DECREE No. 233/8.11.2000 on the foreign trade regime of the Republic of Bulgaria	Amended	№. 52/6.06.2003
RULES on the application of the State Property Act	Amended	№. 53/10.06.2003
Administrative Procedure ACT	Amended	№. 55/17.06.2003
ACT on the Restriction of Administrative Regulation and Administrative Control of Economic Activity	New	№. 55/17.06.2003
NATIONAL FRAMEWORK AGREEMENT between the National Health Insurance Fund and the Bulgarian Doctors Union and the Union of Dentists in Bulgaria 2003	Amended	№. 55/17.06.2003
CUSTOMS TARIFF of the Republic of Bulgaria	Amended	№. 55/17.06.2003
ORDINANCE No. 14/18.05.2001 on the terms and procedure of providing non-repayable financial aid for investments in farms under the Special Pre-Accession Program of the European Union for Agriculture and Rural Development (SAPARD)	Amended	№. 56/20.06.2003
ORDINANCE No. 15/18.05.2001 on the terms and procedure of providing non-repayable financial aid for development and diversification of economic activities, providing opportunities for multilateral activities and alternative income under the Special Pre-Accession Program of the European Union for Agriculture and Rural Development (SAPARD)	Amended	№. 56/20.06.2003
ORDINANCE No. 16/18.05.2001 on the terms and procedure of providing non-repayable financial aid for improvement of the processing and marketing of agricultural and fish products under the Special Pre-Accession Program of the European Union for Agriculture and Rural Development (SAPARD).	Amended	№. 56/20.06.2003
Apiculture ACT	New	№. 57/24.06.2003
Civil Procedure CODE	Amended	№. 58/27.06.2003
ORDINANCE on the procedure of covering officers of the Ministry of Interior in state bodies, organizations and legal persons	New	№. 58/27.06.2003
Feedingstuffs ACT	Amended	№. 58/27.06.2003
ORDINANCE on the categorization of tourist sites	Amended	№. 58/27.06.2003
ACT on the storage and trade in grain	Amended	№. 58/27.06.2003
Special Pledges ACT	Amended	№. 58/27.06.2003
Commercial CODE	Amended	№. 58/27.06.2003

A. THE REVIEW OF BULGARIAN ECONOMY

The present review of Bulgarian economy is an authentic expert product of the Center for Economic Development, which was made possible mostly owing to the long experience of the Center in the field of applied studies of the economic policy and economic development of the country.

The review of Bulgarian economy in the second quarter of 2003 contains detailed presentation of this last period, assessment of the period and subsequent trends. The review is explicitly focused on this quarter of the current year. Where necessary, significant events, facts and data of periods prior to or after the end of the quarter have been highlighted. Where possible, two main types of data comparisons have been made: against the corresponding period of 2002 or against the previous quarter of 2003. Again where possible, the dynamics within the quarter itself has been traced, too. At many points also the short-term trend has been outlined.

The structure of the presentation above follows two principles simultaneously. First, the strive is towards giving a more comprehensive presentation of the subject matter areas, with corresponding prioritization of the range of matters discussed. Second, the different topics and analyses reflect the experience and interests of the experts and of the Center for Economic Development as a whole.

The review of Bulgaria's economy in the second quarter of 2003 starts with presentation of the findings of the business climate survey. The latest values of the Estat index of business climate in Bulgaria are presented. On the basis of the results of the survey an analysis is made of the condition and prospects of the business environment in our country. The business surveys conducted by NSI are presented immediately after that.

The overall dynamics of the economy in the second quarter of 2003 has been discussed against the background of the following basic categories: GDP, inflation, and labor market. The fiscal review of the

quarter starts with a presentation of the budget implementation and the fiscal reserve dynamics. The fiscal review covers also the topics on foreign debt and domestic debt. The privatization topic is followed by the area of small and medium-sized enterprises. The foreign economic relations followed by foreign investments are presented in statistical terms and in their thematic relation, by means of data about the balance of payments and foreign trade. Then comes the review of a number of sectors of significant importance to the economic development of Bulgaria - energy, transport, high technologies, communications, tourism and agriculture. The financial sector is discussed by means of the capital market and the banking system. The wide topic of social policy and industrial relations encompasses the issues of social security, employment and unemployment, labor market policy, income and social partnership. The current problems and condition of the health care reform are discussed briefly. The environmental policy is considered both as a specific element of the economic policy and as a factor for the economic environment. The specialized analysis of the process of Bulgaria's accession to the EU is underpinned by the understanding that in the course of these negotiations often the most determinative elements of economic policy are defined. There exists also a two-way interdependence between the competitiveness of the Bulgarian economy at macro- and company level, and the status of the negotiations. That is why in the context of the review and general analysis of the Bulgarian economy in the second quarter of 2003 the choice was made to lay down the emphasis on the negotiations for EU membership as the most significant aspect of the European integration process, which encompasses the adaptation and application of the *acquis*.

An integral part of the presentation is the annex containing the list of newly passed legislation and amendments to laws, which are of significant importance to the economic development of the country, and were promulgated in the Official Gazette in the second quarter of the year (Annex 2).

The work was finally completed on 9 September 2003.

B. SOURCES

Along with the conclusions from the large number of their own outputs and works, some of which are parts of concrete research projects, the experts of the Center for Economic Development have used statistical and other information and data from the following sources:

- National Assembly
- Council of Ministers
- Ministry of Energy and Energy Resources
- Ministry of Agriculture and Forestry
- Ministry of Economy
- Ministry of Transport and Communications
- Ministry of Labor and Social Policy
- Ministry of Finance
- National Statistical Institute
- National Social Security Institute
- Employment Agency
- Agency for Small and Medium-sized Enterprises
- Privatization Agency
- Bulgarian National Bank
- Bulgarian Stock Exchange - Sofia AD
- Financial Supervision Commission
- Delegation of the European Commission
- European Union
- Official Gazette

The particular sources and publications are quoted at the respective places in the text.

C. THE ESTAT INDEX OF BUSINESS CLIMATE IN BULGARIA

The business climate survey is based on own original methodology, developed by the team of the Agency for Social and Marketing Surveys Estat and the Center for Economic Development. The more significant details are described below.

Methodology of the Sample

The survey was conducted in the period 7 - 18 July 2003 among the managers of 407 companies. The sample is a two-level panel one (at the first level the companies are divided into groups by regions, and at the second level - according to their economic sectors as per nomenclature A6 of the NSI), and it is grouped on the basis of the indices "number of employees" and "type of ownership". The sample is a guaranteed representative one at the level of going concerns.

Methodology of the Registration

The information has been collected using the method of an inquiry at the work place. The interviews were held with the owners of the companies covered by the sample, or with persons authorized to make management decisions and to sign financial statement documents (managers, chief accountants, commercial or marketing directors).

The questionnaire contains eight substantive questions and three passport questions. The integrated index is comprised of three components. The questions from one to five inclusive comprise Component I – "General Condition of the Company"; question six - Component II – "Investment Attitudes and Corporate Strategies; questions seven and eight - Component III – "Business Environment".

General Description of the Index Calculation

1. Preliminary preparation

The preliminary preparation includes weighting of data according to the indices "economic sector" and "number of employees", recoding and calculating values for the respective questions.

- Questions with one possible answer
The original scales are of Likert type with codes from 1 (the highest degree) to 5 (the lowest degree). Recoding is done so as to have a scale from -2 (the lowest degree) to +2 (the highest degree).

- Multiple choice questions
These questions are recoded in advance so that the possible answers are located symmetrically on both sides of the neutral point (the zero).

2. Calculation of the components

The index for each question (indicator) is calculated as a weighted average value.

Weights are assigned to each indicator within a component by means of expert evaluation. The value for each component (“General Condition of the Company”; “Investment Attitudes and Corporate Strategies”; “Business Environment”) is calculated as a weighted average.

The first table above shows the values obtained for the three components and the integrated index.

3. Calculation of an integrated index

The integrated index is calculated as a weighted average of the three components. The weight for each of the components is determined by means of expert evaluation.

The Estat index of business climate assumes values from -100 to +100. The business climate condition is assessed according to the following scale, similar to the one used in the German IFO Business Climate Index:

-100 to -61	very poor
-60 to -21	poor
-20 to +20	average
+21 to +60	good
+61 to +100	very good

Interpretation

All components (with no exception), as well as the integrated index assume values within the interval [-100, +100]. The set of tools allows to determine also the direction of the index. The difference between

the values of questions Q3 (assessment of the expected condition), Q2 (assessment of the condition at a certain point in time) and Q1 (assessment of the condition during the preceding period) is applied as a criterion for determining the direction.

Beside everything aforesaid about the methodology, in many places throughout the text additional methodological and other notes and comments are given.

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