




# **THE BULGARIAN ECONOMY IN 2004**

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**REPORT BY  
THE CENTER  
FOR ECONOMIC  
DEVELOPMENT**

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*The Center for Economic Development (CED) is a Bulgarian non-governmental research institute in the area of economic policy, established in 1997. Its goal is to support the economic development of Bulgaria through encouragement of public debate on economic issues and development of economic policy options.*

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## ABBREVIATIONS USED

AD.....	JOINT-STOCK COMPANY
AEAF .....	AGENCY FOR ECONOMIC ANALYSIS AND FORECASTS
AICB .....	ASSOCIATION OF INDUSTRIAL CPITAL IN BULGARIA
APOS.....	ACT ON PUBLIC OFFERING OF SECURITIES
AST.....	ACT ON THE STRUCTURE OF TERRITORY
BAS .....	BULGARIAN ACADEMY OF SCIENCE
BCCI.....	BULGARIAN CHAMBER OF COMMERCE AND INDUSTRY
BDU .....	BULGARIAN DOCTORS' UNION
BNB .....	BULGARIAN NATIONAL BANK
BNR.....	BULGARIAN NATIONAL RADIO
BNT .....	BULGARIAN NATIONAL TELEVISION
BRS .....	BULGARIAN RIVER SHIPING
BSE .....	BULGARIAN STOCK EXCHANGE
BTC .....	BULGARIAN TELECOMMUNICATIONS COMPANY
BVU .....	BULGARIAN VIRTUAL UNIVERSITY
CEE .....	CENTRAL AND EASTERN EUROPE
CHHP .....	COMBINED HEAT AND POWER PLANT
CITA.....	CORPORATE INCOME TAX ACT
CoM.....	COUNCIL OF MINISTERS
CPC .....	COMMISSION FOR PROTECTION OF COMPETITION
CRC.....	COMMUNICATIONS REGUATORY COMMISSION
DFI.....	DIRECT FOREIGN INVESTMENTS
EA.....	EMPLOYMENT AGENCY
EAPSME.....	EXECUTIVE AGENCY FOR PROMOTION OF SMALL AND MEDIUM-SIZED ENTERPRISES
EC.....	EUROPEAN COMMISSION
EMEPA .....	ENTERPRISE FOR MANAGEMENT OF ENVIRONMENTAL PROTECTION ACTIVITIES
EU.....	EUROPEAN UNION
FR.....	FISCAL RESERVE
FSC .....	FINANCIAL SUPERVISION COMMISSION
FTP.....	FINAL AND TRANSITIONAL PROVISIONS
GDP .....	GROSS DOMESTIC PRODUCT
GS .....	GOVERNMENT SECURITIES
GVA .....	GROSS VALUE ADDED
HIC .....	HEALTH INSURANCE COMPANY
HIC .....	HEALTH INSURANCE COMPANY
ICT.....	INFORMATION AND COMMUNICATIONS TECHNOLOGY
IMF .....	INTERNATIONAL MONETARY FUND
IT .....	INFORMATION TECHNOLOGIES
LE .....	LEGAL ENTITY
LTCA.....	LOCAL TAXES AND CHARGES ACT
MAF .....	MINISTRY OF AGRICULTURE AND FORESTRY
MEER .....	MINISTRY OF ENERGY AND ENERGY RESOURCES
MES.....	MINISTRY OF EDUCATION AND SCIENCE
MEW.....	MINISTRY OF THE ENVIRONMENT AND WATER
MLSP.....	MINISTRY OF LABOR AND SOCIAL POLICY
MoE .....	MINISTRY OF ECONOMY
MoF .....	MINISTRY OF FINANCE
MoH.....	MINISTRY OF HEALTH
MRDPW.....	MINISTRY OF REGIONAL DEVELOPMENT AND PUBLIC WORKS
MRF .....	MOVEMENT FOR RIGHTS AND FREEDOM
MRR .....	MINIMUM RESERVE REQUIREMENTS
MTC.....	MINISTRY OF TRANSPORT AND COMMUNICATIONS
MV .....	MOTOR VEHICLE
NA.....	NATIONAL ASSEMBLY

## ABBREVIATIONS USED

NAMRB.....	NATIONAL ASSOCIATION OF MUNICIPALITIES IN THE REPUBLIC OF BULGARIA
NEC.....	NATIONAL ELECTRICITY COMPANY
NFA.....	NATIONAL FRAMEWORK AGREEMENT
NHIF.....	NATIONAL HEALTH INSURANCE FUND
NMB.....	NAVIGATION MARITIME BULGARE
NMSII.....	NATIONAL MOVEMENT SIMEON THE SECOND
NPISH.....	NON-PROFIT INSTITUTIONS SERVICING HOUSEHOLDS
NPP.....	NUCLEAR POWER PLANT
NRA.....	NATIONAL REVENUE AGENCY
NSI.....	NATIONAL STATISTICS INSTITUTE
NSSI.....	NATIONAL SOCIAL SECURITY INSTITUTE
PA.....	PRIVATIZATION AGENCY
PIC.....	PENSION INSURANCE COMPANY
PIT.....	PERSONAL INCOME TAX
PITA.....	PERSONAL INCOME TAX ACT
PPA.....	PUBLIC PROCUREMENT ACT
PPPCA.....	PRIVATISATION AND POST-PRIVATISATION CONTROL ACT
R&D.....	RESEARCH AND DEVELOPMENT
RB.....	REPUBLICAN BUDGET
RDI.....	REGIONAL DIRECTORATE OF THE INTERIOR
SEE.....	SOUTH EASTERN EUROPE
SERC.....	STATE ENERGY REGULATORY COMMISSION
SHEI.....	STATE HIGHER EDUCATION INSTITUTION
SME.....	SMALL AND MEDIUM SIZED ENTERPRISES
SMEA.....	SMALL AND MEDIUM-SIZED ENTERPRISES ACT
SP.....	SOLE PROPRIETOR
SRI.....	SPECIAL RIGHTS OF ISSUE
SSI.....	STATE SOCIAL INSURANCE
TCA.....	TELECOMMUNICATIONS ACT
TPC.....	TAX PROCEDURE CODE
UDB.....	UNION OF DENTISTS IN BULGARIA
UN.....	UNITED NATIONS
UNDP.....	UNITED NATIONS DEVELOPMENT PROGRAM
USAID.....	UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
VAT.....	VALUE ADDED TAX
VATA.....	VALUE ADDED TAX ACT
WTO.....	WORLD TRADE ORGANIZATION

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## SUMMARY

*The positive development of the Bulgarian economy continues in 2004, while showing no capacity for further accelerated growth.*

*Marked positive dynamics is observed in some sectors and industries (for example, tourism, high technology and communications, banking system, capital market). The policy implemented in some areas can also be given a positive assessment (employment and unemployment policy, environmental policy). The record-breaking levels of direct foreign investments and the confirmed trend of improved business climate (based on the dynamics of the Estat index of business climate in Bulgaria) confirm the higher attractiveness and potential of the Bulgarian economy.*

*However, achievements in many areas of the social and economic policy generate contradictory assessments. This is mostly true for the enterprise policy, public finance, increase of incomes, lowering the social security burden, and the healthcare reform. The high balance of trade deficit remains among the leading macroeconomic indicators of concern.*

Despite some slight delay, the Bulgarian economy continues its development at a high pace. The economic **growth** in the first nine months of 2004 (5.7 per cent) suggests over 5.5 per cent growth for the whole 2004. On the other hand, the dynamics of short-term real sector indicators suggests slower growth in 2005.

The delayed general economic growth in the third quarter of 2004 in terms of supply is a result of the delayed growth in industry. A new point in the general economic growth is the higher and more accelerated growth in services against industry in the third quarter of 2004. While investments remain determinative of the characteristic of GDP growth in terms of demand, the investment dynamics does not result yet in sustainable increase of their share to over 20 per cent of GDP. A tendency of delayed growth in the final consumption of households is observed owing to the slower growth in final consumer expenditure of individual consumption. It is paralleled by a continuing growth in loans to households and can be attributed to the reorientation of households from consumer to investment expenditure.

The high economic dynamics in the first nine months of 2004 contributed to decreased **current account deficit**, contrary to the increased trade deficit and owing to the offsetting effect of the positive development in the balance of some other items – services, current transfers and incomes, among which transfers from abroad and particularly the inflow of private transfers is most significant.

The 2004 trade dynamics reveals that the Bulgarian economy gets the better of the negative effect of the high oil prices and the depreciated dollar. On one hand, they offset each other, and on the other hand, the favorable situation on the international

markets of raw materials (particularly metals) allows the Bulgarian industry to realize its potential. In this respect, only a delayed growth in the Eurozone could seriously threaten the Bulgarian economy. The continuing increase in the **balance of trade** deficit is a challenge for the current account state and for the deficit financing availability. In our opinion, the risk is not high, as growth in imports is, for now, healthy. It is determined by the high investment activity and the increased domestic demand owing to higher net income, lower unemployment rates and bank lending.

**Foreign direct investments** remain an important funding resource for the current account deficit and for increasing the capacity of the economy to generate higher output, higher income and export resources. Planned investment projects and the privatization transactions realized at year end suggest double increase in 2004 total foreign direct investments on 2003.

The established specialization and the improved competitiveness of the enterprises in the light industry, as well as the higher inflow of investments in industry and agriculture provide a stable basis for growth in the volume of export products. Imported goods will register increasingly higher demand as export is dependable on imported materials and components and on the further renovation of production capacities, while the higher inflow of foreign investments encourages imported products demand. All this justifies an assumption that recent trade growth rates will be preserved in the new 2005.

More fluent consumer price dynamics is observed in 2004 against the previous two years, 2003 in particular. Two main factors are influential to 2004 **inflation** – international oil price dynamics has a purely market effect, while the changes of administered prices (fuels, tobacco products, electricity and thermal energy, telephone services and railway transport) contribute more significantly to the overall consumer price dynamics.

In 2004 the **Estat index** of business climate in Bulgaria registers higher values on 2002 and 2003. While in the first three years of its reporting the index remained in the neutral portion of the scale, a strong tendency towards improvement is now observed. Data show that some indicators have distinct seasonal nature. These specifics should not be absolutized, but still they need to be taken into account when analyzing January data (when a “bottom” is always observed) and July data (when there is always a “peak”). Late 2004 and early 2005 are marked by inconsistent development of index components, with the latest aggregated index value (the October 2004 survey) standing at +2.66. It marks a seasonal drop in the Estat index value owing to the lower propensity to invest. However the favorable prospering/sinking companies ratio is preserved at 15 per cent : 5 per cent. Record low is the share of the companies that do not use Internet (31 per cent). Assessments of the quality of

information resources register increase. Problems in the area of human resources aggravate; Euroscepticism increases. Confidence in the banking systems and propensity to take loans register a decline. Confidence in Public Procurement Act procedures is critical low (6 per cent). The State component returns to its rather unfavorable values.

Assessments of the 2004 Bulgarian **enterprise policy** are not synonymous. The main policy subject – the Executive Agency for Promotion of Small and Medium-sized Enterprises, has been better tailored to the needs of entrepreneurs, but remained underresourced. Nevertheless, the regulatory establishment of the public-private partnership mechanisms in enterprise policy implementation was an important positive step in 2004. In addition, the propensity of potential entrepreneurs to take risks increased, which would make the specific measures for improved competitiveness of Bulgarian enterprises more successful and would create additional incentives for new ones.

Some other positive events occurred along the lines of investment promotion, accelerated privatization of minority stakes and shares of the State, higher economic freedom and the assessments of Bulgaria's competitive positions, improved quality of competition protection mechanisms and improved institutional framework for public procurement. The 2005 corporate income tax rate was lowered to 15 per cent.

Despite that, a large number of necessary steps in the enterprise policy are not taken at all or are considerably delayed. For example, the Act on the Promotion of Investments in SMEs is waiting for quite some time its second reading in Parliament and would hardly be passed by the end of this government's mandate. The interindebtedness of enterprises is becoming an aggravating problem which requires accelerated implementation of institutional measures to channel liquidity resource to the enterprises. One such mechanism is the project for the establishment of out-of-court debt collection methods.

While the privatization of some big state enterprises registers particular and measurable success, the process is delayed in most companies planned for privatization. The delayed privatization of Bulgartabac Holding resulted in higher indebtedness of the cigarette and processing factories, in accumulated big quantities of unprocessed tobacco, lack of investments in equipment and technology, loss of markets and strong total decapitalization of the companies. The situation on the international markets and the approaching EU accession of Bulgaria are negative prospects for the future of the holding. BAT - the only international company which submitted a proposal for purchase of companies within Bulgartabac Holding AD, withdrew because of the intricate political situation in Bulgaria.

The lack of transparency in the concession procedure for Trakia Highway, though the procedure is generally lawful, generates

lack of confidence in the future fair concessioning of highways within the mandate of the present government.

In 2004 **public finance** is characterized by a continuing trend of good execution of the consolidated fiscal program, with surplus at year end standing at BGN 1 300.0 m or 3.3 per cent of GDP. The government is expected to spend nearly all of it as follows – BGN 263 m for hospitals, schools and roads; BGN 315 m for small infrastructure projects; BGN 340 m for fixed capital of the newly established state company, named Public Investment Projects; for payment of additional wages and pensions. Thus the surplus will come down to about BGN 100 m, the final sum being transferred to the fiscal reserve. The surplus is basically attributed to the good collection rate of tax revenues, particularly VAT, excise and custom duties. Higher imports and higher fuel prices are other favorable factors. However, a high surplus like this signals either poor revenue planning or purposefully lowered expectations so that the government could use the additional funds at its discretion in the elections year. With both variants, government's fiscal policy deserves severe criticism. A decision to pay USD 940 m of Bulgaria's foreign debt was taken at year end.

The high economic growth in 2004 is accompanied by generally favorable dynamics of key labor market indicators – **employment and unemployment**. According to the labor force survey, in the third quarter of 2004 unemployment decreased to 11 per cent by 1.7 percentage points on the same period of 2003. The tendency is expected to continue in 2005. The permanent unemployed and the unemployed young people remain priority targets of the labor market policy, with the focus placed again on the differentiated approach to the different target groups. However employment growth is higher than productivity growth, which unfortunately indicates that new employment is not highly productive. Restructuring of employment towards more productive activities would favor accelerated total economic growth.

Unlike the labor market, higher values of indicators for **incomes and living standards** seem more difficult to attain. In 2004, in contrast to 2003, delayed growth in private consumption was observed owing to a slower growth in incomes, particularly wages and salaries. In the first two quarters the real average monthly wage of the employed registered negative growth on the same period of 2003 and minimum growth in the third quarter (0.2 per cent). These trends do not allow for sizable positive change projections, although a potential for that does exist, given the economic growth rates and the labor productivity dynamics.

As Bulgarian privatization enters its final phase, **industrial relations** evolve towards more responsibility and constructivism of all actors. However the process of negotiating and regulating the hired labor – employer relationship is far from smooth and trouble-free.



## SUMMARY

The question of whether to keep or not the harmful conditions of work and length of service benefits remained in the focus of discussions in the public space in 2004 and will continue in the country in 2005 as well. In mid-December the syndicates showed willingness to negotiate the hourly pay in the country for which the business has been pressing for quite some time. If introduced, the hourly pay will be the basis for calculating the length of service as well as social security contributions, which is a proper step towards a liberalized labor market in the country with improved flexibility and efficiency.

The financial burden for the business from the implementation of the European standards of health and safety of labor is significant (over EUR 10 b as per data from BIA), however the enterprises were allowed a 6-year transitional period to fulfill their commitments in the analyzed area which they did not manage to use properly. The Bulgarian business must make active use of all financial potentials to implement the European standards and requirements in the areas of environment and health and safety of labor with a view to improve its competitiveness and get successfully integrated in the Single Market of the EU.

The high **social security** burden in Bulgaria is a serious barrier to the competitiveness of the Bulgarian business and of the whole economy, as well as to the higher incomes and living standards of Bulgarians. There is a need to intensify the discussions on a future lower social security burden at expert and political level.

The upward trend in the Bulgarian supplementary pension insurance allows for highlighting pension funds as major Bulgarian institutional investors in a mid-term and long-term perspective. At the end of September 2004 net assets of pension funds stood at BGN 682 m registering a growth of 34 per cent on end of 2003.

The higher interest in discussing **healthcare** problems in the last months of 2004 indicates serious political and social discontent with the results of the implemented healthcare reform. The State should urgently take proper measures to improve the healthcare sector efficiency and the public confidence in the implemented healthcare reform. Opinions in the public space on the development of the Bulgarian healthcare model vary widely. This clearly indicates that Bulgaria still lacks political and public consensus on the basic development guidelines of the health care reform, on the specific steps, mechanisms and the time limits for their implementation, as well as on the distribution of the rights and responsibilities of all persons and institutions concerned with a view to guarantee the sustainability of the Bulgarian healthcare sector.

According to the Center for Economic Development, the Bulgarian healthcare model should not be radically changed; it should be developed along the following lines: achieving optimum public-private sector balance in healthcare;

establishment of an integrated information system for control and monitoring of the sector; encouraging voluntary health insurance, setting up mechanisms for effective competition in healthcare and for effective protection of patient's rights; eliminating NHIF's monopoly, improving the mechanism of NFA negotiation and building adequate administrative capacity to meet the challenges of EU accession in the sector.

The past 2004 can be given a positive assessment in terms of the development of Bulgaria's **environmental policy**. Mechanisms aligning national practice with that of EU Member States have been formulated and started. Following the approval of a new National Environmental Strategy and the update of environmental legislation, future developments are expected to involve adequate economic incentives and new financial mechanisms to encourage the Bulgarian business to implement the European environmental standards.

The interest of the business towards Bulgaria's international covenants on sustainable development has increased, resulting in successfully launched projects under the Kyoto Protocol mechanisms. The higher interdependence of the economic activity and the environmental policy at this stage is a chance to establish the Bulgarian companies as equal actors on international markets. At the same time, it increasingly implies high-level management culture and environmentally responsible behavior of the business in collaboration with the Executive.

In 2004 the credit expansion in the **banking system** continued without slowing. Overall, the condition of banks remains stable, with excellent indicators of capital adequacy and liquidity and well-functioning banking supervision. Measures to limit credit growth, taken or announced by the supervision and the government for a second year now, did not yield the desired results, hence new measures followed. At the end of 2004 banking system assets amounted to BGN 24 917 359 thousand, total deposits stood at BGN 22 185 115 thousand. As of December, net banking system profit amounts to BGN 434 112 thousand. Newly contracted loans in 2004 reached BGN 10122.4 m (BGN 7160.0 m and BGN 5189.7 m for 2003 and 2002, accordingly). The condition of the credit portfolio at banking system level remains good – as end of September 2004, 92.97 per cent of loans are classified as performing.

The top event of the year in the banking sector restructuring was the purchase of Hebrus Bank by Bank Austria Kreditanstalt. According to experts, this transaction marks the beginning of a new consolidation process in a still fragmented sector. In December 2004 BNB's Governing Board adopted three important decisions. First, the base interest rate calculation method was changed. Second, BNB adopted on first reading new Regulation No. 8 on the capital adequacy of banks (including now capital requirements for market risk) and amendments to Regulation No. 7 on the large exposures of banks. BNB's Governing Board

also approved an addendum to the Tariff of charges for cash services concerning the processing and counting of banknotes and coins. In mid-January 2005 the National Assembly passed amendments to the BNB Act. These concern reformulation of BNB's major goal, additional guarantees for the central bank's independence and a ban on the direct funding of the public sector.

The good development of Bulgaria's **capital market** continued in 2004, despite the limited yet contribution of this market in total financial intermediation. Trade on the Bulgarian Stock Exchange is active, with turnover, market capitalization and the stock exchange index registering growth on an annual basis. Trade in compensatory instruments and investment vouchers enjoyed further interest; the positive development of the sale of the residual state share in BTC was translated into record high growth of compensatory instrument prices. As at end of December 2004 total market capitalization of the Bulgarian Stock Exchange – Sofia AD stood at 10.60 per cent of GDP's updated forecast for 2004. As at end of 2004 total market capitalization according to stock exchange data stands at BGN 4 033 204 800 (including BGN 1 374 876 944 on the Official Market). 2004 turnover stands at BGN 660 747 036 with 176 457 031 traded securities (lots), indicating turnover growth of 265 per cent on an annual basis. The trade volume, taken on an annual basis again, registers a growth of 348 per cent. The SOFIX index went up by 38 per cent on an annual basis (from 454.34 at the end of 2003 to 625.31 at the end of 2004). In 2004 FSC proceeded with the development of regulations, working out in addition to some new regulations draft amendments to POSA containing significant changes.

The major development trends in the **energy sector** continued in 2004. The privatization of the electricity distribution companies was carried out in a quiet and predictable environment which contributed to good final results. The privatization of enterprises from the last energy cycle phase was accompanied by privatization of production companies and by liberalization. A significant event contributing to a highly competitive international environment was the restoration of the energy connections destructed during the war in former Yugoslavia. Thus the transfer of electricity throughout Europe is now only a matter of gradually eliminating the administrative barriers. The future of the nuclear power sector was another issue causing serious excitement all over the country. Energy resource prices quotations reached threatening high values throughout the year; stabilization of oil prices is projected for 2005.

Conflicting signals came from the **transport sector**. On one hand, the regulatory framework was improved; some new strategic documents for the future development of the sector were developed and passed. Positive signals came from the state companies in the railway sector. BDZ and Railway Infrastructure paid the overdue salaries and food allowances to their employees. One should not forget, however, that in 2004

BDZ was granted state subsidy again. The intensified interest of investors towards the concession of the Black Sea airports can also be referred to the positive side of the annual balance of events in the sector. Attempts to attract private capital in the transport sub-sectors and project development on the basis of public – private partnership were accompanied by serious misunderstanding. The situation with the privatization of the water carriers NMB and BRS remains uncertain.

Overall, 2004 was positive for the **high technologies and communications sector**. The state did more real work towards an operational e-Government. The market is increasingly active with growing demand of ITC and stronger competition in the sector. While many tasks have to be accomplished yet, the year witnessed a couple of highly contributing events for the sector development – new actors appeared on the fixed telephony market, the third GSM operator license was granted, several new large projects encouraging ITC penetration in education and everyday life have been launched.

The past year was the best ever for Bulgarian **tourism** in terms of the number of foreign tourists as well as of the generated proceeds. Bulgaria was visited by over 4 m foreign tourists which is an increase of over 13 per cent on the previous year. The number of tourists from EU Member States registers higher growth; the country gradually restores its positions on the Central European markets. Revenues from tourism in the period January – October 2004 amount to EUR 1.601 b, going up by 20.77 per cent on the same period of 2003. Net revenues from international tourism for the first 10 months of 2004 stood at EUR 944.8 m, registering increase of 22.9 per cent on the same period of 2003.

In 2004 sizable investments in special infrastructure were made both along the Black Sea coast and in the mountain resorts. At the same time, one of the most severe problems of tourism – the chaotic construction in the big resorts - aggravates further. There is a risk of oversupply of beds and of severe and sustainable damage of the ecological balance. Important strategic documents were adopted, most notable being the draft Strategy on Sustainable Development of Bulgarian Tourism, 2005–2010. The document was developed with the active cooperation of the big tourist associations in the sector. Legislative and institutional changes were made, aiming at enhanced capacity and competitiveness of the tourism sector. The Tourism Act was amended with a view to facilitate the treatment of tour operators and tourist agents from licensing to registration. The Executive Agency for National Tourist Advertising and Information was transformed into Tourism Agency at the Minister of Economy. This is expected to improve the functions concerning the registration, categorization, marketing, advertising and information, as well as the overall tourist product development.

2004 was very important for Bulgaria in terms of its preparation to implement effective **regional policy** and to successfully manage the resources from the EU pre-accession and structural funds. Decisive for the future actions in this area are the financial framework for Bulgaria set by the EC, the closing of Chapter Regional Policy of the negotiations for EU accession and the adoption of a new Regional Development Act. The financial framework for Bulgaria for the three-year transitional period 2007–2009 is envisaged at EUR 4.245 b (EUR 2.3 b will be spent on structural policies). According to experts, this is one of the best financial frameworks a country of such territory and population has ever been given. The passed new Regional development Act lays down the regional planning mechanisms. The resources from the European funds will be allocated on the basis of this planning as well as on the basis of the indicators and the most acute problems of the towns and villages. The six centers of the administrative planning regions are Burgas, Varna, Vidin, Ruse, Plovdiv, and Sofia. A couple of important documents were published to assist the regions and municipalities in developing their strategic and planning documents. These are: Methodological Instructions on the Development of Regional Development Strategies and Methodological Instructions on the Development of Municipal development Plans. They will help the regional and municipal administrations in the process of preparing the necessary documents for utilization of resources from the EU Structural Funds.

There is however a need of proactive measures to enhance the capacity of the central, regional and local structures involved in the different lifecycle phases of the Structural Funds policy.

## Gross Domestic Product

The Bulgarian economy continued growing fast, though with a certain slowdown. In the third quarter gross domestic product grew by 5.8 per cent in real terms on an annual basis against 6.0 per cent growth in the previous quarter. Economic growth in the nine-month period (5.7 per cent) gives ground to assume that annual 2004 growth will exceed 5.5 per cent.

On the other hand, the dynamics of real sector short-term indicators suggest that the slight slowdown in growth may continue. Overall economic growth in the fourth quarter of the year is likely to stand at little over 5 per cent. In November 2004 the general business climate indicator<sup>1</sup> fell below its October level (by 4.6 points) mainly due to lower optimism about business climate in the next six months among all polled sector groups and in December fell by 0.9 points on its November level due to lower optimism about business climate in retail trade and the services sector.

Assessments of current production activity are characterized by a shift from more optimistic to more moderate and towards retained volume of activity.

Value added created by the economy as a whole continued growing faster than the dynamics in 2003 – by 5.5 per cent in the third quarter of 2004 and 5.7 per cent in the nine-month period (against 4.0 and 3.8 per cent in corresponding periods of 2003), though at a slightly slower pace compared to the beginning of 2004. Private sector value added also continued growing faster than in 2003 (9.7 per cent in the third quarter and 10.0 per cent for the nine-month period, against 5.8 and 6.2 per cent in corresponding periods of 2003), but a certain slowdown occurred during the year. Private sector annual growth is likely to stand at about 9.5 per cent.

The slowdown in general economic growth on the supply side in the third quarter is due to slowdown in industrial sector growth at 5.1 per cent, being lower both than growth in the previous 6 quarters and corresponding quarters of the previous 2 years.

A new feature of the characteristics of general economic growth is that in the third quarter of 2004 the services sector grew at a faster and accelerated pace compared to industrial growth, which had been the main driver of value added among the three basic sectors of the economy from the second quarter of 2002 till the second quarter of 2004. Value added growth in the services sector accelerated to 5.9 per cent, mainly attributable to trade growth, 11.9 per cent, with financial services growing fastest (32.5 per cent). However, for the nine months of the year industry outpaced services (growth of 6.3 per cent and 5.8

per cent respectively). There are not sufficient indications that annual growth of the two sectors would exceed those figures.

Although the third quarter was the strongest for agriculture, its share in value added of the economy continued shrinking (due to the faster dynamics of the other two sectors), and the 5.3 growth in the third quarter on the third quarter of 2003 is notable against the backdrop of a more moderate growth in the first half-year and the downward dynamics last year. Annual growth in the sector is expected to remain below 3 per cent.

The decisive role of investments for the characteristics of GDP growth on the demand side is increasing. In the third quarter growth in investments in fixed assets accelerated at 12.0 per cent on an annual basis. Although their share in gross domestic product use (18.6 per cent) is seasonally lower than in the second quarter (21.6 per cent), the emerging upward trend compared to corresponding quarters of previous years suggests increased investment activity in that period of the year. However, investment dynamics by the end of 2004 would hardly contribute to increasing their share to over 20 per cent of GDP.

The importance of domestic savings and current transfers from abroad in the structure of gross capital formation financing in the economy has increased in the nine months of 2004. The rate of saving in the economy has improved, reaching 18.4 per cent of GDP, against 14.1 per cent of GDP for the nine months of last year.

Table 1. Gross capital formation financing, nine months

	Financing, total	Gross national saving, total	Gross domestic savings	Current transfers from abroad, net	Income from abroad, net	External savings
<b>In % of nine-month GDP</b>						
nine months 2004	22.6	18.4	15.9	4.6	-2.1	4.2
nine months 2003	20.2	14.1	13.8	3.5	-3.3	6.1
nine months 2002	17.8	16.6	15.2	3.4	-2.0	1.2
<b>Total financing =100, %</b>						
nine months 2004	100	81.6	70.2	20.5	-9.2	18.4
nine months 2003	100	69.7	68.2	17.5	-16.1	30.3
nine months 2002	100	93.0	85.1	19.1	-11.2	7.0

Source: BNB, Balance of Payments published at 30 November 2004; NSI, GDP, published at 20 December 2004 and own calculations

The trend towards a slowdown in households' final consumption growth continued in the third quarter. The growth rate of final consumer spending for individual consumption fell slightly further and collective consumption (i.e. final government spending for services provided both to the society and to particular social

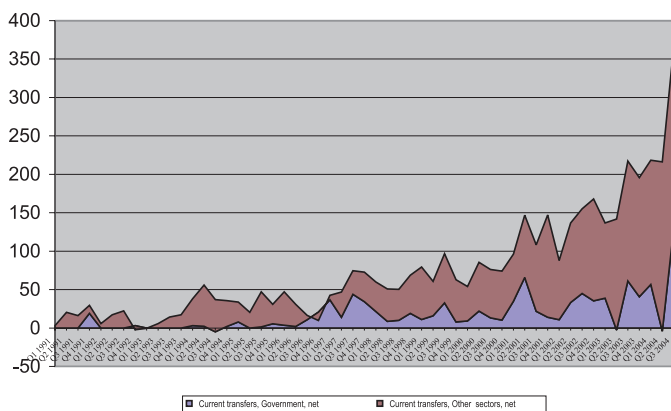
<sup>1</sup> The general business climate indicator, calculated by the National Statistical Institute, is the average weighted arithmetical mean of the business climate indicators of four sectors – industry, construction, retail trade, and the services sector, and the business climate indicator of the services sector has been included in the times series since May 2002.

groups as a whole) in practice sustained the level of the third quarter of 2003. This dynamics resulted in reducing the share of final consumption to 75.9 per cent of GDP, the lowest quarterly level since 1996. Likewise the share of individual consumption fell to 67.6 of GDP while the share of collective consumption hovered around the levels attained in corresponding periods of previous years. Such changes in individual consumption, combined with ongoing growth in credits to households, could be explained in part with households' shifting from consumer to investment spending.

In the third quarter of 2004 real growth in export of goods and services (15.5 per cent) managed to outpace import growth (12.5 per cent) following the convergence started in the second quarter. Notable for export growth is the fact that industrial export sales grew over 5 times faster than those for the domestic market. For the nine months, however, import of goods and services has grown faster (12.0 per cent export growth, 13.6 per cent import growth). The foreign trade balance of goods and services for the third quarter is traditionally positive and has improved slightly compared to the balance in the corresponding period of last year (from 1.3 to 3.5 per cent of GDP). Thus the deficit since the beginning of the year (-6.7 per cent of GDP) remained higher, though slightly, compared to the corresponding period of last year (-6.4 per cent of GDP).

High economic dynamics in the nine months of the year contributed to a reduced deficit on the balance of payments current account, accounting for 2.9 per cent in the nine months of projected annual GDP for 2004. The current account deficit improved despite the higher trade balance deficit due to the offsetting effect of the positive change in the balances of the other items – services, current transfers and income. The figure below illustrates the ever-increasing importance of transfers from abroad, notably the inflow of private transfers.

Figure 1. Current transfers, net, millions of USD



Source: BNB, balance of payments, published at 30 November 2004.

## Foreign Trade

One of the indicators of the state of the country's economy at the end of 2004 is its integration in the global economy.

Foreign trade dynamics shows that the national economy has managed to cope with the adverse impact of high oil prices and cheap US dollar. They offset mutually, on the one hand, and favourable developments on international markets for raw materials (mainly metals) allow materialization of the potential of the Bulgarian industry, on the other hand. In this sense, only a possible slowdown in Euro zone growth could pose a serious threat to the economy.

Foreign trade turnover continued growing faster. For the ten months of 2004 it grew 17.7 per cent compared to the same period of 2003 (against 14.1 per cent a year earlier). Exports amount to EUR 6545.6 m, growing by 16.7 per cent. In the third quarter alone a growth of 25 per cent was reported compared to the third quarter of 2003. In October exports grew by 22.8 per cent. Imports reached EUR 9273.3 m. Import growth (18.4 per cent) still outpaces export growth, but the difference is smaller than one year ago. Moreover, in October imports grew (19.2 per cent) more slowly than exports. The deficit (export FOB – import CIF) has grown but at a slower pace – from 32.5 per cent for the ten months of 2003 to 22.7 per cent in the period January - October 2004. The difference in absolute terms also decreased – from EUR 545 m in 2003 to just over EUR 500 m in 2004. The total deficit already accounts for EUR 2.7 billion, causing concern about the status of the current account and the possibilities of deficit financing. In our view, the risk is not serious, given that import growth can be estimated as healthy at present. The latter is consistent with high investment activity and increased internal demand as a result of increased net incomes, lower unemployment and bank lending.

The commodity structure of exports and imports and the contribution of individual commodity groups to their growth indicate that the bulk of imports are attributable to subsequent export. This refers mainly to import of machines (25.7 per cent of total imports) and raw materials (40.5 per cent). Imported textile materials make up 30 per cent of total raw materials and account for 60 per cent of exported consumer goods. The higher energy efficiency of the economy is reflected in the fact that despite rising prices of energy sources their share in total imports dropped from 18.3 per cent in the nine months of 2003 to 16.9 per cent in 2004. Due to favourable international conditions the value of metal exports grew faster than the total group "Raw materials". This contributes to their increased share, from 15.7 to 19.4 per cent of total exports. Export of foodstuffs and furniture grows fast but their share remains modest (about 8 per cent in total). Out of investment commodities exported, machines and spare parts have the best realisation on the international market.

Import of consumer goods grew fast but their share remained at about 15–16 per cent. The highest growth in this commodity group was reported in medical goods and cosmetics (over 35 per cent) and automobiles (48.6 per cent), consistent with increased consumer demand for items produced outside the

national economy. Such shifting of solvent demand towards higher quality and more expensive goods intensifies competition on the domestic market and boosts competitiveness. Import of household furniture also grew faster than average, but the growth is consistent with satisfaction of postponed needs and is unlikely to be sustained for a long time.

The trade structure by country remains unchanged – EU continued to be a major partner, contributing most to growth in total exports and imports. In 2004 trade with new EU member states grew fastest (by 31 per cent in exports and 26 per cent in imports). Thus the share of EU-25 in exports sustained high, at 60 per cent, and in imports exceeded 54 per cent. Neighbouring Balkan countries play an ever-increasing role in trade – Turkey and Romania (13.7 per cent share in exports and 8.7 per cent in imports) with a positive trade balance (though small in volume). Four countries (Italy, Germany, Greece, and Belgium) account for 67 per cent of exports to EU and 40 per cent of total exports.

The reported dynamics of foreign trade turnover would probably sustain in 2005. Expected steady (though modest) development of the world economy and still favourable conditions on the international markets will boost Bulgarian exports of raw materials and semi-finished products. Existing specialisation and increasing competitiveness of light industry enterprises as well as larger investments in industry and agriculture serve as a stable basis for increasing the volume of export products. Import capacity of export production, further technological innovation of the economy and higher inflow of foreign investments will stimulate demand for import products. All this gives us ground to assume that current upward trends in foreign trade would sustain in 2005.

## Foreign Direct Investments

Foreign direct investments remain a major source of funds for current account deficit financing and increasing the production capacity of the economy and higher income generation. According to BNB official data, attracted foreign investments in the first nine months of the year (USD 1.487 billion) are more than the total amount in 2003 (USD 1.419 billion). Over 50 of these are in share capital in contrast to one year earlier (26 per cent). The volume of investments in other capital (e.g. corporate credit) fell by 26 per cent and made up about 37 per cent of total FDI, whereas a year earlier they accounted for two-thirds of investments. Green-field investments rose by 44 per cent. Stated investment projects after enforcement of the Law on Promotion of Investments as well as implementation of some privatisation transactions at the end of the year give ground to assume that the volume of foreign direct investments for the entire 2004 will be twice as higher than in 2003.

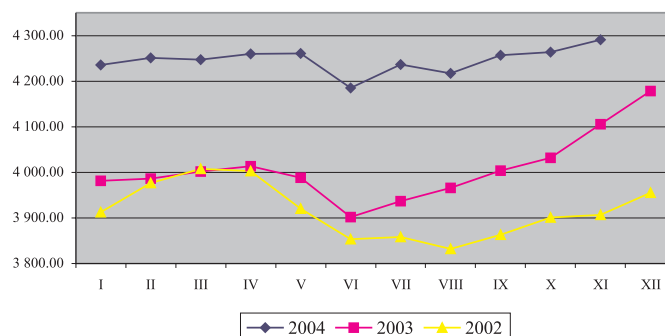
Forecasts for future development of investments are based on clear-cut global trends of outsourcing production to countries

with lower production costs and Bulgaria is one of them. Privatisation of the remaining cigarette factories and large thermal power stations is pending. There is a clearly stated interest by specific companies in implementing specific projects with stated investment value and fixed term. We expect from the companies already operating in Bulgaria to move towards expanding their business and that many new European producers would seek opportunities for enhancing their competitiveness at a later stage. This means, that the amount of FDI may stand at over USD 2 billion in 2005.

## Inflation

Consumer price dynamics throughout 2004 moved more evenly compared to the past two years and 2003 in particular, when the steep curve of prices was due mainly to market price rises of bread and bread products. The following figure of monthly indices of consumer prices based on 1995=100 shows clearly a seasonal pattern in the curve of consumer price fluctuations, on the one hand. On the other hand, the figure illustrates well why average annual inflation will be over 6 per cent, despite the shallow amplitude of price fluctuations in 2004, as a result of which accumulated inflation by November on December 2003 is 2.7, i.e. it could be defined as not high.

Figure 2. Consumer price index, 1995=100 (%)

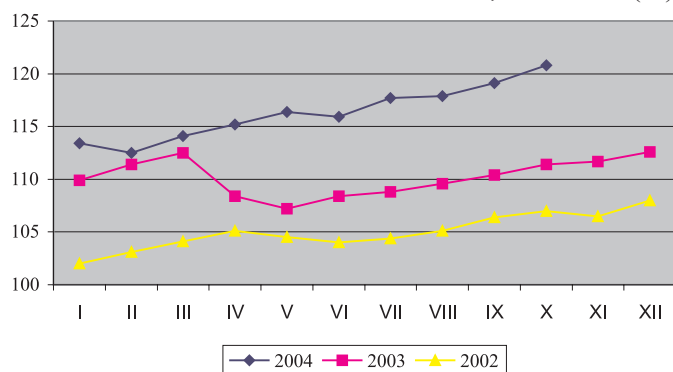


Source: NSI

There are two major factors behind inflation in 2004 – the dynamics of internal oil prices has a purely market impact; however, changes in administratively set prices have a more significant impact on the general dynamics of consumer prices. The administrative factor reflects higher excises on fuels and tobacco products (January), a change in the structure and charges of telephone services (May), higher electricity and heating prices (July) and passenger railway transport prices.

Producer price dynamics (industrial producer prices on domestic market) are also characterised by minor amplitudes but in most cases tending upward, mainly consistent with energy commodities producer prices.

Figure 3. Industrial producer price index on domestic market, 2000=100 (%)



Source: NSI

In November NSI business surveys registered higher inflationary expectations only in construction.

## Employment and unemployment

High economic growth in 2004 is combined with generally favourable development in the dynamics of key labour market indicators – employment and unemployment. NSI data from labour force quarterly survey by the third quarter give ground to expect that the increase in the number of employed persons in 2004 will be about 90 thousands persons as compared to 2003. In the third quarter of the year the number of employed persons exceeded 3 m. The increased number of economically active population<sup>2</sup> (by over 38 thousands) results from the increased number of employed persons (by over 90 thousands) and a decline in the number of unemployed persons (by over 53 thousands).

Labour force survey quarterly data make it possible to assess labour productivity growth, measured as gross value added per one employed person, and to monitor productivity dynamics in 2004. Employment growth outpaced productivity growth, which indicates that new employment is not highly productive. General economic growth could benefit from restructuring employment towards higher productivity activities.

Table 2. GVA, number of persons employed, GVA per one person employed, total for economy – growth on corresponding period of 2003 (%)

	Q1'2004	Q2'2004	Q3'2004
Gross value added, total for economy	6	5.6	5.5
Employed persons, total for economy	2.96	3.27	3.14
Gross value added per one employed person, total for economy	2.95	2.26	2.29

Source: NSI and own calculations

Table 3. GVA, number of employed persons and GVA per one employed person, total for economy – growth on previous year (%)

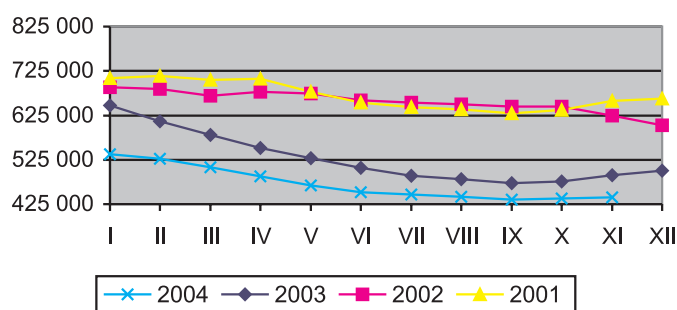
	Gross value added, total for economy	Employed persons, total for economy	Gross value added per 1 employed person, total for economy
2003	4.0	1.4	2.6
2002	5.0	0.4	4.6
2001	3.9	-0.4	4.3
2000	5.0	-3.5	8.8
1999	1.8	-2.1	3.9
1998	2.8	-0.2	3.0
1997	-7.7	-3.9	-3.9
1996	-9.1	0.1	-9.2
1995	2.3	1.3	1.0
1994	1.4	0.6	0.8
1993	-5.9	-1.6	-4.4
1992	-17.5	-8.1	-10.2
1991	-8.4	-13.0	5.3
1990	-9.1	-6.1	-3.1

Source: NSI and own calculations

The sample survey of labour force estimates the number of unemployed persons in the third quarter of 2004 at 373 thousands. The average number of unemployed persons registered with the Employment Agency is still high – about 440 thousands. Differences suggest existing hidden employment.

According to the labour force survey, the level of unemployment in the third quarter fell to 11 per cent, or by 1.7 percentage points lower than in the same period of 2003. Similar is the dynamics according to Employment Agency data – in December the unemployment level was 12.16 per cent, declining by 1.36 on an annual basis – against December 2003. The registered unemployment rate remains at its lowest level since the beginning of 1999.

Figure 4. Registered unemployed, number



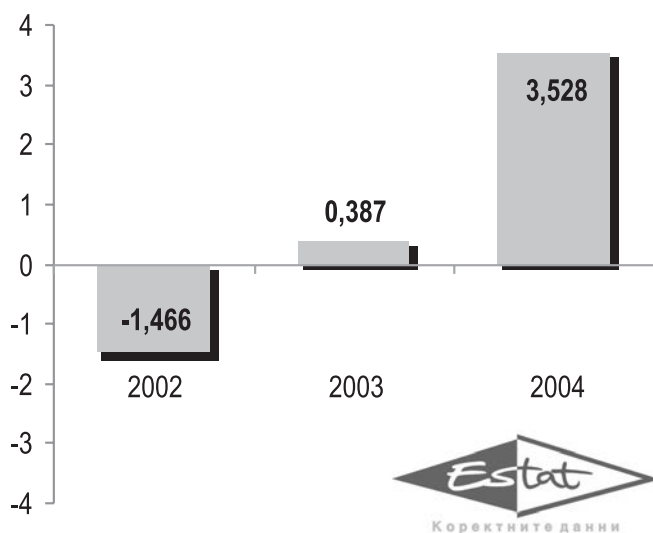
Source: EA

<sup>2</sup> Economically active population comprises persons above the age of 15 who furnish their labour (employed persons) or supply their labour (unemployed persons) for the production of goods and services.

## The Estat index of business climate in Bulgaria

The average value of the Estat index in 2004 is higher as compared to 2002 and 2003. Although the index has kept to the “neutral” range of the evaluation scale for the first three years of its existence, the trend towards improvement in the situation has been distinctly visible since the middle of 2003 (Figure 5)

Figure 5. Average Estat index values by years



Currently the Estat index is operating as a stable mathematical/statistical model: it is at once sensitive to changes in the environment while being quite resistant to accidental fluctuations and factors. Behind the slowly-changing values of the index there has in fact been intense internal dynamics between the components and individual indicators. Thus, for instance, the stable figures observed in 2004 are a combination of the prevailing good condition of businesses, varying investment attitudes and a slowly improving (but still unfavorable) attitude to the state, government, legislation and taxation.

Figures reveal that some indicators feature a distinctive seasonal character. This conclusion applies mostly to investment attitudes and more specifically to the propensity to invest in core and non-core business activities. We have witnessed some seasonal fluctuations also with respect to the perception of competitive advantages. These mark a peak during spring and summer and a visible decline in autumn and winter.

Obviously the socio-psychological component in entrepreneurs' opinions is identical to the one influencing the general public's perceptions, therefore in October and January respondents are much more restrained and skeptical than in spring. Fair weather also serves to deform perceptions, but this time in a positive direction - optimism takes the upper hand of rationality as far as projections and intentions go.

These peculiarities should not be over-generalized but should nevertheless be borne in mind, particularly when analyzing the January figures (when there is always a “rock-bottom”)

and July (when there is always a “peak”). It is exactly at such times, however, that the “stable” components come to our aid: the condition of businesses and the attitudes to the business environment which are almost never influenced by the change of season. It is precisely the indicators within these components that help us “decipher” the processes outlined during 2004 which set the direction of developments in the course of the new year.

The end of 2004 and the beginning of 2005 were marked by the following trends in the Estat index components.

### Condition of companies

The ratio of thriving (15 per cent) to sinking (5 per cent) companies remained stable throughout 2004. These are, on the one hand, businesses in good condition whose managers foresee an improvement over the next quarter, and, on the other, the companies suffering unfavorable developments whose managers believe that their problems will only deepen. By comparison, in 2002 and 2003 the above mentioned groups accounted for only about 10 per cent of businesses in Bulgaria. This is the most prominent indicator for stabilization of the environment. An increasing number of companies are fighting their way towards becoming well-established and thriving - and not, as was the case until not so long ago, to merely survive in the market.

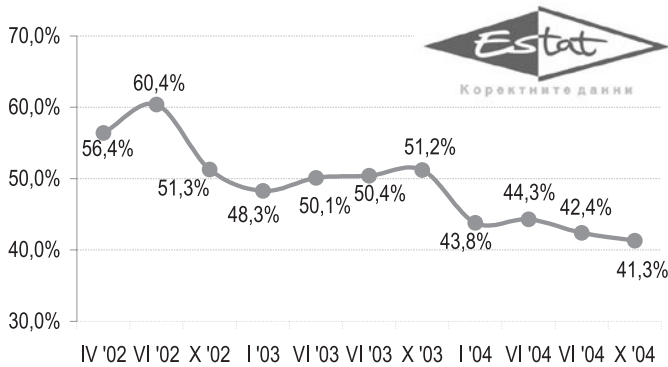
### Investment attitudes

The indicators in this group have a most clearly outlined seasonal nature. Nevertheless, there have been distinctive trends towards:

- focusing efforts on the companies' core business/activity.
- overcoming the chronic deficit of working capital.
- shifting from export activities to the domestic market.
- a decline in the share of those prone to borrow investment loans.
- a decrease in the share of businesses whose managers cannot quote even one competitive advantage.
- an increase in the share of businesses quoting 2 and 3 competitive advantages.
- an improved quality of information resources, Internet connection, new technology, buildings.
- a crisis in the Human Resources area - for 3 years now, the share of managers who find it easy to access the workers and officials they need, has been steadily declining (Figure 6).



Figure 6. Agreeing to the statement “I can easily find the workers and employees I need”



## Government policy and environment

Contrary to common logic, during the last year of its term of office the ruling coalition’s popularity with the business community has been increasing instead of going down.

The share of businessmen according to whom the government’s policy serves to promote business and new technologies is growing.

However slowly, also increasing is the share of those who believe tax rates to be bearable.

The share of managers who have trust in the fair regulation of business activity by the law, is growing.

The first - yet sufficiently recognizable - signs of euro-skepticism, are beginning to appear.

The level of dissatisfaction with the performance of the administration remains constant.

The procedure under the Public Procurement Act is so badly compromised now that the situation looks beyond repair. In this field, it seems, the next cabinet would find the worst part of the legacy it was left with.

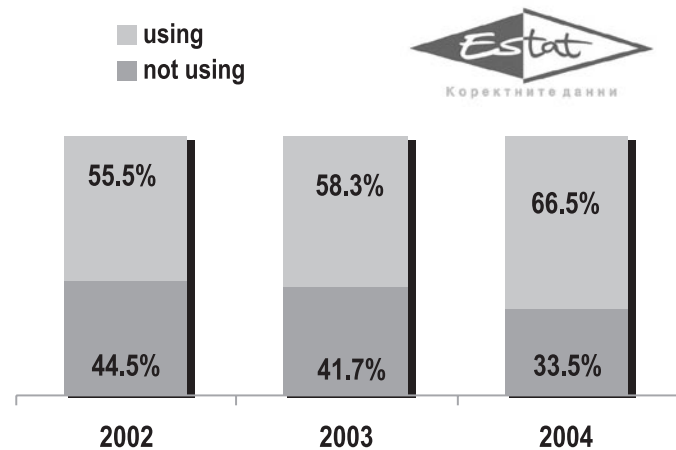
## Changes in the business environment in the course of 2004

January: +1.67

Following the stable growth throughout 2003, in January 2004 the Estat index marked its usual winter decline. The share of businesses without a single competitive advantage is high (32 per cent). Investment intentions are torn between the core business and other activities. As it is, 72 per cent of businesses experience a deficit of working capital. Confidence in the banking system and the propensity to draw investment

loans are growing. The share of businesses using the Internet is growing permanently (Figure 7)

Figure 7. Average share of businesses using the Internet, by years



The Estat index registered the first signs of a subsiding dissatisfaction with the tax rate.

Distrust seems to be the prevailing attitude to the government. As few as 7 per cent find the PPA procedures to be transparent and fair.

April: +4.51

Considerable increase in the Estat index value as compared to the previous quarter. Two-thirds of companies are not tempted by the opportunity to pursue expansion to foreign markets.

The share of businesses implementing long-term business strategies is growing. Confidence in the banking system continues to increase. Credit institutions now have the image of organizations helping the business.

The number of managers according to whom government initiatives are in support of the business environment is going up.

Symptoms of lasting difficulties in staff recruitment are beginning to appear.

July: +5.27

The favorable 18-month trend towards improvement in the business environment is materialized in the index’s highest value in its 3-year history. The ratio of “thriving” to “sinking” companies is extremely favorable - 16 per cent: 4 per cent. The “State” component for the first time falls within the neutral rather than negative part of the scale.

Also higher are the ratings reflecting the quality of key resources such as innovative and information technology, the Internet and buildings.

The euphoria surrounding banks and lending seems to be subsiding. The first signs of euro-skepticism in the business community are starting to show. For the time being, this is manifested in the smaller share of those agreeing to the statement that the alignment of Bulgarian legislation with the EU's *acquis* will improve the business environment in this country.

Conditions are in place for a considerable and lasting improvement of the business climate in the medium-term perspective.

*October:*+2.66

A seasonal decline in the *Estat* index value due to the lower propensity to invest. However, the favorable ratio of thriving to sinking companies -15 per cent: 5 per cent, is preserved.

The share of businesses which do not use the Internet (31 per cent) is record-low. The rating given to the quality of information resources is getting higher.

The Human Resources issue, however, continues to deepen; euro-skepticism is also growing.

Confidence in the banking system is going down, and so is the propensity to borrow loans.

Confidence in the procedures under the Public Procurement Act is critically low (6 per cent).

The "State" component is going back to "moderately unfavorable" values.

## Trends

The positive developments in this area over the course of the past year may be summarized with:

- the establishment of the new Executive Agency for SME Promotion;
- the improved image of Bulgarian entrepreneur;
- the wider access to financing for enterprises;
- the record-high investments into the economy for the past 15 years and the emerging of Bulgarian investment marketing;
- the stepped-up privatization of minority shares and of some large companies;
- the easing of trading restrictions for Bulgarian goods and services in South Eastern Europe;
- the closer alignment of anti-trust mechanisms in Bulgaria to EU good practices;
- the improved competitive positions of the country in the World Economic Forum rankings, with further significant upward movement expected for 2005;
- the major steps taken in the direction of relieving the administrative burden on Bulgarian businesses; an improvement in the institutional framework of public procurement.

On the other hand, the following important issues still remain to be addressed:

- the low level of SME awareness of government programs to support enterprises' competitiveness and preparedness to deal with competitive pressures in the EU market;
- the issue of promoting risk investments in SMEs remained unaddressed throughout the year;
- the problem with mutual indebtedness between enterprises deepened while no adequate measures were taken to address it;
- the administrative capacity building of Bulgarian municipalities needed to absorb funds under EU pre-accession programs is still lagging behind;
- the inadequate measures towards accelerated R&D development in enterprises to compensate for the technological gaps with the enlarged EU;
- the delay in the privatization of a number of large companies and the use of intransparent practices of road infrastructure concession;
- the lack of safety-net measures for textile clusters with respect to the pressure exerted by China on both domestic and the EU market from China.

## Entrepreneurship and SME Encouragement

The official establishment of the new Executive Agency for SME Promotion (EASMEP) gave significant new prominence to the issues of increasing the effectiveness of programs in support of Bulgarian business. The access to information on programs to promote entrepreneurship, the internationalization of SME,

the introduction of new technology and new management processes and practices, is still seen by Bulgarian entrepreneurs as being inadequate. In this respect, the potential role of the 28 new regional EASMEP offices is increasing, because, the necessary information will be disseminated in all regions in the country by them. The EASMEP intention to place its regional units at the currently functioning offices of regional business associations is a further positive development in enterprise policy which will facilitate the businesses in finding information. In practical terms, this means a facilitated or even direct access by businesses to government policy instruments aiming to increase the competitiveness of SMEs. This, however, requires that the Agency put more emphasis on publicizing the new opportunities as they become available; for the time being using the services of government agencies or business organizations is an option largely overlooked by enterprises as a source of increasing competitiveness.<sup>3</sup>

The permanent presence of public administration employees at the offices of regional business associations is beneficial for the business community inasmuch as the initiatives by both partners will be supported by the adequate capacity and willingness for ongoing dialogue focused on the challenges the business faces. Thus, in essence, the necessary setting for an efficient public-private partnership would be created for providing local SMEs not only with information services but also with specialized consultations in various aspects of SME management. This sets the ground for stepping up the processes of consolidation between certain companies and establishing a mechanism of co-operation within the currently emerging economic clusters. Public administration officials could serve as moderators in the process of cooperation between companies in these clusters. Such functions, however, should be performed only after regional EASMEP employees have undergone the appropriate training - both in the field of cluster moderation and in a number of other areas, including: efficient communication with the business community and other public administration officials; EU requirements to businesses and information on projects under pre-accession programs; assisting local authorities in establishing "one-stop shops" for businesses.

Recognizing the need for more information which could be used in support of businesses, the EASMEP launched an initiative to publish a Business Guide. This guide will serve enterprises mostly by keeping them updated on amendments to the tax legislation, current public procurement procedures, charges and fees required, information on concession procedures, foreign trade restrictions, shipping companies. It will also provide information on the currently existing Small Business Information Desks and how they could be useful to the region's economy.

<sup>3</sup> EASMEP, Small and medium-sized enterprises in Bulgaria 2002-2003. <http://www.sme.government.bg/publications/default.asp>, page 100

With the changes in the Bulgarian definition of SMEs introduced in July 2004, there are now higher thresholds for the number of employees and financial criteria according to which an enterprise can qualify as a SME. With regard to number of employees criteria and SME autonomy, the Bulgarian definition has been harmonized with that in the EU. This, however, does not apply to financial criteria which are considerably higher in the EU than in Bulgaria. It is important to note that since 1 January 2005 the EU definition on SME has changed in the direction of a further increasing the financial thresholds. Thus, the scope of SMEs which may benefit from support through EU financial instruments, will be expanded. Starting 1 January 2005, the “autonomous SME” criterion is abolished. The EU definition is amended as follows:

*EU definition of small and medium-sized enterprises, in effect for the EU as of 31 December 2004*

Criteria		Micro enterprise	Small enterprise	Medium-sized enterprise
Number of employees		< 10	< 50	< 250
or	Annual turnover	---	< 7 million EUR	< 40 million EUR
	Total Assets	---	< 5 million EUR	< 27 million EUR
Autonomous		---	Yes <sup>*</sup>	

*In the new EU definition of small and medium-sized enterprises, the “autonomous enterprise” criterion is abolished, and new threshold values for annual turnover and balance sheet total are introduced for micro-enterprises<sup>4</sup>.*

*Definitions of small and medium-sized enterprises, in effect for Bulgaria and the EU since 1 January 2005*

Criteria	Micro enterprise		Small enterprise		Medium-sized enterprise		
	BG	EU	BG	EU	BG	EU	
Staff headcount	< 10	< 10	< 50	< 50	< 250	< 250	
or	Annual turnover	---	≤ 2 m EUR	< 5 m BGN	≤ 10 m EUR	< 15 m BGN	≤ 50 m EUR
Balance sheet total <sup>***</sup>		---	≤ 2 m EUR	< 1 m BGN	≤ 10 m EUR	< 8 m BGN	≤ 43 m EUR
Autonomous		No <sup>**</sup>	No <sup>**</sup>	Yes <sup>*</sup>	No <sup>**</sup>	Yes <sup>*</sup>	No <sup>**</sup>

<sup>\*</sup> No more than 25 per cent of the capital or of the voting rights can belong to one or more enterprises which are not small or medium-sized.

<sup>\*\*</sup> There is no criterion for autonomous enterprise.

<sup>\*\*\*</sup> In the Bulgarian definition of SMEs this criterion is entitled “Value of long-term assets”, instead of “Balance sheet value”. It would perhaps be useful to remind the reader that between the first and second hearing this part of aligning the definitions applied in Bulgaria and the EU was postponed, also as regards the financial thresholds.

As can be seen from the table, the financial thresholds in Bulgaria are considerably lower than these in the EU. This country-specific feature for Bulgaria will be removed by 2007, because no transitional periods were granted on the “Small and medium sized enterprises” Chapter settling the issues of SME definitions. Arguments in favor of the phased-in alignment of the Bulgarian definition to the European definition are mostly that increasing the financial thresholds to values closer to those used in the EU would result in more incentives for larger enterprises in Bulgaria to participate in various programs to promote their competitiveness or capacity for public procurement.

An intriguing connection could be established by including the debate on fiscal decentralization in the thematic scope of entrepreneurship promotion. The constitutional amendment now being discussed, according to which each municipality would be granted the right to set the rates of local taxes and charges and to collect revenues from such taxes, would also mean more incentives for starting new companies. In theory, the more enterprises there are on the territory of a given municipality, the more revenues there will be to the local budget. When the link between services provided by the municipal administration, and its revenues is as weak as it is now, the municipality has no incentive to facilitate the starting-up of companies. But if a certain portion of direct taxes is transferred directly to the municipal budget, then the revenue side will depend on the number of companies in the municipality. Therefore, at equal rates for each municipality, the starting-up of as many companies as possible would depend on the municipal administration and the local policy of start-up promotion. If one were to also introduce to the analysis the hypothesis of applying differentiated rates, then establishing new enterprises will depend also on the municipality’s tax policy.

At the end of the year, for the first time since the mid-90s public attitudes to entrepreneurship in Bulgaria registered a positive change, together with the image of the businessperson in Bulgaria, whether working for a large company or pursuing self-realization through operating a small company. The study of public perceptions on Bulgarian business people and business in general was carried out by the National Center for Public Opinion Studies in early December, 2004. The positive trends underlying the study results are that 2 years before EU accession, citizens are more prone to take a risk and accept the idea of developing one’s own business as a serious alternative to being employed by others, because, according to the study results, 70 per cent of Bulgarians believe that having one’s own business is worth the trouble and efforts. This idea is particularly strong among the younger population, which, in Bulgaria, obviously shows a higher propensity to engage in entrepreneurship. Nevertheless the study also revealed a group which is of quite the opposite opinion - about 43.7 per cent of respondents are not inclined to see the benefits of having one’s own business and prefer to be employed in the public sector<sup>5</sup>. Such attitudes evidence the fact there is still much to be done in

<sup>4</sup> Source: <http://www.evroportal.bg/?tid=40&oid=671689>

<sup>5</sup> [http://www.focus-news.net/pdf/Bul\\_Business.pdf](http://www.focus-news.net/pdf/Bul_Business.pdf)

programs to promote entrepreneurship and start-up companies in Bulgaria, which for the time being do not cover an adequate range of potential entrepreneurs.

Another major aspect during the year was the registered lagging behind of EU economy in trying to keep up with the Lisbon Agenda. This necessitated changes in EU programs to improve the competitiveness of economies and the promotion of SMEs and innovation. As a result, the European Commission launched initiative to draft a new Framework Programme for Competitiveness and Innovation, which will be active between 2007 and 2013. Together with the instruments to promote innovation, the program aims to increase the use of ICT in business, to improve SME access to funding and create incentives for an improved business environment. Taking into account the delay of Bulgarian economy according to a number of indicators as compared to new EU Member States, expectations are that such a framework program will favor innovation in Bulgarian enterprises after 2007. Consultations on the program will continue until February 2005<sup>6</sup>. As early as January 2005 the MoE will launch a project entitled "Supporting the Competitiveness of Bulgarian Enterprises" with a budget of about EUR 30 m under the 2004 PHARE Programme which will be mainly focused on the improvement of business environment at regional and local level.

## Investment Promotion

The new Invest Bulgaria Agency - the successor of the Foreign Investment Agency - within a short period of time created quite a stir in the field of both large-scale investment projects and SME investment projects. Only for the first nine months of 2004 foreign direct investment (FDI) in the country is coming closer the amount of those achieved for the entire 2003 which was the most successful year in terms of FDI up until now<sup>7</sup>.

An additional incentive for the investment process is expected as part of the implementation of the Strategy for Investment Promotion in the Republic of Bulgaria<sup>8</sup> which was approved by the Council for Economic Growth in December, 2004. The Strategy was drafted by various governmental and non-governmental analytical institutes, among which the Center for Economic Development, with the Ministry of Economy acting as the coordinating institution. According to the adopted strategy the expected results from investment promotion in Bulgaria over the next years (by 2010) will be: a higher level of foreign direct and local investment, higher income levels and employment in the economy, and an improvement in Bulgaria's investment image.

The latter is expected to be achieved by entrusting Bulgaria's investment marketing to Deloitte & Touche, one of the five largest consultant companies in the world. The consultant is expected not only to investigate the international investment environment, but also to outline the areas in which the country can be positioned on the global investment map. In addition, the company is expected to propose the measures needed to attract the largest possible investments in these areas, as well as the competitive advantages of the country in the factor conditions for investment. One particularly interesting commitment made by the company is to produce the investment strategies of multinational companies in the region. The benefits from such an analysis to the Invest Bulgaria Agency lies in the fact that it will thus be able to address specific companies with specific offers for investments opportunities in Bulgaria, matching their investment strategies. This will very possibly lead to more greenfield investments than the passive waiting for large investors in Bulgaria.

The stepping-up of the investment promotion of Bulgaria in the course of this year was seen in the first "Investment of the Year" competition organized by the MoE. There are three categories in the competition - "New Investment" "Investment in SMEs" and "Investment in Tourism", with different criteria under the three categories. The parameters according to which investments are ranked, are as follows: volume of investment, liberalization of the industry sector, number of new jobs (for new investment); for the "Investment in SMEs" category, the emphasis is on developing a certain market niche, investment in new equipment and the potential for exports to the European market. Investment in tourism ranked according to 5 different criteria, with the biggest weight falling with "contribution to the development of the region and the quality of services". The competition results were announced at the end of the year. "Socotab" Plovdiv (new investment), "Arexim" - Smolyan (investment in SME), and Ulen - Bansko (investment in tourism) were the winning companies in individual categories.

## Access to financing

The growth in the absolute value of loans granted both to households and the private sector that we have commented on for the individual quarters is now observed as an annual trend. At the end of 2004, loan receivables to the non-governmental sector were reaching levels of over 35 per cent percent of GDP, with the most dynamically developing market being that of consumer lending. A positive trend was observed also with respect to the repayment terms of loans which are also growing. This shows, on the one hand, a propensity in businesses to turn to long-term company development strategies and, on the other - a propensity in banks to participate actively in the process of introducing innovative processes in economy.

A new credit line amounting to EUR 10 m will now be operated by Encouragement Bank. The funds are invested by Nordic

<sup>6</sup> [http://europa.eu.int/comm/enterprise/enterprise\\_policy/cip/consultation.htm](http://europa.eu.int/comm/enterprise/enterprise_policy/cip/consultation.htm)

<sup>7</sup> See Macroeconomic Dynamics in this Report.

<sup>8</sup> [http://www.mi.government.bg/doc\\_pub/Investicionna\\_strategiya.pdf](http://www.mi.government.bg/doc_pub/Investicionna_strategiya.pdf)

Investment Bank. Under this credit line lending conditions are extremely favorable, with repayment terms being up to 10 years, and the amount of the loan up to EUR 1 m with collateral being below the loan value. SME projects will be given priority; projects for the purchase of machinery, facilities and technological equipment from Scandinavian countries.

Lending conditions under the Micro Credits Guarantee Fund managed by the MLSP were also alleviated. The maximum amount of loans reaches BGN 20 000 with the threshold for creating one new job going up to BGN 10 000.

For the last few years the mutual indebtedness between enterprises has been going up, as well as their liabilities to the budget, social security and to their own staff<sup>9</sup>. This could be interpreted as SMEs having difficulty to observe the obligations in economy, which is accounted for by inefficient debt collection procedures. An interesting opportunity to solve the problem is to outsource this activity to agents, instead of burdening the judiciary. As always, this idea may cause some serious arguments in both directions, but from the point of view of the net effect on the economy it should be considered as positive. Putting this idea to practice would lead to expanding the alternative sources of SME funding in Bulgaria, because the more effective collection procedures would impact the expansion of own resources for businesses in Bulgaria. In view of the restrictive measures on the credit expansion, purely institutional incentives on expanding the access to financing (such as a targeted reform of the judiciary) are, for the time being, severely overlooked.

European funds would mean expanding the access to financing only if there are high-quality projects and administrative capacity. A particularly pressing question, related to administrative capacity, is to put such capacity in place in all municipalities in Bulgaria. Concentrating capacity only in certain larger municipalities with a strongly developed non-governmental and consultant sector runs contrary to the goal for which EU structural funds were created - to close the gap between well-developed and poorly developed regions in the Community. At a certain stage it could turn out that regional development programs only help municipalities with strong administrative capacity, while the rest would continue registering a permanent decline in business activity on their territory. A solution to this potential barrier to regional development in Bulgaria was proposed by the UNDP's Bulgarian office: to launch a National Programme for Capacity Building in Project and Partnership Skills. UNDP research shows that Bulgarian municipalities need between 6 000 and 13 000 people to be used as human resource capacity in absorbing regional funds; these people could receive training as part of this program. The idea should also be supported with budget funds channeled to the MRDPW and distributed on competitive basis to various consultant companies in the country. Another possible solution to the problem is through the establishment, currently contemplated

by NAMRB, of a public fund for municipal projects; this fund will finance the development of the project, and, if the project is successfully awarded, afterwards restore its costs.

The need to strengthen the parameters of the country's innovation policy requires also new methods to encourage innovation investment in Bulgarian enterprises. The much-discussed draft law on SME Investment Promotion meant to facilitate SME financing through assets for risk investment companies could not be adopted in 2004. In addition, the share of SMEs investing in new processes and technology - although growing - is not large enough to compensate the gap between R&D investment in Bulgaria and that in new EU Member States or the EU as a whole. In Bulgaria, the share of R&D expenses in GDP is as low as about 0.5 per cent, while in the new Member States it is about 1 per cent. This requires serious tax cuts for research and development and establishing links between business and the academic centers. Taken on their own, the measures adopted as part of the 2005 State Budget Act for accelerated depreciation (50 per cent per year) could hardly lead to a great boost in innovation development in Bulgaria.

## Privatization

The privatization of small and medium-sized companies in Bulgaria is nearing its end. According to figures supplied by the Privatization Agency<sup>10</sup>, enterprises with over 50 per cent of state interest still on sale are 91 in number. The sale of another 116 companies from the "restricted list" requires permission by the Parliament. The sale of the so-called "minority state interest" is also drawing to a close. The last 350 packages still owned by the state will be offered to potential buyers. In about 309 of these companies the "minority" state interest will be preserved until all restitution claims are settled. For the period 1 January 2004 until 31 December 2004, 143 companies with majority state ownership, 65 autonomous parts and 1 168 "residual" share packages were sold. The ownership in 87 per cent of state assets pending privatization is now private.

Revenues from privatization for the same period amount to USD 1 340 m of agreed payments on transactions, USD 89 m in transferred liabilities and USD 511 m in transferred investment commitments.

In the annual workplan for 2005, the PA foresees closing 46 deals for share packages or shares of commercial companies with over 50 per cent of state ownership and 20 deals for autonomous parts. The sale of minority state interest in another 167 companies is also pending. Revenues from sales for 2005 are expected to be in the amount of BGN 450 m in cash proceeds and BGN 300 m in non-cash payment instruments.

<sup>9</sup> EASMEP, Small and medium-sized enterprises in Bulgaria 2002-2003. <http://www.sme.government.bg/bg/publications/default.asp>, page 97-98.

<sup>10</sup> Source: <http://www.priv.government.bg>

In November 2004, the government adopted amendments to the Ordinance on Tender Procedures and Competitions. The aim of these amendments was to accelerate the privatization process by shortening the deadlines for tender procedures and introducing one-stage competitions.

Analysis of the condition of state property in Bulgaria shows that as at 31 December 2004, only 57.45 per cent of assets in the country are private property. The absence of public and political consensus has been hindering the privatization of structurally significant companies, infrastructure and state monopolies has not been happening for the past 11 years. The actions of the current government and the Parliament show no will to change the attitude to the process. The result is that now, in the last year of the term of office of the coalition government of NMSII and MRF, the National Assembly has not yet adopted the privatization strategies for NMB and BRS, "Bulgaria Air", and the companies of the "military-industrial complex". Particularly strong is the political and trade-union resistance to the sale of energy companies, communications companies, defense industry companies, and the tobacco monopoly.

The belated privatization of "Bulgartabac Holding" AD resulted in the growing indebtedness of cigarette factories and processing factories, to the accumulation of large quantities of unprocessed tobacco, to the lack of investment in equipment and technologies, to the loss of markets and strong general decapitalization of the company. Also unfavorable for the holding's future is the situation in international markets and the country's approaching European Union membership. Unfortunately BAT, the only international company that filed a tender offer for the purchase of companies of Bulgartabac Holding AD, withdrew from the procedure due to the complicated political situation in the country.

Attempts to sell individual companies or packages of enterprises in the "Bulgartabac Holding" structure could be assessed as not particularly successful, most possibly because of the way companies were "packaged" which reduced their attractiveness. Prior to the expiry date of the tender - 29 October 2004, only one tender offer was filed for the sale of the two enterprises manufacturing cigarettes - "Sofia-BT" AD and "Plovdiv-BT" AD. The tender offer was by British American Tobacco. For the two cigarette factories "Blagoevgrad-BT" AD and "Slantse-Stara Zagora-BT" AD no bidders appeared. Four processing factories were successfully sold. The sale is awaiting approval by the Supervisory Board and the Managing Board of the holding. Tenders for other companies are also pending. New tender procedures or sale through the Stock Exchange are also possible. The total indebtedness of the 12 factories is over BGN 65 m. Probably by the end of its term of office the government will continue its efforts to restructure and privatize the holding regardless of the strong protest by the opposition and trade unions.

The left-wing opposition creates such obstructions also in the discussion of the strategies for the privatization of NMB and BRS adopted by the government on 28 October 2004. The key objections are related to the exclusion of Bulgarian investors from participation in the privatization process and the desire to preserve 51 per cent state ownership in the company. The strong political interest to the two strategies is also preconditioned by the fact that the NMB is the biggest ship owner in the country and also one of the biggest in the Black Sea region. According to the Register of "Maritime Administration" - Varna, the company owns 65 ships and has monopoly over maritime shipping from and to Bulgaria. It services key sectors of Bulgarian economy - oil-processing, metallurgy, coal-mining, chemical industry and grain production. The lack of fresh investment, the obsolete ships and the dire financial condition of the company requires a rapid progress of the privatization process. BRS is experiencing similar difficulties and therefore its fast privatization is a precondition for any positive prospects to the company.

In November, a strongly disputed and long-drawn privatization deal underwent a significant development. The sale of "Boyana Film" AD National Film Centre started in 1999. On 4 July, 2001 The Council of Ministers adopted the Strategy for the privatization of the company. In January 2004 a competition was announced to select an intermediary for the sale of 95 per cent of the shares of "Boyana Film" AD on the Stock Exchange. In May the government gave up on this method and in June 2004 a two-stage competition for sale was announced. Four film companies showed interest in buying the National Film Center. Their participation in the second stage of the competition is still pending. Expectations are that the privatization contract will be concluded by the middle of 2005.

According to an assessment by experts and investors, the privatization in the energy sector is progressing successfully. The sale of CHPPs which started under the last government and generated considerable interest and good revenues. At the end of 2004, another 22 CHPPs were sold, while a further 15 companies are now being prepared for sale. The state Privatization Agency is working on 11 projects for the privatization of district heating companies, the sale of metal and coal mines. In 2004 the sale of the seven electricity distribution companies was completed; they were divided by the territorial principle. Cash proceeds from the deal amount to EUR 693,2 m. Therefore it could be safely concluded that the key priorities in the privatization of the electric energy and district heating sector are being followed in compliance with the Strategy for restructuring and development of the energy industry adopted by the National Assembly on 17 July 2002. The process of privatization in the industry is fully subordinated to the need for investment towards improving the energy infrastructure. The final goal is to assist the processes of market integration of the Bulgarian electricity generation and competitive presence in the regional electricity market.

The government also sold 35 per cent of BTC shares on the Stock Exchange. 2 869 251 shares were offered up for sale, representing 34.78 per cent of the company's capital. The state also preserved one "gold share". Auctions already held by BSE - Sofia registered the presence of enormous investor interest. Almost all shares were bought upon the first day (27 January 2005), with the minimum price being BGN 212 in compensatory instruments, while all "market" orders were delivered at an average price of BGN 218 in compensatory instruments. Then, on the secondary market, interest to BTC shares lead to an initial sky-rocketing of prices reaching levels over BGN 350 per share.

During the four days of auctioning for the sale of BTC, compensatory instruments with nominal value of over BGN 600 m were spent. Even before the privatization, the owners of compensatory instruments had the opportunity to get a good price for their securities, as they had reached the record-high price of 113 per cent of their face value in January 2005.

The sale through the stock exchange of BTC shares could be described as highly successful. It proved the potential and opportunities provided by the Stock Exchange for conducting an open and fair privatization, resulting also in advantages for the selling party due to the significant growth achieved in the selling price. This potential was unfortunately rarely used in the privatization in Bulgaria, but the stock exchange sale of BTC acquired great publicity and provided a strong argument in favor of this privatization method for some of the remaining major privatization deals.

## Concessioning

In compliance with the Transport Ministry's Program for Development of Civil Aviation, various opportunities are foreseen for restructuring and modernization of existing airports in Bulgaria. Firstly, the concessioning of the larger Bulgarian airports is planned: Varna, Burgas, Plovdiv and Gorna Oryahovitsa. By Council of Ministers' Decision № 647 of 10 August 2004 a competition was announced for granting under concession of the Varna and Burgas airports for a period of 35 years. Out of the eight companies participating in the competition, five foreign consortiums and companies were admitted to the final round in December. There are Bulgarian companies in two of the consortiums. Final offers are expected by 7 March 2005. The government wants airports to see the new tourist season in with already private concessionaires. Investments required for building terminals, for airplane flights and safety measures in the two airports, according to estimates by the Transport Ministry, amount to EUR 134 m. The Application Committee will evaluate the applicants' offers according to their investment proposal, including the investment program, financing plan and assessment of the effect of investment on consumers.

Government measures in the field of attracting investments in the maritime and river shipping business are highly dissatisfactory. The big maritime ports in Burgas and Varna are losing their competitiveness due to the obsolete technical equipment, the slow processing of freight and the long waiting periods for ships. Ports in Thessaloniki, Greece, and Constanza, Romania, are already dominant in the region.

The government awarded the construction of the "Trakia" motorway without a tender or competition procedure to grant a concession. Intentions are for the motorway infrastructure to be constructed using the principles of a public-private partnership. For this purpose, a company was established with the participation of two state-owned Bulgarian companies, who own 49 per cent of shares, and three Portuguese companies owning 51 per cent of shares of the newly established "Magistrala Trakia" /Trakia Motorway/ AD company. The capital of the company is in the amount of BGN 1.21 m. The concession period is 35 years. According to information appearing in the press, EUR 590 m will be invested in the construction of the motorway by end-2007 and another EUR 125 m by end- 2009. Currently, 182 km of the "Trakia" motorway have been constructed, and the concessionaire will construct the remaining 261 km. The motorway's total length is 443 km. On the one hand, a deal like that could improve the quality of the road infrastructure in the country. On the other hand, however, the lack of alternative of the concessionaire leaves some doubt as to the proper conducting of the selection procedure choice from the point of view of the economic reasonableness of concessioning. Although concessioning in this case without any competition is legal according to § 36 of the Transitional and Closing Provisions of the Concessions Act, the very lack of any competition puts the government in a market situation of the "one seller" type which always bends the market in favor of the Seller (in this case, the concessionaire). Instead of using the opportunity to get better terms from a number of sellers (potential concessionaires) by announcing a competition, the government agreed to the only set of proposed parameters under the pretext no candidates for the concession had turned up. Therefore in this specific case the government tolerated the lack of alternatives and at the same time justified the parameters (unfavorable, according to information in the press) with the same lack of many alternatives. The urgent need to continue constructing the road infrastructure in Bulgaria does not mean that concessioning of motorways under the "one seller" concept is good for the country. A possible recommendation would be to revoke § 36 of the Concessions Act, and amend Art. 8 of the same act to make the government obliged to announce a competition procedure when awarding concession for infrastructure of similar significance in the future.

## Efficiently functioning markets

Establishing an environment of active competition in sectors economy which, in the early years of transition and for much



longer afterwards, used to be a monopoly structure, is one of the key conditions to improve the effectiveness of economy. Together with the removal of state aid in certain state-owned enterprises and regulating the use of state aid in the economy, establishing new competition in old industries bolsters such a distribution of resources in the economy which would move in the direction of more efficient production. In 2004 there have been attempts to establish effective competition in the energy and telecommunications industry. These are, however, too limited and although the legal framework presupposes the presence of competition, actual competitive practices are still to be achieved.

In the telecommunications sector for example, and in particular in the area of fixed telephony, there are 14 companies providing this service. After the CRC approved in June 2004 the Framework Proposal for interconnectivity of BTC with the networks of other licensed operators, BTC has so far entered into interconnectivity agreements with 4 companies: "Orbitel", "Nexcom", "Global-tech Bulgaria" and "Trans Telecom". This is a positive development on the market of fixed telephone services, which sets the ground for competitive practices. Pending the achievement of full transferability of telephone numbers from the network of one operator to another, however, competition between operators will be relatively inefficient unless individual operators offer considerably lower prices than BTC along with an active advertising campaign. The opportunity to transfer subscribers between the networks of individual operators however will most probably be delayed as much as possible because the country's commitments under Chapter 19 "Telecommunications and Information Technology" request that the subscriber transferability will be achieved no later than 1 January 2009.

In the mobile communications sector we also witnessed some stepped-up activity during 2004 when the third GSM operator license was granted to BTC. The dynamically developing mobile services market in Bulgaria and the granting of the third license give us grounds to forecast that effective competition in the sector will unfold in 2005 because only two mobile operators are not enough. The new GSM operator is for the time being conducting only trial voice transfers and its launch on the market is planned for the first half of 2005.

In order to establish working competition in the entire communications industry, however, the issuing of at least 3 UMTS licenses is necessary, and also announcing a competition for licensing of wireless voice and data transfers. A schedule has already been prepared for freeing up frequency resources for third-generation GSM operators in Bulgaria. Frequencies will be freed up by the MoD in 2005 and probably before the end of the year the UMTS operators tender procedures will have been successfully completed. Existing operators are expected to also apply for third generation operators licensing. If this hypothesis is confirmed, the competitive structure in the industry will not change considerably. Nevertheless and

in spite of the expected low levels of demand for the services of third generation GSM operators, announcing such tender procedures will be a necessary step forward in the development of the communications market in Bulgaria.

An important step ahead in the area of introducing strict budget restrictions for old state enterprises were also the new Regulations to the State Aid Act. It empowers the CPC to control the legitimacy of state aid for each enterprise in the economy, regardless of how it was acquired. State aids could be subsidies, government guarantees, participation in joint ventures, tax preferential treatment, rescheduling of liabilities to the state budget and NSSI. These will be recorded in a special State Aid Register. Another important change is that each case of state aid will be coordinated with the CPC.

### Preparation for the Single European Market

With the date of Bulgarian EU accession fast approaching, work on the implementation of EU production standards is being stepped up. The enormous difficulties faced by businesses in the SME sector and the danger that most of them would not be able to tackle them unassisted forced the government to intervene. The deadline for introducing EU veterinary and sanitary norms and good practices for meat-processing plants was re-negotiated with the European Commission. Instead of end-2005, businesses must achieve compliance by the middle of 2006. This postponement will mostly affect small companies which are believed to have modernization potential but there is still no clarity whether it will be developed. The postponement will allow the companies already having business plans and approved SAPARD projects, but are still awaiting financing, authorization etc., to have a higher degree of security for their business. An inspection by the veterinary services at the end of the year will give a clearer idea of the state of companies and the opportunities to introduce changes to their investment plans.

Apart from achieving compliance with EU veterinary, sanitary and hygiene norms, small and medium-sized enterprises of the food sector must also introduce good practices in order to be granted a license to sell on the Single Market. The Ministry of Economy proposed its own Project for Assistance to SMEs in the Meat Processing Industry for Introduction of Hazard Analysis Critical Control Point System" - a system for quality self-control. Under this project, the ministry takes over up to 50 per cent of the cost for introducing the system, by helping cover the cost of consultant services, staff training, as well as part of the investment to purchase the necessary equipment. The remaining portion of funds will be provided by the enterprise itself. Any small and medium-sized enterprise is eligible to participate in the competition provided they have already achieved compliance with sanitary and hygiene requirements and its future success depends on the results of the HACCP feasibility study.

The phasing-out of individual installations in industrial enterprises non-compliant with environmental maximum levels agreed with the EU has already started. Under the Environmental Protection Act, over 200 enterprises in metallurgy, chemical industry, cement industry, leather-processing industry etc. must modernize or stop operating by the end of October 2007 any part of their installations which does not comply with these norms. For this purpose, additional investments of BGN 5 b will be required. At this stage no scheme is in place for government support or creating incentives for enterprises to invest in such activities.

## Trade policy

On May 2003, the Ordinance on pre-packaged products - mostly wines and foodstuffs, came into effect. Now the European Commission - for the purpose of easing the bureaucratic procedures and develop a competitive market environment by cutting down on regulation and introducing more flexible rules - is proposing to deregulate the volume of packages for a wide range of consumer goods<sup>11</sup>. This will facilitate launching on the market of modernized and new products, will create an opportunity for a more flexible response to customer demand, will remove one trade barrier while at the same time strengthen consumer protection with the help of clearly spelled out information on the labels, thus avoiding any opportunity of fraud or misleading.

In compliance with the Customs Act, at the end of each year changes are introduced to the Combined Nomenclature and the introduction of the Integrated Tariff of the European Community<sup>12</sup>. Over 1000 tariff positions will undergo a change, starting from the beginning of 2005. In order to align tariff treatment to that of the EU, the autonomous rates of customs duty for some types of petrol products were cut by 20 per cent. In execution of WTO commitments, the conventional customs duty rates are lowered.

In compliance with the EU practice to satisfy specific needs and assist entrepreneurs in a specific area by temporarily reducing or removing the duty rate on the imports of a specific type of products, the government adopted autonomous measures for duty tax suspension for six groups of goods. The goal is to assist end-product manufacturers who depend on imported raw materials and avoid the unnecessary overpricing. Measures are taken as specified in the Ordinance on the introduction and implementation of autonomous measures for tariff suspension adopted at the end of 2003. It foresees for manufacturers themselves (personally or through their branch organizations) to present the Minister of Finance with a justified request for a temporary suspension or reduction of import duty on certain products. The autonomous measures foreseen mostly concern

meat producers to whom a quota of 2000 tons at a reduced duty of EUR 150 per ton was granted for the first three months of 2005. The duty on the import of citrus fruit concentrate was reduced by 50 per cent for the period from 30 January to 30 June 2005 within a quota of 500 tons. Such measures are also open to producers of veterinary-medical drugs, margarine and whiskey.

Since the beginning of 2005, the latest EU agreements concerning trade in agricultural goods have also come into effect. They are oriented to expanding the variety of goods, granted duty-free import, an increase in the zero-duty tariff, the provision of new quotas, the removal of minimum import prices for some types of fruit etc. By tradition, agreed zero-duty or reduced duty quotas for Bulgarian agricultural goods are still largely not implemented due to the non-tariff barriers applied by the EU. These barriers, related to import licensing, quality standards and hygiene requirements, turn out to be hardly surmountable for Bulgarian producers. At the same time, bilateral agreements provide for the reciprocal liberalization of import into Bulgaria of EU agricultural goods that have no direct competition in domestic production.

With a view to ensuring the protection of the EU Member States' market and against low-quality imports of unclear origin, starting from 2005 special laboratories must start testing textile goods imported into Bulgaria; the laboratories will be located at major border crossing checkpoints. They will be in charge of checking the physical characteristics of goods and the composition of fabrics. This will be one of the key measures to cut down on the import of textile goods after the import quotas were removed for goods imported from India, China and Pakistan starting 2005, and thus providing some support to enterprises of the textile industry to tackle the challenges of competition. Taking into account the large share of the export of textile goods in the total exports of the country, together with the general direction of this export type to the EU and the removal of duty tax on the import of textile goods from China into the EU dealing with the competition of Chinese textile will be one of the serious challenges to that industry in the course of the next few years. To be able to successfully sustain the competition, textile enterprises in Bulgaria should benefit from the opportunities provided by the forming of textile clusters in Bulgaria, together with the re-orientation of their strategies towards the joint establishment of own brands and positioning in the higher price segments of the European market with a higher quality of products.

As of 1 November 2004, a free trade agreement came into effect between the Republic of Bulgaria and the Republic of Moldova. With this, customs duty for industrial goods was dropped. Only for some more sensitive goods (for example cosmetics) a phasing-out of duty is planned for the period ending 1 January 2007. As for agricultural goods, lower duty tax was agreed,

<sup>11</sup> [http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2004/com2004\\_0708en01.pdf](http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/com/2004/com2004_0708en01.pdf)

<sup>12</sup> Official Gazette, iss. 104 of 26 November 2004

limited to certain quotas with a tendency to gradually increase their volume.

## *Regulatory regimes*

With the work completed in the summer of 2004, efforts in the area of regulatory reform are continuing. The government started a project aiming to alleviate the 12 regimes businesses find most challenging - these were identified by entrepreneurs in a specially conducted "Vitoshka Research" survey in May 2004.

The successful implementation of the project will enable a considerable improvement of the administrative environment because proposals are expected that would alleviate the regimes affecting the largest group of entrepreneurs, mostly in the area of construction, trade and transport activities.

The goal is to subject to analysis the difficulties created by regimes to seek the point of view of the business community represented by its branch organizations who are well familiar with "problems on the ground" and who, in a number of cases, are able to come up with adequate proposals to solve these problems.

Analysis will also be carried out of the secondary legislation governing these regimes and the conformity of the specialized legislation with the Act on Restriction of Administrative Regulation and Administrative Control on Economic Activity. Specific amendments will be proposed in the texts of specialized legislation that would lead to easing the regimes. Proposals are expected to be forwarded aiming to simplify the way these regimes are administered.

A similar project will also be carried out in the area of regimes administered at municipal level.

The project foresees drafting of guidelines for carrying out preliminary analysis of the impact of potential new regimes and changes to existing ones on the business environment and entrepreneurs' behavior.

The expected effects of the project implementation and the prompt and fast implementation of measures will shorten procedures and result in greater transparency, cut down on corruption opportunities and, in the longer term - the overall improvement of the administrative and legal environment for doing business and expanding the competitive positions of the Bulgarian business.

Special attention should be given to regimes in construction. According to managers who took part in the study, the situation is particularly grave here - two of the most complicated regimes - building permit and permit to use a building, were quoted as the hardest and associated with corruption in the highest degree. In November the Ministry of Regional Development announced

that it was forming a workgroup to draft amendments to TDA. Such changes must result in shortening the pre-construction period and allow more time for the absorption of investment in the construction business. This will allow for a considerable reduction of red tape and corruption sources in construction, which have been thriving over the past years.

The increased activity in construction, the real estate market and the upsurge in the tourist sector can be seen as an indicator of the improving business climate in the country. Further alleviation of the processes in construction will lead to the more successful development of these sectors and of economy as a whole.

## **Public Procurement**

The new Public Procurement Act came into force on 1 October 2004. Its adoption was necessitated by Bulgaria's commitment in the process EU membership negotiations under Chapter One, "Free Movement of Goods". One of the requirements was to establish an individual government body in the field of Public Procurement; that was achieved with the creation of the Public Procurement Agency. The national legislation was thus aligned with the *acquis* in this area. In addition, the law also takes into account some specific conditions when making public calls for works in the country. To summarize, the new aspects introduced with the law are as follows:

- The government policy in the area of Public Procurement will be carried out by the Minister of Economy.
- Two new bodies are established - Public Procurement Agency and Court of Arbitration.
- The law also introduces new, three times higher Public Procurement thresholds.
- The PPA now does not cover public procurement tenders related to defense and national security, as well as arms trade which will be awarded under a special procedure by an international organization.
- The forms for public procurement applications and information on contracts have been prepared.
- The opportunity for two or more contracting institutions to make a decision to pursue a common public procurement procedure is expressly provided for.
- New procedures are also provided for awarding public procurement -negotiated procedure with and without notice; design contest.
- The deadlines for presenting a tender offer are now longer.
- Special rules are now in place for awarding public works contracts through the Commodity Exchange.
- A new Public Procurement Register is also created.
- A Court of Arbitration is also established at the Public Procurement Agency.

- Challenging a decision taken by the contracting authority does not result in the automatic termination of the procedure and does not stand in the way of its execution.

The secondary legislation to the PPA was also promulgated, including an Ordinance on the award of “small” public procurement contracts.

Regardless of the significant alignment of the new Act with the *acquis*, in 2005 it will be amended in its part concerning the rules for participation and the public procurement procedures.

Generally speaking, there are conflicting opinions in the business community regarding the new law. Some doubts have been voiced as to its effectiveness and transparency. The areas of potential disputes and unclear situations are related to the new deadlines for filing offers; problems could also appear in public procurement contracts in the area of computer technology; according to the business community, the monitoring and control on public procurement should be carried out by experts in the respective branch instead of government bodies etc.

According to data from the current temporary public procurement register, for the period 1 October - 31 December 2004 a total of 1018 public procurement notices have been included. Of these, 313 were under PPA, with the remaining 705 - under the Ordinance for public procurement below the threshold. Of note is the fact that 28 per cent of contracting authorities are the municipalities.

Expectations are that in early 2005 the new Public Procurement Register will be already operational. It will be developed by Rila Solutions. The register that was valid pending the coming into force of the new Act, featured a number of deficiencies - it was poorly maintained, containing incomplete or incorrect information regarding procedures and contracts. The new register will be created in compliance with the PPA requirements and European practices in this area.

## Reform of public administration

Improving the business environment is closely related to improving the capacity and the effectiveness of public administration. Efforts in this area are continuing; following the adoption of the Strategy for the Modernization of Public Administration and its pertaining Action Plan, in December CoM drafted a document entitled “A Vision on Public Administration in the year 2007”. It aims to establish the guidelines for the functioning of public administration that would be accepted and supported by all political parties; to determine the areas in which reforms will be carried out, and outline the key measures. In this way a smooth continuity in this area will be achieved; the successful implementation of this vision will allow Bulgarian administration to be prepared for full EU membership.

The vision is based on measures that have already been implemented:

- amendments to the Civil Servant Act aiming to introduce the competitive principle in the recruitment of public administration officers and assessment of the individual performance of civil servants;
- amendments to the Administration Act through which state agencies will be turned into executive agencies; strengthening the role of inspectorates and clarifying the role of political cabinets in the policy making process.

The Vision will allow for the process of reform in public administration to continue based on clearly established principles and priorities. An important aspect after the adoption of this vision by the Government is the discussion of the draft paper with representatives of civil society, the academic community, the business community and municipalities. Such a discussion was held in December, thus establishing a good practice in this respect.

There are several key areas in which reform will continue - improving administrative services; improving the policy-making process; more rational spending of budget funds; improving the effectiveness and capacity of public service. Specific measures were outlined for each of these areas.

Another important document whose draft is already in place is the new Administrative Procedure Code (APC) whose aim is to regulate the interaction between citizens and the administration. It is the third document from the entire “package” expected to “discipline” the administration. The other two are the Act on Restriction of Administrative Regulation and Administrative Control on Economic Activity and the draft State Administration Act.

The code was drafted by the best experts and judges in administrative law in Bulgaria. It foresees setting deadlines for public administration officials and sanctions if these are not adhered to, and provides additional options for appealing officials’ actions before a special commission before going to court; options for out-of-court settlements with public administration and municipal offices. The establishment of regional administrative courts is also proposed; these would serve as “court of first instance” taking over all law suits filed against the local government and some decisions of the central administration.

The expected effects of the adoption and implementation of this Code are the improved quality in the work of the administration, improved access of citizens to justice and better control on bureaucrats. This will result in simplified, accessible and easy-to-understand administrative procedures. The document was published in the website of the Supreme Administrative Court<sup>13</sup>.

<sup>13</sup> Source: [www.sac.governmentnet.bg](http://www.sac.governmentnet.bg)

Another important aspect to optimize services is to privatize some of them. This solution was discussed by the Council on Modernization of the State Administration; the proposal was for part of the services to be outsourced. This will result in the alleviation, above all, of the regulatory regimes. It is still to be established which services will be privatized. In addition, there was a proposal for seven government structures to be closed down or transformed into commercial companies. The intention is to establish a competitive environment as regards the prices and quality of services provided by these structures to citizens and business.

Good practices in the area of administrative servicing are also continuing. In October 2004 the e-portal for administrative services in Stara Zagora was formally launched. This is a pilot project to introduce basic electronic services; it was developed by the regional and municipal administration and the Regional Directorate of the Ministry of Interior. The Internet portal will provide the service "issuing of a certified copy of a state property act", by the regional administration.

### Fight against corruption

Corruption-related issues persist: they are high on the public agenda, continue to be the subject of discussion at various forums, proposals to reduce corruption practices are continuously being filed.

The European Commission's Regular Report on Bulgaria's progress towards EU accession lists corruption as still being a serious problem, regardless of the fact that there is no evidence to claim worsening in the situation. A slight decline is registered in the so-called "small-time" corruption for customs authorities, the police and the judiciary. According to the report, education and healthcare are among the most corrupt sectors of the administration. It is emphasized that the corruption pressure is of crucial significance for the business sectors, and examples are quoted for corruption practices related to the issuing of authorizations, granting of loans, tax evasion and public procurement procedures. It is also pointed out in the report that there are no serious studies available on the spread of corruption at municipal level. Transparency as regards the personal interests of people in elected offices is inadequate; also lacking in transparency is the way political parties and election campaigns are financed.

According to the report, as a whole the Bulgarian government's approach to the fight against corruption overlooks the need to take specific measures to fight corruption in the top echelons of power, in the political circles, the local government and the business sector.

Some insight into how the corruption situation is changing is available in studies carried out by "Coalition 2000" and the "Vitoshka Research" public polls agency. In December, they presented the results of a new study<sup>14</sup> into the level of corruption in Bulgaria, carried out in November. Following a significant drop in corruption practices registered in March 2004, the latest study again registers a return to higher values measured in 2003. The number of corruption-tainted deals is growing - on average monthly basis it exceeds 103 thousand against 80 thousand in the previous study of March 2004. The value of corruption deals is also going up - according to the study, we are witnessing a shift to bigger bribes. About 1/3 of bribes given in different forms are worth between BGN 100 and 500 with their share growing from 15 on 30 per cent for a period of one year. The study also registers a change in the structure of priority issues as seen by public opinion - the importance of unemployment and poverty is going down; issues related to low income levels and crime remain the same while corruption is now ranked third by significance according to respondents. Corruption continues to be most widely spread among customs officers, doctors, police officers, prosecutors, investigators, public administration officials.

Of note is the fact that corruption pressure at the local level is increasing - among municipal officials, councilors and mayors, which, according to the authors of the study, is possibly related to the process of decentralization and re-channeling of bigger financial resources to local authorities.

The government continues to take measures in the fight against corruption. At the end of the year the government Commission on fight against corruption reported what was achieved in 2004. Warnings for corruption practices placed with the commission had increased - for 2004 they were 104 more as compared to the preceding year; 92 officials were discharged because of graft. According to the available information a positive change was seen in MoI, the customs and tax administration. The corruption level remains high in areas such as award and execution of public procurement contracts, licensing and authorization regimes, privatization, investigation and court proceedings, healthcare.

The Chief Prosecutor's Office also summarized the results of the fight against corruption, revealing these figures: in 2004, 5 thousand corruption cases were filed with the prosecutor's office. Of these 5000 cases, 1300 were closed and 130 persons were sentenced for corruption, their sentences effective. In the opinion of prosecutors, the major barrier hindering the effective fight against corruption, is the inadequate legislative framework - this is quoted as being the key problem when working on corruption cases. The most frequently encountered barrier is whether the evidence collected is admissible in court. The creation of specialized departments is recommended for a more successful fight against corruption.

<sup>14</sup> Source: [www.anticorruption.bg](http://www.anticorruption.bg)

The actions planned by the government include prevention, public transparency of actions taken, and providing training to senior government officials. It must be noted, however, that measures to counter corruption are not very widely known to the business community and society as a whole. There is no knowledge of the adopted Program for Fight Against Corruption 2003-2005 and of what its achievements are. A considerable portion of businessmen and citizens are not even aware of the existence of that program, they are not familiar with its mechanisms developed for achieving actual results.

In December, on the occasion of the first anniversary of Bulgaria's joining the UN Convention against Corruption (Bulgaria signed the Convention in December 2003 but has not ratified it to the present) a forum was held to discuss the negative impact of that phenomenon and opportunities to deal with it. Corruption is a serious problem worldwide - according to World Bank figures, each year bribes worth USD 1 trillion change hands in developed and developing countries. It was noted that if investors decide to put their money in a country with high corruption levels, their projects would become by about 20 per cent more expensive.

At the forum, business community representatives put forth proposals for a successful fight against corruption. These include the accelerated introduction of e-government, greater transparency in tender procedures under the Public Procurement Act, the adoption of a Lobbyism Act, the introduction of higher criteria when appointing civil servants.

The impact of results in the fight against corruption in international specialized studies shows an - although slow - improvement of Bulgaria's position.

The annual Transparency International report on corruption was published in October. It was noted that irrespective of the fact that corruption level in Bulgaria went down over the past 7 years, it still presents a problem for the country. Bulgaria was ranked 54th among 146 studied countries. Bulgaria's corruption index is 4.1. The scale goes from 0 to 10, with 0 being the most unfavorable rating and 10 being the best rating.

As compared to last year, Bulgaria improved its rating by 0.2, which, according to the team, means there is moderate corruption pressure in the country. Corruption levels are lowest in Finland, and highest in Haiti. We should point out that Bulgaria is in better positions as compared to some countries of Central and Eastern Europe - these are: Latvia, Slovakia, Poland, Romania. Among SE countries, corruption is lowest in Estonia, followed by Slovenia and Hungary.

Also in October, the World Economic Forum published its Global Competitiveness Report. According to this paper, over the past three years Bulgaria keeps the best positions with respect to public institutions and particularly as regards corruption levels. The corruption level is an important indicator on how the country succeeds in providing efficient, transparent and clear rules and framework for business development as well as efficient and

unbiased mechanisms to provide services to citizens. In terms of this index, Bulgaria has moved from 35th position last year to 30th position according to the latest study, i.e. it is now within the first half of countries with lower corruption levels. According to the "Corruption subindex" indicator, Bulgaria is in a better position as compared to the majority of countries of Central and Eastern Europe - only Estonia is ahead of us, occupying 29th place, while other countries: the Czech Republic, Hungary, Lithuania, Latvia, Poland, are behind Bulgaria.

Such figures are not enough to put us at rest but they do confirm the fact that corruption is a global problem and it is a complex phenomenon which is hard to quantify and measure precisely. Unfortunately, corruption is not the "trademark" of poor countries; it exists and causes difficulties for all countries, including rich ones.

### *Economic freedom rating*

An important indicator for the state of the business environment could be the evaluation of the Heritage Endowment which in early January 2005 published its new Index of Economic Freedom in 161 countries. According to this index, Bulgaria occupies the 52th position and is in the group of countries "Mostly Free" economy. Last year the country occupied the 78th position, i.e. among countries with "Mostly Unfree" economies.

For Bulgaria this positive change is extremely important - moving up 26 positions indicates that serious changes have been made in the country towards strengthening market economy institutions and liberalizing the economy. A significant improvement was registered with respect to trade and monetary policy. Problems in the area of fiscal policy were reported. Taken as a whole, however, Bulgaria's rating on which the index is based, was increased by 0.24 points to 2.74 points.

## Budget Execution

*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, 2004 witnessed a good rate of implementation of the consolidated fiscal program, with some budget items not only registering improved performance as compared to 2003, but also impressively outstripping the Budget 2004 estimates. According to figures supplied by the Ministry of Finance, as of 31 December 2004 the surplus under the consolidated fiscal program increased considerably as compared to the corresponding period of 2003 (BGN 0.94 m) and reached the record-breaking (considering the current economic condition) amount of BGN 659.7 m .

Table 4. Budget surplus/deficit for the respective year (in BGN million)

	Date		
	31 October 2002	31 October 2003	31 October 2004
Amount	- 257.3	0.94	659.7

Source: Ministry of Finance, Budget bulletin.

Comparing the figures for the past three successive years, we must note an increase in the surplus under the consolidated fiscal program by more than four times (values as at 31 December 2004 as compared to values as at 31 December 2002). This fact reconfirms the supposition that the budget is still formed in a way which is much too conservative, there is no willingness for change and desire to “break the mould”.

Revenues and aid at the end of December, 2004 reached BGN 15 858.6 m, or 110.4 per cent of state budget estimates for the year 2004. By comparison, BGN 14 072.0 m were collected during the entire 2003, or 105.22 per cent of the annual estimate. The major reason behind the good execution of the revenue side are tax revenues, and in particular revenues from indirect taxes, while non-tax revenues also registered an increase.

Expenditures for the period amount to a total of BGN 15198.8 m., or 103.78 per cent of the annual amount on expenditures under Budget 2004. By comparison, during the same period of 2003, expenditures were in the amount of BGN 14 071.1 m, or 103.19 per cent of the annual estimates.

With regard to composite budgets, the largest relative share of expenditures is seen in the national budget (mostly in its

part concerning ministries and other agencies), and also the budgets of social insurance funds and municipalities.

Taken together, these three budgets account for 90.9 per cent of all expenditures made as at 31 October 2004.

The enormous surplus results in non-performance of one of the budget's key objectives - to establish clear and precise planning of the revenue and expenditure sides, and comes as another proof of the conservative approach to drafting the budget. In addition, a number of contingency expenditures were made at the year's end, thus increasing the share in GDP of funds re-allocated beyond the levels stipulated in the State Budget Act. This brought about two major consequences: firstly, an increase in the absolute value of the revenue (respectively expenditure) side of budget, i.e. a greater degree of state intervention in economy, and, secondly, the Finance Ministry's desire to participate actively in the process of re-allocation of the budget surplus - a draft law on amendments to the State Budget Act was submitted to the Parliament, granting the executive branch the right to dispose of any surplus in the amount of 1 per cent of GDP. Provided that in 2005 GDP is expected to reach BGN 41 342 m, the executive branch would be granted the privilege to spend over BGN 400 m.

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

There is a surplus of BGN 429.7 m in the national budget for this period (about 65.13 per cent of the surplus under the consolidated fiscal program). Revenues and aids account for BGN 10186.8 m. (112.5 per cent of all revenues planned for the year) while expenses and transfers amount to BGN 9 757.0 m. (105.0 per cent of annual estimates). By comparison, in 2003 these figures read respectively BGN 8 441.6 m in revenues and aid (110.2 per cent of the planned annual amount) and BGN 8 552.2 m in expenditures and transfers (106.6 per cent of the annual amount).

*Central budget*

The surplus under the central budget is BGN 170.0 m with revenues amounting to BGN 8 900.3 m., and expenses and transfers - BGN 1 022.8 m and BGN 7 707.4 m, respectively.

*Fiscal reserve (covers cash in BGN and foreign currency on all current and term deposits with the BNB and commercial banks of the central budget, the budget funds of ministries and agencies, the National Social Security Institute, the National Health Insurance Fund and their extra-budgetary accounts and funds, as well as other high- liquid low-risk financial assets in foreign currency of the government)*

The fiscal reserve continues its non-stop upward trend reaching BGN 4 810.6 m as at 31 December 2004.

Table 5. Indicators of the fiscal reserve (FR) according to the Agreement with IMF

	As at 30 June 2004	As at 31 July 2004	As at 31 August 2004	As at 30 September 2004	As at 31 December 2004
Total amount of FR	5158.5	4096.5	4801.9	5577.4	4810.6
FR funds in BNB deposits	4802.9	3663.0	4346.8	4642.2	4346.0
FR funds in foreign currency deposits	2199.4	2092.0	2544.9	2776.4	3720.2
High-liquidity financial assets	-	-	-	418.3	-

Source: MoF data

The following could be cited as the main reasons behind the fiscal reserve increase:

- the Central Bank's participation in the inter-bank market in fulfillment of its obligation to buy and sell without limitation foreign currency against Bulgarian Leva;
- the regulation of the minimum reserve requirements to increase the foreign currency volume;
- the over-execution of the fiscal program in its part concerning tax and non-tax revenues and aids.

The enormous amount amassed in the fiscal reserve makes it a matter of some urgency to develop a strategy for its active management that would clearly and precisely regulate (including in legislative terms) the fiscal reserve management. The government drafted such a strategy on debt management.

The discussion brought ideas such as to transfer funds from the fiscal reserve to NSSI or to repay part of the foreign debt.

### Municipal finance

As at 31 December 2004 municipal budgets register a surplus in the amount of BGN 75.5 m, calculated from the difference between revenues and aid (BGN 824.1 m) and net transfers (BGN 1 587.7 m) and expenditures (BGN 2 336.2 m).

### Revenue side of the national budget

#### Tax revenues

Tax revenues to the national budget as at 31 December 2004 were in the amount of BGN 8 469.7 m as compared to 6 571.3 m on the same date of last year. Execution at the year's end was 113.1 per cent as compared to the estimates specified in the State Budget Act. These form 83.14 per cent of all revenues as compared to 77.79 per cent for 2003.

In essence, we are witnessing some serious growth not only in absolute but also in percentage terms as compared to the budget estimates for the annual amount of tax revenues.

The largest relative share is that of VAT - 38.2 per cent of total revenues or 45.94 per cent of tax revenues. As at 31 December 2004, a 116.6 per cent execution of this type of tax is reported as compared to the amount projected in Budget 2004. The collection rate of this type of tax marks an increase also in percentage terms as execution for the same period of 2003 was 105.4 per cent.

The key reasons behind this increased VAT collection rate (regardless of the number of unresolved issues with the so-called VAT-chains and ghost companies) are:

- the structure of VAT revenues, where a trend of increased import of goods into the country is being observed;
- the improved competence of the tax administration and the preventive measures against tax fraud, including the criminal prosecution of such acts.

The excise duty and charges on liquid fuels also feature a high relative share, in the amount of BGN 1 881.0 m, which accounts for 18.47 per cent of the total national budget revenues and 22.21 per cent of the amount of tax revenues as at 31 December 2004.

Regardless of the fact that the latter registered an increase both in absolute and percentage terms (107.7 per cent as compared to 102.8 per cent for the same period of last year), we also witnessed their decreasing trend, in percentage terms, in the total amount of tax revenues.

The increase in the nominal amount is mostly due to the higher prices of tobacco products and fuels (fuels, in particular, registered a record-high price increase), while at the same time there have been cuts or even the elimination of excise duty on a number of goods imported in Bulgaria from European Union Member States.

The personal income tax (PIT) as at 31 December 2004 has a relative share of 12.25 per cent as compared to the total revenues and 14.73 per cent of tax revenues. There has been an enormous increase in the nominal value of the amounts collected, with the latter running in the amount of BGN 1 247.5 m at BGN 445.6 m for the same period of 2003. The execution is 112.5 per cent as compared to Budget 2004 estimates.

One of the major reasons behind such tremendous difference appears to be the structural change under the State Budget Act for 2003, through which funds from income tax collected under the Personal Income Tax Act for the same year in the amount of BGN 200 m were ceded to municipalities to fund their activities which are government responsibility, and this amount was not included in the revenue and expenditure side of the state budget.



The share of revenues from corporate tax as at end-2004 was 8.42 per cent of the total revenues and 10.13 per cent of tax revenues, amounting to BGN 857.8 m, or a 100.9 per cent execution of estimates recorded in the State Budget Act for 2004.

The good rate of execution is entirely due to the higher revenues from non-financial enterprises, with the latter reporting higher taxable profit. At the same time we witnessed a lower percentage of execution as compared to figures for the same period of 2003 (113.7 per cent). This is due to the fact that some enterprises (mostly banks) took advantage of their right to file declarations to have their advance installment lowered or deduct overpaid tax from previous years from their current advance installments.

Revenues from duty and customs fees were in the amount of BGN 292.5m, which is an execution of 143.2 per cent as at 31 December 2004. These revenues have a relative share of 2.87 per cent of the total revenues and 3.45 per cent of tax revenues.

Such results are mostly accounted for by the increased rate of import into the country, as well as the improved performance of the administration.

Revenues from dividend and income tax is in the amount of BGN 80.5 m and the tax on the insurance and re-insurance premiums in the amount of BGN 34.3 m are an execution of 132.0 per cent and 137.0 per cent, respectively, as at 31 December 2004. These results, as well as the fact that these revenues account for less than 1 per cent of the amount of tax revenues, come as proof that the time is now ripe to cut tax rates related to these types of income.

### *Non-tax revenues and aid*

Non-tax revenues to the national budget reached the amount of BGN 1 696.8 m as at 31 December 2004, which is 108.4 per cent as compared to Budget 2004 estimates. They account for a relative share of 16.66 per cent of the total amount of revenues and aid.

As compared to the same period of 2003, a decrease of BGN 139.2 m is witnessed, which is due to the lower execution, in percentage terms, as compared to last year for revenues and incomes from property and fines, sanctions and penal interest.

The analysis of revenues and aids in the national budget as at 31 December 2004 clearly shows the conservative attitude applied when drafting the state budget. In spite of the tax relief schemes, tax revenues for 2004 register a growth both in absolute and percentage terms. Therefore the enormous budget surplus at the end of the year was used to pay wages and pensions, as well as other expenses the effect of which had not been calculated in advance.

Thus the government's wish to introduce the so called program-based budgeting continues to be just a fine idea.

### **Expenditure side of the national budget**

#### *Expenditures*

The expenditures made by 31 December 2004 somewhat exceed the Budget 2004 estimates. The total amount runs to BGN 6404.5 m, which is an execution of 101.3 per cent as compared to the execution of 102.6 per cent for the same period of 2003.

The largest relative share of 41.71 per cent of the total expenditures are the running costs in the amount of BGN 2 671.6 m, these incorporating expenditures for medications, fuel, energy, hired services, current repair, and also defense and security expenditures.

Due interest on foreign and domestic loans, which are in the amount of BGN 692.5 m are also a point of focus (BGN 514.7 m on foreign and BGN 177.8 m on domestic loans). The downward trend for their relative share in the structure of expenditures still persists; as at 31 December 2004, these account for 10.81 with per cent 11.85 per cent for the same period of 2003.

With regard to **subsidies** an execution of 136.0 per cent is reported as at 31 December, 2004, the latter being in the amount of BGN 689.1 m. It is rather characteristic of them that they also continue the trend of exceeding the amounts stipulated in the State Budget Act.

Quite on the opposite end of the scale are social expenditures and scholarships, in the amount of BGN 578.9 m, or an execution of 72.6 per cent as compared to estimates. Thus, it is necessary to pay particular attention to keeping the government's commitments in this field, even more so because during the same period of 2003 the execution reached almost the same level - 72.7 per cent.

#### *Transfers*

Net transfers - the difference between transfers made and received from the national budget are in the amount of BGN 3 352.5 m and with an execution of 113.0 per cent (as compared to 117.8 per cent for 2003 these exceed the estimates).

The transfers to social insurance funds could be quoted as an exception. These are in the amount of BGN 921.9 m., with execution running at 93.7 per cent of the estimates in Budget 2004.

### **Future directions of fiscal policy**

Although the fundamental aspects of fiscal policy in the short-term perspective (by end 2004) are set out in the Memorandum

on Economic and Financial Policy of 6 August 2004 between the Government of the Republic of Bulgaria and the International Monetary Fund, we have witnessed some deviations in fiscal policy which do not correspond to preliminary estimates.

This applies, in the highest degree, to the enormous budget surplus achieved. The State Budget Act for 2004 projected a deficit of 0.7 per cent for the year, with the government later claiming that its goal had been to achieve a balanced consolidated budget in 2004. Moreover, as at 31 October 2004, a surplus under the consolidated fiscal program of BGN 1 475.3 m was reported.

This led to the need for a special report to be prepared explaining the reasons for the budget surplus under the State Budget Act of the Republic of Bulgaria for 2004, in which the following were quoted as being the major factors for such a surplus:

- the improved overall economic activity, the rise of fuel prices on the international market, the greater-than-expected growth in the number of employed and tax paying citizens;
- the increased collection rate for revenues;
- the improved fiscal discipline and control on spending by budget-financed enterprises.

Regardless of the fact that the Report on the 2005 State Budget contains figures projecting a budget deficit level of 0.5 per cent of GDP (as a result of the necessary changes in fiscal policy, with a view to the processes expected to start with the European Union accession in 2007), while stating the government's desire to dispose of the potential budget surplus in 2005, in an amount of up to 1 per cent of GDP (about BGN 400 m), with steps being taken to make this official by stipulating it in the 2005 State Budget Act.

All signs are in place that in 2005, yet again, no opportunities will be sought to scale down the role of the state in the re-allocation of funds and no new approach will be applied in trying to achieve higher economic growth.

Because of a conflict of opinion between the government and the IMF, in late 2004 no agreement was reached on the future aspects of fiscal policy. The points of disagreement are the increase of the minimum wage from BGN 120 to 150 as of 1 January 2005, the spending policy for 2005 and the way of spending the additional surplus for this year. At the end of 2004, by Council of Ministers's degree, a single-person joint-stock company with state interest was formed, bearing the name Public Investment Projects EAD, by proposal of the Minister of Finance. The capital of the company is in the amount of BGN 260 m taken from the budget surplus.

In essence, the establishment of such a company contradicts the parameters agreed with the IMF (not to spend a budget

surplus representing more than 1 per cent of GDP), while at the same time the new company duplicates the activities of other government institutions, i.e. yet again we are witnessing the lack of a clear and accurate strategy to manage the budget surplus.

### Foreign and domestic debt

At the end of October the total amount of government and government-guaranteed debt was EUR 8143.6 m, which, when recalculated using the BNB exchange rate of 31 October 2004, runs at BGN 15 909.9 m.

In the structure of debt, domestic debt is in the amount of EUR 1 328.2 m (BGN 2 597.7 m) and foreign debt is EUR 6815.4 m (BGN 13 329.8 m). As a whole, debt is down by EUR 64.9 m (BGN 126.9 m) as compared to its size at the end of the previous month. The major reason behind this is the exchange rate fluctuation.

At the same time, the debt/GDP ratio is 41.9 per cent, registering a decrease of 0.3 percentage points as compared to end of September 2004 and a decrease of 6.3 percentage points as compared to the end of 2003. The domestic debt/GDP ratio is 6.8 per cent, and the foreign debt/GDP ratio is 35.1 as at 31 October 2004.

The downward trend for the relative share of foreign debt in the total debt amount continues, while domestic debt in absolute terms registered a slight increase.

Table 6. Amount of government and government-guaranteed debt (BGN million)

Structure	As at 31 December 2003	2004			
		31.03.	30.06.	30.09.	31.10.
Domestic debt	1 153.8	1 248.7	1 275.4	1 313.4	1 328.2
Foreign debt	7 356.0	7 531.0	7 518.0	6 895.1	6 115.4
Total debt	8 509.8	8 779.7	8 793.6	8 208.5	8 143.6
Total debt (GDP%)	48.2	45.2	45.3	42.3	41.9
Domestic debt (GDP%)	6.5	6.4	6.6	6.8	6.8
Foreign debt (GDP%)	41.7	38.8	38.7	35.5	35.1

Source: MoF data, Government Debt monthly bulletins

The currency structure of debt (as at end of October 2003) is as follows: debt in EUR - 39.76 per cent, debt in US dollars - 35.54 per cent, debt in other currencies - 13.72 per cent, debt in BGN - 11.82 per cent. If we were to compare these figures with those for the currency structure of debt as at 31 October 2003 (debt in USD - 45.17 per cent, debt in EUR - 32.38 per cent, debt in BGN - 8.44 per cent, debt in other currencies - 14.00) we shall

notice that the debt structure is changed entirely in favor of the euro and leva, at the expense of US dollars.

In the structure of debt by types of creditors, the largest relative share is occupied by global and euro bonds - 25.6 per cent, Brady bonds - 15.29 per cent, World Bank -11.77 per cent, IMF -11.37 per cent, and domestic debt (GS) -16.31 per cent.

By comparison, the largest relative share for the same period of 2003 belonged to global and euro bonds - 24.19 per cent, Brady bonds - 23.44 per cent, and domestic debt (GS)-12,80 per cent.

As to the debt structure by interest as at 31 October 2004, the relative share of fixed interest rate debt continues to grow - 46.75 per cent, with floating interest rate debt running at 53.25 per cent.

Payments made for the first ten months of 2004 year were in the amount of BGN 2 703.0 m of which servicing the domestic debt (principal, used to repay government securities, issued to fund the government deficit) - BGN 388.8 m and foreign - 2 364.2 m. BGN. For the same period payments in USD take the upper hand - BGN 1620.9 m (after adjustments), followed by these in EUR - BGN 489.8 m and in BGN - BGN 338.8 m.

Decreasing the foreign debt/GDP ratio is one of the government's major goals, with the trend continuing this year, too. This is further influenced by the downward USD / BGN rate.

The enormous budget surplus achieved in 2004 brought the debate on early repayment of part of the foreign debt to the forefront.

A decision in this respect was made during the last months of 2004 when the government decided to buy back on 28 January 2005 foreign debt in the amount of 937.5 million US dollars. The buy-back will be achieved with USD 250 m, kept off-balance in BNB accounts (freed with the purchase of DISC during the summer) and about USD 690 m of the fiscal reserve.

### *Foreign debt*

As the end of October, foreign debt was in the amount of EUR 6 815.4 m, which means a decrease of EUR 540.6 m as compared to the end of 2003.

Government debt is EUR 6 373.3 m, government-guaranteed debt - EUR 442.0 m.

We have also witness a decrease in government debt (EUR 6 996.1 m as at 31 December 2003), while government-guaranteed debt registers a slight increase (BGN 394,0 m as at 31 December 2003). The currency structure of foreign debt as at 31 October 2004 reveals the following: debt in EUR - (42.75

per cent), debt in US dollars (40.74 per cent), and debt in other currencies (16.51 per cent). The interest structure is changed in favor of fixed interest rate debt, which now reached 40.8 per cent against 59.2 per cent for floating interest rate debt.

Analysis of the residual maturity of foreign debt as at 31 October 2004 shows a prevalence of debt from 5 to 10 years (38.82 per cent) and over 10 years (40.79 per cent), with the weighted average residual maturity of foreign debt being 8 years and 9 months.

### *Domestic debt*

As the end of October 2004 domestic debt amounts to BGN 2 597.8 m as compared to BGN 2193.6 m at the end of October 2003. In the structure of domestic debt as at 31 October 2004 the GS debt for funding the budget deficit was 81.3 per cent (BGN 2 112.2 m) and GS issued to fund the structural reform -18.7 per cent (BGN 485.6 m), while as at 31 October 2003 the figures read 74.5 per cent (BGN 1633.2 m) and 25.5 per cent (BGN 560.4 m), respectively .

Table 7. Total domestic debt structure (%)

Debt structure	As at 31 October 2003	As at 31 October 2004
Debt on government securities issued to finance the deficit	74.5	81.3
Debt on government securities issued for the structural reform	25.5	18.7

Source: MoF data, Government Debt monthly bulletins

The trend towards increase in the share of GS issued in BGN (68.6 per cent of all GS) at the expense of such securities in EUR and USD - 26.6 per cent and 8.8 per cent, respectively, and the increase of medium term GS to 39.4 per cent at the expense of short-term ones - 2.2 per cent and long-term ones, 5.84 per cent.

From the beginning of the year by end October expenditures on the domestic debt (interest paid and discounts) were in the amount of BGN 124.1 m. The largest share is of moneys paid for GS to finance the deficit - BGN 114.6 m (92.4 per cent of the total amount of interest and discounts).

According to MoF figures, in October 2004 GS were issued by BGN 21.9 m more as compared to the same period of 2003. The trend for decreased yield on long-term GS. Three-month treasury bills reached a yield of 2.44 per cent, three-year TB - 3.49 per cent, and ten-year TB - 5.23 per cent. Analysis of the structure of domestic debt shows a permanent increase in percentage terms of the share of GS issued to cover the budget deficit. At the same time, these securities are practically not playing their designated role due to the fact that the budget

deficit in 2003-2004 (and also in the 2005 estimates) was practically non-existent. Therefore, it is necessary to seek alternative approaches to the role and function of GS. A good example could be the issuing of GS to exchange their face value against issued compensatory notes or compensatory bills.

### *New financing*

From the beginning of the year until 31 October 2004, new loans in the amount of BGN 753.3 m were received, against total foreign debt payments of BGN 2 364.2 m. For this period the largest amount is that of World Bank loans - BGN 241.6 m, government-guaranteed loans - BGN 223.9 m, government investment loans - BGN 166.7 m, and the IMF - BGN 121.2 m. Payments for the same period include repayments in the amount of BGN 1 815.5 m and BGN 548.7 m in interest. The largest share falls with principal payments on Brady bonds - BGN 1 286.3 m. Net foreign financing as at 31 October, 2004 is a negative value and amounts to – BGN 1 610.9 m.

### **Development of the legal framework**

In December, 2004, the 2005 State Budget Act was adopted, and also a number of amendments were introduced in substantive and procedural tax legislation - Local Taxes and Charges Act (LTCA), the Personal Income Tax Act (PITA), the Value Added Tax Act (VATA) and the Tax Procedure Code (TPC).

The goal was to introduce clearer rules in the process of fiscal decentralization (LTCA), decrease of key direct taxes and the introduction new tax relief (PITA and CITA) and more fair treatment of taxpayers (VATA).

The fiscal parameters stipulated in the 2005 State Budget Act are fully compliant with the medium-term financial strategy of the government to guarantee the country's fiscal sustainability, i.e. to render the state able to service the debt while adhering to macro-economic stability.

At the same time, the key objectives announced by the Ministry of Finance as 2005 priorities, are to achieve and preserve long-term growth, the efficient absorption of budget expenditures, and putting special emphasis on social policy, healthcare, education and infrastructure development.

A more detailed analysis of these objectives of Budget 2005 parameters would bring to light the following facts:

- the planned real economic growth of 5.0 to 5.6 per cent may not, under any circumstances, be described as "accelerated growth" for the purposes and needs of the country's general economic development;
- regardless of the fact that we have indeed witnessed a decrease in the major types of direct taxes, the tax

revenue estimates for 2005 are rather conservative, which will result in a new budget surplus. Moreover, the total tax/insurance burden will not decrease, as was expected by the business community;

- the efficient absorption of expenditures remains one of the key issues yet to be addressed by the government. The introduction of "program-based budgeting" will continue to be just a piece of wishful thinking. This was proven beyond doubt late in 2004, when, because of the lack of a clear program on the type and size of expenditures needed, the absorption of the budget surplus was done on "piecemeal" bases - the establishment of Public Investment Projects EAD, repayment of foreign debt, Christmas bonuses for government employees and pensioners.

In essence, some of these decisions could have a favorable effect (particularly in the macroeconomic perspective), but making such decisions is far removed from the term of "program-based budgeting";

- the much promoted special emphasis on education, healthcare and infrastructure development is manifested only in increasing the amounts allocated for this purpose, but without actually linking them to performance - improving the qualification of teachers (in education), improving the quality of medical care (in healthcare), clear and precise schedules for spending the amounts earmarked for infrastructure projects (in Public Investment Projects EAD company having a capital of BGN 260 m).

To summarize, the 2005 State Budget Act is in place, it does ensure economic and political stability in 2005, without, however, looking to change the government's medium-term financial strategy, which would reduce the conservatism of Budget 2005 by guaranteeing higher economic growth in the mid-term.

Amendments to the above mentioned tax laws are generally in line with the strategy to cut down on direct taxation, and also in line with the changes related to the practical administration of the same laws.

As to the Local Taxes and Charges Act, changes are mostly related to regulating the process of financial decentralization. Starting in 2006, local taxes and charges will be administered by municipal administrations, this being in fact currently implemented in individual municipalities.

At the same time, the law also regulates in detail the procedure of assigning this activity by the tax administration over to municipal councils, starting in 2005.

The list of real property, exempt from tax this law, is extended; the major reason being that such tax is actually intended for

public and government infrastructure- streets, roads, water basins and others.

The surviving spouse and direct heirs without limitation will be exempt from inheritance tax; also, property acquired between family members and spouses will be relieved from endowment tax.

The major motive behind this tax preferential treatment is the low collection rate for this type of tax and the lack of economic effectiveness in administering it. New motor vehicles will not be levied with tax upon acquisition when imported in the country. The range of persons for whom the grantor /endower is relieved from tax, has been increased.

The road tax was fully eliminated as it was replaced with the vignette charging system. Amendments to the law concerning the charges on household waste are mostly related with the practical administration of these charges by municipalities. Some more noteworthy changes include: the tax administration will collect the household waste charge only in municipalities where it is based on the building's tax evaluation; the budget schedule defining the municipalities' expenditures will be subject to audit by the National Audit Office.

In the Personal Income Tax Act, the range of tax-exempt incomes is increased, with detailed definitions of the various types of the voluntary social security facilities and insurance facilities which are considered social security instruments. An important practical change was introduced in the procedure to reduce the taxable income from employment relationships with the voluntary social security and insurance contributions; in 2005 this deduction can be made also from the annual taxable income. At the same time, deductions from the taxable income of voluntary social security contributions, insurance contributions and donations will be made with the filing of the annual tax return, if not paid by the employer.

The legislator envisaged a decrease by up to 50 per cent of the taxable income by expanding the range of individuals for whom the endower is granted a tax deduction.

Starting from 2005, a relief procedure is in place for individuals who have children, with their tax base reduced by a certain amount according to the number of children.

An important change is related to patent tax; the persons whose turnover in 2005 exceeds BGN 50 000 will follow the general tax procedure while the paid patent tax will be treated as a tax advance as per CITA. Tax returns filing and tax payment will be done using the permanent residential address (individuals and sole proprietors) and tax registration place (legal entities).

The rates for monthly (annual) tax bases and the amount of tax are also changed, with the tax-exempt minimum now being 130

BGN (respectively the annual minimum reaching BGN 1560) with the maximum rate becoming 24 per cent for the excess amount above BGN 600 (respectively the annual amount - over BGN 7200).

Under the Corporate Income Tax Act, there is a change in the taxation of entities engaged in insurance and re-insurance activities; starting from January 1st 2005, they will be taxed under the general procedure. The taxation of telephone or communication service providers will also be under the general procedure, starting from 1 January 2005. The main purpose of these changes is related to finding the fairest method of levying tax on the above mentioned entities because for them the situation was one of levying tax on their turnover rather than the actual financial result.

Under certain conditions, machinery, facilities and equipment may benefit from an accelerated annual depreciation rate. Changes have also been introduced concerning the tax depreciation plan and the accounting depreciation plan, and also new hypotheses on increasing the financial result for tax purposes. Also changed is the procedure and method of regulating thin capitalization.

Dividends and liquidation shares paid to persons who are local for EU countries, will not be tax-levied under certain conditions; also free from tax will be the interest on bonds, accepted for trading on the regulated market of EU countries.

There have been cuts in almost all types of tax: starting 1 January 2005, corporate tax will be 15 per cent, dividends and liquidation shares for local individuals will be levied with a 7 per cent tax, and social and representative costs with 17 per cent.

With the amendments to VATA, in force since 1 January 2005 the transformation of companies, the transfer of enterprises and non-cash contributions will not be treated as a delivery. The calculation of the tax base for lease contracts is also changed. The import of certain goods will be free of VAT.

At the same time, there is an addition to the procedure of deducting tax credit, and in certain cases the term for reimbursement is cut to 30 days. The rights of taxpayers, if their tax credit is not reimbursed within the set deadline, are also expanded; they are now given the opportunity to claim damages before a court of law. A number of changes are also introduced in registration and de-registration proceedings.

Over the period August-December 2004 even more important changes were introduced to the Implementing Regulations on the State Property Act (Official Gazette, issue 80/2004, in force since 14 September 2004). There are insertions in Art. 66a, stipulating that the Regional Governor may sell real property which is private state property, belonging to the state enterprises "Construction and Reconstruction", "Transport Construction

and Reconstruction”, “Communications Construction and Reconstruction”, “Air Traffic Control”, “Prison Facilities Fund” and the “National Company Railway Infrastructure”.

A change is also introduced to Art. 95 of the same Act, stipulating the persons who may construct and sell homes, studios and others immovable property which is private state property.

A number of changes have also been made in the Accountancy Act. The major aspects are the phasing-in of European Union accounting standards, the public sector budgeting, the accountancy framework, the principles and concepts of the Government Finance Statistics Manual issued by the IMF and ISA. The more significant amendments and supplements include:

- the Minister of Finance endorses the accounting standards and chart of accounts while adhering to certain terms;
- the Minister of Finance develops projects in the field of accounting and independent financial audit;
- the requisites of primary accounting records are reduced in number;
- the requirements for presenting the annual financial statements of certain enterprises are changed;
- small and medium-sized enterprises will now prepare and present their annual financial statements on the basis of new National standards for the financial statements for small and medium-sized enterprises;
- the annual financial statements; on enterprises engaged in specialized activities (not-for-profit organizations and enterprises in liquidation) will be defined by the respective accounting standards;
- there is some relief as to requirements to the financial statements of enterprises which are not audited and have a net amount of revenues of less than BGN 100 000;
- the values requiring mandatory audits for enterprises are changed;
- additional requirements are introduced when the annual financial statement is only published in the Internet;
- a legal definition is now given to the term “small and medium-sized enterprises”.

The completion of the draft Tax Procedure Code is of special significance as it grants legitimacy to the National Revenue Agency within the overall process of taxation, identification and collection of mandatory social insurance contributions.

### **Employment and Unemployment. Labor Market Policy**

Developments in 2004 set the grounds for some rather conflicting conclusions as regards the employment and unemployment trends in Bulgaria and the results of the government's active labor market policy and its cost. From the point of view of quantitative indicators, it is obvious that the downward trend in the number of unemployed individuals and their relative share in the economically active population is continuing. The unemployment rate in December 2004 was 12.16 per cent (by comparison, in December 2003 it was 13.52 per cent). The unemployment rate throughout 2004 was 12.67 per cent, and as compared to 2003, it registered a 1.58 point decrease. In certain months this indicator had record-low values for the entire previous five-year period.

At the same time over 300 000 people found employment in the course of the year. In 2004 the private sector reported 45 000 more jobs as compared to last year. The lower unemployment rate was generated both by the greater number of new jobs in the real economy and by efforts to provide employment to a larger number of people from the risk groups on the labor market. The number and relative share of unemployed young people less than 29 years of age are also going down. Also positive are the results from qualification and motivation training courses organized by the Employment Agency.

The MLSP estimates for 2005 show a continuing decrease in unemployment to 12.5 per cent with the intention being to reduce the number of unemployed people by nearly 50 000, or 20 per cent. A similar decrease in relative terms is also expected for unemployed young people.

These positive quantitative changes are the result of the development and implementation of a large number of active labor market measures revealing a definite drive towards a differentiated approach and orienting programs to specific target groups. There is also a considerably improved administrative and institutional capacity for conducting such a policy and a more effective absorption of funds under donor programs as compared to several years earlier. These are also preconditions for a successful government policy in the labor market in the future; a policy that will bring unemployment levels in Bulgaria in line with EU standards and will improve the population's income.

Although short-term positive quantitative results have been achieved, a number of strategic challenges are still to be overcome. These have to do with the duration of subsidized employment programs on such a scale, achieving a balance between such programs and other active employment promotion measures, the cooperation between the Ministry of Labor and Social Policy and other Bulgarian institutions towards finding an integrated solution to labor market issues, above all in terms of education and the qualification requirements to the workforce. An education reform is, beyond any doubt, much needed, as are

efforts to establish more in number, and also more diverse and high-quality opportunities for life-long education. To present, most of these questions have no answers in spite of the drafting and adoption of a number of strategic papers in this area. There are however reasons to expect that in an environment of wide public debate, continuity in the administration, partnership with the business community and local authorities, Bulgaria will achieve good results in its labor market policy over the next several years.

### **Incomes and Standard of Living**

Also conflicting are the opinions on the achievements in this field in the course of 2004. There is evidence of a lower growth in consumption as compared to 2003 as a result of the lower increase of the personal income and labor-related income in particular. During the first two quarters of 2004, the growth in terms of real monthly wages of employed persons as compared to the same period of last year had negative values, and during the third quarter growth was minimal, 0.2 per cent. Increasing the volume of household consumer lending is working in quite the opposite direction.

At the same time, the results of regular consumer surveys carried out by the NSI every three months do not indicate an adequate impact of these adverse trends. Although revealing certain deviations, optimistic statements and positive consumer expectations seems to be prevalent. These findings apply to both the financial situation of households and the overall economic situation in the country, unemployment and consumer price dynamics. The conflicting trends in the area of income and standard of living could be accounted for by the still considerable share of "shadow" economy and incomes generated by it.

Increasing people's incomes and standard of living will continue to be a serious challenge in 2005 in view of the considerable gaps with EU countries and the need for investment in human capital now and in the future. There are grounds to expect an increase in the general income levels in Bulgaria, as we take into account the future rate economic growth and the productivity level. Future economic policy must very responsibly pursue the balance between raising incomes and improving labor productivity. Success in income policy will directly depend on the improved coordination with the labor market policy and programs to overcome poverty and social exclusion.

### **Social partnership and industrial relationships**

With privatization in Bulgaria drawing to its final stage, when some of the most difficult and lengthy privatization procedures are being finalized, industrial relationships are also evolving in the direction of more responsibility and constructivism by all actors. This however does not mean that the processes of negotiating and regulating the relationship between hired

labor and business owners are going smoothly and effortlessly. The past 2004 abounded in such examples, where even after mutually acceptable agreements had been reached, their practical implementation was obstructed, boycotted and put at the service of certain political interests (BTC, "Bulgartabac Holding"). The responsibility for all this is borne by the leadership of the nationally represented trade unions, which sometimes under the pretense of protecting its members' interest, require of their representatives at the branch level or enterprise level such actions and behavior as are not in favor of their regular members. It is time for all participants in the system of industrial relations to recognize their place and role in the mechanisms of social partnership and social dialogue and to correctly abide by their commitments.

Implementing these mechanisms in Bulgaria has its history, achievements and future perspectives. The National Council for Tripartite Cooperation has a sufficiently representative membership both on the part of employers and of trade unions now after their internal census and the inclusion of new members. Its membership and obligations to participate in consultations with the government on key labor social insurance issues, incomes and the standard of living, healthcare and education are a necessary precondition to establishing a dialogue between interested parties and a guarantee for the adoption of reasonable and balanced decisions.

### Social security

*Current and pending legislative changes and initiatives in the area of social security, workplace health and safety and labor law*

The Bulgarian Labor Code does not adequately correspond to the challenges of the country's present-day economic and social development. This is a view shared by a number of Bulgarian and foreign analysts. This is one of the reasons for social partners to draft proposals for changes to Labor Code and ordinances concerning wage bonuses, working time and leave which are expected to be coordinated by the middle of 2005. The current European social model requires that businesses actively participate in ensuring workplace health and safety which is for the time being not the case in Bulgaria and therefore requires some attention on the part of the government.

Adhering to European Union requirements in terms of workplace conditions is a significant challenge to businesses in the process of Bulgaria's EU accession. What Bulgaria has to do in the course of 2005 in the field of workplace health and safety is clearly defined in certain in the European Commission recommendations set out in the Regular Report of October 2004<sup>15</sup>. These are related to:

- introducing the requirements to directives in the field of workplace health and safety in national legislation;
- transforming the compensation system for poor working conditions into a new system of forms to encourage health and safety at work, and also developing criteria to implement the new system (there are plans to analyze and revise implementing legislation that introduces shorter working time, additional annual paid leave, free protective food and additional bonuses for poor working conditions);
- conducting an extensive awareness-raising campaign on the pending legislative changes in the analyzed area and providing support to employers' organizations to develop guidelines and good practices in implementing the legislation;
- changes in the occupational safety guidelines that must be aligned with the *acquis*;
- control and monitoring on legislation in the area of health and safety at work and enforcing the legislation to protect workers in noise-polluted environments.

The main problem for manufacturing enterprises, which seem to be at a bigger risk of occupational accidents, is related to the need for serious investments in modernizing the technical and technological equipment, so that it would comply with EU health and safety standards. According to expert estimates presented by the Bulgarian Industrial Association, businesses will need over EUR 10 b to achieve compliance with EU requirements to working conditions. BIA is predicting that micro- and small enterprises will face the gravest problems, as they have neither experience in this field nor specially qualified staff and knowledge in the field of the legislation governing health and safety at work. According to estimates, enterprises will have to make approximately the same amount of mandatory investment to ensure compliance with the environmental *acquis*. A large portion of the necessary investments of businesses in the two areas is actually overlapping.

There is a considerable financial burden for businesses trying to achieve compliance with the EU standards on health and safety at work, but the truth is that enterprises were given a 6-year transitional period to meet their commitments in this area which they did not use adequately. According to BIA figures, as few as 15 per cent of Bulgarian enterprises have started improving working conditions.

The principal sources of financing for businesses needed to introduce EU standards and requirements is the "Working Conditions" fund, the reinvigorated bank lending, the additional amount of about BGN 200 m expected to remain with businesses as a result of the profit tax cuts to 15 per cent starting 2005, pre-accession funds, and also outside financial sources and also outside financial sources providing longer term financing at more favorable terms. The Bulgarian business should actively use any potential financial opportunities to introduce EU standards and requirements in the area of health and safety

<sup>15</sup> BIA (2004), Bulgaria's EU Membership – Health and Safety at Work. Requirements and standards; Sofia, December 2004, <http://b2b.bia-bg.com/index.asp?i=t2170&l=1>



at work so that it is in a position to improve its competitiveness and be successfully integrated into the Single Market.

The discussion of whether “poor working condition compensations” or “time in service” benefits should be preserved or not was particularly heated during the last months of 2004 because of the IMF mission to Bulgaria. The “social partners” in the country formed a workgroup which is expected by March 2005 to be ready with proposals for amendments to the Labor Code and the regulations governing bonuses, working time and leaves. The workgroup for amendments to the Labor Code and creating a more flexible labor market will also include experts from the European Commission and the International Labor Organization, with the agreed changes to the Labor Code expected to come into force in 2006.

In mid-December the trade unions declared they were ready to negotiate a new hourly wage rate, something the business community has been insisting on for a very long time. If the hourly wage rate were introduced in Bulgaria, then it will become the base to calculate both “time in service” and social security contributions which would be one step forward in the liberalization of the labor market in the country and increasing its flexibility and effectiveness.

Despite the fact that contributions to the “Occupational Accident and Illness” Fund will lower for companies starting from 2005 and will be differentiated depending on the industry of the enterprise, employers still insist on greater objectivity and more detailed rules. They propose that the contribution should be set depending on the working conditions at the companies and that its size should be determined depending on the investment the specific company made towards improving the working conditions. If employers’ proposals are accepted, the more objective calculation of the occupational accident and occupational illness insurance contributions will be an incentive for businesses to continue investing in better working conditions.

According to the 2005 State Social Security Insurance Budget adopted by the Parliament on second reading, pensions will be updated each year by decision of the NSSI Supervisory Board, effective from 1 June, by a percentage equal to the sum of 25 per cent of income for social security purposes and 75 per cent of the inflation rate for the preceding year. A novel aspect is that such a ratio of the two indicators has never before been taken into consideration. This amendment makes the updating of pension amounts even more predictable and removes the NSSI Supervisory Board’s powers to establish the ratio of the two indicators according to institution’s own financial situation.

The Parliament also adopted the 2005 budget schedule for the Guaranteed Claims of Workers and Employees Fund with revenues to the Fund a little over BGN 32 m. The maximum size of guaranteed due payments for wages and compensations for

workers and employees of enterprises declared in bankruptcy will be BGN 450. With the accumulation of more money in the fund, expectations are that in the future the ceiling of guaranteed receivables would be increased and thus provide a better safety net for workers and employees.

During the last months of 2004, as part of discussions on the new tax and social security legislation for the next year, a number of ideas were put forward to reduce the social insurance burden both for businesses and for insured individuals, but in the end the proposals were not reflected in the 2005 State Budget adopted on second reading. Possible explanations could include both the lack of political will to considerably reduce the social security burden and the inadequately justified proposals in this area, the unfavorable ratio of insured individuals and pensioners in the country, the presence of a large “shadow” sector in the economy and the lack of public consensus for proactive changes in the pension system. Discussions on a possible future decrease in the social security burden should continue at the expert and political level, because the relatively high social security burden in the country is a major barrier to both the competitiveness of Bulgarian business and the economy as a whole and to improving the citizens’ income levels and the standard of living.

### *Development of Supplementary Pension Insurance*

The trend of sustainable development in supplementary pension insurance continued. As at end-September 2004, the net assets in the three types of pension funds - universal, occupational and voluntary - amounted to BGN 682 m, which means a 34 per cent growth as compared to end-2003. The largest market share belongs to voluntary funds with net pension assets of 43.40 per cent. These are followed by universal pension funds with a relative share of 30.04 per cent, with occupational funds having the smallest relative market share: 26.56 per cent. According to estimates announced by the Pension Insurance Companies’ Association, pension funds assets will reach BGN 1 b at end-2005. This is an enormous financial resource that should be used proactively to improve the competitiveness of Bulgarian economy. The process of liberalizing the investment regime of companies should continue and their investment opportunities should be diversified so that pension assets could be invested at the optimal risk/rate of return ratio of investment instruments and in order to provide higher yields for insured individuals.

Pension insurance companies continue to manage their investment portfolios in a conservative manner. Pension assets are mostly invested in GS, bank deposits, mortgage bonds and securities registered for trading on regulated markets. During the nine months of 2004 not a single fund of the three types of funds invested in foreign securities in spite of the fact that regulation in this area was somewhat eased.

From the beginning of the year until the end of September, a total of 70 242 insured individuals transferred their accounts to supplementary pension insurance funds, the FSC reported. The relative share of individuals who transferred their individual accounts during the review period as compared to the number of individuals insured in universal pension funds is 2.95 per cent, in occupational funds - 6.86 per cent, and in voluntary pension funds - 1.20 per cent. FSC-reported data reveals that insured individuals are not yet very keenly interested in moving to another pension fund. This is possibly so because of the small difference in yields from investing insurance funds by pension insurance companies. With the expected further liberalization of the companies' investment activity, insured individuals are expected to be more active in seeking to move to another pension fund.

In November the upward trend for the value of shares in supplementary pension insurance funds continued. For all funds, the increase in the value of shares for November was considerably higher as compared to the increase in the value of one share registered in October. According to experts, this is mostly because of the price increase for compensatory instruments on the capital market.

Concentration in the insurance market remains high. Three companies: PIC Doverie AD, PIC "Saglasie" AD and PIC Allianz Bulgaria AD - hold over 76 per cent of the market share of individuals insured in supplementary pension insurance funds. The same companies hold about 79 per cent of the pension assets of supplementary pension insurance funds.

Supplementary pension insurance continues to be a profitable business not only for the insured individuals but also for pension insurance companies. According to figures supplied by the "Social Insurance Supervision" Division at FSC, the profit pension companies registered as at the end of September 2004 was BGN 899 000. Positive bottom line results are now reported by four companies - PIC Allianz Bulgaria AD (BGN 1.936 m), PIC Doverie AD (BGN 632 000), PIC "CCB-SILA" (BGN 19 000) and PIC "Saglasie" AD (BGN 9 000).

The trend of upward development in supplementary pension insurance is expected to continue next year. Particularly favorable in this respect are the tax legislation changes expected to come into force in 2005. Tax relief measures are planned for voluntary pension insurance contributions which will be deducted from the tax base, but no more than 10 per cent of taxable income. The tax levied on the withdrawal of funds under individual insurance accounts before maturity will be cut to 16 per cent from the current 20 per cent. The positive developments in supplementary pension insurance in Bulgaria justifies the forecast that pension funds will become, in the medium-term and long term perspective, major institutional investors in the country, to play an important role both for

boosting the business competitiveness and economy as a whole, and for improving the general standard of living.

## Healthcare Reform

### *Problems, challenges and possible solutions to upgrade the healthcare model in Bulgaria*

During the last months of 2004, healthcare problems were the subject of active public discussion at a series of round-table forums organized on this topic. Discussions covered a wide range of issues, including the challenges faced by health reforms in the enlarged Europe, the problems and perspectives of the Bulgarian health-care system, the place and the role of competition in the healthcare process, and the challenges Bulgaria faces in connection with European e-health practices. The active interest demonstrated to healthcare issues is an indicator of the presence of serious discontent with the results of the health reform in Bulgaria and the need for the government to take urgent and adequate measures to improve the efficiency of the health care sector and public confidence in the health care reform.

The discussions held in the last months on 2004 reveal that the outlooks on the development of the Bulgarian healthcare model vary widely. This is a clear signal that no consensus has been achieved between political parties, employers' organizations, trade unions and civil society structures on the key aspects of development of the health reform, the concrete steps, mechanisms and time-frame for their implementation, as well as the distribution of rights and responsibilities of all stakeholders to guarantee the long-term sustainability of the Bulgarian healthcare sector. A clear vision on the development of healthcare at the local, municipal and regional level must be a major component in the development of the Bulgarian healthcare model. Unfortunately this issue has also been strongly underestimated.

According to the Ministry of Health, the key "pillars" of the health care reform started in 1998 must not be abandoned. The only thing that is possible and necessary is to improve the functioning of the healthcare sector in Bulgaria through various mechanisms. The Ministry's officials propose for the mechanisms of accumulating healthcare financial resources to be developed through:

- a technological and organizational upgrade of the system of mandatory health insurance and a gradual increase of the health insurance contributions of citizens (from 6 to 8 per cent in 2006);
- developing mechanisms for shared financial contribution of patients in the preventive care and treatment of their own health (a mechanism of supplementary health care insurance for "luxury" health services and a mechanism

for mandatory additional payment when receiving medical assistance).

- developing budget-based financing as a “cushion” against possible crisis in the system.

Another important step to be taken in the health care sector, according to the MoH, is to develop mechanisms of payment for medical services through:

- establishing new organizational forms of outpatient care and more closely linking general practitioners' remuneration rates to the quality of their work;
- introducing mechanisms to make health care facilities dependent on the quality of medical services and medical appropriateness, on the one hand, and on the available financial resources, on the other hand.

The protection of patient rights is seen by the MoH as the government's highest commitment in the field of health care. The government intervention involves state-financed investments in the training of healthcare providers, measures to upgrade the accreditation process of health care facilities, promoting the participation of patients' organizations in the drafting of NFA, and, more generally, developing structures devoted to patient rights protection.

The President of the Republic of Bulgaria, on the other hand, insists on a radical change in the inefficient principles and mechanisms of healthcare reform. It is his opinion that the concept for free choice of a personal doctor is still only a chimera, the quality of medical services is deteriorating and the condition of hospitals is boosting the black market of medical services.

The directors of the largest national hospitals insist on clarifications in the financing schemes for in-patient health care and a considerable increase in health care resources in the state budget in GDP percentage terms.

Private hospitals on the other hand continue to insist that the NHIF include them in the financing scheme on equal terms with budget-financed health care facilities. The Private Health Facilities' Association once again requested amendments to the Health Insurance Act that would empower citizens to make a free choice where they should pay their health insurance contributions and respectively where they should be provided with health services.

A good alternative to the NHIF are private health insurance funds, which, like voluntary pension funds, could guarantee a relatively good yield on the invested insurance contributions. If the state were to provide bigger tax relief measures to promote health insurance in private funds, this could become a successful step in the development of health-care reform in this country and guarantee its financial sustainability in the long run.

In our expert opinion, the Bulgarian health care model should not be radically changed but should develop towards:

- striking a balance between state-financed and private sector in health care;
- introducing an integrated information system on control and monitoring in the sector;
- promoting the development of voluntary health insurance;
- establishing mechanisms for effective competition in the health sector and efficient protection of patients' rights;
- eliminating the NHIF monopoly;
- continuing the reform in the hospital sector;
- upgrading the mechanism of negotiating the National Framework Agreements and
- establishing adequate administrative capacity in the sector so that it would be able to face challenges expected as a result of the country's EU accession.

### *The 2005 National Framework Agreement*

On 1 October 2004, the negotiations on NFA 2005 were formally opened between the National Health Insurance Fund, the Bulgarian Medical Association and the Bulgarian Dental Association. The three institutions declared their readiness for intensive talks and finalization of negotiations before the end of the year. The chances for this to happen were however rather slim in view of the belated starting date of negotiations as a result of the delay in drafting the necessary normative documents by the Ministry of Health and the presence of a large number of controversial issues to be discussed by the institutions involved in the process. Only the constructive manner in which negotiations between NHIF, BMA and UDB were held ensured the adoption of a better NFA 2005 on time. This agreement is expected to satisfy reasonably well the interests of all stakeholders.

### *Solution to the issue of unpaid health insurance contributions*

According to NSSI figures, over 2 million people have not been paying their health contributions for more than three months in the course of the last five years, with unpaid NHIF contributions running at between BGN 60 and 70 m. Both the unpaid liabilities to the NHIF, and these of self-insured individuals taken as a total do not represent a large financial pool that could significantly impact NHIF's financial situation. This last statement is supported both by the higher collection rate for health contributions achieved over the past years and the presence of a significant NHIF reserve of about BGN 750-800 m kept with BNB and the momentary blocking of the health reform in the country.

The Bulgarian President also took a stand on the issue of health contributions; he blamed the unpleasant situation on the lack of adequate administrative capacity and up-to-date NHIF information resources. The scandal surrounding unpaid health

insurance contributions and the wave of public discontent with the situation forced the government to adopt urgent amendments to Health Insurance Act in order to find a fair way to give everyone access to the health insurance system while adhering to the principle of solidarity.

The amendments adopted by the government regulated more precisely the relationship between the NHIF and the four “problem” groups of the population (Bulgarians abroad, people with low income, people working under labor contracts with employers who did not pay their share of the contributions and people who failed to pay their contributions to the health care system). Some of the more important changes to the Health Insurance Act included introducing a certain period of time as a requirement for being given a “health-insured” status, separating the definitions of “due health insurance payments” and “loss of health insurance rights”, and providing an opportunity for “entry” and “exit” into and from the health insurance system.

The market of voluntary health insurance continues developing but some legal limitations are still in place.

According to figures supplied by the “Insurance Supervision” Division of the Financial Control Commission, the health insurance companies registered proceeds in insurance premiums in the amount of BGN 7.278 m for the nine months of 2004. Growth as compared to the six months of this year is quite considerable - 67.77 per cent; at the end of the first half of the year 2004 the insurance premium revenues of these companies were only BGN 4.338 m. If the growth rate were to continue like this until the year’s end, the premium revenues of private health funds are expected to BGN exceed 10 m. During the nine-month review period only eight of the existing ten health insurance companies were actually operating. HIF “Bulgaria Zdrave” AD and HIF “Planeta” AD have not yet registered any premium revenues.

In October 2004 a new player appeared on the market of voluntary health insurance: HIF “Sveti Nikolay Chudotvoretz”, which shows that interest to this market is growing. The reasons for this are most possibly the growing demand of medical services in private health facilities and the existing development potential of this market in the future if encouragement measures are introduced by the state. The issued license allows the new company to offer on the market of voluntary health insurance three health insurance packages - “Health improvement and disease prevention”, “Outpatient medical care” and “Hospital medical care” These are the health insurance packages attracting the greatest deal of interest by voluntarily insured individuals.

The biggest share in the total premium revenue in the sector belongs to the health insurance package “Hospital medical care” (36.37 per cent). Next in rank are the packages “Outpatient medical care” (22.78 per cent), “Reimbursement of costs” (16.58

per cent) and “Health improvement and disease prevention” (16.06 per cent). A conclusion could be drawn that the demand for health services will increasingly stimulate an adequate supply which is an important factor for the development of the voluntary health insurance market in the country.

In spite of the fact that the biggest share in the premium revenue falls with the “Hospital medical care” package, the claims paid are highest for the “Outpatient medical care” - 35.91 per cent. Next according to the claims paid are the packages “Hospital medical care” (34.00 per cent) and “Reimbursement of costs” (17.43 per cent).

Concentration in the sector of voluntary health insurance is still high. Three health insurance companies (“BHIC Zakrila” AD with 74.09 per cent, “HIF Medico-21” AD with 13.68 per cent and “United health insurance fund “Doverie” AD with 7.97 per cent) hold over 95 per cent of the premium revenue in the sector. In the medium-term and long term perspective, the expansion of the health insurance market and the ensuing increased competition between health insurance companies to attract more insurance-paying individuals will reduce the concentration in the sector.

For the nine months of 2004 the voluntary health insurance sector registered a positive bottom line result in the amount of BGN 143 thousand. Half of the companies are making a profit, the other half are reporting a loss. The highest profit was registered by the United health insurance fund “Doverie”(BGN 200 thousand), and the highest loss “Bulstrad - health insurance” (BGN -97 thousand). The positive development in the voluntary health insurance sector gives us grounds to forecast that health insurance funds, like pension funds, could become, in the long term, important institutional investors in the country and help develop a modern and efficient health care model in Bulgaria.

Expanding the set of instruments required for the environmental policy continued as a major trend in the course of 2004. The past months reconfirmed that such a positive appraisal is well justified.

## Improved regulatory environment

Bulgaria confirmed alignment with the EU environmental regulations adopted prior to 1 October 2004, and agreed transitional periods on two new EU directives under Chapter 22, "Environment". Under Directive 2002/96/EC concerning waste electrical and electronic equipment, the negotiated transitional period will be by end 2008. It applies to the country's commitment regarding the collection of a certain quantity of waste electrical and electronic equipment (4 kg per capita per year). Under Directive 2004/12/EC (the so-called New Packaging Directive) Bulgaria was granted a transitional period by 31 December 2014 to achieve compliance concerning the use and recycling of packaging waste.

The National Action Plan on Climate Change was drafted and publicly announced; it proposes actions, policies and measures planned over a three-year period (2005 to 2008). The document covers four categories of actions applying to main sectors of Bulgarian economy: energy, industry, transport, agriculture and forestry, public utilities and services:

- implementing policies and measures that would lead to reduced greenhouse gas emissions in various sectors of the Bulgarian economy;
- creating favorable settings to introduce emission-reducing measures, including institutional agreements on capacity building and awareness-raising campaigns;
- monitoring and registering of greenhouse emissions and systematic assessment of the trends and estimates, including an assessment of the impact of policies and measures on these trends;
- introducing Joint Implementation projects and the European Emissions Trading Scheme.

The Action Plan on Climate Change foresees for the government to adopt and implement additional financial measures to create incentives for business operators and, more specifically:

- accelerated depreciation of environmental investments as a general tax relief for businesses investing in specific energy-saving measures;
- making financing from "green" funds tax-exempt;
- lowering VAT for the purchase of equipment contributing to greenhouse emission reductions.

Currently none of these measures is being applied in Bulgaria, and these financial instruments are not seen as additional instruments in the policy on climate change. Within the planned period this type of political instruments could be further

developed and put to practice. These instruments could also be installed if a higher-than-expected increase in greenhouse emissions is registered in the country.

Specific actions related to the objectives under the National Action Plan on Climate Change were the subject of discussion at the Round Table held in late 2004 and entitled "Opportunities for Trading in Assigned Amount Units and Establishing a Green Investment Scheme in Bulgaria" which was attended by officials of the Ministry of Environment and Water, the Ministry of Finance and government representatives from potential buyer countries. The successful future implementation of the Plan would help Bulgaria meet its international commitments under the UN Convention on Climate Change and the Kyoto Protocol.

In December 2004, the Council of Ministers approved a draft law on amendments to the Biological Diversity Act. According to the draft, the most important amendments foresee a simplified procedure for declaring sites part of NATURA 2000 (a European environmental network), upgrading the procedure of establishing buffer zones and updating the lists of habitats and species specified in the law. The secondary legislation in the area of bio-diversity will be further developed in two new ordinances: Ordinance on internal trade and marking of animals, including products from species listed in the Appendices of the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES), and Ordinance on the establishment and functions of a National Biodiversity Monitoring System.

Legislative changes in the area of biodiversity protection in Bulgaria cover nine protected areas with management plans approved over the years, eight new sites declared protected areas in 2004 and 13 which are currently undergoing a procedure to be declared protected areas.

## Sectoral policies and measures

In 2004, Bulgaria ceased the production and use of leaded petrol. As a result, lead emissions in the ambient air are expected to be reduced twofold as compared to 2001, or by about 15 tonnes per year.

At the end of 2004, the Ministry of Environment and Water started a procedure on drafting the sectoral "Transport 2007-2013" Operational Programme. In spite of the fact that the paper only deals one individual economic sector, its significance is indicative of the benefits of applying an integrated approach in the development of environmental plans and programs for the various economic activities. By its significance this document governing the implementation of environmental policies in the country, ranks up with some strategic paper drafted in 2004: the National Environmental Strategy 2005-2014, the draft of a National Strategy for Management and Development of the

Water Sector in the Republic of Bulgaria and the Action Plan for Implementation of the Aarhus Convention in Bulgaria.

The implementation of existing programs to eliminate old pollution and integrated pollution prevention and control programs continued throughout 2004. Results in this area included the elimination of over one thousand illegal waste dumps in the country. Important measures have been undertaken to remove past environmental damage at large industrial installations. Three big enterprises are now completing their programs to eliminate past environmental damage.

2004 witnessed the launching of programmes for control on industrial pollution and risk management. Six operators of industrial installations (according to MoEW figures) are currently in the process of drafting safety reports in line with EU requirements on major industrial risk prevention. By 2004, 23 enterprises in various industrial sectors got their IPPC permits: KCM, Plovdiv "Monbat" Montana; "PrometSteel" Burgas; "Trakia Glass", Targovishte; "Lukoil Neftohim", Burgas; "Lakprom" AD, Svetovrachene BKS EOOD, Vratsa (Solid household waste disposal site); "Terem Ivaylo", Veliko Tarnovo; "BalkanPharma", Razgrad; "BalkanPharma", Troyan; "BalkanPharma", Dupnitsa; "Neochim - site A and B", Dimitrovgrad; "Svilozha", Svishtov; "Panchim", Stara Zagora; "Metalni Izdelia", Burgas; "Polihrom POAP", Sofia "Vidima" AD, Sevlievo - Sevlievo site; "Vetbiopharm" AD, Vratsa; "Orgachim" - East and west site", Ruse; "Nova Plama" AD, Pleven; "Agrida" AD, Plovdiv. Other 150 enterprises are undergoing the procedure to have IPPC permits issued. The latter's significance for environmental policy is that they all contain specific conditions and terms for the implementation of environmental projects and achieving compliance with EU standards over the course of the next few years. From the point of view of national-scale management of environmental activities the effect of the applied mechanism is important for establishing clear procedural relationships between the Ministry of Environment and Water as the competent body on environment, and the operators of industrial installations as representatives of the industry.

The Program for Waste Management in Bulgaria has enormous significance for improving the quality of the living environment and living conditions in residential areas. In 2004, an organization was launched to introduce a national system for separate collection and reuse and recycling of packaging waste. In legislative terms this process was regulated by an Ordinance establishing the rights and obligations of the state, municipalities and business. With the issuing of licenses to four organizations specialized in waste use, conditions were set for businesses to achieve the recycling and use of packaging waste targets in compliance with the Waste Management Act. Projects for waste-treatment installations were launched by healthcare facilities located on the territory of the regions of Plovdiv, Pazardzhik, Haskovo, Smolyan and Kardjali; in addition, the state financed projects for municipalities to introduce the

separate collection of packaging waste in Kyustendil, Karlovo, Ruse, Dobrich, Varna and Troyan. The construction of sites and centers for the dismantling of disused motor vehicles also started. The implementation of projects for home composting of biodegradable waste is pending as part of the National Strategy for Biodegradable Waste.

## Investment programs and projects

In 2004, Bulgaria implemented the management and execution of investment projects under European Union programs worth over BGN 650 m in 57 municipalities. 2004 also witnessed the approval by the European Commission of new projects under the ISPA Program - a project for the construction of desulphurising installations at CHPP "Maritsa-Iztok" worth BGN 140 m and a technical assistance project for drafting new investment projects in the field of water facilities for 13 cities and towns, and for waste facilities where 48 municipalities will benefit from funding of approx. BGN 775 m. National financing was granted to projects worth BGN 118 m in 420 towns and villages for activities in the following areas: waste management; water supply, sewerage and water treatment; safe storage of old pesticides; eco-tourism, eco-agriculture, waste treatment, production of eco-briquettes and HPP construction. In December 2004, EMEPA (MoEW) approved 96 projects worth BGN 30 550 451. Out of this amount, BGN 26 990 204 were given out in grants for 76 investment sites (in the area of water and waste management) and BGN 878 270 for 10 non-investment projects of which 4 for pesticides disposal and 5 projects for biodiversity and tourism.

The country's preparation to absorb financing under the Structural and Cohesion Funds for environmental purposes is continuing. The amount of financial resources agreed by the Bulgarian government under EU funds for the 2007-2009 period is EUR 4.245 billion, with the chunk of this amount - EUR 2.3 billion, earmarked for structural policies, incl. environment protection. A special Environment Operational Programme will be drafted in 2005 to ensure the efficient absorption of these funds. The program's goal is to determine the amounts and priorities in financing environmental projects in the course of the year. The MoEW will administer this activity through a new administrative unit: the Cohesion Policy for Environment Directorate under the MoEW, and training experts for the preparation of specific investment projects.

## Sustainable Development

In 2004, promoting the electric power generation from renewable energy sources was declared a priority of the country's energy policy.

At the end of 2004, the Ministry of Energy officially announced its plans to introduce a new financial mechanism on the domestic market - trade in "green" certificates. Green certificates are

documents to be issued to electric power producers generating energy from renewable sources - HPP, wind, solar collectors and biomass. In order to enable "green energy" producers to cover their costs for each MWatt of electric energy generated under this method, they will be given a green certificate registered with the State Energy Regulatory Commission. After the producer reaches the individual electricity generation quota assigned to it in advance, it would be given the opportunity to sell the green certificates received for the remaining quantity of the awarded quota. The certificates will be available for secondary sale to traditional electric energy producers in the country. The Ministry of Energy expects to promote the development of the renewable energy market without providing direct state subsidy to producers through the introduction of this new mechanism.

The mechanism of voluntary agreements is another option for the government to improve the environmental indicators of industrial enterprises and the energy efficiency of production. By introducing mandatory thresholds for energy efficiency per unit of production, the agreements will create incentives for operators to ensure a lower average growth in energy consumption as compared to the growth of the gross value added. Voluntary agreements are applicable for all industrial subsectors: ferrous and non-ferrous metallurgy, chemical industry, food&beverage industry, construction and construction materials, machine-building, electric industry. These include measures with a return of investment period of over 2 years and will be phased-in in the country over the 2005-2008 period.

The activities in implementation of the Kyoto objectives started in 2004 and attracted considerable interest from Bulgarian companies and foreign partners.

Point Carbon, an company dealing in independent analyses of the greenhouse gas emissions market, announced at the end of 2004 the ranking of host countries under the Joint Implementation mechanism of the Kyoto Protocol. Bulgaria was marked as one of the most attractive countries for JI projects in Europe and was given a BBB rating<sup>16</sup>. Eight contracts for the purchase of emission reduction units from Bulgarian companies were signed through the Joint Implementation mechanism in 2004.

Bulgaria is now taking the necessary steps for the implementation of the second Kyoto Protocol mechanism: International Emissions Trading. The country is in the process of negotiating the conditions of trading its surplus of Assigned Amount Units and plans to proceed to selling those in 2005.

Bulgaria also started preparations to participate in European Emissions Trading Scheme (EU ETS)<sup>17</sup> - the European Union's main instrument to control the greenhouse emissions from large industrial plants and energy producers. Implementing the European Union Emissions Trading Scheme will become mandatory once the country officially joins the Union.

### Environment and competitiveness

Current practices worldwide show that a well-thought-out environmental policy favors innovations, creates new markets and increases the competitiveness of national production, because it enforces an efficient approach to using natural resources and opens new investment opportunities. Bulgaria is on the way to implementing a modern environmental policy which has the potential to become the foundation of a process that will generate growth and jobs and may be turned into a competitive advantage for the national economy. A necessary precondition to achieve such a combination of environmental aspects and enhanced competitiveness is to carefully balance the environmental, social and economic effects in the short-term and long-term perspective and to pick the appropriate political instruments to put these to practice. The business community often perceives environmental restrictions as an obstacle inasmuch as each requirement for additional investment impacts the competitiveness of companies, while high environmental standards are not an advantage for their position on the international market.

In 2004, the annual report published by the World Economic Forum in Davos<sup>18</sup> for the first time included a section on "Social and Environmental Responsibility". The results of the questionnaires filled in by the business leaders from 104 countries included in the November 2004 report enable analysts to make a comparative assessment of the business community's attitudes to issues of environmental legislation, accountability standards and requirements, the role of state subsidies, the cooperation between business and the state and the conformity of environmental policy with the countries' international environmental commitments. As all participants were asked to reply to the same questions, the study is an objective indicator of the attitude of managers to a climate of environmentally responsible behavior established as a result of the activity, or lack thereof, of the state in this area and the attitude of the business community to issues of environmental responsibility. In 2004, Bulgaria is in the group of countries given a "mostly negative" assessment, and it occupies the 89th position in the overall ranking of countries according to their progress in the area of socially responsible environmental policy. The result is interesting from the point of view of the separate components of the overall assessment.

The first group of questions aims to determine to what extent the state is able to efficiently establish a clearly-cut framework for businesses in which they can demonstrate environmental

<sup>16</sup> MoEW data, see. <http://www2.moew.government.bg/> and <http://www.pointcarbon.com/>

<sup>17</sup> Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the EU

<sup>18</sup> The Global Competitiveness Report 2004-2005, World Economic forum, Palgrave Macmillan, N.Y., 2004.

responsibility. Comparative results for Bulgaria show that the business community as a whole is not of the opinion that the country's environmental legislation is stronger than elsewhere, but on the other hand believes that it is not unambiguous enough and is not being consistently implemented. On the other hand, the assessment with respect to keeping environmental international commitments is one of the highest for this section and it is an indicator of business leaders' conviction that the country is strictly adopting and implementing international agreements. During the past 2004 this, to a large extent, also applied to the European environmental directives transposed into the national legislation. There seems to be a prevalent opinion that the positive results in the environmental field are achieved not through cooperation between the government and the business community but rather through formal - administrative and legal - procedures.

The second group of six questions included in the section on national competitiveness and environmental responsibility, provides an assessment of the business community's attitude to environmental issues in terms of implementing environmental management and reporting systems, environmental marketing and eco-labelling, waste reduction, energy efficiency and long-term environmental planning. Generally speaking, these are the mechanisms of voluntary active actions by businesses and the implementation of environmental practices in company policies oriented to improving the company's reputation and competitiveness. Replies to the survey given by Bulgarian businessmen reveal that environmental marketing and eco-labelling do not play a significant role in satisfying the so called "green needs" of consumers; environmentally clean production, waste reduction, recycling activities and production life-cycle management are not of great significance for environmental management, while global climate change and the other environmental risks play almost no role in drafting business development plans. At the same time, the study reveals that businesses do not perceive state subsidy in environmental activities as a factor that corrupts the competitive environment and an obstacle to the efficient use of raw materials and electric power.

The survey among business leaders on environmental policy issues confirms that the business community in Bulgaria takes an active positive stand with respect to environmental and social changes and participates in the implementation of the government program in this area. At the same time, a comparative analysis of the business community's assessment on the effectiveness of specific measures taken by government institutions to establish an environment that encourages the efforts of Bulgarian industry to take competitive positions in the global economy by actively participating in sustainable development policy measures, is the cause of serious concern and calls for a major revision of the instruments used for government intervention on environmental issues.



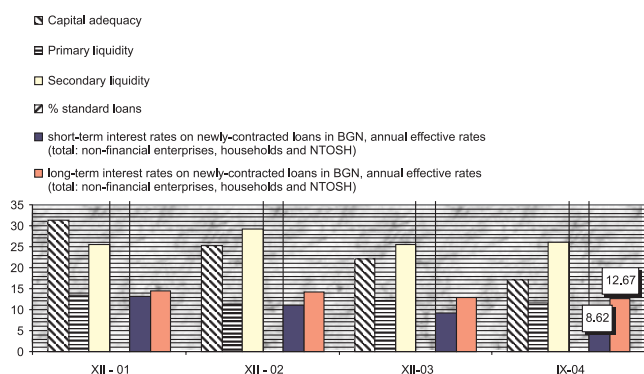
In 2004 the credit expansion continued without slowing down. Nevertheless banks remain stable, with excellent indicators of capital adequacy and liquidity and well functioning banking supervision. Hitherto measures for restricting credit expansion taken or announced by the supervision and the government for the last two years did not produce the desired effect and were followed by new ones.

## Banking system data

Financial sector and financial mediation in Bulgaria are dominated by the banking system. There are 35 banks, including 29 fully licensed banks for conducting operations in the country and abroad, and six branches of foreign banks.

According to BNB data, at the end of December 2004 the banking system assets totaled BGN 24 917 359 thousand against BGN 17 323 643 thousand at the end of 2003 (i.e. an annual increase of BGN 7 593 716 thousand). At the end of December deposits amounted to BGN 22 185 115 thousand while at the end of 2003 they totaled BGN 13 593 516 thousand (an annual increase of BGN 8 591 599 thousand). In December the net profit of the banking system was BGN 434 112 thousand against BGN 379 817 thousand in December 2003. According to BNB data, total capital adequacy of commercial banks at the end of September 2004 was 17.13 per cent (excluding group three) and at the end of last year this indicator was 22.03 per cent (25.22 and 31.32 per cent at the end of 2002 and 2001 respectively). At the end of September 2004 the banking system primary liquidity was 11.48 per cent and secondary liquidity was 26.07 per cent (11.98 and 25.48 per cent at the end of 2003, 11.2 and 29.25 per cent in 2002, and 13.47 and 25.47 per cent at the end of 2001). These indicators are illustrated in Figure 8.

Figure 8. Selected banking system indicators (%)



Source: BNB data, monthly news bulletins

Thus assets, deposits and net current profit of the banking system continued to grow. Growth in assets and deposits in

2004 exceeded considerably the 2003 growth. Growth in assets is 44 per cent by December 2004 over December 2003 (against 19 per cent in the same period of 2003) and 63 per cent in deposits by December 2004 (against 20 per cent in the same period of 2003). Growth in deposit base and growth in assets are factors for and indicators of ever more difficult slowdown in credit growth. Net current profit of the banking system at the end of December 2004 already exceeded that as at December last year<sup>19</sup>. The ratio of net interest income to other non-interest income (the latter includes income from loan servicing) increased in 2004 (after 2.30, 2.25 and 2.21 respectively at the end of 2001, 2002 and 2003, at the end of 2004 it is already 2.49). Thus lending activity remains a primary source of income for the banks in Bulgaria. On the one hand, this reflects banks' efforts to avail of the opportunities presented by a more favorable economic environment and enhanced demand for loans by the business and the public. On the other hand, this suggests certain underdevelopment or insufficient diversification. The indicator of capital adequacy continued its downward trend but remained relatively high, well above the regulatory minimum, indicative of the stability of the system<sup>20</sup>. Liquidity at the end of the half-year is slightly higher than in the first quarter. This confirms the conclusion that the banking system in Bulgaria is stable, but has not utilized all possibilities for development and enhancing its effectiveness.

Such a conclusion is also confirmed if comparing the size and credit exposure of banks in Bulgaria and other transition economies. Despite the growth over the recent years, Bulgaria is still lagging behind most Central and East European countries and the region as a whole is well below the indicators of developed market economies (Table 8). This is a sign that the Bulgarian banking system has a strong potential for growth, including through credit expansion, despite current disputes about the optimal rate of this growth. At the end of 2003 net loans of the banking system to non-financial institutions and other customers made up a mere 26.2 per cent of 2003 GDP at current prices.

Table 8. Bank assets and loans in Central and Eastern Europe, % of GDP (at end 2003)

Country	Assets	Loans
Bulgaria	50	26
Poland	65	31
Romania	33	18
Slovakia	83	34
Slovenia	89	42
Hungary	79	39
Croatia	105	61
Czech Republic	107	35
Average* for the 8 CEE countries	74	34
Average* for Eurozone countries	201	102

\* Non-weighted

Source: Bank Austria Creditanstalt, Banking in CEE, April 2004

Domestic credit growth sustained (under the Currency Board arrangements of note are loans from commercial banks to the

<sup>19</sup> At the beginning of 2003 a major reintegration of provisions was effected, related to adoption of the International Accounting Standards, i.e. real income growth at the beginning of the year was even smaller.

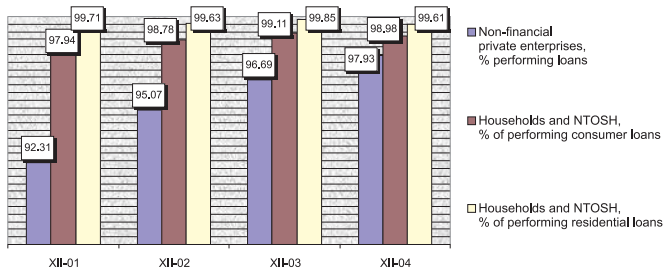
<sup>20</sup> BNB found "violation of the minimum accepted values of the capital regulators with several banks" (BNB, Report January-June 2004, p. 41)

non-government sector – non-financial state-owned enterprises, non-financial private enterprises, non-bank financial enterprises, households and other according to the sectoral classification). Out of BGN 4 442 871 thousand at the end of 2001, receivables on loans to the non-government sector reached BGN 6 397 179 thousand at the end of 2002. At the end of 2003 receivables on loans to the non-government sector already accounted for BGN 9 487 449 thousand and at the end of 2004 they totaled BGN 13 744 209 thousand <sup>21</sup>.

The newly contracted loans in 2004 reached BGN 10 122.4 million from BGN 5 189.7 million in 2002 to BGN 7 160.0 million in 2003. These data show that in 2004 there was no slowdown in credit expansion growth in absolute terms and actual retention of growth on an annual basis. In 2003 newly contracted loans grew by 37.96 per cent against the previous year, and in 2004 they grew by 41.37 per cent compared to the previous year. The conclusion is that so far the new measures of the government and the banking supervision (discussed below) for restricting credit growth did not produce the desired effect. It is possible, however, that this effect would surface in the coming months, as some of the measures have been only recently applied and also new ones have been announced.

**The condition of the loan portfolio remains good** – 92.72 per cent of all categories of loans of the banking system were performing loans at the end of 2003 (against 94.47 per cent at end 2002), and at the end of September 2004 performing ones were 92.97 per cent (Figure 8). The general conclusion about the condition of the loan portfolio is also true for receivables on loans to private non-financial enterprises, households and NTOSH – the percentage of performing loans there is increasing or remains high in 2004 (Figure 9).

Figure 9. Condition of the loan portfolio



Source: BNB data and own calculations

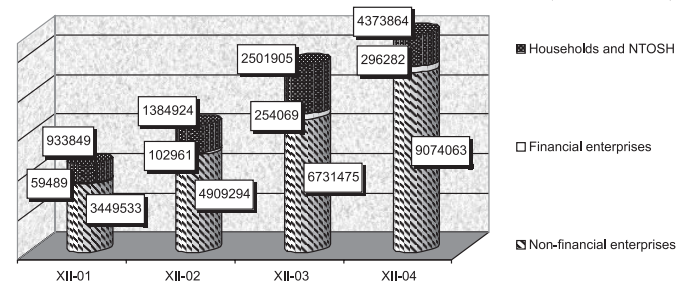
Interest rates on short- and long-term newly contracted loans in BGN in 2004 are near those in the last month of 2003 (again

<sup>21</sup> It should be noted that from the beginning of 2004 BNB, as part of the process of harmonizing monetary statistics with the requirements of the European Central Bank, adopted changes in the presentation of monetary statistics through the monetary report. Since February the sectoral classification under ESA'95 has been applied completely (e.g. introduction of non-trade organizations servicing households, NTOSH), which required reconstruction and revision of time series after December 1995

<sup>22</sup> The influence of the transfer of assets of M-Tel is reflected as well

Figure 8). Credit dynamics reveals other interesting short-term trends (by currency, term and borrower). For example, review of receivables on loans to the non-government sector since the beginning of the year shows the highest absolute growth in loans to non-financial private enterprises, but the long-term trend reveals a growing share in total receivables of loans to households and NTOSH (from 21.02 per cent at the end of 2001 to 31.82 per cent at the end of 2004, Figure 10).

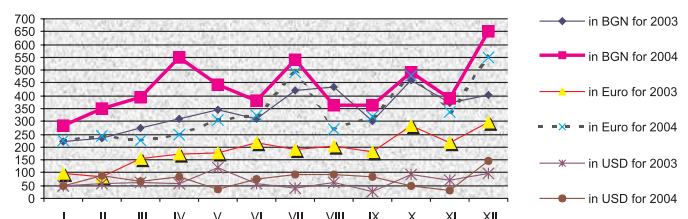
Figure 10. Receivables on loans to non-government sector (BGN'000)



Source: BNB data, monthly news bulletins

Figure 11 illustrates the dynamics of newly contracted loans for 2003 and 2004. As was stated above, the data confirm higher credit activity in comparison with 2003. The trend toward larger share and higher growth of loans in BGN and EUR is sustained. The conclusion again is that this is probably consistent with higher investment activity in the country in line with currency risk rather than with interest rate dynamics or interest rate levels. Expectations about USD/EUR exchange rate dynamics are contradictory and therefore remain of secondary importance in terms of currency choice when applying for loans. Existing currency risk in USD-denominated loans however (the Euro being the reserve currency under a Currency Board arrangement) predetermines preferences to loans in BGN and EUR and this is specifically valid for longer-term loans.

Figure 11. Newly contracted loans in BGN (million BGN)



Source: BNB data, monthly news bulletins

Overall credit growth and the higher volume of longer-term loans in recent years are offset by some changes in the structure of bank assets and liabilities. According to the analytical reporting of commercial banks, net foreign assets<sup>22</sup> declined most significantly in volume and share and some long-term liabilities increased most (Table 9).

Table 9. Changes in the structure of some assets and liabilities

## BANKING SYSTEM

	XII-01		XII-02		XII-03		XI-04	
	BGN '000.	% of total assets/liabilities	BGN '000.	% of total assets/liabilities	BGN '000	% of total assets/liabilities	BGN '000	% of total assets/liabilities
Assets	9995321	100.00	11533708	100.00	13705432	100.00	16776429	100.00
Net foreign assets	3968500	39.70	2909504	25.23	1504314	10.98	203953	1.22
Liabilities	9995321	100.00	11533708	100.00	13705432	100.00	16776429	100.00
Overnight deposits	2681334	26.83	3196871	27.72	4027297	29.38	4824963	28.76
Deposits with contracted maturity up to 2 years	4423218	44.25	4926377	42.71	5430159	39.62	6726291	40.09
Deposits contracted for use after notice of up to 3 months	1232095	12.33	1375995	11.93	1619867	11.82	1938405	11.55
Issued debt securities up to 2 years	-	-	3075	0.03	2335	0.02	2022	0.01
Deposits with contracted maturity over 2 years	14689	0.15	93561	0.81	201740	1.47	377766	2.25
Deposits contracted for use after notice exceeding 3 months	-	-	-	-	-	-	-	-
Issued debt securities exceeding 2 years	6341	0.06	15962	0.14	53981	0.39	168357	1.00

Source: BNB, analytical reporting of commercial banks

The table shows that despite banks' strong efforts to attract more long-term deposits and issue longer-term debt securities on the local capital market, short-term deposits preserved their most significant weight in the structure of liabilities.

### Ownership structure

Through various channels such as privatization, opening of representations, branches and newly established banks foreign participation in the banking system of Bulgaria dominates both in control over equity and in terms of managed assets. Encouragement Bank AD and Municipal Bank AD remain the last banks with state, respectively municipal, control over the capital.

The purchase of Hebros Bank by Bank Austria Creditanstalt was the major event in the restructuring of the banking sector in 2004. The experts' opinion is that this deal sets the beginning of a new process in the consolidation of the Bulgarian banking sector, still fragmented among many banks. After the privatization of banks over the last years, bank consolidation is the expected next stage in the increase of competitiveness of individual banks and of the sector as a whole.

Hebros Bank was privatized in 2000 for USD 23.5 million. To finalize the deal the Bank Consolidation Company approval was needed as the five year period since privatization ends in 2005 and until then the bank cannot be resold without the permission of the government. The seven weeks due-diligence of the candidate buyer of the bank ended on 15<sup>th</sup> of October 2004. The price of the deal was not publicly announced but the amount of EUR 110 million was being spoken of for the purchase of 99.9 per cent of the shares of the bank. Thus Bank Austria Creditanstalt (BA-CA) has become the owner of two banks in Bulgaria – HVB Bank Biochim and Hebros Bank. After

finalization of the deal BA-CA announced that they have 10 per cent market share.

### Measures for restricting credit growth

The discussion about possible threats stemming from increased credit activity of banks continued. Following the visit of the regular IMF mission in the country in the fall of 2003 the issues of the quality of loan portfolios and potential stability of the banking system gave way to the issues of the relation between import growth, current account deficit and credit expansion. IMF representatives have been persistent in their arguments of the need of restricting the banks' credit activity and BNB and the Government practically accepts their arguments.

Despite the prevailing understanding of the benefits of credit growth for overall economic growth and the lack of immediate threat to the stability of the banking system, as early as 2003 BNB started announcing and taking a number of measures aimed at restricting growth in loans to private enterprises and households. The measures included firstly an amendment to BNB Regulation No. 9 (Regulation No. 9 on the evaluation and classification of risk exposures of banks and the setting of provisions against impairment losses) as of August 2003. In the beginning of 2004 Regulation No. 9 was amended again<sup>23</sup>, and banks' risk exposures were classified in four instead of five classification groups (former groups "doubtful" and "loss" were integrated in "non-performing" – over 90-day past-due payments).

The IMF report on the review of the stand-by agreement for Bulgaria of February 2004 specified three more steps of Bulgarian authorities aimed at restricting credit expansion. Firstly, BNB

<sup>23</sup> The amendments are in force since 1st of April 2004

plans for decreasing minimum reserve requirements of banks were postponed. Secondly, the government<sup>24</sup> announced its intention to return the deposited (in mid-2003) funds from the fiscal reserve with commercial banks as soon as the term of deposits expires or even earlier. The government committed not to repeat such operations in 2004 with the argument that shifting a portion of the fiscal reserve to commercial banks creates conditions for additional bank credit expansion.

Thirdly, BNB confirmed its support to the joint project with the Association of Commercial Banks to launch by mid-2004 the single credit register which is to cover loans below BGN 10 000 (this limit was the minimum amount of loans at the beginning of the year – separately or jointly, of individual borrowers and related parties – for which BNB maintained a credit register). To this end, in April 2004 Regulation No. 22 on the Central Credit Register of Banks was amended. Amendments entered into force on July 1<sup>st</sup>, 2004.

Other major regulatory changes in 2004 aimed at restricting banks' credit growth are as follows. Firstly, Regulation No. 8 on the capital adequacy of banks<sup>25</sup> was amended, introducing additional conditions for reintegration of retained earnings from previous years and current year in the capital base.

In addition, amendments to Regulation No. 7 on the large exposures of banks aimed generally at strengthening and elaborating supervision over banks' lending activity in relation to restrictions on their large exposures. Amendments to Regulation No. 21 on minimum required reserves maintained by banks with BNB came into force in June. The deposit base on which the amount of reserves is calculated was expanded to include deposits and debt instruments with contracted term exceeding 2 years. For the latter the banks shall maintain reserves of 4 per cent. The credit growth did not slow down and in November 2004 Regulation No 21 was amended again to make equal the requirement for minimum reserves on all deposits<sup>26</sup>.

Another amendment to Regulation 21 since July 2004<sup>27</sup> decreased by 50 per cent the cash of the banks when calculating the minimum reserves with BNB. In November the cash was fully deleted from the amount of the minimum required reserves.

<sup>24</sup> Additional memorandum to the economic policy of BNB and the government, January 15th, 2004

<sup>25</sup> Effective as of 1st of June 2004

<sup>26</sup> Effective as of 6th of December 2004

<sup>27</sup> Effective as of 1st of October 2004

<sup>28</sup> Additional memorandum to the economic policy of BNB and the Government, 15th of January 2004

<sup>29</sup> Source: IMF, Public Information Notice No. 04/65, 18th of June 2004

<sup>30</sup> BNB, Economic Review, August 2004, p. 37, These expectations were included in the Memorandum dated 6th of August

<sup>31</sup> BNB, Economic Review, November 2004, p. 38

<sup>32</sup> LEONIA, Lev OverNight Index Average

The last measures for restricting credit growth were discussed during the visit of the IMF Mission in September. New measures for restricting credit growth were discussed in September as well. Among the discussed options were the introduction of liquidity limits and increased bank supervision towards banks with aggressive lending behavior.

At the beginning of 2004 Bulgarian authorities expressed expectations before the IMF that real annual growth in receivables from the non-government sector will be restricted to less than 25 per cent at the end of 2004<sup>28</sup>. In mid-2004 IMF expressed a similar forecast, 25.9 per cent nominal annual growth in receivables from the non-government sector at the end of 2004<sup>29</sup>. In August, however, BNB presented a revised forecast that "at the end of the year the annual growth of receivables from non-government sector are expected to fall to some 30-35 percent"<sup>30</sup>. By the end of the year BNB expressed their expectations for a slow down of the growth of receivables from non-government sector "to about 45-46 per cent at the end of 2004 and 43-45 per cent at the end of the first quarter of 2005".<sup>31</sup>

#### Other decisions of BNB

In December 2004 the BNB Board of Directors adopted three important decisions. Firstly, the methodology of setting the Base Interest Rate (BIR) was changed. The Base Interest Rate (BIR) effective from the first day of each calendar month shall be equal to the arithmetic average of the values of the LEONIA index (LEONIA<sup>32</sup> for the business days of the previous calendar month). The BIR is in effect from the first to the last day of the calendar month for which it refers. Till now BIR was set on the basis of the yield on three-month government bonds. Experts commented that the money-market conditions will be better reflected. Till now BIR was more or less an indicator only of the cost of financing of the government. The announcement of the Base Interest Rate as per the newly adopted methodology comes into effect since 1<sup>st</sup> of February 2005.

Secondly, the BNB Board adopted at its first reading the new Regulation No. 8 on Capital Adequacy of Banks, and amendments to BNB Regulation No. 7 on Large Exposures of Banks. The new Regulation No. 8 on Capital Adequacy of Banks with included market risk capital requirements was drafted in relation to the commitments made by the Republic of Bulgaria in the negotiations with the European Union and the need of harmonization of Bulgarian banking legislation with the EU. The amendments made to measuring and reporting capital adequacy of banks in terms of market risks are targeted at banks having significant trading books of financial instruments with the intention to trade in them. A Standardized Approach and Internal Model-based Approach (based on VaR models) will be applied to measure and report risks subject to capital requirements. The application of the Standardized Approach to

measuring market risks will be mandatory, while the Internal Model-based Approach will be applied after proving necessary experience and compliance with additional quality criteria.

At this same session of the BNB Board an amendment to the Cash Servicing Fees Tariff in relation to the fee for banknote and coin processing and counting was adopted<sup>33</sup>.

### **Amendments to the Law on BNB**

In the mid of January 2005 the Parliament adopted the amendments and additions to the Law on BNB. The amendments resulted mainly with relation to the requirements of the EU legislation. The push for the amendments was a result of the requirements of the EU legislation. These amendments cover several main areas – amendment to defining the main aim of BNB, additional guarantees for the independence of BNB and the prohibition for direct financing of the public sector.

The amendments and the motives for them are described in details in the Draft Law presented to Parliament in June 2004<sup>34</sup>.

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<sup>33</sup> Details on the regular meeting of the Managing Board of BNB can be found in the official press release of BNB dated 17.12.2004

<sup>34</sup> Access to web address: <http://www1.parliament.bg/infocenter/zakoproekti/402-01-30.rtf>

The Bulgarian capital market develops successfully in 2004 but its contribution within the overall financial mediation is still limited. Trade on the Bulgarian Stock Exchange - Sofia AD is active, with growing turnover, volume, market capitalization and stock-exchange index on an annual basis. Trade in compensatory instruments and investment vouchers attracted further interest and still depended on current supply and expectations for government sales at public auctions held by the stock exchange. The positive development of the sale of the residual government's stake of BTC led to a record increase of the price of compensatory instruments. Despite improved indicators, of note is the lack of explicitly positive outlook for the market in the long run. Therefore, the need for preservation and expansion of the existing potential requires active measures by institutions and market participants.

The role of the capital market in the Bulgarian financial sector is insignificant irrespective of the recent positive development<sup>35</sup> – at the end of December 2004 the total market capitalization of the Bulgarian Stock Exchange – Sofia AD was 10.60 per cent of the actual GDP estimate<sup>36</sup> for 2004.

The capital market is still unpopular in Bulgaria. This conclusion applies when comparing Bulgaria with EU Member States, especially the newly accepted ones. In absolute terms Bulgaria is lagging far behind (only Latvia has a lower indicator, Table 10). The state of the capital market does not reflect the immediate prospects to the Bulgarian economy as a whole but rather reflects the fact that the mechanisms of financing through that alternative non-banking environment are still unknown or not preferred even with available good investment projects. As per a survey<sup>37</sup> carried out at the end of 2004 almost 65 per cent of the population does not know what shares are and respectively only 5 per cent see shares as a possibility for a profitable investment. Also 80 per cent of the business representatives in the country state that they do not know that the issue of shares through the stock exchange is an alternative way of financing.

Even with ongoing positive macroeconomic development or development in individual industries or enterprises the effects on the capital market could be insignificant or surface out with great delay.

Liquidity increased but generally remained low and market incentives are still insufficient to establish good practices of corporate governance even in some public companies. Investment alternatives are still limited and financial intermediation in Bulgaria is effected predominantly through the banking sector.

<sup>35</sup> The registration of BTC on the BSE-Sofia and the start of trading in January 2005 resulted in a substantial increase of the liquidity and market capitalization.

<sup>36</sup> Based on "Short-term forecasts for Bulgarian Economy" of the AEA, October 2004

<sup>37</sup> Survey on the attitude towards the capital market, effected under a contract with BSE-Sofia, by Estat Agency November-December 2004

<sup>38</sup> Official and Unofficial Share Market

Table 10. Market capitalization in EU countries and Bulgaria (billion EUR)\*

Eurozone (12), total	4360.5
EU (15), total	6821.6
EU (25), total	6954.7
<b>Bulgaria</b>	<b>2.06</b>
Estonia	4.4
Cyprus	3.6
Latvia	1.1
Lithuania	6.1
Malta	2.1
Poland	51.9
Slovakia	3.6
Slovenia	7.1
Hungary	21.1
Czech Republic	32

\* At the end of 2004

Source: Eurostat, Bulgarian Stock Exchange – Sofia AD.

### Stock Exchange trading (excluding the privatization market, compensatory instruments and investment vouchers)

According to stock exchange data, at the end of 2004 total market capitalization is BGN 4 033 204 800 (including BGN 1 374 876 944 on the Official Market), whereas at the end of 2003 total market capitalization was BGN 2 722 008 207 (including BGN 985 984 573 on the Official Market). Turnover in 2004 is BGN 660 747 036 with 176 457 031 traded securities (lots)<sup>38</sup>. Excluded from this turnover and trade volume is the privatization market (e.g. the sale of residual state-owned shares in Petrol AD, Lukoil Neftochim – Burgas AD, Bulgarian River Shipping Company AD, and Bulstrad AD), as well as the rights, compensatory instruments and investment vouchers traded on the stock exchange. Block deals and other contracted deals are not included in turnover and volume. Thus the turnover increased by 265 per cent on annual basis. The trade volume increased by 348 per cent on annual basis.

The data for the block deals and other contracted deals on the BSE-Sofia are as follows: for 2004 the turnover is BGN 435 421 351 (against BGN 151 169 771 for 2003 i.e. an increase by 188 per cent). The trade volume is 558 368 705 traded securities (lots) which is an increase by 83 per cent annually (at 304 953 997 traded volume in 2003).

Thus in 2004 a serious increase of the indicators of the BSE-Sofia was observed compared to the previous year – indicators traditionally used to measure and characterize the capital market in Bulgaria. The liquidity increase, however, displayed

different dynamics to individual issues. That is why low liquidity remains among the main problems of the market irrespective of the positive trends. The number of the issues registered for trading is still high but the liquid positions are small in number (most of them are the securities included in SOFIX plus some of the former privatization funds). This gives sometimes a distorted view of the actual activity on the stock exchange.

In addition, the increase of the prices of part of the traded securities, with practically unchanged liquidity, explains partly the growth in the total turnover. Actually the SOFIX index is increasing on an annual basis (from 454.34 at the end of 2003 to 625.31 at the end of 2004)<sup>39</sup>,

Among significant corporate news affecting trade again were public companies' financial statements. It has been true for several years now that market participants need and carefully monitor fundamental factors affecting the prices of stocks (specifically the financial information and the news about traded companies). Stock price dynamics, especially on liquidity positions, reflects, to a larger extent, corporate events, which is a sign of market participants' enhanced investment culture and improved market efficiency as a whole. Timely presentation of public companies' financial statements is already a practice, reflecting to some extent gradual recognition of the importance of good corporate governance in favor of minority stockholders and potential ones. In 2004 the FSC again enforced several individual administrative acts obliging companies to present their reports for past periods.

In 2004 the activity of the bonds market of the Bulgarian Stock Exchange – Sofia AD increased. By the end of the year 358 transactions in the Official Market (corporate and municipal bonds) were concluded with a total turnover of BGN 42 407 437 (annual growth in both indicators by 36 and 2 per cent, respectively). The Unofficial Bond Market numbered 365 transactions for the twelve-month period, with total turnover of BGN 83 320 756 (annual growth in both indicators by 97 and 221 per cent respectively). Therefore liquidity on the bond market is still below that in other securities markets.

New issues of corporate bonds were listed for secondary trading on the stock exchange. Among these in 2004 is the first issue of convertible bonds on the stock exchange (issued by Industrial Holding Bulgaria AD). Newly registered in 2004 bond issues before that had been placed and executed outside the stock exchange, i.e. again primary capital raising was not effected under the conditions of public offering. Private placement and subsequent registration on the stock exchange remain a preferred strategy for issuers, most probably in order to reduce the risk of unsuccessful placement while providing higher liquidity for investors. Banks' mortgage bonds are still popular

bond issues, consistent with the growing share of mortgage loans in bank assets.

The review of the conditions of the bond market, similar to the share market, has to report also the results of the special sociological survey made among businesses and the population<sup>40</sup>. Over 71 per cent of the population in Bulgaria does not know what bonds are. Only 1 per cent of the interviewed regard bonds as an opportunity for a profitable investment. Almost 83 per cent of the business in Bulgaria says that they are not aware of the BSE bond issue as a means for financing.

Shares of more open-ended investment companies were admitted for exchange trading. By the end of January 2005 FSC had licensed seven open-ended investment companies and two close-ended investment companies (not including the funds of Pioneer Investment Management SA offered since two years ago, registered in Luxembourg, nor the funds offered recently by Capital Invest from Austria after FSC confirmed the prospectuses for their public offering in the summer). In 2004 the first special investment purpose companies were registered for trading. Establishment and development of such companies is driven by the prospect of attracting free resources outside banks and their investment, given better yield opportunities offered by the Bulgarian capital (and generally financial) market.

In line with the expansion of the new schemes of collective investment, the interest in managing investment portfolio of institutional and professional investors is also increasing. New management companies entered the market. At present nine such companies are recorded in the registers of FSC.

At the end of June, following FSC registration and approval of the prospectus for initial public offering of stocks of Investor.BG AD, the issue was registered on the stock exchange (Primary Market segment). 320 000 stocks were offered through the stock exchange (each with a face value of BGN 1, but at minimum issue value of BGN 3.30), or 53.33 per cent of the capital after the increase. Within 10 business days 10 per cent of the offered stocks were tendered in accordance with the rules of a mixed closed auction. On the third business day following the first stage, the unsold stocks were offered. Finally the company attracted BGN 10 400 more than planned, and the stockholders in the company were over 100. Thus Investor.BG AD became the first company in the country to increase its capital through the stock exchange with initial public offering. The step of the management deserves a positive evaluation while the successful initial public offering again confirmed the potential of the Bulgarian capital market, unfortunately underutilized so far.

Later during the year FSC confirmed another prospectus for initial public offering – of 20 000 stocks of Interlogic Property

<sup>39</sup> At the end of January 2005 this index exceeded for the first time 700 points

<sup>40</sup> See the survey quoted above

AD with a face value of BGN 10 and minimum issue value of BGN 40.

### Trade in compensatory instruments

Trade in compensatory instruments on the Bulgarian Stock Exchange – Sofia AD, after its launch in 2002, is still one of the key events in the capital market area in 2004. Interest in trade in compensatory instruments is comparable to that in equities. As this process is directly affected by exchange privatization (especially the sale of larger stocks of more attractive companies) where payment is to be made with compensatory instruments, parallel with the development of the sale of the residual state-owned shares of BTC logically intensification of trade and record increase of compensatory instruments was realized.

Statistics on trade in compensatory instruments and investment vouchers for the period January – December 2004 is as follows: 49 862 transactions were effected (annual growth of 153 per cent) with a turnover of BGN 233 221 148 (annual growth of 199 per cent). These figures include both compensatory instruments and investment bonds.

Compensatory instruments in 2004 were traded within the range of 20.48 to nearly 100 per cent of the face value with a trend towards increase during the last two months of the year. At the beginning of 2005 the compensatory instruments increased their price above the face value and just before the BTC auction the price reached its maximum level of 113 per cent of face value. The interest in compensatory instruments at the end became euphoric. For a long period of time the price was within the range of one fourth of the face value, but since the beginning of autumn, based on the positive expectations of the sale of 20 per cent of BTC, the price of compensatory instruments increased. The registration of BTC as a public company by the Financial Supervision Commission in November 2004 added to this appreciation. The last impetus was the decision to sell the last 15 per cent of BTC on the stock exchange against compensatory instruments.

At the end of 2003 investment vouchers were traded for the first time on the Bulgarian Stock Exchange – Sofia AD. The Board of Directors of the stock exchange adopted changes in trading rules (specifically amendment to Appendix No. 6, adding investment vouchers to compensatory instruments). 134 132 876 investment vouchers of BGN 1 face value were registered on the stock exchange. The first exchange transactions in this instrument were effected on 24 November 2003. Initially interest was high and transactions were closed at some 17 per cent of the face value, followed by a drop down. Over 2003 the minimum price in stock exchange trade in investment vouchers hit 13.05 per cent of the face value, but in 2004 vouchers appreciated considerably. As with compensatory instruments, the general trend was upward reaching its peak during the last

month of the year. The maximum of 60 per cent of the face value was reached at the beginning of 2005.

Although the prices of investment vouchers almost approximated those of compensatory instrument at a certain point of time the difference, however, sustained. The main reason for the lower prices of the investment vouchers in comparison with compensatory instruments lies in the more limited usage of the vouchers in the privatization. In the first half of the year the prices were influenced by the fact that their validity expired at the end of June. In June, however, a new amendment to the Privatization and Post-privatization Control Act (PPPCA) was adopted extending the validity of the vouchers till 30<sup>th</sup> of June 2005. The decision on extending the validity was made in the last minute, after the price of the vouchers had already fallen.

In order to expand the possibilities for usage of investment vouchers, in January 2004 the PA and the stock exchange for the first time started using in practice the trading system of the Bulgarian Stock Exchange – Sofia AD<sup>41</sup> for holding the first two auctions for sale of stocks and company shares against investment vouchers. Stocks of 432 companies were offered at the first auction (Centralized Public Auction stock exchange segment), and company shares of 86 companies were offered at the second auction (Non-Attendance Public Auction stock exchange segment). In addition to investment vouchers, it was possible to pay also by cash and compensatory instruments at these auctions.

The centralized auction in the beginning of 2004 has been the third consecutive one since early 2003 (i.e. from the so-called third wave of mass privatization), but the first one organized through the trade and settlement system of the stock exchange. The non-attendance public auction (i.e. trade of company stakes owned by the government and municipalities) was the first one from the “third wave of mass privatization”. During the next auctions and during the whole year the price of non-cash instruments of payment (compensatory instruments and investment vouchers) on the secondary market was affected to a great extent by the supply at respective auctions.

In summary, the practice of BSE privatization segment and of the centralized and non-attendance public auctions confirms the success of stock exchange privatization as a privatization method. The examples with successful sales of residual state-owned stakes in Petrol AD, Lukoil Neftochim Bourgas AD, Bulgarian River Shipping AD, and Bulstrad AD are supplemented with examples of many other sales in which

<sup>41</sup> This became possible following the adoption at the end of 2003 of the new Regulation No. 8 to the Rules and Regulations by the Board of Directors of the stock exchange by which the conditions and the order for organization of the so called Non-Attendance Public Auctions for sale of shares in limited companies (state-owned or municipal) are determined. For the purpose of holding auctions ordered by the PA but this time for sale of shares in state-owned and municipal companies, the Board of Directors of the Stock Exchange adopted also the new Regulation No. 9 where the conditions and procedures for the so called Centralized Public Auctions are stipulated.



the government (municipalities) ensured both transparency and wide access of investors and attained a very good price. The culmination and the strongest example of successful stock exchange privatization (a proof also for the potential of the stock exchange) till now were the auctions for the sale of the residual state-owned stakes of BTC, carried out by BSE – Sofia in January 2005.

### Development of the legal framework

In the second half of 2003 the legal framework of the capital market in Bulgaria was amended significantly. The Financial Supervision Commission adopted several new (substituting the existing) regulations. These are: Regulation on the requirements to the activity of investment intermediaries; Regulation on the prospectuses for public offering of securities and disclosure of information by public companies and other issuers of securities; Regulation on the capital adequacy and liquidity of investment intermediaries; Regulation on the permits for conducting operations as stock exchange, organizer of unofficial market of securities, investment intermediary, management company and special investment purpose company; Regulation on the requirements to natural persons effecting direct transactions in securities and investment consulting on securities and the terms and procedures for acquiring and revoking the right to exercise such activity; Regulation on the Central Depository of securities; Regulation on tender offering of stock purchase and stock swaps.

In 2004 the FSC continued its work on development of the legal framework. During the year the Regulation on the terms and procedure for effecting margin purchases, short sales and borrowing of securities was promulgated. Commission experts developed and presented for public discussion a draft amending the Public Offering of Securities Act. As stated in the official justification to the draft, the amendments aim at harmonizing the Bulgarian legislation with the EU acquisitions in the field of securities or elaborating existing Bulgarian legal framework. The main amendments can be summarized in the following groups: changes in the regulation of the activity and respectively capital requirements to investment intermediaries; setting up a Compensatory Fund for Investors in Securities; changes in the part concerning public companies (mainly the terms and procedure for their transformation); introduction of a new type of scheme of collective investment in securities (the contract fund); amendments in the part concerning management companies.

In the draft law presented to the Parliament an amendment was proposed which turned into one of the most debated public issues. BICA (Bulgarian Industrial Capital Association) insisted to include in the draft law the possibility for relieved “write-off” of certain companies as public from the registers of the Financial Supervision Commission (FSC). This idea reflects the views and the importance related to the public status of a

given company among a number of issuers and their managing bodies- views that are not related to the active participation of those issuers on the capital market.

On the other hand the trust in the capital market is a key factor for its development. That is why each extreme (even if compromising) decision related to the presence on the stock exchange of companies with lower liquidity or of not so good financial condition should reflect mainly the interest and the equality of all these stockholders.

There is also another major change – exclusion from the “prohibitive” list under the Public Offering of Securities Act of the state holdings in Bulgarian Stock Exchange – Sofia AD and in the Central Depository AD, thus automatically announcing them for privatization. With view of the decreasing influence of the state in the capital market and due to an existing already good market infrastructure, such a decision could be positively assessed as a whole. The development in this respect may influence the market in several directions.

Firstly, the privatization of the stock exchange and of the Central Depository could lead to acceleration or to a parallel consolidation of some regional structures. Secondly, the privatization could create additional incentives for increasing the efficiency of the operational management of the stock exchange. Thirdly, depending on the perspective of turning the Bulgarian Stock Exchange – Sofia AD into a public company (i.e. in addition to the privatization) an improvement of corporate governance of the exchange itself could be expected with all the positive effects for the Bulgarian capital market. Last but not least, the participation in privatization of the stock exchange and of the central depository and in the possible distribution of their financial results may give additional impetus to their members for more active participation in the capital market per se.

In 2004 progress was made regarding the legal framework, privatisation and implementation of investment projects in the sector. Oil quotations and the future of nuclear energy in the country provoked most interest throughout the year.

### Government policy, restructuring and privatization

The process of aligning Bulgarian legislation with EU directives finally ended at the beginning of 2004. After the adoption of the Energy Act at the end of last year, another regulatory act fundamental for the sector was adopted – Energy Efficiency Act. This enabled reforms in the sector to continue. It should be noted that most of the secondary legislation has already been adopted, which is a prerequisite for an effective functioning of the domestic energy market in a liberalised environment.

The privatisation of the seven energy distribution companies was successful. The well-prepared strategy, transparency of procedures and the work of government administration in this case produced good results. They are reflected in the price paid for the three packages and the lack of serious conflicts in the administration usually accompanying privatisation processes in Bulgaria. Time-limits for completion of the transactions did not match the ones set in advance mainly because of the delayed adoption of the legal framework. At the beginning of next year we can expect the private companies EVN, E.ON Energie AG and CEZ to enter into actual possession of the companies. Specific actions and financial parameters of the programmes for development of electricity distribution companies may be prepared then. The envisaged privatisation transactions in the electricity generation sub-sector are expected to be finalized in 2005. After some of the production facilities in Maritsa-Iztok Complex were privatized, privatisation of Varna, Bobovdol and Ruse thermal power plants is forthcoming. Serious interest in purchasing the three plants was shown at the end of 2004. These processes, combined with the process of liberalisation, would lead to a more serious competition upstream and downstream the energy cycle. In 2005 the limit for gaining eligible consumer status is expected to reach 20 GWh annual consumption of electricity. This will provide opportunity to 60 enterprises to negotiate freely electricity prices and supply directly from producers. In practice, as of 7 July 2005<sup>42</sup> almost one-fifth of electricity consumed in the country will be at market-based prices. Signing of a legally binding document on establishing a regional energy market in South Eastern Europe would have a positive impact on competition. These processes will be inhibited by existing contracts for purchase of electricity by NEC at fixed prices which usually serve as guarantees in privatisation transactions or loans. Another possible constraint will be the insufficient knowledge and lack of experience in such type of trading among producers and consumers.

Large investment projects in the Bulgarian energy sector developed further. The construction of Tsankov Kamak water power system began in 2004 and the new facility is to be put into operation in 2007. The other big project, started in 2004, was the rehabilitation of the first four units of Maritsa-Iztok 2 Thermal Power Plant. Thanks to the implementation of the two projects another 170 MGW will be added to the installed capacity in the country. Emission of burnt gases will be reduced and the efficiency of Maritsa-Iztok 2 Thermal Power Plant will be increased. What did not materialize again in the Bulgarian energy sector was the start of the construction of a new plant in Maritsa-Iztok Thermal Power Plant by the American company AES. This led to extending the term for putting them into operation which in turn could be considered as benefits foregone. Information on negotiations between the company and NEC for reduction of purchase prices under contracts for mandatory purchase of electricity is a positive sign in this case, as this would partially make up for the project delay.

Decommissioning of Units 3 and 4 of Kozloduy Nuclear Power Plant and construction of Belene Nuclear Power Plant were the main focuses of discussion about the future of Bulgarian nuclear power. The positive results from the partners' inspection were not an argument strong enough to defend Units 3 and 4. This was an expected outcome, as Bulgaria had already taken the commitment to decommission the two units when closing up the Energy Chapter. At the same time, external political pressure to close down the units was steadily mounting. Moreover, a possible change of already agreed time-limits would mean a precedent allowed by the European administration, which could be used by EU Member States or candidate countries as an argument in negotiations.

Belene Nuclear Power Plant, the other milestone of nuclear energy sector, was at the center of political and expert discussions. The present government resurrected the idea of new nuclear capacities. Several months before the expiry of its term of office DELOITTE Central Europe Limited/Norton Rose was selected for financial consultant determining the funding structure of the project. Parsons Europe Limited was selected an engineering architect. Three options for Belene Nuclear Power Plant are considered in the plans for the development of Bulgarian electricity power system till 2020. The minimal new nuclear capacity envisaged in the NEC report is 1200 MW. According to these plans, one 1000 MW unit will be put into operation in 2010 in the event Unit 3 and 4 of Kozloduy Nuclear Power Plant are decommissioned in 2006. 2014–2015 is the deadline for putting the new reactor into operation if the two VVER 440 reactors operate by the end of their operation life, which seems impossible at present. The government revealed its intentions to make in kind contribution in Belene NPP contributing Units 5 and 6 of Kozloduy NPP, the existing infrastructure in Belene site and one available 1000 MW reactor.

<sup>42</sup> Rules for the Terms and Conditions for Access to Electricity Transfer and Distribution Networks.

The government guarantee on the loans for the project financing is planned to range from 51 to 81 per cent. A positive sign in this case is that no contracts for mandatory purchase of electricity are planned. Government guarantees appear to be a more acceptable option for securing the loan than binding contracts. Mandatory purchase inhibits the effect of market principles. At the same time, the taxpayer will pay twice – the first time through the repayment of the loan granted by the government, which is the majority owner, and on the other hand, NEC will buy out electricity at fixed prices even in the event of surplus and lower market prices. Whereas government guarantees might not be activated. Calculating the increase of government debt as a result of government guarantees, the result shows<sup>43</sup> that this guarantee is unlikely to prevent Bulgaria from meeting the Maastricht criterion for debt/GDP ratio. Including the government guarantee in the government debt for 2004, the result will be that the above ratio will reach a maximum of about 58 per cent. At the same time, the upward trend in GDP is expected to continue, which will render the ratio even smaller when including the guarantees at a later stage.

The construction of new nuclear facilities as well as their decommissioning is closely related to the final phase of the nuclear cycle – processing nuclear fuel and nuclear waste. In relation to this the Ministry of Energy and Energy Resources prepared and presented a “Strategy for Managing Processed Nuclear Fuel and Nuclear Waste”. The Strategy covers all aspects of the issue of processed nuclear fuel and nuclear waste management. The specific parameters and calculations in the Strategy are elaborated on the basis of the two options for managing processed nuclear fuel implemented worldwide. Under the first one processed fuel undergoes secondary processing, while under the second one it is buried directly. Major outcome of the processing is that approximately 30 per cent of the waste can be used again as nuclear fuel. Implementing the methodology<sup>44</sup> under the conditions existing in the country, the results give advantage to the first option. It is the one preferred by MEER. The expected net present value (NPV) of the first option (processing) exceeds more than twice the NPV of the second one (direct burial). It should be noted that the possibility of something going wrong and taxpayers having to pay much higher price is more than twice smaller when choosing the option of processing nuclear fuel.

Specifically, calculations indicate that overall expenses for implementing the first option total EUR 1,962 m, and EUR 3,735 m under the second option. This predetermines the level of the NPV indicator at EUR 554 m and EUR 254 m respectively. These expenses will provide funds for constructing and putting into operation a dry storage depot for 2,800 boxes of processed VVER 440 nuclear fuel, measures for rehabilitation and completion of the sea depot and any other technological and administrative activities related to processed fuel management. The main construction, renovation and optimisation activities

planned with regard to the management of processed nuclear fuel are due to be completed by 2010.

We should note that the portion of expenses at the last stage of nuclear fuel life accounts for only 5 per cent<sup>45</sup> of the price of one KWh of electricity, i.e. approximately BGN 0.005 for the entire final stage no matter which of the two options will be chosen. In this case we can figure that the difference between the two options will be a negligibly small portion of the price of electricity we use. Another significant point we should keep in mind is that when including the expenses for processed nuclear fuel in the NPP’s operational costs, the weight is equally distributed over the years. Under the option of direct burial expenses are postponed over time and would have to be paid in a considerably smaller timeframe.

The management of funds for processed nuclear fuel will be carried out by the Nuclear Facilities Decommissioning Fund. This alternative is far better than the possibility of this process traditionally running through the budget and the money being spent inappropriately. The revenue part of the Fund will be provided on the “Polluter pays” principle.

Timetables for completion of stipulated activities are specified in the Strategy suggested by the government, which gives us ground to conclude that intentions are serious and realistic.

## Prices of Energy Resources

Oil prices were one of the main factors influencing not only the energy sector but also the overall economic development of the country. 2004 was a year of record levels of oil quotations on international markets. The Brent oil prices exceeded the level of USD 50 per barrel in the last quarter of the year. The upward trend throughout the year was sustained mainly by the Middle East news, the level of US reserves and the increasing demand for crude oil in China resulting from the serious economic growth in this country. The issue about the limits to which OPEC<sup>46</sup> countries try to hold prices by regulating production quotas topped the agenda of the year. The regulation principle is to hold crude oil prices within the limits of USD 22-28 per barrel. However, the possibility of raising this limit and maintaining prices between USD 28 - 38 per barrel is given a more serious consideration. Although such a decision is not officially announced, the fact remains that at the last meeting of the year OPEC decided to reduce extraction. This decision was taken when oil prices were USD 40 per barrel of Brent crude

<sup>43</sup> The approximation is very close. The project cost includes the maximum possible amount of EUR 4 billion (according to media information), 81 per cent government guarantee and financing of the full amount of government participation with a loan. For 2004 forecasts of government debt and GDP are included. EUR/USD exchange rate of 1.3. In the calculations we assume that government guarantees will be given only for the construction of Belene NPP.

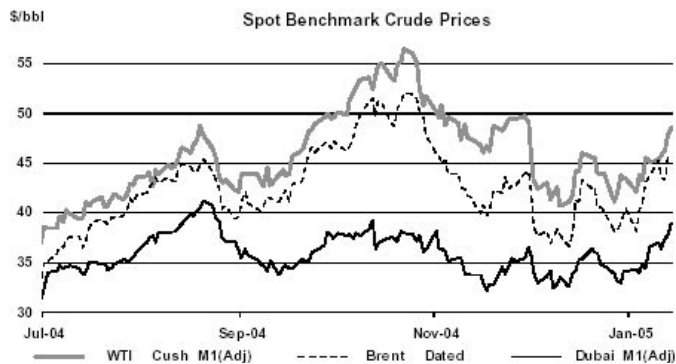
<sup>44</sup> The Methodology on studying the characteristics of the two possible options for processed nuclear fuel is developed by the Organisation for Economic Cooperation and Development and the Atomic Energy Agency.

<sup>45</sup> Trends in the Nuclear Fuel Cycle, OECD 2001.

<sup>46</sup> OPEC provide about 40 per cent of global oil supply.

with a downward tendency due to the news on US reserve levels and the weather, comparatively moderate for the season. We should point out that oil prices in 2005 would be greatly influenced by the possible outcome after the elections in Iraq and the forecasts about a slowdown in consumption growth in China in comparison with this year.

Figure 12. Spot Crude Oil Price Dynamics for WTI, Brent and Dubai Grades



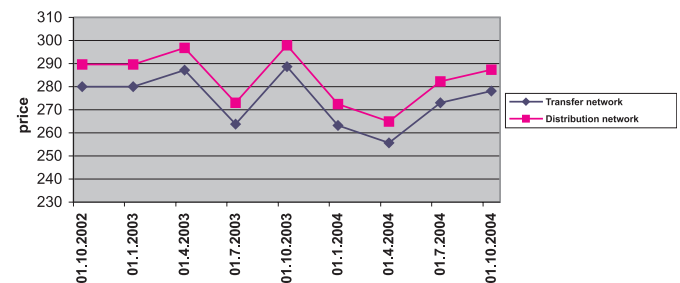
Source: Monthly report on crude oil prices, International Energy Agency, January 2005

The situation on international markets affects prices of crude oil in Bulgaria, because it meets its demand mainly through import. Fuel prices in the country were influenced mainly by rising oil prices and the depreciation of the dollar. The increase in oil prices in December 2004 against December 2003 is about 50 per cent, while the exchange rate of the dollar declined by 10 per cent. This led to an increase of fuel prices on domestic markets.

Natural gas is the other resource which greatly influences the development mostly of cement and fertilizer production plants, glass and chemical industry and companies in the energy sector. Prices of natural gas as an alternative to oil also registered an upward trend throughout 2004.

Actually, the burden of oil price growth was not entirely absorbed by prices of consumer goods. This is mainly due to the existing competition in the transport sector in which prices of services have the closest relation to fuel prices. In this case companies responded mainly by squeezing the profit because of higher expenses and not by raising downstream prices. This prevented disturbances to spread on final consumer goods whose prices include transport expenses.

Figure 13. Consumer prices of natural gas in 1000 BGN/m<sup>3</sup>, related to corresponding dates (VAT included)



Source: SCER

Since the beginning of July the average price of electricity for households has increased by 10 per cent, reaching 0.122 BGN/KWh<sup>47</sup>. It remained unchanged for industrial consumers<sup>48</sup>. This was the last planned rise of electricity prices.

<sup>47</sup> VAT included.

<sup>48</sup> Electricity prices for industrial consumers can be found on SCER website: [www.dker.bg](http://www.dker.bg).

The year 2004 marked the beginning of long-expected reforms in the industry. Parliament passed amendments to existing legislation and adopted new laws on different transport sub-sectors. These were the necessary prerequisite for introducing competitive environment in the different sub-sectors, entry of new investments and harmonization of Bulgarian legislation with the EU one. At the end of the year the Ministry of Transport and Communications presented to the public its "Strategy for the Development of the Republic of Bulgaria's National Transport System till 2015". Establishing joint ventures between state-owned companies and private business is an instrument embedded in the Strategy and implemented with regard to Trakia Highway.

During the year the Maritime Spaces, Inland Waterways and Ports of the Republic of Bulgaria Act was adopted. The amendments of the Civil Aviation Act and the Roads Act were the other two normative documents needed to enter the stage of practical actions essential for transport and the Bulgarian economy as a whole. Legislative amendments actually provided the possibility of private companies to launch activities related to construction, management and exploitation of sea, land and air transport facilities. Simultaneously, the way was paved for competition between individual companies in the aforementioned activities. A contemporary model of business relations in the industry is one of the eight strategic priorities inherent in the transport system development strategy. What lies ahead is the adoption of secondary legislation and practical implementation of the ideology embedded in the laws. Last but not least is the establishment of administrative structures to adequately regulate the activities of different transport sectors.

In the area of railway transport we witnessed the BDZ Development Strategy and the appearance of the first licensed private railway freight company. The realized bond loan for funding repairs of the company's existing assets is undoubtedly a sign of the national carrier's active management. Separation of transport activity from railway infrastructure management was a necessary prerequisite for a more effective management and elimination of cross-subsidy practices between different activities in the sector. At the same time we should note that competition and better financial results of the national carrier are impossible if conditions for access to the infrastructure do not become transparent and prices more affordable. At present there are no officially announced prices of access to the infrastructure. It is not clear what and how is financed within the Railway Infrastructure Company.

In the area of air transport several conflicting points emerged. The construction and renovation of Sofia Airport were accompanied by unnecessary tension generated by the sizable surge of prices of basic materials on international markets. Specifically, we should note that financial risk reduction mechanisms exist. Moreover, when a construction contract is awarded to a private company, part of the risk of the investment

project implementation transfers to it. The company itself should calculate such risks in its plans and include them in its profit in the form of risk premium.

Considerable interest in the concession of seaside airports was reported. Such interest is easily explained by the dynamic development of tourism in the country and the annual increase in passenger flows through airports, as well as by the expectation that this trend would persist in the future. The number of passengers coming through Varna and Burgas airports in 2004 is estimated at approximately 2.7 m, an almost 22 per cent increase on 2003.

Privatization of Bulgaria Air was not given a green light. The delay is an obstacle to the development of the company itself and the air transport in the country as a whole. The country's accession to the European "Open Skies" initiative will grant "low-cost" companies the opportunity to enter and operate freely on Bulgarian territory. This will inevitably give a positive momentum to the development of tourism followed by a healthy effect on airports' operating income. Delay in accessing the "Open Skies" initiative hinders implementation of the above results on one hand, and contributes to the increase of Bulgaria Air's market share and improvement of the future privatization's results, on the other hand.

Preparations to privatize the majority stake in BMF and BRP continued. A major weakness of both companies' privatization strategies is the allocation of weights of different components in the offers of the candidates, the price accounting for 70 per cent of the assessed value and the investment program – only 15 per cent. This could be explained by the fact that the political cycle of the ruling party is considerably shorter than the investment program. The government in office gives priority to one-off but higher budget revenues, while a long-term investment program is far more important to the development of both companies as well as to clients and employees.

Events that impact the future development of the sector provoked serious interest and discussions at the very end of the year. The concession of Trakia Highway deserves to be named the event of the year in the transport sector. As it became known, two state-owned companies, Avtomagistrali EAD and Technoexportstroy EAD, and three Portuguese companies,<sup>49</sup> set up a joint venture, Trakia Highway, for the purpose of obtaining the concession. Under such concession scheme and according to the Concessions Act, the government is not obliged to announce a tender or competition<sup>50</sup>.

The information announced in December outlines two divergent tendencies. The first one is related to the implementation of public-private partnership in road construction with high degree

<sup>49</sup> MSF-MONIZ Da Maia, Serra&Fortunato-Empreiteiros, S.A., Lena Engenharia e Contrucoes, S.A., Somague Concessoers e Servicos, S.A.

<sup>50</sup> Art. 36 of the Transitional and Final Provisions of the Concessions Act.

of liability being transferred to the private company. Private capital, expertise, efficiency and all the other positive results are provided as a result of the concession. The other tendency is related to the manner of selecting the investor and mainly to the lack of information in the public realm.

Public knowledge is a major prerequisite for this process to be conducted smoothly. The lack of timely information and presenting things at the final stage of the process of negotiating state-owned assets of national importance give the impression of non-transparency and existence of conditions for corruption. There is no official information on the agreements reached at the end of the year. The size of government compensations in the event of low use of the highway is not clear. The estimated actual and intended use is not clear either. There is no clear information about the expenses the new company needs to spend for building the remaining section of the highway and exactly how long this remaining section is. The only certain thing is that the country's roads really need rehabilitation and reconstruction and those decisions should be preceded by surveys and analyses, which should be subject to public discussion.

Another surprising government decision related to the situation in the transport sector was the establishment of the Public Investment Projects Company with a registered capital of BGN 260 m. The envisaged objects of the Company is building, reconstruction, and exploitation of sites under public investment projects of national or local importance. Interesting are the motives for establishing a new administrative structure for management and spending funds in the mentioned areas, given the existence of such structures in the specific sectors. This should mean that the existing sector companies do not function efficiently or a centralized decision-making scheme is sought for funds allocation. In practice, this would mean absence of synchronized action between individual institutions and inability to determine projects of national priority, i.e. inability to identify national interests.

The past year 2004 was crucial for the sector in many respects, the most significant event being the BTC privatization. The long-awaited deal stirred once again emotions among all interested when the license for the third GSM operator was involved. Regardless of the disputes, however, contracts were signed and in addition to the 65 per cent of the Bulgarian telecom the buyer Viva Ventures was authorised to build a GSM network.

At the end of the year several interesting analyses were published, relating to Bulgaria's progress in the electronic government area and ICT use in administration. The analyses reveal that despite stated intentions much more work needs to be done for the adequate implementation of e-plans and this applies to local authorities (municipalities) in particular.

The second successive "e-Bulgaria" report prepared by Applied Research and Communications Fund was released in October. The idea of the report is to present, on a regular basis, ICT penetration in Bulgaria in five major areas conditionally designated as e-access, e-education, e-government, e-society and e-business. The document is based on the first report (2002), using the same methodology and tracing the country's progress in the area of ICT use for the period 2002–2004. The "e-Bulgaria" index defined in the report shows a steady growth in the reviewed period, which means that the country has enhanced its capacity to take advantage of ICT possibilities over recent years.

In terms of access to ICT (Internet and mobile communication in particular) the situation in Bulgaria has improved considerably, i.e. there is enhanced capacity of the services offered in combination with lower prices, on the one hand, and higher demand consistent with awareness of the need for ICT use in every area of economic and social life on the other.

According to the report, the e-business area has developed most significantly in the reviewed period – most operating enterprises are connected to Internet and approximately 1/3 maintain their own web sites in the network. At the same time, information systems supporting businesses (ERP, CRM and others) are still insufficiently used.

The initiation of the electronic government is related to the launch of several pilot services provided on-line, as well as with ongoing computerisation of public administration. In spite of the efforts, work in this area is rather fragmented and inconsistent, focusing rather on response than on actual effect.

Bulgaria is not a country of the e-society yet – the share of Bulgarians using Internet is less than 1/5 of the country's population. In recent years, however, the use of the Web increased considerably as well as the Bulgarian content in Internet.

In terms of e-readiness education performs worst. The educational system in the country does not meet adequately ICT realities in modern world and schools and universities do not have the equipment necessary to provide quality training and ICT use.

Given the underdeveloped educational system in terms of ICT training and use, it is not surprising that serious problems in implementing government policy in this area exist. The Scandals about "unreasonably" spent budget funds started with the millions for licensing Microsoft software and continued with repeated tenders for computer equipment supply, implemented by the ICT Development Agency in November. Opened procedures for supply of some 8,000 work stations again stirred the Bulgarian IT market but what receded in the background was the true meaning of the purchase of this equipment – improving the quality of education in the ICT area and guaranteeing students' access to modern technologies. Unfortunately, the supply of computers alone could not resolve existing problems, at least because the issue of teachers and adaptation of academic plans to modern reality is still open. Nevertheless, launch of such procedures could be assumed as the first step toward improving the situation in Bulgarian schools. According to the stated intentions of the government this step will not be the only one.

Similar is the situation with the progress in introducing the electronic government in Bulgaria, according to the latest research of the Economist Intelligence Unit, prepared in collaboration with Oracle. The report ranks Bulgaria 11<sup>th</sup> (last) among Central and Eastern European countries, with a total score of 3.71 (10 is the highest score). There are several major reasons for the insufficiently rapid penetration of the e-government, the most important being the inadequate infrastructure of information and telecommunication technologies and the lack of IT skills among the bulk of the population.

At the end of the year so-called Bulgarian Virtual University (BVU) was established. The BVU is supported by all 37 state universities and is part of the government programme "i-University", aimed to create virtual educational space. The initiative is the third step in enhancing the opportunities of Bulgarian education through ICT use, following the Pilot Virtual Chair on Computing "John Atanasov" and the Virtual Faculty of Information and Communication Technologies (implemented with support from the ICT Development Agency for). For the time being, BVU will be a gateway to the sites of all regional universities and the idea is to expand functionality and add new content of its own in the future.

At the end of October the Communications Regulatory Commission (CRC) announced its decision on determining Mobiltel AD as operator with significant power on the market of mobile telecommunication networks and provision of voice telephone services. The decision is based on the

Telecommunications Act and the Methodology for the Terms and Procedure for Defining Operators with Significant Market Power (published in the State Gazette, issue 61/2004). According to these, CRC determines operators with significant market power after gathering and analysing the necessary information on companies' net income generated in the previous year, total volume of the relevant market segment and relevant share of participants in this segment.

The decision is based on the information provided by Mobiltel AD, Cosmo Bulgaria Mobile EAD and RTK OOD and according to this information the shares of the three participants in the relevant market are as follows: RTK OOD – 2.3 per cent, Mobiltel AD – 82.7 per cent, and Cosmo Bulgaria Mobile EAD – 15 per cent. According to the methodology's prescriptions, an operator holding more than 25 per cent of the total volume of the relevant market segment is defined as an operator with significant market impact.

Announcing Mobiltel AD as an operator with significant market power entails fulfillment of the obligations envisaged in the Telecommunications Act regarding interconnection and accordingly the company is obliged to provide interconnection with the other operators which request it, under the conditions laid down in the TA. Effective legislation does not provide for regulation of prices of mobile telephone services, regardless of whether the respective operator has significant market power or not. At the same time, entry of the third GSM operator on the market in mid-2005 is not likely to bring about changes in market shares, therefore no dramatic change in the policy of the first GSM operator in the country could be expected.

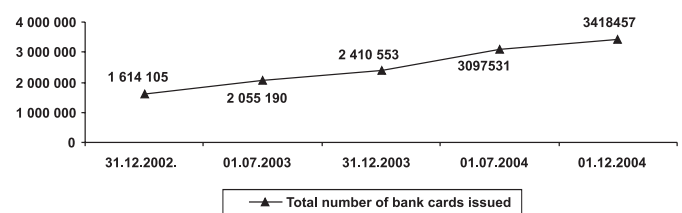
Following the good practice of some ministries, at the beginning of December CRC provided for public discussion via its web site the "Regulatory Policy for Using Numbers, Addresses and Names in Telecommunications" project. The document is designed pursuant to Art. 27, item 10 of the Telecommunications Act and it is aimed at determining the main directions in using and allocating numbers from the National Numbering Plan (NNP), the addresses and names necessary for performing telecommunication activities. Adoption of such policy is part of the liberalisation of the telecommunications market and much more efforts are needed for its actual implementation. Another step in this direction is CRC's intention to issue three licenses for third-generation mobile telecommunication systems under UMTS standard, announced in early November. Within the time limit set five companies showed interest in applying for a license – Mobiltel AD, Cosmo Bulgaria Mobile EAD, BTC AD, the English-based company First Place IR and the Swiss telecommunication company Tele 2. UMTS licenses for the Bulgarian market will be valid for 20 years. One of the three licenses will be class A and will provide capacity of two 10+5 MHz with initial license fee of BGN 70 m. The other two licenses will be class B and will provide capacity of two 5+5 MHz against initial license fee of BGN 42 m. Globally, entry of

UMTS was delayed mainly because of weak consumer interest and high service prices. Overestimation of solvent demand for third generation mobile technologies, however, will hardly be a problem for Bulgaria, as companies interested in obtaining a license already have the example of developed countries and a more "sober" awareness of market realities. It is a fact that most consumers in the country consider GPRS (or 2.5G) as unnecessary luxury and the situation with UMTS appears to be similar. According to the Strategy for introduction of universal mobile telecommunication systems, adopted by the Council of Ministers at the end of July, provision of UMTS services to customers should start by the end of 2006.

At the end of 2004 BTC announced its intention to buy the analogue mobile operator Mobicom. To this end BTC should acquire the 49 per cent of the British company Cable & Wireless and the 12 per cent of Radioelectronic Systems in Mobicom. The purchase of the remaining package of Mobicom is of crucial importance for the launch of operations of the third GSM operator (BTC) since the idea is to use the company's infrastructure as a platform for the new GSM network. Despite certain doubts about the lawfulness of the transaction, probably CRC and the Commission for Protection of Competition will give a green light for its accomplishment. Ultimately consumers will benefit from this as increased competition in the sector could lead to better services and lower prices.

The upward trend in the number of issued cards, functioning ATMs and POS terminals continued at a steady pace in 2004 (Figures 14 and 15). The number of bank cards issued has doubled over the past two years, posting a 40 per cent growth on the end of 2003. The data do not include non-bank credit cards (Euroline and Transcart), which have over 100,000 users. Similar is the situation with the number of ATMs and POS terminals, the latter being twice as many as at the end of 2003. Use of electronic methods of payment contributes to constraining the gray sector of the economy and facilitates transaction processes. At the same time the level of consumer "culture" for this type of electronic money is not sufficiently adequate to ensure their faster spread.

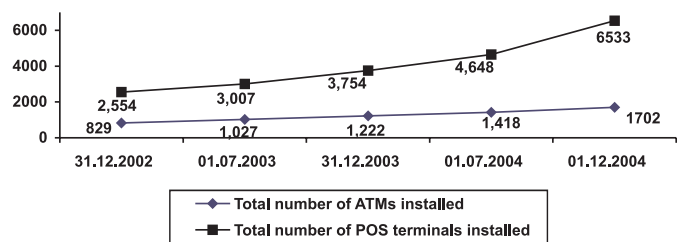
Figure 14. Total number of bank cards issued (2002 – 2004)



Source: Borica AD ([www.borica.bg](http://www.borica.bg))



Figure 15. Total number of ATMs and POS terminals installed (2002 – 2004)



Source: Borica AD ([www.borica.bg](http://www.borica.bg))

## Number of Tourists and Revenues from Tourism

The positive trends in the development of Bulgarian tourism continued in 2004. The past year was the best for Bulgarian tourism in terms of the number of foreign tourists who visited the country as well as revenues earned.

According to data from the Ministry of Economy, the number of foreign tourists who visited Bulgaria for holiday or vacation in the period January – November 2004 exceeded 4.3 m. The European market is increasingly becoming a major tourist market for Bulgaria – with average growth in the number of foreign tourists in January - November 2004 of 14.4 per cent, the number of tourists from EU countries (new members excluded) grew by 25.03 per cent. The highest number of tourists came from Greece (more than 570,000 in the first 10 months of the year) and Germany (560,000). The year saw a considerable growth in the number of tourists from Great Britain – 63.3 per cent. Growth is reported in respect of almost all countries – Sweden 37 per cent, Austria 41 per cent, and Finland 19 per cent.

Bulgaria is gradually recovering its position in the market of Central European countries – the number of nationals of the Czech Republic who visited the country in the first 10 months of the year increased by 30 per cent, Poland – 62 per cent, Slovakia – 17 per cent, and Hungary – 53 per cent.

At the same time, in the period January - October 2004 the number of Russian tourists decreased by 1.7 per cent and the number of Macedonian tourists fell by 1.8 per cent. The most substantial decrease was in the number of Ukrainian tourists – more than 30 per cent compared with the same period of last year, suggesting a possible gradual loss of position in this market.

According to data from the Ministry of Economy, the number of Bulgarians who travelled abroad for all kinds of purposes totalled 3.5 m in the period of January - November. In the last months of the year a downward trend in the growth of the number of travels of Bulgarian nationals abroad was reported as a whole and specifically to Turkey and Greece. However, the growth rate of the number of travels to West European countries and particularly to Germany, Italy and Spain remains unchanged.

The most frequent destinations for Bulgarians continue to be Turkey (1.2 m Bulgarians visited this country in January - November), Greece (514,000), Serbia and Montenegro (380,000) and Germany (244,000).

Revenues from international tourism for the period of January - October 2004 totalled EUR 1.601 b, an increase of 20.77 per cent compared to the same period of last year. At the same time, expenditures of Bulgarians who travelled abroad in the first nine months of the year exceeded EUR 656 m, which is

17.82 per cent more against the same period of 2003. Net revenues from international tourism in the first 10 months of the year reached EUR 944.8 m. This is a 22.9 per cent increase against the same period of 2003.

It is expected that tourism revenues for the whole year will exceed EUR 2 b. Against the background of expected revenues in Croatia for example (EUR 9 b) these figures feature a still low performance indicator, notwithstanding the fact that this year was the most successful for Bulgarian tourism. According to estimates of the World Tourism Organization, the number of foreign tourists in Bulgaria could exceed 10 m not earlier than in 2020.

## Tourism Development Strategy

A draft strategy named “Sustainable Development of Bulgarian Tourism 2005-2010” was presented in October 2004 at a national conference. The document was drafted with the active participation of big companies from tourism industry, which is undoubtedly an advantage. The Strategy will be presented to the Council of Ministers and, if adopted, will turn into a major underlying document of implementing government policy in the field of tourism. The document contains the following major parameters of tourism sector development:

### Ratio of revenues from sea and other types of tourism 2004 -2010

revenues from sea resorts	80	55
revenues from other types of tourism	20	45
Services ratio in %		
basic services	65	45
additional services	35	55
Tourist-days (million)		
total Bulgarians and foreigners	22	60
only Bulgarians	4	24

The main priorities to achieve the above quantitative indicators were outlined. These priorities will be leading when allocating the funds in tourism development. The Strategy envisages the creation of expert councils to oversee the projects for building tourism facilities in resorts and residential areas and monitor the use of maritime, mountain, spa and other tourist resources. The decisions of the councils will be based on the guiding principles set forth in the Strategy.

The Strategy envisages diversification of the tourist product by an active development of all forms of alternative tourism. At present 80 per cent of the hotel base is concentrated in 20 municipalities, which constitutes just 9 per cent of the country's territory. On the other hand, over 80 per cent of the revenues come from sea tourism. This means that rural, hunting, spa, congress, cultural, ecological and other forms of specialised tourism will develop more actively.

It is noted in the Strategy that hunting tourism has an outstandingly potential – Bulgaria has 56 elite hunting reserves, but revenues from this type of tourism total just EUR 2 m, while Hungary for example has only 6 hunting reserves and EUR 300 m of revenues from hunting tourism.

However, sea tourism will be dominant throughout the next five years and the Strategy envisages an enlargement of the summer resorts. The Sunny Beach, Nessebar, Ravda and Sveti Vlas resorts will most probably merge into one.

Among winter resorts, Borovets, Pamporovo and Bansko have priority. According to the Strategy, new facilities will be constructed in Semkovo, Berkovitsa, Syutka in the Velingrad area and in Rakitovo and Perelik near Smolian.

Other strategic priorities in tourism are:

- Improving the quality of the tourist product.
- Attracting more solvent tourists by implementing a targeted pro-active policy for utilising the opportunities of the mineral water springs, orthodox monasteries and other cultural sights. At present a foreign tourist spends in Bulgaria just USD 43 a day, while globally the average expenditures of a tourist exceed USD 80 per day. The average revenues from a holiday of a foreign tourist in Bulgaria are USD 420 at present, while globally this indicator stands at USD 675.
- Reaching a balance in the ratio of basic and additional services revenues – at present 70 per cent of the revenues come from basic services – hotels, food, and transportation. Only 20 per cent of the money comes from additional services. It is necessary that this ratio is equalised.
- Considerable improvement of transport infrastructure.

Developing the Strategy was a good initiative, but the draft was subjected to a critical analysis by experts and people working in the industry and will be thereby improved. The document, as mentioned above, still gives priority to sea and winter tourism. According to small and medium-sized companies operating specific forms of tourism – rural, ecological, cultural and historic – this type of tourism is underestimated and given little comment in the Strategy. According to them, rural, ecological, cultural and historic tourism have an outstandingly potential especially for attracting more solvent tourists. Moreover, it is one of EU recommendations – the focus should be on specific forms of tourism as an opportunity for development of less developed municipalities in the country.

Contrary to this opinion, others argue that specialised forms of tourism do not have the potential yet to influence considerably the image of the Bulgarian tourist product and to change substantially the idea of Bulgaria as a destination for summer sea vacations and winter skiing holidays. This is consistent with

the lack of sufficient financial resources and modern specialised and road infrastructure. It is considered that sea tourism still has plenty of unexplored opportunities, because it uses only about 1/3 of its potential. The problem is that for most of the year the sea resorts are empty – their capacity is almost fully utilised only in July and August. It is necessary to develop programmes for all-year utilisation of the facilities in the sea resorts. Other serious problems are related to high building construction, which drives away the tourists, and recommendations for low building complexes are made.

Winter tourism contributes to about 10 per cent of tourism revenues and also has a considerable and still unutilised potential. The Bansko example and prospects for implementing the “Super Borovets” project could increase the significance of winter tourism as well.

According to experts, other disadvantages of the suggested draft Strategy are: lack of clear definition of specialised forms of tourism, insufficiently clarified role of the government, municipalities, NGOs, and representatives of the business in the process of the Strategy’s implementation.

Experts in the industry also underline that sustained development of tourism has not been considered. In many cases ecological aspects are neglected and tourist industry development leads to destruction of nature and cultural monuments.

It is necessary that the Strategy focus on transport problems and the condition of airports in particular. A serious modernisation of Burgas and Varna airports is necessary. Traffic to seaports has increased by over 40 per cent and modernisation and expansion of their capacity is a mandatory condition for the successful development of sea tourism.

## Legal Framework

Amendments and supplements to the Law on Tourism<sup>51</sup> entered into force 13 November 2004. The amendments provide for transition from licensing to registration regime for conducting tour operator and tourist agent activities.

According to the amendments, licensed tour operators are registered ex officio upon submission of insurance contract to the Ministry of Economy, covering the tour operator’s liability.

Licensed tour operators who fail to submit the legally required documents on a timely basis are not subject to entry in the Register of Tour Operator and Tourist Agencies. Licensed tourist agents will be registered ex officio and no additional documents are required from them.

<sup>51</sup> Published in the State Gazette, issue 39 of 12 May 2004.

A draft Law on the Black Sea Coast was actively discussed throughout the year. A draft of this act was presented in May, updated and published on the web site of the Ministry of Regional Development and Public Works. Protests against the initial draft came from owners of seaside land, investors and mayors, mainly because of the ban on construction along the two-kilometre zone near the seacoast. They argue that in practice this ban means "land nationalisation", lower price of plots and reduced investment and revenues into local budgets.

The new draft has taken into account recommendations made during public and professional discussions and the ban is mitigated.

Limited construction is allowed in the two-kilometre zone mainly of water supply, sports and sanitary facilities. Moreover, an opportunity is given to modify the purpose of agricultural lands and forests in order to enlarge the land underlying buildings and structures.

The general objective of the draft law is to ensure a reasonable build-up of plots adjacent to the beach strip, gradual increase of the intensity of the construction process and extension of the distance to the beaches.

The new draft gives more powers to the local authorities to approve construction plans, but obligates them to include in the respective committees experts from 7 ministries and architecture and construction associations.

It is noteworthy that representatives of the Union of Architects did not approve the new, more liberal draft – they favour the more stringent first draft. They argued that it was necessary to stop the indiscriminate construction along the Black Sea coast which damages nature. The experience of many countries shows that they have adopted restrictive laws to limit construction in seaside areas. Regrettably some of these countries adopted the measures too late when the consequences were irreversible. The same may happen in Bulgaria given the fact that the adoption of the Law on the Black Sea Coast was unusually delayed. Such a specialised law was discussed back in 1992, but it has not been adopted until now, which is detrimental to the future development of the seaside zone.

### **Marketing and Advertising**

Further successful development of tourism in Bulgaria requires active advertising of the country. The presentation of Bulgaria as an interesting tourist destination is among the priority tasks of the Tourism Agency. At the end of 2004 the Agency announced that next year would witness the beginning of gradual establishment of a national tourist information system in Bulgaria. The system is expected to provide comprehensive information on the country – natural, cultural and historic sites, hotels, tourist agencies, restaurants, places of entertainment,

attractions, etc. Funds necessary to implement this remarkably useful initiative are considerable, about BGN 600-700,000 will be needed only in 2005 to make such system operational, according to calculations of Agency's experts. They will be spent for buying software, servers, construction of website and imaging. The system will offer information in several languages – English, French, German, Russian and Spanish.

The national tourist information system is expected to function as part of the National Tourist Information Center existing at present. This will enhance the advertising element in its activities.

The Ministry of Economy maintains a register of categorised hotels, lodging facilities and restaurants, as well as licensed tourist agencies. These data will also be embedded into the future national tourist information system.

Problems related to the completeness and comprehensiveness of the information system in the country would originate from the fact that municipalities do not submit accurate information on facilities categorised by them. These data should also be included in the information system. In principle, municipalities categorise up to two-star hotels and lodging facilities and are obliged to inform the Tourism Agency about this – something which is not happening until now.

Several private companies also work to promote the country as a good place for tourism. Bulgaria is presented in the international Internet hotel system "Inn 26" which includes over 50,000 facilities from 16,000 cities in 204 countries. Lots of Bulgarian facilities are included – hotels, camping and accommodation outlets, rent houses, motels, etc. The system presents hotels in Sofia, the Black Sea coast – Sunny Beach, Golden Sands, Albena, Nessebar and others. Facilities from the winter resorts are also included – Borovets, Bansko, Pamporovo. Access to the website is free and allows quick and easy reference and online reservations. Such practice is a good opportunity to promote hotels and other tourist sites internationally and implement modern ways to establish contact and make reservations.

Bulgaria continues its regular participation in large tourist exhibitions – the country was presented for the 24<sup>th</sup> time at the London exhibition in November. The Tourism Agency and 24 Bulgarian tourist companies participated with a booth 190 sq. m. large. Such exhibitions are one of the most effective ways of attracting foreign tourists. A proof of this is the rising inflow of British tourists (over 60 per cent, as mentioned above). Conventional tourism still prevails, but among other factors this exhibition contributed to the gradual reshaping of the country's image as an attractive place, rich in history, discoveries of global significance and archaeological excavations. This is a way to shift towards more solvent tourists who can visit Bulgaria all around the year.

Implementation of a more targeted policy regarding Asian countries and specifically Japan and China is an innovation in supply and advertising. The country will take part in the first tourist exchange in China.

During last year priorities in advertising are related to the shaping of a new image of Bulgaria not only as a place for summer and winter ski tourism, but as a diversity of opportunities. This requires the implementation of aggressive advertising policy by way of new methods, channels and equipment.

## **Corporate Strategies**

The past summer season outlined again some of the major problems related to the quality of company strategies in the branch. Companies do not use the advantages of marketing sufficiently. Huge funds are invested in constructing hotels, but after that owners and managers do not conduct consistent marketing surveys of the opportunities for utilising the facilities and do not get feedback from guests. No advance surveys are made to establish the potential users of the specific services offered by hotels. The other problems on a company level – low product quality, bad service – are the reason why few of the tourists come back to Bulgaria next year. Conducting of active marketing surveys and drafting of appropriate strategies can provide companies with sustainable competitive advantages. Moreover, these are long-term strategies which would reduce the risk of rapid moral and physical amortisation of specialised infrastructure and prolong the period of its use.

The lack of long-term marketing strategies is one of the reasons for the low competitiveness of Bulgarian tourist companies.

## Condition of the Sector

The year 2004 was a successful one for Bulgarian agriculture, the value of agricultural production at current prices increasing by 7 per cent compared with 2003. However, the clearly outlined downward trend in the share of agriculture contribution in GDP and GVA continued. For the nine months of 2004 this share is 10 and 11.5 per cent respectively, against 10.4 and 11.9 per cent in the same period of 2003.

According to latest data of the Ministry of Agriculture and Forestry, 3.96 m t of wheat, 1.18 m t of barley and 1.89 m t of maize were produced in 2004. Sunflower crop amounted to 1.10 m t. The 2004 crop is considered one of the best over the past 5 years. It allowed for a considerable increase in exports of agricultural products, which are estimated at over USD 1 b for 2004 as a whole (40 per cent more than in 2002). Animal products also showed a steady upward trend, though not so clearly pronounced. The growing number of animals is combined with increased number of professional animal farms. Progress in the development of the dairy sector boosted production and export of dairy products. This was due also to the certification of new enterprises for exports to EU, their number reaching 30.

Good grain crop contributed to reducing purchase prices as a result of increased supply. Increased quantities of goods produced and limited domestic market boosted export of wheat and sunflower, thus enabling price regulation. The intervention of the State and War-Time Reserves State Agency by purchasing approximately 170,000 t of wheat to replenish reserves had a similar impact. Despite expectations, the grain market did not see any significant fluctuations and a trend of staged seasonal rise in quotations set in gradually. Over recent years the agency was granted the right to perform intervention functions but this right was withdrawn with the amended by the government Grain Storage and Trade Act. The Support of Agricultural Producers Act lays down the legal framework for intervention in the grain market in line with European legislation. The aim is to improve the conditions for grain market operation. The problem is that no real independent intervention agency has been set up yet in accordance with such legislation.

The total export volume of agricultural output (mainly grain and oil-bearing crops) is expected to exceed USD 1 b. Good weather conditions and subsidies granted by Agriculture Fund favoured autumn sowing. The land under wheat is estimated at more than 10 m decares, and that under sunflower, at over 2.5 m. The number of cattle increased by 4 per cent, pigs decreased by 15 per cent, and sheep fell by 2 per cent.

The situation in the vine-growing sector proved entirely different – unfavourable weather conditions and poor grapes crop exacerbated problems in the sector: existing vine yards were planted 30-40 years ago; fragmented vine yards render production ineffective; existing wine production facilities

are being expanded and new ones are being established disregarding the quantity of available raw material. All this reflects on the grapes market and higher demand results in higher prices, while the quality offered is not satisfactory to wine producers. The solution is sought by creating own vine massifs to ensure the necessary raw material. This way producers would be able to comply with the amendments to the Regulation on the conditions for quality wines from a designated area, adopted by MAF. According to these amendments, the origin of the wine shall be the region from which the grapes originate, i.e. the origin of the grapes and the processing of the grapes shall originate from one and the same region. The reason for this is the assumption that essential characteristics of the geographical environment do not include only natural conditions, but manufacturing traditions as well.

## Environment for Development

More than a year ago farm census was taken, but the results from it have not been announced yet. Establishing the number and size of agricultural farms turned into yet another uncompleted exercise like the project for creating a land cadastre and property register, without which it is impossible to have real land market, as well as establishing a Land state company to deal with land consolidation. As it seems, the problem with land consolidation and land market realization would be left to be resolved by the next government. For the time being, fragmentation of land and farms does not allow development of efficient production, does not create conditions for attracting investments and does not provide opportunity for mortgaging farm property.

As Bulgaria's accession to EU draws near, the issue of amending the country's Constitution and removing the ban on land purchase by nonresidents emerged. The amendment is expected to stir the land market and result in higher price. On the other hand, linking future agriculture subsidies granted under EU structural funds with the size of arable land will incentivize farmers and leaseholders not only to declare actually processed land but also to expand it with new land. Thus interest in buying farm land will turn into a sustainable trend and the land price, which marked a gradual rise in 2004, would continue rising in the next two years.

As of mid-2004 acceptance of projects under some SAPARD Programme measures was discontinued due to depleted financing. In November the European Commission adopted changes in SAPARD conditions, envisaging increased financial aid for investments in farms, made by young farmers aged up to 40 or in mountain regions. Farmers in Bulgaria, however, will not be able to benefit from those changes as the funds under measure 01 – investments in farms – are entirely depleted. Implemented projects under this measure number 590. The value of stated projects exceeds significantly the funds planned for the country by the end of 2006. Still there is no answer to Bulgaria's formal request for granting additional finance under

this measure. A decision is expected on the country's proposal for shifting funds under other measures to measure 01. Another essential change under SAPARD Programme, adopted by EC, is non-recognition of VAT for companies not registered under the VAT Act applying for financing under the Programme. This would put additional pressure on farmers and would reduce the amount of disposable funds.

The fifth financial agreement with the European Commission was signed at the end of 2004, increasing the financial resources for 2003 by over EUR 386,000. The Commission gave permission to shift funds from areas of less interest to measures 02 and 03 – processing industry and diversification of economic activities. Financing of new projects under the measures for processing of farm products and improving their marketing, rural tourism, improving economic conditions in rural regions, production of organic farm and animal products is expected to be resumed from the beginning of 2005. Less than one-third of planned funds remain to be negotiated in the next two years and they should be directed to such measures as projects in the forestry sector, professional training, creation of producer organisations, wholesale markets, irrigation infrastructure. Accreditation under a new measure – development of agricultural activities aimed at environmental protection – is in the pipeline.

The existing situation in the implementation of the SAPARD Programme outlines clearly the need of improving the agency's work toward more rational utilisation of funds, application of more stringent and clearer criteria in selecting projects, exercising ongoing control on the fulfilment of the conditions for financing, introduction of priority areas and projects from these areas to be financed with priority. At present such a priority area is the dairy sector as it is deemed to be lagging behind compliance with European requirements and needs to be significantly modernized. A shift of EUR 15 m from other measures is expected in order to ensure additional target financing to improve the quality of fresh milk by introducing the necessary sanitary and hygiene requirements. The procedures for accreditation by EC of adopted changes are due to be completed and a new annual financing agreement for 2004 is to be signed. EUR 67 m is expected to be received under this agreement, 20 per cent more than in 2003.

### Legal and institutional framework

The past year 2004 was very important for Bulgaria in terms of the country's preparation to conduct effective regional policy and successfully absorb the financing from EU pre-accession and structural funds. Some important events should be given special prominence - the European Commission established the financial framework for Bulgaria; the country closed the "Regional Policy" Chapter of its EU accession negotiations, and adopted the Regional Development Act.

The financial framework for Bulgaria for the three-year transitional period (2007-2009) will be EUR 4.245 b (EUR 2.3 b will be spent on structural policy). In experts' opinion, this is one of the best financial frameworks (*vis-à-vis* the territory and population) ever granted to a candidate country.

Bulgaria made a commitment to divide the country's territory into 6 planning regions and 28 regions *oblasti*. This was achieved through the new Regional Development Act<sup>52</sup> which stipulates the mechanisms of regional planning. The allocation of financial resources from European funds will be made precisely on the basis of such planning, and also on the basis of indicators from towns and villages and their most pressing problems. The six centers of administrative planning regions in the country are Burgas, Varna, Vidin, Ruse, Plovdiv and Sofia.

The adoption of the new Regional Development Act was necessitated by the need to align it with Regulation EC 1260/1999 laying down general provisions on the Structural Funds; establish a clearer definition of the functions of bodies implementing regional development policy; introduce a better monitoring and evaluation system; providing better information services to ensure that the needs of regional development are met.

Important implementing legislation was also promulgated - the Implementing Regulations on the organization and functions of Regional Development Councils (NUTS level 2)<sup>53</sup>, the Implementing Regulations on the organization and functions of Regional Development Councils (NUTS level 3)<sup>54</sup>, the Ordinance on the Terms and Procedures for the Adoption, Financing and Implementation of Regional Development Strategies, Plans and Program<sup>55</sup>.

Several papers on capacity strengthening of local governments to prepare planning and strategic documents were also drafted. To mention just a few of the more important ones, these are the Methodological Guidelines for drafting Regional Development Strategies at the NUTS 3 level, which enables regional governments to prepare their papers faster and more successfully.<sup>56</sup>

One of the provisions of the Regional Development Act<sup>57</sup> is the establishment of NUTS level 2 Regional Councils. At the end of

the year, the first NUTS level 2 Regional Development Council in Bulgaria was set up for the Southwest Planning Region. It covers the regions *oblasti* of Blagoevgrad, Kyustendil, Pernik, Sofia-City and Sofia-Region. The NUTS level 2 Regional Council is a body established to conduct the government's regional development policy at the "planning region" level. This Council will discuss and coordinate projects under the regional development strategies, approve the draft of the Southwest Planning Region Development Plan while adhering to the principle of public-private partnership; it will discuss and coordinate measures that should be included in the National Operational Program for Regional Development. The NUTS level 2 Regional Council will ensure cooperation with NUTS 3 Regional Development Councils and the central government bodies. In compliance with the requirements of the Implementing Regulations, the council membership includes representatives of several ministries, regional governors of regions constituting the planning region, and one representative for each of the municipalities in the region.

### The process of financial decentralization

During the last months of the year, debate on financial decentralization in Bulgaria was stepped up in connection with the forthcoming (in two years' time) EU membership and the need to improve the absorption capacity for resources under the EU Structural Funds.

A number of proposals were put forth towards enhancing the financial decentralization and transferring more power to local authorities. The proposals foresee changes in the country's basic law - the Constitution. At a conference held in December, the National Association of Municipalities together with the USAID's Reform in Local Government initiative announced they had prepared a draft for amendments to the Constitution<sup>58</sup> in its part concerning the financial independence of municipalities. The paper concerns Art. 141 of the Constitution stipulating how the budget of municipalities are formed. The authors of the draft propose that the following text be inserted: "...municipalities shall have the right to establish the amount of local taxes as well as the amount and type of local charges".

A proposal along the same lines was also put forth by Mrs. K. Kasabova, Deputy Chair of the National Assembly. It foresees preserving the authority of the Parliament to establish the types

<sup>52</sup> Promulgated Official Gazette, iss. 14 of 20 February 2004

<sup>53</sup> Promulgated Official Gazette, iss. 79 of 10 September 2004

<sup>54</sup> Promulgated Official Gazette, iss. 95 of 26 October 2004

<sup>55</sup> Promulgated Official Gazette, iss. 106 of 3 December 2004

<sup>56</sup> The Methodological Guidelines were approved by Order № ПД-02-14-388 of 26 July 2004 r. of the Minister of Regional Development and Public Works and are available on the MRDPW website.

<sup>57</sup> Art. 21, Para. 1 of the Regional Development Act

<sup>58</sup> The proposal was filed with the National Assembly in September 2004



of local taxes and charges, but with municipalities given the power to decide on the precise rates.

Support "in principle" to financial decentralization was also given by representatives of all political parties in the country. There is, however, some amount of doubt as to the financial support to small municipalities whose revenues may decrease if the state were to cut down budget subsidies at the expense of local taxes. This would set the ground for deepening the gaps between municipalities. A balance must be found between the interests of small and large municipalities as the latter generally have more opportunities to secure their revenues.

The proposal for decentralization is also supported by the Ministry of Finance. According to the Ministry, the most successful model for the country would be one where municipalities manage the tax rates on their own, but are restricted as regards establishing the tax base.

The greater financial independence of municipalities would allow them to accumulate more funds as a result of business initiatives and help them absorb more effectively the financial resources under EU structural funds. According to experts, however, changes can be put in place no earlier than 2007. Amendments should be introduced not only to the Constitution but also to the Local Taxes and Charges Act. It is hardly to be expected that municipalities will be given actual power to determine the size of local taxes.

At the end of the year proposals were also made for municipalities to be given a larger percentage of state taxes - VAT, personal income tax, corporate tax. According to mayors, experience in other countries shows that municipalities get between 35 to 40 per cent of funds collected from these taxes, while in Bulgaria municipalities are given as few as 12-13 per cent.

General Tax Directorate officials are also in favor of municipalities' independence in setting local taxes. In their opinion, the state must set only the guidelines for setting tax rates, but not the precise amount. As a whole, the tax administration gives priority to government policy with respect to taxes - VAT, corporate taxes and personal income tax. Municipalities' greater degree of independence will provide more incentives for municipal authorities in the process of defining and collecting local taxes.

The process of delegating authority by the state to local authorities in administering local taxes and charges is currently underway. The first municipality which started exercising these new powers was the municipality of Pomorie; it subsequently reported a 60 per cent growth in revenues. The reasons behind this are the improved control on the collection rate of revenues, the municipality's ability to plan revenues and to control the collection process.

The first large regional cities which took over administering local taxes and charges were Dobrich, Shumen and Silistra.

Agreements to transfer authority in the collection of local taxes and charges have also been signed with the municipalities of Troyan and Dupnitsa. A total of 95 municipalities have taken over the administration of local taxes.

### **Absorption of pre-accession funds**

#### *PHARE Programme*

In early December 2004 the European Commission Delegation to Bulgaria approved 27 projects under the EU PHARE Programme for development of Bulgarian eco-tourism. EUR 4.9 m will be disbursed under these projects, with 75 per cent of funds ensured from the EU budget, 25 per cent will be co-financed from the national budget. Only a small part of it must be provided by the selected municipalities. The approved projects are for municipalities on the territory of 14 regions in Bulgaria.

The programme's goal is to provide conditions for sustainable growth in tourism and improve the competitiveness of the Bulgarian tourist product on international markets. Other important priorities include: expanding the geographical scope of the tourist industry, making the tourist season longer, improving the qualification of those employed in the industry, improving the access to information and the quality of advertising.

Under the programme, the activities in individual projects must be planned and implemented by the end of September, 2006. Some of the approved projects are for upgrading the infrastructure needed for environmental tourism; improving the potential of tourist services through new construction, reconstruction and repair works; improving the infrastructure of protected areas etc.

#### *PHARE - Cross Border Cooperation*

The PHARE CBC Programme provides grants for activities related to the development of cross-border contacts. This contributes to the economic growth and stability in border regions, strengthening administrative structures at the national and local level, and preparing the country for participation in EU structural funds.

During the 2004-2006 period, Bulgaria must absorb EUR 3 m in EU grants for cross border cooperation with Turkey. This is planned for under the Financial Memorandum between the government and the EC's PHARE Programme approved by the CoM late last year. Funds will be used for implementing projects to improve the transport infrastructure and enhance the economic activity and cross-border contacts at the local level through the Joint Small Projects Fund (People-To-People). A large portion of these funds (EUR 2.5 m) would be used to build a road from Malko Tarnovo to the border crossing checkpoint with Turkey. The country's financial contribution is in co-financing EUR 0.850 m.

*ISPA Programme*

The municipality of Ruse will get EUR 30 m under ISPA to be used in the construction of sewerage facilities, a water supply system and water-treatment plant. These funds should be used for solving problems crucial for the municipality.

**Some good practices in local governance**

In November the municipality of Varna announced its intentions to establish in 2005 an Electronic Register of Debtors. An electronic database will be established for all contracts and permits; the incoming revenues from all individuals and legal entities using municipal services will be recorded on real-time basis. This is one of the 10 new financial management practices implemented by the municipality of Varna. The municipality introduced a pilot model of analysis, long-term planning and forecasting of the municipal budget. This allows for more objective estimates and looking for more up-to-date methods to finance capital expenditures. The municipality of Varna is a ground-breaker also in introducing the Financial Management and Control System.

At the end of the year the municipalities of Varna and Gabrovo started the construction of high-tech business incubators, to assist start-up enterprises in the area of high technology. The technical and software tools will be developed for the storage and exchange of citizens' data and for establishing standards for the integration of information systems into the municipal administrations' network.

# ANNEX 1: MAIN INDICATORS FOR 2004

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
Economic dynamics															
<b>Industry</b>															
<b>Industrial production, volume index, previous month =100, %</b>															
2004	85.4	105.8	113.2	89.7	100.5	111.9	98.8	95.2	108.2	99.8					
2003	86.5	96.7	116.7	91.8	94.6	111.8	103.1	93.7	109.0	102.2	99.5	112.6	-	-	-
<b>Industrial production, volume index, corresponding month of the previous year = 100, %</b>															
2004	112.7	120.6	117.8	114.2	121.3	121.5	116.5	118.3	117.4	114.7					
2003	115.4	115.4	123.4	111.9	109.6	115.4	113.0	110.3	115.9	117.9	111.3	123.5	-	-	-
<b>Industrial production, from the beginning of the year, volume index, corresponding period of the previous year = 100, %</b>															
2004	116.1	118.4	117.8	116.9	117.8	117.9	117.7	117.8	117.7	117.4					
2003	115.4	115.4	118.2	116.4	115.0	115.4	115.0	114.4	114.5	114.8	114.5	115.2	-	-	-
<b>Industrial sales, total, volume index, previous month =100, %</b>															
2004	84.2	110.1	114.7	93.6	97.3	115.6	101.6	92.1	110.7	99.1					
2003	86.2	96.8	119.6	92.6	98.5	108.8	102.5	93.9	106.3	103.4	98.2	111.0	-	-	-
<b>Industrial sales, total, corresponding month of the previous year = 100, %</b>															
2004	111.4	124.1	119.1	120.4	118.9	126.4	125.3	122.9	128.1	122.8					
2003	117.7	116.4	130.4	111.3	117.8	118.3	113.4	111.4	116.3	121.5	114.4	121.3	-	-	-
<b>Industrial sales, total, from the beginning of the year, volume index, corresponding period of the previous year = 100, %</b>															
2004	111.4	117.6	118.1	118.7	118.8	120.1	120.9	121.2	122.0	122.1					
2003	117.8	117.1	121.6	118.8	118.6	118.6	117.7	116.9	116.8	117.3	117.0	117.4	-	-	-
<b>Trade</b>															
<b>Trade and repairing activities, total, net receipts from sales, volume index, previous month =100, %</b>															
2004	82.2	106.1	102.4	99.4	100.4	104.3	107.1	104.0	104.5	101.5					
2003	71.0	102.7	107.1	101.7	102.6	102.9	106.5	98.2	104.2	102.7	96.8	114.4	-	-	-
<b>Trade of motor vehicles and motorcycles, repair of motor, retail trade of automotive fuel, net receipts from sales, volume index, previous month =100, %</b>															
2004	79.7	107.4	107.6	105.6	95.4	109.2	106.0	105.4	95.9	108.9					
2003	76.7	98.0	107.3	102.7	103.4	107.0	105.9	100.1	102.8	105.2	99.2	108.1	-	-	-
<b>Wholesale and commission trade, net receipts from sales, volume index, previous month =100, %</b>															
2004	83.9	106.7	100.7	97.9	100.1	103.6	108.0	104.3	106.0	100.0					
2003	70.2	104.1	106.7	101.2	102.2	102.2	107.1	97.3	104.8	102.3	96.4	114.7	-	-	-
<b>Retail trade, repair of personal and household goods, net receipts from sales, volume index, previous month =100, %</b>															
2004	75.1	101.5	109.5	103.0	106.1	104.6	103.2	101.6	103.0	104.4					
2003	71.0	98.9	109.4	104.1	104.3	103.4	103.7	101.1	102.5	103.0	96.9	117.4	-	-	-
<b>Trade and repairing activities, total, net receipts from sales, volume index, corresponding month of the previous year = 100, %</b>															
2004	114.1	114.4	112.8	112.5	110.0	112.2	113.0	116.1	117.2	115.4					
2003	106.1	107.2	108.1	110.0	110.1	108.0	107.2	104.6	105.7	104.9	102.4	105.8	-	-	-

# ANNEX 1: MAIN INDICATORS FOR 2004

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>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, %</b>															
2004	111.9	111.3	112.3	121.9	114.7	119.2	119.8	119.1	117.6	120.4					
2003	103.5	98.8	100.6	101.2	102.5	104.1	103.8	102.3	103.1	103.9	101.5	105.2	-	-	-
<b>Wholesale and commission trade, net receipts from sales, volume index, corresponding month of the previous year = 100, %</b>															
2004	114.5	114.9	113.0	111.4	108.9	110.9	112.0	116.3	117.9	114.8					
2003	107.5	109.5	109.8	112.0	112.2	109.0	107.7	104.6	105.8	104.5	101.7	105.5	-	-	-
<b>Retail trade, repair of personal and household goods, net receipts from sales, volume index, corresponding month of the previous year = 100, %</b>															
2004	113.1	113.9	111.5	112.1	113.0	114.1	113.6	113.2	113.3	115.1					
2003	102.0	102.1	104.4	106.4	105.5	105.9	106.9	106.2	106.9	108.1	106.3	108.0	-	-	-
<b>Trade and repairing activities, total, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %</b>															
2004	114.1	114.2	113.6	113.3	112.6	112.5	112.6	113.1	113.6	113.8					
2003	106.1	107.8	108.0	108.7	109.0	108.8	108.5	108.0	107.7	107.4	106.9	106.7	-	-	-
<b>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, %</b>															
2004	111.9	111.4	111.7	114.3	114.4	115.3	116.0	116.4	116.6	117.0					
2003	103.5	101.5	101.2	101.3	101.6	102.1	102.3	102.3	102.4	102.6	102.5	102.8	-	-	-
<b>Wholesale and commission trade, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %</b>															
2004	114.5	114.7	114.0	113.3	112.4	112.1	112.1	112.7	113.3	113.5					
2003	107.5	109.7	110.0	110.7	111.0	110.7	110.2	109.4	108.9	108.4	107.7	107.5	-	-	-
<b>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, %</b>															
2004	113.1	113.5	112.6	112.4	112.6	112.8	113.0	113.0	113.0	113.3					
2003	102.0	102.6	103.3	104.0	104.3	104.6	105.0	105.2	105.4	105.7	105.7	106.0	-	-	-
<b>Inflation</b>															
<b>Inflation (Consumer price index - 100), previous month =100, %</b>															
2004	1.4	0.3	-0.1	0.3	0.0	-1.8	1.2	-0.4	0.9	0.2	0.6				
2003	0.6	0.1	0.4	0.3	-0.6	-2.2	0.9	0.8	0.9	0.7	1.8	1.8	-	-	-
<b>Inflation (Consumer price index - 100), December of the previous year = 100, %</b>															
2004	1.4	1.7	1.7	1.9	2.0	0.2	1.4	0.9	1.9	2.0	2.7				
2003	0.6	0.8	1.2	1.5	0.8	-1.4	-0.5	0.3	1.2	1.9	3.8	5.6	-	-	-
<b>Inflation (Consumer price index - 100), corresponding period of the previous year = 100, %</b>															
2004	6.4	6.6	6.2	6.1	6.8	7.3	7.6	6.3	6.3	5.8	4.5	6.4	6.4	6.7	6.8
2003	1.7	0.2	-0.2	0.3	1.7	1.3	2.0	3.5	3.6	3.3	5.1	5.6	0.6	1.1	3.1
<b>Employment and unemployment</b>															
<b>Unemployed persons registered, total, end of the period, number</b>															
2004	537 137	527 258	507 508	487 814	466 717	452 428	446 784	442 190	434 737	437 493	440 039	507 508	507 508	452 428	434 737
2003	646 757	611 727	581 350	552 068	528 718	506 424	489 343	480 881	472 614	476 326	489 618	500 664	581 350	506 424	472 614

# ANNEX 1: MAIN INDICATORS FOR 2004

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Unemployment (Employment Agency, ratio to the economically active population from the population census in 2001), end of the period, %</b>															
2004	14.50	14.23	13.70	13.17	12.60	12.21	12.06	11.94	11.74	11.81	11.88		13.70	12.21	11.74
2003	17.46	16.51	15.69	14.90	14.27	13.67	13.21	12.98	12.76	12.86	13.22	13.52	15.69	13.67	12.76
<b>Newly opened vacant jobs, for the period, number</b>															
2004	3 286	4 772	5 050	3 538	4 090	4 571	4 085	2 966	3 009	6 232	7 198		5 050	4 571	3 009
2003	1 759	2 024	2 136	2 480	2 349	6 076	3 890	2 782	2 804	3 365	3 516	3 999	2 136	6 076	2 804
<b>Employed person, total, end of the period, number</b>															
2004	2 077 939	2 097 911	2 118 484	2 148 407	2 165 004	2 180 746	2 179 239	2 169 491	2 161 225				2 118 484	2 180 746	2 161 225
2003	1 946 834	1 991 623	2 016 828	2 043 764	2 054 972	2 068 694	2 075 881	2 067 291	2 063 429	2 050 282	2 034 033	2 005 369	2 016 828	2 068 694	2 063 429
<b>Employed person, public sector, end of the period, number</b>															
2004	751 581	759 430	766 602	767 933	770 037	770 573	742 194	738 504	739 786				766 602	770 573	739 786
2003	730 873	757 271	765 688	771 192	771 746	775 281	778 647	776 774	778 293	772 629	768 505	758 79	765 688	775 281	778 293
<b>Employed person, private sector, end of the period, number</b>															
2004	1 326 358	1 338 481	1 351 882	1 380 474	1 394 967	1 410 173	1 437 045	1 430 987	1 421 439				1 351 882	1 410 173	1 421 439
2003	1 215 961	1 234 352	1 251 140	1 272 572	1 283 226	1 293 413	1 297 234	1 290 517	1 285 136	1 277 653	1 265 528	1 246 574	1 251 140	1 293 413	1 285 136
<b>Fiscal review</b>															
<b>State budget</b>															
<b>Revenues of the Consolidated State Budget, total, BGN million</b>															
2004	1 126.0	2 110.6	3 636.8	5 097.6	6 375.6	7 646.9	8 996.5	10 311.4	11 622.1	12 978.2			3 636.8	7 646.9	11 622.1
2003	1 029.2	1 944.8	3 220.6	4 631.2	5 813.3	6 830.5	8 054.1	9 158.9	10 311.4	11 573.2	12 657.0	14 072.0	3 220.6	6 830.5	10 311.4
<b>Expenditures of the Consolidated State Budget, total, BGN million</b>															
2004	1 152.7	2 260.2	3 408.4	4 568.7	5 665.8	6 769.3	8 019.8	9 119.7	10 322.3	11 502.8			3 408.4	6 769.3	10 322.3
2003	1 130.6	2 105.4	3 109.8	4 221.5	5 195.0	6 203.4	7 402.7	8 429.7	9 463.7	10 602.5	11 758.1	14 071.1	3 109.8	6 203.4	9 463.7
<b>Consolidated State Budget deficit (-) / surplus (+), BGN million</b>															
2004	-26.7	-149.5	228.4	528.9	709.7	877.6	976.7	1 191.7	1 299.7	1 475.3			228.4	877.6	1 299.7
2003	-101.5	-160.6	110.8	409.7	618.3	627.1	651.4	729.2	847.8	970.7	898.9	0.9	110.8	627.1	847.8
<b>Revenues of the Republican Budget, total, BGN million</b>															
2004	777.1	1 368.7	2 343.4	3 368.2	4 241.3	5 098.0	5 912.6	6 764.3	7 571.6	8 434.5			2 343.4	5 098.0	7 571.6
2003	651.3	908.4	1 937.0	2 878.1	3 626.4	4 221.2	4 985.2	5 637.7	6 279.0	7 051.8	7 684.9	8 441.6	1 937.0	4 221.2	6 279.0
<b>Expenditures of the Republican Budget, total, BGN million</b>															
2004	841.2	1 531.5	2 222.5	2 963.0	3 640.1	4 315.5	5 134.6	5 773.9	6 575.3	7 249.0			2 222.5	4 315.5	6 575.3
2003	737.0	1 195.6	1 846.2	2 594.1	3 016.6	3 639.2	4 372.7	4 979.0	5 520.4	6 200.7	6 952.7	8 552.2	1 846.2	3 639.2	5 520.4
<b>Republican Budget cash deficit (-) / surplus (+), BGN million</b>															
2004	-64.0	-162.8	120.9	405.3	601.2	782.4	778.0	990.4	996.3	1 185.6			120.9	782.4	996.3
2003	-85.7	-287.2	90.8	284.0	609.7	582.0	612.4	658.7	758.5	851.1	732.2	110.6	90.8	582.0	758.5

# ANNEX 1: MAIN INDICATORS FOR 2004

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Government and government guaranteed debt</b>															
<b>Government and government guaranteed debt, BGN million</b>															
2004	16 731.7	16 852.8	17 032.7	17 332.8	17 187.1	17 198.8	16 089.2	16 068.7	16 054.2	15 927.5	16 930.8	16 509.7	17 032.7	17 198.8	16 054.2
2003	17 547.9	17 638.7	17 560.2	17 679.7	17 062.1	17 364.8	17 466.7	17 858.3	17 194.7	17 140.1	16 930.8	16 509.7	17 560.2	17 364.8	17 194.7
<b>Domestic government and government guaranteed debt, BGN million</b>															
2004	2 331.3	2 397.3	2 425.6	2 462.3	2 475.3	2 494.5	2 494.7	2 536.8	2 568.9	2 597.8	2 248.4	2 241.2	2 425.6	2 494.5	2 568.9
2003	2 113.5	2 207.4	2 290.7	2 246.2	2 225.5	2 233.9	2 215.4	2 236.5	2 218.1	2 193.7	2 248.4	2 241.2	2 290.7	2 233.9	2 218.1
<b>Foreign government and government guaranteed debt, BGN million</b>															
2004	14 400.4	14 455.5	14 607.1	14 870.4	14 711.9	14 704.3	13 594.6	13 531.8	13 485.4	13 329.8	14 683.4	14 268.6	14 607.1	14 704.3	13 485.4
2003	15 434.4	15 431.3	15 269.8	15 433.7	14 836.3	15 131.1	15 251.2	15 621.8	14 976.6	14 946.6	14 683.4	14 268.6	15 269.8	15 131.1	14 976.6
<b>Government and government guaranteed debt, ratio to the annual GDP, %</b>															
2004	44.1	44.4	44.8	45.6	45.2	45.3	42.4	42.3	42.3	41.9	48.0	47.8	44.8	45.3	42.3
2003	49.7	50.0	49.8	50.1	48.4	49.2	49.5	50.6	48.7	48.6	48.0	47.8	49.8	49.2	48.7
<b>Domestic government and government guaranteed debt, ratio to the annual GDP, %</b>															
2004	6.1	6.3	6.4	6.5	6.5	6.6	6.6	6.7	6.8	6.8	6.4	6.5	6.4	6.6	6.8
2003	6.0	6.3	6.5	6.4	6.3	6.3	6.3	6.3	6.3	6.2	6.4	6.5	6.5	6.3	6.3
<b>Foreign government and government guaranteed debt, ratio to the annual GDP, %</b>															
2004	37.9	38.1	38.5	39.2	38.7	38.7	36.8	35.6	35.5	35.1	41.6	41.3	38.5	38.7	35.5
2003	43.7	43.7	43.3	43.7	42.0	42.9	43.2	44.3	42.4	42.4	41.6	41.3	43.3	42.9	42.4
<b>Domestic government debt, total, BGN million</b>															
2004	2 331.3	2 397.2	2 425.7	2 462.3	2 475.3	2 494.5	2 494.7	2 536.8	2 568.9	2 597.8	2 248.4	2 241.1	2 425.7	2 494.5	2 568.9
2003	2 111.6	2 205.8	2 289.4	2 245.3	2 225.1	2 233.9	2 215.5	2 236.5	2 218.2	2 193.6	2 248.4	2 241.1	2 289.4	2 233.9	2 218.2
<b>Debt on Government Securities issued for budget deficit financing, BGN million</b>															
2004	1 822.7	1 889.3	1 914.9	1 949.0	1 967.8	1 986.8	1 985.9	2 033.6	2 072.6	2 112.2	1 696.7	1 703.9	1 914.9	1 986.8	2 072.6
2003	1 515.4	1 608.5	1 696.0	1 658.9	1 658.5	1 658.2	1 637.7	1 652.5	1 653.9	1 633.2	1 696.7	1 703.9	1 696.0	1 658.2	1 653.9
<b>Debt on Government Securities issued for structural reform, BGN million</b>															
2004	508.6	508.0	510.8	513.3	507.4	507.6	508.9	503.2	496.3	485.6	551.6	537.2	510.8	507.6	496.3
2003	596.2	597.2	593.4	586.4	566.6	575.7	577.7	584.0	564.3	560.4	551.6	537.2	593.4	575.7	564.3
<b>Foreign government debt, USD million</b>															
2004	8 620.0	8 635.2	8 587.7	8 545.4	8 621.3	8 587.6	7 815.4	7 821.0	8 004.8	8 117.7	8 530.4	8 718.6	8 587.7	8 587.6	8 004.8
2003	8 109.3	8 091.6	8 090.0	8 355.8	8 535.8	8 414.6	8 372.2	8 284.1	8 461.0	8 417.2	8 530.4	8 718.6	8 090.0	8 414.6	8 461.0
<b>Foreign government guaranteed debt, USD million</b>															
2004	498.1	542.9	541.8	538.0	554.2	550.7	552.7	558.2	551.1	563.0	473.5	495.5	541.8	550.7	551.1
2003	426.3	415.3	416.0	427.8	432.0	425.8	453.4	443.6	461.3	464.3	473.5	495.5	416.0	425.8	461.3

# ANNEX 1: MAIN INDICATORS FOR 2004

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Foreign economic relations and foreign investments</b>															
<b>Balance of Payments</b>															
<b>Current account, million USD</b>															
2004	-291.1	-161.8	-169.2	-271.0	-272.0	-21.8	265.2	166.4	57.3	-230.8	-315.9	-336.6	-622.1	-564.8	488.9
2003	-152.7	-149.1	-95.0	-390.7	-228.9	28.2	36.9	145.8	14.0	-230.8	-315.9	-336.6	-396.8	-591.4	195.7
<b>Trade balance, (FOB), million USD</b>															
2004	-194.6	-183.8	-256.2	-321.4	-369.8	-260.9	-161.2	-209.8	-190.7	-251.8	-320.9	-366.3	-634.6	-952.1	-561.7
2003	-70.6	-121.0	-117.3	-267.0	-286.9	-161.5	-207.7	-158.9	-148.1	-251.8	-320.9	-366.3	-308.9	-715.4	-514.7
<b>Exports (FOB), million USD</b>															
2004	631.8	736.4	780.3	716.8	721.3	847.7	964.8	816.0	894.3	676.6	634.7	618.6	2 148.5	2 285.8	2 675.1
2003	545.1	539.3	643.6	571.0	568.7	658.7	718.0	618.3	652.3	676.6	634.7	618.6	1 728.0	1 798.4	1 988.6
<b>Imports (FOB), million USD</b>															
2004	-826.4	-920.2	-1036.5	-1038.2	-1091.1	-1108.6	-1126.1	-1025.8	-1085.0	-928.4	-955.6	-984.9	-2 783.1	-3 237.9	-3 236.9
2003	-615.7	-660.3	-760.9	-838.0	-855.6	-820.1	-925.7	-777.3	-800.4	-928.4	-955.6	-984.9	-2 036.9	-2 513.7	-2 503.4
<b>Services, net, million USD</b>															
2004	-26.0	1.6	-10.0	-53.5	80.5	220.6	342.6	315.0	140.5	-21.2	-45.5	-40.1	-34.4	247.6	798.1
2003	-21.7	-14.4	-24.5	-35.0	33.0	169.1	237.4	237.7	124.8	-21.2	-45.5	-40.1	-60.6	167.1	599.9
<b>Income, net, million USD</b>															
2004	-129.1	-33.5	-8.9	5.8	-48.6	-33.8	-64.4	-40.1	-10.0	-7.0	-3.2	-23.0	-171.5	-76.6	-114.5
2003	-101.5	-41.5	-21.2	-135.3	-20.1	-29.6	-58.7	-5.2	-42.9	-7.0	-3.2	-23.0	-164.2	-185.0	-106.8
<b>Current transfers, net, million USD</b>															
2004	58.6	53.8	105.9	98.1	65.8	52.3	148.2	101.3	117.5	49.3	53.7	92.8	218.3	216.2	367.0
2003	41.1	27.8	67.9	46.6	45.1	50.3	64.8	72.3	80.1	49.3	53.7	92.8	136.8	142.0	217.2
<b>Capital account, million USD</b>															
2004	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	0.0	0.0	0.0	0.0	0.0
2003	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	-0.2
<b>Financial account, million USD</b>															
2004	-41.1	458.9	260.7	143.6	472.9	571.6	-721.6	110.4	239.3	503.7	184.3	116.2	678.5	1 188.1	-371.9
2003	-4.6	85.8	155.9	542.2	226.3	121.8	-17.0	61.4	82.2	503.7	184.3	116.2	237.1	890.3	126.6
<b>Direct investment net, million USD</b>															
2004	168.4	166.2	123.7	34.2	113.3	625.2	-807.3	65.4	14.4	323.5	-2.0	54.7	458.3	772.7	-727.5
2003	86.0	65.1	125.6	147.2	191.0	102.3	162.1	69.8	72.5	323.5	-2.0	54.7	276.7	440.5	304.4
<b>Direct investment abroad, million USD</b>															
2004	-6.0	-1.4	-9.5	-0.8	-1.2	-1.0	-0.9	-0.8	-2.2	-2.9	-0.5	-3.0	-16.9	-3.0	-3.9
2003	-0.5	-0.4	-1.6	-2.6	0.7	-2.2	-1.9	-4.8	-2.0	-2.9	-0.5	-3.0	-2.5	-4.1	-8.7

# ANNEX 1: MAIN INDICATORS FOR 2004

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Direct investment in Bulgaria, million USD</b>															
2004	174.4	167.6	133.2	35.0	114.5	407.7	210.9	66.2	16.6				475.2	557.2	293.7
2003	86.5	65.5	127.2	149.8	190.3	104.5	163.9	74.6	74.5	326.4	-1.5	57.7	279.2	444.6	313.0
<b>Mergers and acquisitions net, million USD</b>															
2004	0.0	0.0	0.0	0.0	0.0	218.5	-1017.3	0.0	0.0	0.0	0.0	0.0	0.0	218.5	-1017.3
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	0.0
<b>Portfolio investment assets, million USD</b>															
2004	-64.5	-17.3	36.5	-71.9	27.6	28.2	18.0	18.0	35.4				-45.3	-16.1	71.4
2003	13.0	10.0	-19.9	10.5	86.5	-36.6	-87.2	-55.3	28.2	-36.7	24.7	-10.1	3.1	60.4	-114.3
<b>Portfolio investment liabilities, million USD</b>															
2004	-106.2	-48.9	43.1	-15.7	8.1	125.0	-747.8	-11.5	25.6				-112.0	117.4	-733.7
2003	-29.9	-3.3	-29.8	0.4	30.2	-1.4	-85.4	-16.1	10.2	-14.8	5.6	4.4	-63.0	29.2	-91.3
<b>Other investment assets, million USD</b>															
2004	-101.4	170.7	-42.1	115.3	81.8	-412.7	30.2	10.9	-60.3				27.2	-215.6	-19.2
2003	-15.1	34.7	-60.0	256.7	-140.0	-36.4	-47.2	96.4	-145.6	163.5	88.9	-48.3	-40.4	80.3	-96.4
<b>Other investment liabilities, million USD</b>															
2004	62.6	188.3	99.5	81.8	242.2	205.9	785.2	27.6	224.2				350.4	529.9	1 037.0
2003	-58.5	-20.6	140.1	127.3	58.6	94.0	40.7	-33.4	116.9	68.2	67.2	115.5	61.0	279.9	124.2
<b>Net Errors and Omissions (BP), million USD</b>															
2004	-49.9	-154.2	111.5	202.0	159.5	-51.5	-119.4	93.5	-63.8				-92.6	310.0	-89.7
2003	-142.5	108.4	21.4	23.6	107.6	-82.2	-20.4	-87.6	-21.5	58.2	240.1	145.0	-12.7	49.0	-129.5
<b>Overall balance (BP), million USD</b>															
2004	-382.1	142.8	202.9	74.6	360.4	498.3	-575.8	370.3	232.8				-36.4	933.3	27.3
2003	-299.8	45.1	82.3	175.1	104.9	67.8	-1.6	119.5	74.7	331.1	108.4	-75.4	-172.4	347.8	192.6
<b>Reserves and Related Items, million USD</b>															
2004	382.1	-142.8	-202.9	-74.6	-360.4	-498.3	575.8	-370.3	-232.8				36.4	-933.3	-27.3
2003	299.8	-45.1	-82.3	-175.1	-104.9	-67.8	1.6	-119.5	-74.7	-331.1	-108.4	75.4	172.4	-347.8	-192.6
<b>Finance</b>															
<b>Financial indicators</b>															
<b>Exchange rate BGN / USD, average for the period</b>															
2004	1.550	1.547	1.594	1.634	1.632	1.611	1.595	1.606	1.600	1.566	1.506		1.564	1.625	1.600
2003	1.842	1.816	1.810	1.804	1.684	1.677	1.720	1.756	1.746	1.673	1.672	1.593	1.823	1.721	1.741
<b>Exchange rate BGN / USD, end of the period</b>															
2004	1.579	1.575	1.600	1.637	1.603	1.609	1.624	1.615	1.576	1.536	1.471		1.600	1.609	1.576
2003	1.808	1.814	1.795	1.757	1.654	1.712	1.728	1.790	1.679	1.683	1.631	1.549	1.795	1.712	1.679



# ANNEX 1: MAIN INDICATORS FOR 2004

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Basic interest rate, effective annual, average for the period</b>															
2004	2.82	2.52	2.44	2.58	2.86	3.84	2.46	2.45	2.42	2.42	2.63	2.69	2.59	3.09	2.44
2003	3.27	2.53	2.55	2.60	2.98	2.92	2.54	2.55	2.59	2.62	2.63	2.69	2.78	2.83	2.56
<b>Money (M1), BGN million</b>															
2004	7 788.4	7 852.5	7 835.1	7 987.2	8 035.7	8 422.3	8 735.8	9 047.6	9 239.2	9 220.0	7 376.6	8 029.9	7 835.1	8 422.3	9 239.2
2003	6 291.4	6 376.6	6 274.3	6 434.6	6 559.6	6 834.4	7 110.4	7 314.3	7 416.4	7 421.7	7 376.6	8 029.9	6 274.3	6 834.4	7 416.4
<b>Money (M2), BGN million</b>															
2004	16 439.0	16 655.3	16 678.5	17 081.5	17 270.3	18 032.9	18 292.6	18 281.7	18 674.7	18 777.4	15 604.7	16 464.7	16 678.5	18 032.9	18 674.7
2003	13 550.9	13 722.5	13 541.5	13 762.2	13 765.6	14 197.2	14 623.8	15 045.6	15 073.2	15 698.1	15 604.7	16 464.7	13 541.5	14 197.2	15 073.2
<b>International reserves of BNB, BGN million</b>															
2004	9 841.4	10 112.3	10 494.3	10 605.1	11 167.4	11 952.7	11 033.4	11 607.0	12 163.0	12 576.4	10 556.8	10 382.8	10 494.3	11 952.7	12 163.0
2003	8 363.2	8 472.8	8 602.7	9 233.3	9 315.7	9 451.3	9 517.7	9 799.7	9 881.9	10 413.4	10 556.8	10 382.8	8 602.7	9 451.3	9 881.9
<b>Fiscal reserves at the Issue Department of BNB, BGN million</b>															
2004	3 138.4	3 146.7	3 503.2	3 822.5	4 203.8	4 802.9	3 663.0	4 346.8	4 642.2	4 897.8	4 176.6	3 280.1	3 503.2	4 802.9	4 642.2
2003	2 793.2	2 803.8	3 027.5	3 632.7	3 873.1	3 747.4	3 766.3	3 767.3	3 831.5	3 970.8	4 176.6	3 280.1	3 027.5	3 747.4	3 831.5
<b>Banking system</b>															
<b>Claims on credits granted by the Commercial Banks, total, BGN thousand</b>															
2004	9 565 122 <sup>1)</sup>	9 848 840	10 247 405	10 659 517	11 008 716	11 309 097	11 877 533	12 076 182	12 526 708	12 954 946	9 114 301	9 454 164	10 247 405	11 309 097	12 526 708
2003	6 444 818	6 563 130	6 816 766	7 167 024	7 424 452	7 727 590	7 866 307	8 171 994	8 471 157	8 904 325	9 114 301	9 454 164	6 816 766	7 727 590	8 471 157
<b>Credits to Resident Sector, total</b>															
2004	9 465 473	9 747 743	10 131 312	10 545 411	10 904 864	11 189 803	11 754 355	11 938 957	12 379 729	12 803 003	9 044 229	9 352 878	10 131 312	11 189 803	12 379 729
2003	6 356 088	6 489 721	6 745 467	7 094 504	7 355 881	7 657 439	7 797 284	8 092 008	8 391 057	8 832 873	9 044 229	9 352 878	6 745 467	7 657 439	8 391 057
<b>Credits to Government Sector</b>															
2004	24 891	27 795	26 973	26 451	26 628	28 026	28 586	28 556	28 361	28 265	22 168	24 635	26 973	28 026	28 361
2003	8 673	8 947	9 494	9 380	9 406	9 561	11 924	13 394	19 928	21 667	22 168	24 635	9 494	9 561	19 928
<b>Credits to Non-government Sector</b>															
2004	9 440 582	9 719 596	10 104 001	10 518 659	10 877 937	11 161 514	11 720 617	11 905 251	12 346 446	12 769 818	8 977 126	9 303 120	10 104 001	11 161 514	12 346 446
2003	6 291 902	6 444 260	6 662 763	7 014 528	7 280 799	7 603 463	7 727 111	8 030 421	8 325 688	8 751 119	8 977 126	9 303 120	6 662 763	7 603 463	8 325 688
<b>Credits to Non-financial Public Corporations</b>															
2004	-	245 972	231 880	232 625	244 408	243 272	226 689	207 946	225 757	266 988	217 489	234 230	231 880	243 272	225 757
2003	219 215	229 954	235 631	246 234	245 746	231 489	245 251	237 021	230 292	213 420	217 489	234 230	235 631	231 489	230 292
<b>Credits to Non-financial Private Corporations</b>															
2004	6 785 654 <sup>2)</sup>	6 685 783	6 932 080	7 194 675	7 378 415	7 452 693	7 840 566	7 883 985	8 140 365	8 346 028	6 412 770	6 641 717	6 932 080	7 452 693	8 140 365
2003	4 715 900	4 800 569	4 949 708	5 202 209	5 377 904	5 604 204	5 575 897	5 774 664	5 956 901	6 287 344	6 412 770	6 641 717	4 949 708	5 604 204	5 956 901
<b>Credits to Households and NPISH</b>															
2004	2 530 436	2 655 236	2 802 335	2 950 438	3 107 317	3 302 537	3 487 977	3 644 450	3 806 347	3 976 297	2 116 719	2 201 298	2 802 335	3 302 537	3 806 347
2003	1 260 492	1 300 531	1 355 108	1 438 127	1 532 501	1 645 779	1 758 072	1 853 587	1 933 809	2 035 462	2 116 719	2 201 298	1 355 108	1 645 779	1 933 809

# ANNEX 1: MAIN INDICATORS FOR 2004

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Credits to Non-bank Financial Institutions</b>															
2004	124 492	132 605	137 706	140 921	147 797	163 012	165 385	168 870	173 977	180 505	187 706	193 977	137 706	163 012	173 977
2003	96 295	113 206	122 316	127 958	124 648	121 991	147 891	165 149	204 686	214 893	230 148	225 875	122 316	121 991	204 686
<b>Credits to Monetary Financial Institutions</b>															
2004	-	352	338	301	299	263	5 152	5 150	4 922	4 920	338	263	338	263	4 922
2003	55 513	36 514	73 210	70 596	65 676	44 415	58 249	48 193	45 441	60 087	44 935	25 123	73 210	44 415	45 441
<b>Credits to Non-resident Sector</b>															
2004	99 649	101 097	116 093	114 106	103 852	119 294	123 178	137 225	146 979	151 943	151 943	116 093	116 093	119 294	146 979
2003	88 730	73 409	71 299	72 520	68 571	70 151	69 023	79 986	80 100	71 452	70 072	101 286	71 299	70 151	80 100
<b>Total assets, end of the period, BGN thousand</b>															
2004	17 530 661	18 005 393	18 756 066	19 144 405	19 229 222	20 096 015	20 651 822	20 959 108	21 549 780	22 300 151	18 756 066	20 096 015	18 756 066	20 096 015	21 549 780
2003	14 470 798	14 527 980	14 976 602	14 754 441	14 752 332	15 359 751	15 706 435	16 019 647	16 386 230	16 621 238	16 608 301	17 323 643	14 976 602	15 359 751	16 386 230
<b>Total liabilities, end of the period, BGN thousand</b>															
2004	15 198 323	15 634 800	16 340 560	16 727 099	16 843 176	17 660 577	18 158 670	18 410 401	18 959 571	19 673 263	16 340 560	17 660 577	16 340 560	17 660 577	18 959 571
2003	12 413 277	12 474 347	12 882 639	12 702 089	12 694 628	13 252 494	13 584 220	13 870 342	14 218 293	14 410 754	14 364 457	15 042 658	12 882 639	13 252 494	14 218 293
<b>Interest revenues, BGN thousand</b>															
2004	96 863	194 892	299 962	406 956	519 732	637 944	755 537	877 578	1 000 921	1 128 028	299 962	637 944	299 962	637 944	1 000 921
2003	74 730	145 393	223 314	302 382	385 403	465 864	550 315	636 814	724 416	816 202	908 081	1 012 487	223 314	465 864	724 416
<b>Current profit/loss, BGN thousand</b>															
2004	41 497	78 677	114 157	132 792	169 150	224 081	257 720	300 494	335 347	366 104	114 157	224 081	114 157	224 081	335 347
2003	98 482	122 770	125 420	148 232	180 278	218 487	242 268	266 588	293 663	322 514	355 375	379 817	125 420	218 487	293 663
<b>Social policy and industrial relations</b>															
<b>Wage&amp;Salary<sup>3)</sup></b>															
<b>Average Monthly Wage&amp;Salary of employees under labor contract, total, nominal, BGN</b>															
2004	279	278	292	289	296	290	296	292	305	276	286	302	283	292	298
2003	270	265	280	272	280	274	276	273	286	276	286	272	272	275	278
<b>Average Monthly Wage&amp;Salary of employees under labor contract, public sector, nominal, BGN</b>															
2004	327	321	350	335	361	343	351	349	375	326	344	368	333	346	358
2003	308	299	325	318	340	327	326	324	352	326	344	368	311	328	334
<b>Average Monthly Wage&amp;Salary of employees under labor contract, private sector, nominal, BGN</b>															
2004	251	253	259	262	259	260	267	263	268	245	249	260	254	260	266
2003	238	234	242	244	242	241	244	242	245	245	249	260	238	242	244
<b>Real Average Monthly Wage&amp;Salary of employees under labor contract, total, growth, corresponding period of the previous year = 100, %</b>															
2004	-2.9	-1.6	-1.8	0.1	-1.0	-1.3	-0.3	0.6	0.3	-1.5	0.1	1.4	-2.1	-0.8	0.2
2003	5.7	4.9	5.8	3.6	2.3	2.1	1.3	-0.5	1.4	-1.5	0.1	1.4	5.5	2.7	0.8

# ANNEX 1: MAIN INDICATORS FOR 2004

(Continued and end)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3
<b>Real Average Monthly Wage &amp; Salary of employees under labor contract, public sector, growth, corresponding period of the previous year =100, %</b>															
2004	-0.2	0.7	1.4	-0.8	-0.6	-2.2	0.0	1.3	0.2	0.6	-1.2	0.5	0.6	-1.2	0.5
2003	7.3	4.7	7.1	6.4	5.1	3.8	3.4	0.3	3.5	-1.7	2.6	4.9	6.4	5.1	2.5
<b>Real Average Monthly Wage &amp; Salary of employees under labor contract, private sector, growth, corresponding period of the previous year =100, %</b>															
2004	-0.9	1.4	0.8	1.2	0.2	0.6	1.7	2.2	2.9	0.4	-1.7	-1.2	0.4	0.6	2.3
2003	2.1	1.9	1.8	2.3	0.8	1.3	-0.4	-0.9	-0.3	-1.2	-1.7	-1.2	2.0	1.4	-0.5
<b>Income and consumption of the households <sup>3)</sup></b>															
<b>Total income, monthly, average per person, nominal, BGN</b>															
2004	141.3	135.6	148.7	157.4	161.7	161.9	183.8	172.5	176.8	171.6	162.1	210.6	141.8	160.3	177.7
2003	128.8	122.4	135.8	142.4	146.6	152.3	157.2	157.0	157.0	156.2	162.1	210.6	129.0	147.1	157.0
<b>Cash income, monthly, average per person, nominal, BGN</b>															
2004	136.4	131.9	143.0	145.0	147.3	150.5	154.5	156.6	160.8	158.3	137.2	175.3	137.1	147.6	157.3
2003	124.5	118.3	130.2	132.5	134.2	139.1	142.2	142.0	142.2	140.7	137.2	175.3	124.3	135.3	142.1
<b>Total expenditure, monthly, average per person, nominal, BGN</b>															
2004	140.5	131.6	142.0	156.4	160.0	151.6	176.2	169.5	177.7	169.0	138.1	174.5	138.1	156.0	174.5
2003	125.2	116.0	130.1	135.5	143.2	141.9	147.1	151.1	153.1	154.9	153.4	197.9	123.8	140.2	150.4
<b>Cash expenditure, monthly, average per person, nominal, BGN</b>															
2004	136.3	128.4	136.9	146.8	148.0	140.7	163.2	155.7	164.3	156.2	133.9	145.1	133.9	145.1	161.0
2003	121.1	112.3	124.9	126.0	131.4	129.7	133.2	137.0	139.3	140.4	135.0	163.6	119.4	129.0	136.5
<b>Real total income, monthly, average per person, growth, corresponding period of the previous year =100, %</b>															
2004	3.1	3.9	3.1	4.2	3.3	-0.9	8.6	3.4	5.9	3.8	7.0	2.0	3.3	2.1	6.0
2003	11.6	7.9	7.5	8.7	5.5	11.1	12.2	6.3	2.0	3.0	7.0	2.0	8.9	8.5	6.7
<b>Real cash income, monthly, average per person, growth, corresponding period of the previous year =100, %</b>															
2004	3.0	4.6	3.5	3.1	2.7	0.9	0.9	3.7	6.4	6.4	3.4	5.7	3.7	2.2	3.7
2003	11.9	7.7	7.8	8.3	7.1	11.3	11.7	6.6	1.3	2.9	3.4	5.7	9.1	8.9	6.4
<b>Real total expenditure, monthly, average per person, growth, corresponding period of the previous year =100, %</b>															
2004	5.5	6.4	2.8	8.8	4.6	-0.4	11.3	5.5	9.2	3.2	3.1	1.9	4.8	4.3	8.6
2003	12.4	3.3	8.3	8.9	3.1	7.3	7.9	3.7	0.1	4.3	3.1	1.9	8.0	6.4	3.8
<b>Real cash expenditure, monthly, average per person, growth, corresponding period of the previous year =100, %</b>															
2004	5.8	7.2	3.3	9.8	5.4	1.1	13.9	6.9	10.9	5.2	3.4	5.9	5.4	5.4	10.5
2003	12.8	3.1	8.9	8.6	4.8	7.7	7.7	4.3	-0.4	4.6	3.4	5.9	8.2	7.0	3.7

1) Excluding credits to Monetary Financial Institutions.

2) Including credits to Non-financial Public Corporations.

3) 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 OFFICIAL GAZETTE No. 86 – No. 115

Title	Status	Official Gazette
RULES on the implementation of the Ownership and Use of Farm Land Act	Amended/Supplemented	No. 86/1.10.2004
ORDINANCE on the border check points	Amended/Supplemented	No. 86/1.10.2004
ORDINANCE on business travel and specialization abroad	Amended/Supplemented	No. 86/1.10.2004
CHARGES RATES collected within the Ministry of Environment and Water	New	No. 86/1.10.2004
RULES of the Arbitration Court within the Public Procurement Agency	New	No. 87/5.10.2004
ORDINANCE on the criteria, terms and procedure of including medicines in the positive list of medicines in the Republic of Bulgaria	Amended/Supplemented	No. 87/5.10.2004
ORDINANCE on the rules of pricing and registration of prices of medicines for retail sale	New	No. 87/5.10.2004
STATUE of the Arbitration Court within the Public Procurement Agency	New	No. 87/5.10.2004
ORDINANCE on the terms and procedure of connecting consumers and use of the water supply and sewerage systems	New	No. 88/8.10.2004
ORDINANCE on the content and procedure of sending the notice referred to in Section. 62, subsection 4 of the Labor Code	Amended/Supplemented	No. 88/8.10.2004
ORDINANCE on the minimum requirements for health and safety at work and for the use of working equipment	Amended/Supplemented	No. 88/8.10.2004
ORDINANCE on the servitudes of energy projects	New	No. 88/8.10.2004
ORDINANCE on the maximum admissible quantities of foreign matter in foods	New	No. 88/8.10.2004
INSTRUCTION on the procedure of keeping a Bulgarian science and research activity register	New	No. 88/8.10.2004
TAX PROCEDURE CODE	Amended/Supplemented	No. 89/12.10.2004
ACT on the protection of classified information	Amended/Supplemented	No. 89/12.10.2004
RULES of procedure of the National Assessment and Accreditation Agency	Amended/Supplemented	No. 89/12.10.2004
CHARGES RATES collected by the State Energy Regulatory Commission under the Energy Act	New	No. 89/12.10.2004
CHARGES RATES collected by the Communication Regulation Commission under the Telecommunication Act	Amended/Supplemented	No. 89/12.10.2004
ORDINANCE on the structure of electric facilities and electricity cable lines	New	No. 90/ 13.10.2004 and No. 91/14.10.2004
Export Insurance ACT	Amended/Supplemented	No. 92/15.10.2004
State Property ACT	Amended/Supplemented	No. 93/19.10.2004
Personal Data Protection ACT	Amended/Supplemented	No. 93/19.10.2004
ACT on the control of foreign trade in arms and in goods and technologies of possible dual use	Amended/Supplemented	No. 93/19.10.2004
ACT on the Judiciary	Amended/Supplemented	No. 93/19.10.2004
RULES on the implementation of the Public Procurement Act	Amended/Supplemented	No. 93/19.10.2004
ORDINANCE on the planning and design of the communication and transport systems of urbanized territories	Amended/Supplemented	No. 93/19.10.2004
ORDINANCE on the terms and procedure of connecting consumers and use of the water supply and sewerage systems	Amended/Supplemented	No. 93/19.10.2004
ORDINANCE on the terms and procedure of issuing individual licenses without competition or tender for telecommunication via telecommunication networks by the fixed radio service	New	No. 93/19.10.2004
ORDINANCE on the award of small-scale public procurement contracts	Amended/Supplemented	No. 93/19.10.2004
CHARGES RATES collected by the Commission for Protection of Competition under the Competition Protection Act	Amended/Supplemented	No. 93/19.10.2004
ORDINANCE on the delivery and acceptance of shipping waste and shipload refuse	New	No. 94/22.10.2004
ORDINANCE on the licensing of carriers for inland waterway carriage of cargos	New	No. 94/22.10.2004
DECREE of CoM on the set up of a Coordination Council for Fight against Offences Affecting the financial Interests of the European Communities	Amended/Supplemented	No. 95/26.10.2004
RULES on the organization and activity of municipal development councils	New	No. 95/26.10.2004

## ANNEX 2: REGULATORY DOCUMENTS PROMULGATED IN OFFICIAL GAZETTE No. 86 – No. 115

ORDINANCE on the procedure and forms for communication of information regarding waste treatment activities and on the procedure of keeping the public register of issued licenses, registration documents and closed sites and activities	New	No. 95/26.10.2004
ORDINANCE on the procedure of executing documents relating to the accounting and information about waste activity management	New	No. 95/26.10.2004
ACT on administrative violations and penalties	Amended/Supplemented	No. 96/29.10.2004
Civil Registration ACT	Amended/Supplemented	No. 96/29.10.2004
Independent Financial Audit ACT	Amended/Supplemented	No. 96/29.10.2004
Accountancy ACT	Amended/Supplemented	No. 96/29.10.2004
DECREE on the fight against minor hooliganism	Amended/Supplemented	No. 96/29.10.2004
DECREE on the foreign trade regime of the Republic of Bulgaria	Amended/Supplemented	No. 96/29.10.2004
ORDINANCE on the additional rules for tariff rating of goods	New	No. 96/29.10.2004
DECREE on the approval of Rules on the structure of the Ministry of Economy	Amended/Supplemented	No. 97/2.11.2004
DECREE on approval of Rules on the structure of the Council of Ministers and its administration	Amended/Supplemented	No. 97/2.11.2004
DECISION of CoM for approval of List of the new separated territories for distribution of natural gas in the Republic of Bulgaria, for which license has not been issued	New	No. 97/2.11.2004
RULES on the implementation of the Child Benefits Act	Amended/Supplemented	No. 97/2.11.2004
RULES on the structure and organization of the Public Procurement Agency	Amended/Supplemented	No. 97/2.11.2004
RULES on the structure and organization of the Ministry of Economy	Amended/Supplemented	No. 97/2.11.2004
ORDINANCE on the veterinary, sanitary and hygiene requirements for the production of raw milk, for construction and operation of milk-processing enterprises, production and trade in hot processed milk and milk products	Amended/Supplemented	No. 97/2.11.2004
DECREE of CoM for implementation as of 1 October 2004 of Republic of Bulgaria's obligations resulting from the new trade agreements with EU Member States for processed agricultural products	Amended/Supplemented	No. 98/5.11.2004
ORDINANCE on food labeling and presentation requirements	Amended/Supplemented	No. 98/5.11.2004
ORDINANCE on the minimum health and safety at work requirements for construction and mounting works	Amended/Supplemented	No. 98/5.11.2004
ORDINANCE No. 6/28 July 2004 on the terms and requirements for the building and operation of waste incinerators and combined waste incinerators	Amended/Supplemented	No. 98/5.11.2004
Radio and Television ACT	Amended/Supplemented	No. 99/9.11.2004
Municipal Property ACT	Amended/Supplemented	No. 101/16.11.2004
RULES on the implementation of the Excise Duty Act	Amended/Supplemented	No. 101/16.11.2004
RULES on the structure and organization of the Council of Ministers and its administration	Amended/Supplemented	No. 101/16.11.2004
ORDINANCE on the terms and procedure of acquisition, payment and trade in government securities	Amended/Supplemented	No. 101/16.11.2004
DECREE of CoM for the set up of Information Society Coordination Council	New	No. 102/19.11.2004
ORDINANCE on the terms and procedure of the import, export and transit of waste and on the cases in which a bank guarantee or insurance is required	New	No. 102/19.11.2004
CRIMINAL CODE	Amended/Supplemented	No. 103/23.11.2004
CRIMINAL PROCEDURE CODE	Amended/Supplemented	No. 103/23.11.2004
Bulgarian Identity Documents ACT	Amended/Supplemented	No. 103/23.11.2004
RULES on the structure and organization of the Agency for Post-Privatization Control	Amended/Supplemented	No. 103/23.11.2004
DECREE of CoM on the execution of the Act on the 2004 State Budget of the Republic of Bulgaria	Amended/Supplemented	No. 103/23.11.2004
ORDINANCE on the mandatory minimum reserves of banks in Bulgarian National Bank	Amended/Supplemented	No. 103/23.11.2004
ORDINANCE on tenders and competitions	Amended/Supplemented	No. 103/23.11.2004
METHODOLOGY for the terms and procedure of calculating the social security payment for accidents at work and occupational illnesses	New	No. 103/23.11.2004
ACT on the protection persons endangered in connection with criminal proceedings	New	No. 103/23.11.2004
ORDINANCE on the treatment requirements for motor vehicles waste	New	No. 104/26.11.2004

## ANNEX 2: REGULATORY DOCUMENTS PROMULGATED IN OFFICIAL GAZETTE No. 86 – No. 115

DECISION of CoM for approval of the Updated Sector Policy for the Bulgarian telecommunications sector	New	No. 104/26.11.2004
DECREE of CoM for approval of the Combined Nomenclature and introduction of Bulgaria's Integrated Customs Tariff	Amended/Supplemented	No. 104/26.11.2004
ORDINANCE on the structure and safety operation of oil and oil-products pipelines	New	No. 104/26.11.2004
ORDINANCE on mandatory insurance	Amended/Supplemented	No. 105/30.11.2004
ORDINANCE on the capital adequacy and liquidity of investment brokers	Amended/Supplemented	No. 105/30.11.2004
ORDINANCE on the mandatory insurance pursuant to Section 77, subsection 1, items 1 and 2 of the Insurance Act	New	No. 105/30.11.2004
ORDINANCE on the procedure of trade in ferrous and non-ferrous metal scrap	New	No. 105/30.11.2004
ACT on local taxes and charges	Amended/Supplemented	No. 106/3.12.2004
ORDINANCE on determining the list of illnesses for which the outpatient treatment is fully or partially paid by the National Health Insurance Fund	Amended/Supplemented	No. 106/3.12.2004
ORDINANCE on the production and trade in fruit propagating material	Amended/Supplemented	No. 106/3.12.2004
ORDINANCE on the terms and procedure of issuing air carrier licenses	New	No. 106/3.12.2004
ORDINANCE on the requirements regarding the tariffs for regular and chartered air carriage	New	No. 106/3.12.2004
ORDINANCE on the terms and procedure of approval, financing and implementation of regional development strategies, plans and program	New	No. 106/3.12.2004
ACT on the special-purpose investment companies	Amended/Supplemented	No. 107/7.12.2004
Corporate Income Taxation ACT	Amended/Supplemented	No. 107/7.12.2004
ORDINANCE on the technical rules and norms for design, construction and use of natural gas transfer, storage, distribution and supply sites and facilities	New	No. 107/7.12.2004
ORDINANCE on the procedure of written declaration of goods before customs authorities	Amended/Supplemented	No. 107/7.12.2004
ORDINANCE on the requirements for the staff of tour operators and tourist agencies, for the person carrying out management of tour operator or tourist agency activities and for the premises for carrying out tour operator or tourist agency activities	New	No. 107/7.12.2004
Wine and Alcoholic Drinks ACT	Amended/Supplemented	No. 108/10.12.2004
Value Added Tax ACT	Amended/Supplemented	No. 108/10.12.2004
Personal Income Taxation ACT	Amended/Supplemented	No. 108/10.12.2004
ORDINANCE on the energy characteristics of sites	New	No. 108/10.12.2004
ORDINANCE on the energy efficiency certification of buildings	New	No. 108/10.12.2004
DECISION for approval of the list of republican roads for which road infrastructure use tax is collected	New	No. 109/14.12.2004
ORDINANCE on Ship's Warrants	Amended/Supplemented	No. 109/14.12.2004
ORDINANCE on tender offering	Amended/Supplemented	No. 109/14.12.2004
ORDINANCE No. 18/3 December 2004 on the registration of port operators in the republic of Bulgaria	New	No. 109/14.12.2004
Mediation ACT	New	No. 110/17.12.2004
DECREE of CoM on the introduction of autonomous customs duty suspension measures as of 1 January 2005	New	No. 110/17.12.2004
ORDINANCE on the procedure of establishing pension reserves of the pension insurance companies managing universal and/or voluntary supplementary pension insurance fund	New	No. 110/17.12.2004
ORDINANCE on the terms and procedure of assessment of the risk for the man and the environment from notified chemical substances	New	No. 110/17.12.2004
ORDINANCE on the terms and procedure of marketing biocides	New	No. 110/17.12.2004
Bulgarian Identity Documents ACT	Amended/Supplemented	No. 111/21.12.2004
Health Insurance ACT	Amended/Supplemented	No. 111/21.12.2004
ACT on human medicines and pharmacies	Amended/Supplemented	No. 111/21.12.2004
ORDINANCE on the registration of ports in the Republic of Bulgaria	New	No. 111/21.12.2004
ORDINANCE on the quality and compliance	Amended/Supplemented	No. 111/21.12.2004

## ANNEX 2: REGULATORY DOCUMENTS PROMULGATED IN OFFICIAL GAZETTE No. 86 – No. 115

ORDINANCE on the introduction of the International Statistical Classification of illnesses and health problems – revision 10	New	No. 111/21.12.2004
ORDINANCE on determining the list of illnesses for which the outpatient treatment is fully or partially paid by the National Health Insurance Fund	Amended/Supplemented	No. 111/21.12.2004
ORDINANCE on the carriage of passengers by taxis	Amended/Supplemented	No. 111/21.12.2004
ORDINANCE on energy efficiency survey	New	No. 112/23.12.2004
ORDINANCE on determining the basic package of health activities guaranteed from NHIF's budget	New	No. 112/23.12.2004
ORDINANCE on the terms and procedure of utilization of water treatment sludge in agriculture	New	No. 112/23.12.2004
ORDINANCE on securing health and safety at work with electric and motor trucks	New	No. 112/23.12.2004
Social Security CODE	New	No. 112/23.12.2004
ACT on the 2005 budget of the state social security	New	No. 112/23.12.2004
Excise Duty ACT	Amended/Supplemented	No. 113/28.12.2004
Wine and Alcoholic Drinks ACT	Amended/Supplemented	No. 113/28.12.2004
DECREE No. 2242 on free zones	Amended/Supplemented	No. 113/28.12.2004
ORDINANCE on the procedure and forms for communication of information regarding waste treatment activities and on the procedure of keeping the public register of issued licenses, registration documents and closed sites and activities	Amended/Supplemented	No. 113/28.12.2004
ORDINANCE on the import of goods of importance for human health	Amended/Supplemented	No. 113/28.12.2004
ORDINANCE on maintaining the map of restored property	Amended/Supplemented	No. 113/28.12.2004
ACT on the 2005 budget of the state social security	Amended/Supplemented	No. 114/29.12.2004
ORDINANCE on the terms and procedure of determining the responsibility of the state for removal of environmental damages resulting of past actions or failure to act, upon privatization	Amended/Supplemented	No. 114/29.12.2004
Social Security CODE	Amended/Supplemented	No. 115/30.12.2004
ACT on the 2004 budget of the National Health Insurance Fund година	Amended/Supplemented	No. 115/30.12.2004
ACT on the 2005 budget of the National Health Insurance Fund година	New	No. 115/30.12.2004
Road Traffic ACT	Amended/Supplemented	No. 115/30.12.2004
ACT on the 2005 state budget of the Republic of Bulgaria	New	No. 115/30.12.2004
Railway Transport ACT	Amended/Supplemented	No. 115/30.12.2004
Privatization and Post-Privatization Control ACT	Amended/Supplemented	No. 115/30.12.2004
ACT on the settlement of non-serviced debts negotiated prior to 31 December 1990	Amended/Supplemented	No. 115/30.12.2004
RULES on the implementation of the Social Assistance Act	Amended/Supplemented	No. 115/30.12.2004
ORDINANCE on the award of activities relating to the preparation for privatization or the post privatization control, including procedural representation	Amended/Supplemented	No. 115/30.12.2004
ORDINANCE on due diligence analyses and privatization valuations and on the terms and procedure of licensing valuers	Amended/Supplemented	No. 115/30.12.2004
ORDINANCE on the written declaration of goods before customs authorities	Amended/Supplemented	No. 115/30.12.2004
ORDINANCE on tariff quota management	Amended/Supplemented	No. 115/30.12.2004
ORDINANCE on the refunding of value-added tax to foreign natural persons	Amended/Supplemented	No. 115/30.12.2004
ORDINANCE on the mandatory information provided to persons who have declared interest to participate in privatization under the Privatization and Post-Privatization Control Act, and on the documents and information constituting official secret	Amended/Supplemented	No. 115/30.12.2004
ORDINANCE on tenders and competitions	Amended/Supplemented	No. 115/30.12.2004
ORDINANCE on the terms and procedure of organizing and holding centralized public tenders for sale of state-owned shares	Amended/Supplemented	No. 115/30.12.2004
RULES on the implementation of the Child Benefits Act	Amended/Supplemented	No. 115/30.12.2004
DECREE No. 2/8 January 1993 of CoM on Taxing Imported Vehicles	Amended/Supplemented	No. 115/30.12.2004

## A. GENERAL NOTES

The review of the Bulgarian economy is an authentic expert product of the Center for Economic Development, 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 present report on the Bulgarian economy follows the structure and content of the review established after the report on the second quarter of 2003. The objective of the changes at that time was to satisfy users' interest and to establish the publication as a source of reliable and comprehensive information about the economic development and the economic policy.

The new review of the Bulgarian economy in 2004 contains detailed presentation and assessment of the period. Where necessary, significant events, facts and data of periods before 2004 have been highlighted. Where possible, data comparisons have been made against previous years. Again where possible, the dynamics within the year 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 2004 starts with presentation of the macroeconomic dynamics discussed against the background of the following basic categories: GDP, foreign trade, foreign direct investments, inflation, employment and unemployment. After that the latest values of the Estat index of business climate in Bulgaria are presented and compared. The national economic events in the reviewed period, which have direct or indirect effect on the competitiveness of the Bulgarian enterprises, are analyzed in the section on the enterprise policy. Such events are described in the sub-sections on encouragement of entrepreneurship, investment promotion policy, access to finance, effectively functioning markets, commercial policy and preparation for the single European market, privatization and concessioning, regulatory regimes, public procurement regulation, public administration reform, combating corruption, index of economic freedom. In the specific Bulgarian economic environment the enterprise policy has two basic aspects – transformation, which is mostly associated with the process of privatization and liberalization of the economy, and competitive orientation, which involves the policies to achieve economic growth and competitiveness of the Bulgarian enterprises. The corresponding section of the report

studies problems concerning both aspects of the Bulgarian enterprise policy.

The public finance section covers the budget implementation and the fiscal reserve dynamics, the foreign and the domestic debt. The wide topic of social and healthcare policies encompasses the issues of social security, employment and unemployment, labor market policy, incomes and social partnership. A review is made of the current problems and condition of the healthcare reform. The environmental policy is discussed both as a specific element of the economic policy and as a factor for the economic environment

The financial sector is discussed by means of the banking system and the capital market. Then comes the review of a number of sectors of significant importance to the economic development of Bulgaria – energy, transport, high technologies and communications, tourism and agriculture. The section on regional policy studies the political decisions, facts and events relating to the achievement of balanced and sustainable development of the regions and reduction of the disproportions between them, as well as the process of social and economic cohesion with the European Union

The annexes at the end constitute an integral part of the presentation. Annex 1 presents in detail the basic indicators for 2004. Annex 2 contains the list of newly passed legislation and amendments to laws, which are of significant importance to the economic development of the country, and have been promulgated in the Official Gazette by the end of December 2004.

The work was finally completed on 8 February 2005.

## B. SOURCES

Along with the conclusions from a large number of own outputs and works, some of which are parts of assigned research projects, the experts of the Center for Economic Development have used statistical and other information and data from the following basic 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
- Eurostat
- European Bank for Reconstruction and Development
- Organization for Economic Cooperation and Development
- 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 is conducted on a quarterly basis among the managers of 400 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 the data according to the indicators “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 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 determining 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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## EVENTS

### Presentation of World Economic Forum's Global Competitiveness Report

On 13 October 2004 the Center for Economic Development hosted a press conference at which the Global Competitiveness Report 2004–2005 developed by a World Economic Forum's team was presented. Since 1998 CED is an official partner of the Forum in collecting and processing information on Bulgaria.

The Global Competitiveness Report is the most comprehensive survey of the growth potential of world economies. In the last five years its geographic coverage continued to expand to include this year 104 countries (against 102 in the previous year). The Report employs two competitiveness assessment indexes – the one characterizing the growth potential of national economies in a long term perspective (Growth Competitiveness Index) and the other assessing the competitiveness of companies (Business Competitiveness Index). The first index is the leading one, providing insight in the growth potential of national economies.

Finland remains the most competitive economy in the world for the third consecutive year. The Nordic countries continue to hold prominent positions among the most competitive economies in recent years, with Finland (1), Sweden (3), Denmark (5), Norway (6) and Iceland (10) all in privileged places. Estonia (20) is the most competitive economy of the new EU members. Poland registers notable decline from 45 in the previous year to 60 this year. Most countries of Central and Eastern Europe also exhibit worsening levels against last year: Hungary moved down from 33 to 39, the Czech Republic - from 39 to 40, Latvia – from 37 to 44, Croatia – from 53 to 61.

Bulgaria is ranked 59 in terms of the competitiveness of its economy among the 104 countries covered by the survey. Last year it was ranked 64. For the first time since 1999 when Bulgaria was included in the report it moved five positions upwards, which is definitely worth of a positive assessment. The positive change is a result of the improved values of all components influencing national competitiveness – macroeconomic stability, public institutions, and technological development.

Bulgaria performs best in the area of public institutions, particularly in terms of corruption spread assessments – the country moved up from 35 last year to 30 this year. According to this indicator Bulgaria has improved against most CEE countries.

Major problems in the area of public institutions are still associated with the lack of independence and impartiality in the judicial system, existing organized crime, patronizing, inadequate private property protection.

Bulgaria registers rather good achievements in the area of technological development. According to this indicator it moved up from 63 last year to 59 this year. Major problems result from the lack of proactive policy on technological transfer.

Regarding the macroeconomic environment the country also registered improvement against last year – it moved up from 73 to 60. This is basically due to the macroeconomic stability and the improved credit rating.

The report states that Bulgaria holds quite good positions in terms of labor market regulation and some elements of human resource management – relative flexibility and freedom in determining salaries and wages, workers hiring and dismissal practice, labor productivity/ payment ratio. Unfavorable positions include environment protection and inadequate environmental policy expenditures.

As regards business competitiveness Bulgaria is ranked 70 against 77 last year, registering improvement in this area as well. Most negative assessment is given again to the quality of corporate strategies. Bulgarian companies experience most severe difficulties in the following areas: lack of adequate human resource training and retraining policy, inefficient marketing and poor professional management quality, lack of active advance technology introduction policy. These serious problems also lead to lower competitiveness of Bulgarian companies.

## Volunteers for Europe



Marieta Tzvetkovska, Senior Researcher, CED, during the Information Exchange

EU Information Exchange under the heading “Let’s Ask and Understand” was organized within the “Europe: Pass On” Campaign on 15 and 16 October 2004 in the National Palace of Culture, Hall 6. The objective of this first of its kind initiative for wide public access to information and to the people disseminating the information was to provide opportunity for direct contact, for asking direct questions and getting competent answers. Believing that adequate information is available, but it is important to know how to find and use it, the information exchange presented the information channels in the areas of administration, business, non-governmental organizations, education, the mass media. Representatives of a number of civil organizations were invited to present their projects for expansion

of the European integration process in the public sphere and to explain the challenges of the coming EU membership.

CED presented on its stand the two booklets on the Lisbon Program and the implementation of the Lisbon Goals in Bulgaria: The Lisbon Economic Reform Program (Sofia, 2003) and

Implementation of the Lisbon Goals: Is the Bulgarian Economy Competitive? (Sofia, 2004)  
Mostly students and young people needing further and more profound information were interested in the booklets. The economic portal Econ.bg with its special section on European integration containing information about EU institutions and organizations, Bulgaria's accession, European programs and documents and many links to useful Internet sites was presented on the stand as part of the concept for information provision.

## **Presentation of the Report on the Bulgarian Capital Market – Condition and Perspectives**

On 18 October 2004, within a round table on Public Policies in the Financial Sector, Mr. Ivaylo Nikolov, Program Director, CED, presented the Report on the Bulgarian Capital market – Condition and Perspectives. The round table was organized in Sofia by the Institute for Economy and International Relations and the Sofia Regional Office of Friedrich Ebert Foundation.

The report provides an analysis of the place and role of the capital market since the early XX c., events of recent years, trends and perspectives. Despite the limited space (and hence lack of comprehensiveness) the special analytical approach makes the report the first and most comprehensive so far Bulgarian study of this part of the non-banking financial sector. The detailed analysis of the condition and factors for the recent growth of some stock-exchange indicators outlines key common characteristics and provides reasoned strategic conclusions for the future of the Bulgarian capital market.

The timing of the report's presentation was chosen with the aim to provide an analytical basis for inspiring public discussions on the various development aspects of the Bulgarian capital market. The report was met with approval, provoking discussions within the round table and enjoying serious subsequent interest on the part of business experts, representatives of capital market related institutions and the media. The analysis and the conclusions made in the report as well as the subsequent comments and proposals provide the basis for the new project of CED – elaboration of a development strategy for the Bulgarian capital market till 2007.

The full text of the Report on the Bulgarian Capital Market – Condition and Perspectives is available from CED's site at: [http://www.ced.bg/uploads/publication/Capmarket\\_Nikolov.pdf](http://www.ced.bg/uploads/publication/Capmarket_Nikolov.pdf)

## **Southeast Europe Economic Forum**

By tradition the Center for Economic Development hosted a major panel within the sixth Economic Forum for Southeast Europe held on November 1 – 3 2004 in the National Palace of Culture in Sofia. The focal theme of Forum 2004 was "Development of Public-Private Partnership in Southeast Europe. The Economic Dimensions of Security.". The Bulgarian Prime Minister Mr. Simeon Saxe Koburg-Gotha opened the 2004 Economic Forum for Southeast Europe. Representatives of the government circles in the countries of Southeast Europe – the President of Montenegro, the vice-premiers of Serbia and Albania, ministers of

economy, labor and social policy, finance, regional development, etc. - attended the opening ceremony.

The Center for Economic Development, in cooperation with the Bulgarian Industrial Association, was organizer of the panel on Public-Private Partnership – Successful Business Practices, which aimed at presenting the business view on the role and responsibility of the actors in this type of partnership. Mr. Alexander Boshkov, Co-chair of CED Board of Trustees, was panel moderator; major speeches contributed Mrs. Jacqueline Coolidge, Program Coordinator for Europe, Investments, World Bank, Mr. Kamen Kolev, Executive Director, Bulgarian Industrial Association, Mr. Gerhardt Wagner, E-business, Austria, Mr. Svetoslav Slavov, Deputy Executive Director of Overgas and Executive Director of Sofiagas.

The speakers analyzed the basic principles and conditions contributing for the successful realization of the public-private partnership. Further to the specific cases and examples, they also presented their views of the public-private partnership. It is not viewed as a single act but rather as a long and continuous spiral process, which, as it is, can yield good and significant results for the society. Representatives of the business and its organizations, of the central and local governments, diplomats, experts, representatives of analytical centers, journalists and media people took part in CED's panel.

## **Investment Opportunities in the Countries from the Adriatic to the Black Sea**

The first economic forum on Investment Opportunities in the Countries from the Adriatic to the Black Sea was organized in Vienna on 8 November 2004. CED was represented by Mr. Zdravko Ivanov, Expert. In the forum, organized under the motto Go South East, took part representatives of the government administration and the business circles of all countries in the region. Four basic scopes of questions were discussed at the forum: energy industry, infrastructure development, investment climate and finance. Discussions regarding the energy industry were focused on the construction of the Nabuko gas pipeline. The general opinion of the representatives of the countries involved in the construction of the pipeline was that the project is necessary and will be profitable. The Managing Director of the Nabuko Gas Pipeline Survey Company assured the audience that the surveys and calculations hereto are in support of the thesis that the construction of the gas pipeline is economically practicable.

A major conclusion highlighted at the end of the forum is fully in line with the “Go South East” motto and focuses on the significant investment opportunities and the economic growth potential existing in the countries of the region.

## **Seminar on Regional Aspects of Entrepreneurship and Employment in Southeast Europe**

The objective of the seminar organized on 8 and 9 November 2004 in Skopje was to improve the dialogue mechanism for the business, the ruling and the representatives of the workers and the donors in the region. The Center for Economic Development was represented by Mr. Peter Stankov, Expert. The seminar was organized in two parts. The first part was dedicated to the practices of the economic policies in the region for encouraging entrepreneurship and

employment and targeting more investments by both internal and external to the economies subjects. Mr. Declan Murphy (Program Director, Investment Charter for Southeast Europe) placed the focus on the problem that three of the four major investment sources are of private origin. These include new companies, developing companies and foreign investors. Having in mind this fact, the discussion was focused on the government policy methods for encouraging private investments in Southeast Europe. Special attention was paid to encouraging employment by regional development and to the role of the links between local business support institutions, as well as to the successful regional development practices.

The second part of the seminar was organized in three working groups: 1) Finding the place of the regional development strategies; 2) Establishing local business support institutions and relations with the business, and 3) Coping with industrial change and restructuring.

The focal points of the discussions in the second working group where Peter Stankov took part included:

- Building the basic network of business support organizations
- Improving the competitiveness of local companies
- Taking advantage of the experience of existing initiatives and structures – the European Charter for Small Businesses, European business information centers, credit lines, trade union programs, investment promotion agencies, regional development agencies, agencies for SMEs.

The discussions in this working group were targeted at:

- Explaining the potential for building new business environment, finding mechanisms to improve competitiveness by building cooperation of the different social process actors – local governments, central government, business, supporting organizations;
- Clarifying the existing regional development initiatives in SEE;
- Defining measures to improve the government – business – social partners dialogue.

Specific questions during the discussion included:

- Does the government (at local level in particular) have clear commitments to the Small Business Charter, particularly regarding access to finance, elimination of administrative barriers and capacity building for providing services to the business?
- Are the regional development agencies adequately equipped in terms of their powers and resources?
- Do the agencies for SME development have in place the capacity to find and work with fast-growing enterprises?
- Are the opportunities for accelerated growth provided by the business-research institutes-universities partnerships understood and made use of?
- What specific measures can be taken within the regional development strategies to encourage the building of relationships between the business and the other subjects concerned with business development?

The institutional structure of the policy for encouragement of the small and medium-sized business in Bulgaria attracted the attention during the discussions. The CED representative highlighted for the participants the positive changes in the regional structure of EAPSME. He also shared his views on some aspects threatening the implementation of the goals, generated by the amendments to the Act on SMEs, particularly regarding the resource support of EAPSME's regional units and the inadequate use of the public-private partnership mechanisms

for providing public services for SMEs outside Sofia. The regional structure of the business organizations and CED's view on the role of these organizations for the development of SMEs in the different regions of the country were clarified.

## Fiscal Decentralization Forum

On 19 and 20 November 2004 Belgrade hosted a regional forum on the fiscal decentralization process and reform in the equalization mechanism in SEE countries. The forum was organized by the Central and Eastern Europe Fiscal Decentralization Initiative – a joint undertaking of the Council of Europe, the Organization for Economic Cooperation and Development, the World Bank Institute, the United Nations Development Program, the US Agency for International Development and the Initiative for reform of local self-government and public services within the Open Society Institute - Budapest.

The objective of the forum was to facilitate the exchange of experience and ideas between the countries of the region for reform of the central – local government relationship, for presentation of good practices and results of their implementation, for establishing useful contacts. The forum provided room for the participants to get familiar with the specifics of the equalization mechanism applied in the different countries and with the employed criteria, to gain experience and make conclusions about possible improvement of the mechanism in their respective countries. Mrs. Marieta Tzvetkovska, Senior Researcher, CED, presented the project “Fiscal Decentralization in Bulgaria – Further Steps for Greater Independence of Local Government”. The project dwells extensively on the problem of the mechanism of forming and granting the equalization subsidy.

Representatives of the central and local governments of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Moldova, Serbia and Montenegro, Slovenia, as well as experts from non-governmental organizations, foreign consultants, analysts and research institutes took part in the forum.

## Conference on the European Perspective of the Western Balkans – Regional and National Approach

On 29 November 2004 the European Institute organized its sixth annual conference under the motto “the European Perspective of the Western Balkans – Regional and National Approach”. The conference was devoted to the new direction in the Institute's work – supporting the Balkan counties in their preparation for accession to the EU. Public administration, business and non-government organization representatives from the countries of the region attended the conference.

Within the special panel on the sector policies of the Balkan countries CED representatives Mrs. Marieta Tzvetkovska and Mr. Zdravko Ivanov presented the results of a study of the energy sector condition in the different countries and the perspectives for a common energy market of Southeast Europe. Representatives of all countries in the region as well as CED experts took part in the preparation of this study. The major trends of the energy policy of the countries in the region, the goals they strive to attain and the barriers and problems they encounter were outlined at the conference. Recommendations were made for the future development of the



energy sector in the different countries within the future single regional market. Some of these were addressed to the EU administration engaged in the support of regional cooperation, because it has a vital role to play in facilitating the dialogue and accelerating the integration processes within a single energy market in the region and later in the EU.

## **Round Table on Two Years to Bulgaria's Accession to the European Union – Is the Business in Varna and the Varna Region Competitive? Varna, 7 December, 2004**

The objective of the round table organized by the Bulgarian-American Credit Bank, Varna Branch (BACB – Varna) was to outline the basic development trends of national and local economy and particularly to place the focus on the evolution of the opportunities for business financing and development and the opportunities for investment in certain promising assets.

The Center for Economic Development was represented by the expert Peter Stankov who contributed a speech on “Enterprise Policy in the EU and in Bulgaria. Preparedness of Bulgarian SMEs for integration in the Single European Market”. The basic focal points of the report included comparability of the European and the Bulgarian policy for encouraging entrepreneurship and SMEs, the defects of corporate strategies, management methods and in-house resources for coping with the competitive pressure in the Single Market. The view of the small and medium-sized business on the changes in the business environment in 2003–2004 was presented as well. The report ends with recommendations to the major actors concerned with the development of the SME sector – the State, business organizations, academic society and the SMEs themselves.

The report generated notable interest in the media. It was covered by 4 central and 4 local dailies and by some electronic media as well.

The other speakers also contributed to the round table success. They presented to the business representatives the cluster approach for improving the competitiveness of the small and medium-sized business (Silvia Stumpf, Business Agency - Varna); the relationship of SMEs and the banks serving them before and after the accession to the EU (Evgeniy Djankov, BACB - Varna); the perspectives and challenges to the real estate market in the region (Dobromir Ganey, Foros National Real Estate Company); the future of the construction sector (Plamen Andreev, Planex), the new alternatives for investments in sectors previously inaccessible via the capital market in the face of the special purpose investment companies (Veneta Ilieva (BACB).

## **Discussion Meeting on Education and Qualification Tailored to Labor Market Needs**

On 9 December 2004 Mr. Alexander Boshkov, Co-chair of CED Board of Trustees and Miss Magdalena Varshilova, Expert, took part in a discussion meeting on Education and Qualification Tailored to Labor Market Needs within the Labor Market Project of the US Agency for International Development. Their presentation was on Educational System Adequacy to the Dynamic Economic Environment.

The objective of the discussion was to encourage, on the basis of a recently presented study within the Labor Market Project regarding the attitude of foreign and Bulgarian employers towards the business climate and the labor market in the country, the dialogue between the participants in the event on possible initiatives and policies for solving the problems highlighted in the study. These problems relate to the education and qualification system, achieving a more flexible labor market and successful realization of young people. The Labor Market Project provides technical assistance for successful establishment of student's probation periods as mandatory elements of the training process.

Focal points of discussions included:

- The need of specific qualification and practical experience of young people tailored to the real needs of the labor market
- Opportunities for better realization of young people in the local and the European labor market
- The need of reform of the educational system – opportunities to acquire knowledge as well as practical experience

Deputies, representatives of MLSP, MES, the Employment Agency, of business and employer's organizations, professional associations, student's unions, trade unions and heads of many Bulgarian higher education institutions were guests of the event.

## **Establishment of Policy Association for an Open Society**

The regular meeting of the research centers supported by the Open Society Institute was held on 16 and 17 December 2004 in Prague. The network existing since 2001 involves over 20 organizations from Central and Eastern Europe, Russia, Ukraine, Moldova, the Baltic countries and the countries in Mid Asia. From the very beginning Bulgaria is represented by three research centers – the European Institute, the Center for Economic Development and the International Center for Minority and Intercultural Cooperation Problems. They are active participants in all common initiatives of the network – joint research projects, development and presentation of common positions on important topical international policy issues, training and institutional capacity building. At the meeting in Prague the Center for Economic Development was represented by Mrs. Maria Prohaska, Director for Development.

In the three days of the meeting the participants discussed and approved the statutory documents of Policy Association for an Open Society – PASOS, where all institutions of the network will be members. The new organization is registered as a non-governmental organization under the laws of the Czech Republic and its Secretariat will be based in Prague. It becomes officially operational in early 2005. The organization will strive to support social policies promoting open society values and to assist the development of efficient and sustainable research centers working towards protection of the public interest. The participants in the meeting also discussed the Association's Development Strategy and proposed specific ideas and projects for the future joint work in 2005 and 2006.

The Center for Economic Development is a founding and regular member of the Policy Association for Open Society. CED will remain actively involved in joint initiatives and will contribute for the establishment and development of a community of social policy experts in Central and Eastern Europe and the former Soviet Union.

## MEETINGS “ON THE ROOF”

### Meeting with Mr. Ivan Iskrov, Governor of Bulgarian National Bank



Meeting “On the Roof” with Mr. Ivan Iskrov (the last on the left), Governor of BNB

On 3 November 2004, at the “Roof Hall” hall the management and the team of experts of the Center for Economic Development met with Mr. Ivan Iskrov, Governor of Bulgarian National Bank, and his advisor Mr. Kalin Hristov. The hosts presented the activity, history, publications and the focal points in the work of the Center for Economic Development in 2004. Mr. Iskrov dwelt in detail on the major challenges to BNB in the process of Bulgaria’s accession to the EU, including those described in the newly approved BNB Development Strategy, 2004–2009.

Some more specific topical economic issues were discussed at the meeting, including the current account deficit, the condition of the banking system and possible risks resulting from the credit expansion in recent years. Mr. Iskrov highlighted the view of the banking supervision and explained the motives for some of the measures taken.

Finally the opportunities for development of the cooperation between BNB and CED were discussed.