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BULGARIA: MACRO FISCAL ASSESSMENT

AN ANALYSIS OF THE JANUARY 2010 UPDATE OF THE CONVERGENCE PROGRAMME

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called 'stability programme' for countries that have adopted the euro as their currency and 'convergence programme' for those that have not. The most recent update of Bulgaria's convergence programme was submitted on 30 January 2010.

The attached technical analysis of the programme prepared by the staff and under the responsibility of the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission was finalised on 17 March 2010. Comments should be sent to Bozhil Kostov and Mariana Tomova (Bozhil.Kostov@ec.europa.eu, Mariana.Tomova@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services' autumn 2009 forecast, (ii) the code of conduct ("Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 10 November 2009) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances.

Based on this analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 17 March 2010. The ECOFIN Council is expected to discuss its opinion on the programme on 16 April 2010.

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All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:
> **http://ec.europa.eu/economy_finance/sgp/index_en.htm**

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1. INTRODUCTION

This document assesses the January 2010 update of the Bulgaria's convergence programme, which was submitted on 30 January and covers the period 2009-2012. The programme builds on the 2010 budget proposal and the Medium-term Fiscal Framework for the period 2010-2013. It was approved by the government on 27 January 2009.

This assessment is structured as follows. Section 2 discusses the key challenges for public finances in Bulgaria. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the convergence programme against the background of the Commission services' economic forecasts[1]. Section 4 analyses budgetary implementation in 2009, the budgetary plans for 2010 and the medium-term budgetary strategy. It also assesses risks attached to the budgetary targets. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses institutional features of public finances. Finally, Section 7 concludes with an overall assessment of the programme. The annex provides a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme.

2. KEY CHALLENGES IN THE ECONOMIC DOWNTURN AND THE POLICY RESPONSE

This section describes recent economic and budgetary developments for Bulgaria, which form the background against which the current programme assessment should be viewed, and outlines the key challenges to be addressed by future economic policies.

Before the onset of the global economic and financial downturn, Bulgaria had witnessed strong real GDP growth underpinned by fast credit expansion and large foreign investment inflows. The robust economic activity, however, was accompanied by increasing macroeconomic imbalances such as the build-up of a very large external deficit and private debt as well as substantial inflationary pressures. The FDI-led investment boom and high wage increases, far exceeding productivity gains, aggravated these imbalances. As the global economic slowdown unfolded, economic activity was hit hard, resulting in a contraction of real GDP by 5% in 2009. After a positive output gap in 2004-2008, the Commission services' autumn 2009 forecast projects a sharp contraction of GDP in 2009-2010, opening up a large negative output gap.

The main short- to medium-term challenge for the economy is to secure a sustained catching-up process framed by fiscal and macroeconomic stability. Given the end of the FDI-driven investment boom and its major impact on construction, this would involve a shift to a more export-oriented growth pattern. Thus, real convergence could be enhanced by improved competitiveness and structural reforms to boost potential growth, while maintaining a sound budgetary position to underpin macroeconomic stability.

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[1] The assessment uses the Commission services' 2009 autumn forecast, as published on 3 November 2009, as a benchmark. However, more recent information that has become available has also been taken into account to assess the risks to the programme scenarios.

Table 1. Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012
Real GDP (% change)	**CP Jan 2010**	**6.0**	**-4.9**	**0.3**	**3.8**	**4.8**
	COM Nov 2009	6.0	-5.9	-1.1	3.1	n.a.
	CP Dec 2008	*6.5*	*4.7*	*5.2*	*5.8*	*n.a.*
HICP inflation (%)	**CP Jan 2010**	**12.0**	**2.5**	**2.4**	**2.8**	**2.8**
	COM Nov 2009	12.0	2.4	2.3	2.9	n.a.
	CP Dec 2008	*12.4*	*6.7*	*4.7*	*4.0*	*n.a.*
Output gap[1] (% of potential GDP)	**CP Jan 2010**	**4.8**	**-3.5**	**-5.7**	**-4.7**	**-2.5**
	COM Nov 2009[2]	6.0	-3.1	-6.0	-5.1	n.a.
	CP Dec 2008	*1.1*	*-0.7*	*-1.8*	*-1.4*	*n.a.*
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	**CP Jan 2010**	**-24.6**	**-8.2**	**-4.1**	**-1.2**	**-0.5**
	COM Nov 2009	-22.1	-12.8	-8.7	-6.7	n.a.
	CP Dec 2008	*-22.9*	*-20.7*	*-18.4*	*-16.6*	*n.a.*
General government revenue (% of GDP)	**CP Jan 2010**	**39.1**	**37.5**	**39.2**	**39.6**	**39.1**
	COM Nov 2009	39.1	38.7	38.4	38.4	n.a.
	CP Dec 2008	*41.3*	*43.4*	*43.4*	*43.7*	*n.a.*
General government expenditure (% of GDP)	**CP Jan 2010**	**37.3**	**39.4**	**39.2**	**39.5**	**39.0**
	COM Nov 2009	37.3	39.5	39.5	38.7	n.a.
	CP Dec 2008	*38.3*	*40.4*	*40.4*	*40.7*	*n.a.*
General government balance (% of GDP)	**CP Jan 2010**	**1.8**	**-1.9[3]**	**0.0**	**0.1**	**0.1**
	COM Nov 2009	1.8	-0.8	-1.2	-0.4	n.a.
	CP Dec 2008	*3.0*	*3.0*	*3.0*	*3.0*	*n.a.*
Primary balance (% of GDP)	**CP Jan 2010**	**2.7**	**-1.3**	**0.9**	**1.0**	**1.1**
	COM Nov 2009	2.7	0.0	-0.3	0.5	n.a.
	CP Dec 2008	*3.9*	*3.9*	*3.9*	*3.9*	*n.a.*
Cyclically-adjusted balance[1] (% of GDP)	**CP Jan 2010**	**0.2**	**-0.7**	**1.9**	**1.7**	**1.0**
	COM Nov 2009	-0.3	0.3	1.0	1.5	n.a.
	CP Dec 2008	*2.6*	*3.2*	*3.6*	*3.5*	*n.a.*
Structural balance[4] (% of GDP)	**CP Jan 2010**	**0.2**	**-0.7**	**1.9**	**1.7**	**1.0**
	COM Nov 2009	-0.3	0.3	1.0	1.5	n.a.
	CP Dec 2008	*2.6*	*3.2*	*3.6*	*3.5*	*n.a.*
Government gross debt (% of GDP)	**CP Jan 2010**	**14.1**	**14.7**	**14.6**	**14.5**	**14.4**
	COM Nov 2009	14.1	15.1	16.2	15.7	n.a.
	CP Dec 2008	*15.4*	*15.4*	*15.3*	*15.2*	*n.a.*

Notes:

[1]Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.

[2]Based on estimated potential growth of 3.4%, 3.1%, 2.9% and 3.0% respectively in the period 2009-2012.

[3]Eurostat is currently discussing with the Bulgarian statistical authorities the recording in national accounts of capital injections into Bulgarian energy companies, which could increase the government deficit in 2009 by 0.6% of GDP

[4]Cyclically-adjusted balance excluding one-off and other temporary measures. There are no one-off and other temporary measures in the most recent programme and Commission services' autumn forecast.

Source:
Convergence programme (CP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

The international economic and financial crisis has hit the Bulgarian economy in 2009 mainly via the foreign investment and exports channels. Tighter global financing conditions resulted in a decline of FDI inflows, which led to a sharp deceleration of investment growth. As wage, employment and credit growth decelerated, private

consumption expenditure contracted considerably. Weaker investment and private consumption impacted on domestic demand, which had been the main driver of economic growth before the economic and financial crisis hit the economy.

At the same time, some of the imbalances started to unwind. After reaching a level of around 25% of GDP at the end of 2008, the current account deficit has been adjusting rapidly in 2009 and is expected to continue to improve over the programme period. On the positive side, while in 2009 these dynamics were driven by imports declining faster than exports, in the medium term the correction would be a result of exports picking up faster and earlier than imports. However, although the current account deficit is almost fully financed with FDI, the country's gross external debt at around 110% of GDP remains high.

Additionally, in line with global trends, inflation decelerated sharply in 2009 and is expected to remain subdued in the program period. The decline in energy and commodity prices led to a downward adjustment of the Bulgarian producer and consumer price inflation. In addition, domestic factors, including slower wage growth, restricted credit expansion and deteriorating consumer sentiment, reduced demand and lowered inflation in non-food product categories and services. As a result, annual HICP inflation receded to 1.6% in December 2009 from 12% on average in 2008.

The downturn took a toll on public finances and the budgetary surplus vanished as revenues were decreasing, while expenditures rose. Given concerns about the need to maintain macroeconomic stability in order to underpin the currency board, the Bulgarian authorities have not adopted a short-term fiscal stimulus package in response to the economic slowdown. To mitigate the negative impact of the crisis, the government undertook a number of measures aimed at fiscal consolidation, through restricting expenditures and improving tax compliance, i.e. by strengthening budgetary discipline, connecting the information databases of the tax administration and the customs offices etc. The emphasis of policy efforts was geared toward fiscal consolidation measures which permitted Bulgaria to achieve one of the lowest general government deficits in the EU in 2009. Thus the main challenge for public finances in Bulgaria over the short to medium term would be to sustain a sound fiscal position by restraining expenditure growth and improving tax compliance further in order to counteract possible further revenue shortfalls. In terms of long-term public finance adjustment, the country is confronted with the need to improve the quality of public expenditure while facing a fast ageing population and worsening demographics.

3. MACROECONOMIC OUTLOOK

Against the background of the current macroeconomic situation and the main policy challenges set out in the previous section, this section makes an assessment of the plausibility of the macroeconomic scenario underpinning the public finance projections of the programme.

The baseline macroeconomic scenario underlying the programme, which is the reference scenario for the assessment, envisages that real GDP growth will improve from -5% in 2009 to 0.3% in 2010 before recovering to an average rate of 4.3% over the rest of the programme period (see Table 2). In the short-run the economic recovery would be driven mostly by net exports, as exports are expected to pick up earlier than imports, while in the medium-term the main driver is expected to be the increasing final domestic demand. Export growth would turn positive on an annual basis in 2010 and accelerate over the programme horizon. Imports would still be contracting in 2010 and are expected to start growing faster than exports only in 2012, thereby generating a positive growth

contribution of net exports in 2009-2011. Employment is projected to continue to decline in 2010 under the impact of the economic slowdown. In 2011 it is expected to start rising again, while the unemployment rate would start declining. Both HICP inflation and nominal wage growth are expected to be moderate, compared with the elevated levels in 2008. Inflation is expected to remain subdued in 2010-2012, and its projections appear realistic and broadly in line with the Commission services' autumn 2009 forecast.

Assessed against currently available information[2], this scenario appears to be based on slightly favourable growth assumptions both for 2010 and in the outer years. Compared with the Commission services' autumn 2009 forecast, also taking into account all the available information about more recent developments, the scenario projects a faster and slightly more pronounced economic recovery in 2010, though real GDP growth rates are remaining well below the average recorded in the past five years before the crisis. While the baseline scenario appears to be only slightly favourable compared with the Commission services' autumn forecast and taking into account the most recently available information, its plausibility critically depends on the assumed rebalancing of growth towards a more sustainable pattern, with exports as a main driver.

The wage and productivity outlook in the baseline scenario looks plausible. The decline in labour productivity before 2010 is explained in the programme as a result of the economic crisis and delayed layoffs by employers. With inflation gradually decreasing since the end of 2008, lower labour demand expectations and rising unemployment in 2010, income growth is also projected to slow down. In addition, public sector wages will be frozen at the 2008 level and are expected later on to follow the dynamics of private sector wages, taking into account the fiscal stance during the programme period. While in the short-term labour income is projected again to grow faster than labour productivity, its relatively slow growth would lead to sharp decline of the real unit labour costs growth rate. Lower labour income growth rates are projected to put less pressure on competitiveness and unit labour costs would continue to decline after 2010, when the economic environment will start to improve and wages would start accelerating again.

Within a sensitivity analysis, the programme outlines two other scenarios, a "pessimistic" and an "optimistic" one. They differ from the baseline scenario mainly with respect to the assumptions about the timing of the economic recovery and the dynamics of exports, which highlights their anticipated role as a driver of the economic recovery. The pessimistic scenario presents a continued contraction of real GDP by 2% in 2010 on the back of a further decline in exports. More than 7pps lower real growth rate of exports and 4pps higher unemployment rate would result in further contraction of real GDP in 2010 and would delay the economic recovery until 2011. According to the optimistic scenario, a faster global recovery, 2pps higher export growth in real terms and an almost unchanged unemployment rate would raise GDP growth by ¾ percentage point over the entire programme period.

Cyclical conditions, measured by the output gap as recalculated by Commission services based on the information in the programme using the commonly agreed methodology, reveal that the output gap turned sharply negative in 2009 and would deteriorate further in 2010. It would also remain in negative territory over 2011-2012. These projections are broadly in line with the Commission services' autumn forecast, which foresees a slightly larger negative output gap in 2010, due to an anticipated weaker recovery of the growth rate of real GDP.

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[2]   The assessment notably takes into account the Commission services' autumn 2009 forecast, but also other information that has become available since then.

Table 2: Comparison of macroeconomic developments and forecasts

	2009		2010		2011		2012
	COM	CP	COM	CP	COM	CP	CP
Real GDP (% change)	-5.9	-4.9	-1.1	0.3	3.1	3.8	4.8
Private consumption (% change)	-5.7	-5.4	-2.1	-0.7	2.0	4.1	4.1
Gross fixed capital formation (% change)	-21.1	-25.0	-8.7	-5.6	3.1	1.8	6.2
Exports of goods and services (% change)	-13.3	-10.8	2.3	3.3	4.5	4.9	6.1
Imports of goods and services (% change)	-19.9	-22.8	-2.8	-1.9	2.3	4.0	6.6
Contributions to real GDP growth:							
- Final domestic demand	-11.0	-12.7	-3.8	-3.0	2.1	3.3	5.0
- Change in inventories	-3.4	-4.6	-0.1	0.6	0.1	0.3	0.3
- Net exports	8.5	12.4	2.8	2.7	0.9	0.3	-0.5
Output gap[1]	-3.1	-3.5	-6.0	-5.7	-5.1	-4.7	-2.5
Employment (% change)	-2.0	-3.0	-1.3	-0.7	0.8	0.5	1.0
Unemployment rate (%)	7.0	6.8	8.0	7.1	7.2	6.9	6.5
Labour productivity (% change)	-3.9	-2.0	0.3	1.0	2.2	3.3	3.8
HICP inflation (%)	2.4	2.5	2.3	2.4	2.9	2.8	2.8
GDP deflator (% change)	4.0	4.8	1.9	2.0	2.5	2.9	2.4
Comp. of employees (per head, % change)	7.8	8.5	2.5	3.5	5.1	6.3	6.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-12.8	-8.2	-8.7	-4.1	-6.7	-1.2	-0.5

Note:

[1]In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.

Source:

Commission services' autumn 2009 forecasts (COM); Convergence programme (CP).

4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first three parts discuss the budgetary implementation in the year 2009, the budgetary plans for 2010 and the medium-term budgetary strategy in the programme. The final part analyses the risks attached to the budgetary targets.

4.1. Budgetary implementation in 2009

At -1.9% of GDP, the 2009 general government deficit in the updated programme represents a significant deterioration compared with both the achieved surplus of 1.8% of GDP in 2008 and the original target set in the December 2008 convergence programme. Given the need to maintain macroeconomic stability in order to underpin the currency board, in line with the European Economic Recovery Plan (EERP) the government did not adopt stimulus measures. The deterioration was therefore mainly driven by a shortfall of revenue as a result of the unexpectedly sharp downturn. Revenue losses were however partly compensated by spending cuts. As the economic crisis progressively was taking hold on public finances, the government updated several times its original target, as allowed by the national budget law, from a surplus of 3% of GDP to a balanced budget. To stabilize the fiscal position, in the second half of the year the authorities implemented a fiscal consolidation package equivalent to 2.3% of GDP. It consisted of measures to further decrease non-interest expenditure (beyond the 90% limit implied by the existing budgetary execution rule) as well as measures to improve tax compliance. However, as a

result of the significant shortfall of revenue with respect to the initial programme, which was based on markedly favourable macroeconomic assumptions, the implemented consolidation measures were not sufficient to ensure meeting the 2009 fiscal target. At the end of the year the Parliament approved an amendment of the budget law, providing for a general government budget deficit of 0.8% of GDP on a cash basis or 1.9% of GDP according to the ESA95 rules. Still, the policy efforts geared toward fiscal consolidation permitted Bulgaria to achieve one of the lowest general government deficits in the EU and to be one of the few countries that avoided triggering of the EDP procedure in 2009.

Table 3 compares the projected outcome for the general government balance, revenue and expenditure (as a percentage of GDP) in 2009 as presented in the new convergence programme with the targets from the previous update of the programme. Differences between outcome and targets (excluding the impact of an unanticipated GDP developments which may have affected the ratio, referred to as the 'denominator effect') are decomposed in the impact of a different starting position (i.e. the outcome of 2008 may also have been different from what was anticipated in the previous programme update) and the impact of differences in the revenue / expenditure growth rate from the planned growth rates[3].

The estimated outcome for the general government balance for 2009 is lower than the overall target by -5.1% of GDP excluding the denominator effect. The different outcome was caused mainly by surprises in the growth dynamics of revenue and expenditure, although the deviation has been reinforced by a worse than anticipated starting position at the end of 2008. The budgetary outcome reflects a revenue shortfall of almost 6% of GDP compared to the December 2008 update, partially offset by expenditure savings of approximately 1% of GDP.

Lower-than-targeted revenue was due mainly to a growth shortfall in 2009 but also to base effects (a negative revenue surprise in 2008). According to the January 2010 update, due to the significant contraction of imports and moderate inflation in 2009, the revenue collected from indirect taxes was 2¾% of GDP lower than initially projected. Direct tax revenue collection was approximately 1% of GDP lower than anticipated in the December 2008 update mainly due to shrinking tax bases, particularly with respect to the corporate profit tax, social security contributions, health contributions, property tax revenues in municipal budgets etc.

On the expenditure side, both primary and interest expenditure have been lower than in the initial programme, by almost 1% and ¼% of GDP respectively. Taking into account the denominator effect, the lower-than planned-expenditure ratio in 2009 seems mostly due to slower expenditure growth rate than initially targeted and to a lower extent to a better than expected starting position at the end of 2008. In the first half of 2009, expenditures were not kept fully in control, as additional social spending and infrastructure expenditure frontloading have been adopted in an attempt to counteract the adverse effects of the crisis. The adopted measures to stabilize the fiscal balance in the second half of the year helped to limit the deviation from the 2009 fiscal target.

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[3] Mathematically, the difference in the revenue ratio in Table 3 can be expressed as:

$$\rho^o - \rho^p = \underbrace{\frac{1+r^p}{1+g^p}\Delta\rho_{-1}}_{\text{Base effect}} + \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta r}_{\text{Revenue growth effect}} - \underbrace{\frac{\rho^o_{-1}}{(1+g^o)(1+g^p)}\Delta g}_{\text{Denominator effect}} + \underbrace{\frac{\rho^o_{-1}(r^o g^p - r^p g^o)}{(1+g^o)(1+g^p)}}_{\text{Residual}}$$

where r is the growth rate of revenue and g is the growth rate of GDP. The subscript -1 refers to the previous year's value. Superscripts o and p refer to the outcome and the planned value respectively. Similar for the expenditure ratio.

Table 3: Budgetary implementation in 2009

	2008		2009	
	Planned	**Outcome**	**Planned**	**Outcome**
	CP Dec 2008	**CP Jan 2010**	**CP Dec 2008**	**CP Jan 2010**
Government balance (% of GDP)	3.0	1.8	3.0	-1.9
Difference compared to target [1]	-1.2		-4.9	
Difference excluding denominator effect [1,2]			**-5.1**	
Of which : due to a different starting position end 2008			-1.3	
due to different revenue / expenditure growth in 2009			-3.5	
p.m. Residual [3]			-0.4	
p.m. Nominal GDP growth (planned and outcome)			*10.7*	*-0.3*
Revenue (% of GDP)	41.3	39.1	43.4	37.5
Revenue surprise compared to target [1]	-2.2		-5.9	
Revenue surprise excluding denominator effect [1,2]			**-9.8**	
Of which : due to a different starting position end 2008			-2.3	
due to different revenue growth in 2009			-7.3	
p.m. Residual [3]			-0.1	
p.m. Revenue growth rate (planned and outcome)			*16.3*	*-4.4*
Expenditure (% of GDP)	38.3	37.3	40.4	39.4
Expenditure surprise compared to target [1]	1.0		1.0	
Expenditure surprise excluding denominator effect [1,2]			**4.7**	
Of which : due to different starting position end 2008			1.1	
due to different expenditure growth rate in 2009			3.9	
p.m. Residual [3]			-0.2	
p.m. Expenditure growth rate (planned and outcome)			16.8	5.3

Notes:

[1] A positive number implies that the outcome was better (in terms of government balance) than planned.

[2] The denominator effect captures the mechanical effect that, if GDP turns out higher than planned, the ratio of revenue or expenditure to GDP will fall because of a higher denominator. Although the denominator effect can be very significant for revenue and expenditure separately, on the balance they usually largely cancel against each other.

[3] The decomposition leaves a small residual that cannot be assigned to the previous components. The residual is generally small, except in some cases where planned and actual growth rates of revenue, expenditure and GDP differ significantly.

Source : Commission services

4.2. The programme's budgetary strategy for 2010

The updated programme's targets a balanced general government budget in 2010. While expenditures are set to decrease slightly as a share of GDP, after the implemented significant fiscal consolidation in 2009, the achievement of the budgetary objective is relying mostly on an increase in revenue. In 2010 the revenue-to-GDP ratio would be 1¾pps higher, while the expenditure-to-GDP ratio would contract mildly by around ¼pps.

According to the programme, the revenue-to-GDP ratio increase to almost 39¼% of GDP in 2010 (from 37½% in the previous year) will be supported by higher indirect taxes and other revenues. In spite of moving to a less tax-favourable GDP composition, the strong pick-up in indirect tax revenue is explained by an expected significant improvement in tax compliance and an increase in excise tax rates for cigarettes and electricity for industrial production. However, the programme does not give any details on the expected increase in "other revenues" by almost 1% of GDP. Social security contributions are projected to decline by ¼% of GDP mostly due to a lowering of pension contribution rates by 2 percentage points from 1 January 2010. This measure is largely counter-financed by an increase of the mandatory social security insured income threshold by 4.85% on average. At the same time the minimum social security threshold for self-

employed persons will be raised by 62% from BGN 260 to BGN 420, while for agricultural and tobacco producers it will go up to BGN 240 from BGN 65.

Table 4. Main budgetary measures for 2010

Revenue measures[1]	Expenditure measures[2]
- Reduction of the pension contribution rate by 2pps (-0.3% of GDP) - Increase in the mandatory minimum threshold for social contributions of the self-employed (+0.1% of GDP) - Increase in the mandatory minimum threshold for social contributions of employees with permanent labour contracts (+0.15% of GDP) - Increase in the excise tax rates for tobacco products (+0.34% of GDP) - Increase in the excise tax rate for electricity for industrial consumption (+0.05% of GDP) - Increase in VAT revenue as a result of the higher tax base due to the increase in the excise tax rates (+0.08% of GDP) - Increase in the corporate profit tax rate for organizing lotteries and hazard games (+0.08% of GDP) - Measures to improve tax compliance (+0.47% of GDP)	- Increase in pension old-age supplement (+0.15% of GDP) - Increase of the pensions for widowers (+0.06% of GDP) - Freezing of public sector wages, intermediate consumption and social payments at the 2008 level (+0.5% of GDP) - Freezing of gross fixed capital formation at the 2009 level as a percentage of GDP until 2012

Notes:

[1] Estimated impact on general government revenue
[2] Estimated impact on general government expenditure

Source: Commission services' calculations, January 2010 update of the Convergence Programme and Report of the Bulgarian Ministry of Finance on the 2010 draft budget law

The expenditure-to-GDP ratio is expected to decline slightly in 2010, mostly as a result of streamlining public administration. Nominal public sector wages and intermediate consumption are set to remain unchanged at the 2008 level, reducing their share as a percentage of GDP in 2010. These expenditure-reducing measures more than compensate the increase of 0.2% of GDP in 2010 in pensions for widowers and the elderly. The draft budget does not envisage pension indexation next year under the current indexation rule. However, the government has committed to increase pensions, depending on the dynamics of the economic recovery, budgetary developments, insurable income growth rate, and inflation. The budget rule limiting the disbursement of primary expenditure (excluding social security transfers) in case of a worse-than-budgeted revenue outcome to 90% of budgeted allocations is abandoned in 2010. It is replaced by Art.17 of the Budget law, which permits to the authorities to undertake discretionary budgetary cuts as whenever "the economic and financial indicators suggest a more unfavourable

development of the economy, the Council of Ministers could decrease non-interest expenditure and transfers below the approved amounts".

Apart from a nominal increase in capital expenditure and pensions for the most vulnerable groups, no major measures with budgetary impact in response to the economic downturn are envisaged. Gross fixed capital formation is planned to remain constant as a percentage of GDP in 2009-2011 and to start rising only in 2012.

As a result, the structural balance (recalculated by the Commission services on the basis of the information in the programme according to the commonly agreed methodology) is projected to increase as a share of GDP by 2¾ percentage points compared to 2009, implying a planned restrictive fiscal policy stance in 2010. The bottom-up estimate of the fiscal stance in 2010 accounts for about half of the envisaged structural adjustment, based on the measures that are outlined in the programme. The improvement of the structural balance projected in the programme is significantly above that in the Commission services' autumn forecast. It is based more on an expected increase in revenue, in particular in indirect tax collection and the "other revenues" item, than on further cuts in expenditure.

4.3.The programme's medium-term budgetary strategy

This section describes the medium-term budgetary strategy outlined in the programme - and how it compares with the one in the previous update - as well as the composition of the budgetary adjustment, including the broad measures envisaged.

Taking into account the need to sustain the on-going adjustment in the external imbalances and safeguard investor confidence, the medium-term budgetary strategy aims at maintaining balanced general government budget balances and significant fiscal reserves throughout the programme period. This is achieved by keeping the revenue and expenditure to GDP ratios roughly unchanged at 39¼% on average in the outer years.

The increase in the revenue-to-GDP ratio is expected to be steepest in 2010 and would continue until 2011 albeit at a slower pace. Under a no-policy change assumption, in 2010-2012 revenue from indirect taxes and social contributions would decline by ½pps and ¼pps of GDP respectively, while revenue from direct taxes is set to increase by ¼pps of GDP. No changes in VAT rates are foreseen in the programme. The increase in the item "other revenue" by ½pps of GDP in the medium term is not explained in the programme.

The expenditure-to-GDP ratio would be fluctuating in a narrow band in 2009-2012, with most of the spending items frozen either at the 2008 level or as a share of GDP. The primary balance would turn positive in 2010 and remain almost unchanged at a surplus of approximately 1% of GDP until 2012.

The medium-term objective (MTO), defined in structural terms (i.e. cyclically-adjusted net of one-off and other temporary measures), is a surplus of ½% of GDP, which the programme aims to achieve from 2010 onwards. In view of the new methodology[4] and given the most recent projections and the debt level, the MTO is ambitious and reflects the objectives of the Pact more than adequately. The structural balance of almost 2% of

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[4] The country-specific MTOs should take into account three components: i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure.

GDP in 2010 is significantly larger than the MTO. Thus, the implied adjustment is frontloaded towards the beginning of the programme period and leaves some room for manoeuvre in case of materialization of downside risks.

Box 1: The medium-term objective (MTO) for Bulgaria

As noted in the Code of Conduct[5], the MTO aims to (a) provide a safety margin with respect to the 3% of GDP deficit limit; (b) ensure rapid progress towards fiscal sustainability; and (c) allow room for budgetary manoeuvre, in particular taking into account the needs for public investment. The MTO is defined in cyclically adjusted terms, net of one-off and other temporary measures. On 7 July 2009, the ECOFIN Council took note of a new methodology for setting MTOs, ensuring that implicit liabilities (costs related to ageing populations, in particular projected healthcare and pension expenditure) are also accounted for.

Specifically, the country-specific MTOs should take into account three components: (i) the debt-stabilising balance for a debt ratio equal to the (60% of GDP) reference value (dependent on long-term potential growth), implying room for budgetary manoeuvre for Member States with relatively low debt; (ii) a supplementary debt-reduction effort for Member States with a debt ratio in excess of the (60% of GDP) reference value, implying rapid progress towards it; and (iii) a fraction of the adjustment needed to cover the present value of the future increase in age-related government expenditure. This implies a partial frontloading of the budgetary cost of ageing irrespective of the current level of debt. In addition to these criteria, MTOs should provide a safety margin with respect to the 3% of GDP deficit reference value and, for euro area and ERM II Member States, in any case not exceed a deficit of 1% of GDP.

As communicated by the authorities, the MTO of Bulgaria is a surplus of 0.5% of GDP, revised downward by 1 percentage point in view of the economic crisis. In view of the new methodology and given the most recent projections and debt level, the MTO more than adequately reflects the objectives of the Pact.

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[5] "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council on 10 November 2009, available at: http://ec.europa.eu/economy_finance/sgp/legal_texts/index_en.htm

Table 5: Composition of the budgetary adjustment

(% of GDP)	2008	2009		2010		2011		2012	Change: 2009-2012
	COM	COM	CP	COM	CP	COM[1]	CP	CP	CP
Revenue	**39.1**	**38.7**	**37.5**	**38.4**	**39.2**	**38.4**	**39.6**	**39.1**	**1.6**
of which:									
- Taxes on production and imports	18.1	17.6	16.0	17.3	17.4	17.1	17.3	17.1	1.1
- Current taxes on income, wealth, etc.	6.5	6.4	6.3	6.4	6.0	6.4	5.9	6.2	-0.1
- Social contributions	8.1	8.2	8.0	8.1	7.7	8.0	7.4	7.2	-0.8
- Other (residual)	6.5	6.4	7.2	6.5	8.1	6.8	9.0	8.6	1.4
Expenditure	**37.3**	**39.5**	**39.4**	**39.5**	**39.2**	**38.7**	**39.5**	**39.0**	**-0.4**
of which:									
- Primary expenditure	36.5	38.7	38.6	38.7	38.3	37.8	38.6	38.1	-0.5
of which:									
Compensation of employees and intermediate consumption	16.4	16.6	n.a.	16.4	n.a.	16.1	n.a.	n.a.	n.a.
Social payments	12.0	12.6	n.a.	12.6	n.a.	12.1	n.a.	n.a.	n.a.
Subsidies	0.7	0.8	0.7	0.9	1.2	0.8	1.4	1.3	0.6
Gross fixed capital formation	5.7	6.9	5.1	7.0	5.1	7.1	5.1	5.3	0.2
Other (residual)	1.6	1.8	4.0	1.8	3.2	1.7	3.8	3.4	-0.6
- Interest expenditure	0.8	0.8	0.8	0.9	0.9	0.9	0.9	0.9	0.1
General government balance (GGB)	**1.8**	**-0.8**	**-1.9**	**-1.2**	**0.0**	**-0.4**	**0.1**	**0.1**	**2.0**
Primary balance	**2.7**	**0.0**	**-1.3**	**-0.3**	**0.9**	**0.5**	**1.0**	**1.1**	**2.4**
One-off and other temporary measures	0.0	0.0	n.a.	0.0	n.a.	0.0	n.a.	n.a.	n.a.
GGB excl. one-offs	**1.8**	**-0.8**	**n.a.**	**-1.2**	**n.a.**	**-0.4**	**n.a.**	**n.a.**	**n.a.**
Output gap[2]	6.0	-3.1	-3.5	-6.0	-5.7	-5.1	-4.7	-2.5	1.0
Cyclically-adjusted balance[2]	-0.3	0.3	-0.7	1.0	1.9	1.5	1.7	1.0	1.7
Structural balance[3]	**-0.3**	**0.3**	**-0.7**	**1.0**	**1.9**	**1.5**	**1.7**	**1.0**	**1.7**
Change in structural balance		*0.7*	*-0.4*	*0.7*	*2.7*	*0.4*	*-0.3*	*-0.7*	
Structural primary balance[3]	0.5	1.1	0.1	1.9	2.8	2.4	2.6	1.9	1.8
Change in structural primary balance		*0.6*	*-0.4*	*0.8*	*2.8*	*0.5*	*-0.3*	*-0.7*	

Notes:
[1]On a no-policy-change basis.

[2]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.

[3]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Convergence programme (CP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

4.4. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period until 2011, Table 5 compares the detailed revenue and expenditure projections in the Commission services' autumn 2009 forecast, which are derived under a no-policy change scenario, with those in the updated programme. However, although the assessment uses the Commission services' forecast as a benchmark, it also takes explicitly into account all available information about more recent developments.

The budgetary outcome could be worse than projected, although the past good track record of Bulgaria in meeting the fiscal targets could be considered as a mitigating factor. The main risks stem from the relatively favourable growth assumptions in the baseline macroeconomic scenario as well as from the scale of the planned budgetary adjustment in 2010. Compared with the Commission services' autumn 2009 forecast the economic downturn is projected to be milder and less protracted. In 2010 real GDP is expected to

swing from a contraction of 5% to an expansion of 0.3%, while its growth pattern should rebalance and its main drivers should be reinvented or replaced. The slightly favourable macroeconomic scenario may entail risks for the achievement of the budgetary targets.

First, the revenue projections underpinning the programme could prove to be overly optimistic. Revenue could be lower than expected in 2010-2012 as a result of slower and less pronounced economic recovery. The projected rebalancing of growth towards less tax rich components also poses downside risks to government revenue. Indirect tax revenue, which is anticipated to increase as a share of GDP by 1.1pps in 2009-2012, could be negatively impacted by a stronger-than-expected contraction of domestic demand and delayed economic recovery. In addition, the increase of indirect tax revenues to a large extent relies on measures to improve tax compliance and budgetary discipline, the effect of which remains to be seen. With unemployment still high and expenditure for public sector wages frozen at the 2008 level, it is also possible that direct tax revenue declines more than expected. The social security contribution projections seem to be on the optimistic side, given that the net reduction by 2pps of the contribution rate as of 2010 is not expected to be fully offset with other revenue-raising measures.

Second, in view of the uncertainties clouding the timing, speed and scale of the expected recovery of the Bulgarian economy as well as the pressures to increase demand-enhancing expenditure, controlling expenditure growth might prove difficult in 2010-2012. After the significant frontloading in 2009 of fiscal consolidation efforts, the scope for further expenditure cuts to restructure and contain primary expenditure in case of materialisation of downside risks may turn out to be limited, while their implementation could prove difficult. From a long-term perspective, the deterioration of the population age structure may pose some pressure on budgetary expenditure for pensions and healthcare and represents a challenge to the sustainability of public finances. Furthermore, the projected surpluses of the local governments budgets compared with the expected deficits of the central government throughout the programme period are not sufficiently explained or justified.

Bulgaria's track record in respecting its budgetary targets has been very good (see Table 1 and Figure 2), although in a context of buoyant economic growth in the years before the global economic downturn. Better-than-targeted budgetary outcomes have been recorded, due to traditionally very conservative revenue projections and buffers on the expenditure side.

The programme does not envisage any one-off or temporary measures to achieve the budgetary targets. However, provisions in the Budget law enable the government to take additional fiscal consolidation measures and reveal its intentions to stand ready to react in case of materialization of downside risks.

In summary, revenue projections appear to be optimistic over the programme period, while expenditure projections are broadly plausible. However, the risks that the budgetary outcome could be worse than expected are to a large extent offset by the very strong track record in meeting budgetary targets over the past several years and the envisaged space for discretionary fiscal consolidation measures.

Figure 1: Government balance projections in successive programmes (% of GDP)
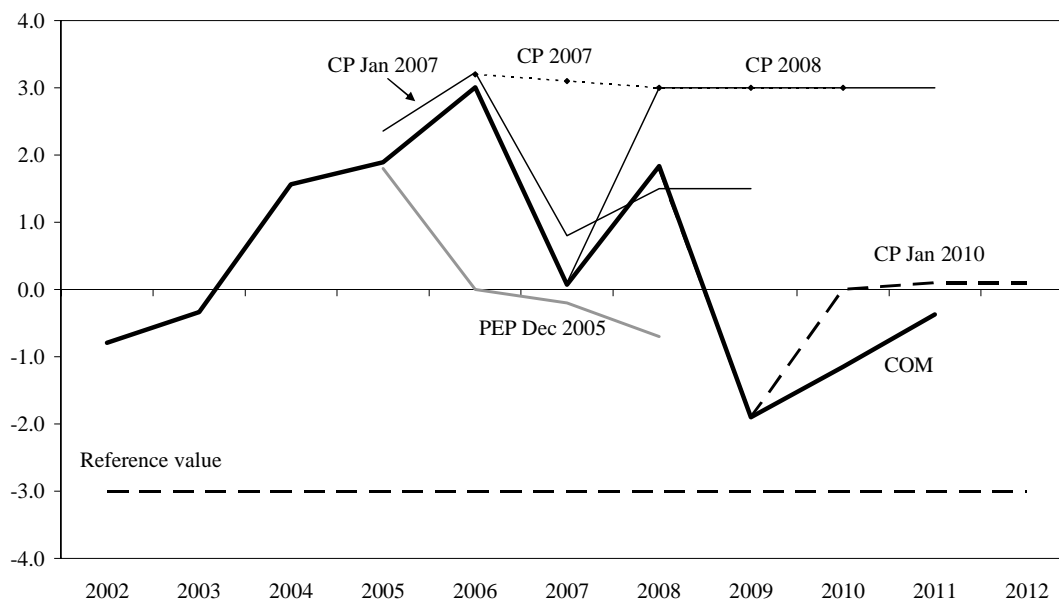
Note: PEP = pre-accession economic programme.

Source: *Commission services' autumn 2009 forecast (COM) and successive convergence programmes*

5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

The debt-to-GDP ratio has been considerably reduced from over 100% in 1997 to around 14% in 2008 as a result of high primary surpluses, strong nominal GDP growth, and substantial privatization revenues (see Figure 2). The programme projects the debt ratio to have increased slightly to close to 15% of GDP in 2009 and then to stabilize at this level for the remaining forecast period given projected balanced budgets in the medium-term and expected off-setting effect of debt-increasing stock-flow adjustments on the positive impact of nominal GDP growth (see Table 6).

Figure 2: Debt projections in successive programmes (% of GDP)
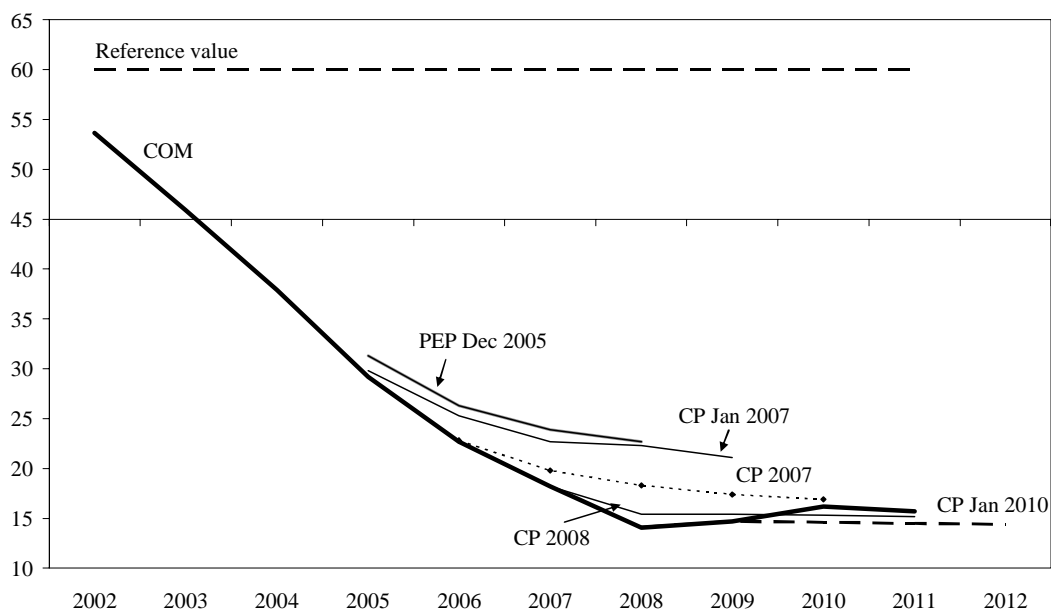
Note: PEP = pre-accession economic programme.

Source: Commission services' autumn 2009 forecast (COM) and successive convergence programmes

The debt-increasing stock-flow adjustments are expected to reach around 1% of GDP on average in 2010-11 reflecting an accumulation of net financial assets, mainly through the government fiscal reserve account with the central bank. Nevertheless, the fiscal reserve decreased to around 11.5% of GDP in December 2009 down from 12.6% at the end of 2008 reflecting the negative impact of the financial crisis on public finances. The programme envisages also certain controversial stock-flow adjustments such as persistently increasing cash/accruals discrepancies, the nature of which is not explained. According to the programme, no new foreign financing will be sought throughout the programme horizon – neither from the IMF nor from the international Eurobond market.

Table 6: Debt dynamics

(% of GDP)	average 2003-07	2008	2009 COM	2009 CP	2010 COM	2010 CP	2011 COM	2011 CP	2012 CP
Gross debt ratio[1]	**30.8**	**14.1**	**15.1**	**14.7**	**16.2**	**14.6**	**15.7**	**14.5**	**14.4**
Change in the ratio	-7.1	-4.1	1.1	0.6	1.0	-0.1	-0.5	-0.1	-0.1
Contributions[2] *:*									
1. Primary balance	**-2.8**	**-2.7**	**0.0**	**1.3**	**0.3**	**-0.9**	**-0.5**	**-1.0**	**-1.1**
2. "Snow-ball" effect	**-2.0**	**-1.8**	**1.1**	**0.6**	**0.7**	**0.6**	**0.1**	**0.0**	**0.0**
Of which:									
Interest expenditure	1.6	0.8	0.8	0.6	0.9	0.9	0.9	0.9	1.0
Growth effect	-2.0	-0.9	0.8	0.7	0.2	0.0	-0.5	-0.5	-0.6
Inflation effect	-1.6	-1.8	-0.6	-0.7	-0.3	-0.3	-0.4	-0.4	-0.3
3. Stock-flow adjustment	**-2.1**	**0.5**	**0.0**	**-1.3**	**0.0**	**0.2**	**0.0**	**0.9**	**1.0**
Of which:									
Cash/accruals diff.	0.1	0.6		-3.0		1.0		2.4	2.7
Acc. financial assets	-1.1	-0.4		1.8		-0.7		-1.4	-1.5
Privatisation	-2.8	-0.9		0.1		0.3		0.7	0.5
Val. effect & residual	-1.2	0.2		-0.3		0.0		0.1	0.0

Notes:

[1]End of period.

[2]The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Convergence programme (CP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations

5.1.2. Assessment

The projections for the debt-to-GDP ratio in the programme appear broadly plausible taking into account the Commission services' autumn 2009 forecast and the latest available information. In the Commission services' autumn 2009 forecast, government debt is estimated to increase to around 16% of GDP in 2010 in line with a deterioration of the headline budgetary balance and then to fall to 15¾ of GDP in 2011 thanks to improvement in the primary balance. The differences with the programme are due to the more conservative underlying growth assumptions and their impact on the primary balance as well as the lack of stock-flow adjustment not known at the cut-off date for the forecast. In the programme the impact of the stock-flow adjustments offsets the slightly stronger nominal GDP growth effect in 2010 and the higher primary balances in 2011-12.

5.2. Long-term debt projections and the sustainability of public finances

5.2.1. Sustainability indicators and long-term debt projections

This section presents sustainability indicators based on the long-term age-related government spending as projected by the Member States and the EPC in 2009 according to an agreed methodology[6].

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[6]   Economic Policy Committee and the European Commission (2009), '2009 Ageing Report: Economic and budgetary projections for the EU-27 Member States (2008-60)', *European Economy* No. 2/2009. European Commission (2009), 'Sustainability Report 2009, European Economy No. 9/2009. European Commission (2008), 'Public finances in EMU – 2008', *European Economy* No. 4/2008.

Table 7 shows that age-related spending is projected to rise by 3.2 percentage points of GDP between 2010 and 2060, which is below the EU average (4.6 pps). Sustainability indicators for two scenarios are presented in Table 8. 'The 2009 scenario' is based on a no-policy-change assumption and the 2009 structural primary balance as a starting year, while 'the programme scenario' takes into account the consolidation planned in the programme up to 2012 and is based on the projected 2012 structural primary balance as a starting position. Including the increase of age-related expenditure and assuming that the structural primary balance remained at its 2009 level, the sustainability gap (S2)[7] would amount to 2.8% of GDP; about 4 percentage points more than in last year's assessment. This is mainly due to deterioration in the estimated structural primary balance in the starting year, in contrast with a projected lower increase in age-related expenditure in the 2009 projection than in the previous one. The starting budgetary position is not sufficient to stabilize the debt ratio over the long-term and entails a risk of unsustainable public finances even before considering the long-term budgetary impact of ageing.

Table 7: Long-term age-related expenditure: main projections

(% of GDP)	2007	2010	2020	2030	2040	2060	Change 2010-60
Total age-related spending	**16.6**	**17.1**	**16.5**	**16.9**	**17.9**	**20.2**	**3.2**
- Pensions	8.3	9.1	8.4	8.6	9.5	11.3	2.2
- Healthcare	4.7	4.8	5.0	5.1	5.4	5.4	0.6
- Long-term care	0.2	0.2	0.2	0.2	0.3	0.4	0.2
- Education and unemployment benefits	3.4	3.0	2.9	2.9	2.8	3.1	0.2
Property income received	1.5	1.4	1.3	1.3	1.2	1.2	-0.2
Source: Economic Policy Committee and Commission services.							

In contrast to the "2009 scenario", the "programme scenario", which foresees an improvement in the structural primary balance over the programme period, shows only a small sustainability gap. If the budgetary consolidation planned in the programme was achieved, risks to long-term sustainability of public finances would be largely mitigated.

Based on the assumptions used in the projection of the age-related expenditure and the calculation of the sustainability indicators, Figure 3 displays the projected debt-to-GDP ratio over the long-term.

Table 8: Sustainability indicators and the required primary balance

	2009 scenario			Programme scenario		
	S1	S2	RPB	S1	S2	RPB
Value	1.3	2.8	2.6	-1.3	0.3	2.5
of which:						
Initial budgetary position (IBP)	0.9	1.0	-	-1.6	-1.6	-
Debt requirement in 2060 (DR)	-0.5	-	-	-0.6	-	-
Long-term change in the primary balance (LTC)	0.9	1.9	-	0.9	1.9	-
Source: Commission services.						

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[7] The S2 indicator is defined as the change in the current level of the structural primary balance required to make sure that the discounted value of future structural primary balances (including the path of property income) covers the current level of debt.

Figure 3: Long-term projections for the government debt ratio
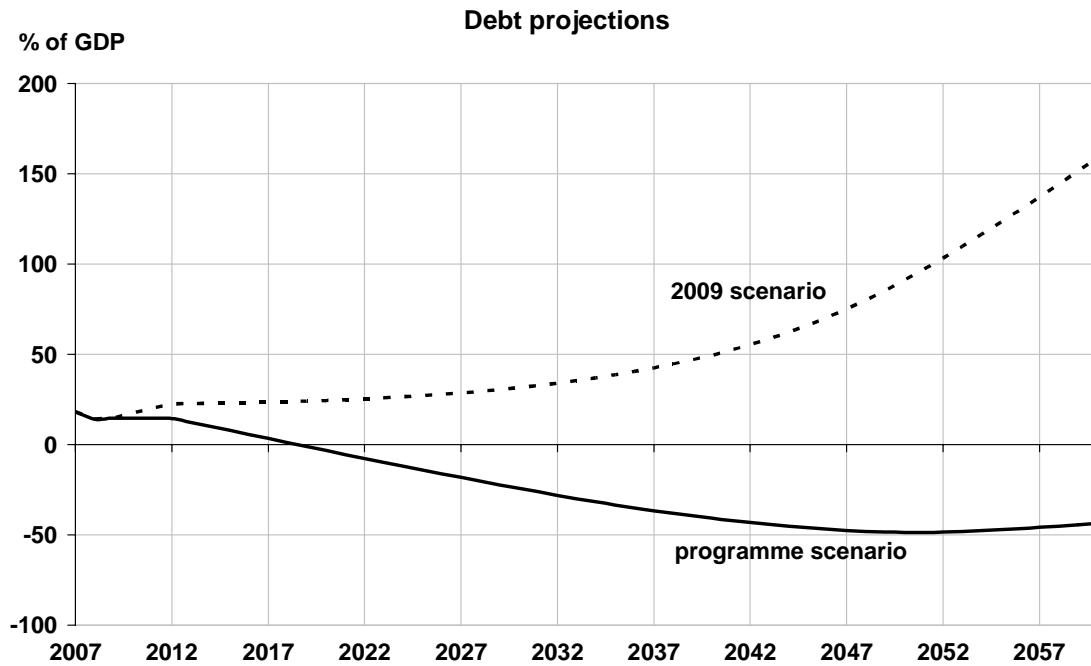
Debt projections

Note: Being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services' short-term forecasts, but as an indication of the risks faced by Member States.

Source: Commission services calculations

Based on the alternative assumptions of economic developments presented in the commission services' autumn 2009 forecast publication[8], Figure 4 shows projected medium-term trajectory of the debt-to-GDP ratio. The projected debt trajectories show the debt level turning into a decreasing path under the programme scenarios and turning into a net asset position before 2020, while the 2009 scenario would follow this path only under the assumptions of most recent economic developments (below).

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[8] Section 3.5 in European Commission (2009), 'European Economic Forecast – autumn 2009', European Economy No. 10/2009. This economic scenario assumes that the output gap caused by the crisis will be closed by 2017. This economic scenario assumes that the output gap caused by the crisis will be closed by 2017.

Figure 4: Medium-term projections for the government debt ratio[9]
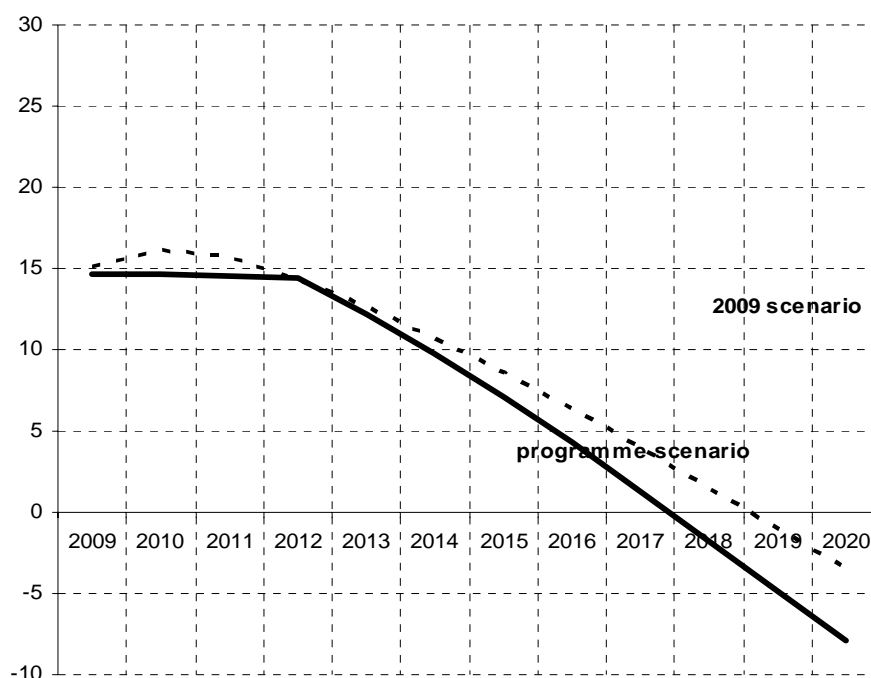
Source: Commission services' calculations

5.2.2. Additional factors

For an overall assessment of the sustainability of public finances, other relevant factors are taken into account (Table 9). Overall, the additional factors do not change the assessment of the long-term sustainability risk.

Table 9: Additional factors for the assessment of long-term sustainability risks

	Impact on risk
Debt and pension assets	na
Decline in structural balance until 2011 in COM Autumn 2009 forecast	na
Alternative projection of cost of ageing	na
Strong decline in benefit ratio	na
High tax burden	na
Difference between S1 and S2	na

Note: '-': factor tends to increase the risk to sustainability, '+': factor tends to decrease the risk to sustainability.
'na': not applicable.

Alternative projections are often presented in the programmes, whose assumptions often diverge from the common method. Projections currently discussed in the Economic Policy Committee but not yet published, are for the time being also considered "unofficial".

An explanation on these factors can be found in chapter V of: European Commission (2009), Sustainability Report 2009, European Economy No. 9/2009.

Source: Commission services.

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[9] As the government debt ratio shown in the graph is in gross terms, it can not be negative. The negative values should be interpreted as net accumulation of assets for the countries that would fully reimburse their debts.

5.2.3. Assessment

An illustrative debt projection until 2020 show that the budgetary development envisaged in the programme is more than enough to stabilise debt in the medium term. The '2009 scenario' that is based on the budgetary situation of 2009 shows that debt would be negative by 2020 even if the policy measures described in the programme would not be implemented.

The long-term budgetary impact of ageing is slightly lower than the EU average. The budgetary position in 2009, as estimated in the programme, compounds the budgetary impact of population ageing on the sustainability gap. Achieving higher primary surpluses over the medium term, as already foreseen in the programme, would contribute to reducing further the risks to the sustainability of public finances which were assessed in the Commission 2009 sustainability report as low. The government gross debt is at a low level and the medium-term debt projections that assume GDP growth rates to only gradually recover to the values projected before the crisis and tax ratios to return to pre-crisis levels show that the budgetary strategy envisaged in the programme, taken at face value, would stabilise the debt-to-GDP ratio. As a result a net asset position would be reached before 2020.

6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES

This section is subdivided into two elements: the fiscal framework and the quality of public finances in a broader sense.

6.1. Fiscal framework

The existing domestic budgetary framework appears relatively strong as evidenced by the demonstrated good track record on meeting the budgetary targets, although during years of favourable economic environment. However, in 2009 as a result of the severe global economic crisis and its negative impact on public finances, the general government budget outcome came below the official target. Nevertheless, due to the government political commitment to fiscal discipline and the undertaken strict budgetary consolidation measures as well as to the high public surpluses prior to the recession, Bulgaria will probably be one of the few EU countries which will avoid a breach of the 3% of GDP reference value in the current downturn.

In the recent past, the budgetary framework has been improved by streamlining budgetary procedures, enhancing reporting requirements, and including a more comprehensive macroeconomic analysis and assessment of the fiscal risks in the budgetary documents. Until recently the framework followed a non-binding expenditure rule that aimed at limiting the overall expenditure to 40% of GDP. The shortcomings to the current fiscal framework are related to the existence of certain discretionary powers of the central government which undermine the transparency and credibility of the framework and reduce the authority of the parliament. In addition, the framework does not incorporate multi-annual rules, and the expenditure ceilings set in the course of the medium-term fiscal planning are binding only in the short-term. The existence of administrative inefficiencies in tax collection has contributed to the large revenue shortfall last year in addition to the negative revenue impact of the crisis.

The programme does not envisage any changes to the existing budgetary procedure except for increasing the time horizon of the medium-term fiscal framework from three to four years to coincide with the government mandate and thus making the medium-term policy more predictable.

According to the programme, a number of measures have been undertaken or are planned in order to help counter the budgetary deterioration in 2009/10 and to ensure implementation in line with fiscal targets. In the 2010 state budget law the so called 90% expenditure execution rule, according to which only 90% of the budgeted non-interest allocations are disbursed to the spending units in case of worse than expected economic developments, has been replaced by a more stringent rule. Under the new rule the government has the power to reduce the disbursement of non-interest expenditure and transfers granted by the national budget below the level of the annual appropriations without any limit (i.e. even below the level of expenditure disbursement mandated by the 90%-rule) if the economic environment deteriorates more than expected. The rule provides for higher discretionary powers to the government for controlling the budget expenditure and, thus, for meeting the budgetary target. However, a better design and definition of the rule and clearer conditions on its application would have been important to improve predictability and transparency of budget execution and the efficiency of resource allocation.

The programme presents substantial structural reforms launched in the area of revenue administration (tax and customs) and EU fund management aimed at improving the efficiency of tax collection, the effective fight against corruption practices, and increasing the absorption rate of the funding available under the EU structural funds. The most important reform steps are directed at improving the interaction and coordination of activities between the revenue authorities and the law enforcement authorities. The reforms include serious optimization of the staff and structures, concentration of control and collection functions in fewer offices leading to gains in efficiency, integrating the information system of the National Revenue Agency with that of the Customs Agency, streamlining the procedure for VAT refunding including by cutting the refund period in half, strengthening the customs border control and collection mechanisms, intensifying tax inspections. The reforms are expected not only to raise the collection of budgetary revenues but also to increase the quality of public services provided to taxpayers.

6.2. Quality of public finances

The quality of public finances and in particular the quality of public expenditure is of key importance for Bulgaria, which has one of the fastest ageing populations and worsening demographics among the EU countries and needs to tackle the still large external imbalances and sustain the catching-up process.[10] Although reforms have been recently launched in certain areas, due attention is needed to enhance the efficiency of spending in growth-enhancing areas such as education, healthcare, public administration, public infrastructure, R&D and innovation.

The programme recognises the existing weaknesses in the quality and efficiency of public spending and the unfavourable consequences of an aging population on the long-term sustainability of public finances and acknowledges the urgent need to take policy action in this respect. Ambitious structural reforms are presented in the areas of healthcare, education, the pension system, and public administration with a view to enhancing the efficiency and effectiveness of public revenue and expenditure and increasing the growth potential of the economy. The structure and composition of tax revenues are envisaged to be kept unchanged whereby the share of direct tax revenue in total will continue to decrease at the expense of indirect taxes, shifting the tax burden from labour and companies to indirect taxation.

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[10] See Annex 1 of Bulgaria: Macro Fiscal Assessment, An Analysis of the December 2008 Update of the Convergence Programme.

Following successive reductions of the pension contribution rate over the past few years, leading to an increasing financing gap in the pension system, the programme envisages another 2 percentage point reduction in the rate from the beginning of 2010 and a further reduction by 3 percentage points by 2012. According to the programme this measure will reduce the tax burden on employers, encourage labour demand, and help retain existing jobs in the current downturn. However, the cut in the rate does not seem to be underpinned by other sufficient offsetting revenue raising measures in the programme in 2010 which may further aggravate the financial situation of the pension system. In the long-term this may be partially balanced by measures outlined in a pension reform strategy adopted on 25 January 2010 which envisages increasing the minimum retirement age for both men and women to 65 years (currently 63 for men and 60 for women) or increasing the mandatory requirement for length of experience.

The reform in the health sector includes changing the costing model of health services as well as optimizing the redundancy in the hospital sector and changing the certification procedure for receiving funding from the National Health Insurance Fund. A new law on health insurance is being elaborated that would provide for a three pillar health insurance system, similar to that in the pension area, from the beginning of 2011. The reform is expected to streamline healthcare into larger and better equipped hospitals, increase the quality of healthcare services and efficiency of spending as well as to ensure equal access to the system.

In the education sector, the programme envisages the reform process to further optimize the school network, raising the quality of spending through implementing and fostering the system of delegated budgets as well as implementing legislative changes concerning tertiary education, R&D, and reforming the Bulgarian Academy of Sciences. The reforms aim at providing equal access to education, improving the overall quality of education, bringing science, higher education, and business closer together and envisage separation of the academic and financial management in the universities.

Regarding public administration, the government has continued to improve the efficiency of delivering public services by closing down two ministries and three state agencies in 2009 while shifting their functions to other line ministries. As a result, the administrative staff in the budgetary sector has been reduced by over 11% by the beginning of 2010. The programme envisages further reform measures to take place following a review of the administrative capacity and public administration to be conducted in the first half of the year. The aim is to streamline the public sector and increase the performance and quality of public services provided by the state, both at national and municipal level. The income policy in the public sector will aim at a stronger connection between wages and labour productivity.

7. OVERALL ASSESSMENT

Taking into account risks attached to the budgetary targets discussed above, this section assesses the appropriateness of the fiscal strategy in relation to the budgetary objectives of the Stability and Growth Pact, against the background of the current economic situation, the debt and long-term sustainability position of the country, and the institutional features of its public finances.

The programme's budgetary strategy can be regarded as broadly in line with the requirements of the Pact and conducive to preserving macroeconomic stability and investor confidence in the Bulgarian economy. It aims at maintaining a general

government balanced budget in the medium-term.[11] However, the macroeconomic scenario underlying the budgetary targets appears slightly favourable throughout the entire programme horizon. At the current economic juncture the main risks continue to be associated with uncertainty in the external environment, namely with respect to the magnitude and speed of recovery of the country's main trading partners from the recession, as well as with the ability and the extent to which the economy could shift towards a solid and sustainable export-led economic growth pattern. A more protracted slowdown and less tax-intensive growth structure with depressed domestic demand could put pressure on the revenue and undermine the achievement of the budgetary targets.

The budgetary framework envisages measures that offset a possible drop in government revenue by expenditure reducing measures in order to ensure meeting the fiscal targets. The rule on disbursement of only 90% of budgeted non-interest allocations in case of adverse economic development has been replaced with a more stringent rule which allows the government to offset a likely budget revenue shortfall by cutting non-interest expenditures in a corresponding level below the annual appropriations. The rule provides greater flexibility and space for discretionary consolidation policy by the government. However, the lack of clearer design and definition of the rule with respect to its implementation induces certain non-transparency in the budgetary framework and undermines the authority of the parliament. This also undermines the objective of improving the quality and efficiency of public spending.

The reduction of the pension contribution rate from the beginning of 2010 and the envisaged further reduction by 2012 aim at retaining existing jobs in an environment of low growth as well as stimulating future labour demand. However, this measure together with the envisaged permanent increase in certain pension allowances in 2010 and the deteriorating demographic structure could undermine the sustainability of the pension system as it may have not been fully accompanied with offsetting revenue raising measures.

Under the medium-term reform agenda, the programme has outlined ambitious structural reform measures in the area of public administration, healthcare, revenue administration, education, and pensions aiming at improving the quality and sustainability of public finances, achieving greater efficiency of government spending, and boosting productivity to ensure sustainable convergence within the European Union. The reforms envisage optimization of existing structures, streamlining of public employment, changing the costing and funding mechanism for health services, implementing reform measures under the newly adopted pension reform strategy, legislative changes related to tertiary education, research and development, and changing the model of managing public state assets.

With respect to the medium-term budgetary objective, the programme targets a general government budget surplus of ½% of GDP in structural terms against a minimum benchmark of a deficit of 1¾ of GDP. The MTO seems to be more than sufficient as required by the Pact, given that Bulgaria is a low-level public debt country with accumulated large fiscal reserves and relatively low to moderate risks to long-term sustainability. However, maintaining a positive MTO appears to be appropriate to help tackle the still large external deficit and the expected burden on public spending from the projected fast aging of population.

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[11] According to the programme the main fiscal policy objective is to maintain a balanced national budget throughout the period before adjustment for the European Funds and Programs which allows for setting rigid expenditure ceilings by sectors financed by Bulgarian taxpayers.

The programme envisages the MTO to be reached and exceeded by quite a large margin already in 2010 making the pace of structural consolidation quite ambitious in view of the economic bad times that the economy is undergoing and the risks to the budgetary strategy outlined above. After the quite significant structural consolidation by 2¾ % of GDP in 2010, no further improvements are anticipated in the following years. The consolidation in 2010 is not fully underpinned by measures outlined in the programme. In 2012 the fiscal policy stance implied by the programme provides for a fiscal relaxation in the order of ¾% of GDP. However, the structural balance is projected to remain above the MTO. Thus, the medium-term budgetary strategy is broadly in line with the requirement of the Pact.

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ANNEX. COMPLIANCE WITH THE FORMAT AND CONTENT REQUIREMENTS FOR STABILITY AND CONVERGENCE PROGRAMMES

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned.

(i) Model structure

The January 2010 update of the convergence programme broadly follows the model structure of Annex 1 of the code of conduct and is in compliance as far as the table of contents is concerned. However, the separation of certain sections could be clearer.

(ii) Data requirements

As far as data requirements are concerned, the programme update provides almost all compulsory and most of the optional data prescribed in the standard tables in Annex 2 of the code of conduct, as amended by the September 2007 EFC. Regarding compulsory data, in Table 2&5 information on one-off and other temporary measures, structural balance, and compensation of employees and intermediate consumption is not provided. In table 2, there are no figures for total taxes and social payments, although the table includes their components. In Table 4, data on interest expenditure is missing. Regarding optional data, in Table 2 no information on government consumption is included. In table 4, data on liquid financial assets and net financial debt is missing. In table 7, data on social security pensions, occupational pensions, and pension reserve fund is not reported.

The tables on the following pages show the data presented in the January 2009 update of convergence programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

(iii) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

* * *

The SCP…	Yes	No	Comments
a. Involvement of parliament			
… mentions status vis-à-vis national parliament.		X	
… indicates whether Council opinion on previous programme has been presented to national parliament.		X	
b. Economic outlook			
… (for euro area and ERM II Member States) uses "common external assumptions" on main extra-EU variables.			Not applicable
… explains significant divergences with Commission services' forecasts[1].		X	
… bears out possible upside/downside risks to economic outlook.	X		
… analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.	X		Not for private sector
c. Monetary/exchange rate policy			
… (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.	X		Bulgaria has a currency board
d. Budgetary strategy			
… presents budgetary targets for general government balance in	X		

The SCP…	Yes	No	Comments
relation to MTO and projected path for debt ratio.			
… (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.	X		
… (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).	X		
… backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.	X		Partially
… specifies state of implementation of measures.	X		
e. "Major structural reforms"			
… (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible 'major structural reforms' over time.	X		
… includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.		X	
f. Sensitivity analysis			
… includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of: a) changes in main economic assumptions b) different interest rate assumptions c) (for CP only) different exchange rate assumptions d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.	X		Partially
… (in case of "major structural reforms") analyses how changes in assumptions would affect budget and potential growth.	X		Partially
g. Broad economic policy guidelines			
… provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.	X		
h. Quality of public finances			
… describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
i. Long-term sustainability			
… outlines strategies to ensure sustainability.	X		
… includes common budgetary projections by the AWG and all necessary additional information (esp. new relevant information).	X		
j. Other information (optional)			
… includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		Partially
Notes: SCP = stability/convergence programme; CP = convergence programme [1]To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme. *Source:* *Commission services*			

Tables from Annex 2 of the code of conduct

Table 1a. Macroeconomic prospects

	ESA Code	2008 Level	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change	2012 rate of change
1. Real GDP[1]	B1*g	*34118*	6.0	-4.9	0.3	3.8	4.8
2. Nominal GDP	B1*g	*34118*	18.1	-0.3	2.3	6.8	7.3
Components of real GDP							
3. Private consumption expenditure	P.3	*23256*	4.8	-5.4	-0.7	4.1	4.1
4. Government consumption expenditure	P.3	*5552*	0.0	-4.1	-7.4	1.1	6.3
5. Gross fixed capital formation	P.51	*11378*	20.4	-25.0	-5.6	1.8	6.2
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	*5.0*	-2.0	-4.6	0.6	0.3	0.3
7. Exports of goods and services	P.6	*20631*	2.9	-10.8	3.3	4.9	6.1
8. Imports of goods and services	P.7	*28403*	4.9	-22.8	-1.9	4.0	6.6
Contributions to real GDP growth							
9. Final domestic demand		-	9.4	-12.7	-3.0	3.3	5.0
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	-1.1	-4.6	0.6	0.3	0.3
11. External balance of goods and services	B.11	-	-2.3	12.4	2.7	0.3	-0.5

[1] At 2008 prices

Table 1b. Price developments

	ESA Code	2008 Level	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change	2012 rate of change
1. GDP deflator		*100*	11.4	4.8	2.0	2.9	2.4
2. Private consumption deflator		*100*	11.0	1.5	1.7	2.2	2.2
3. HICP[1]		*100*	12.0	2.5	2.4	2.8	2.8
4. Public consumption deflator		*100*	18.9	2.8	3.0	3.5	3.6
5. Investment deflator		*100*	8.3	0.9	2.5	1.5	1.4
6. Export price deflator (goods and services)		*100*	9.4	-6.5	5.4	4.0	2.1
7. Import price deflator (goods and services)		*100*	9.6	-10.0	5.2	2.7	1.7

[1] Optional for stability programmes.

Table 1c. Labour market developments[1]

	ESA Code	2008 Level	2008 rate of change	2009 rate of change	2010 rate of change	2011 rate of change	2012 rate of change
1. Employment, persons[1]		*3835.6*	3.3	-3.0	-0.7	0.5	1.0
2. Employment, hours worked[2]		*6371.8*	3.2	-3.2	-0.6	0.6	1.0
3. Unemployment rate (%)[3]		*5.6*	5.6	6.8	7.1	6.9	6.5
4. Labour productivity, persons[4]		*8895*	2.7	-2.0	1.0	3.3	3.8
5. Labour productivity, hours worked[5]		*5.4*	2.7	-1.8	0.9	3.1	3.8
6. Compensation of employees	D.1	*12340349*	23.6	4.2	2.4	6.9	7.1
7. Compensation per employee		*4364.5*	19.3	8.5	3.5	6.3	6.1

[1]The rates of change in items 4 and 5 are in real terms and those in item 6 in nominal terms.

[2]Occupied population, domestic concept national accounts definition.

[3]National accounts definition.

[4]Harmonised definition, Eurostat; levels.

[5]Real GDP per person employed.

[6]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	2008	2009	2010	2011	2012
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-24.6	-8.2	-4.1	-1.2	-0.5
of which :						
- Balance on goods and services		-22.9	-8.3	-5.6	-4.5	-4.6
- Balance of primary incomes and transfers		-2.4	-1.6	-1.1	0.3	0.8
- Capital account		0.8	1.7	2.7	3.0	3.3
2. Net lending/borrowing of the private sector	B.9	-26.4	-6.2	-4.1	-1.3	-0.6
3. Net lending/borrowing of general government	EDP B.9	1.8	-1.9	0.0	0.1	0.1
4. Statistical discrepancy		n.a.	n.a.	n.a.	n.a.	n.a.

Table 2. General government budgetary prospects

	ESA Code	2008 Level	2008 % of GDP	2009 % of GDP	2010 % of GDP	2011 % of GDP	2012 % of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	*625.6*	1.8	-1.9	0.0	0.1	0.1
2. Central government	S.1311	*677.3*	2.0	-2.1	-0.9	-0.6	-0.2
3. State government	S.1312	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
4. Local government	S.1313	*-131.7*	-0.4	-0.5	0.7	0.6	0.3
5. Social security funds	S.1314	*80.1*	0.2	0.7	0.2	0.1	0.1
General government (S13)							
6. Total revenue	TR	*13354.5*	39.1	37.5	39.2	39.6	39.1
7. Total expenditure	TE[1]	*12728.9*	37.3	39.4	39.2	39.5	39.0
8. Net lending/borrowing	EDP B.9	*625.6*	1.8	-1.9	0.0	0.1	0.1
9. Interest expenditure	EDP D.41	*286.1*	0.8	0.8	0.9	0.9	0.9
10. Primary balance[2]		*911.7*	2.7	-1.3	0.9	1.0	1.1
11. One-off and other temporary measures[3]		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
12a. Taxes on production and imports	D.2	*6190.5*	18.1	16.0	17.4	17.3	17.1
12b. Current taxes on income, wealth, etc	D.5	*2202.3*	6.5	6.3	6.0	5.9	6.2
12c. Capital taxes	D.91	*185.8*	0.5	0.3	0.3	0.3	0.3
13. Social contributions	D.61	*2757.2*	8.1	8.0	7.7	7.4	7.2
14. Property income	D.4	*472.0*	1.4	1.3	1.1	0.7	0.7
15. Other[4]		*1546.8*	4.5	5.6	6.7	8.0	7.6
16=6. Total revenue	TR	*13354.5*	39.1	37.5	39.2	39.6	39.1
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]		11229.9	32.9	30.2	30.9	30.5	30.5
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
17a. Compensation of employees	D.1	*3061.8*	9.0	9.5	8.8	9.0	8.9
17b. Intermediate consumption	P.2	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
18. Collective consumption	P.32	*2966.6*	8.7	8.6	8.6	8.6	8.7
19. Social payments (19=19a+19b)		*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.
19a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	*2585.2*	7.6	7.7	7.0	7.0	7.1
18b. Social transfers other than in kind	D.62	*3584*	10.5	12.5	13.3	12.6	12.3
19=9. Interest expenditure	EDP D.41	*286.1*	0.8	0.8	0.9	0.9	0.9
20. Subsidies	D.3	*247.0*	0.7	0.7	1.2	1.4	1.3
21. Gross fixed capital formation	P.51	*1936.4*	5.7	5.1	5.1	5.1	5.3
22. Other[6]		*1123.6*	3.3	4.0	3.2	3.8	3.4
23=7. Total expenditure	TE[1]	*12728.9*	37.3	39.4	39.2	39.5	39.0
p.m.: Government consumption (nominal)	P.3	*n.a.*	n.a.	n.a.	n.a.	n.a.	n.a.

[1] Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2] The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3] A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5] Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	2007	2012
1. General public services	1	8.2	5.4
2. Defence	2	1.6	1.3
3. Public order and safety	3	3.1	2.3
4. Economic affairs	4	5.0	5.5
5. Environmental protection	5	1.4	1.6
6. Housing and community amenities	6	1.4	1.2
7. Health	7	3.1	3.5
8. Recreation, culture and religion	8	0.8	0.8
9. Education	9	3.9	3.9
10. Social protection	10	13.1	13.5
11. Total expenditure (=item 7=23 in Table 2)	TE[1]	41.5	39.0

[1] Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	2008	2009	2010	2011	2012
1. Gross debt[1]		14.1	14.7	14.6	14.5	14.4
2. Change in gross debt ratio		-4.1	0.6	-0.1	-0.1	-0.1
Contributions to changes in gross debt						
3. Primary balance[2]		2.7	-1.3	0.9	1.0	1.1
4. "Snow-ball" effect		-1.9	0.9	0.5	-0.1	-0.2
5. Interest expenditure[3]	EDP D.41	n.a.	n.a.	n.a.	n.a.	n.a.
6. Stock-flow adjustment		0.5	-1.6	0.3	1.0	1.2
of which:						
- Differences between cash and accruals[4]		-2.1	-3.0	1.0	2.4	2.7
- Net accumulation of financial assets[5]		2.3	1.8	-0.7	-1.4	-1.5
of which:						
- privatisation proceeds		0.8	0.1	0.3	0.7	0.5
- Valuation effects and other[6]		0.3	-0.3	0.0	0.1	0.0
p.m.: Implicit interest rate on debt[7]		5.4	5.5	6.0	6.0	6.0
Other relevant variables						
7. Liquid financial assets[8]		n.a.	n.a.	n.a.	n.a.	n.a.
8. Net financial debt (7=1-6)		n.a.	n.a.	n.a.	n.a.	n.a.

[1] As defined in Regulation 3605/93 (not an ESA concept).

[2] Cf. item 10 in Table 2.

[3] Cf. item 9 in Table 2.

[4] The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5] Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6] Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7] Proxied by interest expenditure divided by the debt level of the previous year.

[8] AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2008	2009	2010	2011	2012
1. Real GDP growth (%)		6.0	-4.9	0.3	3.8	4.8
2. Net lending of general government	EDP B.9	1.8	-1.9	0.0	0.1	0.1
3. Interest expenditure	EDP D.41	0.8	0.8	0.9	0.9	0.9
4. One-off and other temporary measures[1]		n.a.	n.a.	n.a.	n.a.	n.a.
5. Potential GDP growth (%)		5.4	3.4	3.1	2.9	3.0
contributions:						
- labour		1.2	0.8	0.8	0.6	0.4
- capital		3.1	1.6	1.3	1.2	1.3
- total factor productivity		1.2	1.1	1.1	1.1	1.3
6. Output gap		5.8	-2.7	-5.3	-4.5	-2.8
7. Cyclical budgetary component		2.1	-0.9	-1.6	-1.5	-0.9
8. Cyclically-adjusted balance (2 - 7)		-0.2	-1.0	1.6	1.6	1.0
9. Cyclically-adjusted primary balance (8 + 3)		0.6	-0.2	2.5	2.5	1.9
10. Structural balance (8 - 4)		n.a.	n.a.	n.a.	n.a.	n.a.

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	2008	2009	2010	2011	2012
Real GDP growth (%)						
Previous update		6.5	4.7	5.2	5.8	n.a.
Current update		6.0	-4.9	0.3	3.8	4.8
Difference		-0.5	-9.6	-4.9	-2.0	n.a.
General government net lending (% of GDP)	EDP B.9					
Previous update		3.0	3.0	3.0	3.0	n.a.
Current update		1.8	-1.9	0.0	0.1	0.1
Difference		-1.2	-4.9	-3.0	-2.9	n.a.
General government gross debt (% of GDP)						
Previous update		15.4	15.4	15.3	15.2	n.a.
Current update		14.1	14.7	14.6	14.5	14.4
Difference		-1.3	-0.7	-0.7	-0.7	n.a.

Table 7. Long-term sustainability of public finances [1]

% of GDP	2000	2007 [1]	2010	2020	2030	2050	2060
Total expenditure	42.6	41.5	42	41.4	41.8	44.6	45.2
Of which: age-related expenditures	18.3	16.2	16.7	16.1	16.6	19.3	19.9
Pension expenditure	9.4	8.3	9.1	8.4	8.6	10.8	11.3
Social security pension	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Old-age and early pensions	8.3	6.8	7.3	6.9	7.1	9.4	10
Other pensions (disability, survivors)	1.1	1.4	1.8	1.5	1.5	1.4	1.3
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care	3.3	4.7	4.8	5	5.1	5.5	5.4
Long-term care *(this was earlier included in the health care)*	n.a.	0.2	0.2	0.2	0.2	0.3	0.4
Education expenditure	4.2	3.3	2.9	2.8	2.9	2.9	3
Other age-related expenditures	0.7	0.1	0.1	0.1	0.1	0.1	0.1
Interest expenditure	4	1	0.9	1.1	1.1	1.3	1.5
Total revenue	42.2	41.5	41.2	41.2	41.2	41.2	41.2
Of which: property income	3.6	1.5	1.4	1.3	1.3	1.2	1.2
Of which: from pensions contributions (or social contributions if appropriate)	7.4	5	7.6	7.4	7.3	7.4	7.4
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Of which: consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions							
Labour productivity growth	9.2	4	4	3.3	2.7	1.7	1.7
Real GDP growth	5.4	5.9	4	2.4	1.7	0.3	0.8
Participation rate males (aged 20-64)	73.4	71.4	72.3	74.3	72.9	71.8	72.9
Participation rates females (aged 20-64)	61	62.3	63.4	66.3	65.1	63.8	65.6
Total participation rates (aged 20-64)	67.1	66.8	67.8	70.3	69	67.9	69.3
Unemployment rate	16.9	7	4.7	4.7	4.7	4.7	4.7
Population aged 65+ over total population	16.5	17.3	17.5	20.3	23.3	31.3	34.2

[1]Instead of 2005

Table 8. Basic assumptions

	2008	2009	2010	2011	2012
Short-term interest rate[1] (annual average)	4.6	1.2	2.0	2.8	3.5
Short-term interest rate[1] (annual average)	3.1	1.0	1.7	2.5	3.0
Long-term interest rate (annual average)	4.1	4	4.1	4.1	4.1
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.46	1.40	1.45	1.45	1.45
Nominal effective exchange rate	2.7	-3.0	0.0	1.5	0.0
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	2.0	2.0	2.0	2.0	2.0
World excluding EU, GDP growth	3.6	-1.2	3.1	3.5	4.0
EU GDP growth	0.8	-4.1	0.7	1.6	2.0
Growth of relevant foreign markets	5.2	1.4	3.4	4.1	4.4
World import volumes, excluding EU	6.4	0.5	2.1	4.0	3.1
Oil prices (Brent, USD/barrel)	97.0	62.1	67.5	77.0	84.0

[1]If necessary, purely technical assumptions.