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Assessment of the 2020 Convergence Programme for

Bulgaria

(Note prepared by DG ECFIN staff)

CONTENTS

EXECUTIVE SUMMARY

- On 6 April 2020, the Commission provided guidelines to the Economic and Financial Committee on how the format and content of the 2020 Stability and Convergence Programmes can be streamlined in light of the exceptional circumstances related to the Covid-19 pandemic. This assessment takes into account the severe constraints that Member States faced in providing the information usually required in their Programmes. The assessment focuses on the near term in light of the high uncertainty attached to the projections.
- According to the Convergence Programme, the Bulgarian economy is expected to contract by 3% in 2020. The forecast is based on the assumption that the pandemic will be contained by the second half of 2020, both domestically and abroad and the impact on domestic demand will be moderate. The Commission 2020 spring forecast projects a deeper recession of 7.2% in 2020 and a relatively strong but still incomplete recovery in 2021 mainly due to subdued investment.
- The Convergence Programme projects a headline deficit of 3.1% of GDP in 2020, marking a deterioration of the general government balance by 5 percentage points of GDP compared to the previous year. Despite the different macroeconomic assumptions, the Commission forecast a slightly lower deficit of 2.8% of GDP.
- The main measures in the 2020 Convergence Programme concern the policy response against the COVID-19 epidemic. The package includes measures of 1.3% of GDP to support the health sector, reinforce security services and preserve jobs financed by the state budget, re-allocation of 0.8% of GDP of EU funds to finance medical staff remunerations, employment schemes and SMEs working capital and 0.6% of GDP of state guarantees through the Bulgarian Development Bank for business and household loans.
- The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic.

1. INTRODUCTION

This document assesses the economic and budgetary projections contained in the 2020 Convergence Programme of Bulgaria covering the period 2019-2020 (hereafter called the Programme), which was submitted on 30 April 2020.[1] The note also assesses Bulgaria's compliance with the preventive arm of the Stability and Growth Pact in 2019. The government approved the Programme on 29 April 2020.

On 20 March 2020, the Commission adopted a Communication on the activation of the general escape clause of the Stability and Growth Pact. The clause, as set out in Articles 5(1), 6(3), 9(1) and 10(3) of Regulation (EC) 1466/97 and Articles 3(5) and 5(2) of Regulation (EC) 1467/97, facilitates the coordination of budgetary policies in times of severe economic downturn. In its Communication, the Commission shared with the Council its view that, given the expected severe economic downturn resulting from the COVID-19 outbreak, the current conditions permit the activation of the clause. On 23 March 2020, the Ministers of Finance of the Member States agreed with the assessment of the Commission. The activation of the general escape clause allows for a temporary departure from the adjustment path towards the medium-term budgetary objective, provided that this does not endanger fiscal sustainability in the medium term. For the corrective arm, the Council may also decide, on a recommendation from the Commission, to adopt a revised fiscal trajectory. The general escape clause does not suspend the procedures of the Stability and Growth Pact. It allows Member States to depart from the budgetary requirements that would normally apply while enabling the Commission and the Council to undertake the necessary policy coordination measures within the framework of the Pact.

Bulgaria is among those Member States that have applied national clauses to suspend budgetary constraints set by their national fiscal rules, as part of the effort to accommodate the budgetary implications of the outbreak.

2. MACROECONOMIC DEVELOPMENTS

Real GDP growth in Bulgaria continued its strong performance in 2019, reaching 3.4%. Private consumption growth accelerated and continued to be the main growth driver, supported by positive labour market developments and credit activity. The trade balance of goods and services strengthened to 3.4% of GDP on the back of lower imports and resilient exports, contributing to the increased current account surplus of 5.5% of GDP.

The COVID-19 pandemic affects the Bulgarian economy via shrinking private demand due to the containment measures and worsened labour market situation, as well as via lower exports reflecting deteriorated external demand and disruptions in supply chains. Soon after the first coronavirus cases in Bulgaria were confirmed, a state of emergency was declared from 13 March until 13 May. Partial restrictions were imposed in the retail and transport sector, while catering services, sports,

[1] The Convergence Programme contains only short-term budgetary projections, in line with the guidelines for a streamlined format of the 2020 Stability and Convergence Programmes in light of the COVID-19 outbreak, provided by the Commission services on 6 April 2020.

cultural and entertainment activities were temporarily closed. Free movement within the country was restricted and access to city parks and natural sites was banned. The gradual lifting of the confinement measures started on 4 May 2020.

According to the Programme, the Bulgarian economy is expected to contract by 3% in 2020. The forecast assumes that the pandemic will be contained by the second half of 2020, both domestically and abroad. It is assumed that the shock is of temporary nature and that in 2021 the economic activity is set to return to its levels of 2019. Household consumption is projected to suffer initially from the restrictions imposed, but also be negatively influenced by the labour market developments and heightened uncertainty. Exports are expected to decline mainly due to lower external demand. A disproportionate decline in services exports is envisaged, as transport and tourism that are more exposed to the coronavirus shock and are expected to recover with a lag, constitute a high share of exported services. Investment is expected to remain suppressed throughout 2020 and recover only gradually in 2021 in parallel with improved external environment and firmed up domestic demand. Employment is set to decline on impact and start recovering only by the end of 2020.

In contrast with the Programme, the Commission 2020 spring forecast projects a deeper recession and a relatively strong but still incomplete recovery in 2021. While the factors behind the slowdown and the rebound are similar, the external assumptions for 2020 in the Commission forecast are more pessimistic than the ones underpinning the Programme’s macroeconomic outlook. The risks outlined in the Commission 2020 spring forecast are broadly in line with those in the Programme, but the Commission forecast gives more prominence to the uncertainty concerning the take up of the support measures.

Table 1: Comparison of macroeconomic developments and forecasts

	2019		2020		2021		2022	2023
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	3.4	3.4	-7.2	-3.0	6.0	n.a.	n.a.	n.a.
Private consumption (% change)	5.8	5.8	-5.8	-2.0	5.6	n.a.	n.a.	n.a.
Gross fixed capital formation (% change)	2.2	2.2	-18.0	-2.5	1.0	n.a.	n.a.	n.a.
Exports of goods and services (% change)	1.9	1.9	-13.2	-16.3	10.8	n.a.	n.a.	n.a.
Imports of goods and services (% change)	2.4	2.4	-12.5	-12.9	6.8	n.a.	n.a.	n.a.
Contributions to real GDP growth:								
- Final domestic demand	4.8	4.8	-6.0	-0.3	3.7	n.a.	n.a.	n.a.
- Change in inventories	-1.2	-1.2	-0.2	0.0	0.0	n.a.	n.a.	n.a.
- Net exports	-0.3	-0.3	-0.9	-2.6	2.3	n.a.	n.a.	n.a.
Output gap[1]	3.4	3.8	-5.0	-0.4	-0.7	n.a.	n.a.	n.a.
Employment (% change)	0.3	n.a.	-2.5	n.a.	0.5	n.a.	n.a.	n.a.
Unemployment rate (%)	4.2	n.a.	7.0	n.a.	5.8	n.a.	n.a.	n.a.
Labour productivity (% change)	3.0	n.a.	-4.8	n.a.	5.6	n.a.	n.a.	n.a.
HICP inflation (%)	2.5	2.5	1.1	0.1	1.1	n.a.	n.a.	n.a.
GDP deflator (% change)	4.7	4.7	0.5	1.9	2.4	n.a.	n.a.	n.a.
Comp. of employees (per head, % change)	6.1	n.a.	3.4	n.a.	2.3	n.a.	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	6.4	n.a.	4.7	n.a.	6.8	n.a.	n.a.	n.a.

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2020 spring forecast (COM); Convergence Programme (CP).

3. Recent and planned budgetary developments

3.1. Deficit and debt developments and Medium-term strategy and targets[2]

In 2019, Bulgaria's general government surplus reached to 2.1% of GDP, compared to the planned deficit of 0.3% of GDP in Bulgaria's 2019 Budget law and Convergence Programme. This was mainly due to public investment, which turned lower-than-expected and higher-than-expected non-tax revenue, mostly sales and fees. Compared to the previous year, the fiscal stance remained broadly unchanged in 2019, with some improvements in tax revenue collection and savings in government consumption more than compensating for the implemented increases in public sector wages and investment.

[2] In light of the activation of the general escape clause, the measures taken in response to the coronavirus outbreak in 2020 are not treated as one-off and are thus not excluded from the estimation of the structural budget balance.

The general government balance is planned to turn into a deficit of 3.1% of GDP in 2020. This deterioration by 5 percentage points of GDP is partially due to the adverse impact of the economic recession caused by the COVID-19 pandemic, including the impact of automatic stabilisers, and partially due to the impact of the policy measures to reinforce the health and security sectors and to support the economy. The Convergence Programme provides information on substantial new measures to contain the pandemic and to support the economy and on the estimated impact of the macroeconomic situation. The Convergence Programme estimates the budgetary impact of these direct support measures at 1.3% of GDP in 2020. The main measures include higher spending on medical equipment, wage bonuses and increases for the medical and security staff, and subsidies to businesses to maintain jobs, and tax deferrals. Debt is projected to increase from 20.4% of GDP in 2019 to 28.5% of GDP in 2020. This increase in debt-to-GDP ratio reflects a precautionary rise of the debt ceiling by BGN 10 billion on top of the underlying budgetary developments.

The Convergence Programme presents a qualitative outline of Bulgaria’s medium-term budgetary strategy, namely that it will remain focused on the sustainability of the budgetary framework and committed to Bulgaria’s medium-term objective without specifying the path. The Convergence Programme mentions explicitly Bulgaria’s medium-term objective of a structural deficit of 1% of GDP, which is more stringent than required by the Pact. The Programme targets would require specified measures. The programme does not imply the continuation of the COVID-19 measures beyond 2020.

The Commission forecasts a deficit of 1.8% of GDP under a no-policy-change assumption in 2021, resulting from an improved macroeconomic outlook and the fading impact of some of the measures against COVID-19 pandemic. The debt level is forecast at 25.5% of GDP this year and to remain broadly stable next year.

Table 2: General government budgetary position

(% of GDP)	2019	2020		2021		2022	2023	Change: 2019-2023
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**38.4**	**39.3**	**37.1**	**38.3**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
of which:								
- Taxes on production and imports	15.4	15.6	15.3	15.2	n.a.	n.a.	n.a.	**n.a.**
- Current taxes on income, wealth, etc.	5.9	5.6	6.0	5.3	n.a.	n.a.	n.a.	**n.a.**
- Social contributions	8.9	9.4	9.3	8.9	n.a.	n.a.	n.a.	**n.a.**
- Other (residual)	8.1	8.6	6.5	8.9	n.a.	n.a.	n.a.	**n.a.**
Expenditure	**36.3**	**42.0**	**40.2**	**40.2**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
of which:								
- Primary expenditure	35.7	41.4	39.6	39.5	n.a.	n.a.	n.a.	**n.a.**
of which:								
Compensation of employees+Intermediate consumption	14.7	17.0	16.0	16.4	n.a.	n.a.	n.a.	**n.a.**
Compensation of employees	10.3	12.1	11.1	11.7	n.a.	n.a.	n.a.	**n.a.**
Intermediate consumption	4.4	4.9	4.9	4.7	n.a.	n.a.	n.a.	**n.a.**
Social payments	13.5	15.2	15.2	13.9	n.a.	n.a.	n.a.	**n.a.**
Subsidies	2.4	3.0	2.1	2.5	n.a.	n.a.	n.a.	**n.a.**
Gross fixed capital formation	3.2	3.7	4.3	3.7	n.a.	n.a.	n.a.	**n.a.**
Other (residual)	2.0	2.6	1.9	3.0	n.a.	n.a.	n.a.	**n.a.**
- Interest expenditure	0.6	0.6	0.6	0.7	n.a.	n.a.	n.a.	**n.a.**
General government balance (GGB)	**2.1**	**-2.8**	**-3.1**	**-1.8**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Primary balance	**2.6**	**-2.2**	**-2.5**	**-1.2**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
One-off and other temporary measures	0.0	0.0	0.0	0.0	n.a.	n.a.	n.a.	**n.a.**
GGB excl. one-offs	**2.1**	**-2.8**	**-3.1**	**-1.8**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Output gap[1]	3.4	-5.0	-0.4	-0.7	n.a.	n.a.	n.a.	**n.a.**
Cyclically-adjusted balance[1]	1.1	-1.3	-3.0	-1.6	n.a.	n.a.	n.a.	**n.a.**
Structural balance[2]	**1.1**	**-1.3**	**-3.0**	**-1.6**	**n.a.**	**n.a.**	**n.a.**	**n.a.**
Structural primary balance[2]	1.6	-0.7	-2.4	-1.0	n.a.	n.a.	n.a.	**n.a.**
Gross debt ratio	**20.4**	**25.5**	**n.a.**	**25.4**	**n.a.**	**n.a.**	**n.a.**	**n.a.**

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

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

Source :

Convergence Programme (CP); Commission 2020 spring forecasts (COM); Commission calculations.

3.2. MEASURES UNDERPINNING THE PROGRAMME

Bulgaria declared State of Emergency on 13 March 2020 and the main measures to address the COVID-19 pandemic were established with the Law on Measures and Actions during the State of Emergency adopted the same day. These measures and other initiatives adopted by the government during the emergency period can be divided into three broad categories: measures financed by the state budget and thus have a direct impact on the budget balance, measures financed through the re-allocation of EU funds in the context of the Coronavirus Response Investment Initiative (CRII) and measures to support liquidity without direct impact on the budget balance.

The state budget is expected to finance measures of BGN 1.5 billion (1.3% of GDP). These include additional spending for health equipment, prevention of disasters and remunerations for security (police, firefighting and military) staff in order to implement the confinement measures and the necessary controls at the borders and the interior of the country (BGN 500 million or 0.4% of GDP). The state budget is also expected to finance a significant instrument, the so-called 60-40 scheme (BGN 1 billion or 0.9% of GDP). The scheme aims at supporting jobs by subsidising 60% of the gross wage of employees in enterprises that despite the adverse impact of the crisis do not reduce work positions.

The government plans a re-allocation of EU funds of BGN 870 million (0.8% of GDP) in the context of the CRII. The majority of these funds is going to support the working capital of SMEs (BGN 473 million) and short-term employment schemes (BGN 200 million). The rest of the amount is set to finance additional remunerations of the medical and non-medical personnel (BGN 60 million), purchase of medical equipment (BGN 40 million) and assistance to elderly, disabled and quarantined persons (BGN 45 million).

Table 3: Discretionary measures adopted/announced in response to COVID-19 outbreak

List of measures	Description	ESA Code (Expenditure / Revenue component)	Adoption Status	Budgetary impact (% of GDP - change from previous year)		
					2020	2021
1.	Urgent measures to prevent the spread of COVID-19	D.1/P.2/P.5, expenditure	Adopted		0.43	n.a.
	Of which: Overtime by Police and Fire Safety and Population Protection Authorities	D.1, expenditure	Adopted		0.14	n.a.
	Remuneration of military personnel for the implementation of the anti-pandemic measures	D.1/P.2, expenditure	Adopted		0.14	n.a.
	Other	D.1/P.2/P.5, expenditure	Adopted		0.14	n.a.
2.	"60/40" scheme to preserve jobs	D62, expenditure	Adopted		0.85	n.a.
				Total	**1.28**	**n.a.**

Source: Convergence Programme

Table 4: Guarantees adopted in response to COVID-19 outbreak

List of measures	Description	Adoption Status	Maximum amount of contingent liability* (% of GDP)	
1.	Guarantees from the Bulgarian Development Bank up to BGN 700 million, for business (BGN 500 million) and households (BGN 200 million) subject to state aid legislation	Adopted		**0.6**
			Total	**0.6**

Source: Convergence Programme

The updated state budget provided for an increase of the capital of the state-owned Bulgarian Development Bank (BDB) by BGN 700 million (0.6% of GDP) in order to issue portfolio guarantees to banks, allowing them to provide loans to business (BGN 500 million) and households (BGN 200 million). On the revenue side, the government postponed the deadlines for tax declarations and payment for businesses, entrepreneurs and farmers from March and April to June 2020. The target of the measure was to support liquidity in the form of tax deferrals of around BGN 390 million (0.3% of GDP). In the Commission 2020 spring forecast, however, it is estimated a negative impact of 0.3% of GDP on 2020 corporate income tax revenue due to delays in tax payments, which at the moment of the forecast were assumed to be carried over throughout the year and be collected in 2021. Subject to more detailed information, the competent statistical authorities are to examine whether all these measures entail an immediate impact on the general government balance or not.

Overall, the measures taken by Bulgaria are in line with the guidelines set out in the Commission Communication on a coordinated economic response to the COVID-19 outbreak.[3] The measures appear timely, temporary and targeted at cushioning the shock induced by COVID-19. The full implementation of those measures, followed by a refocusing of fiscal policies towards achieving prudent medium term fiscal positions when economic conditions allow, will contribute to preserving fiscal sustainability in the medium term.

3.3. Risk assessment

The macroeconomic and fiscal outlook are affected by high uncertainty due to the outbreak of the COVID-19 pandemic. The pandemic could become more severe and last longer than assumed, requiring more stringent and longer lasting containment measures. This would result in worse economic and fiscal outcomes. It could also require further fiscal policy measures. That would result in worse fiscal outcomes but

[3] https://ec.europa.eu/info/sites/info/files/communication-coordinated-economic-response-covid19-march-2020_en.pdf.

help to mitigate the economic impact. An additional risk stems from the considerable size of public guarantees issued in response to the crisis.

Compared to the Commission 2020 spring forecast, the Programme adopts a less adverse macroeconomic scenario, however, the budget outcome is slightly below the Commission forecast. This is mainly due to the Programme's cautious assumption on revenue performance given the highly uncertain macroeconomic situation. According to the Convergence Programme, total revenue is projected to fall well below nominal GDP mainly driven by non-tax revenue despite some higher receipts that should be expected from the EU due to the re-allocation of EU funds.

On the expenditure side, there are both upside and downside risks. The public investment projections seem to be relatively optimistic given the past experience, while social payments and compensation of employees seem to be on the low side despite the adopted measures (the Convergence Programme classifies the "60-40 scheme" in the social transfers, while the Commission forecast in subsidies). Additional risks on the expenditure side stem from the plans of the government to support tourism sector for which no details were announced by the time of publication of the Convergence Programme.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

4.1. COMPLIANCE WITH THE DEFICIT CRITERION

According to the Convergence Programme, Bulgaria's general government deficit is expected to reach 3.1% of GDP in 2020, thereby exceeding the Treaty reference value of 3% of GDP. This provides prima facie evidence of the existence of an excessive deficit in Bulgaria for the purposes of the Treaty and the Stability and Growth Pact. The Commission has therefore prepared a report under Article 126(3) TFEU, which analyses Bulgaria's compliance with the deficit criterion of the Treaty. Overall, the analysis suggests that the deficit criterion as defined in the Treaty and in Regulation (EC) No 1467/1997 is fulfilled.

4.2. COMPLIANCE WITH THE MTO OR THE REQUIRED ADJUSTMENT PATH TOWARDS THE MTO IN 2019[4]

Bulgaria is subject to the preventive arm of the Stability and Growth Pact and should ensure compliance with its medium-term objective. Under the European Semester in July 2019 the Council considered that Bulgaria complied with the Stability and Growth Pact.

[4] The possible retroactive impact on output gap estimates as a result of the recession induced by the COVID-19 outbreak and the possibility of abnormal responses of government revenues to major swings in economic activity underline that compared to the structural balance the expenditure benchmark is likely to provide a more reliable and predictable indicator in times of severe economic downturn.

The general government budget surplus increased from of 2% of GDP in 2018 to 2.1% of GDP in 2019, complying with the 3% of GDP reference value of the Treaty and is expected to remain compliant over the Programme period.

According to the Commission 2020 spring forecast, the structural surplus decreased by 0.2 percentage points of GDP (from 1.3% of GDP in 2018 to 1.1% of GDP in 2019) suggesting that Bulgaria overachieved its medium-term objective, of -1% of GDP, and is compliant with the Pact preventive arm requirements in 2019.

Table 5: Compliance with the requirements under the preventive arm

	(% of GDP)	2019	2020		2021	
	Background budgetary indicators[1]					
(1)	Medium-term objective (MTO)	-1.0	-1.0		-1.0	
(2)	Structural balance[2] (COM)	1.1	-1.3		-1.6	
	Setting the required adjustment to the MTO					
(3)	Structural balance based on freezing (COM)	1.0				
(4) = (1) - (3)	Position vis-a -vis the MTO[3]	At or above the MTO				
(5)	Required adjustment[4]	0.0				
(6)	Required adjustment corrected[5]	-2.3				
(8)	Corresponding expenditure benchmark[6]	11.8				
	Compliance with the required adjustment to the MTO					
		COM	COM	CP	COM	CP
	Structural balance pillar					
(8) = Δ (2)	Change in structural balance[7]	-0.2				
(9) = (8) - (6)	*One-year deviation from the required adjustment*[8]	2.1				
	Two-year average deviation from the required adjustment[8]	2.5				
	Expenditure benchmark pillar					
(10)	Net public expenditure annual growth corrected for one-offs[9]	5.1				
(11) = (10) - (8)	One-year deviation adjusted for one-offs[10]	2.1				
	Two-year deviation adjusted for one-offs[10]	2.3				
	Finding of the overall assessment	***Compliance***				

Legend

'*Compliance*' - the recommended structural adjustment or a higher adjustment is being observed.

'*Some deviation*' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'*Significant deviation*' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[7] Change in the structural balance compared to year t-1. Ex post assessment (for 2019) is carried out on the basis of Commission 2020 spring forecast.

[8] The difference of the change in the structural balance and the corrected required adjustment.

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source:

Convergence Programme (CP); Commission 2020 spring forecast (COM); Commission calculations.