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Report No. 23078

PROJECT PERFORMANCE ASSESSMENT REPORT

BULGARIA

REHABILITATION LOAN
(Loan 4078-BUL)

CRITICAL IMPORTS REHABILITATION LOAN
(Loan 4157-BUL)

FINANCIAL AND ENTERPRISE SECTOR ADJUSTMENT LOAN I
(Loan 4239-BUL)

FINANCIAL AND ENTERPRISE SECTOR ADJUSTMENT LOAN II
(Loan 4521-BUL)

October 30, 2001

Operations Evaluation Department

Currency Equivalents

(as of June 1, 2001)

Currency Unit = Bulgarian Lev (BGN)
BL1 = US$0.439
US$ = 2.274 BL

New Bulgarian Lev replaced the Old Leva (BGL) on July 5, 1999 @ 1BGN=1,000BGL

Fiscal Year = Calendar Year

Abbreviations and Acronyms

CAS	Country Assistance Strategy
CBA	Currency Board Arrangement
CEE	Central and Eastern Europe
CEM	Country Economic Memorandum
CEMA	Council of Mutual Economic Assistance
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
ESW	Economic and Sector Work
EU	European Union
FDI	Foreign Direct Investment
FESAL	Financial Enterprise Structural Adjustment Loan
FIAS	Foreign Investment Advisory Service
FSU	Former Soviet Union
GDP	Gross Domestic Product
GOB	Government of Bulgaria
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
IMF	International Monetary Fund
M&E	Monitoring and Evaluation
MIGA	Multilateral Investment Guarantee Agency
NGO	Nongovernmental Organizations
OED	Operations Evaluation Department of The World Bank
PAL	Programmatic Adjustment Loan
PSA	Private Sector Assessment
PSD	Private Sector Development
QAG	Quality Assurance Group
SAL	Structural Adjustment Loan
SAR	Staff Appraisal Report
SME	Small and Medium Enterprise
TA	Technical Assistance
USAID	United States Agency for International Development

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The World Bank
Washington, D.C. 20433
U.S.A.

Office of the Director-General
Operations Evaluation

October 30, 2001

MEMORANDUM TO THE EXECUTIVE DIRECTORS AND THE PRESIDENT

SUBJECT: Project Performance Assessment Reports on Bulgaria – Rehabilitation Loan (Loan 4078-BUL), Critical Imports Rehabilitation Loan (Loan 4157-BUL)), Financial and Enterprise Sector Adjustment Loan I (Loan 4239-BUL), and Financial and Enterprise Sector Adjustment Loan II (Loan 4521-BUL)

Attached is the Project Performance Assessment Reports for Bulgaria for the Rehabilitation Loan (Loan 4078 for US$30 million), the Critical Imports Rehabilitation Loan (Loan 4157 for US$40 million), FESAL I (Loan 4239 for US$100 million, with cofinancing by the Export Import Bank of Japan for US$50 million, and FESAL II (Loan 4521 for Euro 95.59 million with cofinancing by the Japan Bank for International Cooperation US$50 million. The Rehabilitation Loan was approved on August 1, 1996 and closed on schedule on July 31, 1997. The CIRL was approved by the Board on May 8, 1997 and closed on schedule on June 30, 1998. FESAL I was approved by the Board on October 30, 1997, and closed on schedule on April 30, 1998. FESAL II was approved by the Board on December 2, 1999, and closed on schedule on March 31, 2000.

Bulgaria's transition to a market economy began in 1989/90, but until 1997 was marred by stop and go policies. During this time, highly excessive banking sector financing of unreforming state-owned enterprises both inhibited reform and generated bouts of severe inflation. The Rehabilitation Loan, approved in 1996, supported an unsuccessful attempt to break the link between the SOEs and the banking sector. The CIRL, FESAL I and FESAL II, by contrast, were core components of wide-ranging reforms for the SOE and banking sectors which broke this link and played a key role in the fundamental transformation of the economy. At the same time, they played a key role in implementing the macroeconomic stabilization program by cutting off inflationary bad lending from state-owned banks to state-owned enterprises, which had also caused a steep decline in GDP. FESAL II also supported reforms in the energy sector, essential to the transformation of the economy because of Bulgaria's extremely high energy intensity and inefficiency. The IMF's EFF played an important role not only in stabilization but also in supporting implementation of structural reforms with its detailed conditionality and overlap with the FESALs.

Under these projects, 32 percent of the assets of state-owned enterprises were privatized (so that 50 percent of SOE assets have been privatized by the end of FESAL II, representing 80 percent of the assets of SOEs other than public utilities), as were 5 large state-owned banks. Remaining SOEs were constrained from obtaining bad loans, and pricing and other reforms were introduced to improve their financial condition with a view towards moving to privatization in the future. The energy sector is now guided by a new regulatory agency and has been restructured to facilitate privatization of transmission and other facilities in the near future. Central bank supervision was strengthened. Impressive as these achievements are, FESAL II in particular would have had an even greater impact had there been less reliance on Management-Employee Buyouts (almost 1/3 of privatizations involved MEBOs) and if fewer privatization agreements contained constraints on post-privatization investment and employment arrangements (which were incorporated in 90 percent of such agreements). The FESAL I and II reforms could have been even more advantageously leveraged had the Bank been able to assist Bulgaria with Governance and related reforms which could have further facilitated the adoption of efficient market-based modalities by the newly privatized enterprises and banks.

The PPAR rates the outcome of the Rehabilitation Loan as unsatisfactory, but rates the outcome of the CIRL and FESAL I as satisfactory. The outcome of FESAL II is rated as moderately satisfactory. These are all in accord with the ratings of the Evaluation Summaries. The PPAR rates sustainability of the Rehabilitation Loan as highly unlikely, compared to the Evaluation Summary rating of unlikely. The sustainability of the CIRL, FESAL I, and FESAL II is rated as likely. Institutional Development Impact of the Rehabilitation Loan is rated negligible, of CIRL, modest, of FESAL I, substantial, and of FESAL II, as modest, in accord with the Evaluation Summaries.

Five OED lessons were confirmed by the experience of these projects. First, the difference that ownership and commitment to the program makes is dramatically demonstrated by the contrast between the unsuccessful Rehabilitation Loan, which was pursued in the absence of any realistic indication of government commitment, and the CIRL and FESAL I and II which were pursued in support of a fully credible government reform program. Proceeding with lending operations in circumstances such as those surrounding the Rehabilitation Loan does not benefit the country nor further Bank assistance objectives. Second, the Bank needs to pursue complementary reforms in a realistic and timely fashion. The absence of agreed programs covering a range of aspects such as governance and judicial reforms has circumscribed the achievements of the FESALs and limited the benefits they provided to the economy. Third, the Bank needs to pay close attention to the form of privatization and any constraints which may be imposed on privatized enterprises. It should seek to avoid a prevalence of MEBOs and post-privatization constraints on investment and employment which limit the benefits of privatization. Fourth, the Bank needs to pay attention to management continuity. Although FESAL I was successfully implemented, the fact that it had five task managers inevitably caused a loss of momentum in the reform effort and a loss of some credibility to the Bank. Finally, partnerships can play valuable roles, as in this case where the IMF's EFF helped provide an overall context and continuity for the reforms.

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Annexes

Attachment

This report was prepared by Michael Lav (consultant). Betty Casely-Hayford and Tirsit Dinka provided administrative support.

Ratings And Responsibilities

Rehabilitation Loan (Loan 4078-BUL)

Performance Ratings

	ICR	*ES*	*PPAR*
Outcome	Unsatisfactory	Unsatisfactory	Unsatisfactory
Sustainability	Unlikely	Unlikely	Highly Unlikely
Institutional Dev. Impact	Negligible	Negligible	Negligible
Bank Performance	Satisfactory	Satisfactory	Unsatisfactory
Borrower Performance	Unsatisfactory	Unsatisfactory	Unsatisfactory

Key Project Responsibilities

	At Entry	*At Exit*
Task Manager	Eduardo Somensatto	Eduardo Somensatto
Division Chief	Christiaan Poortman	Christiann Poortman
Department Director	Kenneth Lay	Kenneth Lay

Critical Imports Rehabilitation Loan (Loan 4157-BUL)

Performance Ratings

	ICR	*ES*	*PPAR*
Outcome	Satisfactory	Satisfactory	Satisfactory
Sustainability	Likely	Likely	Likely
Institutional Dev. Impact	Modest	Modest	Modest
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

Key Project Responsibilities

	At Entry	*At Exit*
Task Manager	Neeta Sirur	Neeta Sirur
Division Chief	Christiaan Poortman	Christiaan Poortman
Department Director	Kenneth Lay	Kenneth Lay

Financial and Enterprise Sector Adjustment Loan I (Loan 4239-BUL)

Performance Ratings

	ICR	***ES***	***PPAR***
Outcome	Satisfactory	Satisfactory	Satisfactory
Sustainability	Likely	Likely	Likely
Institutional Dev. Impact	Substantial	Substantial	Substantial
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

Key Project Responsibilities

	At Entry	***At Exit***
Task Manager	Hans Moritz	Hans Mortiz
Division Chief	Franco Batzella	Franco Batzella
Department Director	Kenneth Lay	Andrew Vorkink

Financial and Enterprise Sector Adjustment Loan II (Loan 4521-BUL)

Performance Ratings

	ICR	***ES***	***PPAR***
Outcome	Satisfactory	Moderately Satisfactory	Moderately Satisfactory
Sustainability	Highly Likely	Likely	Likely
Institutional Dev. Impact	Modest	Modest	Modest
Bank Performance	Satisfactory	Satisfactory	Satisfactory
Borrower Performance	Satisfactory	Satisfactory	Satisfactory

Key Project Responsibilities

	At Entry	***At Exit***
Task Manager	Albert Martinez	Albert Martinez
Division Chief	Yasuo Izumi	Yasuo Izumi
Department Director	Andrew Vorkink	Andrew Vorkink

Preface

This is a Performance Assessment Report (PAR) for four projects for Bulgaria. The Rehabilitation project was supported by a one-tranche adjustment loan (Loan 4078-BUL) approved by the Board of the World Bank for the total amount of US$30 million on August 1,1996 which became effective on October 11, 1996. The single tranche of the loan was fully disbursed on November 1, 1996 and the loan closed on schedule on July 31, 1997. The Critical Imports Rehabilitation Project was supported by a one-tranche adjustment loan (Loan 4157-BUL) for the total amount of US$40 million approved by the Board of the World Bank on May 8, 1997, and was made effective on August 12, 1997. It was fully disbursed on August 14, 1997, and closed on schedule on June 30, 1998. The Financial and Enterprise Sector Adjustment project was supported by a one-tranche loan (Loan 4239-BUL) for the total amount of US$100 million approved by the Board of the World Bank on October 30, 1997 and made effective on February 10, 1998, two months behind the original planned date. The loan was fully disbursed on March 3, 1998 and closed on schedule on April 30, 1998. The Financial and Enterprise Sector Adjustment Project II was supported by a one-tranche loan (Loan 4521-BUL) for the total amount of Euro 95.59 million on December 2, 1999, and became effective on December 15, 1999 on schedule. It was fully disbursed in December, 1999 and closed on schedule on March 31, 2000.

This report is based on the Implementation Completion Report (ICR) by the Europe and Central Asia Regional Office of the World Bank issued on June 28, 1999, for RH, CIRL, and FESAL I, and FESAL II dated June 29, 2001, as well as the Report and Recommendation of the President of the World Bank dated July 15, 1996 for the RH, April 21, 1997 for the CIRL, October 6, 1997, for the FESAL, and November 3, 1999 for FESAL II, as well as on loan documents, project files, economic and sector work, discussions with Bank staff, and a mission to Bulgaria. The Operations Evaluation Department (OED) mission visited Bulgaria March 20 to March 30, 2001, as part of an OED country assistance evaluation, to discuss the effectiveness of the Bank's assistance with the Government of Bulgaria (GOB), various project implementation agencies, other donors, and other stakeholders. The full cooperation and assistance of all government officials visited are gratefully acknowledged.

The draft PPAR was sent to the Borrower for comments. Comments received are attached as Attachment 1.

1. Introduction

1.1 OED selected these four lending operations to Bulgaria for assessment to provide an opportunity to review important aspects of Bulgaria's adjustment and reform program and to provide lessons for the Country Assistance Evaluation and for future support. The Rehabilitation Loan (RL) of US$30 million and the Critical Imports Rehabilitation Loan (CIRL) of US$40 million were quick disbursing operations to support the initial phases of the stabilization and reform program of the government. The RL was approved on August 1, 1996 and made effective on October 11, 1996, and the CIRL was approved on May 8, 1997 and made effective on August 12, 1997. The two Financial and Enterprise Sector Adjustment Loans (FESAL I and FESAL II) supported specific reforms in these sectors which were essential to both the stabilization and transformation of the economy. FESAL I was approved on October 30, 1997 and made effective on February 10, 1998. FESAL II was approved on December 2, 1999 and made effective on December 15, 1999.

1.2 Bulgaria's transformation from a socialist economy to a market economy began in 1989 under difficult circumstances. Bulgaria was more heavily dependent on Council of Mutual Economic Assistance (CMEA) markets than most other Eastern European countries, and in consequence, its markets more heavily distorted. Bulgaria's trade orientation and limited contact with market economies resulted in a population less exposed to the ideas and ways of thinking associated with markets which were so important in countries like Poland and Hungary in promoting domestic reforms.

1.3 Although many Bulgarians wanted a market economy, drawing on the same lessons which other Eastern European countries found compelling, political support for reform was fragmented. Bulgaria had traditionally seen Russia and the Soviet Union as an ally, dating back at least to Russia's key role in assisting Bulgaria in 1878 to attain independence from the 400 years of rule by the Ottoman Empire. Bulgaria was the only Eastern European country never occupied by Russian troops. This ambivalence led to a close balance between socialist and non-socialist parties which alternated in power through the 1990s, resulting in nine governments since 1989, with varying commitment to reform.

1.4 Sectoral constraints were also important, a number of which were in the energy sector. Energy prices were far below border prices, energy intensity extremely high, and 42 percent of energy was supplied by six nuclear power plants, four of which were unsafe. Bulgaria's external relations were complicated by its exceptionally high external debt, in excess of 150 percent of GDP.

1.5 As reform began in 1989/90, the economy declined. A phased liberalization was introduced in 1991. Price controls were relaxed but by no means eliminated, the exchange rate unified, subsidies reduced and fiscal reform introduced. But the reform government fell in less than a year. A new government in early 1992 tried to follow through with reforms, but as wages fell and unemployment increased, that government fell, and a new government tried to press forward in December, 1992.

1.6 The Bank provided assistance to Bulgaria's reform program with a FY92 SAL. The SAL supported elimination of central planning, trade reforms such as progress towards elimination of quantitative restrictions and export taxes in the effort to expand trade with market economies, and a phased price liberalization. It also supported initial steps in reforms needed for private sector development by transforming SOEs into joint stock companies and for the banking sector by initiating a program of bank supervision at international standards.

1.7 The SAL was implemented over 3 years, with the second tranche released after a delay of 14 months. OED's assessment[1] rated the outcome of the SAL as satisfactory with likely sustainability and moderate institutional development impact. Despite this positive overall assessment, the audit report notes that "Implementation of the project did not go smoothly", ascribing shortfalls in the main to a changing and uncertain political environment. The audit went on to note that "there are two important areas, the SOEs and their privatization and the banking sector, where progress has been less satisfactory and which could undermine the recent stabilization progress and the potential supply response of all sectors of the economy…." However, some progress was made, including passage of a comprehensive privatization law, creation of a framework for mass privatization, and efforts by the Central Bank to improve supervision and the merger of a number of public sector banks with majority ownership assumed by a holding company.

1.8 Following the SAL, reform did not take hold in the enterprise and banking sectors. SOEs were financed to a large degree by increasing arrears and by borrowing from the state-owned banks, which in turn were refinanced by the Central Bank. In the process, assets were privatized while liabilities remained in the public sector. At the same time, the creation of a competitive banking sector got off on the wrong foot when the authorities allowed a large number of undercapitalized and ill-staffed private banks to operate. Meanwhile, the phased price liberalization fed inflationary expectations. In sum, transformation of the real sector stagnated, the money supply increased, and confidence in money eroded leading to decreased demand, all of which led to falling production and bouts of inflation.

1.9 The Bank tried to further the enterprise and banking reforms which were initiated with the SAL, and began work on identifying a FESAL with initial identification missions in 1992. But it was difficult to achieve progress, as a closely divided public resisted change. In response to concern over fiscal deficits which had averaged 15 percent of GDP from 1991-93, a new restrictive budget was formulated. However, without supporting monetary and other policies, excess demand spilled over into the balance of payments and the economy was financed by an increasing current account deficit, which in turn led to a foreign exchange crisis.

[1] Report No. 16396, March 21, 1997.

1.10 The Bank also tried to assist Bulgaria's development with a number of investment projects, most of which were not successful, partly as a result of recurring macroeconomic and fiscal problems. The Bank did assist Bulgaria to address its external debt and foreign exchange crises as it supported Bulgaria in a commercial bank debt and debt service agreement in 1994 and a loan for US$125 million. About US$8.1 billion of commercial debt was restructured and commercial debt was reduced by about US$2.5 billion to US$6.5 billion. However, in the absence of a sustained reform program, Bulgaria could not capitalize on the achievements of the DDSR at the time.

1.11 A number of aspects of sectoral reform also languished, including those to address issues in the important energy sector. Improving performance in this sector was a SAL I objective, but conditionalities relating to energy prices and social safety net provisions were inappropriately specified and did not yield the desired adjustment, as they were formulated in the absence of sufficient analytical work. For example, energy prices did not reach even the intermediate goal of cost recovery and still less the long-term goal of long-run marginal cost pricing even though they were continually raised.

2. Objectives

2.1 As a result of all of these macroeconomic and sectoral shortfalls, confidence in the government evaporated, and the economy continued to deteriorate. The crisis which emerged in 1995 motivated Bulgarians to take reforms more seriously. But the road was by no means easy, and further setbacks remained in store. Nevertheless, efforts to reform the economy began in 1996 and led to the first of the four operations comprising this audit, all of which had a common theme of supporting the transformation of the economy by supporting financial sector and enterprise reforms where the SAL had left off.

2.2 *Rehabilitation Loan.* An emergency program of measures was launched in mid – 1996 to stabilize the economy and accelerate banking and enterprise reforms. The government's program included closure of two banks, placing an additional three in conservatorship, and introduction of an explicit partial deposit scheme.[2] A bank restructuring program was introduced to (i) provide limited capitalization of the banks; (ii) restrict unsecured financing by the Bulgarian National Bank (BNB); (iii) provide arrangements to improve capital adequacy; and (iv) improve supervision and accounting practices. Enterprise reforms included (i) closure of some of the largest loss making enterprises; (ii) restructuring of potentially viable strategic enterprises; (iii) acceleration of privatization; and (iv) assistance for redeployment of redundant workers to alternative productive employment.

2.3 The Bank, the IMF, and other development partners assisted Bulgaria in these efforts. The Bank approved the RL to provide rapid financial support, and the loan helped finance some of the immediate costs of the reforms, the most important of which

[2] However, the partial nature of the deposit scheme heightened the public's concern about the safety of deposits and so did not really address the issue.

was the fiscal burden of assisting workers being displaced in the enterprise restructuring and liquidation programs. The RL had not been proposed in the CAS date March 15, 1996, which instead had two scenarios, a full adjustment scenario and a non-reform scenario. The RL was developed quickly as the most support the Bank could offer to what was seen as an incomplete reform program. The IMF approved a new Stand-By Arrangement (SBA) in July, 1996.

2.4 In the event, the government's program failed as the emergency measures proved short-lived, and more fundamental enterprise reform measures were only partially and hesitantly implemented. Policy slippages prevented completion of the first review of the IMF's SBA, and no funds were withdrawn after those provided at the time of Board approval. This, in turn, further reduced confidence in the government's program.

2.5 The lack of sustained reform and resulting economic problems finally led to a full-blown economic crisis in 1996 in which real wages fell by 30 percent accompanied by shortages of bread, medicine, energy, and agricultural inputs. Additional hardships resulted from inappropriate use of price policy for wheat which exacerbated shortages. The population's hardships and discontent led to the resignation of the government and the dissolution of Parliament. An interim government came to power in February 1997 and was granted broad powers to address the crisis and to negotiate with the IFIs.

2.6 *Critical Imports Rehabilitation Loan.* The interim government responded quickly to the crisis. It addressed wheat shortages by liberalizing the wholesale price and arranging for emergency imports, and worked to alleviate shortages in energy and agriculture. The government also set the stage for more fundamental reforms on the basis of a new program designed with assistance from the World Bank and IMF. The program was based on macroeconomic stabilization, a renewed emphasis on quick and transparent privatization, liberalization of trade, rapid reduction of SOE losses, a reduced fiscal deficit with a restructured the budget and a smaller public sector, improved incentives for business and investment, rapid completion of the farm restitution program, improved targeting of the social safety net, and improved governance by a reduction in corruption.

2.7 These initial steps to address the economic crisis aided in generating substantial public sentiment supporting the transformation of the economy, and a reform government was elected in April 1997 with an absolute majority in Parliament and a commitment to implement an accelerated transformation. Building on the Interim Government's program, the new government determined that stabilization would underpin the transformation, and accepted the IMF's recommendation to institute a Currency Board Arrangement (CBA) as the key to stabilization. The hyperinflation of the previous months had finally eliminated the monetary overhang, completing the job that 7 years of phased price liberalization (albeit in the context of excessive lending by the BNB) had left undone. The CBA would keep inflation low by requiring 100 percent backing of the *lev* with foreign exchange reserves, thereby also ensuring full convertibility. Inflation dropped to one percent per month by the end of 1997, real wages recovered by 25 percent during the year, and foreign exchange reserves increased sharply to US $2.5 billion.

2.8 To provide support for the program, the IMF approved an SBA in April, 1997 and the Bank followed with the CIRL in May, 1997. The CIRL was essentially based on the program that the Bank had worked on since 1992 as a basis for a FESAL, which, in broad terms, encompassed isolating, liquidating, and privatizing SOEs and privatizing most of the large publicly-owned banks. Because the government was not yet ready to credibly commit to implementing an adjustment operation, the Bank developed the CIRL as a rehabilitation loan with less stringent conditionality. (Like the RH, the CIRL had also not been programmed in the 1996 CAS.) The CIRL was in effect funded by reallocating US$40 million of the US$140 million that the Bank had allocated for the FESAL, leaving US$100 million for the time when a FESAL (as a full adjustment loan) could be developed.

2.9 *FESAL I.* Building on the stabilization and transformation measures supported by the CIRL, the government followed with additional implementation of the adjustment program, building credibility which enabled the Bank to support the program with FESAL I, approved on October 30, 1997. The loan did not become effective until February, 1998, largely due to delays in the formalities of government loan processing. The key features of the reform program supported by FESAL I were isolation/liquidation of 64 large loss-making SOEs, privatization of small, medium, and large SOEs through a variety of programs,[3] imposition of loss reduction and financial discipline measures on other SOEs, and privatization of public sector banks and the development of a sound banking system.

2.10 *FESAL II* was programmed in the April, 1998, CAS and was approved and made effective in December, 1999, to support further progress in these same areas, namely sale or initiation of liquidation or insolvency proceedings of SOEs, including those under the purview of the privatization agency and the line ministries, cessation of operations of SOEs under liquidation, sale of 6 large publicly-owned banks, and, additional to FESAL I sectoral coverage, reforms in the structure of the energy sector to be based on a new energy law. FESAL II was appraised and implemented in very close coordination with the IMF's EFF. By the time the Bank appraised FESAL II, however, a number of issues were identified which needed to be addressed in order for Bulgaria to pursue more vigorously private sector development, such as public sector management, government regulations, judicial reform, bankruptcy, collateral, the form of SOE privatizations, etc. These issues are addressed more fully below. The conditionalities in both the EFF and FESAL II were similar and covered all important issues including rationalizing energy prices and subsidies while providing a safety net for vulnerable groups; and creating an enabling institutional framework for restructuring and privatizing energy institutions.

[3] Privatization was pursued on three levels. The largest loss-making SOEs were handled by the Privatization Agency (individually under PATA (privatization agents financed by donors), or in Pools by agents, or separately by the PA without assistance). Branch Ministries handled the privatizations of those enterprises which they managed. Finally, small-scale enterprises were privatized through a mass privatization program (CMP).

3. Design

3.1 All four of these operations were limited to one tranche to avoid the uneven implementation experience of the two-tranche SAL. In fact, FESAL I had originally been designed as a two tranche operation but was redesigned in response to the implementation problems of SAL and the inability of successive governments to implement reforms as had been agreed. This redesign corresponded to the reallocation of US$40 million for the CIRL. Detailed implementation programs were specified for both FESAL I and II.

3.2 Concerning FESAL I, the objective was to pursue further progress in the same areas addressed by CIRL. (A complete set of the CIRL's conditions and their status is given in annex 5-B.) In addition to supporting the macroeconomic framework, a number of actions were pursued to accelerate privatization, including: (a) further privatization, building on the 17.8 percent of total SOE long-term assets privatized by Board presentation, with the objective of supporting privatization of SOEs accounting for at least an additional 23 percent of SOE long term assets; (b) appointing privatization agents for an additional 27 SOEs in addition to privatization agents previously appointed for 3 large SOEs; (c) concerning the liquidation program, 59 of 64 SOEs slated for liquidation were either privatized or closed, with the objective of implementing legislative and regulatory measures to streamline and accelerate the process of bankruptcy and liquidation; (d) concerning the isolation program for non utilities which prevented these SOEs from borrowing from banks, financial recovery plans of all 41 SOES in this group (group B) were approved by Board presentation, with the objective of insuring that all such SOEs exit the isolation program; and (e) concerning the isolation program for utilities (group A) which also prevented these SOEs from borrowing from banks, measures taken by Board presentation to improve finances included raising tariffs for electricity, railways, telecommunications, district heating, natural gas, and lignite, with the objective of implementing costs reduction measures proposed in the financial recovery plans. A new banking law was introduced by Board presentation, and further objectives during implementation included enacting a new Deposit Insurance Law and establishing a sound deposit scheme. Banking supervision was improved and steps taken towards privatizing the 6 public sector banks (all of them except for the state savings bank). The Collateral Law was to be amended and a registry of collateral was to be introduced. A complete set of conditions and their status is given in Annex B.

3.3 FESAL II continued with further progress on essentially the same agenda, with the addition of restructuring the electricity sector. Conditionality concerning SOEs included the sale or initiation of liquidation or insolvency proceedings equivalent to at least 80 percent of the long term assets of the SOEs in the Privatization Advisors and Transactions Agents program, and sale or initiation or insolvency proceedings of SOEs equivalent to at least 30 percent of the long term assets of SOEs in the pool privatization program. Banking sector conditionality included completing the privatization of one publicly-owned bank and steps towards the privatization of four others.

3.4 Conditionality concerning the energy sector included: (a) passage of a Law on Energy and Energy Efficiency to provide for a competitive energy market and private investment; (b) rationalization of policy, regulatory and process functions under three new bodies: State Agency of Energy and Energy Resources (SAEER); State Energy Regulatory Commission (SERC, and appointment of its commissioners); and State Energy Efficiency Agency (SEEA); (c) stabilization of the financial condition of Bulgargaz' (the gas import and distribution company) and separation of its supply, transmission, storage and distribution functions from an accounting point of view; (d) separation of loss-making coal mines and pits from profitable sections in preparation for privatization; (e) adoption of an Action Plan to commercialize potentially viable District Heating (DH) companies (phasing out producer subsidies over the next 4-5 years); (f) closing of nonviable DH companies, and increasing the role of municipalities in their governance; and (g) unbundling of the vertically integrated NEK into independent generation, transmission and distribution companies. A complete set of conditions and their status is given in Annex B.

3.5 The programs dovetailed very closely with the IMF's SBA and EFF. The SBA of April, 1997, contained as a review condition "adequate progress under FESAL (to ensure adequate financing of the program)". FESAL I conditions were repeated explicitly in the EFF and even amplified (so that the EFF included more detailed implementation guidelines than did FESAL I, such as removing preferences for Management Employee Buyouts (MEBOs) in the privatization process). The detailed specification of conditions was useful in supporting implementation, and, given Bulgaria's past problems in implementing reforms, was desirable.

3.6 While privatization processes could have been specified more precisely to avoid these problems, the overall scope of FESAL II was reasonable. However, the Bank recognized that a number of government reforms were necessary to promote private sector development. The expectation by the Bank when FESAL II was being formulated was that a number of these issues would be addressed in a parallel Government Modernization Loan. When this loan did not materialize (see section 5), an important component of the Bank's country assistance strategy could not be addressed, and the reforms needed in governance, judicial sector reform, and the like could not be pursued as had been expected. This reduced the relevance and efficacy of the Bank's assistance strategy and FESAL II, but such shortfalls should not be attributed to FESAL II.

Quality at Entry

3.7 *The Rehabilitation Loan is rated unsatisfactory for Quality at Entry* because it lacked an adequate assessment of risk. A range of sustainability considerations were inadequately addressed, including resilience of design to shocks and provision of measures to minimize risks. The Bank proceeded with the loan despite the lack of readiness for implementation of the program. There was no strong "champion" agency for this kind of program, and a lack of political support for the reform measures which Bulgaria needed. Two fundamental flaws were the undiminished SOE/banking linkages and the lack of essential and credible central bank reforms, both of which should have signaled the likely failure of the program. The Bank was placed in the position of acceding to supporting the IMF, but the support provided by the Rehabilitation Loan did not benefit Bulgaria's reform.

3.8 CIRL, by contrast, was implemented with greater attention to risk and sustainability, as the Bank awaited more favorable conditions before proceeding. There was strong government ownership of the underlying program, which, based on a CBA, curtailed lenient lending to SOEs and severed SOE/banking linkages which had undermined previous reform efforts. The CIRL ranks high in readiness for implementation, including having a credible "champion" agency with firm support by a Deputy Prime Minister. The CIRL was also well grounded in ESW, was consistent (more than consistent, it was a centerpiece) with the Bank's country strategy. It rates a *satisfactory* rating for quality at entry.

3.9 FESAL I and II are both rated as having *satisfactory* quality at entry. Readiness for implementation, technical aspects, economic aspects, government ownership, development objectives, grounding in ESW, consistency with CAS and country strategy, all merit ratings of substantial to high. Partly offsetting these strengths were some weaknesses in institutional capacity analysis and some shortfalls on output and, especially, impact indicators (see below). FESAL I was rated by QAG as having satisfactory quality at entry. FESAL II was not rated by QAG at entry. However, FESAL II would have been a stronger project had it more clearly specified the details of the privatization process. In particular, it would have been useful to more firmly ensure that privatization processes brought in new management and ownership, rather than relying on buyouts by management and employees to any great extent. Another such issue relates to the post-privatization constraints placed on enterprises concerning employment and investment A third issue is the length of time it has taken to resolve bankruptcy and liquidation issues. These issues are discussed in more detail below.

4. Implementation

4.1 *Rehabilitation Loan.* Implementation was successful only in the narrow sense of helping offset the fiscal cost of severance payments for workers affected by SOE restructuring. The objectives of the loan, however, were much broader, including to support stabilization measures and lay the groundwork for the structural adjustment program. The stabilization effort collapsed, with the fiscal deficit increasing from 6.3 percent of GDP in 1995 to 12.6 percent in 1996, and the rate of change of the CPI increasing from 33 percent in 1995 to 311 percent in 1996 and 579 percent in 1997. Implementation of the structural adjustment program lagged badly. Although state enterprise reforms included filing court bankruptcy petitions for 40 of the 64 enterprises identified for closure, these were not effective in putting these enterprises out of business as bureaucratic and legal procedures tied up proceedings. In the banking sector, 2 banks were closed and 5 banks were placed in conservatorship, and higher capital adequacy ratios were introduced, but the core problem of excessive central bank refinancing was not addressed.

4.2 *Critical Imports Rehabilitation Loan.* Widespread public discontent over the hyperinflation and shortages resulting from the collapse of the program ineffectively supported by the Rehabilitation Loan had the salutary affect of mobilizing public support for a new program. As this support gathered momentum, the new program introduced in mid 1997 had substantial public support. The CBA functioned as prescribed, and forced Bulgaria to follow a conservative monetary policy limiting money creation to changes in reserves. The fiscal deficit was reduced from 12.6 percent of GDP to 2.5 percent by strengthening revenue collection, raising the VAT threshold, and increasing penalties and interest on overdue tax liabilities.

4.3 As supported by the CIRL, and the SBA, the enterprise reform program was accelerated, including: (a) privatization, with 5 percent of state owned assets privatized through cash based programs and another 18 percent through voucher based programs; (b) liquidation, towards the objective of reducing upfront 28 percent of SOE sector losses in 1995 with the closing of 30 and privatization of 11 out of original list of 64 problem SOEs to be addressed; and (c) isolation, with the objective of reducing upfront 50 percent of SOE sector losses in 1995, isolated SOEs from the banking system and increased administered prices for water, coal, heating for industries, electricity, natural gas, and telecommunications to cover costs. A number of banking sector reforms complemented BNB reforms supported by the IMF, including placing 15 banks in conservatorship and filing for bankruptcy against these banks, and signing MOUs with 18 other banks which outlined targets for loan recovery and cost cutting measures. In agriculture, the sales price of wheat by state entities was increased to maintain a price of at least 85 percent of international prices CIF Sofia. A number of social sector reforms were pursued to raise and better target social assistance to children, and to augment temporary resources for social care institutions via a supplement from the EU.

4.4 *FESAL I* implementation was satisfactory. By mid-1999, about 35 percent of total SOE long-term assets had been privatized. International privatization agents for 31 selected SOEs were appointed by March 30, 1998. To further the liquidation program, SOEs accounting for at least 32 percent of losses in 1995 were effectively closed or privatized. Tariffs were increased for railways, electricity, telecommunications, and district heating, though further improvements were required. A number of banking sector reforms were supported by FESAL I (see paragraph 3.2 for a more complete listing); most notably, steps were taken towards privatizing the 6 public sector banks (all except for the state savings bank), although this progress was slower than expected. The Collateral Law was to be amended and a registry of collateral was to be introduced.

4.5 *FESAL II* continued with further progress on essentially the same agenda, with the addition of restructuring the electricity sector. By the end of 2000, 90 percent of the non-energy and non-infrastructure assets had been divested. However, MEBOs and post-privatization agreements constraining employment and investment decisions were prevalent. These and related issues are discussed in more detail in Section 5 below. Financial discipline was imposed on the remaining SOE sector through the isolation program. All 48 SOEs in the isolation program including the steel mill and the airline had exited: 32 were privatized, 13 were liquidated, and 3 were placed under bankruptcy proceedings. Reforming the banking sector proceeded apace as 5 out of 6 state-owned banks slated for privatization were privatized. Upgrading of banking supervision continued and the Banking Supervision Department began adopting the CAMELS bank rating system. The energy sector was substantially restructured as discussed under

Outcomes (section 5, below). This required considerable effort and expertise on the part of the Bank, and the IMF, as government was not united in its will to proceed with this reform.

4.6 The IMF's EFF of 1998 followed FESAL I but preceded FESAL II, and in any event incorporated many of the conditions found in both FESAL I and FESAL II. Because the Fund drew heavily on Bank expertise in designing and implementing the EFF, this overlap was quite beneficial. The government found it desirable to work in this way because the IMF's EFF brought with it large disbursements based on quarterly reviews, so that stepwise progress could be monitored and tied to disbursements. The IMF also had a strong centrally directed team which addressed a variety of issues at once with government counterparts, so that the key counterpart, a deputy prime minister, could quickly resolve any problems which arose in the course of implementation

4.7 The generally successful implementation of the CIRL and FESALs I and II was based on careful and detailed project preparation work with the government. The agenda of reforms supported by these operations had been a high priority for the Bank since the SAL, and a number of missions and related work by the Bank had carefully laid the groundwork for these operations. The operations also benefited from close collaboration with the IMF, and the umbrella of the IMF's SBA and EFF. The 1997 SBA provided the groundwork for the CIRL and helped preparation of FESAL I, while the EFF incorporated many conditions of both FESAL I and FESAL II. With its large financial impact and intensive quarterly implementation meetings with Bulgarians, backed in turn by the active participation of the IMF's top management, the IMF provided a great deal of the fabric within which reforms supported by these loans were actually implemented.

5. Outcome

5.1 *The outcome of the Rehabilitation Loan was unsatisfactory* because the government was not committed to the reforms it supported and did not proceed with SOE privatization, isolation, or liquidation, nor with adequate banking sector reform. The reforms supported by the Rehabilitation Loan were not implemented, and the program itself stalled. The only aspect of outcome which was satisfactory was the loan's rapid disbursement and the use of counterpart funds for packages for employees affected by enterprise sector restructuring which did take place.

5.2 *The CIRL is rated as having a satisfactory outcome.* The reforms that it supported were fully relevant, supporting the macroeconomic program driven by the Fund, and focusing on complementing the introduction of the CBA by privatizing, isolating, and/or liquidating the SOEs, thereby starting to follow through on the agenda first implemented with the SAL. In the banking sector, the CIRL helped to set the framework for privatizing publicly owned banks. Although the CIRL was clearly a supporting component of the IMF led program, it was highly efficient in that a relatively small amount of funding brought Bank support for the nascent reform program.

5.3 *FESAL I achieved a satisfactory outcome*, as almost all of its objectives were met, in terms of carrying forward the enterprise and banking reform previously outlined under the CIRL. Under FESAL I, the privatization framework was firmed up, and the government appointed privatization agents for several of the largest SOEs accounting for 10 percent of long-term SOE assets. It also set in train the privatization program for smaller SOEs accounting for 15 percent of long-term assets. To impose financial discipline in the SOE sector as privatization proceeded, 64 SOEs were placed under bankruptcy and liquidation procedures and another 71 SOEs were placed in isolation to shut down their access to the banking sector. Two banks were privatized and the process for privatizing another three was implemented. One shortfall in implementation concerned a future policy action to amend the Collateral Law and establish a registry of collateral which was a component of " the indicative plan for the next sixth months". Despite the implementation of this conditionality in the Fall of 2000, a number of bankers reported to OED in the Spring of 2001 that they still have no confidence in the collateral system and that this is an impediment to expanding banking activity, and is one of the reasons why bank credit to the private sector is still so low. While other examples of shortcomings are given below, FESAL I's substantial efficacy is clear in that it established the enterprise/banking sector reform agenda. It was also clearly efficient in so doing.

5.4 Privatization of the SOEs and state-owned banks was essential for several reasons. First, it broke the link which had caused the quasi-fiscal deficit and the money supply to increase so rapidly. Second, it set the stage for private sector development and continued growth. The paragraphs below detail some the achievements of FESAL II, following which is a discussion of some shortcomings of the reforms supported by FESAL II.

5.5 The key reform of SOE privatization was vigorously pursued, and 78 percent of all non-infrastructure assets had been divested by the end of 2000.[4] (Divestiture of infrastructure assets is proposed to be a focus for a subsequent adjustment operation.) Taking infrastructure and non-infrastructure together, 51 percent of all assets have been divested. Tracking this successful outcome in terms of the conditionality of FESAL II, it is useful to refer to the three levels on which privatization was pursued. The largest loss-making SOEs, handled by the Privatization Agency individually under PATA (see paragraph 3.3), accounted for 51 percent of the value of sales. Branch Ministries handled the privatizations of those enterprises which they managed, and these accounted for 20 percent of the value of sales.[5] Finally, small-scale enterprises were privatized through a mass privatization program (CMP) which accounted for 29 percent of the value of sales.

[4] As quoted in IMF Fifth Review of EFF, March 9, 2001.

[5] This procedure created a conflict of interest, since Branch Ministries lacked incentive to privatize enterprises within their purview, which probably resulted in slower progress than could have been achieved in other circumstances.

More than 50 percent of the value of sales occurred from 1998 to 2000. Finally, residual shares[6] in most nonstrategic enterprises were sold or otherwise disposed of.

Table 5.1: Long-Term Assets Privatized (billion *leva* at end 1995 valuation)

	1993	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*Total*
Total	2	9	6	24	107	26	98	26	298
PA	2	9	3	20	14	10	81	13	152
Line Ministries	0	1	3	3	8	16	17	12	61
CMP	0	0	0	0	85	0	0	0	85

5.6 Banking reforms specified under FESAL I and II have proceeded on target. All six of the state-owned banks targeted for divestiture have been sold to private banks. Supervision has been strengthened. In October, 2000, parliament approved amendments to the Commercial Code designed to simplify and accelerate bankruptcy procedures. Judges have been trained to some extent in bankruptcy procedures. A central credit registry accessible to all banks was made fully operational in March, 2001. These last items were specified in FESAL I as future reforms. A modern bankruptcy law was submitted to parliament in September, 2000, and passed a first reading in November.

5.7 Energy was the one important sector added in FESAL II. Reforms in this sector were built on pre-1997 achievements in the power sector (under the Energy Project) including laying initial control and information systems to enable the "unbundling" of NEK (National Electricity Company). FESAL II achievements in the energy sector include: (a) the Energy and Energy Efficiency Act was passed in 1999 providing for a competitive energy market and private investment; (b) the State Agency of Energy and Energy Resources (SAEER); State Energy Regulatory Commission (SERC); and State Energy Efficiency Agency (SEEA) were established; (c) the vertically integrated NEK was unbundled into independent generation, transmission and distribution companies; (d) the financial condition of Bulgargaz' was stabilized and its supply, transmission, storage and distribution functions were separated in terms of their accounts; (e) loss-making coal mines and pits were separated from profitable sections in preparation for privatization; and (f) an Action Plan was adopted to commercialize potentially viable District Heating (DH) companies (phasing out producer subsidies over the next 4-5 years), close down nonviable DH companies, and increase the role of municipalities in their governance.

5.8 The reforms, especially the privatization of SOEs and banks, achieved (in support of the CBA) a full break in the cycle of financing which has generated rapid growth of the money supply and inflation. Thus, from the macroeconomic/quasi-fiscal deficit/money supply perspective, the privatization component of FESAL II was fully relevant.

5.9 FESAL II did not explicitly address a number of emerging constraints to private sector development, such as judicial sector reform, which were clearly apparent at the time of appraisal. However, these were to be addressed in a separate Government

[6] Enterprises were considered divested if government held less than 1/3 of the outstanding shares, so that the government could not block actions of the majority owners. Residual sales refers to the sale of government held assets of privatized enterprises.

Modernization investment loan,[7] which, in the event, did not materialize despite a substantial amount of background work on judicial reform and other issues. With the failure of the Government Modernization operation to materialize (it had been proposed in the FY98 CAS as the US$20 million investment operation), important issues essential for successful private sector development were not addressed. However, this is more of an issue of country assistance strategy than an issue for FESAL II per se.

5.10 The efficacy of the SOE/bank privatization component of FESAL II for private sector development is more difficult to rate. The paragraphs below look at some drawbacks to the privatization process within the scope of FESAL II, and ask whether the reforms they supported comprised a fully satisfactory package designed to have a reasonably positive impact on the economy.

5.11 The implementation of the privatization program has led to an outcome which now limits more vigorous private sector development in three important ways:

- Management and Employee Buyouts (MEBOs) were favored for a range of purchases, yet are not as likely as other privatization modes to bring injections of management and capital to restructure SOEs. MEBOs accounted for 119 of the large enterprises (and 23 percent of total assets) privatized, whereas sales to local investors comprised 86 deals for 26 percent of total assets, and 64 deals involving 42 percent of total assets involved foreign strategic investors. Another 7 percent of total assets were privatized through consortia of foreign investors and MEBOs, with 2 percent accounted for by consortia of local investors and MEBOs. FESAL II conditionality did not specifically address the MEBO issue (although the Task Manager did work with the government to reduce the preferences in favor of MEBOs). This despite the fact that the EFF had specific conditionality which, had it been more effectively implemented, would have severely curtailed MEBOs. The "Review of Privatization of Large Enterprises" (funded by WB PHRD Grant Privatization) found that nearly all MEBOs have retained their whole management team after privatization, which portends slow adjustment in the future. While MEBOs enabled the privatization process to occur more rapidly, and, were therefore a plus in terms of stabilization and reducing the capacity of the SOE sector to destabilize the economy, the Bulgarian economy will bear the burden of MEBOs in terms of slower growth and less efficient production for some time to come.
- Ninety percent of PA deals included investment commitments and employment arrangements. This will further slow the restructuring and adjustment needed by many of the enterprises.
- Despite the care taken by authorities to promote transparent sales, reports of a scandal late in 2000 led to a new director and management structure for the PA, and other reforms, so that auctions and tenders will now be more widely used and privatization

[7] The decision to pursue this high priority agenda in the context of an investment loan rather than an adjustment operation is questionable in view of the well-known government reticence to borrow for investment from the Bank.

intermediaries will not be used as widely, despite the fact that privatization intermediaries are more likely to bring in substantial investments, including FDI.

5.12 Aside from these very specific aspects of the privatization process which limit the efficacy of FESAL II, there are a number of broader issues concerning governance and the environment for private sector development which have not yet been adequately addressed. These limit the relevance and efficacy of FESAL II, but are country assistance strategy issues rather than FESAL II issues per se.

- Major additional efforts are needed to improve governance in Bulgaria according to various surveys as cited in IMF Staff Report (March, 2000). The Report cites an EBRD enterprise survey in which Bulgaria places 15th out of 20 transition economies in the impact of Law and Order on business.
- There are concerns about corruption beyond those related to privatization noted above. Data cited in the IMF Staff Report of March, 2000 shows that Bulgaria ranks behind many other transition countries in this area. The 1999 Corruption Assessment Report published by Coalition 2000 highlights the inefficiency of the judicial system and stresses the need for judicial reform.

5.13 It should be noted, however, that the Bank has picked up on one of the issues which could have been addressed under the dropped Government Modernization Loan, namely, the issue of excessive business regulations. The Bank and the government have jointly pursued this issue with an extensive work program guided by the FESAL II Task Manager, even though at this juncture this is not supported by a lending operation. Substantial progress has been achieved in terms of evaluating and benchmarking existing regulations and devising a strategy for their reform.

5.14 There is also concern that banking sector reforms, while implemented according to FESAL (and IMF) conditionalities, were not fully relevant in terms of promoting private sector development, though they were clearly fully relevant to address the issue of excessive bank lending to SOEs and macroeconomic stability. Despite the privatization of 6 major state-owned banks (so that 80 of bank assets are now privately owned), the passage of a new law governing collateral and institution of a new central registry, and progress towards a new bankruptcy law, the actual behavior of the banking system has not changed as much as would have been desirable. The banks themselves have not begun to change staffing or operational procedures, nor develop new lines of business, and their outreach to the private sector is attenuated. Net foreign assets of the banking sector continue to expand much more rapidly than does lending to the private sector. These issues, outlined in the following paragraph, relate to wider issues of governance and judicial reform and the like, which need to be addressed at the level of country assistance strategy.

5.15 There are a number of reasons why the lack of attention to these issues limits the impact of FESAL II reforms on the banking sector:

- The kind of judicial system needed for vigorous private sector development seems to be lacking. According to a survey among banks conducted by Koford and Tschogel

(1999) cited in the IMF Staff Report (March, 2000), nine out of ten respondents answered positively to the question "Do you have difficulties with court action?," and The World Bank (1999) "Bulgaria: Legal and Judicial Reform," highlights a variety of shortcomings such as understaffing, low salaries, potential corruption, insufficient training mechanisms, and overly complex legal procedures (as quoted in FIAS, 1999). Since law enforcement is weak, banks have difficulties in seizing collateral. It can often take many months before a creditor can physically assume possession of pledged property. Courts are generally overloaded, and enforcement by the executive is often slow (BIBA, Bulgarian International Business Association, 1999, White Paper).

- Bulgaria ranks low in an international comparison of the prevalence of the "Rule of Law", according to a recent study cited in IMF Staff Report (March, 2000), which relates this finding to low levels of financial intermediation. This study, by Kaufmann, Kraay, and Zoido-Lobaton (1999) constructs an aggregate variable measuring the prevalence of the rule of law for 167 countries. According to this variable, Bulgaria ranks 81, below most transition economies showing higher financial intermediation.

- Banks lack information about private business so that they cannot assess the situation of potential borrowers (IMF Staff Report, March 2000), and there are important asymmetries in the quality market information.

- Bankruptcy and liquidation procedures remain fraught with ambiguity and uncertainty (IMF Staff Report, March 2000). Processes can easily be delayed by debtors. The Commercial Code indicates no order of priority for payment of creditors. Bankruptcy procedures are controlled entirely by the Court, which results in slow procedures. Some of these issues are addressed by a recent amendment to the Commercial Code, but it remains to be seen how effective these will be. The Ministry of Justice maintains a list of trustees for bankruptcy cases, but training and supervision are inadequate, so that trustee practices vary widely and often lack required professionalism.

- A number of technical issues need to be addressed which have the effect of raising the cost of funds to banks and increasing the spreads which market conditions warrant between deposit and lending rates.

- Finally, Bulgaria introduced a new law in 1997 making it a criminal offense for a bank to lend without proper collateral. No one has been tried under this law, but it does have a somewhat chilling effect.

5.16 Looking at reform even more broadly, beyond the enterprise and financial sectors, Bulgaria rates lower than many countries of Eastern Europe, though better than many FSU countries. In an index of overall policy reform (see Transition after a Decade, Figure 2.4), Bulgaria moved from 1.0 in 1990 (where zero was an unreformed centrally planned economy) to 2.8 in 1998, where 4 represented a reformed market economy. For comparison, in 1998, Hungary was at 3.8, Poland 3.5, and Croatia, 3.0, while Bulgaria was in same group as Kyrgyz, Kazakhstan, FYR Macedonia, Georgia, Moldova, Romania, and Armenia. Russia, Ukraine, Azerbaijan, Uzbekistan, Tajikistan, Belarus, and Turkmenistan were ranked significantly below Bulgaria.

5.17 A large number of these issues could have been addressed through the Government Modernization Project proposed in the FY98 CAS. However, the government declined to pursue this approach, because it preferred not to pursue investment loans, as well as for other reasons (see CAE, Bulgaria, 2001). It is not clear why the Bank chose not to suggest adjustment lending in parallel with FESAL II to begin to address these issues.[8]

5.18 The successful implementation of the IMF's EFF raises an additional question. With this backstopping by the IMF on the privatization agenda, the Bank had a certain degree of freedom to expand the reform in the areas complementary to privatization itself. The IMF's EFF which preceded the FESAL II, specified many of the reforms subsequently supported by FESAL II. From this platform, the Bank could have had more flexibility to address governance, judicial reform, and related issues in a separate adjustment operation.

5.19 The question of efficacy is also related closely to the IMF's EFF. Since the IMF depended on the Bank for technical specification of the reforms and their technical implementation, FESAL II can be thought of as having substantial efficacy. But the fact remains that much of the implementation depended on the quarterly reviews held under the EFF, and it seems clear that the reforms would not have been implemented so effectively without the Fund's program.

5.20 One important benefit not highlighted by the FESAL documentation was the large FDI inflows which have benefited Bulgaria. FDI generated by the privatizations directly supported by the FESALs has reached US$200-300 million per year, which is a multiple of FESAL funding, and won't have to be repaid in contrast to the FESALs. FDI as a whole has reached US$800 million in each of 1999 and 2000, or between 4 and 5 percent of GDP. In per capita terms, Bulgaria in these years ranked ahead of all Eastern European countries besides the Czech Republic. The stock of FDI reached US$3,037 millions at the end of 2000. For comparison, Bulgaria's net foreign assets of the BNB and domestic banks at the end of 2000 was US$3,339 million.

Table 5.2: Inward Direct Investment[9] (in millions of US dollars)

Year	*1996*	*1997*	*1998*	*1999*	*2000*
Privatization Purchases	36	340	214	227	366
Direct (non-privatization purchases)	73	152	290	249	389
Reinvested earnings	0	0	50	-21	58
Other changes in ownership by non-residents[10]	0	13	-17	351	188

[8] An alternative strategy could have been to begin to address these issues, such as taking stock of government regulations, in FESAL II, although this could have been more problematic than a separate adjustment operation dedicated to these issues.
[9] Measured on a balance of payments basis.

5.21 Turning to the energy sector, a wide range of reforms have been implemented. There is, however, a very serious debate about how and whether to continue the reform and how to address the issue of providing incremental capacity. This latter is part of a broader issue concerning the overall public investment program. An adjustment loan would normally be based on an assessment of and agreement on an appropriate role for public investment at least in the sectors covered by the loan. However, the government has not yet pursued a serious public investment review to address energy needs for the future. Such a sectoral review would normally accompany adjustment lending in support of the sector. In the absence of an investment review, the government may end up spending (and borrowing) a substantial amount of money for new investment to meet needs which might be addressed much more efficiently as by enhancing existing capacity. Despite this shortcoming, however, the energy component of FESAL II is rated as relevant and satisfactory.

5.22 On the basis of this largely successful program, but with some noticeable shortcomings, particularly in the prevalence of less desirable MEBOs in privatization process, the longer than desirable time needed to dispose of cases of bankruptcy and liquidation, and the post privatization constraints of employment and investment for privatized SOEs, *OED rates the outcome of FESAL II as moderately satisfactory.*

6. Institutional Development Impact

6.1 *Rehabilitation Loan. This loan is rated as having a negligible impact on institutional development.* The reforms it supported which would have led to stabilization and private sector development were not successful and the program collapsed without achieving its objectives.

6.2 *Critical Imports Rehabilitation Loan. The operation achieved modest institutional impact.* It helped to move foreword the SOE reforms and banking sector reforms in a modest way, and helped with the stabilization effort although the CIRL clearly took a back seat to the IMF.

6.3 *FESAL I and II.* OED rates the *FESAL I as having achieved substantial institutional development impact* as the centerpiece of government's reform to a market economy. However, *FESAL II had only a modest institutional impact.* In each sector (SOEs, banking, energy), a substantial amount remains to be done before the new institutions have the desired impact on the economy. The reform of the Privatization Agency in 2000 in response to charges of corruption will mean slower progress on privatization in the future. The newly privatized banks operating in the absence of an adequate judicial and legal framework are not yet engaging vigorously in pursuing lending to the newly developing private sector. In the energy sector, the new system of pricing and regulatory arrangements remain to be tested. These are all areas in which ID objectives were met only to a limited extent and which need further development, not

[10] Inter-company loans among subsidiaries and other related enterprises, IMF definition.

surprising given the scope of changes and the fact that the FESALs were both one tranche loans covering a fairly short space of time.

6.4 Other institutional development aspects of FESAL II were somewhat more successful and include expansion of the role of the Deposit Insurance Fund, the creation of a unit for supervising SOE liquidators, the strengthening of the Enterprise Monitoring Unit in the Ministry of Finance, and the upgrading of the Banking Supervision Department of the Bulgarian National Bank.

7. Sustainability

7.1 *The Rehabilitation Loan clearly merits a sustainability rating of highly unlikely,* since almost none of the reforms which were to be supported by the loan were actually implemented.

7.2 *CIRL. Sustainability is rated as likely for the CIRL.* The stabilization program it supported and the beginnings of the SOE and banking reforms did in fact take hold and lead to more concrete reforms which were implemented under FESAL I and FESAL II.

7.3 *FESAL I and II.* The issue of sustainability is more complex for FESAL I and FESAL II. The privatization and liquidation of the SOEs is very unlikely to be reversed, as is the privatization of the 6 publicly-owned banks. Therefore, from the macroeconomic stability/quasi-fiscal deficit perspective, the operations clearly merit a rating of likely sustainability. However, there are a number of complementary reforms which are needed for satisfactory private sector development, those which were to have been pursued under the Government Modernization Loan, which would have been helpful to more fully insure sustainability. In addition, the prevalence of MEBOs and the constraints imposed by post privatization employment and investment agreements could pose some risk to the sustainability of the operation. *However, on balance, a rating of likely sustainability is warranted for both operations.*

7.4 Concerning the energy sector reforms supported by FESAL II, it is somewhat early to judge the sustainability of the Bank's most important interventions since there are still many follow-up actions to be taken before the new institutional arrangements can deliver their mandate. To ensure that the current gains are consolidated, the process of reform needs to be pushed forward strongly. For instance, even though the enabling legal and institutional structure is mostly in place, the only element of competition envisaged in Bulgaria's electricity market in the foreseeable future is the bidding process for new capacity. The appropriate sequence and coverage of privatization needs to be pursued strongly. Another issue concerns the newly created State Agency for Energy and Energy Resources (SAEER), which is in a dominant position vis-à-vis the State Energy Regulation Commission (SERC). As things stand, SERC will have little say in tariff setting until January 2002, and may be handicapped by lack of sufficient financial independence and inability to attract well-qualified personnel. If there is undue delay in making SERC more effective, there is a great danger that the new arrangement may continue to function *de facto* in the manner of the older institutions.

8. What Has Happened to Growth

8.1 Looking at the record, it seems apparent that the reforms reported by the FESALs have not yet had the desired impact. Of course, the reform is really only 4 years old, and many countries have required a longer time period to pursue and effectively implement a transformation. But it is also important to look at the overall record to understand Bulgaria's problems today and the issues it faces.

8.2 Bulgaria has suffered a greater decline in income than other countries in Eastern Europe, and a greater peak decline than all but one country (Table 8.1). Growth has been positive since 1998, so the GDP decline occurred before FESAL I and II were effective. However, it is worth noting that the 37 percent decline in GDP from 1989 through 1997 gave some scope for accelerated growth with the return of macroeconomic stability and the implementation of reforms.

Table 8.1: Cumulative Change in GDP, 1989-2000

Country	*1989-2000*	*Peak Decline since 1989*[11]
Albania	-1	-40
Bulgaria	-30	-37
Czech Republic	-5	-15
Hungary	5	-18
Poland	34	-14
Romania	-23	-25
Average (unweighted)	-3	-25

8.3 Even though GDP growth has been solid since 1998, it has been modest, particularly in view of the precipitous declines of the previous years (Table 8.2). The record to date falls below GDP growth as projected in the 1998 CAS of 4 percent per year, and well below a growth rate needed for Bulgaria to achieve a level of development over time more consistent with its aspirations to join the EU. Even taking into account external factors such as war in neighboring countries, the sharp and sustained declines in income suffered by Bulgaria through the early and middle years of the decade would have appeared to offer an opportunity for a much stronger rebound in GDP. Further, much of the private sector growth shown in national income statistics simply reflects the privatization of assets. Thus, the somewhat disappointing overall growth rates for the economy as a whole.

[11] Compares the GDP in the year of its lowest level since the beginning of the transition with the level of 1989.

Table 8.2: GDP Growth (percent)(at market prices)

1996	*1997*	*1998*	*1999*	*2000*
-10.1	-7.0	3.5	2.4	5.3

Source: WEO.

9. Bank Performance

9.1 *Bank performance under the Rehabilitation Loan is rated as unsatisfactory,* because the Bank proceeded with the operation in the absence of an adequate risk assessment and in the face of a high likelihood of failure. However, *Bank performance under each of the following three loans is rated as satisfactory.* It probably would have been difficult to achieve progress more quickly in the face of intermittent and sometimes limited support for the essential reforms supported by these operations. Having to work with a succession of governments from the inception of the FESAL I identification in 1992 through the Rehabilitation, Critical Imports and FESAL I and II loan by 2000 was a difficult challenge. Much of the technical work which the Bank did was of very high quality and could have formed a sound basis for much more rapid implementation of the reform program.

9.2 There was clearly room for some improvement in Bank performance beyond the project specific concerns mentioned above for the Rehabilitation Loan. Bank management changed frequently during this decade, with a total of 4 different departmental directors from 1992 to 2000. It would have been surprising if the Bank could have been a fully effective advocate for reform in the face of theses changes.

9.3 Looking beyond Bank Management to Task Management, FESAL I suffered from having 5 different task managers. This clearly created a confusing situation for counterparts which would have impinged on implementation. By contrast, FESAL II shows a marked improvement over FESAL I on this score, since there has been only one task manager and only one department director from appraisal through implementation and completion.

9.4 However, the one task manager for FESAL II has faced new challenges. The Bank's system of matrix management, whereby the Task Manager who is from a sector department needs to draw on staff from other sector departments, the COD, and various networks, has made project management quite challenging, both in terms of logistics as well as work programming priorities. Despite this, the Task Manager has opportunistically pursued tasks such as deregulation which are important in moving the agenda along as quickly as possible.

9.5 Added to this challenge has been the need to coordinate extremely closely with the IMF during this time, since the agenda of the IMF's EFF and the FESALs have overlapped so strongly. Indeed, during this time, it has sometimes been seen as more important that the technical inputs be available in Bulgaria to coincide with an IMF EFF mission and its review of the EFF since the IMF has been effective in pursuing implementation of the program.

10. Borrower Performance

10.1 Borrower performance has clearly been more uneven. Concerning the Rehabilitation Loan, the government played a satisfactory role in preparation. The fact that only a very short amount of time was needed to prepare the loan (12 days) in response to the emergency financing needs of the time is remarkable, along with the completion of negotiations by fax. However, the government was not able to sustain the program supported by RH, and could not meet the objectives of the program. *Therefore, borrower performance must be rated as unsatisfactory.*

10.2 *CIRL. Borrower performance is rated satisfactory* in both preparation and implementation. However, the CIRL was a rehabilitation loan supporting the initial phases of a stabilization and reform program, so that standards for satisfactory performance are lower than they would have been for an adjustment loan. In addition, the CIRL was essentially support for an ongoing program already being supported by the IMF, and with implementation of key reform aspects of the program such as the CBA under the purview of the IMF, satisfactory borrower performance owes much to assistance from the IMF.

10.3 *FESAL I*. Preparation for FESAL I "formally" began in 1996, but in fact, preparation missions and discussions began in 1992/3 and extended in one form or another for some time. The origin of the CIRL was based on work done to prepare the FESAL I agenda from 1996, so that in April 1997, the CIRL could be appraised and negotiated in 10 days, which was also facilitated by basing CIRL funding on a reallocation of US$40 million from its original FESAL I allocation of US$140 million. However, in the context of sustained preparation from 1996, preparation was satisfactory. During implementation, the government addressed constraints as they became known so that even though the program to address SOEs was ambitious, government implementation has been satisfactory. It has created a Structural Reform Committee of the Council of Ministers to focus on implementation problems at the interministerial level and where necessary bring to bear the highest levels of government. Overall, *borrower performance for FESAL I was satisfactory.*

10.4 FESAL II as noted above basically carried forward the agenda of FESAL I, with the addition of energy sector reforms, and both preparation and implementation were satisfactory on the part of government, benefiting from the same kind of attention to implementation as did FESAL I. Government followed through on its commitments under FESAL II so *that performance is rated as satisfactory.*

11. Main Findings

11.1 To build support for reform the Bank needs to invest sufficiently in reaching broad segments of the population with lessons of development to promote a common understanding of needs of reform. A large proportion of the Bulgarian public has remained skeptical for much of this decade. The anti-reform forces may have been led by a smaller group of those who profited from a stalled reform process. But they were permitted to do so by a larger group of citizens who were not convinced of the merits of reform until the hyperinflation of 1996; some of them continue to remain skeptical. The Bank could have been more active in bringing to bear the lessons of neighboring countries and in showing that Bulgaria was only a special case in terms of its initial position and the hurdles to be cleared, and that in facing these difficult problems, the need was to move more quickly, not more slowly.

11.2 The Bank's country assistance strategy outlined in the FY98 CAS rightly identified a number of public sector management issues which are needed for private sector development. Judicial sector reform, governance issues, regulations, are all important aspects within the purview of the public sector of which the Bank needs to be aware and supportive of reforms.

11.3 In pursuing public sector reform, however, the Bank needs to be fully aware of the government's priorities and preferences. The decision to pursue Government Modernization as an investment operation (which in the event did not materialize) rather than a parallel adjustment operation appears to have delayed the reform effort by several years, so that the reforms needed to complement the reforms supported by FESAL II are slow to materialize. There was no reason why the Bank could not have supported Government Modernization with an adjustment loan which would almost certainly have been more acceptable to the government.

11.4 The Bank needs to carefully consider the implications for continuity and quality of dialogue as it rotates managers and staff. The five directors responsible for the Bank's operations in Bulgaria since the start of policy dialogue in 1990, and the four directors responsible for operations since the start of adjustment operations in 1992, appear to have been a costly rotation in terms of the Bank's credibility and continuity of message. With the messenger changing so frequently, it was difficult to get messages across with conviction, regardless of the quality of each individual dialogue. Similarly, having five task managers for FESAL I was costly to the Bank's effort to support Bulgaria's reforms.

11.5 In the case of Bulgaria, the agenda is already largely given by the goals Bulgaria needs to meet for accession to the EU. The Bank needs to work more closely with the EU to firm up this agenda and translate it into a work program.

11.6 The experience with the Rehabilitation Loan once again reinforces the lesson of not lending until a credible program is in place. In the case of Bulgaria of 1996, a corrupt central bank and the SOEs' heavy influence on the government for their own advantage should have led the Bank to withhold support even if the Fund was going ahead.

11.7 Partnerships need to be carefully fostered to ensure satisfactory outcomes. In the case of privatization, Bulgaria did not want to rely on Bank-financed TA and chose to utilize EU grant financing more actively. Yet, the outcome in terms of MEBOs and post-privatization employment and investment agreements is less satisfactory than it could have been. Closer work with the EU on this aspect of TA might have led to a more satisfactory result.

11.8 It is important to focus on the quality of privatization which will affect private sector development for the future. In the case of Bulgaria, the unfortunate prevalence of MEBOs will constrain private sector development, as will the post-privatization employment and investment constraints. A more vigorous approach on the part of the Bank would have been useful to limit MEBOs and employment and investment constraints which would have further facilitated private sector development in the future.

Annex A

Basic Data Sheet

I. Rehabilitation Loan (Loan 4078-BUL)

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	30	30	100
Loan amount	30	30	100

Estimated and Actual Disbursements *(US$ millions)*

		FY97
Appraisal estimate (US$m)		30
Actual (US$m)		30
Actual as % of appraisal		100%
Date of final disbursement	November 1, 1996	

Project Dates

Lending Cycle	*Actual*
Preparation	06/15/96
Appraisal	07/05/96
Negotiations	07/08/96
Board Presentation	08/01/96
Signing	08/02/96
Effectiveness	10/11/96
First Tranche Release	11/30/96
Loan Closing	07/31/97

Staff Inputs *(staff weeks)*

Stage of Project Cycle	*Actual*	
	Weeks	*US$ (000)*
Appraisal	7.2	15.7
Negotiations through Board Approval	2.0	13.7
Supervision	5.4	35.8
Total	**14.6**	**65.2**

Mission Data

Stage of project cycle	Month/ Year	No. of persons	Days in Field	Specialization	Performance Rating: Implem. Status	Performance Rating: Develop. Objectives	Types of Problems
Through Appraisal	None						
Appraisal through Board	None						
Supervision	None						
Completion	None						

Other Project Data

Borrower/Executing Agency: Government of Bulgaria

Operation	*Loan no.*	*Amount (US$ million)*	*Board Date*
Critical Imports	4157	40	05/08/1997
FESAL I	4239	100	10/30/1997
FESAL II	4521	100	12/02/1999

II. Critical Imports Rehabilitation Loan (Loan 4157-BUL)

Key Project Data *(amounts in US$ million)*

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	40	40	100
Loan amount	40	40	100

Cumulative Estimated and Actual Disbursements *(US$ millions)*

	FY98
Appraisal estimate (US$ m)	40
Actual (US$m)	40
Actual as % of appraisal	100%
Date of final disbursement	08/14/97

Project Dates

Lending Cycle	*Actual*
Appraisal	04/10/97
Negotiations	04/21/97
Board Presentation	05/08/97
Signing	07/10/97
Effectiveness	08/12/97
First Tranche Release	08/31/97
Loan Closing	06/30/98

Staff Inputs *(staff weeks)*

Stage of Project Cycle	*Actual*	
	Weeks	*US$ (000)*
Preparation to Appraisal	20.2	77.5
Appraisal	1.3	3.5
Negotiations through Board Approval	6.7	20.1
Supervision	5.1	129.8
Total	**33.3**	**230.9**

Mission Data

					Performance Rating		
Stage of project cycle	*Month/ Year*	*No. of persons*	*Days in Field*	*Speciali zation*	*Implem. Status*	*Develop. Objectives*	*Types of Problems*
Through Appraisal		7					
Appraisal through Board		1					
Supervision		2					
Completion							

Other Project Data

Borrower/Executing Agency: Government of Bulgaria

Operation	*Loan no.*	*Amount (US$ million)*	*Board date*
FESAL I	4239	100	10/30/1997
FESAL II	4521	100	12/02/1999

III. Financial and Enterprise Adjustment Loan I (Loan 4239-BUL)

Key Project Data (*amounts in US$ million*)

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Total project costs	100	100	100
Loan amount	100	100	100
Cofinancing:	50	50	100

Cumulative Estimated and Actual Disbursements (*US$ millions*)

	FY98
Appraisal estimate (US$m)	100
Actual (US$m)	100
Actual as % of appraisal	100
Date of final disbursement	**03/3/98**

Project Dates

Lending Cycle	*Actual*
Preparation	02/28/96
Appraisal	06/23/97
Negotiation	09/25/97
Board Presentation	10/30/97
Signing	11/14/97
Effectiveness	02/10/98
First Tranche Release	03/31/98
Loan Closing	04/30/98

Staff Inputs (*staff weeks*)

Stage of Project Cycle	*Actual FY 1997- 1999*	
	Weeks	*US$ (000)*
Preparation to Appraisal	131.8	348.6
Appraisal	13.3	44.2
Negotiations through Board Approval	6.1	22.1
Supervision	32.3	108.8
Completion	1.7	6.4
Total	**185.2***	**530.1***

*Note: Previous fiscal years staff weeks and financial information is not retrievable.

Mission Data

Stage of project cycle	*Month/ Year*	*No. of persons*	*Days in Field*	*Speciali zation*	*Performance Rating* Implem. Status	*Performance Rating* Develop. Objectives	*Types of Problems*
Through Appraisal	4/29 - 7/94	8					
Appraisal through Board Approval	10/96	1					
Supervision	3-4/98	2					
Completion							

Other Project Data

Borrower/Executing Agency: Government of Bulgaria

Follow-on Operations

Operation	*Loan no.*	*Amount (US$ million)*	*Board Date*
FESAL II	4521	100	12/02/1999

IV. Financial and Enterprise Sector Adjustment Loan II (Loan 4521-BUL)

Key Project Data (*amounts in US$ million*)

	Appraisal estimate	*Actual or current estimate*	*Actual as % of appraisal estimate*
Loan amount	100	100	100

Cumulative Estimated and Actual Disbursements (*US$ millions)*

	FY00
Appraisal estimate (US$m)	100
Actual (US$m)	100
Actual as % of appraisal	100
Date of final disbursement	12/16/99

Project Dates

Lending Cycle	*Actual*
Appraisal	6/28/1999
Board Presentation	12/2/1999
Signing	12/3/1999
Effectiveness	12/10/1999
Loan Closing	3/31/2000

Staff Inputs (*staff weeks)*

Stage of Project Cycle	*Actual*	
	Weeks	*US$ (000)*
Identification/Preparation	62	101
Appraisal/Negotiations	78	144
Supervision	19	15
ICR	1	5
Total	**160**	**265**

Mission Data

				Performance Rating[1]	
Stage of project cycle	*Month/ Year*	*No. of persons*	*Specialization*[1]	*Implem. Status*	*Developm. Objectives*
Identification/Preparation	3/98	4	2 Enterprise, 1finance, 1economist		
	11/98	7	2 finance, 2 enterprise, 3 economists		
	4/99	4	1 enterprise, 1 finance, 2 economists		
Appraisal /Negotiation	6/99	4	1 enterprise, 1 finance, 2 economists		
	10/99	4	1 Task Manager, 1 lawyer, 1 disbursement officer, 1 loan officer		
Supervision	1/00	2	1 enterprise, 1 finance	S	S
ICR	5/01	2	1 enterprise, 1 finance	S	S

1. Key to Performance Ratings: S= Satisfactory

Other Project Data

Borrower/Executing Agency: Government of Bulgaria

Preceeding Operations

Operation	*Loan no.*	*Amount (US$ million)*	*Board Date*
Rehabilitation Loan	4078	30	08/01/1996
Critical Imports	4157	40	05/08/1997
FESAL I	4239	100	10/30/1997

Key Indicators for Program Implementation
Action Matrix

A. REHABILITATION LOAN (P047057)

OBJECTIVES	MEASURES TAKEN	FUTURE POLICY ACTIONS	STATUS
I. Macroeconomic Program *Re-establish confidence and macroeconomic stability and promote economic growth and private sector development.*	*A program of measures to stabilize the economy, arrest the decline in confidence and accelerate the process of reforms was introduced in May 1996, after consultation with the World Bank and the IMF.*	*Maintain a sustainable fiscal and external positions.*	*Sustainable fiscal and external positions maintained through 1997 and 1998.*
a) Fiscal Policy - Reduce budget deficit from 5.7% of GDP in 1995 to 3.1% in 1997 and limit the borrowing requirements of the consolidated government budget.	- Increased value added tax rate from 18% to 22%. Doubled excise taxes on wine and beer, and increased taxes on hard liquor and tobacco by 50%. - Reduced non-interest real expenditures in 1996 to 26.5% of GDP by limiting subsidies to SOEs while allowing for increased social spending especially those associated with labor retrenchment policies	- Enhance efficiency of tax system and tax and customs administrations by equalizing corporate income tax rates on all enterprises; reducing dividend taxes; and restricting tax preferences. - Limit non-interest expenditures in 1997 to less than 28% of GDP, by further reducing subsidies and transfers while increasing social expenditures, wages and maintenance and operations.	- Budget deficit increased from 6.3% of GDP in 1995 to 12.7% in 1996 before reducing to 2.5% in 1997. - Revenue collection fell in 1996 and in Q1-1997. - Non-interest expenditures were limited to 24.9% of GDP in 1996 and to 25.7% of GDP in 1997; subsidies were further reduced from 11.1% of GDP in 1995 to 0.8% in 1996 and 0.7% in 1997; social expenditures were also reduced to 8.5% of GDP in 1997 from 10.8% in 1995 and 9.1% in 1996.
b) Pricing Policies - Adjust prices and tariffs in order to limit subsidies to strategic enterprises and maintain their financial viability.	- Doubled electricity tariffs to the equivalent of US3.3 cents/Kwh and increased fuel prices to reflect international prices and exchange rate movements.	- Increase further and maintain electricity tariffs at US3.5 cents/Kwh. Continue to adjust fuel prices on a monthly basis in line with international prices and most recent exchange rate movement.	- Further increases and adjustments of administered prices to international levels continuously carried out.

c) Monetary and Foreign Exchange Policies - Restore confidence in the domestic currency and lower the rate of inflation.	- Raised basic Central Bank interest rate to 108% (180% annualized). - Restricted foreign exchange intervention and allowed exchange rate to depreciate by close to 100% in the last two months. - Sharply lowered availability of refinancing to weak banks	- Limit growth of broad money to levels consistent with declining inflation targets in the context of market determined floating exchange rate. Use more extensively open market operations for monetary management.	- In late September 1996 the BNB tried unsuccessfully to limit money supply growth and restore confidence in the Lev and the banking sector by raising the base interest rate to 300 % (simple annual), putting nine ailing banks under conservatorship and providing support for viable banks. Open market operations were extensively conducted but turned out insufficient to bring money supply under control because of lack of foreign financing, decline in real demand for money, induced by bank runs and lack of confidence in the Lev, and high inflationary expectations fueled by a huge budget financing gap filled by the BNB. - Fixed exchange rate regime introduced in mid-1997 under a currency board arrangement (CBA), inflation reduced and confidence in the Lev and banks restored; open market operations discontinued prior to the CBA introduction; money supply growth brought in line with growth of demand for money; a limited lender of last resort facility introduced by the CBA that has not been used so far.
II. State-Owned Enterprise Reforms and Privatization *Strengthen financial discipline in SOEs and accelerate the process of privatization*			
a) Liquidation Process - Eliminate 25% of the losses of state-owned enterprises by liquidating (either through closure or privatization) 64 of	- Filed court bankruptcy petitions for 40 of the 64 enterprises identified for closures. Trustees appointed in each of the 64	- Complete bankruptcy petitions and the liquidation of the enterprises, pursue privatization of remaining assets, and assist workers in	- Twenty-nine of the 64 enterprises have been privatized, the remainder are still under court supervised bankruptcy and liquidation procedures. Reform of bankruptcy and liquidation framework is

the worst performing SOEs.	enterprises.	process of retrenchment.	being undertaken as part of FESAL II reforms. Laid-off workers under the liquidation program were entitled to severance pay equivalent to up to six times their average wage (COM Resolution No. 131 of 1996). Under COM Resolution No. 100 of April 1998 workers in enterprises in liquidation laid off after March 1, 1998 were entitled to a lump-sum payment of Lev 1 million.
b) Isolation Process - Isolate and restructure 70 large and potentially viable state-owned enterprises in order to improve their profitability through significant downsizing, enforcement of financial discipline, and management accountability with a view of eventual privatization or restoration of financial viability.	- Identified key SOEs that will be isolated through a government process supervised reorganization. - Drafted new legislation for the process akin to bankruptcy procedures. - Sharply reduced credit to identified enterprises. - Raised electricity tariffs and fuel prices to improve financial viability. - Established period for isolation to be no more than 24 hours.	- Have new legislation governing isolation restructuring process approved. - Finalize and implement individual plans to downsize, eliminate non-core businesses and reduce red. - Continue to adjust prices to maintain financial viability. - Liquidate identified SOEs that are not turned around or privatized within two years.	- The Isolation Program was legally established by the "Law on Financial Rehabilitation of State-Owned Enterprises", adopted on August 9, 1996, published in State Gazette #68/1996. - To this end, rehabilitation plans were prepared for all companies by mid 1997. Some of the plans were not of sufficiently high standard and have not been fully implemented. - Electricity prices were adjusted several times. In 1998, the GOB reached an agreement with the IMF on regular adjustments till the year 2001. This agreement has been complied with so far. Latest adjustment took place on 01/01/99. Next one is planned for 07/01/99. District heating prices do not ensure financial viability, and are being adjusted as per agreed with the IMF time schedule. Regular railway tariff increases have been implemented. - The Law on Financial Rehabilitation of State-Owned Enterprises was amended on December 29, 1998 to extend the isolation program till June 30, 1999. As per agreement with IMF, an exit strategy for each enterprise was developed, and the GOB is firmly committed to liquidate enterprises that have not been privatized by then.
c) Privatization - Accelerate the process of privatization through an	- Distributed vouchers to 2.8 million citizens.	- Expand the privatization program to include SOEs accounting for	- About 65% of total state-owned LT assets as measured at end 1995 are covered by the current

expanded voucher "mass privatization" program. Include 1000 companies with total capital of Lev 90 billion in first wave of auctions.	- Scheduled first auction for October 1996. - Established new Stock and Securities Exchange Commission. - Prospectuses approved for 60 privatization funds that can own up to 34% of shares in any one company.	50% of all SOE assets. - Enhance the mass privatization program by including majority private stake position in large enterprises. - Facilitate cash privatization by extending a deferred payment scheme to all investors, selling enterprise to managers and workers on concessional terms.	Privatization Program. - By April 15, 1999 two majority stakes were offered for privatization under the "second" mass privatization wave. - Deferred payment schemes are available only to management-employee buyers.
d) Labor Market Program - Alleviate social costs associated with labor retrenchment under enterprise liquidation and isolation programs by providing support to retrain and redirect laid-off workers and extend severance payments to those affected by downsizing.	- Issued the decree governing the retrenchment program. - Established national and rapid response teams in National Employment Service agency to deal with layoffs and provide retraining program. - Established the program to and affect severance payments and magnitude of payments.	- Notify and pay severance to projected 65,000 workers affected by the government program. - Use the unemployment and retraining fund and support from other donors to provide labor market information, employment counseling, retraining, and small enterprise development skills to workers dislocated by the reform program.	- As of 15 April 1999, 67,717 workers affected by restructuring have been notified and received severance pay. - Legislative changes with the enactment of the Unemployment Protection Act (1998), better funding and management of the unemployment and retraining fund. No verifiable data exists as to the extent to which the workers affected by the government program used the services of the local unemployment offices.
III. *Banking Sector Reform* *Reestablish the soundness of the banking system through a program of closures, restructuring and improved asset position, and to strengthen the role of supervision and improve accounting practices.*	- Closed two banks. - Placed three banks in conservatorship. - Approved law and established new policies governing deposit guarantees. - Introduced limited program of bank recapitalization. - Restricted Central Bank refinancing credits. - Signed Memorandum of Understanding with 18 banks to be recapitalized or with negative	- Adhere to programs outlined in Memorandum of Understanding, including prohibition of any new lending by banks with negative networth. - Adhere to program requiring banks to achieve specified capital adequacy positions under new accounting standards. - Prohibit any bank without 4% capital adequacy standard to pay dividends.	- Memoranda of Understanding signed with all recapitalized banks and with seven private banks with negative capital adequacy positions in 1996; five banks placed in conservatorship in May 1996, followed by another nine banks in September 1996; licenses of banks in conservatorship revoked in 1997. - Higher capital adequacy requirements introduced for 1997 (8 %), 1998 (10%) and 1999 (12%) and met in 1997 and 1998.

	net worth. Memoranda outline targets for bank operations including goals for loan recovery and cost cutting measures.	- Increase staff and training of supervisory agencies.	- Intensive banking supervision department staff training carried out in 1997 and 1998.

Key Indicators for Project Implementation
Action Matrix

B. CRITICAL IMPORTS REHABILITATION LOAN (P050540)

POLICY AREA	MEASURES TAKEN	FUTURE POLICY ACTIONS	STATUS
I. Macroeconomic Program Re-establish macroeconomic stability and restore economic growth.	A program of measures to stabilize the economy, arrest the decline in confidence and accelerate the process of reforms was agreed with the IMF in March 1997.	*Maintain sustainable fiscal and external positions*	*Sustainable fiscal and external positions maintained through 1997 and 1998.*
a) Fiscal policy - Reduce budget deficit from 11% of GDP in 1996 to 3.8% in 1997 and eliminate the need for central bank credit.		- Accelerate cash privatization. - Strengthen revenue collection by establishing a large-taxpayers unit, raising VAT threshold, and increase penalties and interest on overdue tax liabilities. - Control non-interest expenditure by rationalizing programs and reducing public employment by 10 percent of work force.	- Budget deficit in 1997 reduced to 2.5 % of GDP down from 12.7 % in 1996 and 6.3% in 1995. - Some progress in cash privatization achieved; - Improvement of revenue collection achieved in 1997; a large tax-payers' unit established in Q2-Q4 1997; VAT raised from 18% to 22% in 1996; government penalties, fines, fees, patent and charges expressed in the legislation in nominal terms increased in 1997 to reflect inflationary developments; strengthened collection of outstanding tax liabilities in 1997. - Non-interest expenditures were limited to 24.9 % of GDP in 1996 and to 25.7 % of GDP in 1997; subsidies were further reduced from 11.1 % of GDP in 1995 to 0.8 % in 1996 and 0.7 % in 1997; social expenditures were also reduced to 8.5 % of GDP in 1997 from 10.8 % in 1995 and 9.1 % in 1996. Public sector employment reduced by 58,000 workers in 1997.
b) Monetary & Exchange Rate Policies - Restore confidence in the domestic currency and lower the rate of inflation.	- Linked the determination of basic Central Bank interest rate to the market yields of TBills. - Eliminated unsecured	- Establish a currency board arrangement.	- Currency board arrangement (CBA) established in mid-1997

POLICY AREA	MEASURES TAKEN	FUTURE POLICY ACTIONS	STATUS
	refinancing to weak banks. - Observed strict limits on the creation of net domestic assets.		
II. Enterprise Reform *Accelerate privatization and strengthen financial discipline in SOEs.*			
a) Privatization - Accelerate drastically the privatization of SOEs to transfer ownership, governance and management responsibilities to private operators. This is the overriding priority of the program.	- Privatized 5 percent of the state owned assets through cash-based programs and another 18 percent through voucher based programs. - International privatization agent appointed for the privatization of BTC.	- Privatize SOEs accounting for at least 40 percent of total SOE long term assets (as of December 1995) by end 1997. - Offer for sale BTC.	- By mid-1999, about 35% of total state-owned LT assets were privatized. - Offers for the sale of BTC were collected by mid-March, 1999. Negotiations with prospective buyer(s) are underway.
b) Liquidation - Reduce upfront 28 percent of the SOE sector losses in 1995.	- Closed 30 and privatized 11 out of the original list of 64 SOEs.	- Close or privatize by mid-1997 enterprises that contributed at least 28% of SOE losses in 1995. - Effective sale by end-1997 of at least 50% of the long term assets of the closed enterprises.	- Enterprises accounting for at least 32% of losses in 1995 have been effectively closed or privatized. No information is available on the losses of enterprises beyond the list of 64 - Completed.
c) Isolation - Reduce upfront 50 percent of the SOE sector losses in 1995.	- Isolated the enterprises from the banking system. - Prepared Financial Recovery Plans. - Increased administered prices of water, coal, heating for industries, electricity, natural gas, liquid fuels, and telecommunications to cover costs. - Increased prices of household heating and transportation and	- Approve and implement Financial Recovery Plans. - Privatize or liquidate all enterprises which are not utilities or mines. - Maintain revenues of the utilities (including budgeted subsidies) to	- Rehabilitation plans were approved for all companies by mid 1997. Some of the plans were not of sufficiently high standard and have not been fully implemented. Some of the plans are being updated or redrafted. - The isolation program was extended till June 30, 1999. As per agreement with IMF, an exit strategy for each enterprise has been developed, and the GOB is firmly committed to liquidate enterprises that have not been privatized by then. - Relative financial stability has been maintained through price and tariff adjustments (electricity,

POLICY AREA	MEASURES TAKEN	FUTURE POLICY ACTIONS	STATUS
	budgeted subsidies.	cover at a minimum their operating and financial expenses.	district heating, railways) and budget subsidies
d) Financial Discipline - Restore financial discipline and ensure that utilities are effectively collecting their accounts receivable.		- Require utilities to suspend service to enterprises in arrears.	- Utilities have adopted procedures for suspending service to enterprises in arrears. These procedures are to be further discussed in light of the FESAL II agreements.
III. Banking Sector Reforms *Re-establish the soundness of the banking system through a program of privatization and strengthening the role of regulation and supervision.*			
a) Legal and regulatory framework - Strengthen the legal and regulatory framework to facilitate privatization and promote sound banking practices.		- Amend the Law on Banks and Credit Activity; Enact a Law on Bank Insolvency. - Amend the Commercial Code, the Tax Law and related laws/regulations to facilitate foreign investment in the banking sector. - Raise the requirement of capital adequacy to 12% and revise other banking regulations to reflect international standards. - Introduce international bank accounting standards (IAS) and disclosure standards, and start implementation. - Enact a new Deposit Insurance Law acceptable to the Bank/IMF.	- The new Law on Banks and the Law on the BNB passed in mid 1997; the Law on Banks and Credit Activities amended in May 1996 to make the establishment of conservatorship and bankruptcy procedures possible; it was accompanied by the establishment of a depositor protection scheme. - Higher capital adequacy requirements introduced for 1997 (8 %), 1998 (10%) and 1999 (12%) and met in 1997 and 1998. - Banking regulations have been amended to reflect international standards. - IAS are currently under implementation; - A new Deposit Insurance Law acceptable to the Bank/IMF enacted in 1998.
b) Banking supervision - Enhance BNB's authority and effectiveness in enforcing the legal and regulatory framework.	- Signed Memorandum of Understanding with 18 banks which outlined targets for loan recovery and cost cutting measures.	- Contract four residential international banking supervisors and form joint on-site inspection teams. - Adopt a banking supervision program acceptable to the Bank/IMF and	- Residential international banking supervisors contracted and joint on-site inspection teams formed in 1997-1998. - Banking supervision program acceptable to the Bank/IMF adopted and currently under

POLICY AREA	MEASURES TAKEN	FUTURE POLICY ACTIONS	STATUS
	- Placed 15 banks in conservatorship and filed for bankruptcy against these banks.	initiate its implementation.	implementation.
c) Privatization of public sector banks (PSBs) - Improve the governance of the PSBs by changing their ownership and/or control.	- Adopted a privatization strategy for BCC. - Appointed privatization adviser to BCC. - Started due diligence review.	- Announce in the international media the government's intention to privatize all PSBs or to enter into management contracts with reputable banks. Initiate an intensive search for strategic investors. - Conclude by end-1997 four transactions, of which at least two are privatizations.	- The government's intention to privatize all PSBs or to enter into management contracts with reputable banks announced in 1997-1998; an intensive search for strategic investors initiated. - Two PSBs privatized in 1997 and 1998; three more PSBs are currently in a process of privatization.
IV.Agricultural Sector Liberalization *Create a competitive market-based and export-oriented agriculture and food industry.*	- Increased the sale price of wheat by state entities to $160 per ton, and maintain the price at least 85% of international price CIF Sofia.	- Eliminate the system of controls on profit margins of agricultural and food products by end-May. - Eliminate by end-May import quota and duties on cereals and cereal products.	- Price controls and price mark-ups cancelled as of July 1, 1997 by a Decree of CoM No 269 from 1997. - No duty free import quotas for cereals and cereal products are envisaged in the Customs Tariff for 1999.
	- Started using competitive bidding procedures for the emergency government purchases of wheat this spring.	- Eliminate all export bans by mid-1997 (no export tax to be introduced). - Liberalize the sale prices of cereals and other cereal products by mid-1997. - Remove non-tariff barriers against import and export of fertilizers by mid-1997. - Abolish any direct or indirect	- Export bans and export taxes were abolished mid-1997; the remaining export taxes on sunflower and sunflower products were cancelled by CoM Decree No 169, July 31, 1998 - Prices were liberalized by CoM Decree No 187 of August 13, 1998. As of July 1, 1999 a new Law for Consumer Protection enters into force which cancels the old Law on Prices - Only the imports of chemicals is subject to licensing. - Abolished

POLICY AREA	MEASURES TAKEN	FUTURE POLICY ACTIONS	STATUS
		subsidies to prices of wheat, wheat flour, bread and other cereal products by mid-1997. - Eliminate import and export administrative constraints. - Use open and transparent auctions for the sale of government-procured supplies of cereals. - Submit a new law to Parliament in July to facilitate privatization of state-owned land, revamp the regulations for leasing, titling, and occupation rights, and revise the ban on foreign land ownership. - Offer for sale all state mills and the 26 state trading companies by end-1997.	- No registration and licensing are currently applied according to CoM Decree No 271/98 on trade policy measures, related to exports and imports - A transparent and open procedure is applied – announcements in newspapers are published. - Several measures were applied to facilitate land restitution process, all limitations on land lease were lifted (in terms of areas and duration of lease), decisions of the Land Commissions will have the legal power of notary deeds, foreign legal entities registered in Bulgaria can own land. - All mills are in the process of privatization, 49 of total 59 mills have been privatized covering 76 % of their assets, on average 55 % of the assets in agriculture are private by end March 1999.
V. Social Protection Reform *Increase effectiveness, efficiency, transparency and sustainability of social protection programs.*			
a) Social Assistance - Improve targeting of programs to provide adequate protection to vulnerable groups at affordable cost.	- Revised benefit coefficients to increase assistance to children in poor households supported by the minimum income guarantee program (MIGP). - Set up temporary utility voucher program for poor households and benefit levels raised since 3/97.	- Establish a consolidated two-tier MIGP (utility voucher and cash benefit). - Set up matching fund scheme for MIGP. - Improve targeting of child allowances, medical support programs and maternity assistance.	- Two-tier MIGP established, based on new Social Assistance Act (1998), including energy support program and consolidated benefit – both in cash. All benefits, payments and eligibility, is based on an annually calculated Base Minimum Income (BMI). - As of FY 1999 MIGP payments, except energy support program, based on 50/50 cost sharing between municipal and central government budgets. - A draft Family Support Law was submitted to Parliament, that includes universal child benefits and means tested birth grants and other one time

POLICY AREA	MEASURES TAKEN	FUTURE POLICY ACTIONS	STATUS
		- Eliminate payment of untargeted social assistance through insurance funds.	benefits. Both testing and benefits are based on BMI.
- Provide sufficient quality of social care services.	- Augmented temporary resources for social care institutions via EU supplement.	- Involve NGOs in services and recentralize financing for inter-municipal institutions.	- The Social Assistance Act (1998) provides for licensing NGO social services. In 1999 Regional Social Assassinate centers were created to supervise quality of services provided at municipal level and ensure adequate information flows to the central government.
b) Severance Pay - Protect workers laid-off under structural reform program.	- Introduced severance benefit scheme for laid-off SOE workers.	- Extend program to cover budgetary sector employees.	- Budgetary sector employees receive severance benefits as per the Law on Unemployment Security and Employment Incentives, adopted on December 16, 1997.
c) Pensions - Increase fiscal transparency, sustainability and targeting of the pension system.	- Separated pension fund from budget. - Made legal provision for transparent budget subsidy for non-insurance expenses. - Adopted program for improved payroll tax administration and tracking of individual records. - Changed benefit formula to require extended contribution period for full pension. - Introduced employee contribution.	- Establish one-month reserve fund for PAYG pension scheme. - Comply with legal provision for budget subsidy to cover non-insurance expenses. - Cease financing of recreational facilities. - Enact new PAYG pension law to: (a) eliminate most early-retirement categories (b) phase in later pensionable age (c) introduce actuarially sound benefit formula (d) establish targets for gradual reduction of pension payroll taxes - Prepare legislation for voluntary,	- One-month reserve funds has been established and is being maintained. - Legal provisions have been complied with. - Financing of recreational facilities was discontinued through the establishments of a commercial affiliate of NSSI. An action plan has been prepared and in being followed for the privatization of the affiliate's assets. - A comprehensive Pension Insurance Code is under advanced preparation. Early drafts of the legislation indicate compliance with the WB requirements, as defined in the Social Protection Adjustment Loan. Regulations eliminating most early retirement categories were adopted in October 1998, with an implementation date 01/01/2000. The target date for introduction of the new pension system is 01/01/2000. - A draft Law on Supplementary Voluntary

POLICY AREA	MEASURES TAKEN	FUTURE POLICY ACTIONS	STATUS
		private pension and funded occupational schemes.	Pension Insurance has passed first reading in Parliament and is awaiting second reading.
d) Unemployment	- Reduced unemployment fund payroll tax from 7% to 5% - Made adequate budgetary allocation to clear arrears of government to domestic pharmaceutical suppliers (approximately $20 million equivalent) and to ensure adequate purchase of supplies in 1997 (at least $22 million equivalent).	- Further reduce payroll tax rate from 5% to 3%. - Extend contribution period for benefit eligibility. - Change the benefit formula to reduce work disincentives. - Eliminate ineffective active labor programs and strengthen job information services.	- Unemployment payroll tax is reduced to 4% (1998).[1] - The contribution period for benefit eligibility has been extended from 6 months of employment within the last 12 calendar months, to 9 months of employment within the last 15 calendar months. - Benefits formula has been changed to (1) take into account only the years worked. The former formula included an index for age as well. - Detailed analysis of the effectiveness of active labor marker policies is almost complete. Completion of the analysis and agreement on action plan is a SPAL second tranche condition.
e) Supply of medicines - Ensure adequate supplies in 1997 of medicines to hospitals and clinics.		- Take all necessary administrative steps to ensure that medical supplies are in fact provided to hospitals and clinics.	- Necessary steps were taken to ensure regular supply of medicines in 1997 within budgetary constraints. In 1998 amendments to the Pharmaceuticals Act were passed by Parliament and will become effective for outpatient care in January 2000.

[1] In 1997 the unemployment payroll tax was reduced to 4.5 percent in accordance with SPAL Board presentation condition. As of 1 July the Government proposes to reduce it to 4.0 percent.

Key Indicators for Program Implementation
Action Matrix

C. FESAL I (P049531)

Objectives of Policy Measures	Measures already taken	Indicative plan for the next 6 months	Status
I. Macroeconomic Framework			
The main objectives of the Government's macroeconomic program are to achieve stabilization and restore economic growth.	Agreed macroeconomic framework in place.	Maintain agreed macroeconomic framework.	The government was able to maintain the agreed macroeconomic framework
II. Enterprise Sector			
Acceleration of Privatization Drastic acceleration of the privatization of state-owned enterprises (SOEs).	SOEs, accounting for 17.8 percent of total SOE long-term assets (as of December 1995), have been privatized.[2]	Privatize SOEs accounting for at least an additional 23 percent of total SOE long-term assets (as of December 1995).	By March 30, 1998, only an additional 5% of SOE assets were privatized. As of April 30, 1999, about 30% (cumulative) of total state-owned LT assets were privatized. However, with the expiration of the privatization contracts with privatization agents in 1999, large SOEs representing 20 percent of assets would be divested by end-1999. The SME privatization is expected to be almost complete by end-1999, representing an additional 15 percent of SOE assets.
	International privatization agents have been appointed to privatize three large SOEs already selected or to assist in selling individual assets in cases where shares cannot be sold. A further group of 27 SOEs has been selected for privatization by such agents, including 11 SOEs from the isolation program.	Appoint international privatization agents for the 27 selected SOEs.	By March 30, 1998, international privatization agents for 31 selected SOEs were appointed. As of April 30, 1999, there were privatization agents for about 90 SOEs.
	An international privatization agent has been appointed for the privatization of	Implement the strategy for the sale of BTC shares, designed by the	Bids for 51% of BTC shares were received in March 1999. Negotiations with the prospective buyer are

[2] To be counted as privatized, at least 67 percent of the shares of an enterprise must have been transferred to private owners.

Objectives of Policy Measures	Measures already taken	Indicative plan for the next 6 months	Status
	BTC, and a decision of the Council of Ministers has been issued abolishing the 25 percent limit on the sale of BTC shares.	privatization agent. Offer for sale or for restitution all residual shares from the first wave of the Mass Privatization Program.	underway. Portions of the residual shares were sold during the Centralized Public Auctions of January 25 - February 5, and March 3 - March 19, 1999.
Liquidation Reduction of the 1995 level of SOE losses by 28 percent.	59 of the 64 SOEs slated for liquidation under Government Decision 480/96, plus a further group of 86 loss-making SOEs, have been either privatized or closed. (These enterprises employed 26,000 workers and accounted for 28 percent of the SOE sector losses in 1995.)	Take legislative and regulatory measures to streamline and accelerate the process of bankruptcy and liquidation, while protecting the rights of the creditors.	Amendments to the Bankruptcy Law, approved in June 1998, set the limit of two months for courts to decide on the bankruptcy petition and three months for the supreme court to rule on appeals concerning such decisions. Enterprises accounting for at least 32% of losses in 1995 have been effectively closed or privatized.
Isolation Program (41 Group B enterprises) Reduction of the 1995 level of SOE losses by 50 percent.	The Financial Recovery Plans (FRPs) of all 41 Group B enterprises have been approved and are under implementation, and decisions have been taken on whether these enterprises will be liquidated or privatized.	Ensure that all SOEs selected under Government Decision 480/96 are in the process of exiting the isolation program, either through liquidation or privatization.	The Isolation Program was legally established by the "Law on Financial Rehabilitation of State-Owned Enterprises", adopted on August 9, 1996. As of March 30, 1998, seven SOEs were privatized and one liquidated. As of April 30, 1999, 17 SOEs have been privatized and 13 are in liquidation/bankruptcy procedure. The 1996 Law on Financial Rehabilitation of State-Owned Enterprises was amended on December 29, 1998 to extend the isolation program till June 30, 1999. As per agreement with IMF, an exit strategy for the remaining 11 enterprise was developed, and the GOB is firmly committed to liquidate enterprises that have not been privatized by then.
Isolation Program (30 Group A			

enterprises) Revenues of the utilities and the mines (including budgeted subsidies) to cover, at a minimum, their operating and financial expenses.	Decisions have been taken and implemented for all Group A enterprises on: (i) the level and adjustment mechanisms for tariffs; (ii) the level of subsidies; and (iii) cost cutting measures.	To implement the cost reduction measures proposed in the FRPs and meet the cost recovery targets.	Rehabilitation plans were approved for all companies by mid 1997. Some of the plans were not of sufficiently high standard and have not been fully implemented. Some of the plans are being updated or redrafted now. At the end of 1998, 28 Of 30 enterprises reported losses.
	Electricity The average tariff has been increased to about US$0.035/kWh in October 1997 and will be maintained at a cost covering level by the application of a fuel adjustment formula agreed with the World Bank under the Power Project.	To adjust all tariffs, as necessary to ensure continued compliance with FESAL conditions.	Electricity prices were adjusted several times. In 1998, the GOB reached an agreement with the IMF on regular adjustments till the year 2001. This agreement has been complied with. Latest adjustment took place on 01/01/99. Next one is planned for 07/01/99. Electricity and rail tariffs were adequate but district heating tariffs remained well below the level required for cost recovery in 1997.
	Railways Passenger tariffs have been set, and will be adjusted, as required, to achieve recovery of at least 50 percent of operating and financial expenses before subsidies. Freight tariffs have been set, and will be adjusted as required, to achieve full cost recovery without subsidies.		Regular railway tariff increases have been implemented.
	Telecommunications Tariffs have been set to achieve full cost recovery, and will be adjusted and rebalanced as required, to maintain an adequate level of investment and self-financing ratio.		
	District Heating Industrial tariffs have been set, and will be adjusted, as required, to achieve full cost recovery plus an adequate margin to finance investments and working capital requirements without subsidies.		District heating prices do not ensure financial viability, and are being adjusted as agreed with the IMF.

	Household tariffs have been set, and will be adjusted as required, to achieve cost recovery after subsidies.		
<u>Isolation Program (30 Group A enterprises)</u> (continued)	<u>Natural Gas</u> Pending liberalization of the gas trade, the price of gas has been set, and will remain regulated, on the basis of the CIF price of gas delivered to Bulgaria, plus a margin to cover transit costs and overheads of Bulgargas. <u>Coal and lignite</u> Domestic prices of coal and lignite have been raised close to world levels, and imports are freely allowed with a low tariff of up to 5 percent.	Further liberalize the trade and prices of gas, petroleum products, and mining products. No entry barriers to firms.	
<u>Financial Discipline</u> Restore financial discipline and ensure that utilities are effectively collecting their accounts receivable.	The Council of Ministers has issued a Decision requiring the utilities to suspend service to, or to require advance payment from, enterprises with arrears for more than 30 days. A monitoring system has been established that reports on the status of arrears on a weekly basis to allow the government to take action in a timely fashion in the most important cases.	Enforce the measures to restore financial discipline. Ensure that the aggregate payment arrears in the enterprise sector have not increased by more than 10 percent above their level of June 30, 1997.	Utilities have adopted procedures for suspending service to enterprises in arrears. These procedures are to be further discussed in light of the FESAL II agreements.
III. Banking Sector <u>Adjustments to the Legal Framework</u> Create a legal framework for the banking sector that is suitable for the introduction of the Currency Board Arrangement (CBA) and the development of a safe and sound banking sector.	A new "Law on Banks" has been passed, mainly to facilitate the resolution of insolvent banks, improve bank licensing procedures, strengthen accounting and external auditing provisions, introduce provisions on bankers' fiduciary duty and conflicts of interest, rationalize penalties for regulatory non-compliance, and limit the coverage of the Law to	Enact a new Deposit Insurance Law, and establish a sound Deposit Insurance Scheme. Decide on whether a new SSB Law	A new Deposit Insurance Law acceptable to the Bank/IMF was passed in April 1998 and became effective in January 1999. The law guarantees both BG Lev and foreign currency deposits at 95% for deposits up to BG Lev 2 million, and at 80% for those above BG Lev 2 million but no more than BG Lev 5 million. A Deposit Insurance Fund was set up in early 1999. A Draft law on the Transformation of the SSB into a sole

	banks.	will be enacted and/or the existing Law will be revoked, with SSB then subjected to the Law On Banks. Clarify the future role of SSB, including the option of a "narrow" bank.	proprietor joint stock company became effective in April 1998. It provides for subjecting SSB to the Law on Banks and for its transformation into a commercial bank. The SSB is currently in a process of restructuring and transformation into a commercial bank. In August 1998 agreement was reached between the BNB and the SSB on restrictions on the SSB's activities until it has the capacity to conduct all normal commercial bank operations. A transition period was introduced that would last until May 2000; during that transition period all Lev deposits at the SSB will have a full government guarantee; by end of 1998 the SSB had to comply with all prudential regulations.
	A new "Law on the Bulgarian National Bank" has been passed to adjust BNB to the needs of the CBA and to increase its independence and accountability. In particular, the new Law ensures the independent authority of the Deputy Governor responsible for banking supervision.	Amend the Collateral Law and establish a registry of collateral.	The Law on Registered Pledges has been passed, amendments to it have been suggested and are expected to be approved by Parliament soon. The collateral registry is being modernized.
<u>Strengthening of Banking Supervision</u> Develop a safe and sound banking system through enhancing BNB's authority and effectiveness in enforcing the legal and regulatory framework.	Banking Supervision has been improved by strengthening the independent authority of BNB's Supervision Department. The new Law on Banks authorizes BNB to revoke licenses of banks that violate the Law or the BNB regulations, and obliges it to revoke licenses under clearly defined conditions. If a license is revoked, a conservator must be appointed, and BNB must file for liquidation of the bank or for bankruptcy proceedings. The revocation of a bank license cannot be appealed.	Ensure that at least five joint on-site inspection teams are operating; effective off-site surveillance are functioning; and an acceptable training program is ongoing.	Intensive banking supervision department staff training carried out in 1997 and 1998. Joint on-site inspection teams have been formed as needed and feasible, and training is being carried out by international on-site experts.

	BNB has recruited a resident international banking regulation/ supervision expert with assistance from the IMF and is recruiting two resident international experts for off-site surveillance (EU-Phare) and two resident international experts plus short-term experts (USAID) for on-site examinations.	Ensure that full implementation of the banking supervision program is underway.	Programming and implementation of banking supervision needs to be further strengthened. Banking supervision program acceptable to the Bank/IMF adopted and currently under implementation.
	BNB has adopted a Strategic Plan for On-site Examinations which requires: (i) the formation of joint on-site inspection teams that will include the foreign examiners; (ii) improvement of the procedures for on-site inspections, off-site analysis and early warning; (iii) intensive training for bank supervisors; and (iv) preparation of an annual compliance report covering all banks. The 1996 accounts of all PSBs have been audited by international auditing firms and provided to the World Bank for review.	Ensure that all banks are either in compliance with revised banking regulations, or that effective regulatory enforcement measures have been taken, including withdrawal of bank licenses and filing for bankruptcy; that Bank licenses have been revoked for all banks under conservatorship; and that recapitalization of banks will be carried out only in the context of a change in governance resulting from privatization or a management contract.	Higher capital adequacy requirements introduced for 1997 (8 %), 1998 (10%) and 1999 (12%) and met in 1997 and 1998. The Banking Supervision Department monitors banks' compliance with revised banking regulations; in January '98 the license of a private bank was revoked; recapitalization of banks has been carried out in the context of privatization.
<u>Privatization of Public Sector Banks (PSBs)</u> Ensure stabilization and growth of the banking system through improving the governance of, and the public's confidence in, the PSBs by changing their ownership and/or management.	The Government has announced repeatedly its intention to privatize the six PSBs (all PSBs other than SSB), or to enter into management contracts with reputable private banks, and an intensive search for strategic investors has been initiated.		The government's intention to privatize all PSBs or to enter into management contracts with reputable banks announced in 1997-1998; an intensive search for strategic investors initiated.
	Resident international bank privatization/restructuring consultants	Conclude two transactions by end-1997 and initiate the preparatory	Two PSBs privatized in 1997 and 1998; three more PSBs are currently in a process of privatization.

	have been contracted for BCC, with reputable investment banks to be contracted, as necessary, to assist in the privatization of selected PSBs. The shares of a PSB (United Bank of Bulgaria) have been sold to EBRD (35%, plus a 35% call option), Bulbank (35%) and Oppenheimer & Co. (30%), and an agreement with the new owners provides for an additional substantial capital injection. A Resolution Plan has been adopted for an insolvent bank (Biochim Bank), which provides for the strengthening of the bank's management, restrictions on new lending, enhanced supervision, recapitalization, and initiation of bidding procedures for the bank's privatization or the conclusion of a management contract. The first steps of The Plan is under implementation.	measures for the privatization of the remaining four PSBs.	A management contract for Biochim Bank has been signed. It provides for the strengthening of the bank's management, restrictions on lending, enhanced supervision and preparation for privatization.

Key Indicators for Program Implementation
Action Matrix

D. FESAL II (P008317)

Objectives	**Measures Taken**	**Future Policy Actions**	**Status**
Privatization[3] or Liquidation of State Owned Enterprises			
	• Sale[4] or initiation of liquidation or insolvency proceedings of SOEs equivalent to at least 80 percent of the long term assets of SOEs in the Privatization Advisors and Transaction Agents (PATA) Program.	• By March 31, 2000, completion of the PATA program.	• **85.2% completed** (Only BTC left).
	• Sale or initiation of liquidation or insolvency proceedings of SOEs equivalent to at least 30 percent of the long term assets of SOEs in the Pool Privatization Program.	• By March 31, 2000, completion of the Pool Privatization Program (covering all eight pools).	• **55.5% completed**, including Arsenal & Trema, where the state has kept the blocking stake, and 8 of the hydropower plants. The procedure for the remaining HPPs was closed and await a new strategy. Incoms Telecom Holding, Bulgartabak Holding, and Balkancar Holding remain.
	• Sale or initiation of liquidation or insolvency proceedings of SOEs equivalent to at least 85 percent of the long term assets of SOEs under the responsibility of the PA[5] as of June 30, 1999.	• By March 31, 2000, completion of the sale or initiation of liquidation or insolvency proceedings of all SOEs under the responsibility of the PA.	• **95.9% completed**. Data on liquidation and insolvency has been requested but has not been received in full.

[3] An SOE is considered privatized when at least 67 percent of its equity is transferred to private owners.
[4] An SOE is considered sold when the privatization contract is signed and a down payment is paid.
[5] The SOEs under the responsibility of the PA are: (a) the SOEs privatized by the PA or placed under bankruptcy or liquidation upon recommendation of the PA; and (b) the SOEs which the PA has the mandate to privatize as of June 30, 1999 excluding the SOEs whose privatization mandate has been transferred by the PA to the line ministries in July 1999. The SOEs under the PATA and Pool programs are not included in the SOEs under the responsibility of the PA.

Objectives	Measures Taken	Future Policy Actions	Status
		• By March 31, 2000, completion of the sale or initiation of liquidation or insolvency proceedings of all SOEs whose privatization mandate was transferred by the PA to the line ministries in July 1999.	• Out of 59 enterprises, 1 is in liquidation, 2 are in insolvency, 22 have been sold, and 17 have been transferred back to the PA.
	• Sale or initiation of liquidation or insolvency proceedings of small SOEs equivalent to at least 80 percent of the long term assets of small SOEs under the responsibility of the line ministries as of June 30, 1999.[6]	• By March 31, 2000, completion of the sale or initiation of liquidation or insolvency proceedings of all small SOEs under the responsibility of the line ministries.	• **84% completed** (2,692 enterprises divested out of some 3,086).
	• Cessation of operations of SOEs under liquidation as of June 30, 1999 with the exception of two SOEs.[7]	• Cessation of operations of all SOEs under liquidation within six months of the initiation of the liquidation proceedings.	• Ongoing process.
	• Completion of sale to private owners of assets of at least 140 out of the 280 SOEs under liquidation[8] as of June 30, 1999.	• By December 31, 2000, completion of sale to private sector of assets of SOEs under liquidation as of June 30, 2000.	• Information not received.
	• Sale of residual share packages in at least 50 percent of enterprises privatized as of June 30, 1999.[9]	• By December 31, 2000, sale of the residual shares of the State in all enterprises privatized as of June 30, 2000.	• **68% of the residual shares of enterprises privatized by end June 2000**, and 70% of those privatized by end June 1999, have been sold. Ongoing process.

[6] In computing the percentage performance, the base will exclude: (a) the large SOEs transferred in July 1999 by the PA to the line ministries; and (b) the small SOEs which have legal and restitution issues that prevent the finalization of the privatization process.

[7] These two SOEs will cease operations upon completion of their current production commitments, but not later than March 31, 2000.

[8] Defined as sale of at least 70 percent of assets of an enterprise.

[9] Residual shares are defined as State holdings net of those shares held due to restitution or legal proceedings or reserved for employees. Shares reserved for employees should be disposed of by June 30, 2000.

Objectives	Measures Taken	Future Policy Actions	Status
		• Starting January 2000, begin the process of privatization of SOEs, or components of large SOEs, in the energy, transport and infrastructure sectors.	• **The process has started**. Restructuring of the energy sector is underway, including preparation for privatization of generation facilities and distribution companies (seven power distribution companies, five thermal power plants and the nuclear power plant were legally separated from NEK in May/June, 2000 and have been spun off from NEK). The Bulgarian River and Sea Fleets, Hemus Air, and some plants in the railways have been slated for privatization. Two of the largest municipal water utilities are up for concession. In addition, assets under the ministries of defense and finance (the state insurance industry)are being sold.
Imposition of Financial Discipline in the Enterprise Sector			
	• Sale or initiation of liquidation or insolvency proceedings of all Group B SOEs[10] under the Isolation Program[11].	• By June 30, 2000, completion of sale of assets of all Group B SOEs under liquidation.	• Sale of assets of former Group B SOEs under liquidation is underway although not yet completed.

[10] This includes Arsenal, where 65 percent of the equity shares were sold to the private sector. Because Arsenal is a defense related enterprise, the State will continue to hold a 35 percent share.

[11] Group A and Group B SOEs refer to the SOEs under the Isolation Program which ended June 30, 1999.

Objectives	Measures Taken	Future Policy Actions	Status
	• Increase in tariffs of District Heating Companies (DHCs). • Submission of long term plans for the DHCs, acceptable to the Bank.	• Implementation of programs for improving efficiency, collection, restructuring and privatization of DHCs agreed with the Bank.	• A Strategy for the development of DHCs along with an Action Plan for the period 2000-2005 for restructuring of DHCs has been approved by Parliament as of August 23, 2000. **DHCs closed the year 2000 with a net loss of BGN 30 million. Investors' interest has been demonstrated towards DHCs, however, no privatization procedure has been launched as of end-2000.**
	• Sale or closure of eight plants of Bulgarian State Railways (BDZ).	• By December 31, 1999, sale or closure of additional five plants of BDZ.	• Out of the 16 railway subsidiaries, 15 have been sold, and one has been merged into a privatized subsidiary.

Objectives	Measures Taken	Future Policy Actions	Status
	• Submission of a restructuring plan for BDZ acceptable to the Bank.	• Implementation of restructuring plan for BDZ.	• The Financial Recovery Plan (FRP) has been approved by the Council of Ministers with Decision No 710 of November 17, 1999 for the period 1999-2001. **The FRP is under implementation** but the targeted improvement of BDZ's financial performance has not materialized yet. **The expected loss of BDZ for 2000 amounts to BGN 100 million. A plan for the reduction of BDZ loss has been developed, and awaits Ministry of Transport approval.**
	• Submission of privatization or liquidation plans, acceptable to the Bank, for seven collieries from the coal mining companies and the briquette factory under Group A of the Isolation Program.	• By December 31, 2000, privatization of viable coal mining SOEs and cessation of operations of nonviable mines.	• An Action Plan for accelerated privatization of the coal output sub-sector for the period 2000 – 2001 has been adopted with CoM Decision No. 356 of June 19, 2000. **All nonviable mines are under technical liquidation procedures. Large investor interest exists for the privatization of the viable mines.**
	• No increase in arrears to Bulgargaz from the level as of June 30, 1999.	• Continued implementation of the collection policies of Bulgargaz.	• Collection policies of Bulgargaz have been **largely followed** with recurring periods of increased arrears.

Objectives	Measures Taken	Future Policy Actions	Status
	• Submission of a restructuring plan for Bulgargaz acceptable to the Bank.	• Implementation of Bulgargaz restructuring plan. • By March 31, 2000, issuance of international tenders for private regional gas distribution companies.	• Bulgargaz continues to implement the current restructuring and the Financial Recovery Plan **on target.** • Information memoranda for low-pressure regional gas-distribution companies are prepared for the future tenders.
	• No increase in the arrears to the National Electricity Company (NEK) from the level as of June 30, 1999.	• Continued implementation of the collection policies of NEK.	• Collection policies of NEK have been **largely followed** with recurring periods of increased arrears. **Following NEK's restructuring, the established 7 distribution companies have not registered arrears to NEK. However, the top 20 direct clients of high voltage have kept a steady level of overdue liabilities to NEK.**
	• Second reading by Parliament of a *Tax Procedure Code* acceptable to the Bank which provides for improvements in the ability to deal with enterprises in arrears.	• Implementation of the *Tax Procedure Code*. • By January 1, 2000, establishment of an Agency for Collection of State Claims to deal with the securing and collection of arrears to the State.	• Implementation of The Tax Procedure Code is underway. • The Agency for Collection of State Claims has been set up. The Japanese government has provided grant financing to help set up a Unified revenue Agency.
	• Submission to Parliament of a *Social Security Code* acceptable to the Bank which provides for improvements in the ability of the National Social Security Institute (NSSI) to deal with enterprises in arrears.	• Implementation of the *Social Security Code*.	• Implementation of the Social Security Code is underway.

Objectives	Measures Taken	Future Policy Actions	Status
	• Creation by the Council of Ministers (COM) of a unit under the COM which will set standards, train, select, remove, and generally supervise liquidators of SOEs.	• Enforcement of selection and performance standards for liquidators. • Submission of quarterly reports on SOEs under liquidation.	• The unit in the Council of Ministers has been revamped and is working on the selection and performance standards of liquidators. • Reports **not submitted**.
	• Submission to the Parliament of amendments, acceptable to the Bank, to the *Commercial Code* that would result in faster, more efficient, and more transparent wind up or sale of SOEs through the court system.	• Submission of quarterly reports on SOEs under insolvency proceedings.	• Reports **not submitted**.
	• Setting up of an inter-ministerial commission to analyze and recommend amendments to the current insolvency legislation to reform the court insolvency procedures and structure.	• By June 30, 2000, submission to Parliament of amendments to the insolvency legislation to reform court procedures and structure.	• Parliament approved amendments to the Commercial Code in October 2000.
	• Establishment of a system, acceptable to the Bank, for monitoring financial discipline and fiscal risk in the enterprise sector.	• Submission to the Bank of quarterly reports on financial discipline.	• Establishment of Financial Discipline and Fiscal Risk Monitoring Unit with the Ministry of Finance reporting quarterly to the Bank on 154 SOEs.
<u>Reforming the Banking System</u>			
	• Completion of the privatization transaction, including full payment, in the sale of Postbank.		
	• Signing of the share purchase agreement between BCC and Societe Generale in the sale of Express-bank, including a 10 percent down payment.	• By December 31, 1999, completion of the privatization transaction of Expressbank.	• 97.9% of Expressbank was sold to Societe Generale on November 30, 1999.

Objectives	Measures Taken	Future Policy Actions	Status
	• Review of bid submissions from interested private buyers in the sale of Hebrosbank.	• By March 31, 2000, completion of the privatization transaction of one more public sector bank.	• 97.6% of Hebrosbank shares were transferred to Regent Pacific on March 29, 2000.
	• Issuance of Invitation to Bid in the sale of Bulbank.	• By June 30, 2000, completion of the privatization transactions of two more public sector banks.	• Share purchase agreement for the sale of 98% of Bulbank to UniCredito/Allianz was signed on July 7, 2000.
	• Approval of Information Memorandum and start of the marketing process in the sale of Biochim.		• Tender procedure for Biochim is under preparation **for the third time**.
	• Implementation of MOU between the State Savings Bank (SSB) and BNB. • Submission of medium term strategy for SSB, acceptable to the Bank.	• Implementation of SSB privatization strategy starting January 2001.	• A medium-term strategy for SSB has been approved and is currently under implementation. Privatization plan has not yet been finalized.
	• Enforcement of all prudential regulations.	• By March 31, 2000, adoption of a regulation establishing consolidated supervision.	• The Regulation on consolidated supervision is under preparation.
	• Passage of amendments to Banking Law dealing with existing insolvent banks.	• By March 31, 2000, submission of legislative provisions to Parliament to enable the Deposit Insurance Fund to administer newly closed banks.	• A draft Bank Bankruptcy Act has been prepared by the working group led by the Deposit Insurance Fund and BNB, and has been submitted to Parliament.

Objectives	Measures Taken	Future Policy Actions	Status
	• Start of the auction process which will enable the Ministry of Finance to take over the assets of eleven closed banks.	• By December 31, 1999, complete the takeover of the assets of eleven closed banks by the Ministry of Finance.	• Tenders for eleven closed banks have been conducted. The Ministry of Finance is still in the process of taking over the assets (a couple have been transferred, and two banks, FPB and Economic Bank, have been acquired by private investors)
	• Monitoring by BNB of the lending portfolio of the remaining public sector banks, including the Central Cooperative Bank (CCB), the Business Promotion Bank, and the Municipality Bank of Sofia,[12] and submission by BNB to the Bank of reports as of June 30 and September 30, 1999.	• Beginning December 31, 1999, submission by BNB to the Bank of quarterly reports on the lending portfolio of the remaining public sector banks, including the Central Cooperative Bank, Municipality Bank of Sofia and the Business Promotion Bank.	• **Quarterly reports are being submitted.**
		• By June 30, 2000, reduction of the direct and indirect share of the government in the equity of Central Cooperative Bank to 33 percent or less.	• Government share in CCB reduced to 32.77 percent • **The government transferred its 32.77 percent share in CCB to the Bank Consolidation Company on February 9, 2000**
	• No increase in the lending portfolio of CCB from the level of June 30, 1999, until CCB has met the capital adequacy requirements under the prudential regulations issued by BNB.	• No increase in the lending portfolio of CCB from the level of June 30, 1999, until CCB has met the capital adequacy requirements under the prudential regulations issued by BNB.	
	• No increase in the equity of CCB through the infusion of public resources.	• No increase in the equity of CCB through the infusion of public resources.	• Complied with.

[12] The Municipality Bank of Sofia is not considered a public sector bank due to the independence of the Sofia Municipality from the central Government. Nonetheless, the Municipality bank of Sofia is not a private sector bank and its loan portfolio is being closely monitored by the BNB.

Objectives	Measures Taken	Future Policy Actions	Status
<u>Restructuring the Energy Sector</u>			
	• Passage of *Law on Energy and Energy Efficiency*.	• By March 31, 2000, adoption by the Council of Ministers of all regulations envisaged in the *Law on Energy and Energy Efficiency*.	• All but one key regulations have been adopted, minor regulations remain to be adopted. The World Bank and other donors are providing technical assistance.
	• Establishment of a State Commission for Energy Regulation and appointment of commissioners.	• Starting 2000, implementation of privatization of different components of the energy sector according to a plan agreed with the Bank.	• **The privatization component in the three year action plan is being delayed**, as agreed with IMF/WB.
	• Increase in electricity prices. • Completion of accounting separation of generation, transmission, and distribution functions of NEK.	• By December 31, 1999, establishment of electricity distribution companies.	• Seven power distribution companies were legally separated from NEK and incorporated as separate entities in early May 2000.
		• By June 30, 2000, establishment of generation and transmission companies.	• Complied with. Six generation and one transmission power companies were legally separated and established in early June 2000.
		• Continued implementation of three year action plan for the restructuring of the energy sector.	• **The plan is being implemented according to schedule** with the exception for the privatization component.

REPUBLIC OF BULGARIA

MINISTRY OF ECONOMY

Mr Ruben Lamdany 17-00-249/01.11.2001
Manager Country Evaluation and Regional Relations
Operations Evaluation Department
The World Bank
1818 H Street
Washington, DC 20433
USA
fax: 001 202 522 3124

Re: Draft Project Performance Assessment Report

Dear Mr Lamdany,

The draft Project Performance Assessment Report of the Operations Evaluation Department (OED) assesses objectively the four operations of the World Bank in Bulgaria – the Rehabilitation Loan (Loan 4078-BUL), the Critical Imports Rehabilitation Loan (Loan 4175-BUL), the Financial and Enterprise Sector Adjustment Loan I (Loan 4239-BUL) and II (Loan 4521-BUL).

The Government of Bulgaria shall take into consideration all recommendations of the OED when contracting new loans. The most urgent problems we shall address are the quality and the speeding-up of the large-scale privatisation as well the efficiency of the legal system, which impair the functioning of the private sector and the banking system. We hope that the improved dialogue between the World Bank and the European Union will result in the much desired for our country synergy effect.

Yours sincerely,

Nikolay Vassilev

Nikolay Vassilev
Deputy Prime Minister and Minister of Economy

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REPUBLIC OF BULGARIA

Mr. Ruben Lamdany
Manager
Country Evaluation and Regional Relations
Operations Evaluation Department
World Bank

October 23, 2001

RE: BULGARIA: Rehabilitation Loan (Loan 4078-BUL); Critical Imports Rehabilitation Loan (Loan 4157-BUL); FESAL I (Loan 4239-BUL); and FESAL II (Loan 4521-BUL)

Draft Project Performance Assessment Report

Dear Sir,

We would like to thank you for sending us a copy of the Draft Project Performance Assessment Report on the above operations. We appreciate your efforts to assist the Bulgarian Government in improving the implementation of the projects supported by the World Bank and are convinced that the use of the findings and lessons from past experience is the best way to enhance effectiveness of the project cycle.

Please be advised that as for the provided draft PPAR on the above loans selectively evaluated by your Department we have no comments. We would be grateful to receive a copy of the final report which will be distributed to the Board of Executive Directors.

Sincerely yours,

Krassimir Katev
Deputy Minister of Finance

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