WORLD BANK OPERATIONS EVALUATION DEPARTMENT

OED REACH

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Country Assistance Evaluation: Bulgaria

- The Bulgarian economy deteriorated through early 1997 leading to a financial crisis as a result of which output was one third lower than at the beginning of the transition. Economic growth revived and poverty was reduced, following the adoption of a currency board arrangement on July 1, 1997, tight fiscal policy and structural reforms.
- Throughout the past decade, the Bank's strategy was relevant but through 1997 it was not effective mainly due to poor government performance. Since then outcomes have improved, but much more needs to be done in strengthening institutions.
- Looking forward, the Bank should complete the ongoing public expenditure review in partnership with the Government and assess the steps that have been taken to strengthen public financial accountability institutions. It should complete a poverty assessment update and use it to inform strategy and policy design. In the energy sector, it should clarify the mandate and functions of different regulatory bodies.

Background

Unfavorable initial conditions combined with reckless lending by state banks to state enterprises precipitated a financial crisis in 1994 and again in 1996. As a result, real GDP in early 1997 was a third lower than its 1989 level and poverty had increased.

Outcomes only improved in mid-1997 following a successful stabilization program supported by the IMF and the World Bank. On July 1 of that year a newly elected Government adopted a Currency Board Arrangement and committed to structural reforms. Real GDP grew by 3.0 percent in 1998 and in 1999, rising to 5 percent in 2000. In 1999, per capita income was estimated at US$1390.

Bank Assistance

The Bank started its activities in Bulgaria in 1990. To date, the Bank has approved US$1.5 billion in loans. Early assistance took the form of a Structural Adjustment Loan (SAL) in FY92, a debt reduction operation shortly after, and selected investment operations. But the frequent change in governments (ten since 1989), combined with a flagging interest in reforms on the part of successive governments, and expectations of financial crises, led the Bank to take an appropriately cautious approach in its own assistance during the mid-1990s, which translated into a modest lending program, focused on investments and keeping on hold a major adjustment loan. The Bank's strategy during 1990-97 could not achieve the desired outcomes; however, the Bank appropriately adjusted its activities to reflect the lack of government responsiveness.

After 1997, once the new Government began implementing reforms, the Bank adopted a prudent stance and only gradually launched a full lending program. During this time, the Bank partnered effectively with the IMF by providing advice on structural reforms in a wide number of sectors on which it had been conducting policy dialogue in 1990-97. With growing evidence of government commitment and the achievement of macroeconomic stabilization, the Bank began to support a broad reform program through a series of sectoral adjustment loans. IFC investments increased from only four approvals in FY94 to FY98 to ten in FY99 through FY01 while MIGA's program remained modest. Most of the objectives of the Bank assistance over this later period have been substantially met, and the overall outcomes of the Bank's strategy since 1997 to the present are considered satisfactory.

Many institutional development issues remain outstanding, in particular with respect to reforms needed for Bulgaria's accession to the European Union (EU), the country's top priority. Among the constraints are shortcomings in privatization that hamper effective restructuring of formerly state owned enterprises, a difficult environment for private banks and enterprises, fragile social safety nets and poorly targeted poverty reduction programs. Most important is the lagging public sector reform, which was planned in the FY98 CAS, but could not be carried out in the absence of Government commitment. A public financial accountability assessment would be an important contribution in this area. The institutional development impact of Bank assistance throughout the period under review is rated as modest.

The sustainability of reforms is enhanced by the public consensus favoring EU accession, which would be threatened by any significant backtracking. On the other hand, discontent with unemployment, low assistance benefits to the poor, and perceptions of corruption constitute significant risks. Still, on balance, OED rates the sustainability of the outcomes of reforms as likely.

Recommendations for Future Bank Assistance

The challenges for the Bank are to foster ownership of structural reforms with the new Government. Stronger World Bank leadership will be needed now as the IMF will focus only on those conditions critical for macroeconomic stability.

Specifically, the Bank should focus on areas which are important for EU accession and where it has a clear comparative advantage. In the public sector it should complete the ongoing public expenditure review in partnership with the Government. This should build capacity to prioritize public investments. It should also assess with other stakeholders the steps that have been taken to strengthen public financial accountability institutions.

The Bank should also complete a poverty assessment update integrating qualitative and quantitative inputs, which could establish the basis for targeting of social assistance. The poverty update should build government capacity for regular monitoring of poverty and its findings should inform strategy and policy design. In the energy sector, it should reinforce the sustainability of institutional reforms by clarifying the mandate and functions of different regulatory bodies (e.g., the State Energy Regulatory Commission). Finally, the Bank should foster Government leadership of aid coordination.

Reactions of the Borrower and Management

Management agrees with the CAE diagnosis that the main factor affecting performance until 1997 was weak government commitment. They emphasized that support for public sector management was not possible until recently due to a lack of government commitment.

The borrower also largely agreed with the analysis in the CAE. They stated, however, that design problems in Bank projects continue to persist. In the early 1990s, the Bank emphasized lending, sometimes at the cost of project design, without comprehensive ESW and without taking into consideration low domestic absorptive capacity. Going forward, they support Bank assistance for developing domestic capacity for prioritizing public investments, making progress on public financial accountability issues, and increasing the effectiveness of donor coordination.

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