

Committee on Balance-of-Payments Restrictions

REPORT ON THE 1998 CONSULTATIONS WITH BULGARIA

1. The Committee on Balance-of-Payments Restrictions consulted with Bulgaria on 28 and 29 September 1998. The consultations were held under the Chairmanship of Mr. Peter R. Jenkins (United Kingdom) in accordance with the terms of reference of Article XII:4(b) of the GATT 1994 and the Understanding on the Balance-of-Payments Provisions of the GATT 1994. The International Monetary Fund was invited to participate in the consultations in accordance with Article XV:2 of GATT 1994.

2. The Committee had before it the following documents:

WT/BOP/S/7	Background Paper prepared by the Secretariat
WT/BOP/G/6	Basic Document supplied by the Republic of Bulgaria
WT/BOP/N/38	Notification from the Republic of Bulgaria
WT/BOP/N/37	Notification from the Republic of Bulgaria
WT/BOP/N/30	Notification from the Republic of Bulgaria
WT/BOP/R/34	Report on the 1997 Consultations with Bulgaria

IMF: Bulgaria: Supplementary Background Material for the WTO,
17 September 1998

Opening Statement by the Representative of Bulgaria

3. The opening statement by the representative of Bulgaria is attached as Annex I.

Statement by the Representative of the International Monetary Fund

4. The statement by the representative of the International Monetary Fund is attached as Annex II.

Discussion in the Committee

5. Members noted the dramatic improvement in some of the economic indicators such as inflation since the last consultation and commended Bulgaria for its persistence in executing structural reform, considering that the medium-term program was positive for stabilization with privatization a key factor. Members warmly welcomed Bulgaria's decision to accelerate the elimination of the import surcharge, in spite of the recent serious deterioration in the trade balance. It was noted that, in spite of positive results in many areas, exports to neighbouring countries, including Russia, were falling, and Members asked how Bulgaria planned to cope with the fall in exports and the other challenges mentioned by the IMF, including high public and external debt, still to be met. One member, while aware of the currency board system operating in Bulgaria, expressed concern that depreciations might be pursued to enhance exports; another member considered that Bulgaria should be given every assistance from its WTO trading partners in this time of transition.

6. In response, a member of the Bulgarian delegation cited statistics showing that total exports had fallen by 11.4% in the January-July period compared to 1997. For July alone, exports shrank by 25.1%. Exports to Russia had declined by 24.1% in the first seven months of 1998 compared to the year earlier period and in July alone had fallen by 39.2%. As to tools with which to face economic difficulties, he said that his Government would continue to rely on a strong fiscal programme, financial discipline and accelerated adjustment measures.

Conclusions

7. The Committee commended Bulgaria for sustaining its commitment to reform and liberalization. The Committee welcomed the recent decision to eliminate the measure notified under Article XII of GATT 1994 eighteen months earlier than originally envisaged, all the more so given the recent evidence of a deterioration in the trade balance. The Committee renewed its appreciation for the fact that the measure was the least disruptive to trade.

8. The Committee recognized that Bulgaria's external trading environment had become more difficult in recent months and understood Bulgaria's concerns about the sharp decline in its exports. The Committee noted that, in responding to these difficulties, Bulgaria intended to give continued priority to fiscal and structural reform measures although it would also rely on timely disbursement of official external assistance.

9. The Committee decided that Bulgaria was in conformity with its obligations under Article XII of GATT 1994.

ANNEX I

Statement by the Representative of the Republic of Bulgaria

Mr. Chairman,

Distinguished Members of the Committee,

This is the second time that this Committee meets to examine the balance-of-payments measure of Bulgaria.

Bulgaria introduced an import surcharge in mid-1996, after consultations with the IMF, before its accession to the WTO. The measure was subject to negotiations in the accession process. The timetable adopted foresaw that the import surcharge would be reduced from 5% to 4% as of 1 July 1997, i.e. one year after its adoption and then to 2% from 1 July 1998, to 1% from 1 July 1999 and finally eliminated on 1 July 2000.

After the adoption of the measure, in late 1996 and early 1997 Bulgaria experienced a severe financial, economic and political crisis - the most serious one since the beginning of economic reforms in 1991. In 1996 the Bulgarian currency depreciated against the U.S. dollar by 589% in nominal terms and then by a further 319.7% in the first quarter of 1997. In 1997 the real GDP declined by 10.9%. Inflation soared to 596% e.o.p. Official reserves fell to a precariously low level. In 1996 total exports declined sharply by US\$463.6 mln (8.7%) compared to 1995. The situation called for a forceful response. Such a response was provided through deep economic reforms: the introduction of a currency board system based on strong financial discipline, consistent macroeconomic policies, privatization etc.

In spite of these enormous economic difficulties, which emerged *after* the introduction of the import surcharge, Bulgaria carried out its reduction as originally foreseen. At the first consultations with Bulgaria held in July 1997 this Committee 'welcomed the fact that the import surcharge was transparent, non-discriminatory and, as a price-based measure, least disruptive to trade'. It 'appreciated the timely notification of the measure... along with the announcement of a time schedule in accordance with paragraph 1 of the Understanding'. In its conclusions the Committee found that recourse to Article XII of the GATT 1994 was justified and decided to recommend to the General Council 'that Bulgaria be deemed in compliance with its WTO obligations' and subsequently the Council so decided.

Mr. Chairman,

At these first consultations in July 1997 this Committee 'commended Bulgaria for having maintained, during its recent difficulties, its commitment to reform and liberalization'. It 'was unanimous in viewing Bulgaria's balance-of-payments situation as delicate' and 'recognized the serious economic crisis that had affected Bulgaria'. However, some Members of the Committee urged Bulgaria to accelerate the elimination of this measure, well ahead of the existing commitment, as recommended by the IMF, and expressed their hope to see progress in this regard by the next consultation.

Indeed, one year thereafter, on 12 August 1998, after negotiations with the IMF on a new three-year arrangement, the Bulgarian Government decided to eliminate the surcharge as from 1 January 1999 which is one-and-a-half years ahead of the previously planned removal.

According to preliminary data, the current account for the first half of 1998 was slightly positive (US\$28.2 million) as compared to US\$235.3 for the same period of 1997 (down by US\$207.1 million). The main factor for the deterioration of the current account was the merchandise trade balance. The shrinking of the trade surplus which dropped by US\$323.8 million to US\$27.4 million was related to the terms of trade deterioration. Exports were down by 9.4% while imports rose by 4.7%.

The revised trade figures for the first half of 1998 which were available at the end of last week show a much more serious deterioration of the trade balance than the preliminary figures given in the Bulgarian Basic Document. Now they show that the trade balance is in fact negative (- US\$11.4 million). In July 1998 exports dropped by 25.1% compared to July 1997.

As a small and open economy, Bulgaria depends heavily on export growth. The export to GDP ratio amounts to about 50%. The decline of exports raises concerns about its negative impact on output, incomes, and employment which in turn are important for the expectations of economic agents and the sustainability of the currency board.

Mr. Chairman,

Bulgaria has decided to eliminate the import surcharge in spite of the delicate current account situation and its negative impact on the balance of payments. This was done because of the Government's strong commitment to trade liberalization and because we believe that the key to the overcoming of economic difficulties should not be sought in the restriction of trade. On the contrary, we believe that it is the expansion of trade that should be part of the solution to economic difficulties and economic crisis.

Thank you.

ANNEX II

Statement by the Representative of the International Monetary Fund

1. At the time of last year's consultation with Bulgaria, the Bulgarian economy had begun to recover from the deep financial crisis of early 1997. The newly elected reformist government had adopted a currency board arrangement (CBA) and initiated a comprehensive stabilization and structural reform program supported by a stand-by arrangement (SBA). Since then, the government has continued to demonstrate a steadfast commitment to the program allowing a restoration of confidence in policies and attracting significant external support. The SBA, which expired in June this year, was successfully completed, despite some delays in structural reforms. Realizing that much of the transition of the Bulgarian economy towards a competitive market-based economy still lies ahead, the authorities have begun to implement a medium-term reform program in the context of Bulgaria's EU accession strategy. The authorities' request for an extended Fund arrangement in support of this program will be considered by the Executive Board on September 25, 1998.

2. The SBA-supported program achieved impressive stabilization results much sooner than expected and set the stage for relatively favorable developments in 1998 despite a deterioration in Bulgaria's external environment. Reflecting the carryover of the recovery from the crisis in early 1997, real GDP is expected to grow significantly in 1998, by about 5 percent. Inflation declined rapidly to about one percent per month in late 1997/early 1998 and has been negative during June–August 1998, giving confidence that the end-year inflation target of 9 percent will be achieved. Yields on government securities fell rapidly at the time of the adoption of the CBA and have remained low since. Most of the remonetization, reflecting the return of confidence, took place during the second half of 1997 and left the banking system highly liquid. Official reserves rebounded from a low of US\$0.4 billion in January 1997 to US\$2.4 billion at end-August 1998 (equivalent to 4.8 months of imports of GNFS). Crisis induced import compression contributed to a large current account surplus in 1997 (4.3 percent of GDP). The subsequent return of imports to a more normal level and weakening of key export markets—only partially offset by the sharp decline in energy and commodity import prices and stronger tourism receipts—worsened the current account. As a result it was broadly in balance during the first half of 1998. Foreign investment inflows, which were strong in 1997 (nearly 5 percent of GDP), tapered off significantly during 1998 reflecting the turmoil in international markets and a slowdown of privatization.

3. The favorable economic developments and prospects for 1998 owe much to the CBA's impact on interest rates, the stronger than expected fiscal stance, and the revitalization of the structural reform efforts designed to strengthen financial discipline and liberalize the economy. The first two factors limited the deficit of the general government to 2.6 percent of GDP in 1997 and are expected to lead to a balanced budget in 1998. Together with official external support, and substantial privatization receipts, this has permitted a substantial increase in the balance of the fiscal reserve account, thus underpinning confidence in the program.

4. The authorities are now facing the challenge of achieving strong economic growth, higher living standards, and external viability on a sustainable basis while substantially advancing the transition to a competitive market economy and addressing critical social and infrastructure needs. The obstacles the government faces are formidable, including high public and external debt, a high dependency ratio, underdeveloped financial markets, inefficient energy and agricultural sectors, crime and corruption, a shrinking formal sector, and a worsening external environment.

5. The authorities are determined to tackle these issues in the context of an ambitious medium-term economic adjustment program, targeting strong growth, at 4 to 5 percent per annum; a decline in inflation to about 5 percent per year by 2001; and a substantial decline in the public and external debt

burden. Aside from a firm commitment to the CBA, the authorities plan to implement prudent fiscal policies aimed at an underlying balanced budget with an allowance for an actual deficit for up to 2 percent of GDP to cover transitional costs of structural reform and higher public investment in infrastructure. Financial discipline will be ensured by strengthening banking supervision; completing the privatization of enterprises and banks and the enterprise isolation program; and by implementing appropriate incomes and restructuring policies. Investment in infrastructure and other structural reforms, including the further liberalization of exchange and trade regimes are expected to raise efficiency and create a favorable investment climate. This would set the stage for an investment driven recovery, initially financed from abroad, and later from internally generated resources as export capacity improves.

6. With trade liberalization continuing, the economy recovering, and investment projected to increase, the current account is expected to post a small deficit in 1998 which would widen to about 3 percent of GDP in subsequent years. On the capital account, foreign direct investment and portfolio inflows are expected to remain modest in light of adverse investor sentiment toward emerging markets. While reserves have reached a comfortable level, with large external amortization falling due, Bulgaria will rely on sustained implementation of its adjustment and reform program and the associated official inflows to continue to meet its external financing needs.

7. The authorities' success in overcoming Bulgaria's balance of payments problems, as reflected in the substantial increase in international reserves, has permitted them to reduce the import surcharge as planned and to issue a decree announcing its abolition as of January 1, 1999, eighteen months ahead of initial commitments. The Fund commends the authorities for their sustained commitment to sound economic policies and their preparedness to take bold and difficult decisions to liberalize trade and allow the early elimination of the import surcharge. The authorities remain strongly committed to further trade liberalization to increasing domestic competition and creating a favorable environment for investment and growth. The three-year program includes significant liberalization of non-tariff barriers, the elimination of remaining export taxes, and the reduction in average tariffs. The authorities are actively considering the acceptance of the obligations under Article VIII, sections, 2, 3, and 4, of the Fund's articles of agreement in the near future. The Fund emphasizes that sustained implementation of appropriate macroeconomic policies and structural reforms will safeguard balance of payments viability and obviate the need for import restrictions.
