Opinion on a draft law on the State Budget of the Republic of Bulgaria for 2025, Updated Medium-Term Budget Forecast 2025-2028 and Autumn Macroeconomic Forecast

Content

Introduction

This Opinion is prepared pursuant to the provisions of Article 6. of the Fiscal Council and Automatic Correction Mechanisms Act.

In the 2025 budget procedure, the coordination of the draft State Budget Law 2025 with the Fiscal Council should occur by October 17. Once again, the adoption of the budget has been postponed, this time until after the parliamentary elections. Since the beginning of the pandemic, the budget procedure has been permanently disrupted, making it impossible for business entities to build expectations regarding the approval of strategic documents essential to their planning process.

The Fiscal Council stresses that the state budget is a strategic document not only for the management of public finances and the policies implemented through them, but also for the state's participation in the economy. For this reason, it is essential for the planning that each economic entity carries out.

It should be stressed that the draft law on the State Budget of the Republic of Bulgaria for 2025 and the Updated Medium-Term Budget Forecast 2025-2028 were made public on 9 December. Neither these documents nor the accompanying documents have been submitted to the Fiscal Council. The Council therefore prepares its opinion on its own initiative within the framework of its legal obligations on the basis of the publicly available documents within a reasonable time according to the consultation procedure.

In fulfilment of its obligations, the Fiscal Council has prepared this Opinion, which includes the following main components: an analysis of the macroeconomic framework; an assessment of compliance with fiscal rules, an assessment of expenditure and revenue policies and discretionary measures. The opinion is based on: published documents in the framework of the consistency procedure, macroeconomic analyses and forecasts of leading national and international institutions.

I. Analysis of the macroeconomic framework

The analysis of macroeconomic indicators is a mandatory element of fiscal monitoring. Their importance is driven by the central role of the macroeconomic framework in establishing fiscal indicators. Accurate forecasting of macroeconomic indicators is therefore essential.

In this project, the main macroeconomic assumptions of the Ministry of Finance are based on the autumn 2024 macroeconomic forecast. In the current context, the Fiscal Council considers GDP to be the leading indicator and therefore the focus of the analysis falls on GDP. At the same time, the dynamics of the labour market are determined not only by economic developments, but also to a large extent by the unfavourable demographic developments in the country.

Nominal GDP is a determinant of all fiscal parameters. The price stability criterion is a requirement for joining the euro area. We expect Bulgaria to achieve compliance with this criterion in early 2025.

Table. 1. Deviations in macroeconomic indicators for 2024 between the spring 2024 and autumn 2024 macroeconomic forecasts.

Indicator	Spring 2024	Autumn 2024	Diff. (value)	Diff. (%)
GDP (mln. BGN)	199 759	201 470	1 711	0,9%
GDP (real growth, %)	3,2	2,2	-1	-31,3%
GDP (nominal growth, %)*	8,7	8,8	0,0	0,6%
Consumption	4,1	4	-0,1	-2,4%
Gross capital formation	8,5	-2,7	-11,2	-131,8%
Average annual inflation (HICP, %)	2,4	2,6	0,2	8,3%
Deflator GDP (%)	5,4	6,4	1	18,5%

*Calculations FC Source: FC on MoF data

The data for 2024 are essential as they express the basis for the assumptions for the 2025 state budget too. If they are unrealistic in macroeconomic terms for the base year or inconsistent with the dynamics of the budget parameters, the reliability of the calculations for the following year may be compromised.

It is important to stress that a more conservative approach is needed in the ex-ante assessment of compliance with fiscal rules. In case compliance is planned around the tolerable limit, it is very likely that a very slight deterioration in economic developments and a lower GDP figure in the ex-post analysis will reveal a breach of the rules. Inaccurate GDP forecasting leads to unrealistic ex-post fiscal analyses and assessments based on it. Overestimation of GDP, for example, leads to underestimation of key indicators such as: government participation in the economy (measured by government expenditure as % of GDP); the level of government debt (measured as % of GDP); the size of the deficit (also as % of GDP), etc. In view of these considerations, the Council does not consider that fiscal planning should be carried out in a too positive scenario for macroeconomic developments - especially given the country's aspiration to join the euro area and the need to strictly respect the deficit criterion.

In this case, between the projections in Tab. 1, there is a substantial reduction in the level of real growth. Clearly, the 2024 growth rate in the spring 2024 forecast was substantially overestimated. For consumption, the expectation is essentially unchanged. For gross fixed capital formation, there has been a sharp downward revision of very substantial magnitude. It is this revision of investment that has led to the downward revision of the real growth forecast. As a consequence of the slightly higher inflation, the nominal GDP forecast is also revised up by BGN 1.7 billion. Nominal growth is also unchanged.

The unrealistic GDP growth expectations for 2024 in the MoF's spring forecast appear inconsistent with macroeconomic developments to date. This assertion is supported by the growth revision in the MoF's autumn forecast for 2024. The real growth figures for the nine months of 2024 also do not support the value of the MoF's spring forecast - annual growth is 2.0% in the first quarter of 2024, 2.2% in the second quarter and 2.4% in the third quarter. The tax revenue underperformance also points to lower nominal GDP. This raises the question of the deflator estimate, as import and export prices do not show any significant dynamics in 2024 that would lead to such significant deviations between the deflator and the HICP.

The Fiscal Council's forecast for economic growth in 2024 is 2.2%. In the main indicators it is close to the MoF's autumn forecast.

Potential inaccuracies in the 2025 forecast are essential both for compliance with fiscal rules and for meeting the euro area accession criteria. This is because the deficit, for example, is calculated by comparing the balance in absolute terms with nominal GDP. A lower GDP value would imply a higher deficit ratio. However, it would also lead to lower tax revenues (as in the current year), which would further worsen the deficit. Therefore, with too optimistic forecasts and planning at the margin, there is a significant risk that the rule will be breached. The situation is similar with the national rule, which limits to 40% the size of the state in the economy.

Table 2. Deviations in macroeconomic indicators for 2025 between the spring 2024 and autumn 2024 macroeconomic forecasts.

Indicator	Spring 2024	Autumn 2024	Diff. (value)	Diff. (%)
GDP (mln. BGN)	211 580	215 231	3 651	1,7%
GDP (real growth, %)	2,7	2,8	0,1	3,7%
GDP (nominal growth, %)*	6,0	6,8	0,8	13,6%
Consumption	3,4	4	0,6	17,6%
Gross capital formation	5,1	6,9	1,8	35,3%
Average annual inflation (HICP, %)	2,8	2,4	0	-14,3%
Deflator GDP (%)	3,2	3,9	0,7	21,9%

* Calculations FC Source: FC on MoF data

The nominal GDP estimate for 2025 has been revised upwards and its nominal value has been increased by BGN 3.7 billion. Real growth has also been revised up slightly. Consumption is up on the spring forecast but unchanged from 2024. Gross fixed capital formation is revised sharply upwards, rising substantially relative to 2024. It should be emphasized again that it is precisely the sharp changes in investment forecasts that are the main reason for the change in real growth forecasts.

In the spring macroeconomic forecast, a comparison with the forecasts of leading institutions and organisations that publish their expectations was proposed. This is also the methodology that the Fiscal Council has traditionally applied in assessing the realism of projections. This good practice has been continued in the autumn macroeconomic forecast.

The comparison shows that the Ministry of Finance's growth expectations for 2024 are optimistic - only 0.3 pp below the maximum, but 0.4 pp above the minimum and exactly in line with the average. It is important to emphasise that these figures are actually projected at the end of the second half of the year. The closer in time to the time of preparation of the forecast, the more accurate the expectations in the forecast should be, to the extent that more and more up-to-date data are available.

Table 3. Latest most important forecasts compared with the Fiscal Council's forecast.

Real Growth GDP, %, Forecasts	**2024**	**2025**
International Monetary Fund (IMF)	2,3	2,5
World Bank (WB)	2,2	2,8
European Commission (EC)	2,4	2,9
Organisation for Economic Co-operation and Development (OECD)	2,5	2,9
Bulgarian National Bank (BNB)	2,2	2,7
UniCredit Bulbank	2,5	2,9
United Bulgarian Bank	2,3	2,8
Ministry of Finance	*2,2*	*2,8*
Fiscal Council negative scenario	**2,2**	**1,8**
Fiscal Council optimistic scenario	**2,2**	**2,,6**

Source: FC on MoF data

The Fiscal Council also considers the forecast for real growth in 2025 to be optimistic. A number of countries in the European Union are currently experiencing economic slowdowns, including the largest among them, Germany. Restrictive monetary policy and high interest rates, the reduction of which has been slow and gradual, call into question the prospects for economic growth next year. The removal of the European Commission's derogation clause on budget deficits, on the other hand, restricts governments from implementing measures to support the economy. These developments will inevitably have an impact in Bulgaria, as the economy is small and open and highly dependent on European trends. It should also be stressed that interest rates in our country have yet to rise from the current record lows.

The Fiscal Council's forecast for GDP growth in 2025 is as follows:

Table 4. Fiscal Council forecast.

Indicator	Forecast 2024	Pessimistic 2025	Optimistic 2025
GDP (mln. BGN)	201 451	213 954	215 087
GDP (real growth, %)	2,2	1,8	2,6
GDP (nominal growth, %)*	8,8	6,2	6,8
Consumption	4,0	3,0	3,0
Gross capital formation	-2,7	2,4	10,7
Compensation per employee	14,3	9,0	9,0
Import	2,2	2,4	5,6
Export	0,2	1,2	2,7
Average annual inflation (HICP, %)	2,6	1.8	2,4
Deflator GDP (%)	6,4	3,9	4,1

* The forecasts are calculated by the FC

Due to the turbulent economic environment and above all the uncertainty about the absorption of the funds under the Recovery and Resilience Plan and other EU funds (e.g. under the RePowerEU chapter), the Fiscal Council has developed two forecast options - a pessimistic and an optimistic one.

In the pessimistic variant, the assumptions are that due to political instability the absorption of the above-mentioned EU funds will not take place in 2025. As a consequence, the growth of public investment in gross fixed capital formation will be weaker (BGN 8 billion instead of the projected BGN 14 billion), partly offset by weaker imports. In our EU trading partners, structural problems combined with political uncertainty and increasing trade fragmentation may lead to weaker growth. Accordingly, Bulgarian exports will also slow down. Consumption growth will be somewhat weaker due to lower wage increases in 2025. The deterioration in the business environment would also have an impact on private sector employment and earnings plans, albeit partly offset by projected public sector wage increases. As a result, real GDP growth would slow to 1.8%.

In the optimistic forecast, the above-mentioned EU funds will be absorbed and public investment growth will be stronger. Consumption will also remain at the same level as in the pessimistic scenario. Exports and imports will grow at a stronger pace. The budget shock would be partly minimised, but overall the withdrawal of significant resources from the private sector would have a negative effect. Consequently, real GDP growth would accelerate to 2.6%.

Real labour productivity growth slows to 0.8% in 2023 and 1.7% in the third quarter of 2024 due to the slowdown in economic activity. There is a significant discrepancy with nominal compensation per employee growth of 13.4% for 2023 and a 14.3% forecast for the end of 2024. Such a trend could be pro-inflationary. Under such conditions, wage increases have the effect of worsening the competitiveness of the economy and, consequently, a negative current balance of payments and slowing economic growth.

Unemployment is expected to be slightly above 4% in the spring macroeconomic forecast compared to the autumn forecast. The tight labour market is also pushing up private sector incomes.

Structurally, it is striking that the dependency ratio has risen significantly relative to previous years and to demographics. These trends are difficult to explain logically. From a structural point of view, it is noticeable that the burden of the employed with incomes from the budget has increased significantly compared to the previous years and compared to the demographics. It is hard to find a logical explanation for these trends.

The stated policy of raising incomes in 2025 through significant wage increases in secondary and tertiary education, as well as for employees in the Ministry of Interior and the Ministry of Defence (due to the increase in the average wage in the country for that year), including above the nominal GDP change in other incomes, is likely to manifest itself as an additional pro-inflationary factor. Overall, the fiscal stance calculations suggest that public finances will continue to pursue a pro-cyclical expansionary policy. These circumstances put at risk both the fulfilment of the price stability criterion and, above all, the achievement of a deficit below 3% of GDP, criteria which are necessary for euro area accession.

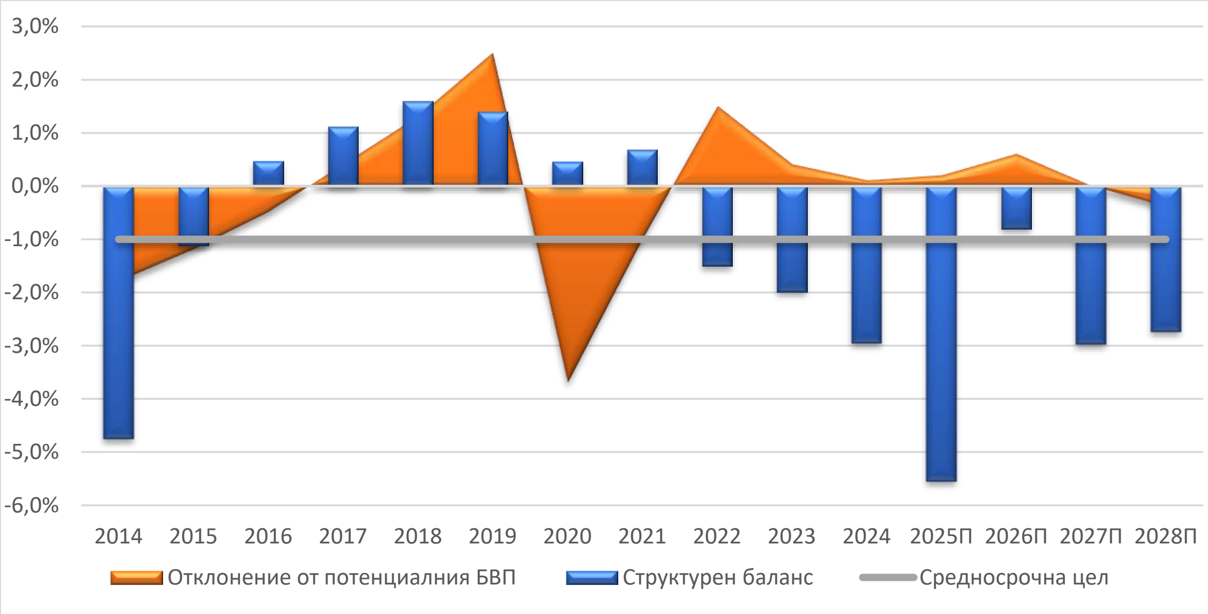
II. Assessment of the fiscal framework

The overall budget balance, while a very important indicator of the budgetary position, is not in itself sufficient to adequately assess fiscal policy. The fiscal position is assessed in relation to the change in the structural balance and the level of the economy relative to potential. The change in the structural balance, in turn, indicates the direction of the government's policy path, insofar as the structural balance is the part of the overall budget balance that reflects the government's discretion. The Fiscal Council has used MoF data on potential GDP and output gap to calculate the indicators below. It should be noted that these differ substantially from the EC estimates for which official information is available. We consider that the labour market situation and developments rather support the EC estimates for the level of the output gap for 2021-2025 and MF uses a lower estimate to justify the significant deviation from the allowed equilibrium budget position.

A series of unforeseen events, starting with the COVID-19 pandemic, have seriously challenged the stability of public finances and necessitated a shift in fiscal policy.

Many of the sectors responsible for responding to this type of crisis were unprepared, and responses to risks were overexposed. A significant part of the measures were unnecessarily prolonged, resulting in substantial costs for the budget. Many of the decisions were inert, especially against the backdrop of a changed economic environment and further complicated by the ongoing war in Ukraine. The structural budget balance is presented in Chart 1.

Chart 1. Structural Budget Balance



Source: FC on MoF data

It is evident from the graph that the effects of the pandemic have affected overall economic activity, so in 2020 and 2021 the economy has been growing below its potential. In 2022, we observed opposite paths of development, conditioning the closure of the deviation from potential GDP and its transition to positive territory. In contrast, a structural deficit was allowed to form in 2022. Its deterioration continues in 2023, in parallel with a narrowing of the deviation from potential GDP.

The fiscal position as of 2024 is again characterised by pronounced pro-cyclicality: against the background of a closing deviation from potential GDP, the increase in the structural deficit for general government is again not prevented.

In the projections for 2025, the deteriorated structural balance reaches record levels. The structural deficit is projected to almost double in size and to expand more than in 2024.

Chart 2. Bulgaria's fiscal stance for 2017-2028

In 2026, for example, we see how, completely unexpectedly, the fiscal position recovers so well that it becomes not only countercyclical, but also meets the medium-term budgetary objective criterion for the structural deficit (-1%), even going below its threshold.

In both 2026 and 2027, the structural deficit returns to current year levels which is far from the medium-term budgetary objective, and the failure to take into account the direction and dynamics of the business cycle again gives rise to pronounced pro-cyclicality. Strangely, fiscal policy is zigzagging from expansionary pro-cyclical in 2025 to contractionary pro-cyclical by 2028, i.e. it is out of sync with the economy and stated monetary policy.

The fiscal indicators and rules are undoubtedly only benchmarks for fiscal policy. In this case, both the old rules and the new indicators based on the new European legislation show a breach and lack of systematicity in the budget approach. Conducting one-off and isolated efforts to meet the criteria in a single year of the medium-term forecast period, which has been beset for years with severe, chronic structural deficits - out of sync with the economic cycle - is not only counterproductive, but shows a lack of effort to apply a strategic approach to structural deficit planning and targeting.

It can be said that since the beginning of the observation period, the fiscal stance has been systematically pro-cyclical, with minimal deviations for 2020. It should be noted that fiscal policy as it stands does not support price stability and the decline in inflation is exclusively due to external factors and market openness, without fiscal policy support. We believe that the 2025 budget sends very mixed confusing signals to other market actors.

The Public Finance Act regulates several numerical fiscal rules, which the Fiscal Council monitors compliance with. The COVID-19 epidemic has been the main challenge to compliance not only in this country, but around the world. In this context, on 20.03.2020, for the first time in history, the European Commission proposed to trigger the general escape clause provided for in the Stability and Growth Pact as a measure to react quickly and decisively against the COVID-19 pandemic. The general escape clause allowed EU member states to pursue adequate anti-crisis budgetary policies and to temporarily deviate from established fiscal rules in the event of a severe economic downturn, provided that medium-term fiscal sustainability was not jeopardised.

It should be noted that the derogation was valid for the fiscal rules governed by the Stability and Growth Pact and monitored by the European Commission, but the other fiscal rules regarding the Consolidated Fiscal Programme stemming from the SGP remained in force, and have been therefore strictly monitored by the Fiscal Council.

The general escape clause was deactivated and a new EU economic and fiscal governance framework entered into force in 2024.

At the same time, the Fiscal Council continues to monitor compliance with all national fiscal rules set out in the Public Finance Act.

2.1.1. Balance rules

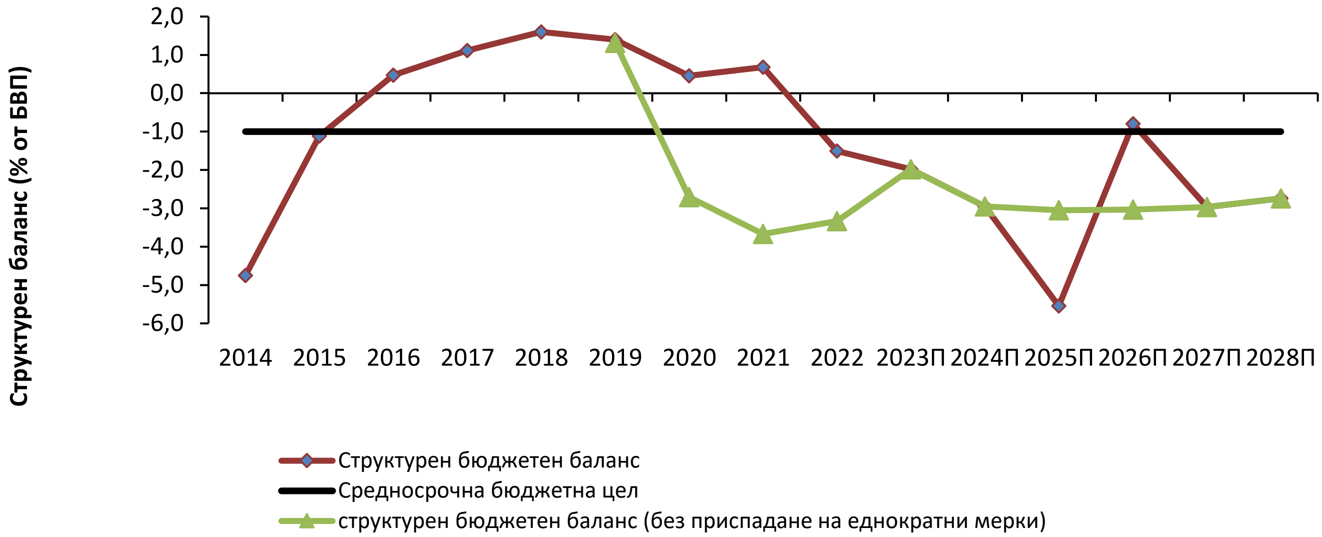
Medium-term budgetary objective (MTO) and structural balance

With the EU's new economic and fiscal governance framework, the use of the MTO indicator has changed, but it is still a part of the budget assessment system in the Public Finance Act and the fiscal rules. The new ways of calculating fiscal sustainability give more flexibility to countries with low debt, but require more responsibility for decisions with long-term implications, due to the significant size and inertia of the budget sector.

Due to the low level of general government debt (below 40% of GDP), Bulgaria's MTO is assumed to be -1% of GDP over the medium-term budgetary projection period analysed. For the calculation of the structural balance, the size of the so-called one-off measures is important, so we have also shown in the graph what the structural deficit would be if these one-off costs were not deducted.

It is clear from the graph that budgetary policy from 2022 permanently shifts from structural surpluses to structural deficits. The shift is from restrictive fiscal policy to a major fiscal expansion. The 2026 exception in the structural balance does not affect the overall trend over the projection period.

Chart 3. Structural budget balance and MTO



Бележка: Текущата средносрочна бюджетна цел за България е -1% от БВП

Source: FC on MoF data

As shown in Chart 3, a structural deficit larger than the MTO is planned throughout the projection period, except for 2026.

We should underline that one of the main reasons for the deterioration in the budget balance is the transformation of temporary expenditure associated with the response to various shocks after 2019 into permanent expenditure.

According to Article 24 of the Public Finance Act, it is permissible not to meet the medium-term budgetary objective for the structural deficit on an annual basis only in exceptional circumstances and provided that the non-achievement is of an amount that does not endanger the sustainability of public finances.

General government deficit and balance on cash basis

Pursuant to Article 25(1) of the Public Finance Act, the general government balance target is to achieve and/or maintain a zero or positive balance. Paragraph 2 regulates the general government deficit on an annual basis, that may not exceed 3% of GDP. Exceptions are allowed in exceptional circumstances, such as the COVID-19 pandemic.

According to the MoF's preliminary data, the general government balance for 2024 is negative at 3% of GDP, i.e. on the edge of the rule.

The projected deficit indicates our country's adherence to fiscal constraints. This avoids the possible risk of entering into an excessive deficit procedure, which the Fiscal Council has signalled in previous opinions.

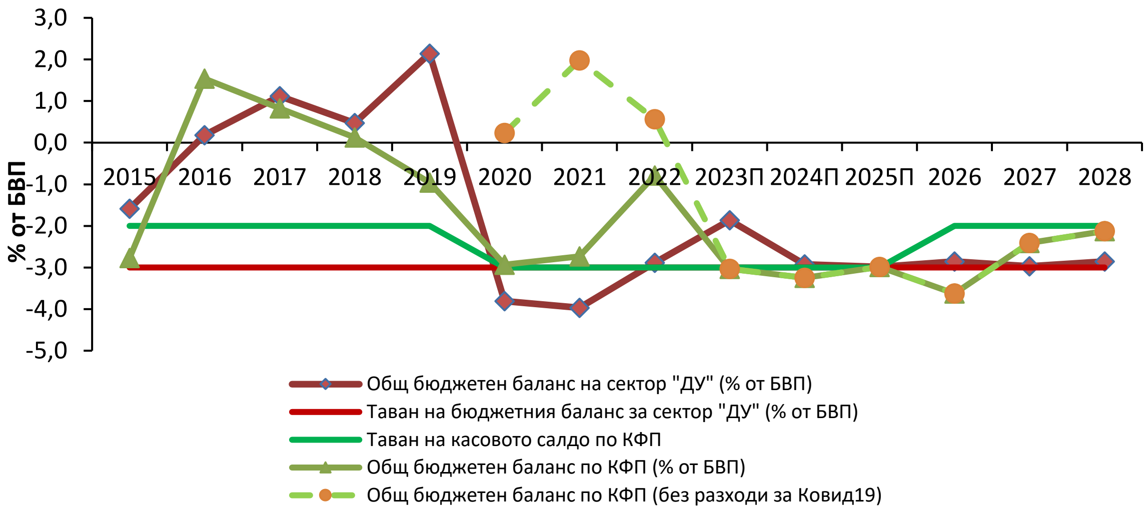
Avoiding a deficit of more than 3% of GDP for the general government sector is also one of the convergence criteria that Bulgaria has to respect in order to join the euro area (Maastricht criteria).

In the medium term, the deficit is foreseen to remain at 3% in 2025 and 2027 and to fall to 2.9% in 2026 and 2028, respectively.

With regard to the budget deficit calculated on cash basis under the Consolidated Fiscal Programme, , Article 27(4) of the Public Finance Act stipulates that it may not exceed 3% of GDP, with higher deficits allowed in exceptional circumstances. The rule is national and has no analogue in European documents.

For 2024, compliance with the rule has been set at the upper legal limit of 3.0% of the deficit. **However, the Ministry of Finance's expectation for 2024 is that the negative Consolidated Fiscal Programme balance will increase and the rule will be breached - a deficit of 3.3%. An even larger deficit of 3.6% is planned for 2026.**

Chart 4. General government balances and CFP (% of GDP)



Source: FC on MoF data

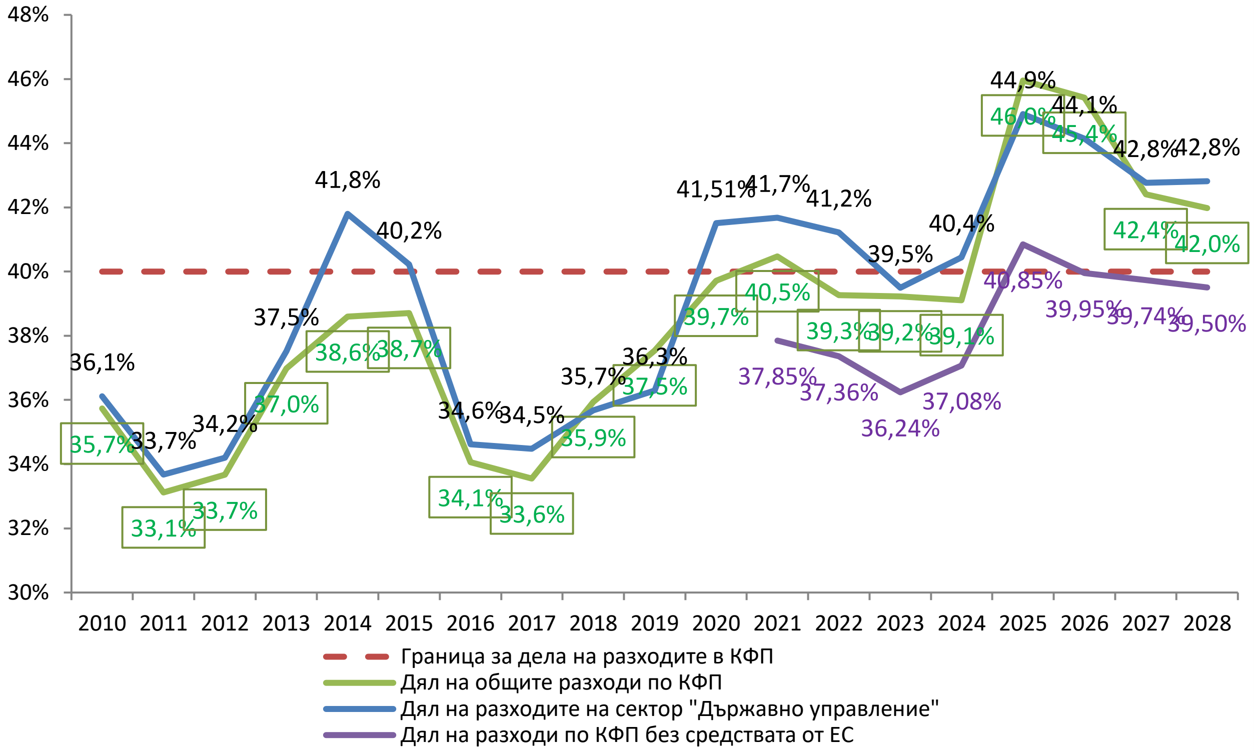
The Fiscal Council would like to warn that this is a formal fulfilment of criteria based on too flexible and optimistic assumptions on the revenue side in the absence of formally budgeted buffers. The alternative revenue estimate developed for 2025 shows a risk of tax revenue underperformance of up to 8.6 billion BGN compared to the figures published to date. The Fiscal Council cannot validate the revenue estimates or the reliability of the data in the General Government format. For greater transparency, we believe that the MoF should publish a technical section on the transition between the cash format of the Consolidated Fiscal Programme and the General Government format.

2.1.2. Expenditure rules

GDP expenditure rule

This rule is national and aims to limit the size of the public sector to 40% of GDP.

Chart5. Share of spending in GDP



Source: FC on MoF data

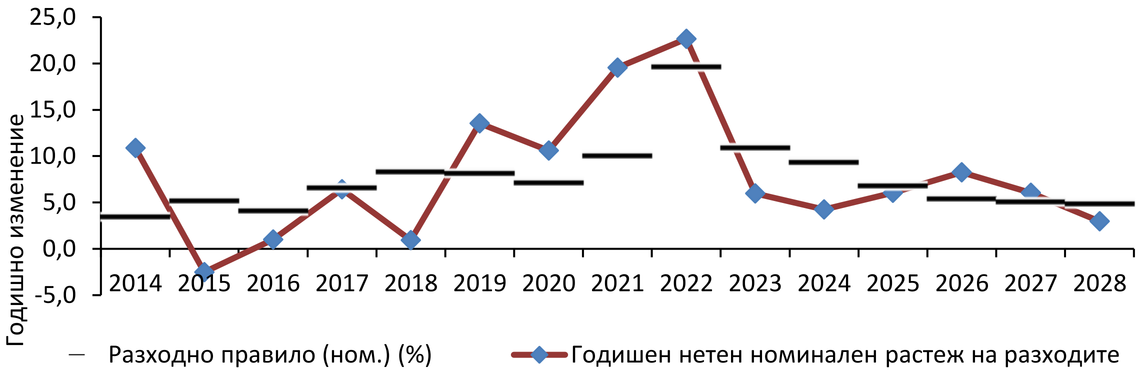
Until 2021, the total budget expenditures under the Consolidated Fiscal Programme are within the limit of 40% of GDP. After that, they begin to vary and settle above this limit imposed by the Public Finance Act. In 2020, the scope of the rule excluded expenditures made from accounts for funds from the European Union with the motive of not limiting the absorption of funds. From chart 5 it can be seen that for the current year after deducting EU funds, the planned expenditures under the Consolidated Fiscal Programme amount to 37.08% of GDP. **For 2025, they are expected to increase to 40.8% of GDP, if national co-financing is taken into account, which affects the deficit, or to 46% of GDP, without this transfer, which is already in violation of the requirement of the Public Finance Act. In the remaining years of the forecast period, the percentages remain on the edge of the upper limit of the rule, which implies risks of its violation. This raises the question of whether a budget that does not meet a legal requirement under the Structural Act can be approved by the Council of Ministers and considered in the National Assembly.**

According to the Fiscal Council, the exception for European accounts should be dropped and the Public Finance Act should be amended due to the contradiction with the economic logic of this rule to limit fiscal expansion and the impact of budget expenditures on macroeconomic aggregates. As illustrated in Chart 5, without deducting the expenditures made from accounts for funds from the European Union, the share of total expenditures under the Consolidated Fiscal Programme as a percentage of GDP for 2025 shoots up to 46% and remains above 40% for the entire forecast period.

Expenditure growth limit rule

The expenditure growth limit is defined as a fiscal rule in the Public Finance Act, Art. 26, according to which the annual growth of expenditure should not exceed the reference growth of potential GDP, with the scope of expenditure and the methodology for calculating the reference growth of potential GDP being determined in accordance with the requirements of the EC. A higher growth is permissible only when extraordinary circumstances require it and when compensated by additional measures leading to an increase in budget revenues (which are not of a one-off nature).

Chart 6. Expenditure rule



Source: FC calculations based on MoF data

The above graph clearly shows that the main reason for the lack of fiscal space is due to the overtaking growth of expenditures in the period 2019-2022 and the lack of structural measures in the following periods.

In the considered forecast period, the rule is under pressure.

2.1.3. Debt rule

The fiscal rule for limiting the share of the consolidated debt of the "General Government" sector is established in Art. 29 of the Public Finance Act, according to which the nominal amount of the consolidated debt of the "General Government" sector at the end of each year cannot exceed 60 percent of GDP. This rule is also one of the main requirements of the Stability and Growth Pact.

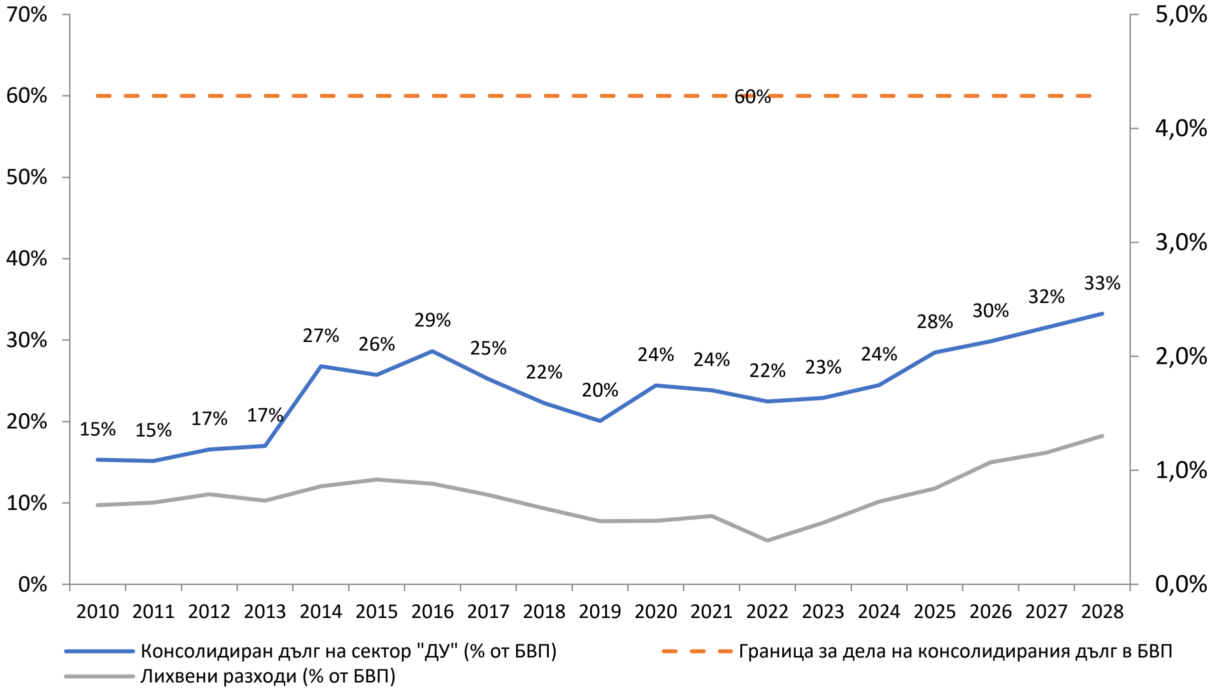
As a result of the more conservative fiscal policy over the last decade, the level of debt in our country maintains levels that are far lower than the limit. In addition, after 2016, a lasting trend for its decrease was established, reaching 20% in 2019. However, this positive trend did not last long.

The loosening of fiscal policy in recent years and the projected deficits in the following periods lead to a significant increase in the nominal ratio of debt.

Although the relative share of consolidated debt to GDP is growing, the indicator remains well below the maximum reference value of the Maastricht convergence criteria of 60%.

However, the Fiscal Council has repeatedly noted that the pace of its growth since the beginning of the pandemic has been too intense, and if the projected budget deficits are achieved, the debt will increase to over 30% of GDP, crossing this psychological threshold.

Chart 7. Consolidated debt of the general government sector



Source: FC calculations based on MoF data

It should be emphasized that when considering the dynamics of the debt as a share of GDP, the importance of its increase in nominal terms may be underestimated (especially given the fact that Bulgaria is far from the 60 percent limit). This is because, in parallel with the debt, the nominal amount of GDP is also increasing significantly. However, this trend is determined to a much greater extent by inflation than by real growth.

The increase in debt during the forecast period is carried out with increases of two to three percent of GDP per year, which in nominal terms has a serious impact. It should also be noted that if the macroeconomic forecast is overestimated, the debt as a percentage of GDP will also change.

The significant nominal increase in debt also leads to an increase in interest expenses to 1,007.9 million leva for 2024, 1,624.7 million leva for 2025, 2,181.9 million BGN for 2026, 2,614.7 million BGN for 2027, 3,042.9 million BGN for 2028. **In real terms, this means that interest expenses will increase from levels of around 0.5% of GDP to around 1.2% of GDP at the end of the forecast period, reducing the opportunity for investments or other productive spending.**

III. Analysis of revenue and expenditures under the Consolidated Fiscal Programme

3.1.1 Analysis of revenue under the Consolidated Fiscal Programme

Traditionally, the tax policy of the Republic of Bulgaria is oriented towards ensuring macroeconomic and budgetary stability in the medium and long term, as well as the necessary financial resources for the implementation of the government's fiscal policy, with predictability being built in order to encourage investment activity by maintaining low tax rates. This trend was disrupted after the onset of the pandemic, with numerous measures being introduced and amended. The most significant example in this regard is the additional differentiation of the VAT rate. The scope of goods and services with a reduced rate of 9% was expanded several times, and a zero rate was also introduced. Some of these temporary measures were practically transformed into permanent ones. As a result, predictability regarding tax management, as well as revenues in the state budget, decreased. The Fiscal Council supports the restoration of the standard 20% VAT rate for restaurant services and bread and flour, not only from a fiscal point of view - as a fiscal effect in the state treasury, but also as a guarantee of equality and fairness in taxation in relation to other sectors of the economy. The measure was temporary and is currently not relevant to the changed economic conditions. In principle, it did not achieve the expected result - maintaining or reducing the prices of final consumer products. In addition, the restoration of the tax rate is also a guarantee for the prevention of possible VAT abuses.

Revenue policy should be considered in two aspects, from the point of view of economic goals and technical implementation, incl. the realism of the implementation of the estimated revenues.

According to the Fiscal Council, the set of the proposed policies and measures does not meet the economic objectives and problems that the budget is supposed to address. Furthermore, there is no political validation, through a management political program, that would allow for the practical change of the established tax system. It can be said that there are two major challenges in macroeconomic terms - an outpacing increase in wages, due to the shortage in the labor market, and the decreasing productivity for this reason. The second major challenge is related to the competitiveness of the economy and the very low level of investment. Especially as regards the second, the logic of the proposed measures leads to a decrease in private investment in the long term, due to the deterioration of the business environment, in order to finance possible state investments. The crowding out effect of the budget, which is proposed as a policy in the coming years, will have an impact on long-term growth, without solving any significant problem, considering the efficiency of state spending. On the other hand, there is no significant measure, but quite the opposite, to stimulate labor productivity and to cool consumption and income. The budget, neither in the revenue nor in the expenditure part, does not address in any significant way the challenges in the "Dragi report" to improve the competitiveness of the economy. The planned increase in social security contributions in 2026 and 2027 is the exact opposite of such a measure, significantly increasing the tax burden and increasing the cost of production. We believe that it would be right to support the technological transformation in the real sector with tax instruments, which would also reduce the pressure and distortions on the labor market. Unfortunately, such a policy is not being discussed or envisaged for the period until 2028.

As for the reliability of the measures and their implementation, although in 2024 the error in the GDP estimate is significant, both nominally and in terms of growth, the realized tax revenues are 12.5% higher than in 2023, and are nearly 1 billion leva higher than planned. There has been a significant improvement in collection by revenue agencies for the last three quarters. Non-tax revenues and aid revenues are significantly underperforming compared to the plan for 2024, nearly BGN 4 billion less than planned

Table 5. Nominal revenue growth (%)

КОНСОЛИДИРАН ДЪРЖАВЕН БЮДЖЕТ	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
% in nominal terms												
Приходи и помощи	4.0%	12.3%	11.1%	0.6%	18.4%	23.5%	3.5%	7.8%	28.0%	2.8%	-0.1%	3.7%
Данъчни приходи	10.0%	9.0%	9.4%	1.6%	14.0%	14.4%	11.8%	12.5%	25.2%	2.7%	5.7%	4.9%
Преки данъци	13.4%	11.3%	10.7%	3.3%	14.9%	15.5%	13.5%	14.6%	24.6%	2.1%	8.0%	4.8%
Данъци върху печалбата	11.2%	6.8%	9.4%	-2.4%	29.4%	34.8%	7.0%	12.5%	30.0%	-7.1%	5.7%	5.7%
Данък върху доходите на физическите лица	12.7%	9.9%	9.6%	4.1%	16.0%	9.9%	18.3%	14.2%	27.4%	-6.2%	2.8%	4.7%
Социално и здравно-осигурителни вноски	14.3%	13.1%	11.5%	4.4%	11.1%	12.3%	13.7%	15.5%	21.8%	8.6%	10.5%	4.5%
Косвени данъци	7.2%	6.9%	8.5%	-0.7%	13.5%	13.5%	5.6%	13.0%	25.9%	3.5%	3.9%	5.2%
Данък върху добавената стойност	9.0%	8.0%	10.2%	-0.6%	17.8%	18.1%	5.8%	14.3%	26.3%	2.6%	4.9%	6.0%
Акцизи и пътна такса	3.7%	4.4%	5.4%	-0.8%	4.0%	0.8%	7.7%	10.3%	25.6%	5.9%	1.0%	3.0%
Мита и митнически такси	12.2%	16.4%	2.1%	-9.1%	38.0%	55.7%	-28.5%	-3.9%	10.3%	5.7%	5.7%	5.8%
Други данъци	5.4%	7.3%	5.1%	11.2%	8.4%	11.9%	72.3%	-11.8%	25.3%	1.2%	-4.4%	4.0%
Данък върху застрахователните премии	9.3%	12.4%	18.9%	5.1%	2.8%	8.1%	15.5%	7.8%	13.5%	7.0%	7.0%	11.2%
Неданъчни приходи	1.6%	25.8%	18.9%	-8.5%	40.8%	47.8%	-9.2%	-11.6%	17.9%	6.5%	-9.1%	0.7%
Помощи	-47.7%	38.9%	16.7%	9.4%	28.5%	73.3%	-36.2%	-2.5%	99.2%	-2.2%	-45.7%	-12.8%

Against this background, the projected revenue trajectories under the Draft Budget 2025 seem insufficiently justified. The caretaker government expects a record collection of 92,485.8 billion leva – an increase of 20.2 billion leva or 28% compared to the expected revenues for 2024. This reflects the unrealistic forecast for the country's economic growth next year, as well as a number of revenue measures loaded with optimism regarding their fiscal effect, which the Fiscal Council will consider below. Optimistic and rather wishful also seems to be the receipt of the long-awaited second tranche of funds under the Recovery and Resilience Plan, which are embedded in the MoF's assumptions for revenue dynamics. As in the case of the Recovery and Resilience Plan RRF, the projected revenues from the so-called tax amnesty must be tied to a buffer mechanism on the expenditure side, due to the significant risks, including the wishful collection of these revenues.

Table 6. Estimated revenue from the Fiscal Council (million BGN)

	2024 очаквано	2025	
		Фискален съвет	МФ
Приходи и помощи	**72 242.3**	**79 404.9**	**92 486.0**
Данъчни приходи	**58 877.2**	**65 032.0**	**73 693.2**
Преки данъци	**30 780.0**	**33 448.4**	**38 339.2**
Данъци върху печалбата	5 530.0	5 878.4	7 191.0
Данък върху доходите на физическите лица	7 203.6	7 779.9	9 176.6
Социално и здравно-осигурителни вноски	18 046.4	19 790.1	21 971.6
Косвени данъци	**25 696.0**	**28 542.3**	**32 345.7**
Данък върху добавената стойност	18 541.0	20 489.3	23 413.0
Акцизи и пътна такса	6 780.0	7 642.1	8 516.9
Мита и митнически такси	310.0	340.0	342.0
Други данъци	2 401.2	3 041.3	3 008.3
Данък върху застрахователните премии	65.0	70.9	73.8
Неданъчни приходи	**9 630.6**	10 472.9	**11 353.9**
Помощи	**3 734.5**	3 900.0	**7 438.9**

The Fiscal Council made an approximate estimate of revenues based on the available information on discretionary measures by the Ministry of Finance and its own assessment of the development of the economy. The estimate does not include possible revenues from the Recovery and Resilience Plan and tax amnesty plans. The assessment of the Aid is based on extrapolation and may contain a significant error, but this does not change the main problem with the assessment of tax revenues. The projected revenues correspond to an increase in the tax base by about 10 billion leva with GDP estimate for 2025 of over 225 billion leva or real economic growth for 2025 between 5-6%.

The measure with the most serious fiscal effect proposed by the Ministry of Finance in the Draft Budget 2025 is the so-called Tax amnesty - a one-time opportunity to pay undeclared, overdue or unpaid tax liabilities, including the remission of penalty interest and sanctions, as a measure to increase revenues and reduce the budget deficit. The measure is defined in two aspects:

- Exemption from interest upon payment of principal on public receivables due, incurred by 31.12.2023, aimed at paying principal on public liabilities due as of 1 January 2025.
- One-time declaration of undeclared income - 15% one-time tax. The measure aims at a one-time declaration and payment of taxes due for income that has not been declared for previous reporting periods.

According to the calculations of the Ministry of Finance, this measure is expected to bring about 5.1 billion leva in additional revenue to the budget for 2025. The Fiscal Council expresses serious doubts that such a huge overall fiscal effect can be expected from a one-off measure of a similar nature to prevent the worsening deficit. In addition, the Fiscal Council believes that the implementation of a tax amnesty undermines trust in the tax system and tax administration and may discourage honest taxpayers from fulfilling their responsibilities to the state. Having studied the practice of other countries that have implemented a tax amnesty, the Fiscal Council came to the conclusion that the country does not have the extraordinary conditions and prerequisites that necessitated the implementation of a tax amnesty in other countries. In addition, as a result of a study of international tax amnesty practices, which the Fiscal Council undertook, it was established that expectations about their effects usually remain largely unjustified. This creates a potential risk of a permanent loss of revenues due to the state treasury. Also, the Fiscal Council believes that a one-off measure with a significant risk of non-implementation, such as a tax amnesty, should not be promoted as the main means of addressing the state budget deficit.

Another revenue measure with a significant fiscal effect in the Draft Budget 2025 was the intention of the Ministry of Finance to introduce a new Tax on the extraction of underground resources. The measure is pointed out as necessary in order to achieve a updated level of payment for the rights to extract underground mineral resources on the territory of the country, which are exclusively state property. Although an agreement was reached between the Ministry of Finance and representatives of the industry after the negotiations, the envisaged one-time contribution will not compensate for the damaged confidence in the business climate and the impact on the development plans of these companies. We must emphasize that the mining industry plays a fundamental role in the plans for the reindustrialization of Europe.

In third place are revenue measures in the Draft Budget 2025, coming from the increase in excise rates, which the Fiscal Council supports:

Increase in the excise rate on cigarettes, cigars and cigarillos, smoking tobacco, heated tobacco products, and e-cigarette liquid - with expected revenues of BGN 270.2 million.

Increase in the excise rate on alcohol and beer - with expected revenues of BGN 64.2 million for 2025.

The expected VAT revenues from increasing the excise rates on tobacco and tobacco products, alcohol and beer are estimated at BGN 64.2 million.

Next, to justify the higher revenues set in 2025, measures for higher collection are announced in the fight against the shadow economy. In view of the data from previous years, these reserves seem to be somewhat exhausted. The government is proposing a wide package of measures - for example, providing a financial stimulus for individuals who submit information containing specific facts and circumstances that are unknown to the tax authorities and lead to the establishment and collection of additional obligations for taxes, duties, mandatory social security contributions and interest thereon, totaling over BGN 100,000; Expanding the scope of the definition of "employment relationships", thereby achieving greater tax transparency regarding income and taxes and mandatory social security contributions due; preliminary declaration of goods with high fiscal risk. Most of the proposals have been discussed in the past and were rejected due to the inconsistency of some of the measures.

The overall effect of the proposed measures, which are significant both in their number and in their severity, would lead to a significant increase in the administrative burden for small businesses. The trend of introducing unequal administrative procedures on business is unfavorable. The measures and procedures introduced by the National Revenue Agency contradict the intentions of improving the business environment and reducing business regulations, which is a major priority of policies at the community level in the EU.

Regarding the measure "Cancellation of the increase in the registration threshold from 100 thousand BGN to 166 thousand BGN from 01.01.2025", the Fiscal Council believes that it does not improve the economic environment for small and medium-sized businesses and is a step backwards. Again, it is a measure that facilitates the control authorities, but burdens small businesses with costs.

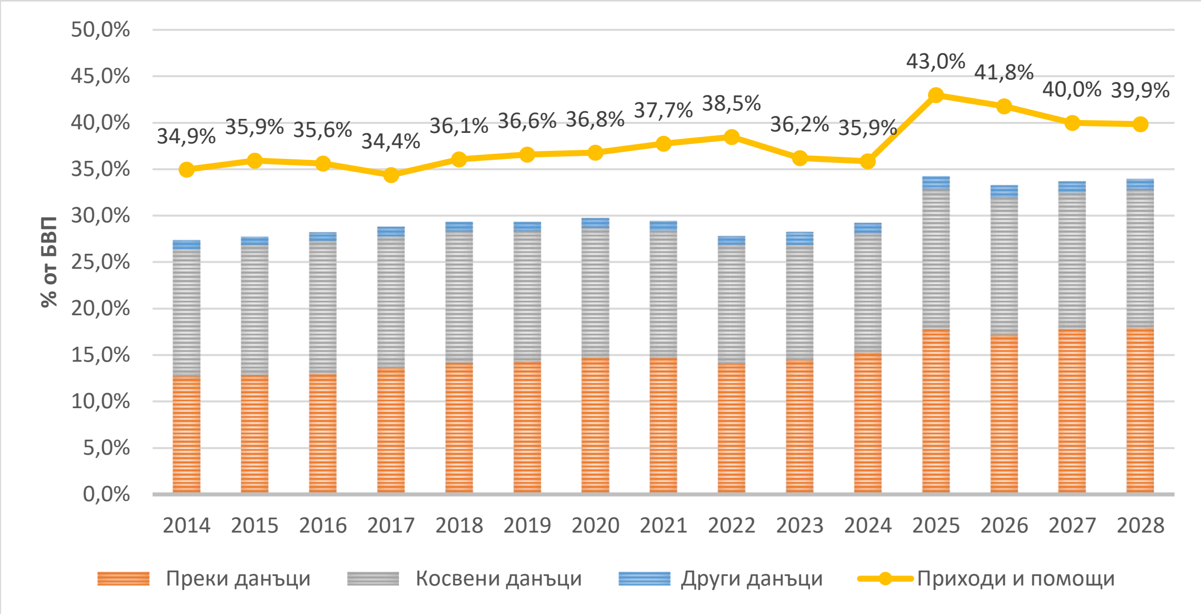
For the fourth consecutive year, it is proposed to pay dividends from state-owned enterprises into the budget at 100%, which puts their management in the medium and long term at risk, related both to the lack of liquidity and the inability to develop and maintain competitiveness.

The level of revenues as a share of GDP for the entire forecast period 2025-2028 exceeds 40% of GDP. It is expected that by the end of 2024 they will amount to 72.2 billion BGN, which is 35.9% of GDP compared to the planned 36.6% GDP. For 2025, 92.4 billion BGN or 43.0% of GDP are planned. At the end of the forecast period, the level reaches 98.4 billion BGN, but marks a gradual decline to 39.9% of GDP.

For 2025, revenues from indirect taxes increase by 15% or over 6.6 billion BGN to 32.3 billion BGN compared to 12.8% or under 3 billion BGN growth in 2024 compared to 2023. At the same time, the macroeconomic forecast assumes an unchanged level of consumption and a very strong boost in investments.

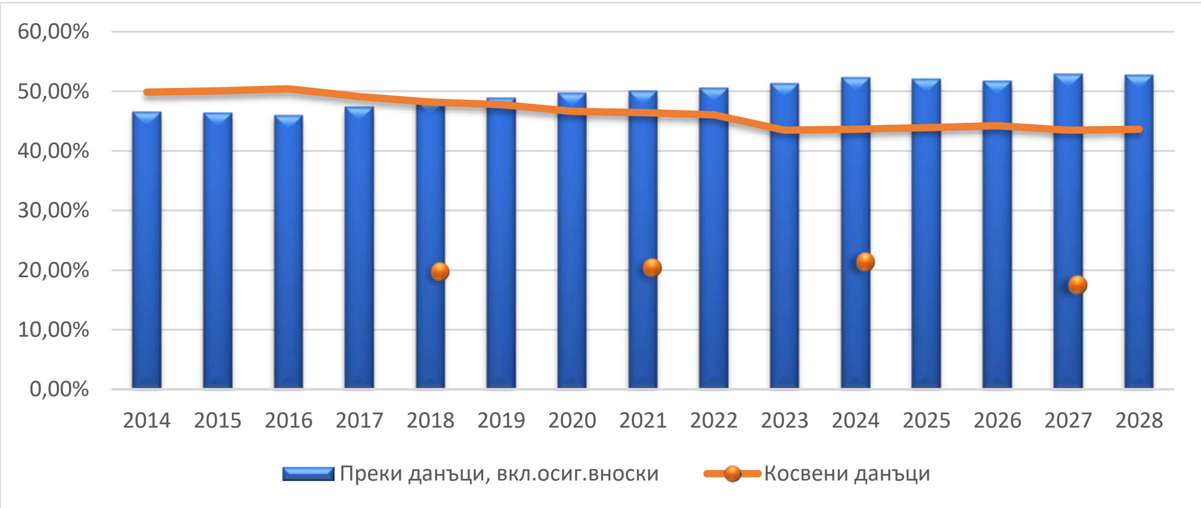
The share of direct taxes in GDP for 2025 (17.8%) continues to exceed that of indirect taxes (15.0%). This trend is expected to continue, with the former expected to increase to 17.9% of GDP by the end of the forecast period, while the latter will slightly decrease to a level of 14.8% of GDP.

Chart 8. Structure by type of revenue as a share of GDP



Source: FC on MoF data

Chart 9. Share of direct and indirect taxes in tax revenues

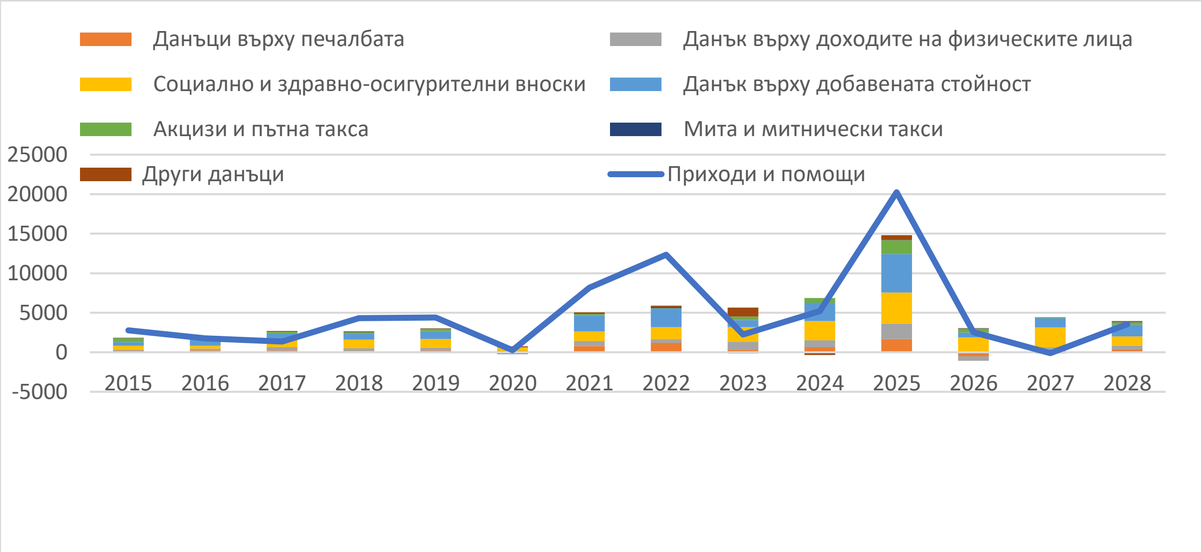


Source: FC on MoF data

We would like to emphasize once again that the increase in the share of direct taxes, including social security contributions, contradicts the idea of stimulating growth and employment.

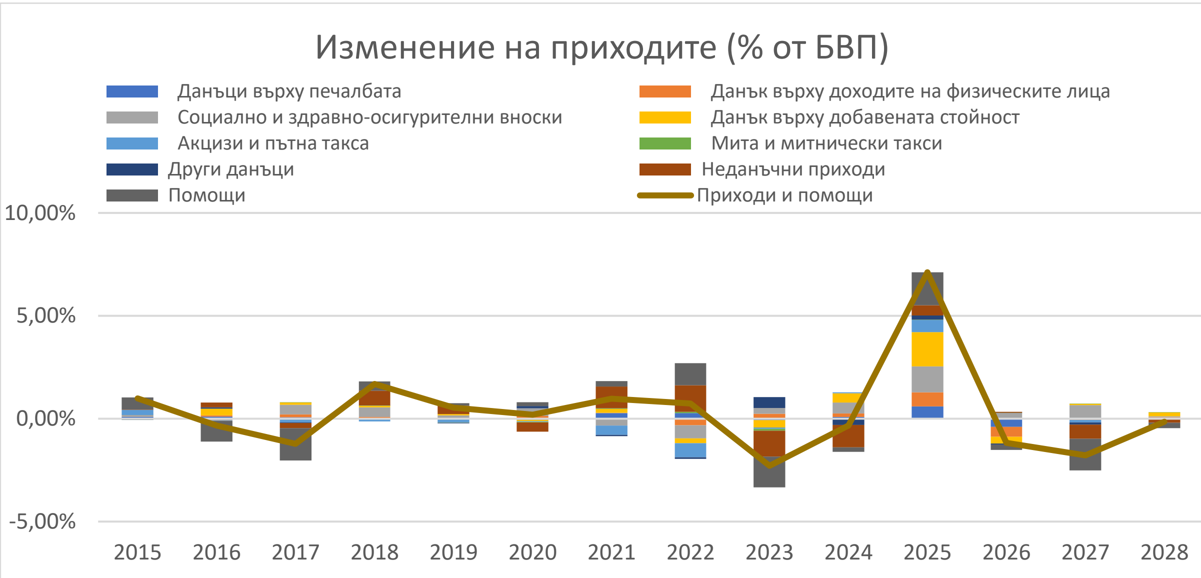
The change in revenues by type of taxes in absolute value and as a share of GDP is presented in Chart 10. and Chart 11.

Chart 10. Change in revenues by type of taxes, million BGN.



Source: FC on MoF data

Chart 11. Change in revenues by type of taxes as a share of GDP



Source: FC on MoF data

3.1.2. Analysis of expenditure under the CFP

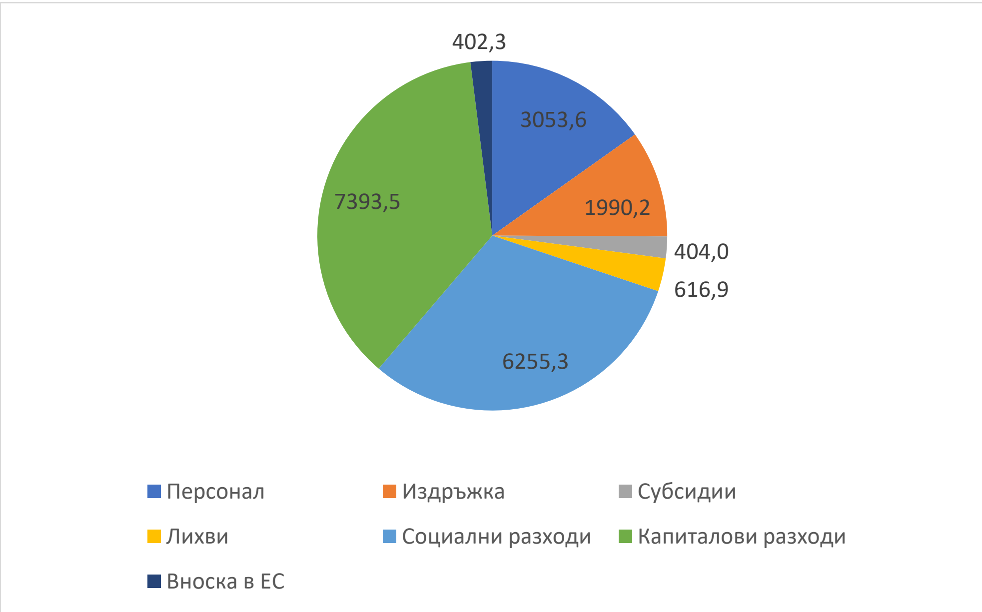
The planned expansion of government expenditure in 2025 is impressive – the public sector reaches 46% of GDP. In the current 2024, the approved government expenditure under the budget amounts to 39.6% of GDP, and the expected implementation is within 39.1% of GDP. **This means that the government sector is increasing by nearly 7% of GDP in just one year, without any extraordinary need for it.** Even during the Covid pandemic, we have not observed such an expansion. The huge growth in expenditure is the reason for such growth on the revenue side, in order to keep the budget deficit within the 3% limit.

As it can be seen from the plan for the coming years, the intentions are to reduce expenditure to 42% of GDP by the end of the forecast period. The contraction of expenditures as a share of GDP will occur rather as a result of the outpacing growth of GDP, since in nominal terms government expenditures increase in each year of the planned period, and in 2028 they will be 103.7 billion leva.

The total increase in expenditures for the four years amounts to 24,905 million leva, with the most serious increase in 2025 – by 20,116 million leva. The planned expenditures under the Consolidated Fiscal Programme for 2025 amount to 98,908.4 billion leva, which, compared to the expected implementation of expenditures for 2024, represents a growth of 25.5%. **The planned growth in expenditures in 2025 is worryingly high.** In the next three years of the forecast, expenditures increase at a much more moderate pace (in 2027 they even decrease).

The analysis of the distribution of additional expenditures of 20 billion leva in 2025 by direction shows that almost 40% of them will be for financing the capital program (7.4 billion BGN), 1/3 of them will finance social expenses (6.3 billion BGN), 15% of the increase or 3 billion BGN are additional personnel expenses and 10% (almost 2 billion BGN) will be for maintenance. The increase in interest expenses and the EU contribution requires another 1 billion BGN.

Chart 12. Distribution of additional expenditures for 2025, million BGN.



Source: FC on MoF data

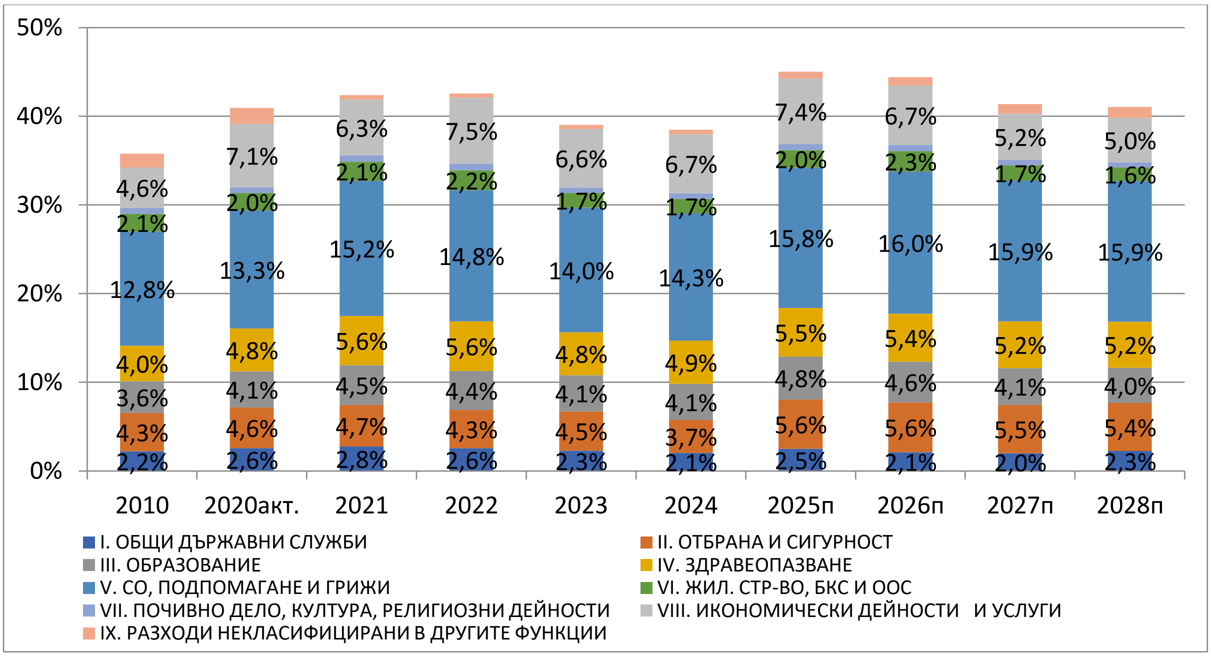
According to the Fiscal Council, the intention to increase personnel costs by 28% in just one year will have a highly pro-inflationary effect, will put strong pressure on the budget annually, and will disrupt the balance of the labor market by placing civil servants in a more advantageous position than those in the private sector.

The percentage increase in capital expenditures is record breaking – by 40% compared to the plan for 2024. In 2024, their share in GDP reaches 4.9%, and in 2025 it already reaches 6.6%. In nominal terms, a growth of 7.4 billion BGN is outlined compared to the expected amount for 2024. It should be borne in mind that the powerful fiscal stimulus for public investments envisaged by the government will lead to a displacement of private investments. In other words, the state takes more resources from the private sector to build public infrastructure.

The structure of expenditures by function shows that expenditures in all functions are increasing. For the total increase in expenditures by 6.5 percentage points of GDP in 2025, the largest contribution is made by defense expenditures with 1.9 percentage points of growth, followed by social expenditures with 1.5 percentage points of growth. After them, with 0.7 percentage points of growth, are economic activities and education, followed by healthcare expenditures with 0.6 percentage points, expenditures for public services with 0.4 percentage points and expenditures for housing construction, household communal economy and environmental protection with 0.3 percentage points. The widespread increase in expenditures is not related to the implementation of reforms and assessment of the effectiveness of expenditures.

In the medium term, by 2028, a reduction in government spending as a share of GDP is planned (mainly due to outpacing GDP growth, not at the expense of reducing spending) in all functions, with the exception of the "Social Security, Assistance and Care" function, which is around 16% of GDP.

Chart 13. Dynamics of the structure of expenditures by function, % of GDP



Source: FC on MoF data

Among the priorities in the spending policy, the "Defense and Security" sector stands out with a nearly 60% increase in spending for 2025. The annual growth in all functions is double-digit. **The Fiscal Council believes that the rates of increase in spending in the 2025 budget are worryingly high, widespread and significantly exceeding the growth rate of the economy. Such a policy will sooner or later lead to the need for a serious increase in the tax burden and puts the sustainability of public finances at risk.**

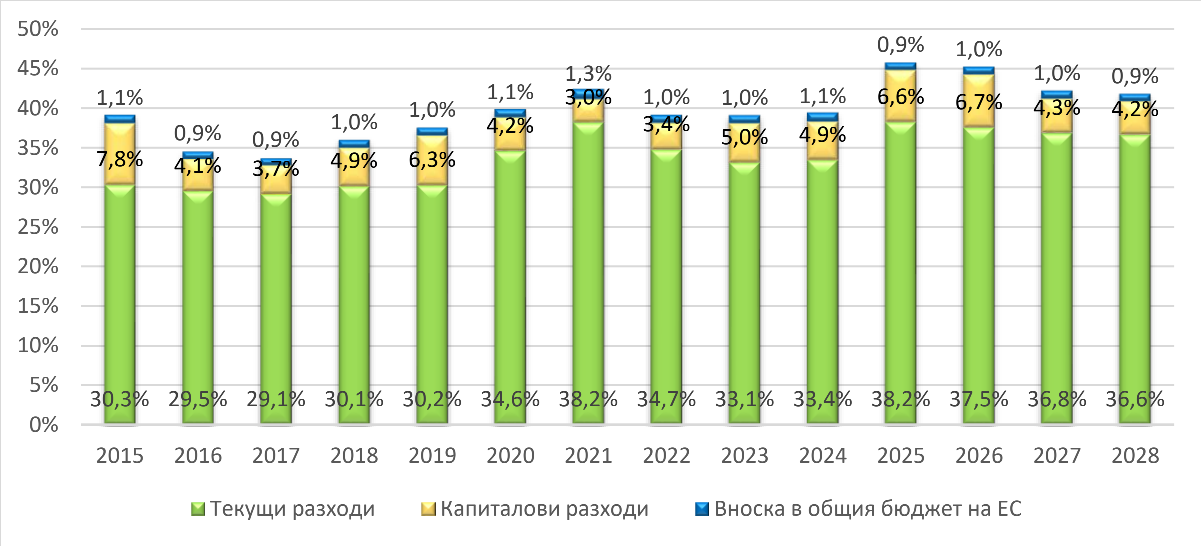
Table 7. Change in expenditures by function 2025/2024.

Consolidated Fiscal Program	2024	2025	Difference, mln. BGN	Difference, %
Expenses by CFP functions	**79 238,0**	**96 887,7**	**17 649,7**	**22,27%**
I. General government services	4 234,4	5 365,8	1 131,4	26,72%
II. Defense and Security	7 601,7	12 030,8	4 429,1	58,26%
III. Education	8 396,1	10 347,6	1 951,5	23,24%
IV. Healthcare	10 024,2	11 837,0	1 812,8	18,08%
V. Social security, assistance and care	29 509,5	34 020,1	4 510,6	15,29%
VI. Housing construction, public works, utilities and environmental protection	3 446,6	4 271,4	824,8	23,93%
VII. Culture, sports, leisure activities and religious work	1 277,4	1 490,6	213,2	16,69%
VIII. Economic activities and services	13 737,5	15 899,7	2 162,2	15,74%
IX. Expenditures not classified in other functions	1 010,6	1 624,7	614,1	60,77%

Another notable increase in pensions is nearly 2.5 billion BGN as a result of the planned increase of 8-9% in implementation of the Swiss rule. The policy of increasing pensions began in 2021 as a continuation of the so-called COVID-19 supplement. From mid-2021 to mid-2024, a total of 5 significant increases were implemented. The application of the Swiss rule leads to an additional significant increase due to the dynamic growth of insurance income, motivated by efforts to preserve the real disposable income of households as a countermeasure to inflation.

The structure of expenses by economic elements is presented in Chart 14.

Chart 14. Expenditure structure by economic elements (% of GDP)



Source: FC on MoF data

With the 2024 Law on the State Budget of the Republic of Bulgaria, lists of priority national and municipal investment projects were published (Appendix 2 and 3). The so-called National Capital Investment The program includes projects financed from the state budget, under programs and mechanisms of the European Union and under other international programs and agreements. In this way, publicity is increased regarding the types of investment projects implemented by individual budget spending units, as well as their value. A resource has been allocated in the central budget, with funds being provided monthly, based on upcoming payments for the projects. The new approach aims to promptly direct funds to projects with higher project preparedness.

However, the mechanism and criteria for evaluating, prioritizing and approving the investment proposals of individual budget spending units remain unclear. In this regard, the Ministry of Finance in 2025 proposes to separate the projects into three categories:

- "Projects related to administrative activities"
- "Projects in the field of electronic governance and information and communication technologies"
- "Strategic investment projects"

It is not clear how the projects from the capital program are grouped into the three categories and what their total value is. There is no total amount for the projects included in Appendix 2 and Appendix 3. The structure by funding sources is also not indicated, as it is often complex - state budget, municipal budget, EU funds, debt, etc.

Regarding the selection of projects, the Ministry of Finance envisages introducing a new provision in the Public Finance Act, which would authorize the Council of Ministers to issue a by-law on the method for evaluating and the procedure for approving public investment projects with national financing.

The Fiscal Council has been recommending for years to improve the process of planning, managing and implementing capital expenditures and approves the concrete steps taken by the Ministry of Finance in this direction. The recommendation to publish a list of strategic investment projects has also been taken into account.

In conclusion, we can summarize that the revenue forecast seems overestimated, expenses are growing at a tremendous pace, the trend of increasing pensions and salaries is maintained, but without reforms to guarantee the long-term sustainability of the system, huge amounts of capital expenditure are planned, which continue to be unimplemented. The policy of maintaining significant deficits continues, which leads to an increase in the government debt in nominal terms and a significant increase in interest expenses (in 2025 alone, they increase by 60%). **The Council considers that this fiscal policy has a strong pro-inflationary impact, therefore it puts at risk compliance with the price stability criterion with a view to Bulgaria's accession to the euro area.**

IV. Discretionary revenue and expenditure measures

Discretionary revenue measures

The net cumulative effect of the discretionary revenue measures for the period 2025-2028 amounts to BGN 6,452.8 million in additional revenue, with the measures for 2025 having the greatest significance. For 2025 alone, discretionary revenue of BGN 7,351 million is expected. Discretionary revenue in 2026 is negative and amounts to a total of BGN 3,053 million, and the reason is the exhaustion of the effect of the one-time revenue from the amnesty in 2025. In 2027, discretionary revenue amounts to BGN 1,696 million and is due to the projected increase in the amount of social security contributions by 2 percentage points and the increase in the maximum social security income, as well as increases in excise duty on tobacco products. In the last year of the plan, discretionary measures are the most modest – only BGN 458.8 million and are due to an increase in the excise tax rate on tobacco products (BGN 300 million) and an increase in the maximum social security income.

Of the specific measures with the greatest fiscal significance, the announced **amnesty** for undeclared, overdue or unpaid debts for taxes, social security contributions and household waste fees is expected to have a net effect of BGN 5,150 million for 2025.

Next in importance for the budget is the measure to **increase the amount of insurance contributions** for the Pension Fund by 3 percentage points from 2026 and by 2 percentage points for 2027. The total revenues for the two years are equal to BGN 2,819 million in additional revenue.

The increase in the maximum social security income has a significant fiscal effect in each of the years in the forecast - a total of BGN 855.2 million in additional revenue will be received over the four years.

Introducing a **tax on underground mineral resources** is one of the proposed measures, from which BGN 900 million are expected in 2025.

A positive effect of BGN 850 million for 2025 is expected from **measures to reduce the share of the shadow economy**, to combat tax fraud, tax evasion, including those included in the Financial Action Task Force (FATF)

The restoration of the standard 20% VAT rate on bread, tourism and restaurant services is a measure that is expected to generate an additional BGN 464.5 million in 2025. The Fiscal Council has repeatedly called for the abolition of reduced VAT rates in its opinions.

The increase in the excise tax rate on tobacco products will bring BGN 300 million in additional revenue to the budget for 2026, 2027 and 2028, or a total of BGN 900 million for the entire period. An increase in excise taxes on alcohol and beer, as well as on cigarettes, is also planned for 2025 alone, from which an additional BGN 370 million is expected.

All proposed discretionary measures on the revenue side lead to an increase in revenues. Only the Energy Program to mitigate the economic consequences of the instability of electricity and natural gas prices has a negative effect on revenues, leading to a decrease in revenues in 2025 by BGN 877 million.

Discretionary expenditure measures

Discretionary expenditure measures amount to almost BGN 3,840 million in total for the entire period, with BGN 2,439 million for 2025 alone. Over the next three years, the net increase in spending is BGN 496.5 million for 2026, BGN 484 million for 2027 and BGN 420.5 million for 2028, respectively. All discretionary spending is of a current nature. In general, discretionary spending arises as a result of an increase in personnel costs.

The costs of **increasing salaries in the Defense and Security sector** represent 85% of all discretionary spending and amount to BGN 3,280 million. For 2025 alone, the additional cost amounts to BGN 2,148 million.

Another significant additional expenditure for the budget in 2025 is related to the **increase in personnel costs in the budgetary sphere by 10%**. The net negative effect on costs is BGN 834.3 million.

In connection with the **increase in the maximum social security income**, additional social security expenses of BGN 131.9 million are planned for the entire period. **The increase in social security contributions** in 2026 and 2027 leads to additional expenses of BGN 180.6 million.

The increases in the number of newly granted pensions and widow's allowances have an effect only for 2025 in the amount of BGN 245 million in additional costs.

Discretionary revenues exceed expenditures by BGN 4,912.1 million in 2025, which at first glance seems to indicate that the government is moving towards fiscal consolidation. In total, for the entire forecast period, the result of government discretion is BGN 2,613 million in additional revenues.

V. Conclusions and recommendations

Based on the analysis prepared, the Fiscal Council formulates the following conclusions and recommendations:

1. Real growth expectations for 2025 appear high due to uncertainties about the absorption of some EU funds, structural problems in some of our EU trading partners and a possible deterioration of the business environment, which would also affect private sector employment and income plans. Inaccurate GDP forecasting compromises the assessment of all other fiscal indicators - revenue, expenditure, balance, debt level, size of the state in the economy, etc.

2. Even the most optimistic projections of GDP growth and inflation for 2025 do not provide any basis for the expected 28% increase in revenues under the Consolidated Fiscal Programme. Such growth is unrealistic and is the most serious threat to the implementation of the projected budget deficit under the Consolidated Fiscal Programme.

3. In the projections for 2025, the deteriorated structural balance reaches record levels. There is a sharp, almost double size increase of the structural deficit and an increasing expansion compared to 2024. The lack of systematicity in the budget approach results in the budgetary policy shifting from

expansionary pro-cyclical in 2025 to contractionary pro-cyclical by 2028. It is not in line with economic developments and the stated monetary policy. The Council reminds that in order to ensure macroeconomic stability and a sustainable long-term trend, the fiscal stance should be countercyclical or, as a least, neutral.

4. In view of the great importance of the amnesty revenues envisaged, which are of a one-off nature and the high risk to their implementation, the Fiscal Council recommends linking them to counterpart one-off expenditures to not be implemented in the event of non-implementation of the amnesty revenues. This will create a buffer to manage the risk of non-compliance with the budget deficit target.

5. The revenue forecast appears to be overestimated, expenditures are rising at a huge pace, the trend of increasing pensions and wages is continued but without reforms, huge amounts of capital expenditure are planned and continue to be under-executed, substantial deficits are maintained and public debt is increasing. The Council considers that the planned fiscal policy has a strong pro-cyclical impact and puts at risk fiscal sustainability in the medium term.

6. Inflation in Bulgaria is declining but still outpacing the EU average. Curbing inflation should be among the main fiscal policy objectives for the next year, as it is the most important criterion to be met for the country's accession to the euro area.

7. The expansion of government spending in 2025 to 7% of GDP entails a major shift in the public/private sector ratio. The public sector reaches 46% of GDP, which is well above the 40% limit set in the Public Finance Act. There has not been such an annual surge in public spending since 1996, and the reason for the spending growth of around 10% of GDP then was interest payments on debt. A large public sector will also constrain economic growth. The Fiscal Council recommends a revision of the expenditure side of the budget, looking for options to optimise and reduce them.

8. According to the Fiscal Council, the intention to increase personnel costs by 28% in just one year will have a highly pro-inflationary effect, will put severe pressure on the budget each year, and will upset the balance of the labour market by putting public employees in a more advantageous position than those in the private sector. The Fiscal Council recommends revising the public sector wage bill commitments.

9. The Fiscal Council recommends that any proposed measures leading to an increase in the purchasing power of the population should be considered very carefully and, if possible, postponed in view of the likelihood of a pro-inflationary impact and the risk of possible non-fulfilment of the euro area membership criteria.

10. Fiscal loosening in recent years has led to a significant increase in debt in nominal terms. The size of the general government debt is growing at an alarming pace, increasing by 64% over the forecast period. Interest expenditure is also rising sharply, by 60% in 2025 alone, and will represent 1.2% of GDP by the end of the projection period. At this rate, Bulgaria could very quickly lose its image as a low fiscal risk country in terms of its indebtedness. The Fiscal Council recommends to approach the increase in the debt burden with caution and not to take on debt to finance current expenditure.

11. The MoF expects the negative balance to increase to 3.3% in 2024, breaching the 3% deficit rule. For 2025, the deficit is projected to be at the edge of the limit, and for 2026 a deficit of 3.6% is projected.

12. In 2020, expenditure made from accounts for European Union funds was excluded from the scope of the Consolidated Fiscal Programme expenditure share rule as a percent of GDP so that it

would not limit the absorption of funds. According to the opinion of the Fiscal Council, the exclusion for European accounts should be removed and the Public Finance Act should be amended because it is contrary to the economic rationale of the rule to limit fiscal expansion and the impact of government spending on macroeconomic aggregates. Despite the change in the scope of the rule, its violation is again observed for 2025.

13. The Fiscal Council considers that the revenue projections in the draft budget are overestimated and unrealistic. The Fiscal Council's alternative revenue estimate for 2025 shows a risk of tax revenue underperformance of up to 8.6 billion levas compared to the published figures to date. The Fiscal Council also cannot validate the revenue estimates or the reliability of the data in the General Government format. For greater transparency, we believe that the MoF should publish a technical section on the transition between the cash format of the Consolidated Fiscal Programme and the 'General Government' format.

14. The Fiscal Council warns that the continued policy of deducting 100% of dividends from State Own Enterprises will lead to their decapitalization, inability to develop and maintain competitiveness in the medium term.

15. According to the Fiscal Council, the set of policies and measures proposed in the Draft Budget 2025 does not meet the economic objectives and problems that the State Budget should address. The Draft Budget does not address in any significant way, either in the revenue or expenditure side, the challenges in the 'Draghi Report' to improve the competitiveness of the economy.

16. The Fiscal Council considers that the proposed tax amnesty undermines the confidence in the tax system and tax administration and may discourage honest taxpayers from fulfilling their responsibilities to the state. The Fiscal Council, after examining international practices, concluded that the country does not have the unusual conditions and prerequisites that would necessitate a tax amnesty. There is a potential risk of an outright loss of revenue due to the Treasury. Such a one-off measure with a significant risk of non-compliance should not be promoted as the main means of tackling the deficit.

17. The Fiscal Council draws attention to the controversial provisions in Section 30 of the Transitional and Final Provisions of the draft law on the State Budget of the Republic of Bulgaria for 2025 concerning the powers of the revenue authorities to conduct search and seizure based on an order of the Executive Director of the National Revenue Agency.

VI. Conclusion

Based on the analysis of draft law on the State Budget of the Republic of Bulgaria for 2025 and Updated Medium-Term Budget Forecast 2025-2028, the Fiscal Council recommends their further revision, taking into account the recommendations in this Opinion.

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