Bulgaria – From Transition to Convergence: The Challenges Ahead

Opening remarks
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Good morning ladies and gentlemen. Welcome to this public seminar jointly organized by the Bulgarian National Bank and the International Monetary Fund. While the substance of the seminar—its purpose, sessions, topics—reflects the shared inputs of both the Governor and his colleagues at the BNB and ourselves, it goes without saying that pulling everything together on the ground here in Sofia was not possible from Washington. So I want to start off by expressing the IMF's gratitude for the tremendous energy and conviction that the BNB has put into orchestrating this event.

A little background to the seminar. Indeed, the timing is noteworthy. With IMF Executive Board approval of the final review under the Stand-By Arrangement in March this year, Bulgaria's relationship with the Fund is shifting from a so-called program relationship to one of surveillance. After about 15 years of successive programs, and especially 10 years since the deep crisis of 1996/97, the moment seemed right to mark this milestone with an event such as this seminar. One option was to look only at the past and to talk about what had worked, and what had not worked, under various IMF programs. But this did not appear to us to hold much promise of yielding useful findings for moving the country forward. So, together with the BNB, we opted for a more forward-looking focus. A forward-looking perspective also seemed most appropriate in view of Bulgarians' understandable exuberance over EU accession and their aspirations for raising their living standards to the ones enjoyed by citizens of wealthier countries. Taking full advantage of the economic opportunities offered by accession, however, will require appropriate policies. While EU membership confers many rights and offers many opportunities, accession is no panacea. It is the aim of this seminar to identify, to the extent permitted by so short an event, how best Bulgaria can tackle the challenges ahead.

Given this aim, how then were the topics decided? Several factors were at play. It’s obvious that a one-day seminar can tackle only so many subjects and issues. For instance, financial sector issues and development of the capital markets would require a full seminar for proper consideration. Second, some issues are more pressing than others. Take for instance population aging. With Bulgaria’s population projected to decline quite substantially over the next 2-3 decades, the economic and public finance implications of the accompanying aging of the population could be enormous. But these effects are far off, and there are more pressing concerns. One obvious preoccupation of policymakers is ERM2 participation and eventual euro adoption, and while Bulgaria is presently in good shape with regard to 4 of the 5 criteria set out in the Maastricht Treaty, inflation remains a challenge. Another near-term concern is of course the current account deficit. The deficit in many respects reflects a lot of positive factors, including especially foreign investors’ favorable outlook for the country. At the same time, the underlying vulnerabilities that accompany the deficit have to be managed carefully.

This brings me to the structure of our seminar today. As I mentioned a moment ago, we need to be forward-looking, to identify the challenges that will confront Bulgarians and the Bulgarian authorities. Nevertheless, it is certainly worth our attention to cull lessons from both Bulgaria's experience under IMF programs and the experiences of other new EU member states' following their accession. This is the subject, then, of our first session.

That there will be challenges ahead is of course obvious; EU membership is no panacea. The authorities have been consistent in their commitment to euro adoption as a strategy for exiting the currency board arrangement. In turn, policies must continue to be tailored to support the currency board. In the absence of monetary policy, fiscal policy will remain the sole macro lever, and the fiscal stance needs to be cast in a medium term context and calibrated so as preferably to avoid, and certainly to minimize, being pro-cyclical. But at the same time, Bulgaria's infrastructure needs are substantial, and spending plans need to be carefully programmed to provide predictability of the public sector's claims on resources, avoid bottlenecks and minimize inflation. The authorities have of course given considerable thought to the overall policy framework, and Deputy Minister Datsov will provide the seminar an overview.

Presently at over 16 percent of GDP, Bulgaria's current account deficit not surprisingly captures attention. For many reasons, the deficit is a natural consequence of forces at work in a transition economy short of savings and capital, and where expectations of rising permanent incomes lead to consumption smoothing over the life cycle. But current account deficits can also reflect a loss of competitiveness, all the more so in an environment of a fixed exchange rate. With investment and consumption needs likely to remain high over the medium term, a substantial boost to exports will be the key to bringing the current account deficit down to a sustainable level. Ms. Rahman of the IMF seeks to shed light on the extent to which loss of competitiveness has or has not been at work in recent years.

Inflation is a challenge for all transition economies, and recent experience in Bulgaria points to risks here too. That the currency board has been instrumental in bringing inflation under control is without question. Indeed, from the stratospheric heights attained in 1997, inflation even satisfied the Maastricht criterion a few years ago. Since then, however, it has crept back up and, while moderate, exceeds the criterion by a wide margin, despite the prudent stance of fiscal policy. We know the potential sources of inflation, including the so-called Balassa-Samuelson effect, rising energy prices, one-off increases due to tax changes or administrative price increases, etc. But how important are these various effects? The paper by my colleague Ms. Zhou will provide some preliminary evidence on some of the factors contributing to inflation in the recent period.

With the exchange rate fixed, there is essentially little alternative to improving the flexibility of the economy for sustaining competitiveness. In turn, enhancing the agility of the Bulgarian economy will require continued vigorous structural reforms in many areas. While structural reforms are central to maintaining competitiveness, sustaining reform momentum is also likely to become increasingly challenging. Indeed, the depth and breadth of the built-up inefficiencies prior to the 1997 crisis made possible huge efficiency gains achieved during the early years of reform. Empirical studies find clear evidence that total factor productivity growth was the main source of growth during the post crisis period. Reform momentum is perhaps understandably greater in the immediate aftermath of a crisis, when the need for drastic action is most obvious. Although structural reform continued to progress under the successive programs with the Fund, there has been some evidence that reform fatigue may be setting in. Structural reform is of course a serious challenge everywhere, given the strong political incentives of vested interests and intrinsic preference for the status quo; no country is immune from reform fatigue. In view of Bulgaria's monetary framework, however, there is little choice but to persevere with needed reforms to both product and labor markets. The final substantive session—on the political economy of reform—will bring together a diverse group of informed persons from both the public and private sectors to help inform us about the political economy of reform in Bulgaria, with the aim of identifying ways of sustaining the reform momentum going forward.

With these few words aimed at providing a "road map" for today's seminar, I want to again welcome everyone, and I look forward to enlightening presentations and productive discussions today.

Thank you.