

EU ACCESSION CANDIDATES: MORE PROGRESS NEEDED IN THE POLITICAL AREA, BUT GOOD ECONOMIC PERFORMANCE

Bulgaria: Government budget in surplus

Based on the findings of the EU Monitoring Report of September 26, Bulgaria must make further efforts at judicial reform and the fight against organised crime and corruption. In the area of money laundering, Bulgarian legislation is now largely in line with the *acquis communautaire*. Implementation of legislation, however, is limited to date and so far no successful prosecutions for money laundering can be reported.

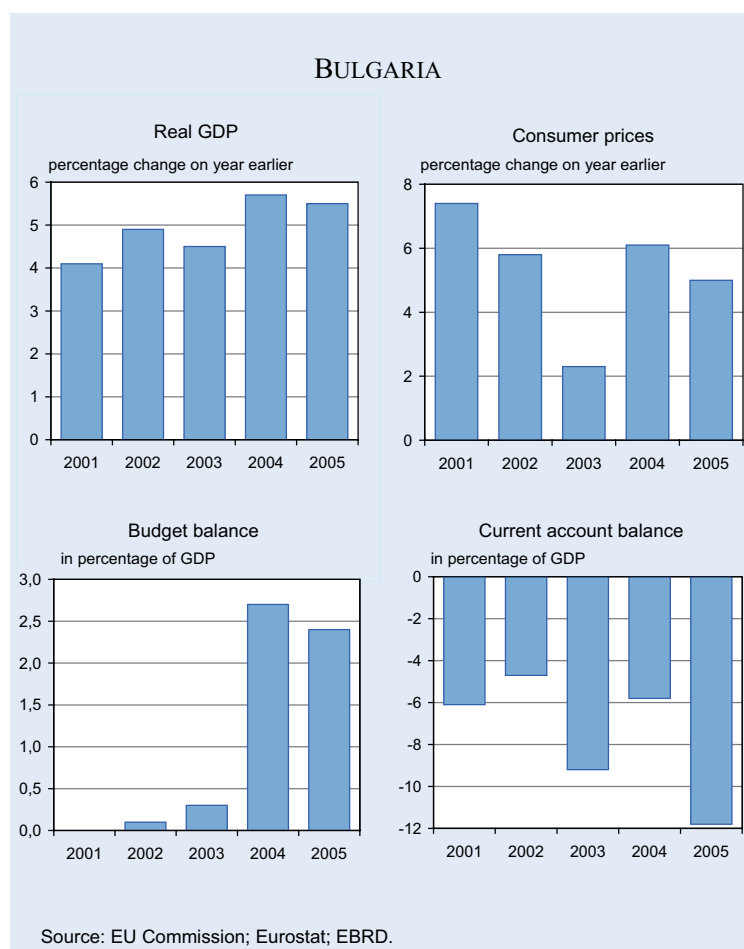
In contrast to the political area, Bulgaria has made substantial progress in the economic area. Useful steps were taken to contain the external deficit. The privatisation process and the liberalisation and restructuring, notably of utilities, have well advanced.

Some additional progress has been made in improving the business environment and in reducing non-wage labour costs. However, the current account deficit widened warranting continued prudent fiscal and wage policies. Regarding the structural reforms, further easing of the regulatory burden on business is required. The labour market also needs to be made more flexible.

The macroeconomic situation shows GDP growth at 5.5 percent for 2005 and an estimated 5.4 percent in 2006. Economic growth is mainly driven by strong investment growth as well as by a rebound of consumption. The catching-up in terms of GDP per capita, however, has been slow reaching 32.1 percent of the EU-25 average in 2005. The gap between imports and exports of goods and services increased further to 20.2 percent of GDP for the full year 2005. The current account deficit widened accordingly to 11.3 percent of GDP. Average consumer price inflation dropped from 6.1 percent in 2004 to 5 percent in 2005. The unemployment rate (ILO methodology) declined further to reach 9.0 percent of the labour force in the second quarter of 2006, compared to 10.1 percent in 2005 and even 12.0 percent one year earlier.

Apart from sustained job creation in the private sector, this seems to be due also to an increasing shift of informal employment to the formal sector, following the reduction of social security contributions at the beginning of 2006. Real annual average wages grew by around 4.1 percent in 2005 and thus largely in line with productivity gains.

Following a better than expected revenue performance in 2004 and 2005, the general government balance achieved a surplus of 2.7 percent and 2.4 percent of GDP respectively. In 2006 a further government surplus of 3.3 percent of GDP is expected. Public debt has continued falling from above 100 percent of GDP in 1997 to 29.8 percent of GDP in 2005.



Romania: Sectoral restructuring

A liberal “Government programme” was adopted on 28 December 2004. The period 2005 to 2008 is presented as the “second modernisation of Romania”. The September 2006 Monitoring Report confirms that Romania made further progress to complete membership preparations, notably in the key areas of justice and the fight against corruption, demonstrating its capacity to apply EU principles and legislation from the accession date.

In Romania, too, economic performance has been remarkable, although the gap of GDP per capita at 32.9 percent of the EU average remains wide. In the first half of 2006, GDP grew by 7.4 percent, up from 4.9 percent in the same period of 2005. In the same period, industrial production grew strongly by 7.1 percent y-o-y, despite the reallocation of output growth from labour-intensive sectors such as textiles, clothing and footwear to capital and technology-intensive ones such as automobiles, car parts, equipment and appliances. Growth continued to be driven by strong domestic demand in the second quarter of 2006. Private consumption increased by 12.7 percent

while the growth of gross fixed capital formation remained equally vigorous at 12.2 percent. Although imports expanded more than exports, the trade deficit widened further to around 10.9 percent of GDP in the second quarter of 2006. The current account deficit stood at 8.7 percent of GDP in 2005 and at 9.8 percent in the second quarter of 2006. Registered unemployment stood at 5.1 percent in July 2006, lower by 0.5 percent points than one year earlier. Deflated by consumer price inflation, average net real wages in July grew by 8.6 percent over one year earlier.

The 2005 end-year inflation stood at 8.6 percent, missing the target that had been initially set at 6 percent by the central bank. The relatively restrictive monetary stance adopted in the first half of 2006 led to a decline in CPI inflation to 6.0 percent y-o-y in August. The more rapid than expected disinflation process was also supported by the rescheduling of increases in administered prices and the appreciation of the currency.

In the fiscal notification submitted in September 2006, the Romanian authorities revised upwards the general government deficit for 2006 from originally 0.5 percent of GDP to 2.5 percent of GDP. This pro-cyclical policy deviates from the medium-term fiscal policy earlier presented by Romania. It creates a higher risk of exceeding the 3 percent of GDP reference value for the budget deficit in the future. Budgeted expenditures were increased by nearly 3.5 percent of GDP, of which 0.4 percent of GDP is for higher public wages.

