Canadian NATO
Parliamentary Association

Association parlementaire
canadienne de l'OTAN

Report of the Canadian Parliamentary Delegation respecting its participation at the Sub-Committee on East-West Economic Co-Operation and Convergence

Canadian NATO Parliamentary Association (NATO PA)

Sofia, Bulgaria
April 27-29, 2010

Report

The Canadian NATO Parliamentary Association has the honour to present its report on the meetings of the Economics and Security Committee's Sub-Committee on East-West Economic Co-Operation and Convergence, held in Sofia, Bulgaria April 27-29, 2010. Canada was represented by Mr. Sukh Dhaliwal, M.P.

Bulgaria is a middle sized European country with a population of roughly seven million people. 83% of that population is ethnically Bulgarian, 9.4% are Turkish, and 4.7% are Roma. Bulgarians pride themselves on a tradition of tolerance and good interethnic relations and this remains an important source of domestic stability.

ECONOMIC OVERVIEW

The country today confronts serious economic challenges. Its per capita income stands at 47% of the average for the EU 27. Joining the Euro area has been a consistent goal for the nation and towards that end, the government created a currency board in 1997. This tied the value of the leva to the euro and thereby stripped the state of any power to set interest and exchange rates. The only powerful monetary tool the state wields is the power to set minimum reserve requirements. The exchange rate is locked at euro 1.95 and inflation today stands at 2.4%

The country's oldest public institution is the central bank. Its primary goal today is to maintain the current exchange rate until the euro is adopted as the national currency. This compels the government to pursue tough and consistent fiscal policies. The government is determined to join the euro and sees this as inevitability. The goal had been to adopt the euro in 2007, but political factors are slowing the process. The current difficulties in the Euro area are also complicating factors.

Bulgaria has been very consistent in its approach to the euro which it aims to adopt as soon as conditions are ripe for accession. It has maintained a currency board arrangement and will do so until it is able to adopt the euro formally. The fixed exchange rate means that the country is essentially operating as if it were already in the Euro zone and the current arrangements have forced important adjustments on the national economy and on policy makers. It is generally seen to have been a successful policy although it has meant that Bulgarian officials have not had the option of depreciating the currency in difficult times. It has rather liberalized the labour market, imposed fiscal discipline and sought to improve the business climate as ways to bolster national competitiveness. The EU has allowed Bulgaria to maintain the currency board rather than moving to the ERM II. This has allowed the country to adopt a fixed exchange rate until adopting the euro, which Bulgarian officials had long hoped would happen 2010. This has now been postponed partly because of the unsettled condition of international exchange markets.

Bulgaria's economic structure is weighted toward manufacturing which accounts for 16% of GDP. Transport and communication generate 9.5%, trade 8.9% real estate.8.5%, financial intermediation 7.9%, public administration 7.2%, agriculture and forestry 6.8%, electricity, gas and water supply 4.5% education 3.7% and health care 2.5%. Bulgaria is an important producer of steel, copper, zinc and other metals and mining generates 1.7% GDP.

Over the past two decades, Bulgaria has orchestrated a massive reorientation of its trade. Commercial exchange was one largely limited to the COMECON countries but today Bulgarian exports and imports are largely western oriented. The country's primary trade partners are Germany, Italy, Greece, Romania and Turkey. Russia remains an important supplier of energy imports and accounts for 16% of Bulgarian imports but only 3% of exports. By contrast 65% of Bulgaria's trade today is with the EU-a relationship which the currency board peg reinforces. Most invoices are registered in Euros. The Balkan region including Turkey is Bulgaria's second largest regional trading partner, accounting for 15% of the country's trade. The figures for China and the United States are 5% and 2% respectively.

The EU accounts for 85% of the total foreign investment flowing in Bulgaria. Among EU countries, Austria is the largest investor followed by the Netherlands, the United Kingdom, Greece, Germany and Cyprus. The United States accounts for only 4.4% of FDI. Financial intermediation attracts 24% of all FDI followed by real estate and business activities, manufacturing, transport and communication. Large capital inflows in 2008 drove up prices and inflation, which that year reached 12%. It subsequently fell dramatically in 2009. The EU average today is 1.2% and the expectation is that Bulgarian inflation will rise to 2.4% this year.

The crisis in Bulgaria accelerated after the collapse of Lehman Brothers in New York; after growing by 6% in 2008, it then shrank by 5% in 2009. The crisis first became apparent in Bulgaria when exports fell in October 2008. This was followed by an ever-mounting contraction of financial flows. By the first quarter of 2009, domestic demand and export revenues had begun to collapse and the government was compelled to reduce spending to ensure the country's sustained fiscal health. The fall in domestic demand, however, has kept external imbalances in check. Bulgarian savers did not have the reserves to bolster demand. By the second half of 2009, job losses began to mount with unemployment reaching 7.9% in the fourth quarter of last year. The unemployment rate for 2010 will likely hit 8.8% although this is below the European average. Relative to many other transition economies, Bulgaria's labour markets have fared rather well. Exports are now starting to recover and Bulgaria has enjoyed four months of export growth. The economy is forecast to grow at 1% this year and 4% in 2011.

The governments of Bulgaria have consistently pursued tough fiscal policies. In 2007 the budget surplus was over 3%. In this election year, initial government reports did not include anticipated outlays for a range of projects. When those costs were factored in, the deficit jumped to 3.9%. This is nonetheless a relatively small deficit. Bulgaria thus has one of the lowest budget deficits in Europe and outperforms most European countries in this regard, with the exception of Sweden and Estonia. The government has steadfastly remained compliant with the stability and growth pact targets and is very dedicated to qualifying for Euro membership. Indeed government policy is backed by a strong social consensus on the need to pursue anti-inflationary policies, which is partly inspired by the severe consequences of the inflationary crisis of 1997. The ratio of gross government debt to GDP has improved dramatically. It was once over 100%, and in 2010 will stand at 15.3%. The current account deficit has declined dramatically over the past two years, a trend driven by falling foreign direct investment. That deficit stood at

24% of GDP in2008, 9.4% in 2009 and will likely be 6% in 2010. Foreign reserves, however, have remained fairly constant. Bulgaria's total debt stands at roughly 100% of GDP, although this is not considered a serious vulnerability for the country. Roughly 42% of this debt originates in intercompany loans. Recently interest rates have begun to stabilize and are now falling while equities prices are beginning to rise.

The standard of living in Bulgaria remains low relative to that of its European partners. The average monthly salary is roughly 350 Euros, and pension payouts are one third of that. This can be a source of anger and frustration and sometimes the currency board is blamed for the difficulties. But there is a strong anti-inflationary bias in the country because of the ill effects of the financial crisis of 1996-1997.

The Bulgarian banking sector is very tightly regulated and well capitalized. This has helped insulate the country from the worst effects of the global financial crisis. For all intents and purposes, Bulgaria has not suffered a financial crisis although the real economy has undergone a significant fall in domestic and international demand. Bulgaria's banking sector has remained robust as very strict reserve requirements essentially cordoned off the country from financial contagion. Capital adequacy requirements (17%) significantly exceed the Basle ratio. There are 24 banks operating in Bulgaria, and 81% of these are EU based. Bulgarian owned banks make up 16% of the total.

Bulgaria did, however, suffer a very serious banking crisis in 1997, and this helped lay the foundation for important macro-economic and regulatory reforms. Greek investors have been partially active in Bulgaria and Greek banks play an important role there as well, although they are subject to Bulgaria's strict rules.

Corruptions in Bulgaria, and particularly problems in the judicial branch, have complicated relations with the EU. The current government is confronting this in an open fashion and is now reforming the pre-trial process of investigations, which have posed real problems in Bulgaria. But the political challenge goes beyond this particular matter and obviously the serious situation in Greece has put the Euro accession on hold for the moment. The impact of the Greek crisis is particularly evident in the southern Bulgaria where there is a greater presence of Greek companies, some of which have lay off workers or ceased paying salaries.

Bulgarian officials feel that they have resisted contagion from the Greek crisis largely by managing its budget in an austere manner, imposing tough controls on the banking sector and ensuring a degree of flexibility in key markets including the labour market. Government debt is low by any standard of comparison and much of that debt is intercompany debt. One third is market debt and most of this is of a long-term nature.

As suggested above, there were some concerns that Bulgaria had abruptly revised its figures on the deficit. In fact, the previous government had engaged in several public spending projects that were not reported on the initial estimates as the funds had not yet been disbursed. The new government revised the numbers. The preliminary numbers suggested a deficit of 1.9% but the final announced deficit was 3.95% which included works concluded but not yet settled. The government has made its declaration on an accrual basis to be totally transparent — something that was seen as particularly important in light of the Greek crisis which is partly rooted in fundamentally inadequate budgetary reputing.

The economic and political situation in Bulgaria was also the focus of discussions with parliamentary representatives from both opposition and governing parties held at the parliament. Bulgarian politicians are clearly worried about the situation in Greece which is an important neighbour and partner country. If the crisis worsens, the political fallout could have serious implications for the region. The crisis is also leading to uncertainty about Bulgaria's ambitions to join the Euro area anytime in the immediate future. Some in the opposition are also expressing reservations about the austere fiscal environment, and some of the specific spending choices the government has made.

Over the long run, Bulgarian officials would like to build a more diversified national economy which is somewhat less reliant on real estate and banking, both of which have attracted significant levels of foreign direct investment. Business outsourcing represents a potential growth industry given the advanced technical skills of Bulgarian workers and the low cost of doing business in Bulgaria. There is some confidence that Bulgaria can compete with countries like India in this field and a number of high tech multinationals have indeed established regional offices in the country.

Bulgaria is very dependent on natural resource sales while innovation industries generate far less national income than in most EU countries. Bulgaria's economy is also heavily dependent on capital intensive industries which generate 25% of GDP as opposed to the 19% EU average. Although capital intensive industries have grown in recent years, they do not create many jobs. This is why the county's leaders are looking to higher technology sectors where job creation might be more robust. Energy saving green technologies may also hold some promise.

ENERGY

Bulgaria is pushing to increase the share of renewable sources in its overall energy basket. The goal is that renewable energy will account for 16% of energy use by 2020. Bulgarians have suffered terrible consequences when Russia has cut off gas supplies, and its leaders are determined to build in redundancies to the national energy structure as a hedge against future Russian gas cut offs. Diversification of gas supplies, the construction of reverse flow energy interconnections with neighbouring countries, constructing an LNG terminal and improved gas storage are all critical priorities. Bulgaria strongly supports both the Nabucco and South Stream gas pipeline projects and would host both on its territory. It would like to see far greater transparency in the operation of energy pipelines in Europe and feels that transmission system operators should be independent of energy producers.

CONCERNS OVER THE RESET OF RELATIONS BETWEEN RUSSIA AND UKRAINE

Bulgarian officials and members of parliament have been very concerned about the situation in Ukraine. The recent chaos in the Ukrainian parliament and the decision of the government to sign a very long naval basing lease with Russia is worrying. An unstable Ukraine would pose serious problems for the Black Sea Region. Although Bulgarian officials recognize that settling the energy dispute between Russia and

Ukraine will stabilize supplies to Bulgaria itself, there are some concerns that this decision was made without achieving a genuine consensus in Ukraine itself. Indeed that country is terribly divided politically, and these fault lines could ultimately prove destabilizing. Russian energy policies have at times very adversely affected Bulgaria and the country has seen its energy supplies surreptitiously cut off as a result of disputes to which it was not a party. Russia's policies in the Black Sea are also a source of concern, particularly in the wake of Russia's aggression in Georgia and its plans to build or upgrade bases in Abkhazia and Ukraine. Russia is also refusing to renew its participation in CFE Treaty arrangements, and this could trigger an arms race in the region.

DEFENCE ASPECTS

Members of the delegation had an opportunity to observe a joint Bulgarian US military exercise — Thracian Spring. This is an annual training exercise designed to help Bulgarian forces become more interoperable with their NATO allies. The exercise this year was run out of the Plovdiv International Airport and Krumovo Airbase. It engaged members of the US Air force and the Bulgarian Army, Air force and Navy in exercises to train Bulgarian paratroopers, pilots and support crews in a range of different of jumps including night jumps. These jumps were made from the American Hercules aircraft. The goal was to perform these jumps to NATO standards, to exercise the conduct of tactical tasks and mission planning, share maintenance and support experiences, improve force interoperability and share airlift experience techniques and procedures. 350 Bulgarian paratroopers participated in the exercise.

A key priority for the MOD is to develop modern and efficient management structures to improve the capability, performance and efficiency of Bulgarian armed forces. NATO and Euro-Atlantic security and defense play a central role in defense planning and Bulgarian officials strive to ensure that Bulgaria remains a consistent and reliable ally.

The global financial crisis has compelled defense officials to make tough cuts and defense spending in 2010 stands at 1.4% of GDP as opposed to 2.4% in 2009. Of course these spending reductions will complicate efforts to upgrade force management systems, modernize national forces and improve interoperability — all of which remain important priorities. Defense leaders are seeking new helicopters for the air force and navy as well a new transport aircraft and a multi-role fighter. The financial crisis will delay some of these acquisitions and has also been a factor in personnel reductions. Over the past decade, Bulgarian authorities have implemented far tighter financial controls over defense spending procedures to ensure more effective use of scarce resources and to make corruption more difficult.

Since Bulgaria moved to an all-volunteer force, the number of military personnel has fallen 32%. The previous government had set social goals within the defense budget list of priorities including housing for soldiers. The current government has decided to cut many of these programs simply because they were too expensive. A central priority for the Ministry is to make Bulgarian force interoperable with NATO and prepare that force for critical missions including those outside of the NATO area. Force modernization is critical but financial constraints are obviously impinging on the capacity of the state to affect these changes. The MoD currently hopes to acquire a multi-role fighter and new helicopters as well as new transport aircraft and transport vehicles.

Bulgaria has deployed troops to Afghanistan but the mission in not popular in the country. The government accepts it as a critical obligation and recognizes that NATO must succeed in its mission there. Members of parliament expressed concern about the corruption problem in Afghanistan and feel that poor governance there is undermining the NATO mission. Bulgarian soldiers are serving in Kabul and Kandahar. A decision will soon be made whether or not to increase the size of the Bulgarian contribution in Afghanistan.

BULGARIA'S VIEWS FOR THE NEW NATO STRATEGIC CONCEPT

Bulgarian authorities believe that Article 5 should remain at the very core of NATO's strategic functions and have pushed to reaffirm this in the new strategic concept. The government accordingly supports the notion of bolstering NATO's Article 5 capabilities and for this reason would like to see an anti-missile system capable of working with the US system developed as a pan-NATO project. Bulgarian officials take it for granted that Iran aspires to develop a nuclear weapons capability. Equally Bulgaria supports the principle that NATO retain the right to deliver military infrastructure to all new member states and it is delighted to host US joint facilities on its territory. This is indeed a core priority for many new member states. Bulgarian officials are also very wary of dismantling the tactical nuclear deterrent on the continent without clear evidence of reciprocity.

Article 4 must also be reaffirmed and Bulgaria is particularly keen on the Alliance making energy security a key priority. Bulgarian officials are adamant that diversifications of energy resources, supply and delivery systems are essential to security.

Bulgaria strongly supports NATO enlargement and is prepared to welcome new members from the Western Balkans and the Black Sea Region as long as those countries are fully dedicated to accession and are able to meet the criteria for membership. Bulgarian officials also strongly advocate deeper military and strategic cooperation between NATO and the EU. The current level of cooperation is unsatisfactory and the monthly meeting of the capabilities group is not encouraging the kind of cooperation some had expected it would. Bulgarian officials want to ensure that the Black Sea is considered part of the Euro-Atlantic space, and security there should neither be regionalized nor seen as a potential zone of influence for one or two countries.

Respectfully submitted,

Mr. Leon Benoit, M.P.
Chair
Canadian NATO Parliamentary Association (NATO PA)

Travel Costs

ASSOCIATION	Canadian NATO Parliamentary Association (NATO PA)
ACTIVITY	Sub-Committee on East-West Economic Co-Operation and Convergence
DESTINATION	Sofia, Bulgaria
DATES	April 27-29, 2010
DELEGATION	
SENATE	
HOUSE OF COMMONS	Mr. Sukh Dhaliwal, M.P.
STAFF	
TRANSPORTATION	**$9,158.00**
ACCOMMODATION	**$148.79**
HOSPITALITY	**$0.00**
PER DIEMS	**$731.75**
OFFICIAL GIFTS	**$0.00**
MISCELLANEOUS / REGISTRATION FEES	**$0.00**
TOTAL	**$10,038.54**