
LOCAL FINANCES IN BULGARIA ON THE THRESHOLD OF THE THIRD DECADE AFTER THE REFORMS IN THE SECTOR

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Abstract: Thirty years after the Fiscal Decentralization began, the process of imposing the principles of local self-government in the Republic of Bulgaria and the policy of expanding local autonomy are still incomplete. The aim of this study is to present the state of local finances in the structure of public finances in Bulgaria and through appropriate tools to position our country towards the rest of the EU countries, outlining the achievements and weaknesses in the sphere of fiscal decentralization over the past 10 years. The analysis is based on a toolkit assessing the quantitative indicators of fiscal decentralization, respectively local autonomy, and results in identifying deceleration of fiscal decentralization at the macro level, incl. in Bulgaria, which requires a rethinking of the philosophy of operation of the tax system in our country in order to bring the results closer to the EU average.

Keywords: : fiscal decentralization, municipalities, local revenues, tax autonomy, local taxes.

1. INTRODUCTION

Thirty years after the Fiscal Decentralization began, the process of imposing the principles of local self-government in the Republic of Bulgaria and the policy of expanding local autonomy are still incomplete. The effects achieved in the post-1991 period (when the new Constitution of the Republic of Bulgaria laid down the guiding principles of local self-government) to this day are an indisputable fact, but the growing expenditure responsibilities of municipalities and the limited opportunities for self-financing make the issue of their dependence on the central government increasingly pressing.

At present, all EU countries have ratified the ECLSG and are embracing the idea of extending the powers of local authorities to “manage a substantial share of public affairs” (European Charter of Local Self-Government, Art. 3, 1985). The process of fiscal decentralization in Europe began with the preparation and signing of the ECLSG in 1985 by 7 European countries, among which Austria, Denmark and Germany and it is still going on. The Charter has been ratified by all EU Member States chronologically, as well as by a number of other European countries, the last of which was San Marino in 2013.

2. MATERIALS AND METHODS

The analysis is based on a toolkit assessing the quantitative indicators of fiscal decentralization, respectively local autonomy. These are the indicators for: revenue and expenditure decentralization, significance of local revenues and expenditures in the public sector and tax autonomy of the ‘Local Government’ sub-sector. Each of these per se has informational significance and, studied jointly and within the European practice, can confirm/reject the hypothesis of slowing down the fiscal decentralization process in Bulgaria in recent years. In terms of methodology, the study is based on scientific literature from Bulgarian and foreign sources. The analysis relies on publicly available financial information and uses dynamic, structural, comparative and coefficient analysis, deduction and induction methods, graphical method, and statistical analysis methods.

3. DISCUSSIONS

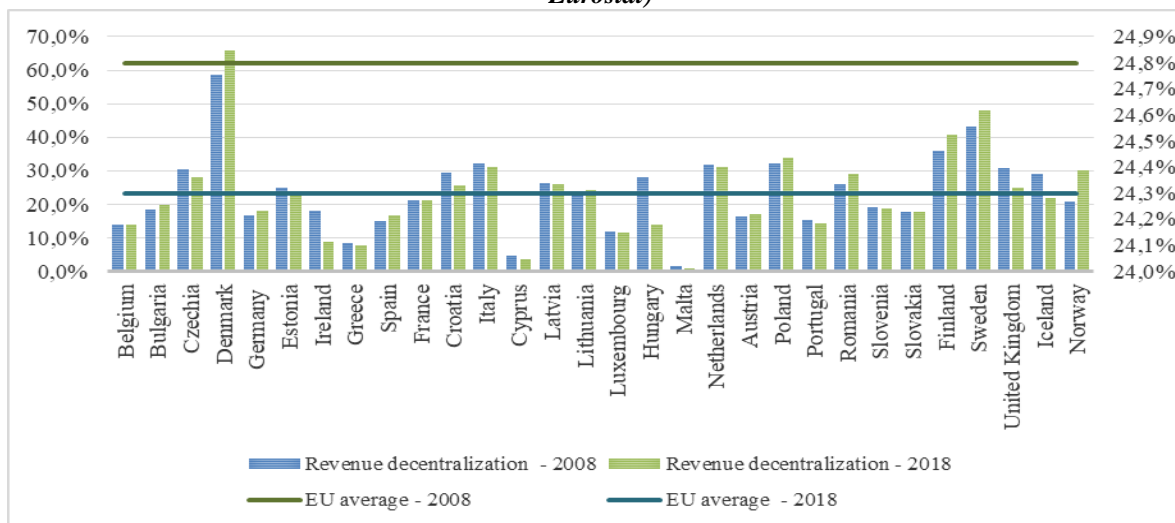
In Bulgaria, this process has been going on for nearly three decades and in this aspect the research and evaluation of the achievements in the area of local finances are of interest. The analysis of the latter has been the subject of study by a number of researchers, most of whom have focused on: funding opportunities for local governments in Macedonia, Bulgaria and other European countries (Milenkovski et al, 2016, pp. 1-11.), tax autonomy in the EU (Prodanov & Naydenov, 2020, pp. 20-42), debt financing and capacity of Bulgarian municipalities (Zahariev et al, 2020, pp. 40-60), fiscal rules and responsibilities in the EU (Lilova et al, 2017, pp. 31-39). The aim of this study is to present the state of local finances in the structure of public finances in Bulgaria and through appropriate tools to position our country towards the rest of the EU countries, outlining its achievements and weaknesses in the sphere of fiscal decentralization over the past 10 years.

4. RESULTS

4.1. Trends in revenue and expenditure decentralization

The quantitative assessment of **revenue** decentralization within the EU in 2008 and 2018, measuring the contribution of local revenues to the structure of total revenues under the Consolidated Fiscal Programme (CFP), is presented in Figure 1. According to the latest data, the coefficient of **revenue** decentralization in Bulgaria is 19.8%, and is 1.4% higher than the initial value in 2008. The results in France, Germany, Slovenia, where the studied indicator assumes values between 18.1 and 21.3% according to the latest data are comparable to the Bulgarian results. There is a clear deviation from the European average among a significant number of EU countries. For example, in 2018, revenue decentralization in only five EU countries deviated from the European average (-2% to +2%): Estonia, Latvia, Lithuania, the Republic of Croatia and the United Kingdom. Ten years earlier, there were four countries – Estonia, Latvia, Lithuania and Romania. With this in mind, the countries have to be divided into groups in order to monitor how each country managed to increase the of revenue decentralization for ten years (2008-2018). The object of study are the EU countries, and the cluster analysis is based on the deviation from the European average during the first year of study – 2008, and the last one with complete up-to-date data (2018). In 2008, more than half (16) of the 30 surveyed countries had values of revenue decentralization below the EU average – 24.8%. These countries are divided into two cluster groups – countries with more than 10% deviation below the average (Cluster 1) and countries with up to 10% deviation below the average (Cluster 2). The findings are that in Belgium, Ireland, Greece, Cyprus, Luxembourg, Malta and Portugal the revenue decentralization has a high deviation, whereas in Bulgaria, Germany, Ireland, Spain, France, Lithuania, Austria, Portugal, Slovenia, Slovakia and Norway the indicator deviates slightly, respectively gets closer to the EU average. The countries whose values of revenue revenues of the ‘Local Government’ sub-sector, respectively the coefficient decentralization exceed the EU average prove successful in the process of fiscal decentralization. In 2008, these were 14 countries of which the Scandinavian ones – Denmark, Finland and Sweden (see Appendix 1) had the best results. Ten years later, a smaller number of countries fall into Clusters 3 and 4 of the analysis. Estonia, Hungary and Iceland lost their place at the expense of Norway. On the other hand, 18 of the countries analyzed had revenue decentralization values below the EU average of 24.3%, with a deviation ranging from -0.2% for Lithuania to 23.2% for Malta (see Appendix 1).

Figure 1. Revenue decentralization – territorial aspect – EU, time aspect – 2008 and 2018 (Data source – Eurostat)

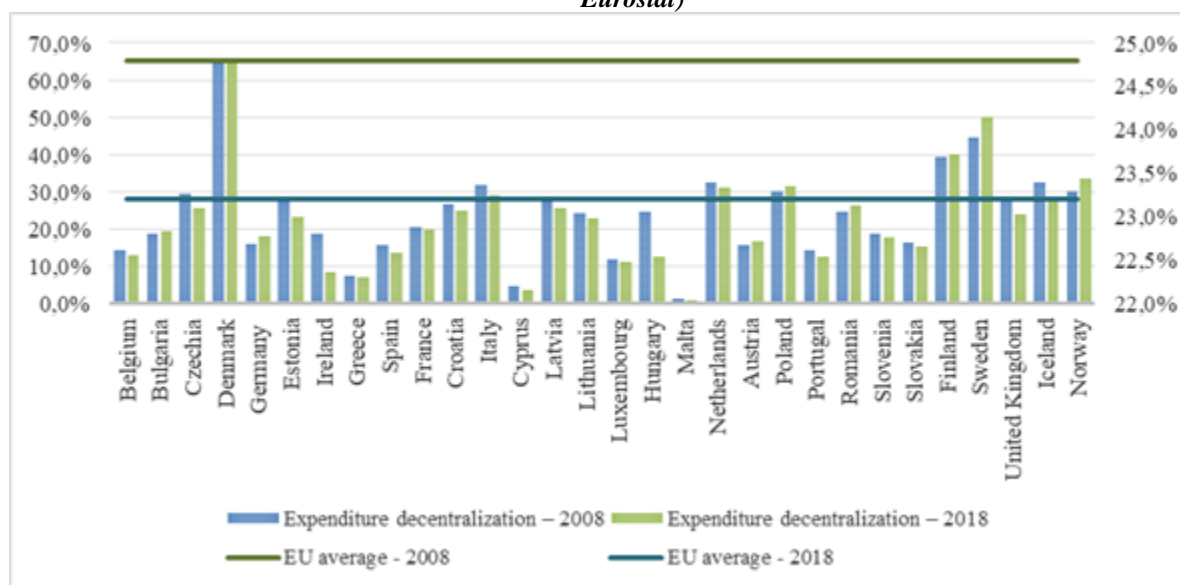


The coefficient of expenditure decentralization is defined as a key indicator for measuring the degree of fiscal decentralization according to a number of authors. This is due to the fact that local authorities implement the policy of providing public goods and services to the population on the basis of the expenditure side of their budgets. In this sense, the increase in expenditures in the ‘Local Government’ sector, *ceteris paribus*, implies more benefits for society. The high degree of expenditure decentralization also means that the authorities are able to solve existing problems ‘on the spot’, as close as possible to the citizens.

Figure 2 below illustrates the progress of the countries surveyed in this respect, and shows that only 9 of the 30 surveyed countries show an increase in local expenditures towards the total expenditures in the public sector, among which is Bulgaria (along with Germany, Poland, Portugal, Romania, Sweden and Norway). The fact that our country

maintains values below the EU average both at the beginning and at the end of the analyzed period is considered a negative aspect: 18.8% of public sector expenditures were made at the local level in 2008, and in 2018 there was a 0.8 percentage points increase to 19.7%. The results for 2018 are comparable to those of Germany and France. The wide range of coefficient variation (1% - 50.2%) requires studying the trends based on grouping towards the deviation from the EU averages. In 2008, in 14 of the analyzed countries the level of expenditure decentralization was lower than the European average. A significant deviation (over 10% below average) was observed in: Greece, Cyprus, Luxembourg and Malta, and a slighter deviation (up to 10% below average) – in Belgium, Bulgaria, Germany, Ireland, Spain, France, Austria, Portugal, Slovenia and Slovakia. For comparison, in 2018 the number of countries grew to 17, with Estonia, Lithuania and Hungary being added. Eight countries had significant deviations (more than 10% below the average), and in 2008 they were one less – Ireland deepened its lagging behind, reducing its expenditure decentralization from 19 to 8.5 percent. There were 16 ‘outstanding’ countries in 2008, with Lithuania, Hungary and Romania deviating slightly from the EU average (see Appendix 1). Given the fact that in 2018 the number of countries in which the level of expenditure decentralization exceeded the European average dropped to 13, it can be argued that the process of fiscal decentralization at the macro level is slowing down. In support of this, the empirical analysis shows that 22 countries reduced the coefficient of expenditure decentralization in 2018 compared to 2008. At the national level, the measure in question, for example, in Hungary decreased by 11.8% in 2018, lagging behind the European average by 10.5%. Although such trends should be viewed in the context of the country’s overall macroeconomic policy, they are an indication of limiting the redistributive processes through local budget expenditures (Bordás, 2016, pp. 89-96).

Figure 2. Expenditure decentralization – territorial aspect – EU, time aspect – 2008 and 2018 (Data source – Eurostat)

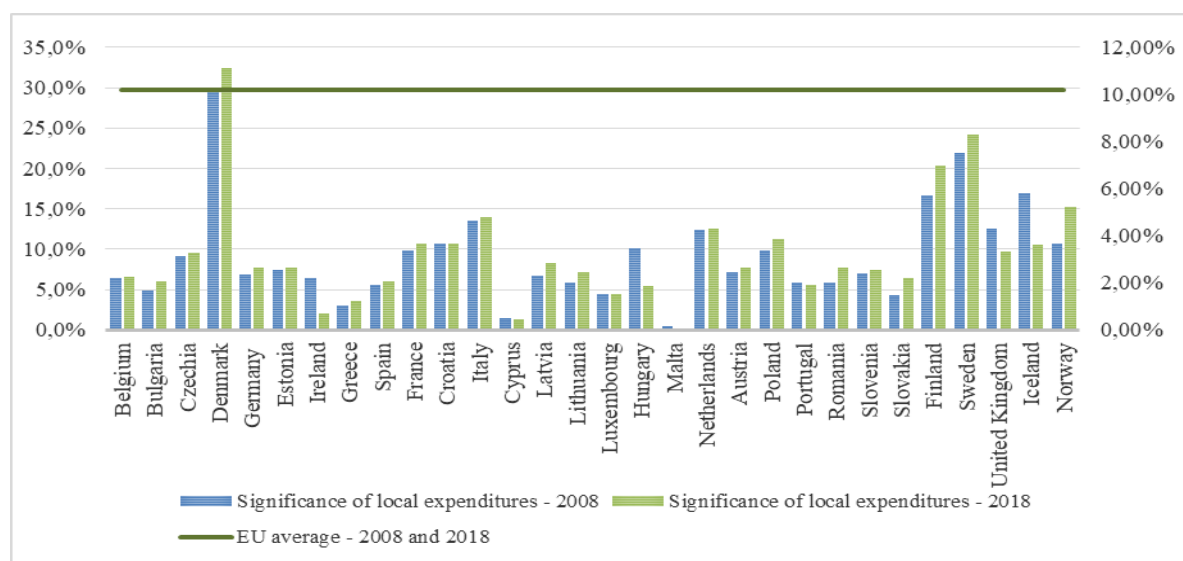


4. 2. Significance of local expenditures and tax autonomy

The ‘Significance of local expenditures’ indicator reflects the above process: it is known that budget expenditures are a tool for redistributing national income between economic agents, and the ratio of local expenditures to gross domestic product for a given reporting period should reflect both the achieved degree of fiscal decentralization and its significance for the national economy. The average European value of the examined measure coincides for the two analyzed years and is positioned at a 10.2% level. By 2018, twenty countries, including Bulgaria, failed to reach this benchmark. In Bulgaria, only 6 percent of the GDP was redistributed through the local government budget according to data from 2018, with an upward trend compared to 2008. The highest degree of fiscal decentralization and the best developed process of redistribution through local expenditures unsurprisingly are reported again by the Scandinavian countries, where the examined indicator varies from 32.4% in Denmark to 15.3% in Norway. Of the Balkan countries, only the Republic of Croatia is in the ‘top ten’, with a value close to the European average. The opposite situation, at an extremely low ‘Significance of local expenditures’ coefficient, is measured in Malta and Cyprus – 0.3% and 1.3% of GDP, respectively. The wide margins of variation again require that a cluster analysis be made in order to reveal the similarities between the countries. In 2008, two thirds of the countries included in the

analysis deviated downwards from the EU benchmark (10.2%). In Bulgaria the discrepancy is 5.4%, while in neighbouring Greece it is 7.1%. Comparable to the Bulgarian results are those of Luxembourg and Slovakia, and ten years later: Spain, Hungary and Portugal. Our country made progress in the process of decentralization of the public sector, after the analyzed indicator increased by 1.2 percentage points and the deviation from the EU average decreased by 1.1%. The data show that half of the surveyed countries improved their position, bringing their values closer to the EU benchmark. Poland and France, which moved to a higher cluster group and exceeded the benchmark of 10.2% in 2018, marked great success. The above-mentioned countries, together with 6 others, report an increase in the ‘Significance of local expenditures’ coefficient, as well as getting closer to the EU benchmark. The Republic of Croatia does not change the value of the analyzed measure for the period, and in Iceland it falls dramatically – from 17 to 10.6 percent. On this basis, the authors express their conviction that the high degree of the ‘significance of local expenditures’ measure confirms the high degree of completion of the process of fiscal decentralization at the national level and the achievement of financial autonomy at the local level, including the provision of sufficient quantity and quality of local goods and services.

Figure 3. Significance of local expenditures – territorial aspect – EU, time aspect – 2008 and 2018 (Data source – Eurostat)



The ‘Significance of local revenues’ indicator should be considered in the same context given the fact that budget revenues are the basis for the implementation of the expenditure policy of each budgetary institution, including municipalities. Therefore, government revenue is also an instrument for redistributing GDP. The commented indicator is not subject to detailed analysis, as the results derived overlap largely with those of the ‘Significance of local expenditures’ indicator.

The national legislation of each country, in accordance with the principles of the ECLSG, imposes on local authorities the responsibility for providing a certain amount of public goods and services at the local level in accordance with public needs. In Bulgaria, local activities are subject to financing with local revenues and a total balancing subsidy (Public Finance Act, Articles 52-55). Therefore, the accumulation of a larger volume of revenues from own sources, incl. tax, opens to the local government more opportunities to increase economic efficiency and public welfare, and the independence of local government from the central government in financial terms can be measured by the amount of their own revenues to implement the expenditure programme of the respective municipality. In this case, the own revenues from tax revenue are important, which as a rule constitutes a significant part of the total own revenues. A joint study shows that local parliaments have limited powers in the organization of local taxes in Bulgaria (Naydenov & Pavlova-Banova, 2020, pp. 1-28), which creates difficulties in fulfilling local expenditure responsibilities. In this sense, the analysis of the ‘tax autonomy’ indicator is completely reasonable and reveals important features in terms of financial capabilities of Bulgarian municipalities. The latter measures the significance of local tax revenue for the total revenues of municipalities and has a high informational significance for measuring the degree of decentralization in the public sector.

Figure 4. Tax autonomy – territorial aspect – EU, time aspect – 2008 and 2018 (Data source – Eurostat)

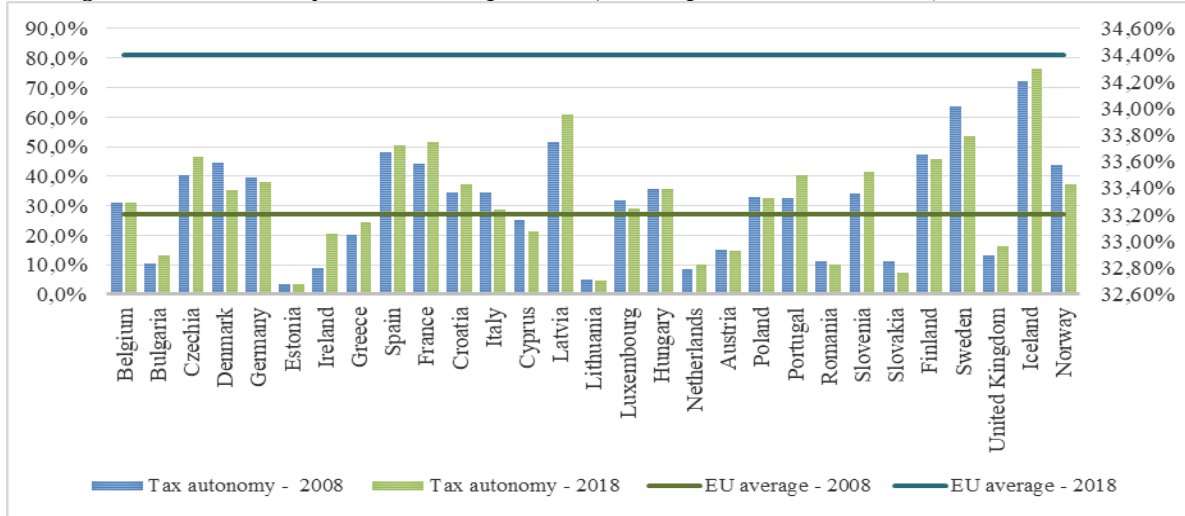


Figure 4 shows the summarized results of the countries subject to analysis, which shows that local tax revenue in Bulgaria in 2018 constituted 13.3% of the budget revenues, total for the sub-sector, and a decade earlier it was even lower – 10.7%. The value of the indicator in the two analyzed years is lower than the European average, which is positioned at 33.2% and 34.4% respectively for 2008 and 2018. At the macro level, the indicator varies widely – between 3.5 % for Estonia and 42% for Iceland according to the latest data. The identified differences suggest a re-examination of the countries based on cluster analysis. The countries are divided into 4 groups according to the deviation from the European average for the respective year (2008 and 2018), which allows us to track the extent to which the sub-sector in a particular country has succeeded in its efforts to break away from depending on the central government. Clusters 3 and 4 group the countries with a low degree of tax autonomy compared to the benchmark for the respective year. The findings are that in half (15) of the analyzed countries the coefficient of tax autonomy does not exceed 33.2% in 2008. In Bulgaria it deviates downwards by 22.5%, and in Romania and Slovakia the results are close in value, too. Cluster 4 includes the following countries: Estonia, Ireland, Greece, Lithuania, the Netherlands, Austria and the United Kingdom. The distribution is heterogeneous in Cluster 3 of the analysis, too, which includes economies whose tax autonomy coefficient is lower than the EU average by up to 10% and unites the following countries: Belgium, Cyprus, Luxembourg, Poland and Portugal. Compared to 2018, the tax autonomy of the ‘Local Government’ sub-sector in some countries registers progress. The measure determining this increases its value in five countries of Clusters 3 and 4 of the analysis. Portugal registers the highest result, whose coefficient increased from 32.7% to 42.4% to be repositioned in a higher cluster group in 2018. The place of the latter is taken by Italy, where the analyzed measure reports a decrease of 34.4% to 28.7%, deviating downwards, according to the latest data, from the European average by 5.7%. Bulgaria, Estonia, Greece and the United Kingdom, for their part, get closer to the 2018 benchmark, reporting an increase in the coefficient of tax autonomy, similar to Portugal, but retaining their place in Cluster 3 of the analysis. Therefore, the country’s affiliation to a particular region in Europe or the degree of socio-economic development (as they are often classified) is not determinative for the tax autonomy of the countries’ economies. This is confirmed by the distribution of countries whose tax autonomy is higher than the European average (Clusters 1 and 2 of the analysis). Iceland records the highest coefficient (76.3%) with 42% over the EU average in 2018. The other countries grouped downwards in the highest cluster group are: Latvia, Sweden, France, Spain, Belgium and Finland. Denmark, Germany, Republic of Croatia, Hungary, Norway and Slovenia are close in value to the EU average (exceeding by up to 10% the benchmark of 34.4% for 2018), retaining their position in Clusters 1 and 2 of the analysis for the last 10 years.

According to the authors, the analyzed measure most accurately reflects the achieved degree of autonomy of local government from the central government, as it is directly dependent on the size of the local taxes, which are allocated for local activities in accordance with the needs of the local citizens. In this sense, the financial capabilities of the separate unit of local government (municipality) are determined by:

- Its ability to increase the collectability of taxes, which it accumulates through specific ‘on-site’ measures;
- The ability to control the use of tax reliefs and preferences by taxpayers in order to achieve maximum revenue;

- The ability to independently determine the tax rates of local taxes in order to optimize revenues (the so-called Scandinavian model of taxation, which is not applicable in Bulgaria);
- Its right to dispose of tax revenues assigned in its favour, which are legally paid into the state treasury;
- Provision of other sources of own revenues, other than tax.

The idea of tax reform with a view to assigning a certain part of the personal income tax, for example, in favour of municipalities, is seen rather as vanguard for the Bulgarian reality, but the adoption of such good practices, in the authors' opinion, would contribute essentially to increasing the financial capabilities of municipalities and improving their fiscal position. Such a proposition is supported by the fact that countries like Germany, Portugal, Sweden, Spain have a high degree of tax autonomy, and at the same time assign taxes in different formats (Bahl & Cyan study, 2010, shows that Austria, Belgium, Portugal, Germany and the Scandinavian countries use personal income tax as a local source of revenue).

5. CONCLUSIONS

In conclusion, the present study generalizes that expanding autonomy and affirming its principles is crucial for local self-government and overcoming inefficiencies in the provision of public goods and services and the rationalization of the use of public resources, as well as for increasing the financial capacity of municipalities and improving their fiscal position. In this respect, our country (Republic of Bulgaria) has made some progress in the last ten analyzed years, and in the clustering of selected countries, it is positioned in the middle of the distribution. Comparable to the Bulgarian results are those of Austria, Ireland, France and Germany in terms of revenue and expenditure decentralization and the significance of local expenditures for the national economy, and in terms of tax autonomy – with Estonia, Greece, Lithuania, Austria and Romania. The deceleration of fiscal decentralization at the macro level, incl. in Bulgaria, requires a rethinking of the philosophy of operation of the tax system in our country in order to bring the results closer to the EU average and achieve maximum public satisfaction with the received local goods and services.

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Appendix 1. Measures of fiscal decentralization – territorial and time aspect

Country	Revenue decentralization		Expenditure decentralization		Significance of local expenditures		Tax autonomy	
	2008	2018	2008	2018	2008	2018	2008	2018
Austria	C2	C1	C2	C2	C2	C2	C1	C1
Belgium	C1	C2	C1	C1	C2	C2	C2	C2
Bulgaria	C2	C1	C2	C2	C1	C2	C1	C1
Croatia	C3	C3	C3	C3	C3	C3	C3	C3
Cyprus	C1	C2	C1	C1	C1	C1	C2	C1
Czechia	C3	C3	C3	C3	C2	C2	C3	C4
Denmark	C4	C4	C4	C4	C4	C4	C4	C3
Estonia	C3	C3	C3	C2	C2	C2	C1	C1
Finland	C4	C4	C4	C4	C4	C4	C4	C4
France	C2	C1	C2	C2	C2	C3	C4	C4
Germany	C2	C1	C2	C2	C2	C2	C3	C3
Greece	C1	C2	C1	C1	C1	C1	C1	C2
Hungary	C3	C3	C3	C1	C2	C2	C3	C3
Iceland	C3	C3	C3	C3	C4	C3	C4	C4
Ireland	C2	C1	C2	C1	C2	C1	C1	C1
Italy	C3	C3	C3	C3	C3	C3	C3	C2
Latvia	C3	C3	C3	C3	C2	C2	C4	C4
Lithuania	C2	C1	C3	C2	C2	C2	C1	C1
Luxembourg	C1	C2	C1	C1	C1	C1	C2	C2
Malta	C1	C2	C1	C1	C1	C1	-	-
Netherlands	C3	C3	C3	C3	C3	C3	C1	C1
Norway	C2	C1	C3	C4	C3	C3	C4	C3
Poland	C3	C3	C3	C3	C2	C3	C2	C2
Portugal	C2	C1	C1	C1	C2	C2	C2	C3
Romania	C3	C3	C3	C3	C2	C2	C1	C1
Slovakia	C2	C1	C2	C2	C1	C2	C1	C1
Slovenia	C2	C1	C2	C2	C2	C2	C3	C3
Spain	C2	C1	C2	C2	C2	C2	C4	C4
Sweden	C4	C4	C4	C4	C4	C4	C4	C4
United Kingdom	C3	C3	C3	C3	C3	C2	C1	C1