

Financial Decentralization in Bulgaria: An Outlook

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This study is intended to provide a critical overview of the local government finance reform and analyze the process of strengthening financial decentralization in Bulgaria. First of all, the specifics of government structure and the main components of the legal base in the scope of local self-government are presented. The quantitative analysis is focused on dynamics of the public expenditure indicators and the structure of local revenues, based on fact figures for the period 1990–2011 and forecast for 2012. The influence of economic crises on local government finance is discussed and estimated. A comparison is drawn between the three most severe downturns of Bulgarian economy during the last 20 years, namely the price liberalization in the beginning of transition (1991–1993), the credit crunch and series of bank bankruptcies, which caused the financial crisis in 1996–1997, and the current worldwide crisis. Some of the most important actions, taken by the government in order to consolidate the crisis are described and evaluated on the base of their effects on the local finance. The conclusion is that although the current crisis reached Bulgaria at comparatively mature stage of financial decentralization reform, municipalities can do very little without active central government support and cannot substitute for it in regard of the basic anti-crisis measures.

Key words: financial decentralization, local finance, intergovernmental fiscal relations

Introduction

The process of decentralizing public sector in Bulgaria started parallel to the transition from a planned, socialist type economy toward market based economy. During the last 20 years a remarkable progress has been achieved, although local government finance reform in Bulgaria proved to be a very long and difficult process. The main purpose of this paper is to provide a critical overview of the local government finance reform and analyze the process of strengthening financial decentralization in Bulgaria. It is structured in five sections. Section two introduces the specifics of country's government structure and presents the legal base of local self-government.

TABLE 1 Dynamics of administrative and territorial structure

Year	Regions		Districts		Municipalities	
	(1)	(2)	(1)	(2)	(1)	(2)
1950	—	—	14	516 300	2 178	3 300
1961	—	—	28	261 000	979	8 000
1979	—	—	28	315 900	291	30 400
1987	—	—	9	997 400	273	32 900
1999	—	—	28	284 800	262	30 300
2006	6	1 280 000	28	280 000	264	29 900
2011	6	1 230 000	28	263 000	264	27 900

NOTES Column headings are as follows: (1) number, (2) average population. Source: National Statistical Institute (<http://www.nsi.bg>).

Third section traces out the main stages in the evolution of financial decentralization. The role of different governmental tiers within the public sector of the country is analyzed on the base of the dynamics of public expenditures indicators. Development of the financial decentralization process is assessed through the relative importance of the local expenditures both in the consolidated public expenditures and the GDP. Special emphasis is placed upon the evolution of local budgets revenue structure over the period 1991–2012. The relative share of own-source revenues is analyzed as a precondition for expanding local financial autonomy. Fourth section illustrates the impact of economic crises on the local government finance. The last section concludes.

Foundations of the Local Self-Government in Bulgaria

GOVERNMENT STRUCTURE

Government structure of Bulgaria is not very fragmented. Due to the five administrative reforms, which have been conducted during the second half of the 20th century, the number of the administrative-territorial units at different levels decreased. Presently, as a unitary state, with 7.4 million population and territory of 111 000 km², Bulgaria enjoys comparatively simple subordination scheme. Territorial structure of the country includes two regions on level NUTS I, 6 regions, defined as level NUTS II, 28 administrative districts corresponding to level NUTS III, and 264 municipalities, which represent the level LAU 1.¹

It is important to note, that regions are not administrative, but only statistical units, created according to the Regional Development Act ('Zakon za regionalno razvitie' 2008, §4) and in compliance with the requirements of the European Union for allocation of regional

development funds. The districts are deconcentrated administrative units of the central government, which coordinate national and local interests, but they neither enjoy financial autonomy, nor provide public services to the population. According to the Constitution ('Konstitucia na Republika Bulgaria' 1991, §136), the municipality – a legal entity is the only one tier of really autonomous subnational government in the country. It has the right of ownership and adopts independent municipal budget, which must be used in the interests of the local population. The bodies of local government – Municipal Council and Mayor – are elected directly by the local population for a 4-year mandate with the purpose to make and perform local government decisions. The last local elections held in 2011, elected respectively 264 mayors and 264 municipal councils with 5 145 municipal councilors. Men prevailed among the municipal councilor seat takers (71.6%).

LEGAL GROUNDS OF FINANCIAL DECENTRALIZATION

The basic principles of local self-government in Bulgaria are provided by the Constitution, adopted by the Parliament in 1991 ('Konstitucia na Republika Bulgaria' 1991). In addition, there is a package of laws, shaping the legal grounds of decentralization. The Local Self-Government and Local Administration Act ('Zakon za mestnoto samoupravlenie i mestnata administracia' 1991) regulate organization and functions of local governments. The Act on Administrative and Territorial Structure of the Republic of Bulgaria (1995) determines the legal criteria and procedures for establishing, merging, splitting and liquidating administrative units. The Local Elections Act ('Zakon za mestnite izbori' 1995) and the Referendum Act (1996) prescribe the rules for citizens' participation in political process at local level. The issues of acquiring and managing municipal property are solved by the Municipal Property Act ('Zakon za obshtinskata sobstvenost' 1996), while procedure and organization of the municipal budgeting process are formalized by the Municipal Budgets Act ('Zakon za obshtinskite budjeti' 1998). Some important financial issues as type, base, and rate of local taxes and charges are specified by the Local Taxes and Fees Act ('Zakon za mestnite danaci i taksi' 1997), whereas the procedure, conditions and limits of local debt service are determined by the Municipal Debt Act ('Zakon za obshtinskia dolg' 2005). Thus, the most important legal pillars of the local self-government are stipulated, providing a stable base for expanding financial decentralization in Bulgaria. This is in consistence with the efforts of the EU coun-

tries for strengthening the legal base of government decentralization (Patonov 2011, 37)

Local Government Finance

EVOLUTION OF FINANCIAL DECENTRALIZATION

Local government finance reform in Bulgaria proved to be a very long and difficult process. Decentralization of the public sector was conducted by the transition process, from centralized, socialist type economy to a market based economy, which started in 1990. Basically, the process of reforming local finance comprised of several distinct periods. During the first period, in the very beginning of transition (1991–1993) the highly centralized system was preserved. The independence of municipal budgets within the consolidated state budget was acknowledged in 1993, meaning that the State abandoned centralization of local budgetary surplus and financing of local deficit. In addition, the intergovernmental fiscal relations were organized on the base of a newly introduced formula for distribution of the state subsidies to the municipal budgets.

The second period started in 1994, parallel to the process of gradually building the capacities of local authorities. The National Association of Municipalities in Republic of Bulgaria (NAMRB) and regional associations of municipalities emerged as main champions of financial decentralization. Several changes in intergovernmental relations were provoked, gradually eliminating mandatory priorities in the allocation of municipal expenditures. However, to the end of 2002, the intergovernmental fiscal relations remained centralized as far as the central government established a model of almost complete control over the municipal budgets (Thcavdarova, Ivanov, and Savov 2000, 36)

During the third period the real financial decentralization in Bulgaria evolved. It was initiated in 2003, based on the Cooperation Agreement, signed by the Council of Ministers and the NAMRB in 2002, whereby both parties agreed to decentralize local government and to increase financial independence of municipalities. Moreover, both the Financial Decentralization Concept and the program for its implementation were adopted. As a result, one of the main achievements in the scope of intergovernmental fiscal relations became a reality, namely the clear division between the local and central responsibilities for the public services. Provided for the first time by the Annual State Budget Act for 2003 ('Zakon za darjavnia budget na Republika Bulgaria' 2003) it was continued and improved during

the following years. Additionally, this law provided a framework for regulating a new, simple and transparent model of assigning government subsidies. As a result subsidies allocation is based on a formula, which takes into account the expenditure needs and revenue capacity of local governments.

The lack of local tax autonomy has been a fundamental weakness of the revenue assignment system in Bulgaria during the transition period. Before the constitutional amendments in the beginning of 2007 Bulgarian municipalities were prohibited from setting either rates or bases of local taxes. Property tax, motor vehicle tax, inheritance tax, donation tax, and tax on the real estate and movable property purchase, recognized as local taxes, were entirely regulated by the central governmental level. In this respect local taxes in Bulgaria have been considered as special transfers, based on the location of taxable property.

This is the reason why, 2007 can be pointed as a beginning of the fourth period, when two important legislative changes considerably influenced local taxation. Firstly, municipalities were given the authority to set local tax rates within certain legal limits. However, they are still disallowed to define local tax base and provide additional (or remove the existing) legal alleviations for certain taxpayers. Secondly, the patent tax was reassigned as a local tax. Basically, the patent tax is a net annual income tax, which is collected from the craftsmen and the owners of small enterprises, who offer handmade products and a variety of services. The patent tax replaces the payment of personal income tax or corporate income tax, so it has the potential as an important part of local revenues and powerful instrument of the municipal tax policy.

LOCAL GOVERNMENT EXPENDITURE

During the transition period public sector expenditures have been very dynamic, in response to the fast-changing legal and financial environment. Due to the economic stagnation, financial instability, and vertical imbalance in the last decade of the 20th century, the relative importance of local governments within the governmental system decreased. Moreover, regardless of the financial stabilization and economic growth, achieved during the first years of the 21st century, the downward tendency has proved its persistency. The relative share of local budgets in GDP has been reduced to 7.5% in 2000 and 6.1% in 2004 by comparison with 12.3% in 1990. At the same time expenditures of the local governments, which formed 21.5% of the consolidated state budget in 1991, reached respectively 17.9% in 2000

TABLE 2 Dynamics of the public expenditure indicators

(1)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
(2)	51.11	53.66	56.09	54.41	49.09	43.65	34.29	38.45	40.52	41.99	40.45
(3)	10.95	13.04	11.30	9.24	7.71	6.34	5.68	7.40	7.84	7.50	6.69
(4)	21.47	24.33	20.16	16.99	15.71	14.53	16.57	19.24	19.34	17.85	16.56
(1)	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
(2)	39.30	40.63	39.15	38.92	38.93	38.93	37.95	39.50	37.90	35.70	38.00
(3)	7.38	6.48	6.14	6.40	6.79	7.42	7.57	7.40	6.70	6.20	4.70
(4)	18.78	15.95	15.68	16.24	18.24	19.20	20.40	19.80	17.50	17.50	12.40

NOTES Row headings are as follows: (1) year, (2) consolidated public sector expenditures/GDP (%), (3) local government expenditure/GDP (%), (4) local government expenditure/consolidated public sector expenditure (%). Source: Ministry of Finance (<http://www.minfin.bg>); data for 2012 are based on prognosis.

and 15.7 % in 2004. The reversion of this negative trend happened in 2005, due to the ongoing process of financial decentralization during the third period of local finance reform and increasing financial autonomy of local governments. The positive dynamics has been accelerated by the clear expenditure assignment, transparent intergovernmental transfer system, and local tax authority. In 2008 local governments appeared as an important part of the public sector in the country, accounting for 20.4% of total government spending. At the same time municipal budgets reached 7.6% of the GDP. In the period 2009–2011, as a result of the reflection of the worldwide economic crisis in Bulgaria, local government expenditures tend to decrease. In 2012 local government budgets are expected to reach to 12.4% of the consolidated budget and 4.7% of GDP.

COMPOSITION OF LOCAL REVENUES

In the beginning of the transition period, local governments have suffered more than the central government from the decreased financial capacity of the public sector in the country. Because of the advantages of taxation at the central level and spending at the decentralized level, public sector in Bulgaria has often ended up with vertical and horizontal fiscal imbalance. Several problems had a decisive influence on the own-source local revenues, causing a significant decline of their relative share, especially during the 1990s.

First of all, the difficult interrelation of the local governments and the tax administration, which in 1991 became subordinated to the Ministry of Finance. As a result, the efforts of centrally dependent officers were aimed at collecting taxes from the larger taxpayers, causing delays of the local taxes and charges collection and even waste

TABLE 3 Composition of local revenues (%)

(1)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
(2)	3.9	5.1	4.9	19.6	20.4	20.6	8.3	15.2	17.6	18.1	22.0
(3)	0.7	0.9	1.2	2.3	2.5	2.9	0.5	5.0	4.8	4.9	5.2
(4)	96.1	94.9	95.1	77.1	77.7	77.5	91.4	83.9	80.3	81.9	77.6
(5)	—	—	—	3.3	1.9	1.9	0.5	0.9	2.1	—	0.4
(1)	2002	2003	2004	2005	2006	2007	2008	2009	201	2011	2012
(2)	23.9	31.7	33.8	35.6	36.9	40.2	35.4	35.1	32.4	35.5	37.4
(3)	7.0	9.6	9.3	9.5	10.7	13.4	13.4	13.6	11.6	13.1	14.5
(4)	75.7	67.9	65.9	64.0	61.3	58.7	60.3	63.2	67.4	64.4	62.6
(5)	0.4	0.4	0.3	0.4	1.8	1.1	4.3	1.7	0.2	0.1	0.0

NOTES Row headings are as follows: (1) year, (2) own-source revenues, (3) local taxes, (4) governmental transfers, (5) borrowing. Source: Ministry of Finance (<http://www.minfin.bg>); data for 2012 are based on prognosis.

of local revenues. In a dynamic inflationary environment any postponement led to additional losses for the municipal budgets. The second serious problem was the outdated tax base for the property tax, which was also used for the calculation of inheritance tax, donation tax, and tax on the property purchase. These were the reasons why in the period 1991–1997 local taxes accounted for less than 3% of the local revenues. Especially low was local tax revenue share in 1997 (0.5%), due to the hyperinflation, which additionally devaluated local tax base. Moreover, it was beyond the municipal competence to solve the problem. Although autonomous on paper, municipalities did not have any possibility to influence tax revenues. In addition, the inability of local governments to impose local charges and to set their rates freely, particularly in the inflationary situation, resulted in a growing gap between local revenue potential and the actual costs of local service provision. This was the reason why in 1990s own-source revenues accounted for only 12.8% of the total local revenues on the average.

During the period 2000–2007 local own-source revenues have gradually increased, from 18.1% toward 40.2% of the total municipal revenues, provoked by the expanding financial decentralization. Since 2003 local governments have been given full discretion over local charges and service prices, which have quadrupled their importance in real and relative terms. In 2006 municipalities started to collect local tax revenues. Especially high is the growth of local taxes in 2007 and the first half of 2008, due to the considerable revaluation of the property tax base on the one hand and the newly assigned tax competences on the other hand. At the same time, because of the

expansion of the own-source revenues, intergovernmental transfer system has lost its dominant role in financing local governments in Bulgaria. However, having in mind the great difference between the fiscal capacity in several richest municipalities and the rest of the local governments in the country, for the present the strong intergovernmental transfer system still has no effective alternative.

Of great significance for the process of strengthening financial decentralization in Bulgaria were some macroeconomic and financial factors, such as constantly increasing economic activity, low levels of unemployment, moderate inflation rates, dynamically decreasing public debt, and consolidated budget surpluses exceeding 3% of the GDP. This process was broken in the autumn of 2008, due to a new and deep worldwide financial and economic crisis. Due to the severe financial discipline provided by the Currency Board, which preserved financial stability, Bulgaria faced the crisis consequences later and in a milder form than most of the countries all over the world. In 2009 crisis hit Bulgarian economy with all its might. Decreasing economic activity (GDP reduction of -5.1%) strongly affected public finance by reducing government revenues and increasing social pressure, mainly due to the fast growing unemployment rate. As a result a budget deficit of 4.7% of the GDP was reported in 2009. Although completely different from the expected 3% surplus, Bulgarian budgetary deficit is among the lowest in the European Union. In addition, bank system remained stable, inflation rate decreased to 2.8%, and public debt did not exceed 15.5% of the GDP.

At the local level economic crisis both sharply reduced local own-source revenues and – via budget constraints at the central level – increased the pressure on the grant system. As a result own-source revenues decreased to 35.4% of the total local revenues in 2008 and hardly reached 35.1% in 2009. In 2010 own-source revenues decreased vastly to 32.4% of the total local revenue. Especially low are the revenues from the tax on movable and immovable property purchase, mainly because of the collapse of the real estate market, reduction of the construction sector, and decrease of motor vehicles purchases. The increased share of the own-source revenue for 2011 (35.5%) is partly due to the reduction of the state transfers and partly due to the increase in the tax revenue. In attempts to consolidate the crisis, national government centralized public sector expenditures, as the role of the state increased.

Local Finance in Times of Crisis

Current financial crisis is often defined as the worst worldwide economic crisis since the Great Depression. However, a brief review of

TABLE 4 Basic economic indicators

(1)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
(2)	-11.7	-7.3	-2.4	1.4	2.5	-9.4	-5.6	4.0	2.3	5.4	4.1
(3)	11.1	15.2	15.8	12.8	11.1	12.5	13.7	12.2	16.0	18.1	17.5
(4)	303.2	92.0	73.4	121.3	64.1	121.6	1058.4	18.7	2.6	10.3	7.4
(1)	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
(2)	4.5	5.0	6.6	6.3	6.3	6.2	6.0	-5.1	0.4	1.7	2.9
(3)	15.6	13.7	12.0	10.1	9.0	6.9	5.6	9.1	10.2	11.2	11.2
(4)	5.8	2.3	6.1	5.0	7.3	8.4	12.3	2.8	3.0	3.4	3.2

NOTES Row headings are as follows: (1) year, (2) annual GDP growth (%), (3) unemployment rates (%), (4) inflation rates (%). Sources: Ministry of Finance (<http://www.minfin.bg>), Bulgarian National Bank (<http://www.bnb.bg>), National Statistical Institute (<http://www.nsi.bg>), National Employment Agency (<http://www.az.government.bg>); data for 2012 are based on prognosis.

the country's economic development showed that the current downturn is not the most severe crisis, faced by Bulgaria during the last 20 years, mainly due to the lessons for fiscal policy drawn from previous crises and the Currency Board, which preserved financial stability.

Since the beginning of transition from centralized to market based economy Bulgaria has survived during two extremely difficult periods. First of all, following the 1990 moratorium on external debt repayments, Bulgaria lost access to commercial external financing. During the period 1991–1993 the expansion of the private sector took place against the background of the steep decline in production and high unemployment associated with the transition. The cumulative decline in real GDP during this period reached almost 25%, mainly due to the drop in domestic demand and loss of the export markets. The restructuring of the economy resulted in enormous unemployment rate, which went up to 16% of the labor force and stabilized around that level. Price liberalization caused severe inflation in 1991 (303.2%). After the initial price shock the inflation rate steadily declined to 73.4% in 1993. However, the sharp changes in relative prices and costs, and the drop in imports led to additional decline in the output. Reflecting the economic conjuncture during the period, consolidated budgetary deficit reached 12.1% of the GDP and public debt was calculated to 180% of the GDP.

The second hard period was the financial crisis of 1996–1997. The two factors, which provoked the crisis, were bad loans on commercial banks' balance sheets and large government deficits. Until 1996, commercial credit in Bulgaria was expanded to a degree that was unprecedented relative to any other European transition economy. Government attempts to recapitalize the banks failed. The govern-

TABLE 5 Public finance indicators

(1)	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
(2)	-4.5	-7.0	-12.1	-4.6	-5.2	-15.4	-0.4	1.3	0.2	-0.6	-0.6
(3)	180.7	145.6	176.0	180.0	120.0	303.0	96.9	86.0	86.8	77.1	70.1
(1)	2002	2003	2004	2005	2006	2007	2008	2009	201	2011	2012
(2)	-0.6	0.0	1.7	3.2	3.6	3.8	3.0	-4.7	-3.2	-1.8	-1.3
(3)	55.9	47.9	40.9	33.3	23.0	18.5	15.0	15.5	16.1	16.7	16.2

NOTES Row headings are as follows: (1) year, (2) budgetary deficit/GDP (%), (3) consolidated public debt/GDP (%). Sources: Ministry of Finance (<http://www.minfin.bg>), Bulgarian National Bank (<http://www.bnb.bg>), National Statistical Institute (<http://www.nsi.bg>), National Employment Agency (<http://www.az.government.bg>); data for 2012 are based on prognosis.

ment replaced bad loans to enterprises with government bonds. Banks then made additional loans, so their balance sheets did not improve. The credit crunch was followed by series of bank bankruptcies. The economy slumped as a result of the collapse of the bank system. At the same time the government bonds increased the level of government debt (303% of the GDP) and the interest obligations on this debt ballooned, creating enormous government deficit (-15.4% of the GDP). Hyperinflation of more than one thousand percent was registered in 1997, which totally deformed all the economic and financial relations.

As a last resort, the Currency Board was introduced on 01 July 1997, in order to restore the confidence in the national currency and bank system, to impose financial discipline and stabilize the economy. Generally speaking, Bulgarian Currency Board proved to be a great success. It established a fixed exchange rate and relied on automatic mechanisms to restore macroeconomic equilibrium, limiting severely the discretion of policymakers. From hyperinflationary levels during the first half of 1997, inflation fell to very low levels in the following years. The significant decrease of nominal interest rates made it possible for the government to reduce large government deficits. The economy started to grow, although more slowly that might be hoped during a recovery period.

The anti-crisis measures in response to the current worldwide crisis were taken comparatively late – in the second half of 2009, mainly due to the national elections in mid July. The efforts of the newly elected government were aimed at stabilizing public finance and diminishing budgetary deficit to the end of the year. The government actions were related both to the revenue and expenditure side of the state budget, mainly intended to increase the efficiency

in the public sector. First of all, state administration was significantly reduced (by 15%), and salaries in the public sector were frozen for an indefinite period of time. As part of the measures intended to optimize administrative expenses, the Parliamentary Commission of Regional Policy and Local Self-Government discussed the possibility of merging municipalities with few citizens. According to the Law on Administrative Territorial Structure of the Republic of Bulgaria ('Zakon za administrativno-teritorialno ustroistvo na Republika Bulgaria' 1995, §8 (1) 1), municipalities must have population of at least 6000 in order to be administrative centers. Although local government in Bulgaria is not very fragmented, having in mind that the average municipality has 30 000 citizens, such a measure would affect 53 municipalities with population between 1242 and 5944. However, representatives of the central government declared that merger of municipalities could become a reality only after referendum.

Secondly, public sector investments were postponed for better times. Targeted capital investment subsidy, which used to be a significant source of financial resources for the local governments, has been reduced with 65.8%, from 205.5 million BGN in 2009 to 117 million BGN in 2010, 90.2 million BGN in 2011 and 70.2 million BGN in 2012. Under the circumstances, most of the local governments rely on the European funds for investment financing. Moreover, the central government assumed the responsibility to pay on behalf of the local governments the required 5% project co-financing, in order to support local investments.

Thirdly, tax collection efforts were strengthened. Bulgaria applies the lowest tax rates of the personal income tax and corporate income tax (both of them equal to 10%) among the EU countries, so the most unpopular anti-crisis fiscal measures (decreasing income taxes) are not applicable (European Commission 2009). Instead, the National Revenue Agency launched large scale audits of legal entities and physical persons in order to improve tax collection. Moreover, local governments were given full legal rights of public executives, meaning in essence that they can levy distraint upon the bank accounts, salaries, and properties of the incorrect taxpayers. In order to expand local fiscal capacity, the maximum rates of the tax brackets were increased from 0.2% to 0.45% for the property tax and from 2.6% to 3.0% for the tax on the movable and immovable property purchase. In spite of these measures, public sector revenues dropped significantly, especially in the second half of 2009, mainly due to the decreasing economic activity.

TABLE 6 Public sector arrears

(1)	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
(2)	54.8	2.2	4.8	4.6	2.8	8.0	602.2	237.2	169.4	146.9
(3)	74.3	42.3	47.9	51.4	54.2	73.6	196.8	194.3	207.1	179.2
(4)	129.1	44.5	52.7	56.0	57.0	81.6	799.0	431.5	376.5	326.1
(5)	57.5	95.1	90.9	91.9	95.3	90.2	24.6	45.0	55.0	55.0
(6)	-2.9	1.3	-5.1	2.4	-1.1	-4.2	-7.8	-1.8	-0.7	-0.3
(7)	0.0	4.3	8.0	9.6	8.9	7.9	-2.4	-10.6	-5.5	-10.4

NOTES Row headings are as follows: (1) year, (2) central government arrears (mio BGN), (3) local government arrears (mio BGN), (4) consolidated arrears (mio BGN), (5) local/consolidated arrears (%), (6) local deficit/expenditures (%), (7) consolidated deficit/expenditures (%). Source: Ministry of Finance (<http://www.minfin.bg>); data for 2012 are for Q1.

At the same time consolidated public sector arrears increased nearly ten times, from 81.6 million BGN in the end of 2008 to 799.0 million BGN in the end of 2009. Local government arrears reached 196.8 millions BGN in the end of 2009 and 207.1 millions BGN in the end of 2011, which is the highest level since the start of financial decentralization reform. It is interesting to note that public sector arrears are more rapidly accumulated at the central level than the local level. During the period 2004–2008 local governments' arrears have formed more than 90% of the total public sector arrears. In the end of 2009 they represent only 24.6%. The increased amount of local arrears is partly due to the low local revenues. In 2009 only 60.2% of the expected local revenues were actually collected. On the other hand, pressed by the scarcity of financial resources, central government retained 10% of the state subsidies for the municipalities, which is in accordance with the regulations of the Annual State Budget Act 2009 ('Zakon za darjavnja budget na Republika Bulgaria' 2009, §17).

It is interesting to note, that local governments in Bulgaria have generally not been sources of severe fiscal deficits in recent years, as a result of the adopted equalization scheme. According to the calculations smaller municipalities register lower indebtedness. The equalization scheme provides smaller local governments with more subsidies per capita and thus compensates them for the shortage of funds caused by low fiscal capacity. Because large and medium size municipalities traditionally rely more on the own-source revenues than on the governmental transfers, they have lost significant part of their revenues due to the economic downturn. However, the local deficit did not exceed 7.8% of the total municipal expenditure in

2009 and decreased to 1.8% in 2010 and 0.7% in 2011, so it does not represent a significant burden on the local budgets.

Conclusion

During the period 1991–2012 Bulgaria has made remarkable progress in reforming and decentralizing local government finance. First of all, the most important pillars of the legal base of local self-government have been adopted, providing a stable background of financial decentralization. Secondly, the importance of local governments has significantly increased, as a share respectively into the gross domestic product and consolidated public sector of the country. Thirdly, expenditure assignment and intergovernmental transfer system have been put on a clear and transparent basis. Fourthly, local governments have been given full control over some of the own-source revenues (local fees, service prices and revenues from municipal asset management) and limited control over the local tax levy. As a result local governments became powerful component of the public sector.

The process of financial decentralization in Bulgaria has been hampered by the worldwide economic and financial crisis. In spite of the anti-crisis measures, public sector revenues dropped significantly, especially in the second half of 2009, mainly due to the decreasing economic activity. The current crisis reached Bulgaria at comparatively mature stage of financial decentralization reform, but municipalities can do very little without active central government support and cannot substitute for it in regard of the basic anti-crisis measures.

Notes

1. NUTS I, NUTS II and NUTS III are the abbreviations respectively of the level I, II and III of the Nomenclature of Territorial Statistical Units within the meaning of Regulation (EC) no. 1059/2003 of the European Parliament and of the Council of 26 May 2003. LAU 1 is denotation for local administrative unit.

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