

**BULGARIA:**  
**MUNICIPAL FINANCE**  
**REFORM STRATEGY**

Prepared for



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**MUNICIPAL FINANCE REFORM STRATEGY**

**CHAPTER I.  
SUMMARY OF FINDINGS AND RECOMMENDATIONS**

**PURPOSE AND ORGANIZATION OF THIS STUDY**

This report examines the need and the potential for municipal finance reform in Bulgaria. It identifies current opportunities and constraints affecting the process and recommends a strategy for a possible USAID effort in support of municipal finance reform in Bulgaria over the next five years.

In order to establish the context for such a strategy, the report analyzes current problems in municipal decentralization and local finance in Bulgaria and describes their recent evolution. The analysis is based on existing documents and on interviews by team members with national government officials, with the executive staff of organizations representing local governments and with the experts and consultants of USAID's Local Government Initiative program and those of other relevant donor programs in Bulgaria.

Using data on aggregate municipal budgets and on the consolidated national budget provided by the Ministry of Finance, the report also looks at trends in local finance over the past six years, that is, from 1991 to 1996. It compares those trends to the evolution of the national budget and of the economy of Bulgaria during the same period.

As the final element in setting the context for a municipal finance reform strategy, the report looks at the factors that might contribute to the success of the reforms, as well as those that could constrain the process over the next few years. Among the former are the ongoing efforts by representatives of local governments, national government officials and members of Parliament to amend existing legislation on local taxes and fees and to enact a new Law on Municipal Finance. Among the latter are the current fiscal crisis in Bulgaria and the measures implemented by the Government to address that situation.

Finally, the report makes recommendation on a municipal finance reform strategy that has two components. The first is a reform agenda that describes the key areas of reform and ranks them according to their relative importance and to the likelihood that they might be enacted given current and projected fiscal constraints. The second is a series of activities designed to support the reform process and show early results.

This chapter summarizes the principal findings and recommendations of the study. Chapter two examines current problems in municipal finance in Bulgaria. Chapter three looks



at the corresponding trends over the last six years. Chapter four analyzes the principal opportunities and constraints regarding the reform process. Chapter five describes the proposed municipal finance reform strategy.



## **CHAPTER II. CURRENT PROBLEMS IN MUNICIPAL FINANCE**

The present diagnosis covers the interrelation between the central and the local governments; local revenues and relevant local government authority; local expenditures and relevant local government authority. It looks at the status of local finance between 1993-1994, as reflected in the diagnosis of the Economic Policy Group, KPMG - Peat Marwick of 1994. It also analyzes the status of local finance in 1997 and the nature and trends of the changes that have taken place during the last five years.

### **INTERRELATION BETWEEN CENTRAL AND LOCAL GOVERNMENTS**

Out of the entire set of draft laws, aspiring to provide the framework for the national regional policy and local self government by 1994, only one, the law on local self government and local administration, was adopted in 1991. The outdated precepts about the levels of local government and the existence of certain texts which hinder local decision-making (the interrelation between the municipal councils and the municipal administration) led to the need of amending this law in 1995. Some laws, pertaining to the administrative and territorial structure and the internal division of cities were also adopted in that year. The law on municipal property was adopted in the following year while the law on local finance was not enacted within the mandate of the 37<sup>th</sup> National Assembly.

Since 1993 the size of the state transfers for municipalities has been established by means of an "objective formula". Instead of making up for the deficit this formula strives to provide a pre-determined subsidy to each municipality. Originally planned for gradual adoption over a 5-year period, this mechanism has been subjected to annual modifications and made increasingly complex, to be abandoned infrequently for the sake of "manual steering".

The significant amendments to the law on local self government and local administration are positive yet insufficient. The areas of local government discretions have been defined in a very general way, without a clear cut distinction from those of the central government. The provisions on the local revenues and expenditures are also far too general and refer the reader to other laws (awaiting adoption) for clarification.

The law on municipal property provided the legal framework to one of the major problems experienced by the local governments. The separation of municipal property from that of the state has a direct bearing on local self government and particularly on local finance. Unfortunately, the practical separation of these two types of property has turned out to be quite complicated an issue due to the lack of title deeds for part of the property. Another hindrance



are the conflicting interests of the local governments and the central authorities. The latter, represented by the regional administrations, are often aspiring to nationalize and subsequently sell public establishments as a source of fresh revenue to the national budget.

Although local budgets are closed in nominal terms, there is a common understanding among the central and local governments that local budgetary deficits should be financed. To some extent the multiple exceptions to this practice are determined by the overall social and economic instability which calls for a subjective redistribution of state subsidies favoring such local governments as are financially most affected.

### ***Assessment of the Relations between the Local and Central Governments***

There has been an overall delay in the legislative reform. The initial idea of adopting all laws relevant to the national regional policy and local self government in a package and in correlation, was abandoned. Laws are adopted piecemeal and this makes the task of coordinating every consecutive law with its predecessors an arduous one. Moreover, although the laws passed over the reviewed period have significant weight they are not as fundamental, as the law on local finances and the law on local taxes and fees which were first proposed in **199x** and are still pending adoption after numerous revisions.

The executive power demonstrates its willingness to support the process of decentralization. However there is no coordination between its separate entities, hence its inability to come up with a coherent reform strategy.

The postponed adoption of the major laws, i.e. the law on local finance and the law on local taxes and fees has enabled the central government to centralize some main local budget revenue sources and to restrict local government discretions with respect to municipal expenditure.<sup>1</sup>

The annual modifications of the state transfer mechanism render it increasingly complicated. The subsidies allocated to local governments depend extensively on the decision of the central government. The state transfer mechanism lacks transparency and also gives no possibility to local governments to predict their subsidies.

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<sup>1</sup> In 1994, the turnover tax (of which the local governments received 10 percent of revenues) was replaced by the value added tax which accrued 100 percent to the central government.

## LOCAL REVENUES AND RELATED LOCAL GOVERNMENT AUTHORITY

Taxes—shared and other tax revenue—constitute the major source of revenues to the local governments. In 1996 they accounted for 47.3 percent of total local revenues. Of this, the majority share (44.5 percent) belongs to the shared taxes levied on the profits and the income of the population. Fees account for 8.7 percent of the non-tax revenues, while other non-tax revenues from municipal activities (rents, transactions in municipal property, etc.) account for approximately 9 percent. In 1996 state transfers constituted 33.1 percent of the total local revenues, while borrowed funds were insignificant, accounting for less than 2 percent.

The above numbers show the breakup of revenue sources for all municipalities. However, municipalities can also be classified into three different groups showing a wide variance in the share of individual revenues in their budgets. The first group comprises small municipalities (5-8 in all), which accommodate large enterprises, and therefore earn substantial shared taxes—profits and income tax—since these taxes are shared with the local government based on the place of employment not residence. This group of municipalities are not entitled to state subsidies, and in fact have to contribute to the central government budget. The second group consists of large urban municipalities (approximately 30) whose developed economy provides their budgets with a relatively steady flow of revenue, despite the critical blow they suffered when the turnover tax was abolished in April 1994. The remaining municipalities are heavily reliant on state subsidies which in the cases of the most poorly developed ones amount up to 80 percent of their total revenues.

Bulgarian local governments have no power to set tax rates. They can set the fees rates within a range, determined by the central government. Full discretion is delegated to them only with respect to setting the solid waste collection fee, prices of individual services and municipal property rents. Local governments are in full possession of the proceeds raised through privatization of municipal property, although some constraints are still in place as to their utilization.

The protracted passage of the tax laws enabled the central government to continue diminishing the share of local governments in the shared taxes, which form their major sources of revenue. The changes resulted in an erosion of local revenues. Although local governments have greater freedom to set the local fees rates and thus increase local revenues, this measure has had little impact on their financial state.

The following current problems have a decisive influence over local revenues:

- the interrelation of the local governments and the tax administration which in 1991 became subordinated to the MOF. Its interests and corresponding efforts are aimed at collecting taxes from the larger taxpayers, resulting in the delayed



- collection and disbursement of the revenues from local taxes and fees to the local governments. In an dynamic inflationary environment this leads to additional losses for the municipal budgets;
- the outdated tax bases for the real estate tax. These taxes account for a mere 1 percent approximately of the local revenues;
  - the inability of local governments to impose local fees and to set their rates freely results in a growing chasm between their revenue potential and the actual costs in providing the respective services. Another significant circumstance is the lack of incentives for local governments to use their existing discretions;
  - the collection and sharing of the general income tax by place of employment rather than residence creates great financial inequality among municipalities;

All the above conditions lead to a greater decline of the share in the G.P. of local revenues in comparison to the share of the consolidated national budget (see next item).

### ***Assessment of The Change in Local Government Revenues***

Local governments have suffered more than the central government from the decreased financial capacity and public finances of the country. During the reviewed period, rules were subject to continuous changes resulting in a centralization of local revenues. Local governments have limited possibilities to influence the size of their revenues and therefore project or plan their budgets. The share of different sources of own revenues in the local budgets, i.e. the insignificant share of the real estate tax and the prevailing share of the revenues from shared taxes (which depend on the business results of the respective taxpayers), is another reason why local governments cannot project their revenues. The tax administration has no incentive to perform timely and fully, the collection of the local budget revenues. All the above factors results in local governments contineuing to focus their efforts to ways to increase transfers (unconditional and targetted state subsidies) from the central government.

### **LOCAL EXPENDITURES AND LOCAL GOVERNMENT AUTHORITY**

Bulgarian local governments finance activities in the area of education, health care, social care and welfare, culture, sports, tourism, urban development and public utilities. All the above activities are matched with a corresponding local or municipal infrastructure of services. Exceptions to this rule are certain schools, hospitals and public establishments, located predominantly in major population centers which service the population of adjacent municipalities.

In 1996 the share of the expenditures for education on an average for all municipalities was approximately 31 percent, for health care 29 percent, for social welfare 8.7 percent and for urban development and public utilities 16 percent. There exist certain differences among



municipalities in the allocation of expenditures - the larger ones allocate a higher share for health care, while in the case of smaller ones the greatest expenditure is claimed by education. During the reviewed period there were no substantial changes either in the discretions of the local governments to finance and manage certain activities, nor in the relative shares of the corresponding expenditures.

The KPMG report of 1994 points out that “there should be drawn a distinction between expenditures which are nominally financed through the local budgets and expenditures for which municipal councils have a certain freedom to decide upon”. This statement remains valid in 1997. The strongest points of conflict exist in the area of shared responsibility, such as education and health care. The corresponding national ministries direct the entire activity of the health and education establishments and appoint their staff. Additionally, they decide whether an establishment will be placed under municipal or central management.

The standardization of the relative shares of the individual objective criteria, applied in calculating the state subsidy, fails to account for the differences among the expenditures of the separate local governments by functions. The lack of clear criteria for distribution leads to general discontent and suspicion of subjectivity. It is impossible to precisely determine the benefit to small municipalities which do not incur any costs for having a part of their population served by larger neighboring municipalities, nor to determine what benefits do the larger municipalities extract from receiving greater subsidies and from the distribution of the general income tax by place of employment.

Local governments are responsible for adopting their total budget, but have no subsequent say as regards their expenditure. Whenever they run short of funds, they simply stop cashing the invoices issued to various suppliers, and start amassing unpaid expenses. The other alternative to which local governments often resort, especially when wages need to be paid out, is to borrow temporary non-interest loans from the extra budgetary funds of municipal owned enterprises. Given the high inflation rate, the nominal repayment of the funds becomes easier for local governments and turns into a major tool for circumventing the restrictions laid on their expenditures.

### ***Assessment of the Change in Local Expenditures***

The central government has continued its practice of taking decisions impacting local expenditures without offering local governments the appropriate financial resources for implementing them. There is no clean demarcation of responsibilities among local governments and the corresponding ministries in the areas of health care and education. This fact has added to the discrepancy between the responsibilities of local governments to finance activities and their discretions to manage the respective expenditures.



The responsibilities of the local governments in the management and financing of public activities are not clearly defined. This prevents them from making accurate revenue calculations and projections. The inability of local governments to influence the management of the activities relating to education and health care also diminishes their motivation to seek ways of improving the respective services. Financing is provided for the maintenance of public establishments, and not for the actual services rendered. The existing opportunities for temporary and interest-free borrowing of extra budgetary funds leads to their actual reallocation in contradiction to their original specific designation. The manner in which public establishments with supra-municipal functions are financed places the interests of neighboring municipalities in conflict. This provides little encouragement to inter municipal co-operation.



## CHAPTER III. TRENDS IN MUNICIPAL FINANCE 1993 - 1997

### TREND ANALYSIS

The trend in expenditure responsibilities and revenue sources for the different levels of government are important indicators of the economic direction of the country. The allocation of expenditures and revenue sources of local governments are a further indication of the extent of decentralization and the move towards an autonomous and accountable structure of governance. It also forms the basis for the need for an effective system of intergovernmental transfers.

#### *Expenditure Assignment*

Clear specification of expenditure responsibilities between different levels of government is the starting point for a new role of government in a market economy. Since expenditure responsibilities have to be clarified before the allocation of limited local revenues, it is important to assess the break up of responsibilities and the discretion allowed to local governments. As explained in the diagnostic section, local governments in Bulgaria, have limited flexibility and discretion in their expenditure responsibility.

The current legal expenditure assignment across government levels is summarized in Table one. This table updates the expenditure assignments as they existed in 1993, to 1996. The changes that have occurred are marked in italics. They are few. In most cases the assignment of responsibilities today remains as it was in 1993. Changes in the assignment of water and sewerage show a more positive shift—away from the existence of only state enterprises to the emergence of limited liability companies (with the central government have the majority share and local governments the minority share). The only other substantial change has been the privatization of most public transportation at the local level.

Most functions allocated to the central government have a national dimension and include defense, the justice system, foreign relations and research in health and education. Local governments have been assigned responsibilities for services which have a local benefit area, such as primary and secondary schools, health care and sanitation. However, the expenditure assignments in table one should not be interpreted as representing fiscal autonomy for local governments. The central government continues to determine some mandatory levels of expenditure in sectors such as health, education and social service, and local governments lack the freedom to shut down or discontinue service provision in any institution associated with the above three sectors.

**Table 1: Expenditure assignments, Bulgaria, 1996**

| Category                   | Central Government |  | Municipality |  | Settlement |  |
|----------------------------|--------------------|--|--------------|--|------------|--|
| Defense                    | C                  | Entire responsibility  |              |  |            |  |
| Justice/Internal security  | C                  | Entire responsibility  |              |  |            |  |
| Foreign economic relations | C                  | Entire responsibility  |              |  |            |  |
| Education                  | C                  | All universities and research institutions                             | C            | All expenditures (capital and current) of primary and secondary schools                            | C          | Some kindergartens                             |
|                            | C                  | Some technical and vocational schools                                  | C            | Some kindergartens   |            |  |
|                            |                    |  | C            | Some technical and vocational schools  |            |  |
| Health                     | C                  | Research medical institutions  | C            | Homes for elderly population   | C          | Some primary health facility                   |
|                            | C                  | Some special service hospitals   | C            | Tertiary care and psychiatric hospitals  |            |  |
|                            |                    |  | C            | Polyclinics  |            |  |
|                            |                    |  | C            | Some primary care  |            |  |
|                            |                    |  | C            | Some special service hospitals   |            |  |
|                            |                    |  | C            | Medicine   |            |  |
| Roads                      | C                  | Construction of all roads  | C            | Maintenance of third- and fourth- class roads and urban streets                                    | C          | Maintenance of local networks                  |
|                            | C                  | Maintenance of state highways and roads linking cities & villages      |              |  |            |  |
| Public Transportation      | C                  | Airport  | C            | <i>Subsidy to some inter village bus service within municipalities (most have been privatized)</i> |            |  |
|                            | C                  | Railway subsidy  |              |  |            |  |
| Fire Protection            | C                  | <i>All fire protection service</i>                                     |              |  |            |  |
| Libraries                  | C                  | National libraries   | C            | Local libraries  |            |  |
| Police Services            | C                  | National police and traffic police (serving national and local levels) | C            | Municipal police (optional)  | C          | Armed personnel (optional)                     |
| Sanitation                 |                    |  | C            | Part of garbage collection and street cleaning   | C          | Part of garbage collection and street cleaning |

| Category                         | Central Government |   | Municipality |   | Settlement |                                    |
|----------------------------------|--------------------|---|--------------|---|------------|------------------------------------|
| Water and Sewerage               | C                  | <i>Limited liability or joint stock companies (with the national government having majority share) constructing and operating the water mains</i> | C            | <i>Municipal owned companies</i>  | C          | Some operation (primarily repairs) |
|                                  |                    |   | C            | Some construction (via targeted subsidy from the national government) and operation |            |                                    |
|                                  |                    |   | C            | Water supply infrastructure for the inner city                                      |            |                                    |
| Heating                          |                    |   | C            | Municipal owned enterprises   |            |                                    |
|                                  |                    |   | C            | Operation and maintenance of the service  |            |                                    |
|                                  |                    |   | C            | Heating subsidy from the municipality to cover losses and differences in prices     |            |                                    |
| Electricity                      | C                  | State owned enterprise covering the full range of service<br>Some state subsidy   |              |   |            |                                    |
|                                  | C                  |   |              |   |            |                                    |
| Housing                          |                    |   | C            | Financing for low income population   |            |                                    |
|                                  |                    |   | C            | Construction by private and municipal/national enterprises                          |            |                                    |
|                                  |                    |   | C            | Subsidy for maintenance of residential housing                                      |            |                                    |
| Price Subsidies                  |                    |   | C            | Mass transport  |            |                                    |
|                                  |                    |   | C            | Medicine (for old, disabled, children, chronic disease)                             |            |                                    |
| Welfare payments                 | C                  | Unemployment fund   | C            | Homeless, disabled, orphans   |            |                                    |
|                                  |                    |   | C            | Large family subsidies (if meet low income criteria)                                |            |                                    |
| Enterprises in Productive Sector |                    |   | C            | Capacity to invest in joint ventures, including banks                               |            |                                    |
|                                  |                    |   | C            | Keep all proceeds from privatization of municipal enterprises                       |            |                                    |

| Category    | Central Government |   | Municipality |   | Settlement |
|-------------|--------------------|---|--------------|---|------------|
| Environment | C                  | Responsible for national environmental issues           | C            | Responsible for local environmental issues  |            |
| Enterprises | C                  | National enterprises (including most types of industry) | C            | Local and municipal enterprises (transport, construction, and other local economy services) |            |

#### Notes

Table was updated from 1993 to 1996.

Source: Table 5.1 Expenditure assignment in Bulgaria, 1993. From "Intergovernmental fiscal relations in Bulgaria" by Jorge Martinez-vazquez in Decentralization of the Socialist State. Intergovernmental Finance in Transition Economies. Edited by Richard M. Bird, Robert D. Ebel and Christine I. Wallich. Washington, D.C.: The World Bank. 1993.

Another analysis of expenditure assignments is shown in Table 2, which examines the share of local expenditures in total consolidated expenditures across sectors.<sup>2</sup> Even though both central and local governments are involved in most activities, local expenditures account for a larger share of education, health, and housing and communal services. In 1993, the share of local expenditures in total consolidated expenditures in the education, health and social welfare activities was 70, 70, and 80 percent respectively.<sup>3</sup> In 1996 it decreased to 55, 59 and 46 percent respectively. The capital expenditure responsibility of local governments has also been decreasing over the years. In 1993, the share of capital expenditures by local governments in total capital expenditure in the education, health and social services sector was 53, 65 and 52 percent respectively.<sup>4</sup> This has declined to 6, 25 and 15 percent respectively in 1996.

The decrease in local government expenditures in education and health from 1993 to 1996 has been greater than the decrease in central government expenditures in these two sectors. This is seen in the following box which shows expenditures first in millions of leva and then as a percent of GDP.

| Level of Government<br>(millions of leva)<br>(% of GDP) | 1993            |                 | 1996            |                 |
|---|-----------------|-----------------|-----------------|-----------------|
|   | Education       | Health          | Education       | Health          |
| Central   | 5,636<br>1.89%  | 4,973<br>1.66%  | 28,576<br>1.72% | 23,074<br>1.39% |
| Local   | 12,871<br>4.31% | 11,638<br>3.89% | 34,781<br>2.09% | 32,899<br>1.98% |

Note

GDP (in millions of leva) in 1993 was 298,934, and in 1996 it was 1,660,200.

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<sup>2</sup> Total consolidated central government includes the central government + judiciary + social security + local governments.

<sup>3</sup> From Jorge Martinez-Vazquez "Intergovernmental Fiscal Relations in Bulgaria." 1995. Intergovernmental Fiscal Relations in Transition Economies. Edited by Richard Bird, Robert Ebel and Christine Wallich. Washington D.C.: The World Bank.

<sup>4</sup> From Jorge Martinez-Vazquez "Intergovernmental Fiscal Relations in Bulgaria." 1995.



**Table 2  
Consolidated Fiscal Expenditures and Decentralized Expenditures by Function, 1996**

| Category                       | General Admin | Defense | Police and Fire Protection | Education | Health | Social Security Revenue | Social Assist | Social Welfare Activities | Housing and Com Development | Recr and Culture | Transport and Commun. |
|--------------------------------|---------------|---------|----------------------------|-----------|--------|-------------------------|---------------|---------------------------|-----------------------------|------------------|-----------------------|
| Total consolidated expenditure | 26,472        | 41,362  | 24,651                     | 63,357    | 55,973 | 118,224                 | 38,511        | 9,475                     | 22,000                      | 9,336            | 16,953                |
| Total central expenditures     | 19,718        | 41,362  | 24,214                     | 28,576    | 23,074 | 118,224                 | 33,167        | 5,140                     | 4,253                       | 6,116            | 13,431                |
| Total local expenditures       | 6,754         | -       | 437                        | 34,781    | 32,899 | -                       | 5,344         | 4,335                     | 17,747                      | 3,220            | 3,522                 |
| Local as % of central          | 25.51         | 0.00    | 1.77                       | 54.90     | 58.78  | -                       | 13.88         | 45.75                     | 80.67                       | 34.49            | 20.78                 |
| Total capital expenditure      | 1,598         | 557     | 1,446                      | 5,658     | 2,196  | -                       | -             | 115                       | 5,884                       | 482              | 3,425                 |
| Central Capital Expenditures   | 1,433         | 557     | 1,446                      | 5,308     | 1,651  | -                       | -             | 98                        | 712                         | 462              | 3,425                 |
| Local capital expenditure      | 165           | -       | 0                          | 350       | 545    | -                       | -             | 17                        | 5,172                       | 20               | -                     |
| Local as % of central          | 10.33         | -       | 0.00                       | 6.19      | 24.82  | -                       | -             | 14.78                     | 87.90                       | 4.15             | -                     |

Source: Ministry of Finance, Bulgaria.



Table 3 shows the breakup of local government expenditures by sectors, and local government revenue sources from 1991 to 1996. The relative share of expenditures in the different sectors has remained approximately the same across the years. This is specifically seen in the education and health sector and is due to the fact that the central government continues to mandate minimum expenditure requirements in these sectors, especially with respect to salaries. Since salaries account for a large portion of expenditure in these two sectors, and local governments are also obliged to maintain these services, the relative share of expenditures in the health and education sector is usually the same across different years.

### **Revenue Sources**

Local governments in Bulgaria have two main sources of revenue: shared tax revenues and transfers.<sup>5</sup> Shared revenue includes revenue from the company profit tax (36 percent goes to the central government and 6.5 percent to the local government), personal income tax (50 percent to the central and 50 percent to the local government), and until January 1994, 10 percent of the turnover tax. The turnover tax was replaced by the value added tax (VAT) which is not shared with the local governments. Revenues from excise tax and customs duties are also shared but they account for a very small portion of local shared taxes. In 1991, shared revenues accounted for 72 percent of local revenue sources. Its share in local revenues decreased until 1994 (33 percent), and then had a relative increase in 1995 (36 percent) and 1996 (44 percent).

The share of non-tax revenues, especially from fees has been increasing for local governments. In 1993 fees accounted for only 3 percent of local revenues, but increased to 9 percent by 1996. Transfers from the central government have always accounted for a significant portion of local revenues. Transfers from the central government reached a high of 48 percent of local revenue sources in 1993. Since then they have been steadily declining and in 1996 accounted for 33 percent of local revenue sources.

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<sup>5</sup> In Bulgaria, local governments refer to all tax and non-tax revenues as "own revenue". This is irrespective of the fact that some of the taxes are shared, and that local governments have no authority in setting the tax rates (except for local fees which are set by the Municipal Council within a upper and lower bound determined by the Ministry of Finance.)



Revenue sharing in Bulgaria is based either on a derivation basis (profit tax)<sup>6</sup> or origin basis (personal income tax).<sup>7</sup> The amount shared with the local government has also been changing and decreasing since 1992, thus local governments are not able to accurately forecast their annual revenue sources.

**Table 3**  
**Local Government Revenues and Expenditures in Bulgarian Leva ('000) - nominal values**

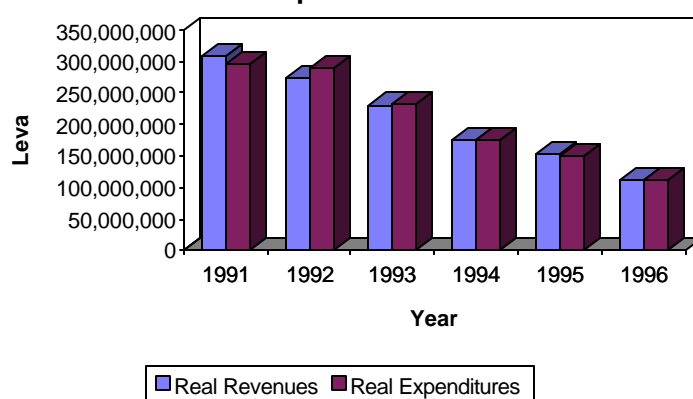
| Revenues                        | 1991                 | Jan-June 1992        | 1993                 | 1994                 | 1995                 | 1996                  |
|---------------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|-----------------------|
| Tax Revenue (2+3)               | 11,309,700<br>73.19% | 6,189,900<br>57.15   | 16,530,000<br>47.84  | 17,075,567<br>35.00  | 26,070,697<br>38.00  | 52,994,779<br>47.00   |
| Shared Rev. (2)                 | 11,175,500<br>72.32  | 6,090,400<br>56.23   | 16,127,700<br>46.68  | 15,980,358<br>32.66  | 24,332,893<br>35.66  | 49,813,388<br>44.45   |
| Other Tax Rev. (3)              | 134,200<br>0.87      | 99,500<br>0.92       | 402,300<br>1.16      | 1,095,209<br>2.24    | 1,737,804<br>2.54    | 3,181,391<br>2.84     |
| Non-Tax Rev. (4+5)              | 546,400<br>3.54      | 1,093,500<br>10.10   | 1,338,100<br>3.87    | 8,499,581<br>17.37   | 12,334,128<br>18.00  | 19,941,387<br>17.79   |
| Fees (4)                        | 245,900<br>1.59      | 226,000<br>2.09      | 942,500<br>2.73      | 4,896,794<br>10.10   | 6,396,979<br>9.34    | 9,713,008<br>8.67     |
| Other Non-Tax Rev. (5)          | 300,500<br>1.94      | 867,500<br>8.01      | 395,600<br>1.14      | 3,602,788<br>7.36    | 5,937,149<br>8.67    | 10,228,379<br>9.13    |
| Transfers                       | 3,595,900<br>23.27   | 3,546,900<br>32.75   | 16,684,800<br>48.29  | 21,705,480<br>44.36  | 28,808,430<br>42.05  | 37,099,227<br>33.10   |
| Borrowing (6+7+8)               | na                   | na                   | na                   | 1,648,407<br>3.37    | 1,291,316<br>1.89    | 2,041,742<br>1.82     |
| Temporary Non-Int. (6)          | -                    | -                    | -                    | 766,446<br>1.57      | 881,767<br>1.29      | 2,103,311<br>1.88     |
| Int. Bearing fr. Fin. Insti (7) | -                    | -                    | -                    | 683,388<br>1.40      | 82,057<br>0.12       | -74,200<br>-0.07      |
| Bonds (8)                       | -                    | -                    | -                    | 198,572<br>0.41      | 327,492<br>0.48      | 12,631<br>0.01        |
| Total                           | 15,452,000<br>100.00 | 10,830,300<br>100.00 | 34,552,900<br>100.00 | 48,929,035<br>100.00 | 68,504,571<br>100.00 | 112,077,135<br>100.00 |
| Expenditure                     | 1991                 | Jan-June 1992        | 1993                 | 1994                 | 1995                 | 1996                  |
| Education                       | 5,023,000<br>33.84   | 3,343,000<br>32.54   | 12,871,000<br>37.02  | 15,804,660<br>32.49  | 21,989,619<br>32.43  | 34,780,633<br>31.21   |
| Culture                         | 419,000<br>2.82      | 245,000<br>2.39      | 1,006,000<br>2.89    | 1,395,786<br>2.87    | 2,115,053<br>3.12    | 3,185,406<br>2.86     |

<sup>6</sup> The taxes shared are those actually paid in the jurisdiction.

<sup>7</sup> The taxes are shared based on the location of employment, not on the location of residence.

|                    |                    |                    |                     |                     |                     |                     |
|--------------------|--------------------|--------------------|---------------------|---------------------|---------------------|---------------------|
| Health Care        | 4,135,000<br>27.86 | 3,023,000<br>29.43 | 11,638,000<br>33.47 | 15,010,007<br>30.86 | 20,681,337<br>30.50 | 32,505,260<br>29.17 |
| Housing & Communal | 2,482,000<br>16.72 | 1,797,000<br>17.49 | 3,320,000<br>9.55   | 8,103,934<br>16.66  | 10,960,457<br>16.16 | 17,747,105<br>15.93 |
| Social Welfare     | 1,054,000<br>7.10  | 836,000<br>8.14    | 3,632,000<br>10.45  | 4,707,774<br>9.68   | 6,367,033<br>9.39   | 9,678,484<br>8.69   |
| Local Admin.       |                    |                    |                     |                     |                     | 6,754,192<br>6.06   |

**Figure 1**  
**Local Government Real Revenues and Expenditures**



|       |                      |                      |                      |                      |                      |                       |
|-------|----------------------|----------------------|----------------------|----------------------|----------------------|-----------------------|
|       | 637,000<br>4.29      | 390,000<br>3.80      | 1,104,000<br>3.17    | 2,630,631<br>5.41    | 4,077,951<br>6.01    |                       |
| Other | 1,092,000<br>7.36    | 638,000<br>6.21      | 1,201,000<br>3.45    | 991,851<br>2.04      | 1,615,729<br>2.38    | 6,775,591<br>6.08     |
| Total | 14,842,000<br>100.00 | 10,272,000<br>100.00 | 34,772,000<br>100.00 | 48,644,643<br>100.00 | 67,807,179<br>100.00 | 111,426,671<br>100.00 |

Source: Numbers for 1991—1993 are from Table 5.3 and 5.4 of "Intergovernmental Fiscal Relations in Bulgaria," by Jorge Martinez-Vazquez. Numbers for 1994—1996 are from the Ministry of Finance, Bulgaria.

### **Combined Expenditure and Revenue Analysis**

Figure 1 shows local government real revenues and expenditures from 1991 to 1996.<sup>8</sup> There has been a steady decline in both revenues and expenditures through the years with a local government deficit in 1992 and 1993.

<sup>8</sup> The consumer price index (CPI) was used from 1991 to 1996, and nominal values inflated to 1996 prices. It was decided to inflate values to 1996 prices rather than deflate values with 1991 as the base, since the CPI for 1996 is a more accurate reflection of the economy than the index for 1991 or 1992.



Figure 2 shows local expenditures as a percent of the consolidated national budget (CNB) and as a percent of gross domestic product (GDP). Local government expenditures as a percent of national government expenditures and as a percent share of GDP, have declined at a similar pace. The high was reached in 1992 as a result of the new reforms initiated in 1991. However the role of local governments in the economy has decreased from 1992 to 1996 by 51 percent as a share of GDP, and 48 percent as a share of CNB.

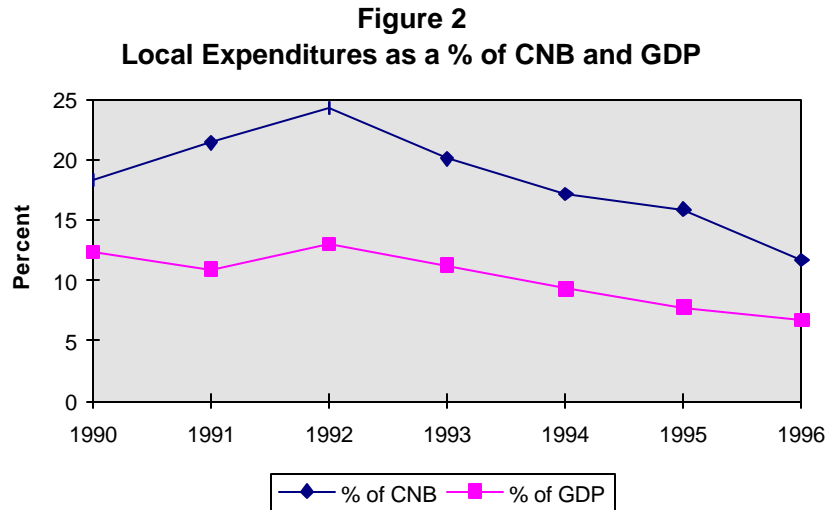


Figure 3 shows both the local and central expenditures as a percent of GDP. It also shows CNB minus debt service as a percent of GDP. Comparing local expenditures to expenditures of the CNB shows that local expenditures have been compromised when compared to central expenditures—central expenditures show a positive trend after 1992, but local governments show a negative trend.

When we examine the extent of debt service of the central government—which has been increasing since 1990—and compare local expenditures as a percent of GDP with CNB minus debt service as a percent of GDP, the disproportionate local loss in expenditures is not as severe. The divergence between local and central expenditures is still seen in two years—between 1992 to 1993 and 1995 to 1996, with central expenditures showing a positive trend and local expenditures a negative trend.



**Figure 3**  
**Local Budget & CNB as a % of GDP**

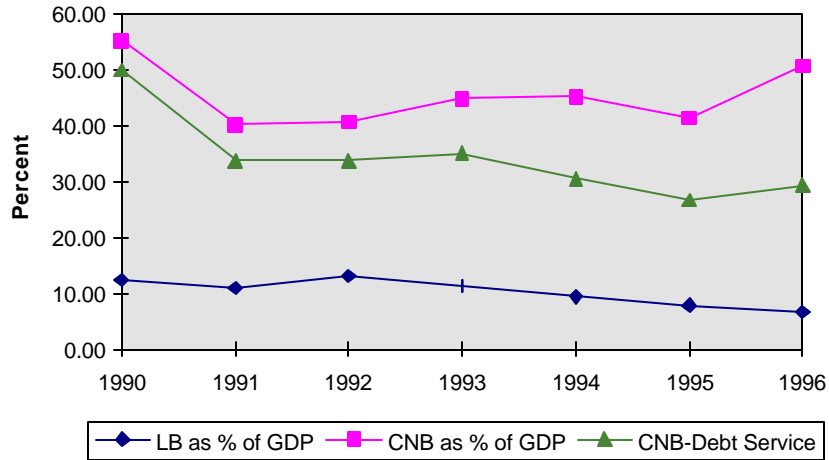


Table 4 on the next page presents a variety of socioeconomic and fiscal data for local governments grouped according to the size of their population for 1996. In 1993 Sofia spent considerably more on a per capita basis than the other groupings of local government.<sup>9</sup> This remains the same in 1996. Excluding these extremes there is not much variation across the other groups except in health care, housing and local administration.

<sup>9</sup> "The Decentralization of Local Government in Bulgaria." 1994. Prepared by KPMG Peat Marwick Policy Economics Group for the National Center for Regional Development and Housing Policy, Ministry of Regional Development and Construction.

**Table 4**  
**Aggregate Data for Local Governments According to the Size of Urban Population, 1996**

| Category   | 1,000 to<br>5,000 | 5,000 to<br>10,000 | 10,000 to<br>50,000 | 50,000 to<br>100,000 | 100,000 to<br>500,000 | Sofia     | National<br>Aggregate |
|--|-------------------|--------------------|---------------------|----------------------|-----------------------|-----------|-----------------------|
| <i>Socio Economic Indicators</i>   |                   |                    |                     |                      |                       |           |                       |
| Number of Municipalities   | 22                | 60                 | 139                 | 21                   | 12                    | 1         | 255                   |
| Total Population   | 76,950            | 465,703            | 2,994,275           | 1,549,998            | 2,064,969             | 1,189,043 | 8,340,938             |
| % of Population Urbanized  | 0.92%             | 5.58%              | 35.90%              | 18.58%               | 24.76%                | 14.26%    | 100.00%               |
| % of Population < age 18   | 0.65%             | 5.11%              | 37.54%              | 18.98%               | 25.15%                | 12.57%    | 18.61%                |
| % of Population > age 60   | 1.65%             | 8.24%              | 40.68%              | 16.42%               | 19.89%                | 13.12%    | 24.45%                |
| 18 < % of Population < 60  | 0.70%             | 4.60%              | 33.31%              | 19.38%               | 26.72%                | 15.29%    | 56.94%                |
| <i>Revenues as a Percent of Total Municipal Expenditures<sup>a</sup></i> |                   |                    |                     |                      |                       |           |                       |
| Tax Revenue  | 31.41%            | 36.31%             | 34.72%              | 48.47%               | 53.29%                | 65.31%    | 47.62%                |
| Shared Tax Revenue   | 30.03%            | 35.22%             | 32.78%              | 46.25%               | 49.44%                | 60.99%    | 44.76%                |
| Other Tax Revenue  | 1.38%             | 1.09%              | 1.94%               | 2.23%                | 3.85%                 | 4.31%     | 2.86%                 |
| Non-Tax Revenue  | 21.67%            | 11.59%             | 14.67%              | 16.60%               | 20.78%                | 22.50%    | 17.92%                |
| Fees   | 4.72%             | 5.56%              | 6.84%               | 8.07%                | 10.22%                | 11.75%    | 8.73%                 |
| Other Non Tax Revenue  | 16.95%            | 6.03%              | 7.83%               | 8.53%                | 10.56%                | 10.76%    | 9.19%                 |
| Transfers  | 49.83%            | 52.04%             | 50.02%              | 34.03%               | 23.60%                | 11.04%    | 33.33%                |
| Borrowing  | 0.85%             | 1.05%              | 1.66%               | 1.56%                | 2.50%                 | 1.75%     | 1.83%                 |
| <i>Percent Distribution of Expenditures by Sectors</i>                   |                   |                    |                     |                      |                       |           |                       |
| Education  | 26.59%            | 29.93%             | 36.44%              | 31.87%               | 30.35%                | 23.48%    | 31.21%                |
| Culture  | 3.67%             | 2.92%              | 2.92%               | 3.29%                | 3.11%                 | 1.84%     | 2.86%                 |
| Health Care  | 10.29%            | 15.57%             | 23.96%              | 37.48%               | 37.83%                | 22.16%    | 29.17%                |
| Housing  | 28.14%            | 18.91%             | 13.54%              | 12.06%               | 13.80%                | 25.59%    | 15.93%                |
| Social   | 10.75%            | 12.96%             | 11.73%              | 7.82%                | 7.28%                 | 4.89%     | 8.69%                 |
| Local Admin.   | 11.45%            | 11.58%             | 8.36%               | 5.11%                | 4.19%                 | 3.72%     | 6.06%                 |

| Other                                    | 9.11%     | 8.13%     | 3.06%     | 2.37%     | 3.44%     | 18.32%    | 6.08%     |
|--|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| <i>Per Capita Expenditure by Sectors</i> |           |           |           |           |           |           |           |
| Education                                | 4,219.10  | 4,176.09  | 4,138.66  | 4,253.91  | 4,319.92  | 3,872.72  | 4,192.68  |
| Culture                                  | 582.11    | 408.06    | 332.18    | 438.86    | 442.58    | 304.26    | 387.86    |
| Health Care                              | 1,633.62  | 2,172.06  | 2,720.71  | 5,003.31  | 5,384.83  | 3,655.76  | 3,915.60  |
| Housing                                  | 4,465.35  | 2,638.04  | 1,537.49  | 1,610.14  | 1,964.44  | 4,221.09  | 1,967.05  |
| Social                                   | 1,706.39  | 1,808.83  | 1,331.94  | 1,044.32  | 1,036.01  | 806.18    | 1,187.54  |
| Local Admin.                             | 1,817.67  | 1,615.57  | 949.27    | 682.32    | 597.02    | 613.23    | 824.85    |
| Other                                    | 1,445.90  | 1,134.04  | 347.20    | 316.76    | 489.90    | 3,022.59  | 642.70    |
| Total                                    | 15,870.15 | 13,952.68 | 11,357.45 | 13,349.61 | 14,234.71 | 16,495.83 | 13,118.27 |

## Notes

<sup>a</sup>The grouping of local governments into population groups does not capture the fact that there exist some very small local governments which earn very high tax revenues which are then contributed to the central government.

Source: Ministry of Finance data, Bulgaria.



## CHAPTER IV. THE CONTEXT FOR MUNICIPAL FINANCE REFORM

### THE NEED FOR CHANGE

Given the current problems in municipal finance and given the general problems that Bulgaria faces today, there are two major areas of need that argue for a significant municipal finance reform.

The current system of municipal finances includes disincentives to sound management of local finances and impairs severely the ability of municipalities to sustain service coverage and improve service quality. Thus, this first statement of need relates to the basic function of local governments. The reforms are required in this case to enable local governments to address local service needs, either by maintaining current service coverage or by improving service quality.

At the same time, Bulgaria is undergoing a difficult process of structural adjustment. Bulgaria had a budget deficit equivalent to 11.7 percent of GDP in 1996. The target for 1997 is a deficit equivalent to 6.2 percent of GDP. The preliminary target for 1998 is around 3 percent. Meeting these targets will entail a massive contraction of public expenditures over three years. Bulgaria has adopted the use of a currency board, with the *Leva* pegged to the German mark. This will make the process all the more difficult. As payment of the internal and external debt and growing unemployment benefits claim a larger share of the diminishing public budget, those expenditures that are the responsibility of municipalities, such as the health and education service delivery, will come under intense pressure. This will require, inevitably, very difficult choices that will entail significant changes in these important services.

Municipalities should play a major role in the current process of structural adjustment. They are in a unique position to allow local residents to participate in making the difficult decisions. That is not possible under current circumstances because municipalities do not have authority over their expenditures in these areas. The reforms are required in this case to empower municipalities to make autonomous decisions at the local level so that the choices regarding the impending changes in service delivery reflect local priorities as expressed directly by their constituents.

### OPPORTUNITIES AND CONSTRAINTS

Municipal officials have a clear reform agenda and are well organized to push for reforms. Interviews with the National Association of Municipalities, the Foundation on Local Government Reform and with the National Association of Public Finance Officers confirmed that these organizations have clear, well-articulated views on municipal finance reform. Much of their attention at this time is centered on the Law on Local Taxes and Fees and on the Municipal Finance Law. The fact that these two laws already are in advanced stages of drafting and discussion adds to the likelihood of some action in this area.

National government officials and members of Parliament are willing to support the reforms. However, they do not appear to have a clear reform agenda of their own. Further, it is highly likely that in their mind the



measures to address the national fiscal crisis will take precedence over municipal finance reforms. This is already evident in the legislative agenda for the balance of 1997, which is burdened with an ambitious agenda of laws to address various aspects of the ongoing adjustment process.

An additional complicating factor is that key aspects of the municipal finance reform will depend on the enactment and implementation of many of the key measures involved in the overall adjustment process, such as reforms to the national tax system, and in health and social safety. These reforms are extremely complicated and will take time to enact and implement. Municipal financial reform will not be complete until these other initiatives have produced initial results.

## **PROSPECTS FOR CHANGE**

Given these circumstances, it is not surprising that the prospects for municipal finance reform are mixed and difficult to assess. It is possible to implement basic reforms within the next six months, largely in the form of policy decisions reflected in the annual budget law. But, it will take several rounds of legislation and related regulatory changes over more than one year to implement all the key reforms. This means that it will be important for those most interested in municipal finance reform to have the ability to stay the course

The early reforms can lead to improvements in municipal finances and services. Progress will have to come from efficiency gains made possible by increased local autonomy rather than through an increase in local revenues. Given the severe adjustment process and the claims on scarce national budget issues of key items, such as debt service and unemployment insurance, it is unlikely that it will be possible to implement a major increase in municipal revenues until budget year 1999 at the earliest.

In turn, it will not be possible to achieve a sustained increase in local investment levels until it is possible to increase the overall revenues available to municipalities. Overall public sector investment will barely reach 1.1 percent of GDP in 1998, just slightly up from 0.8 percent in the current year.

Finally, as noted above in the discussion of the opportunities and constraints, the improvements in municipal finances that depend on the reforms in health and social safety will take many years. Health reform involves a major restructuring of the sector with a shift toward financing through individual insurance. The resources needed to capitalize the new system will be scarce for many years. Eventually, this reform should have a major beneficial impact on the finances of municipalities.



## CHAPTER V. MUNICIPAL FINANCE REFORM STRATEGY

### STRUCTURE OF THE PROPOSED STRATEGY

Given these prospects, there are two ways in which USAID can contribute to the municipal finance reform process. The first is to help articulate and shape a “reform agenda” that would serve to establish priorities among the various elements of the reform process and understand how they fit together. The objective should be to build a clear, strong consensus around this shared agenda. This will be very important in the early years, when reforms will be most difficult. A clear idea of what is most critical and at the same time viable will help make the most of the initial reforms. On the other hand, a clear reform agenda also will help stay the course over the many years it will take to complete the reform process.

On a parallel level, USAID can support specific activities to promote the reforms and to help show tangible results. First among these are the efforts to help build the consensus over the proposed reform agenda. Also, it will be important to have the option to provide direct assistance to those involved in drafting the actual reforms, including the MOF, should they express an interest in such assistance. Given the complicated, technical nature of many of the issues, the national representatives of the municipalities, as well as local think tanks that collaborate with them, would benefit from assistance in developing policy analysis skills applied to municipal finance. Finally, as the reforms go forward, some limited support for the rapid dissemination to local officials of information on the changes will be useful and important.

### REFORM AGENDA

#### *Priorities*

This section includes the main priorities for a municipal finance reform agenda, which constitute key elements of the proposed strategy. It explains their relative importance and their interrelationships. In addition, for each priority it identifies the immediate reforms that could be taken without a need for legal changes and those that require new legal instruments. The priorities described below are presented in order of their relative importance.

#### **1. Close “open-ended” budget process**

As long as municipalities see the state budget as an “*open-ended*” source for additional revenues, there will always exist the incentive to demand larger subsidies (general and targeted) from the state budget. Therefore, there is a need to set clear *limits* that would not only facilitate the implementation of the macroeconomic policy stabilization program; but would also provide municipalities with both clearly defined budgetary constraints as well as *certainty* over fiscal transfers (“subsidies”) from the state budget.

The above implies, however, that the criteria and the corresponding formula to establish limits should not be subject to yearly *discretionary* changes made by the central government. Rather, the *share* on



national revenues should be based on a stable formula in order to allow the forecast of fiscal transfers as a whole and the corresponding share for each municipality. In order to insure stability, the fiscal transfer system should be established by a law. Also, yearly budgetary appropriations should be consistent with a law on fiscal transfers. An adequate fiscal transfer system should be based on indicators of *actual* expenditure needs, rather than on *current* expenditure levels. Since the Bulgarian system does not meet this premise, it may be expected that some adjustments in the current level of transfers (subsidies) will be necessary when establishing a new system. A new system of fiscal transfers would automatically generate winners and losers, and adjustments will be particularly difficult in those municipalities that are currently overspending. In order to make the transition smooth, those municipalities that would need drastic expenditure cuts would have to be assisted with additional transfers that should decrease gradually over a specific time period. A reformed system of fiscal transfers, and any adjusting mechanism, would need to be *transparent* and *predictable*. This would provide *certainty* for expenditure planning at the state and local level.

Closing the concept of an “open-ended” budget through a reform of the fiscal transfer system is a necessary condition for fiscal discipline. Also, it would determine the degree of success that could be attained in other areas of municipal finance such expenditure efficiency and local revenue mobilization efforts. Without this reform there would be little incentive to save and to mobilize own local revenues. Therefore, a first priority of the proposed municipal finance strategy must be the elimination of the concept of an “*open-ended*” state budget. Furthermore, the current system of local requests to MOF for the approval of greater subsidies (other than putting a large administrative burden on the MOF), is financially and politically unsustainable. Therefore, an agenda for reform should include as first priority setting specific percentage shares on national tax sources to finance fiscal transfers (“subsidies”). This would provide a clear *limit* to the amount of resources that local governments can expect from the central government. Transfers need to be based on a formula that allow both the central government and the municipalities to forecast the corresponding magnitudes.

### # 1.1 Immediate Reforms

They include the elimination of the concept of subsidies through the design and implementation of objective and transparent formulas. For instance, this may include specific formulas for health and educational grants as well as for fiscal equalization across municipalities. Transfers should be automatic, transparent and predictable. This would close the incentives to run “deficits” establishing a fixed budgetary constraint.

### # 1.2 Legal Reforms

Establish fiscal transfers by law to insure greater stability to the system. Also, establish that local governments have the right and the responsibility to approve their own budgets. Municipal budgets approvals should be independent of the national budget. However, this would be possible only if fiscal transfers (“subsidies”) are based on revenue sharing mechanisms, rather than on yearly-discretionary-budgetary appropriations. Municipalities would report to OF only for information purposes.

## 2. Clarify Assignment of Expenditure Responsibilities



A clearly defined budgetary constraint (i.e., *apredictable* magnitude of fiscal transfers as well as other local revenues) will not be *sufficient* to promote sound financial management (efficient revenue and expenditure planning) if municipal governments are not *also* given the responsibility to decide over their main expenditure functions—i.e., health and education. If the responsibility over the *size* of the main expenditures in health and education continues to be that of the central government, it is necessarily the function of municipal governments (responsible to cover these expenditures via central government subsidies) to request greater subsidies to meet increasing costs in service provision. Therefore, as part of a strategy, and in the case of Bulgaria, a budgetary constraint would be *insufficient*; a well-defined assignment of expenditure responsibilities would also be *necessary* for the municipalities to be able to make efficient, responsive, and accountable choices about their roles and responsibilities. Financial resources (fiscal transfers) without adequate expenditure authority defeat the goals of a local government. Consequently, a main objective of the strategy is to empower local governments with full *discretion* over expenditure management to make them financially and politically *accountable* for their decisions.

## # 2.1 Immediate Reforms

Current regulations of the MHO and ME could be amended to devolve more responsibilities to the municipal governments on health and education. Clarify national and local expenditure functions. Greater responsibility (delegation) could be given to local governments to reduce current education and health expenditures. Ministries should not mandate or transfer specific function without adequate financing sources.

## # 2.2 Legal Reforms

The assignment of expenditure functions by level of government should be legally established. Give the legal right to the municipalities to hire and fire the staff of the functions they are legally in charge. Eliminate unfunded mandates. Proposed reforms regarding a clear assignment of expenditure responsibilities together with specific budgetary constraints (transfers) would create the incentives for expenditure-efficiency.

## 3. Encourage Sound Management of Local Finances

If a clear assignment of expenditure functions is in place, together with an adequate and predictable assignment of revenue sources, then, it may be expected that municipalities will have no other alternative but to make efficient, responsive, and accountable choices; unless they are willing to pay the political cost associated to a bad performance. In principle, however, given a budgetary constraint and a set of responsibilities, local financial managers will have no other alternative but to try to *optimize* revenue and expenditure efficiency to insure the coverage and quality of municipal services. Consequently, as part of a strategy, it is a priority to establish the institutional arrangements associated with a system of *incentives* that would encourage a sound management of local finances.

## # 3.1 Immediate Reforms



Transfers for fiscal equalization should include incentives in its design to reward local revenue collection efficiency. Also, revenue data should be shared with local governments to allow for greater efficiency in revenue collection. In addition, fully and timely disclosure of budgetary and financial information should be open to the public. Furthermore, local budgets and results should be subject to annual external audits.

### # 3.2 Legal Reforms

Legal reforms should require the devolution of local revenue collection authority to municipal governments. Adjustments for inflation to the tax base should be established. Cross-subsidies should be incorporated in the design of user-tariffs. Also, it should be required the adoption of multi-year capital budgeting planning, balanced budgets, and cash management authority. Budgetary rules should establish the authority to carry forward surpluses of all revenues. In addition, limits should be established regarding short-term treasury loans and extra-budgetary borrowing as well as commercial borrowing. The above reforms would create both the incentives for a more effective and efficient financial management, as well as the conditions for a more responsive and accountable local government.

## 4. Enhance Local Revenues

As stated in the diagnosis, there have been structural changes in the distribution of fiscal resources between the central and the local governments. Therefore, in order to correct the current disequilibrium between local revenue sources and municipal expenditure responsibilities specific reforms will have to be introduced in the current revenue sharing system of national taxes. Furthermore, taking into account the trends in the decentralization of central government responsibilities towards the municipalities (many of them through unfunded mandates), it has become even more crucial the adoption of a fiscal reform to strengthen local revenue sources.

Furthermore, if other revenue sources different to fiscal transfers are not certain to local government (because municipalities have not been given control over them) then, there will be again not only an incentive but a need for local governments to rely on subsidies (transfers). Therefore, it is also important for the strategy as a whole that local governments be given the authority to manage their own revenue sources (i.e., local taxes and fees). Efforts to increase and establish more adequate local revenue sources nevertheless should be supported; however, without solving first the issues regarding the “openness” of the state budget and the lack of a clear assignment of functions, such efforts will be substantially defeated.

Municipalities who are in charge of providing local services should also be in charge of setting the level of local taxes, fees and user charges. Otherwise, municipalities will hardly face the need to be cost-efficient, responsive, and accountable. Furthermore, and assuming that clear budgetary constraints are in place, the only way to insure the *sustainability* of municipal services (their coverage and quality) would have to be through cost efficiency and adequate user-charges. Therefore, in consistency with the objectives of the strategy it is important to gradually create the institutional arrangements associated with a system of incentives that would encourage a sound revenue enhancement.



## # 4.1 Immediate Reforms

The national government should establish a policy to maintain at least the current share of local revenues and expenditures as a percent of consolidated sector figures. The central government should address the apparent current imbalance between revenue sources and expenditure responsibilities. Better information systems regarding municipal revenues should be developed to allow for more timely, effective control and forecasting. This should contribute to make revenues more transparent to the local administration. The above should contribute to make local governments more effective, responsive and accountable.

## # 4.2 Legal Reforms

Legal reforms are needed to give discretion to local governments to set local tax and fee rates within specified ranges. Current proposals for reform already consider devolving fee rate setting authority to the municipalities. The municipal association request to set only a minimum rate for user-tariffs, rather than a rate range. Prudential limits should be established regarding debt exposure. Rules on defaults should be explicitly established as well as limits on state guarantees.

## 5. Investments

Taking into account that most municipal expenditures are devoted to cover recurrent expenditures and that investments are fairly small, the strategy must concentrate first on the issues that affect the largest part of municipal finances. Improvements in the process of investment decision-making and capital financing are important but in terms of a strategy they may be defeated if other key elements of municipal finance are not addressed first. For instance, a system of matching grants, or issuing bonds would have fairly limited possibilities of success.

Long term financing of local investments need to be supported by savings or surpluses in recurrent account to cover debt service obligations or matching grants' arrangements. Consequently, the current system of targeted subsidies (as part of the concept of an "open-ended" state budget) needs to be reformed as a necessary condition to encourage local governments to be more efficient. However, under current conditions, and without carrying out the above reforms first, bringing municipalities to a situation to be able to finance long term investment may be fairly difficult to attain. Also, under current national fiscal conditions, full-cost financing of specific local investments through the state budget is fairly limited. In addition, the state budget should not be expected to finance (co-finance) all types of local capital expenditures. Therefore, the need to develop the financial conditions at the local level to gradually make municipalities creditworthy.

In summary, the implicit system of *perverse incentives* that needs to be eliminated can only happen if: i) the system of financing local deficits is eliminated; ii) fiscal transfers are made predictable and equalize for fiscal differences; iii) the assignment of responsibilities is clarified, the practice of unfunded mandates eliminated, local governments are given discretion over their expenditure functions; and iv) local revenue authority and its administration is made the responsibility of the municipalities. This would not only eliminate the current system of perverse incentives but would make local governments more accountable, responsive, and more efficient in their functions.



## # 5.1 Immediate Reforms

Incentives for inter-municipal cooperation should be included in a grant system for capital expenditures. Also, objective criteria should be established for targeted subsidies. In addition, local control should be established for user-tariffs and cost recovery of basic services. Implementation of cross-subsidies should help to solve the problems of affordability.

## # 5.2 Legal Reforms

Central government should eliminate limits on local investment levels. Also, control over project selection should also be eliminated. It should be left to the discretion and priorities of local governments. Objective criteria should be established for project funding. A system of matching grants in support of regional development and national policy priorities should be instituted. Matching arrangements and competition for limited resources should incentive and reward local savings and surpluses in current account. In addition, matching arrangements should incentive cooperation in capital expenditure planning among local governments. The above reforms are expected to develop local financial capacity for long term financing, which is necessary for an adequate provision of local public goods and services.

## PROPOSED ACTIVITIES

### *Promote reforms*

Of the two major categories of activities that USAID might want to undertake, the first would be to provide direct support to the reform process. This could include efforts to build a consensus on the reform agenda and priorities at national and local level through conferences and workshops. In the early phase, the participants will be largely the municipalities themselves and perhaps the MOF. Much of the attention at this point will center on the analysis and discussion of the elements of the reform agenda and of their relative priority and feasibility. In the latter stages, after there is preliminary agreement among the critical participants, the emphasis can shift to expanding the dialog to other interested parties, such as other national government ministries, members of Parliament, as well as the general public. This is perhaps the least costly of the proposed activities and the one that may have the biggest payoff in the long run.

It will be important to provide direct assistance to MOF and other national ministries on municipal finance reform. It is likely that the MOF will originate many of the most important measures. It makes sense to work with them, rather to be constantly in the position of trying to undo misguided or incorrect reform proposals emanating from that institution. In addition, there are legitimate national policy concerns regarding municipal finance reform that merit direct attention. This assistance probably should accompany the early dialog on the reform agenda.

At the same time, it would be extremely important to develop the capability of municipal associations and related NGOs, such as economic think tanks, to formulate and analyze policy options in the area of municipal finance. These are complicated issues for which there are many alternative solutions. The MOF



should not be the only institution with the capacity to articulate the options and select from among them. USAID has a program such as this in Poland that might serve as a model.

Finally, it could be useful to provide support for initial implementation of reforms through the dissemination of any new measures and large scale focused training to support initial implementation of reforms. Legislative cycles often lead to the enactment of new laws late in the calendar year. Municipalities may have to adapt quickly to new rules of the game. Also, it is vital to take at least some time to get the word out on the changes as a way of supporting the early successful implementation of the reforms.

### **Show results**

Going back to the two reasons why reforms are needed - improved financial management and service delivery and local involvement in the structural adjustment process - it is important to show early results in these areas. The report recommends a series of pilot projects, similar in design to those currently supported through the LGI that would show that the reforms can translate quickly into measurable, significant results.

Once municipalities receive more authority to make local expenditure choices, a good pilot project might build on work done earlier by the LGI to implement local efficiency gains in areas of health and education. Given greater local discretion, municipalities would be able to work with directors of local health and education facilities and with the community to “reengineer” the services in these areas, saving funds in one facet of the services to apply in improving performance in another.

As municipalities receive more authority, and eventually more resources, it will be important to demonstrate methods to enhance local financial accountability. This can include improved budget formulation, expanded audit activities and the development of disclosure standards and practices that provide timely and accurate information on municipal financial results to the local community and any other interested parties.

Local revenue management already is a major priority of municipalities. Given greater local authority over revenues and, possibly, new sources of revenues, municipalities can focus their attention on maximizing their revenue potential. This can include effort related to asset management, for example, or to improved revenue forecasting.

Finally, although major sustained increases in the volume of investments are some year away, small *ad hoc* investment deals for local infrastructure might help show how to accelerate that process. Solid waste collection and disposal is an important local service where small investments, such as in better garbage trucks, can have big payoffs. This also is an area where there have been extensive experiences in other east and central European countries with privatization or with competition in the provision of services.

These pilot projects will provide a base of valuable lessons learned that can serve to expand the benefit of the finance reforms to other municipalities.

## APPENDIX A

### COMMENTS ON DRAFT LAWS

#### COMMENTS ON THE MUNICIPAL FINANCE LAW

These comments are based on the draft approved by the Council of Ministers on 8 July 1996. There are subsequent versions of this law which were not available for the team to review. Therefore, some of the comments made here may no longer be relevant. Also, any proposals included in the new draft that were not reflected in the draft reviewed here, if any, of course are not addressed in this report.

1. The bulk of the proposed law is devoted more to the local budget process, rather than to broader municipal finance issues.
2. Art. 6 (2) and Art. 9: The law does not differentiate between *recurrent* and *capital* revenues and expenditures. This economic and budgetary distinction is particularly important for financial analysis in order to determine surpluses in current account to measure municipal creditworthiness.
3. Art. 6 (3) and Arts. 34-35: The proposed law makes several references to fiscal transfers; however it does not cover their basic elements. Even if the topic of fiscal transfers merits a separate law, as may be the case, the Law on Municipal Finance should at least establish their source and distribution criteria as well as their role in municipal finance. The main features of a fiscal transfers system do not appear in the version of the law reviewed for this report. The specifics of a fiscal transfer system should be established in a Law on Municipal Finance or in a separate law. Ideally, the definition of the pool of resources and its distribution criteria should not be left to yearly decisions as part of the annual State Budget Law--as it is currently done.
4. A law on municipal finance should ideally address the potential issue of unfunded mandates. However, no explicit reference is made in the draft regarding this matter.
5. Art. 10 (1): The law sets a debt limit of 10 percent of municipal revenues from credit. This limit has nothing to do with local debt service capacity and/or municipal creditworthiness which are the main parameters to determine the magnitude of potential municipal credit.
6. Art. 10 (2): The law specifies limits for the budget deficit. In principle, local governments should not be running any deficits, but should operate under the principle of balanced budgets that include contingent reserves. Ideally, local governments would want to operate always on the assumption that they want to end the year with a small surplus.
7. Art. 3 (1) states that the municipality has an *independent* budget, but Art. 11 and 12 link the local budget approval to the approval of the state budget. The approval of municipal budgets should be practically independent of the approval of the state budget. law.
8. Art. 19 (4): The administration of local revenues continues centralized in the MOF. The authority for local tax collection and fees should be devolved to the local governments.

9. Current budgetary classification is based on current practice which should be reviewed. Budgetary classification should be adequate to compute surpluses or deficits in current and capital accounts in order to determine municipal credit worthiness.
10. Art. 35 (3): It is not quite clear what are the implicit matching arrangements for targeted funds. The level of cofinancing and financial conditions should be transparent.
11. Art. 39 (3): It should establish a limit on state guarantees for credits denominated in foreign exchange.

## **COMMENTS ON THE LAW ON LOCAL TAXES AND FEES**

These comments are based on the draft of the Law on Local Taxes and Fees that is dated January 6, 1997. The Ministry of Finance apparently has a new version of this law. As with the Municipal Finance Law, some of the comments made here may no longer be relevant. Also, any new proposals included in the new draft that are not included in the draft reviewed here, if any, of course are not addressed in this report.

### ***General Comments***

1. The law should constitute an "enabling act," which describes the authority of local governments to impose taxes and fees. This review is limited by the following factors:
  - a. The fiscal system in which this operates has not been analyzed by this reviewer. Therefore, these comments do not assess the fiscal capability of local governments nor the relationship between these taxes and fees and those that may be imposed by other units of government.
  - b. The law describes the powers of "municipalities" without reference to other units of local territorial administration. It is recognized that reforms are consolidating the number of local administrative units and that "municipalities" are the principle unit of local administration. However, the term "municipality" should be defined by the law. If the term does not refer to all types of local administrative units comprehensively, then the law should be rationalized according to the fiscal capabilities of various types of local administrative units.
2. The draft law is clearly written and well organized. It is helpful that the provisions of each section proceed in a similar progression of subjects (i.e. "scope", "declaration", etc.)
3. Several of the subjects of taxation in the draft law are mobile, such as the vehicle tax, or may be located in a variety of local jurisdictions, such as inherited property. This complicates assessment and collection of such taxes by an individual local authority. Therefore, such taxes should be collected by a national authority and then allocated to individual local authorities in an appropriate manner.

4. Chapter Three contains authority to impose fees. This is for the use of publicly owned property. There is justification for defining the upper limits of taxes, in order to achieve uniformity as between local jurisdictions. However, the same justification does not exist for limiting the imposition of fees (except, perhaps road fees). Instead, charges for the use of public property should be gauged by demand for the use and the cost of private use of public property. Therefore, greater local discretion should be allowed for imposition of fees by local authorities.

### ***Specific Comments***

Article 2. This provision is mandatory, requiring these taxes to be assessed. It is recommended that the section allows the local units to exercise discretion regarding whether a specific tax is assessed and, if so, the rate of the tax (within limits defined in the law).

A vehicular tax is on property that is movable and therefore may not be appropriate for assessment and collection by local administrative units.

Since the method of assessing and the limitations on the assessment of these taxes are described in subsequent sections, this article should specifically state "As described in Chapter Two of this law,..."

Article 3. This provision does not clearly state that these "fees" are for the use of publicly owned property or services provided by the municipality. Therefore, the distinction between "tax" and "fee" is also unclear. A tax is a levy imposed upon a private activity, ownership or privilege. A fee is a payment made in exchange for the receipt of a privilege, right or service provided by a governmental unit.

Since the method of assessing and the limitations on the assessment of these fees are described in subsequent sections, this article should specifically state "As described in Chapter Three of this law,..."

There is a numbering error in Article 3.

Article 4. This article is unclearly stated (perhaps a translation problem).

Article 6. (1) This states that municipality councils may exercise discretion in setting the tax rate, within the limits of this law. This is an important provision, in that local units should be able to adjust rates based upon local needs and conditions.

(2) The relationship between this provision and Article 3 (authorizing assessment of fees) and Chapter Three (describing the limits of fees) is

unclear. If it is merely redundant, it should be eliminated. If it supplements these other provisions, it may result in undermining the more specific limitations and conditions set forth in the law.

(3) There should be careful limitations upon the granting of exemptions, in order to avoid favoritism.

Article 7. A tax system relies upon its stability and facial validity. Therefore, this article should be carefully drafted to confine the powers of the Minister of Finance to invalidate a local tax and limit the time during which the Minister may act.

(1) This provision does not state the purpose of referring the resolution to the Minister of Finance or the scope of review.

(2) The provision should limit the time during which the Minister may invalidate a tax. Otherwise, a tax could be perpetually vulnerable to invalidation and could raise difficult questions about the refund of invalidated taxes that have been collected.

Article 8. This article undermines the provisions of this law which (a) establish limits of taxes and fees and (b) provide municipal councils with discretion to set rates.

It is recommended that this article either be eliminated or that this power be clearly described as only advisory and without legal effect.

Article 11. This article describes the things on which the tax is assessed. Therefore, the types of property that is to be assessed should be specifically identified. Certainly, if there is a real estate law (or section on real property in the Civil Code), it should be referenced and its definitions of categories of property should be identified.

It is likely, however, that there is not a precise definition of real property. Therefore, the categories to be taxed in Section I should be defined by such terms as land, building and other fixtures. The article should then describe whether these are taxed separately or cumulatively.

Article 12. This article implies that leases are to be taxed. Some laws allow the assessment of real estate taxes on the ownership (paid by the owner) and, in addition, a tax on the possessory right if the land is used by a person other than the owner (paid by the lessee).

As written, the article assesses the tax on either the user or the owner. This raises several questions.

- ! First, under Bulgarian law there is probably the right to lease only part of the land or to lease the building but not the land. In this case, the application of the article will be confusing.
- ! Second, the obligation to pay the tax should always be on the owner, unless the law creates a separate leasehold tax. This allows the owner to shift the obligation to the lessee by terms of the lease, but always makes the obligation collectible by a person who can be easily identified. In addition, if the tax is delinquent, it can then be enforced as a lien against the property (an obligation of the owner).
- ! Finally, the article does not clarify whether the a casual user (at-will tenant), easement holder or month-to-month tenant is the obligee, or whether such situations make the owner the obligee.

Article 13. A better practice is not to allow such proportional assessment. The assessment is against the land, and is enforced as a lien against the land. Therefore, it is left to the owners to decide how to divide the obligation among each other.

Article 14. This is an important provision.

Articles 15-19. These articles place the burden of reporting upon the property owner or user. This raises several problems:

If, as provided by Article 12, the obligation for payment is the user, there may be confusion as to whether the owner or user is obligated to report. This is especially true if the user has rights to use only a portion of the property.

These articles should be reconciled with Articles 21 - 23 which set the value of the property. These articles rely on self-reporting and self-calculating of the value of the property and the application of the tax rate to the assessed value. This is probably impractical. A better system would be for the tax officials to calculate the amount of tax and maintain a record of the assessed valuation.

It is recognized that Article 25 may place responsibility for calculation and notification on government officials, but this is not clear when Article 25 is reconciled with the prior sections.

These provisions and other provisions of this Chapter do not adequately provide for enforcement of the tax, such as the imposition and execution of a lien on the property in cases of delinquency.

Articles 21-23. These articles should be clarified to set forth a clear and objective basis for valuation of the property. Article 21 states a variety of factors, leaving room for many interpretations of the value. Article 22 distinguishes between the value of the land and the value of fixtures. Lacking a "market value" at this point, it may be necessary to identify criteria that determine value. However, it is important that these criteria lead to a clear and objective establishment of value.

The articles should provide for a public record which contains the assessed valuation of the property.

Article 24. This article does not provide local officials with any discretion in the establishment of tax rates. It is recommended that the article establish a maximum rate, and allow local officials to set a rate that is within that maximum.

Articles 31-43. The Inheritance Tax is treated as a local tax. This raises several problems that are not resolved by the draft law:

! A deceased's property may be located within more than one local jurisdiction. The draft law does not indicate which local government shall have jurisdiction to collect or how the tax proceeds shall be shared among local jurisdictions.

! The draft law does not indicate which local jurisdiction has the duty to set the tax rate, assess the value or collect the tax.

Article 35(1)-1: This refers to assessed valuation of the property. However, Chapter Two does not clearly establish a public record that states assessed valuation.

Article 38 is unclear in its application. It is recommended that the tax be assessed by the government against the estate and that the heirs have the responsibility of apportioning the tax among themselves.

To reduce administrative burden, it is recommended that small estates be exempt from taxation. This would require the reporting of inheritance by all heirs, but provide for an exemption from payment of the tax for estates below a defined amount.

Articles 44-52. To reduce administrative burden, it is recommended that small gifts be exempt from taxation.

Articles 53-61 These articles establish a sales or transfer tax. If it is the only sales tax that is used by national and local authorities, consideration should be given to

expanding the types of property or transactions to which it applies. If it is not the only sales tax, consideration should be given to whether it is wise policy to impose a higher tax rate on the types of property identified by Article 53.

Articles 57 and 59 standardize the tax rate among local jurisdictions. This is a good practice, in that it avoids influencing the location at which a transaction takes place.

Articles 62-69 It appears that Articles 63 and 69 make vehicles taxable at the domicile of the owner of the property. This location is not necessarily the place at which the vehicle is used. However, since this is a tax, rather than a fee; its purpose is not to compensate a local authority for the burden that the use imposes, such as maintenance of a harbor for ships or roadways.

The large number of categories of vehicles may complicate administration of the tax.

## APPENDIX B

**Appendix B, Table 1**  
**Local Government Real Revenues and Expenditures in Bulgarian Leva ('000)<sup>a</sup>**

| Real Values                  | 1991                         | Jan-June<br>1992             | 1993                         | 1994                         | 1995                         | 1996                         |
|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|------------------------------|
| <i>Revenues</i>              |                              |                              |                              |                              |                              |                              |
| Tax Revenue                  | 226,194,000<br>73.19         | 68,776,667<br>49.34          | 110,200,000<br>47.84         | 60,984,168<br>34.90          | 57,934,882<br>38.06          | 52,994,779<br>47.28          |
| Shared Revenue               | 223,510,000<br>72.32         | 67,671,111<br>48.67          | 107,518,000<br>46.68         | 57,072,707<br>32.66          | 54,073,096<br>35.52          | 49,813,388<br>44.45          |
| Other Tax Revenue            | 2,684,000<br>0.87            | 1,105,556<br>0.66            | 2,682,000<br>1.16            | 3,911,461<br>2.24            | 3,861,787<br>2.54            | 3,181,391<br>2.84            |
| Non-Tax Revenue              | 10,928,000<br>3.54           | 12,150,000<br>4.42           | 8,920,667<br>3.87            | 30,355,646<br>17.37          | 27,409,173<br>18.00          | 19,941,387<br>17.79          |
| Fees                         | 4,918,000<br>1.59            | 2,511,111<br>1.80            | 6,283,333<br>2.73            | 17,488,550<br>10.01          | 14,215,509<br>9.34           | 9,713,008<br>8.67            |
| Other Non-Tax Rev.           | 6,010,000<br>1.94            | 9,638,889<br>2.62            | 2,637,333<br>1.14            | 12,867,100<br>7.36           | 13,193,664<br>8.67           | 10,228,379<br>9.13           |
| Transfers                    | 71,918,000<br>23.27          | 39,410,000<br>46.25          | 111,232,000<br>48.29         | 77,519,571<br>44.36          | 64,018,733<br>42.05          | 37,099,227<br>33.10          |
| Borrowings                   | -                            | -                            | -                            | 5,887,168<br>3.37            | 2,869,591<br>1.89            | 2,041,742<br>1.82            |
| Temporary Non-Int.           | -                            | -                            | -                            | 2,737,307<br>1.57            | 1,959,482<br>1.29            | 2,103,311<br>1.88            |
| Int. Bearing from Fin. Insti | -                            | -                            | -                            | 2,440,671<br>1.40            | 182,349<br>0.12              | -74,200<br>-0.07             |
| Bonds                        | -                            | -                            | -                            | 709,186<br>0.41              | 727,760<br>0.48              | 12,631<br>0.01               |
| <b>Total</b>                 | <b>309,040,000</b><br>100.00 | <b>120,336,667</b><br>100.00 | <b>230,352,667</b><br>100.00 | <b>174,746,554</b><br>100.00 | <b>152,232,380</b><br>100.00 | <b>112,077,135</b><br>100.00 |
| <i>Expenditures</i>          |                              |                              |                              |                              |                              |                              |
| Education                    | 100,460,000<br>33.84         | 37,144,444<br>32.54          | 85,806,667<br>37.02          | 56,445,214<br>32.49          | 48,865,820<br>32.43          | 34,780,633<br>31.21          |
| Culture                      | 8,380,000<br>2.82            | 2,722,222<br>2.39            | 6,706,667<br>2.89            | 4,984,950<br>2.87            | 4,700,118<br>3.12            | 3,185,406<br>2.86            |
| Health Care                  | 82,700,000<br>27.86          | 33,588,889<br>29.43          | 77,586,667<br>33.47          | 53,607,168<br>30.86          | 45,958,527<br>30.50          | 32,505,260<br>29.17          |

|                            |                       |                       |                       |                       |                       |                       |
|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| Housing & Communal Service | 49,640,000<br>16.72   | 19,966,667<br>17.49   | 22,133,333<br>9.55    | 28,942,621<br>16.66   | 24,356,571<br>16.16   | 17,747,105<br>15.93   |
| Social Welfare             | 21,080,000<br>7.10    | 9,288,889<br>8.14     | 24,213,333<br>10.45   | 16,813,479<br>9.68    | 14,148,962<br>9.39    | 9,678,484<br>8.69     |
| Local Admin.               | 12,740,000<br>4.29    | 4,333,333<br>3.80     | 7,360,000<br>3.17     | 9,395,111<br>5.41     | 9,062,113<br>6.01     | 6,754,192<br>6.06     |
| Other                      | 21,840,000<br>7.36    | 47,088,889<br>6.21    | 8,006,667<br>3.45     | 3,542,325<br>2.04     | 3,590,509<br>2.38     | 6,775,591<br>6.08     |
| Total Expenditure          | 296,840,000<br>100.00 | 114,133,333<br>100.00 | 231,813,333<br>100.00 | 173,730,868<br>100.00 | 150,682,620<br>100.00 | 111,426,671<br>100.00 |

Notes:

<sup>a</sup> Numbers have been inflated to 1996 prices (base year).

Source:

Ministry of Finance, Bulgaria.

**Appendix B, Table 2**  
**Summary of Local Government Expenditures in Bulgarian Leva (millions), 1996**

|   | 1990   | 1991    | 1992    | 1993    | 1994    | 1995    | 1996      |
|---|--------|---------|---------|---------|---------|---------|-----------|
| <i>Local Government Expenditures</i>                                |        |         |         |         |         |         |           |
| Total Expenditure   | 5,599  | 14,863  | 26,181  | 33,695  | 48,758  | 68,033  | 111,294   |
| Current Expenditure   | 4,888  | 12,855  | 22,625  | 30,380  | 44,390  | 63,044  | 105,032   |
| (as a % of total)   | 87.30  | 86.49   | 86.42   | 90.16   | 91.04   | 92.67   | 94.37     |
| Capital Expenditure   | 711    | 2,008   | 3,556   | 3,315   | 4,369   | 4,989   | 6,262     |
| (as a % of total)   | 12.70  | 13.51   | 13.58   | 9.84    | 8.96    | 7.33    | 5.63      |
| <i>Expenditures of Consolidated National Budget - Local Budgets</i> |        |         |         |         |         |         |           |
| Total Expenditure   | 25,028 | 54,497  | 81,591  | 133,877 | 235,905 | 360,607 | 840,566   |
| Current Expenditure   | 24,291 | 53,429  | 78,713  | 130,570 | 229,767 | 347,049 | 818,269   |
| Capital Expenditure   | 737    | 1,068   | 2,878   | 3,307   | 6,138   | 13,558  | 22,297    |
| GDP   | 45,390 | 135,711 | 200,832 | 298,934 | 522,233 | 871,396 | 1,660,200 |
| <i>Expenditures of Consolidated National Budget + Local Budgets</i> |        |         |         |         |         |         |           |
| Total Expenditure   | 30,627 | 69,360  | 107,772 | 167,572 | 284,663 | 428,640 | 951,860   |
| Current Expenditure   | 29,179 | 66,284  | 101,338 | 160,950 | 274,157 | 410,093 | 923,301   |
| Capital Expenditure   | 1,448  | 3,076   | 6,434   | 6,622   | 10,507  | 18,547  | 28,559    |
| <i>Local Expenditures as a % of CNB&amp;LB</i>                      |        |         |         |         |         |         |           |
| Total Expenditure   | 18.28  | 21.43   | 24.29   | 20.11   | 17.13   | 15.87   | 11.69     |
| Current Expenditure   | 16.75  | 19.39   | 22.33   | 18.88   | 16.19   | 15.37   | 11.38     |

|  |       |       |       |       |       |       |       |
|--|-------|-------|-------|-------|-------|-------|-------|
| Capital Expenditure                            | 49.10 | 65.28 | 55.27 | 50.06 | 41.58 | 26.90 | 21.93 |
| <i>Expenditures of LB as a percent of GDP</i>  |       |       |       |       |       |       |       |
| Total Expenditure                              | 12.34 | 10.95 | 13.04 | 11.27 | 9.34  | 7.81  | 6.70  |
| Current Expenditure                            | 10.77 | 9.47  | 11.27 | 10.16 | 8.50  | 7.23  | 6.33  |
| Capital Expenditure                            | 1.57  | 1.48  | 1.77  | 1.11  | 0.84  | 0.57  | 0.38  |
| <i>Expenditures of CNB as a percent of GDP</i> |       |       |       |       |       |       |       |
| Total Expenditures                             | 55.14 | 40.16 | 40.63 | 44.78 | 45.17 | 41.38 | 50.63 |
| Current Expenditure                            | 53.52 | 39.37 | 39.19 | 43.68 | 44.00 | 39.83 | 49.29 |
| Capital Expenditure                            | 1.62  | 0.79  | 1.43  | 1.11  | 1.18  | 1.56  | 1.34  |

Source:  
Ministry of Finance, Bulgaria.

## APPENDIX C

### MATERIALS AND DOCUMENTS REVIEWED

*“Quantitative Analysis and Evaluation of Municipal Budgets in Bulgaria”* Stefan Ivanov, PhD

Datasets on Local Revenues/Expenditures by Line Item and Functions for 1994-1996 MoF

Data on the Local Budget Implementation for 1996; Data on the Planned Budget for 1997; Data on the Extrabudgetary Accounts for 1996 Stan Zagora

Data on the Local Budget Implementation for 1996; Data on the Planned Budget for 1997; Data on the Extrabudgetary Accounts for 1996 Blagoevgrad

Datasets on the Consolidated National Budget 1990-1996 Budget Directorate, MoF

Law on Municipal Finance - Draft, as prepared by an expert team headed by Tsonyo Botev Tsonyo Botev, Parliamentary Local Government Commission

BULGARIA 2001 PROGRAMME of the Government of Bulgaria 1997 - 2001

Conference *“Municipal Finance Reform: Opportunities and Perspectives”*, Sofia, 2-4 July 1997, Materials:

Strengthening Local Government through Finance Decentralization, The Need of Legislation Reform (Prepared by a working group of NAPFO)

Improving the Scope and Function of the Internal and External Control of Public Finance (Prepared by a working group of NAPFO)

Problems of Municipal Finance in Bulgaria (Position of the Ministry of Finance on Financial Decentralization)

Real Exchange Rate Overvaluation in a Currency Board Arrangement: Consequences and Solutions (Emil Dimitrov, Head of BNB Balance of Payments and Foreign Debt Department)

Mayors Urge Upped Municipal Tax (by Toni Alexova, Capital Press, No. 28, 14-20 July, 1997)

Proposals of the Member Municipalities of the National Association of Municipalities in the Republic of Bulgaria

Work Group 2: Municipal Budgets: Item Structure, Revenues and Expenses, Related Authority

Discussion Results and Recommendations for Legislative Reform

Record of Proceedings

Other Materials:

Ministry of Finance Ordinance No. 4 (March 20 1995)

National Budget Procedures Act (Prom. Official Gazette No. 67 of August 6, 1996 by Presidential Decree No. 270 dated July 25, 1996)

Regulations for the Implementation of the National Audit Office Act (Prom. State Gazette No. 28/02.04.1996)

National Audit Office Act (as Amended - Promulgated in the Official Gazette No. 71 of August 11, 1995 by Presidential decree No. 232 dated August 3, 1995)

Public Procurement Act (Prom. Official Gazette No. 9 of January 31, 1997 by Presidential Decree No. 74 dated January 28, 1997)

Local taxes and Fees Act (Draft January 6, 1997)

Regulations for the implementation of the Excise Tax Act (Prom. Stat Gazette No. 27/31.03.1994, Amended SG Nos 86/1995 & 46/1996)

Tax Administration Act (Prom. State Gazette No. 59/09.07.1993, Amended SG No. 19/1996)

Excise Tax Act (Prom. State Gazette No. 19/02.03.1994,  
Amended SG Nos. 58 & 70/1995; 21 & 56/1996)

Government Collections Act (Prom. SG No. 26/26.03.1996)

Municipal Property Act (Prom. SG No. 44/21.05.1996,  
Amended SG No. 104/1996; 55/1997)

State Budget of the Republic of Bulgaria for 1997 Act (Prom.  
SG No. 52/01.07.1997)

Transformation and Privatization of State Owned and  
Municipal Enterprises Act (Prom. SG No. 38/08.05.1992,  
Amended SG Nos 51/1994; 45, 57 & 109/1995; 42, 45, 68 &  
85/1996; 55/1997)

Local Taxes and Fees Act (Prom. Izvestiya, No.  
104/28.12.1951, last Amendment SG No. 55/1997)

Value Added Tax Act (Prom. SG, No. 90/22.10.1993,  
Amended SG No. 57/1995; 56 & 104/1996; 51/1997)

Tax Procedures Act (Prom. SG No. 61/16.07.1993, Amended  
SG No. 20/1996; 51/1997)

Tax on profits Act (Prom. SG No. 59/12.07.1996, Amended  
SG No. 110/1996; 16 & 49/1997)

## APPENDIX D

### LIST OF PERSONS INTERVIEWED SEPTEMBER 11 TO 23, 1997

| <u>NAMES</u>                 | <u>POSITIONS</u>  |
|------------------------------|---|
| RAYNA KOSSEVA                | Manager of the Financial Department of the Stara Zagora Municipality  |
| ROZA BAKALSKA                | Expert at the Financial Department of the Blagoevgrad Municipality  |
| BOYKO GEORGIEV               | Head of Local Finance Directorate of MoF  |
| LYUBOMIR DATSOV              | Expert at the Budget Directorate of MoF   |
| Mr. ZLATKOV                  | Expert at the National Accounting Directorate of MoF  |
| TINKA POPOVA                 | Expert at the Capital Expenditure Department of the State Expenditures Directorate of MoF                                 |
| EMIL SAVOV                   | MTKK Expert on Local Finance, Local Governance  |
| DAYAN KAVRAKOV               | MTKK Expert on Local Finance, Local Governance, Acting Executive Director of the National Association of Public Financers |
| AKSENIA MONOVA               | Head of Local Taxes and Fees Department of MoF  |
| ELAINE PATTERSON             | World Bank Senior Project Officer   |
| THIERY LIPPERT               | EU Delegation, Consultant on Large Taxpayers Project to MoF   |
| MAYA KOLEVA                  | MTKK Expert on Local Finance, Local Government  |
| SAVIN KOVACHEV               | Ministry of Regional Development and Construction, Head of Local Government Department                                    |
| GINKA CHAVDAROVA             | Executive Director of the National Association of Municipalities of the Republic of Bulgaria                              |
| GINKA KAPITANOVA             | Local Government Reform Foundation, Bulgaria  |
| TSONYO BOTEV                 | Parliamentary Local Government Commission   |
| NIKOLA BABAMOV, MILAN PETROV | Councillors to the Parliamentary Budget Commission  |