



LOCAL FINANCES IN BULGARIA – NATURE, OBJECTIVES AND FINANCIAL STATUS OF THE MUNICIPALITIES

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ABSTRACT

Purpose of the research is to formulate proposals for improving the local financial system by strengthening/enhancing the relationship between local revenues and expenditures and the economic development of the municipality. The study uses large data sets for economic development at municipal level, financial data for municipal budgets and comparative data on local finances in the European countries. The Results show the stronger connection between local revenues and expenditures and the economic development of the municipality is, the more local problems will be solved at a local level, whereas the population will be aware of the cost of local services, and local government will depend on its taxpayers, will be guided and controlled by them, i.e. business and living conditions for the local population will be improved. Main inferences from the analysis are drawn and recommendations for changes in the local financial system are justified.

Key words: economic status, municipal revenues, expenditures, public funds

INTRODUCTION

In EU-28, there are 90,324 administrative and territorial units in which local self - government is being exercised. 89705 of them are at level one, and 265 are in Bulgaria (1).

Many of them have become historically differentiated, and over the years they have been a natural centre for stimulating economic development, social and demographic processes. Through the prism of the system of local finances we will observe the relations between central and local government, between local government and representatives of local community.

The subject of the study is municipalities, and the topic is the system of local finances.

The object of the study is all 265 municipalities in Bulgaria, as well as the local structure of the EU-28 member states.

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To achieve this aim the following tasks have been set: To present the essence of the system of local finances, its goals, to make a comparative analysis and evaluation of the types of services provided by local authorities in EU countries, the usual sources of revenue for local budgets, the way of functioning of the system of state transfers. Chapter One

To analyze the existing system of local finances in Bulgaria, the sources of revenues and the main responsibilities for the expenditures of the municipalities. To assess the financial condition of the municipalities, formed by the estimates of revenues, expenditures, the degree of coverage of expenditures with certain revenues, and the balance of local budgets. Chapter Two

To analyze the impact of the financial state of municipalities on the type and amount of municipal revenues and expenditures. Chapter Three.

To draw the main conclusions from the analysis and to substantiate recommendations for changes in the system of local finances. Conclusion
The topic is structured into an introduction, three chapters, a conclusion, and a list of references.

MATERIAL AND METHODS

Both general and specific scientific methods, such as analysis, synthesis, induction, deduction, method of expert evaluations, have been applied in the study.

Large data sets of municipal budgets and comparative data on local finances in European countries have been used.

There are four main sources of information:

NSI for the economic indicators of the municipalities;

Eurostat - for comparative data on local finances of EU countries;

Ministry of Finance - for the municipal budgets in Bulgaria (2);

Institute for Economic Research at BAS - research project, 2016;

Nature and objectives of the local finance system

1. Type and scope of public services;

2. Levels of local self-government and optimal size of local jurisdictions (3);

3. Local public services;

4. Local revenues;

5. Powers of local authorities;

Local public services

The distribution of public services between central and local government must be carried out according to the principle of subsidiarity. It is formulated in the European Charter of Local Self-Government (4). We can formulate the following requirements for local public services:

These are services whose benefits extend beyond the municipality, can be provided faster and with higher quality by the local government, are cheaper for consumers and better meet their preferences.(5)

The distribution of public services between central and local government can be assessed by the share of local service expenditures in all public service costs. (6) This distribution, as well as by sectors (according to COFOG) for the EU countries can be seen in **Table1**.

Table 1. Share of local expenditures in all public expenditures for EU countries in 2014 (in%)

COFOG99	Total	General state services	Public order and security	Economic activities	Protection of the environment	Public Works and Communic. Activities	Culture Recreation and Religion	Education
EU-28	23.5%	23.8%	23.3%	33.9%	71.6%	74.1%	61.5%	39.6%
max	64%	44%	50%	48%	95%	100%	82%	81%
min	1%	3%	0%	0%	4%	0%	3%	0%
Bulgaria	21.3%	12.6%	3.1%	19.9%	84.7%	93.1%	43.6%	62.3%
The Czech Republic	27.4%	28.6%	11.0%	36.6%	87.2%	74.2%	69.9%	62.5%
Hungary	15.8%	18.6%	2.2%	18.5%	63.4%	73.3%	35.4%	21.8%
Romania	25.8%	19.4%	4.5%	30.3%	60.6%	74.5%	67.1%	60.8%
Slovenia	19.7%	11.5%	8.2%	20.1%	72.4%	80.3%	45.2%	57.7%
Slovakia	16.1%	15.5%	3.6%	25.8%	58.8%	72.3%	41.8%	64.6%
Poland	32.0%	27.4%	12.7%	47.3%	81.7%	82.0%	79.9%	69.8%
Croatia	25.8%	43.6%	7.0%	9.8%	3.6%	5.8%	34.6%	73.2%
Denmark	64.3%	16.6%	9.9%	36.4%	51.2%	58.4%	46.1%	44.8%
Finland	41.0%	43.9%	20.7%	34.6%	27.6%	56.0%	56.6%	66.1%
Sweden	49.1%	38.7%	15.0%	35.3%	59.5%	93.0%	78.1%	77.2%
The Netherlands	30.1%	20.1%	20.3%	47.8%	95.3%	75.7%	81.6%	80.6%
Portugal	11.8%	20.1%	12.9%	13.0%	80.0%	81.5%	63.0%	14.2%
Spain	13.4%	30.8%	23.9%	22.1%	70.4%	59.2%	56.9%	5.1%
France	20.5%	33.8%	21.4%	42.6%	88.9%	70.2%	79.7%	30.8%
United Kingdom	25.2%	16.1%	48.9%	31.2%	54.0%	82.6%	37.5%	59.4%
Italy	28.7%	21.4%	13.4%	47.9%	90.4%	87.3%	48.0%	24.3%
Latvia	26.8%	16.9%	8.7%	22.2%	28.7%	93.2%	52.4%	65.7%
Lithuania	22.8%	13.6%	15.5%	21.6%	51.9%	82.5%	43.9%	54.2%
Estonia	24.1%	19.6%	1.3%	27.5%	43.3%	99.8%	46.2%	58.7%
Luxembourg	11.5%	27.8%	11.7%	16.1%	57.6%	32.2%	56.0%	11.0%
Ireland	9.4%	3.0%	8.3%	27.0%	62.4%	69.8%	28.4%	9.4%
Greece	6.7%	9.5%	1.1%	16.6%	37.3%	67.6%	45.7%	7.6%
Cyprus	3.2%	3.4%	0.0%	0.0%	88.0%	20.0%	29.8%	0.0%
Malta	1.5%	4.2%	2.0%	2.0%	11.4%	0.0%	2.8%	0.0%
Belgium	13.5%	16.1%	50.2%	9.8%	52.6%	72.1%	51.8%	22.5%
Germany	17.8%	22.6%	16.6%	34.6%	57.2%	69.6%	60.6%	28.0%
Austria	16.4%	19.9%	11.8%	13.9%	36.9%	43.7%	53.1%	28.1%

Source of data: Eurostat, extracted on 22.03.16. The "Defense" function is excluded, where the share of local government expenditures is zero or with values close to zero.

The share of local expenditures shows the scope of local self-government and is one of the main indicators of decentralization. The

ranking of the EU countries according to its value is presented in **Figure 1**.

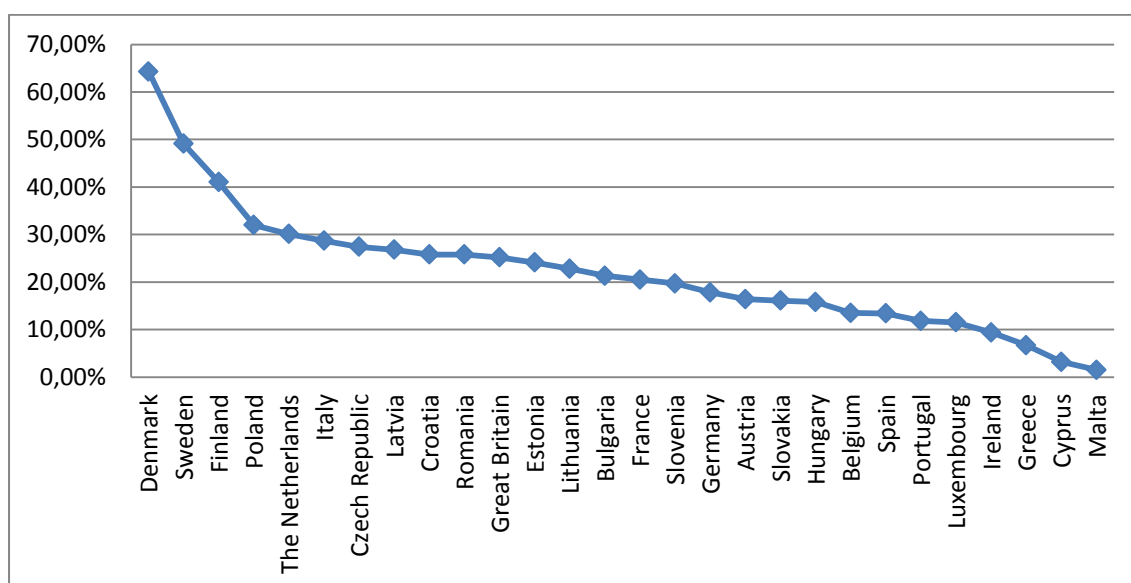


Figure 1. Share of local service expenditure of total public expenditure

The graph shows that at the top of the list significantly separated from the rest are the three Scandinavian countries - Denmark, Sweden and Finland. At the bottom - with less than 10% share of local spending, are four countries - Ireland, Greece, Cyprus and Malta. An interesting fact in this arrangement is that there is no division between the countries of Eastern and Western Europe.

The data show that on average for the EU, local authorities provide 23.5% of all public services. They provide the majority of public services in the field of public utilities, environmental protection and culture. The share of local services in education and economic activities is relatively high. There are fewer local competencies in healthcare and social assistance.

In contrast to public spending, here the differences between countries are significant - from 64.3% for Denmark to 1.5% for Malta. The results of the analysis by function show that the high share of the Scandinavian countries is mainly due to local responsibilities for the provision of services in education, social assistance and especially in healthcare. It is in these functions that the share of the four lagging

countries is 0% or with shares close to zero. Relatively large differences in the share of local expenditures compared to the EU-28 average are observed in Croatia, where local authorities have a relatively small share in the provision of environmental and public works services, and in Italy, where almost all health services are provided by the local authorities. At the other pole are countries such as Germany, France, the Czech Republic, Romania and others, whose differences with the EU-28 average share of local spending are minimal.

The share of local authorities in Bulgaria is 21.3% and is close to the EU average. The biggest discrepancy with the average values for other European countries is in the function "Public order and security", the share of local expenditures is lower in the field of social protection, culture and economic activities. Bulgarian municipalities have a relatively larger share in the provision of educational and communal services.

Local revenues

Principles of the revenue system

Stability. Part of the revenue should come from sources that are not affected by large and sudden changes in the external

environment. To provide compensatory mechanisms in case of collapse of the local revenues caused by such changes, local authorities to be able to form tactical stocks of funds to meet expenditures due to the uneven flow of revenues into their budgets during the year. (7)

Viability. There needs to be a high degree of dependence between local revenues and the socio-economic development of the territory. Local authorities must be interested and contribute, within their powers, to business development. At the same time, they should not be directly involved in economic activities, as this would be unfair competition for their own taxpayers. Only participation in activities that are in local monopolies, where there are no conditions for real competition, is allowed.

Justice. The system of local revenues should promote a fair redistribution of resources between: rich and poor consumers, realized through free or subsidized services financed by local taxes and fees; (8) rich and poor municipalities, realized through the use of equalization transfers. Municipalities must have access to the credit market, from where they can obtain resources to finance large infrastructure projects, the benefits of which are shared by more than one generation.

The local revenue system must contain incentives for local authorities to make efforts to increase and use them rationally.

The share of local government revenues in all public revenues in EU countries shows how they are distributed between central and local governments (**Figure 2**).

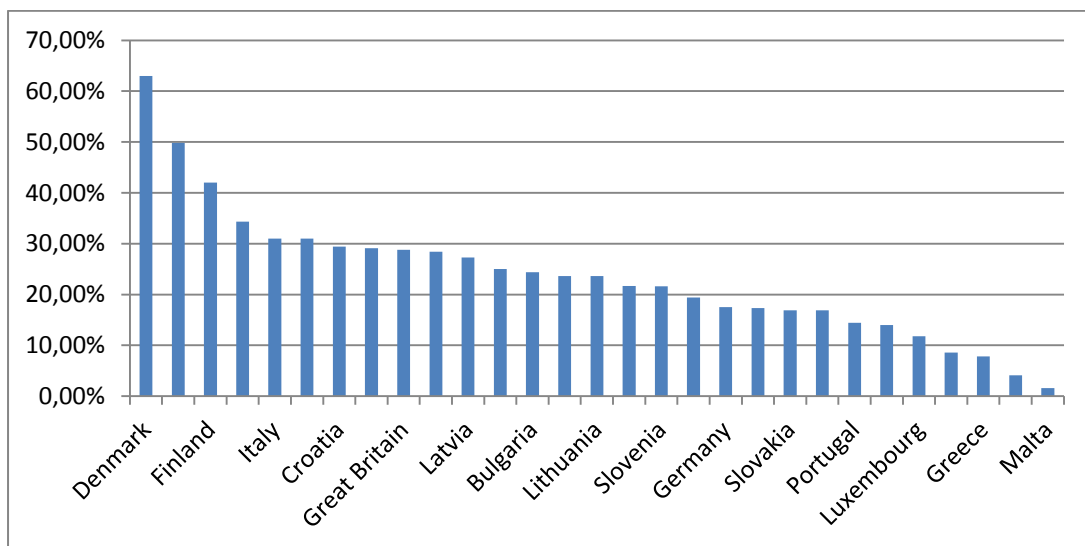


Figure 2. Share of local government revenues in EU countries in total public revenues in 2014

It is logical that this distribution corresponds to the distribution of public expenditure. (9) The calculations show almost complete comparability - the correlation coefficient is 99.5%. The data show that Scandinavian countries are in the first place, led by Denmark,

and last come Ireland, Greece, Cyprus, Malta with a share of less than 10%. Bulgaria ranks just below the EU average with a share of 24.4%. Revenues of local authorities in the EU are formed from two main sources - taxes and transfers.

Table 2. Revenue structure of local governments in the EU in 2014 (sample)

	Total revenue	including		
		Tax revenues	Transfers	Other revenues
EU (28 countries)	100.0%	35.5%	48.3%	16.3%
max	100.0%	57.5%	95.7%	32.6%
min	100.0%	0.0%	30.0%	4.3%
Bulgaria	100.0%	9.6%	83.8%	6.6%
The Czech Republic	100.0%	42.5%	41.3%	16.3%

In **Table 2** the share of tax revenues in total revenues for the EU-28 is 35.5%. The highest share of tax revenues in 2014 were Latvia - 57.5%, Sweden - 53.6, Spain - 51.4, France - 48.3%, etc. In last places, with a share of less than 10% are Bulgaria - 9.6%, Lithuania - 5.7%, Estonia - 3.8% and Malta, whose local authorities do not generate tax revenues. The share of government transfers is inversely proportional to the share of tax revenues. As can be seen from the data, in 5 countries, including Bulgaria, the share of transfers is over 80% of all local government revenues. What this means, is that the municipalities in Bulgaria rely on and

depend to the greatest extent on the financial support of the state.

Local Finances in Bulgaria

1. General characteristics of local self-government (10)
2. Place and structure of municipal budgets
 - 2.1. Share of local finances in all public finances in Bulgaria
 - 2.2. Costs for municipal services
 - 2.3. Municipal revenues
 - 2.4. Relationships and dependencies between municipal revenues
3. Main conclusions

Table 3. Structure of the services according to the expenditure powers of the local authorities and by groups of municipalities.

	Cost structure (BGN / per capita)				Share of costs in total costs		
	Total costs	Expenses for delegation services	Local services costs	Co-financing	Expenses for delegation services	Local services costs	Co-financing
Large	593	288	291	14	48.6%	49.0%	2.3%
Medium	620	333	268	20	53.6%	43.2%	3.2%
Small	751	415	319	18	55.2%	42.5%	2.3%
Total	615	311	288	16	50.6%	46.9%	2.5%

As can be seen from the data in **Table 3**, more than half of the expenditures of the municipal budgets are written by the Minister of Finance. This share increases with the size of municipalities. There are no major differences in the structure of expenditures by groups of municipalities, unlike their size.

Small municipalities have three times as high, while medium-sized municipalities - twice the amount of expenditures in municipal administration activity than those in large municipalities. This proves that the administration in smaller municipalities is relatively more expensive.

Table 4. Structure of municipal revenues by groups of municipalities

	Revenue structure					Revenue per capita				
	Total revenue	Own revenues	Transfers	Attracted funds	Transient residue	Total revenue.	Own revenues	Transfers	Attracted funds	Transient residue
Large	100%	41%	52%	-1%	8%	647	264	336	-3	51
Medium	100%	31%	59%	0%	11%	698	216	411	-2	74
Small	100%	27%	63%	0%	10%	836	226	529	-2	83
Total	100%	37%	55%	0%	9%	677	249	372	-3	59

In **Table 4** can be done two main conclusions can be drawn: first, small municipalities receive significantly more revenue per capita than others; second, large

municipalities take up a larger share of their own revenues, and small municipalities receive relatively more transfers.

Table 5. Degree of coverage of expenditures with revenues by groups of municipalities

	Total expenses (BGN/per capita)	Local taxes (BGN/per capita)	Own revenues (BGN/per capita)	Transfers (BGN/per capita)	Local taxes / total costs	Own revenues/ total costs	Transfers/ total costs
Large	593	109	264	336	18%	45%	57%
Medium	620	71	216	411	11%	35%	66%
Small	751	56	226	529	7%	30%	70%
Total	615	95	249	372	15%	41%	60%

The data in **Table 5** show that most of the revenues for municipal services are received by the state through various types of transfers. The dependence of the municipalities increases with the decrease of their size in the small municipalities as well reaches an average of 70%. Consumer awareness that they pay for the services provided to them, which is most strongly formed by local taxes, are supported by a 15% share of local taxes, which is 18% for large municipalities and only 7% for small ones. Approximately the same is the impact of local fees. The conclusion is that the pay-as-you-go link for municipal services is very weak, especially for small municipalities. This is confirmed by the degree of coverage of costs with revenues from local fees.

RESULTS

The results of the analysis and assessments of the financial state of Bulgarian municipalities show that they have the following characteristics:

The largest influence on the formation of inter-municipal differences in the financial state is exercised by the indicators of the revenue sector. The differences in revenues in medium and small municipalities are particularly large.

The current system of municipal revenues is characterized by: low share of own, including tax revenues; weak relation to the level of socio-economic development of the territory; strong dependence on government transfers.

CONCLUSIONS

The financial dependence of municipalities increases with a decrease in their size, as on average for small municipalities it is 70%, and for individual municipalities it exceeds 90%. This greatly narrows the area in which citizens can make decisions about specific services and

reduces the impact of the funds they pay for their use. It is natural in this situation for the interests of municipalities to shift from efforts to increase their own revenues to efforts to provide more transfers, i.e. strengthening the influence of the central government over local authorities and moving away from the real nature of the decentralization process.

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