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BULGARIAN FISCAL POLICY IN THE STABILIZATION PROGRAM

BY

NIKOLAI GULUBOV

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1. THE CHANGES IN FISCAL POLICY 1.1.

Fiscal Policies up to 1990

State interference with real economy processes in developed market systems is primarily realized by respective fiscal and monetary policies. Changes in the fiscal policy are of paramount importance in the transition from a centrally-planned command economy to the market economy because of the large share of budget revenues and expenditures in the Gross Domestic Product (GDP). For Bulgaria this share amounts to 60-65 percent. On the other hand monetary policy effectiveness is greatly reduced by the underdevelopmem of the banking system and by its excessive dependence on the executive. These facts are not accidental. The philosophy of a centralized economy is best served by fiscal relations because they imply redistribution of resources from certain economic or consumer entities (industries, sectors) to others on the subjective will of the managing center.

In the late 1980s, the existing system in Bulgaria showed ever more pronounced signs of obsolescence. In spite of the attempts at an economic reform "within the framework of the existing system", the efficiency of the economy and its management was continuously declining. Imbalances were accumulated in almost all macroeconomic indicators; inflation was growing. The too frequent changes had become an obstacle factor for development.

Generally, the centralization of resources and the "overheating" of the economy were strongly encouraged and brought to an absurd level. The ambitious five-year national plan also contributed to these developments with the high growth rates which it envisaged. Although the average growth rate of the national income was actually 3.7 per cent over the period 1981 to 1985, it was planned to reach 5.4 per cent in 1986-1990. Those unrealistic targets together with the efforts to maintain the existing standard of living (mainly due to domestic political and ideological reasons) increased macroeconomic disproportions and contributed to the accumulation of large domestic and external debts.

Growing budget deficits were covered "automatically" by credit facilities from the Bulgarian National Bank (BNB) which was directly subordinate to the Government. The budget was formally voted on in its "crude shape" on the basis of grossly aggregated indicators. The budget and the monetary and lending system were passively adapted ID the prescribed physical indicators of the central plan. In practical terms, the communist government had unrestricted power to modify the structure and weight of taxes and other revenues and budget expenditures.

Taxation and other regulations changed every year, or even within each year, to suit actual results. This enabled state-owned enterprises to exert pressure on the Ministry of Finance for tax facilities and exemptions, greater subsidies in various forms, and budget (nonrepayable) investments. Since tailor-made budget contributions and subsidies were geared to prescribed physical indicators of the central plan, it was impossible to establish which of the enterprises demands were justified.

The first changes (after the most important political change on November 10, 1989) toward a pluralistic society and market economy appeared in 1990. In that year for the first time Bulgaria began its fiscal year (which coincided with the calendar year) without a budget prepared and approved by Parliament - due to the complicated economic and political situation. In 1990 alone. Parliament voted the state budget twice (the second budget was an updated version of the earlier one and its basic indicators were even worse). The actual implementation, in turn, was a less successful version of the second budget. This tradition was followed throughout 1991 and will obviously prevail as well in 1992.

The real decline in production started as far back as December 1989. In 1990 the tension in the economic and political tension was continuously growing. On March 29 the government unilaterally cancelled repayments on the principal of almost the entire foreign debt, which at that time exceeded $ 10 billion. Later, debt service was also discontinued. These actions placed the country into a credit blockade position which, together with fully depleted foreign exchange reserves (only $ 200 min), increased the shortage of raw and prime materials. The events in the Persian Gulf caused the balance of payments to further deteriorate due to a shortfall of exports amounting to hundreds of millions of dollars and the restrictions on repayment of old debts to Bulgaria with Iraqi oil. During 1990, the economic ties with East European countries and the Soviet Union were disintegrating rapidly; terms of trade worsened significantly.

The domestic political situation was characterized by an aggravating political crisis, especially after the June elections and the pressure (including strikes) for pay increases (i.e. wages, pensions). The average decline in output was 11 per cent, while the average nominal wage increased by 24 per cent. At the end of November, about a month after the presentation of the government program for overall radical reforms, the government fell as a result of extra-parliamentary pressures though it enjoyed great parliamentary support.

The formation of a new coalition government supported by the trade unions delayed implementation of the radical reform program for another three months, i.e. until February 1, 1991. Meanwhile, the economic situation worsened: general shortages, black marketeering and excessive buy-out of consumer goods reached an exorbitant scale.

The actions of the governments in 1990 were inadequate to meet the quickly deteriorating internal and external economic conditions. Initially, partial measures were relied on, e.g. stringent rationing of budget spending, investments included, increased share of market-determined prices from 12 to 40 percent of the retail turnover, spending of foreign currency and material reserves, including the accumulation of negative balances on the clearing with some East European countries. Later, the implementation of a radical market reform program was thwarted by the opposition fighting for power. Thus, instead of becoming the year of reforms, 1990 was the subject of political struggles. The year was practically lost for the reforms and changes in the fiscal policy in particular, and in that sense 1990 became the last year of the old economic system (See Tables). The conditions at the outset of the changes were worsened by the necessity of gearing the needed radical economic changes to the political events. The budget revenues for 1990 were almost equal to the expected level. The deficit, however, increased due to the growth in expenditures, including production subsidies, payments for the difference in foreign exchange coefficients for the trade in non-convertible currency, general government needs and the State Investment Lending Fund.

1.2. The Reform of February 1, 1991 and Its Impact on Fiscal Policy

In the second half of 1990, Bulgaria became a member of the International Monetary Fund (IMF) and the World Bank. Actually, the preparations for the economic reform of February 1, 1991 and its further implementation were carried out with the direct assistance and consultation of the missions of these international financial organizations as well as to conform with some conditions they established. Fiscal parameters occupied a prominent place among the monitored indices. The consultations with the IMF were reflected in the Letters of Intent sent to it by the Minister of Finance and the Governor of the Bulgarian National Bank (BNB). In 1991, the economic program in general and the budget in particular were reviewed on a quarterly basis. In this sense, fiscal policy in 1991 and 1992

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was part and parcel of the stabilization program carried out in close collaboration with these international financial organizations.

The economic reform of February 1 was, in the most general terms, the standard IMF program. The preparations and consultations started under the second Communist government, and continued under the next coalition government on a more radical ("shock") version. The monetary part of the program consisted of measures to free the prices of some basic goods (food, transport) from administrative control or to drastically raise them (fuel and energy). Free market prices accounted for 74 per cent of the retail trade turnover and reached 90 per cent in the middle of the year. Besides, the introduced high market-oriented basic interest rates with a strongly restrictive and anti-inflationary impact (initially 45 per cent and then, after some fluctuations, 64 per cent). An interbank foreign currency market was introduced as a tool for attaining internal convertibility of the national currency. These measures were accompanied by the introduction of a system of partial indexing and compensations on wages, pensions and childcare allowances.

In the fiscal sphere, the initial State Budget Act voted by Parliament on February 8 envisaged revenues of about Leva 60.7 bin (41.4 per cent of the GDP), total spending of Leva 65.8 bin (44.9 per cent of the GDP), including 5.3 bin for outstanding interest out of a total of 11.9 bin interest payments (3.6 and 8.1 percent of the expected GDP respectively). The budget envisaged an primary surplus equal to 4.6 per cent of the GDP, almost "zero" cash balance (0.1 per cent) and a moderate overall deficit (- 3.5 per cent of the GDP). Furthermore, the net bank lending to the government was expected to be negative (- 0.5 per cent of the GDP).

The monetary phase of the reform developed under more difficult conditions and caused harsher effects than initially expected. Decline in production was nearly twice the estimated 11 per cent of GDP. Retail prices were almost double their estimate and real wages dropped by some 44 per cent instead of the expected 35 per cent for the year (during the first half of the year the drop reached 60 to 65 per cent). Instead of 7 to 10 Leva per U.S. dollar, the exchange rate of the Bulgarian currency reached as high as 18.1 Leva for a U.S. dollar. This could be partially explained by the shortage of external financing. Instead of USD 1.6 bin, the external financing received, mainly from the IMF and the World Bank, amounted to approximately USD 700 million. The BNB maintained high basic interest rates as an anti-inflationary measure.

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There were substantial difficulties in collecting cash revenues for the budget, especially in the first half of the year. During the first quarter, only 7.4 per cent of the planned revenues were collected, while during the first five months receipts reached 23 per cent. Therefore, during the first half of the year, the limited budget resources were almost entirely earmarked for financing the social sphere i.e. health care, education and social security as well as for financing measures aimed at partial compensation for higher prices.

In the middle of the year, the "second price shock" occurred, i.e. the rising retail prices as a result of the liberalization of the prices of liquid fuels and energy. Against the background of mounting social discontent, upcoming elections and an economy in stagnation, the government softened its monetary policies. The updated budget envisaged a primary balance of 0.5 per cent a cash deficit of 0.7 per cent, a total deficit of - 22.3 per cent, and net bank lending of 7.5 per cent, of the GDP. In this sense, the budget became less restrictive and more inflationary.

The attempts at structural reforms boiled down to a decentralization which was unsuccessful as a whole and actually turned every enterprise into a separate economic entity, including those enterprises which were technologically linked. The Privatization Act and the Agrarian Reform Act were postponed until after the parliamentary (October 1991) and presidential (January 1992) elections.

Preliminary data for 1991 showed that budget revenues were equal to 42.7 per cent of the GDP, while total budget expenditures amounted to 58.5 per cent (including revenues and spending for social security in budget-supported organizations). As compared to 1990, the reduction in revenues was quite considerable (by approximately 11.8 per cent of the GDP) and much less in expenditures (5.2 per cent). The overall budget deficit increased tangibly in comparison to 1990 (from -9.2 to -15.8 per cent of the GDP) mainly as a result of the increased share of outstanding interest on the external debt. The overall share of interest payments grew from 9.5 to 18.7 per cent of the GDP. Social security spending increased from 13.3 to 14.5 per cent of the GDP. As compared to 1990, defence expenditures were substantially reduced (from 4.2 to 2.9 per cent) and investments decreased from 3.1 to 1.8 per cent of the GDP. The cash deficit reached 3.9 per cent and the internal financing accounted for 5.4 per cent of the expected GDP (including net bank financing of 2.6 per cent).

Efforts were made to preserve other expenditures of vital importance, mainly for health care and education purposes. Spending for education increased from 4.6 per cent of the GDP in 1990 to 5.1 per cent in 1991 and the figures for health care were 3.6 and 4.3 per cent respectively. The priority of these spheres is even better illustrated by the structure of cash spending. Education accounted for 7.7 per cent of cash expenditures in 1990 and 12.5 per cent in 1991; health care increased its share from 6 to 9.2 per cent and pensions, social allowances and benefits increased from 22.5 to 31.1 per cent. The increase of the latter group of expenditures partially offset the elimination of subsidies for consumer goods. The purpose of unemployment allowances was similar and it accounted for 90.4 per cent of the resources raised in the extra-budgetary Retraining Fund equal to about 0.8 per cent of the GDP in 1991.

In the course of 1991 (from February through September), taxation legislation underwent a series of amendments and adjustments. The major objective was to attain a more uniform tax weight by reducing the differentiation of rates, restricting tax facilities and exemptions and eliminating ceiling (upper limit) tax rates. Those changes began as far back as 1988 but they were particularly emphasized after the reform of February 1, 1991, covering practically all basic taxes and tax groups. The measures were basically consistent with the requirements of modem tax theories. Their impact was undoubtedly beneficial insofar as they promoted tax neutrality (equal standards applied to all taxpayers) and reduced the distortion caused by all taxes when production factors were distributed.

Parallel to this major trend in tax policies, another one took shape, i.e. the preferential treatment of private and foreign capital over the state sector. That trend, based prim .inly on direct taxes, was appropriate to a certain extent since the prevalence of private property is associated with a market economy. But if this process is overly emphasized and le;id^ to the ruin of the state sector by economic and non-economic means, it may endanger the production structures. It should be remembered that private property will take a long time to establish itself and increase its share.

There was no tangible change in the structure of tax revenues in comparison to the late 1980s. A substantial change may be anticipated in 1993 when a package of new and interrelated tax laws will come into force. In 1991, only the share of non-tax payments increased.

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The basic tax rate was reduced from 50 to 40 percent in 1991. Initially, the non-basic rates of the tax were almost eliminated (mainly 0, 20, 25 and 65 per cent). Later on, under the pressure of real hardships, some tax facilities were re-introduced, though in a modified and relaxed form (for agriculture, border areas, cooperative societies, etc.).

Contributions to the municipalities equal to 10 per cent of the profit were preserved in 1991 and 1992. Former sole proprietorships were exempted from this tax. In addition, municipal budgets collected contributions from the profit tax payable by enterprises where the interest of the municipality exceeded 50 per cent as well as contributions to the special Land Reclamation Fund equivalent to 2 per cent of the profit. The profit was also the source for paying the tax for the Excees Wage Bill Tax (about Leva 480 min in 1991) and the rental tax which was negligible in size.

Considerable changes were introduced in the other groups of direct taxes, i.e. taxes paid by the population, and the major tax in this group, the income tax. In April 1, 1991, a uniform tax rate scale superseded the four different scales applied to income from different sources. The Tax Act of 1992 envisaged certain minimal untaxable earnings (Leva 5,400 per annum earned prior to 1 March 1992 under Article 4 and the earnings in 1991 under Article 13 and Leva 9,000 for the earnings after March 1, 1992 under Article 4 and the earnings for 1992 under Article 13). Those provisions were illogical and unfair to a certain extent. Both in 1991 and 1992, rates ranged from a minimum of 20 per cent which was rather high to a maximum of 40 per cent (previously up to 85 per cent under Article 13). For the sake of comparison, it should be pointed out that the average maximum rate is currently about 50 per cent in the European countries. These and other issues will probably be regulated with the future Tax Act which is now in the preparatory stage and is expected to come into force at the beginning of 1993.

In September, the Parliament amended the regulations concerning local taxes. Inheritance tax rates were updated and real estate tax rates were doubled.

Indirect taxes were also altered to achieve greater uniformity of application. In March 1991, when prices were already based on a free market, turnover tax was reduced from 46 rates (from 5 to 70 per cent plus 0) to initially three and then four (0, 2, 10 and 22 per cent). A similar approach was taken to excise taxes; from 25 different rates (ranging from 24 to 80 per cent) plus another nine for oil products calculated in Leva per ton, excise tax rates were reduced to four groups (70, 60, 50 and 40 per cent of retail prices) and two more groups for oil products (35 and 25 per cent).

The future of the turnover tax lies in its transformation into an improved variety, i.e. the Value Added Tax. It is expected that after the National Assembly adopts this system and thorough technical preparations are made, the Value Added Tax will be introduced at the beginning of 1993 in the form of a single rate of 20 per cent almost without exceptions. Excise tax rates will be changed in accordance with the value added tax because they will be paid in addition to this tax.

Until now, customs duties and related customs and export charges have played no significant part. The Harmonized Customs System practised in more than 100 countries was adopted at the beginning of 1991. The new customs tariff expected to come into force in 1992 will introduce greater uniformity, changing the rates from 0-200 per cent to 5-40 percent. Over the last two years, customs duties and customs export charges for a number of consumer goods and raw materials have been constantly changing in order to react flexibly to the changes in the economic situation, though this has not always been sufficiently quick and adequate.

The system of social security contributions is undergoing substantial change. In the past, this system was only formally independent from the government budget. Such a position, however, runs counter to the nature of the market economy and, more specifically, to the essence of social security contributions. Unlike taxes, social security contributions are actually insurance contracts which distribute the risk among all contributors. Funds raised in this way do not belong to the state. The state can only take care of their proper management because of their special importance to society. Therefore, the first and foremost task of the reform underway in the social security contributions system is to separate it from the government budget. But this is neither an easy nor a quick task to perform since the economic and demographic situation in Bulgaria accounts for the shortage of revenues to the system. The shortage was reinforced by the populist decisions on early retirement, especially in 1990.

To reduce of the deficit in the social security system, on March 1, 1991 contributions were increased and different rates were established. These rates are calculated as a percentage of the gross wages. The rates are 35, 45 and 50 per cent depending on the category of labor (previously 30 per cent). Besides, there were increases in the contributions to the special extrabudgetary Training and Retraining Fund from 0.5 per cent to 3.75 and then to 5 per cent, while the budget bill for 1992 envisaged 7 percent.

Another characteristic feature of the social contributions system, as envisaged above is its transformation into a system of separate specific social security funds. Alongside with the previously mentioned Training and Retraining Fund which is actually used for paying unemployment benefits, a Health Insurance Fund is expected to be established in 1993. The contributions to this fund will probably be equivalent to 6.5 per cent payable both by the employer and employee. Another fund will be the Pension Fund and a fourth one should also be established for payments related to demographic policies (allowances, grants, etc.).

The establishment of these organizational forms is an important prerequisite for the more efficient raising and utilization of funds. Regarding the shortage of resources, it is expected to be covered with the interest rates payable on 20-year government bonds as well as yields on stock from part of state-owned property.

The renovated tax and customs administration is weak, still inefficient and underpaid. The measures for strengthening it were rather late (not until September 1991).

2. ANALYSIS OF THE 1992 STATE BUDGET BILL

The consolidated state budget for 1992 envisages revenues of about Leva 77.8 bin or 36.3 per cent of the expected Gross Domestic Product (GDP), total outlays of Leva 106.1 bin or 49.6 per cent of the GDP and a total budget deficit of 13.3 per cent of the GDP (See Table 1). After the deduction from the total deficit of the external debt interest rates which will not be paid (about Leva 19.2 bin), the cash deficit will be equal to Leva 9,169 min or approximately 4.3 per cent of the GDP. The preliminary data for 1991 indicate revenues equal to 42.7 per cent of the GDP, outlays equal to 58.5 per cent, a overall deficit of 15.8 per cent and a cash deficit of 3.9 per cent of the GDP. As a matter of fact, the amount of the internal financing is a more important indicator than the cash deficit and it is envisaged to account for 5.7 per cent of the GDP (5.4 per cent in 1991).

These indicators *per se* are not too high when compared to other European countries. The share of budget expenditures of the 12 member countries of the European Community, for instance, was as follows in 1985, 1988 and 1990: 48.3 per cent, 47.4 per cent and 46 per cent, while revenues accounted for 43.9 per cent, 43.5 and 42.7 per cent respectively. Internal financing was not particularly large either. Even the total budget deficit is comparable to those in the "champions" in the **EC, Greece** and Italy.

In this case, however, it is important to consider not only the relative but also the absolute levels of macroindicators. In comparison to the peak year 1988, the size of the GDP is expected to be reduced by one third in 1992 and the per capita decline in income is expected to be about 26 per cent. Such indicators are comparable in peace time only with the Great Depression of 1929-1933. Under these complicated conditions, it is only natural for the budget to increase its share of the GDP. Conversely, when the real GDP is restored to its pre-crisis levels, budget revenues can be expected to grow at slower rates. From this perspective, the share of budget revenues planned for 1992 is too low, especially with a view to its reduction as compared to 1991 and the increase of internal financing from 5.4 to 5.7 per cent of the GDP. Claims that the reduction of budget revenues under such conditions is a success because it allegedly reflects "the further withdrawal of the state from the economy" are irrelevant. This reduction will rather reflect the inability of the tax administration to collect more revenues under the existing complicated situation.

The macroeconomic framework of the Budget Act seems quite controversial. The prevailing opinion is that it is too optimistic. For instance, the decline of the output (GDP) is envisaged to be 3.8-4.0 per cent, while pessimists estimate it at 10 percent. Initially, the plan was to reduce the monthly inflation rates by one point every quarter: from 5 per cent during the first quarter of the year to 2 per cent during the last quarter which meant an accrued annual inflation rate of approximately 51 percent. Since the inflation rate was 5.8 per cent in February and 3.9 per cent in March, estimates have probably been changed to an annual rate of up to 65 per cent. Unemployment which affected 10.5 per cent of the active population at the end of last year is expected to reach only up to 12 per cent at the end of 1992. In fact, it has been announced that the objectives of the fiscal policy may remain unchanged in the event of deviations from expected inflation rates, production decline and unemployment by 15 to 20 per cent.

The intentions of the government to reduce the average real wage by only 0.6 per cent (forecast nominal amount of Leva 1,780) and to make the average pension about Leva 619 (Leva 507 last December) do not seem feasible. The average annual basic interest rates forecast at 40 per cent in accordance with the inflation rates also sound too optimistic. The forecast related to the exchange rate of the Bulgarian national currency is similar: it "must" increase by 5 percent. Apart from these conditions, political and economic stability is also needed but it will be difficult to achieve. This puts into question the intention of the government to avoid the updating the budget during the course of the year.

For the same reason the structure of budget revenues is not expected to change substantially as compared to 1991 (See Table 2) or the previous years. For example, if the turnover tax was transformed into value added tax this year, the treasury would receive an additional amount of Leva 9 bin which is equal to the planned bank lending.

2.1. Budget Revenues

The Budget Bill attaches paramount importance to the group of direct taxes, 44.1 per cent of total revenues. This share is too high and it is at the expense of indirect taxes. The structure of these taxes is characterized by a large share of profit taxes and a small share of taxes paid by the population. The situation in a market economy is just the opposite.

Profit taxes are expected to yield a total of 36.1 per cent of budget revenues. They are the single largest source of revenues (50.6 per cent in 1991). The basic tax rates remain unchanged. What changes is the range of taxable profit. It is expected that 50 per cent of the interest payments will be deducted before taxation (compared to 7.5 to 25.0 per cent in 1991). Besides, in connection with the re-valuation of long-term assets which will increase their value six to ten times, the depreciation allowances for taxation purposes will increase to 50 percent. Though insufficient, this change will reduce the tax burden by 10.5 percent. The basic profit tax rate for commercial banks is being increased from 40 to 50 per cent as a set-off measure. This is justified to a certain extent because the high interest rates introduced last February which "shifted" profits from production to banking was a negative development. Furthermore, more than one third of the existing enterprises are expected to finish 1991 with operating losses. In spite of these changes, the share of profit taxes paid by financial institutions will increase from about 36.6 to 42 per cent. One might object to the fact that the tax for the State Savings Bank (where the population traditionally keeps most of its savings) is envisaged to become 70 percent. The State Savings Bank is like any other commercial bank and placing it under uneven conditions will be unfair to small savers. In 1992, former collective firms which are now limited partnerships will p;iy profit taxes, though perhaps with some facilities.

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A number of tax exemptions exist but they spread the tax burden unevenly (mainly for agriculture, cooperative companies, the private sector and underdeveloped regions). In spite of them, the average tax burden was approximately 38 per cent last year. This fact, together with the wide range of taxable amounts, makes profit taxation quite heavy, even when judged by international standards. It is necessary to further reduce such taxation in order to ease the financial position of nonfmancial enterprises which are overburdened with high interest rates and accumulated old debts. In this sense, it is with respect to profit and not the budget revenues as a whole that the state should further "withdraw". Given the budget deficit, this may become possible only when other sources of revenues are identified to replace profits.

Ordinance No. 27 of the Council of Ministers dated February 7, 1991 provided that part of the dividends of the state firms would be taken away in 1991. The same trend will probably be preserved in 1992. Under the existing regulations additional reserves are raised out of profit and then 50 per cent of the residual profit after taxation is allocated as dividends to the owner. They are accumulated in a special extra-budgetary account of the Ministry of Finance for covering some of the bad debts of state-owned enterprises. This is correct from a strictly legal point of view. But this is a way to restore the differentiated profit taxation in a latent form. Profitable enterprises are deprived of additional resources and their development is restricted.

The income tax, the basic tax paid directly by the population was, in fact, updated. If inflation rates exceed estimates, this tax may "collect" much more than the envisaged Leva 6.1 bin. That was the reason for the collection of Leva 4.5 bin in 1991 instead of the anticipated Leva 2.5 bin.

Revenues from customs duties and import charges (belonging to the groups of indirect taxes) seem underestimated. According to the forecast for 1992 they will reach only Leva 1.5 bin or about 2 per cent of all budget revenues (Leva 1,516 min or 2.7 per cent last year). The major point here is not so much the direct collection of funds in the form of customs duties as their role in regulating the external competition. Under severe crisis conditions it is of vital importance for the economy to protect the greater part of the limited domestic market for Bulgarian manufacturers. Currently, the market is flooded with imported consumer goods which are often of poor quality. Many of them have been imported illegally. Hence, they have not been taxed with customs duties, excise or turnover taxes. Restricted access of such products to the Bulgarian market should be achieved, if necessary, by means of a more efficient customs control system and by higher customs duties. This may give rise the so urgently needed incentive for local production which, from the viewpoint of the budget, implies less unemployment benefits and more revenues from income and profit taxes as well as social security contributions.

The system of social security contributions continues to exist within the government budget. Transfers to this system are envisaged to reach Leva 1,677.7 min or approximately 6.9 per cent of all expenditures.

2.2. Budget Expenditures

The character of the consolidated government draft-budget for 1992 is best illustrated by budget expenditures. Though cash expenditures, i.e. those which will be actually effected, exceed the revenues, there is shortage of funds relative to existing needs. This does not imply, of course, that relatively superfluous expenditures will be ruled out. This is the case, for instance, with the "oversecurity" provided for raising children which was noted by the World Bank.

32.1 per cent of cash outlays (31.1 per cent in 1991) are earmarked for social security and social care. When social security contributions from budget-supported organizations (calculated in other functional groups of expenditures) are added, the relative share will reach 36.3 per cent (34.6 per cent last year). These expenditures are of vital importance for pensioners, families with children and people in need of social care. Undoubtedly, these resources are insufficient to meet the needs in spite of their large share in cash expenditures. Interest payments for about 13.5 per cent of cash expenditures (14.7 per cent in 1991 and an average of 4.8-5 per cent in the EC countries). Efforts have been made to maintain spending levels for education and health services at a comparatively high level;
nevertheless, the funds allocated for these purposes fall short of needs and tend to reduce their share in the GDP (Table 3).

Defence expenditures account for only 2.7 per cent of the GDP (2.9 per cent in 1991) with the average world level of 4.5 per cent and up to 6.8 per cent in Greece. The budget provides resources for additional 2,800 policemen but the funds for technical equipment are insufficient. The share of economic services is declining which makes the structure of expenditures similar to the one typical of market economies. Subsidies in particular decrease both relatively, i.e. as a share of the GDP (from 4.1 to 1.9 per cent) and absolutely - from Leva 5,272 to 4,074 rnln. This induces price increases in the energy sector.

The insignificant share of investment expenditures reflects the excessive restriction of spending in general. They account for only 1.7 per cent of the GDP (1.8 per cent in 1991, 3.1 per cent in 1990 and from 5.4 to 6.3 per cent over the period 1987-1989). To comparison, even in the EC countries with a developed market economy and a viable private sector such expenditures were equivalent to 2.9 per cent of the GDP on the average in 1985 and 2.7 per cent in 1988 and 1990. Hence, almost all budget expenditures are used for current consumption, while investments are reduced below the "subsistence level".

In spite of some statements, no tangible progress is expected with respect to the separation of municipal budgets from the central government budget in 1992. For example, the Amended State Budget Act of 1991 (July) ruled that 20 out of a total of 250 municipalities had to cover their spending with their own revenues. Those 20 municipalities had to contribute "surpluses" of Leva 433.5 min to the central government budget, while the remaining 230 had to receive budget subsidies of Leva 4,868.2 min. Thus revenues to municipalities covered 69.6 per cent of the planned spending and their percentage dropped to 66.3 when the redistribution of surpluses was taken into account. According to the 1992 Budget Bill, 249 out of 255 municipalities receive subsidies from the budget to finance four basic types of spending, 4 municipalities pay contributions from their "surpluses" and two are self-supporting. Such a situation provides no incentives for economizing on resources. A major reason for the growing dependence of municipalities is the fact that in 1992 they will be entitled to only 70 per cent of the income tax (100 per cent for the last few years). Against this background, the separate voting of municipal budgets seems rather a formality.

2.3. Budget Deficit

A whole set of problems is related to the financing of budget deficit (Table 1). The net amount of external financing is less than the size of the interest due on foreign loans, mainly due to the payment for accumulated negative balances in the trade with some Eastern European countries (Poland, Czechoslovakia and Hungary). Problems arise mainly in connection with the internal financing. Its share is planned to increase from 5.4 to 5.7 per cent of the GDP and, furthermore, there are no guarantees that the envisaged level will not be exceeded. In this connection, the internal government debt is envisaged to increase by another Leva 12 bin plus, thus reaching about Leva 34.2 bin. The structure of internal financing is unfavorable; up to 74 per cent will be in the form of bank loans (mainly from the BNB) and 26 per cent will come from the net issuance of government securities due to the underdevelopment of the securities market. Besides, in the first half of the year bank loans are expected to exceed the envisaged net amount which increases the danger of inflation. And inflation is "the worst tax on everything".

The financing of the budget deficit mainly through bank loans continues to crowd out nonfinancial enterprises from the credit market and makes loans more expensive. This reinforces the stagnation in production. 1991 experience proved that out of the two major instruments for indirect regulation, i.e. the monetary and and the budget policy, it is the latter that turned out to be "the bottleneck". In this sense, the difficult and yet correct path seems to lie in reducing internal financing, especially the bank lending, to the budget by means of increasing budget revenues. Hence, the reduced basic interest rates and stabilized exchange rate should be expected to stimulate production. Naturally, for this purpose, it is necessary to implement more active structural policies through the requisite extra-budgetary funds.

An advantage of the draft-budget for 1992 and also the 1991 budget is that no direct budget revenues are envisaged from fresh external loans. The latter are allocated for the replenishment of foreign currency reserves (at the BNB) or the State Fund for Reconstruction and Development from where they will be extended in the form of credits. The resources in this Fund are envisaged to reach the equivalent of Leva 14,860 min in 1992 (about Leva 4,462 min at the end of 1991). Another positive feature in the same spirit is the fact that the budget is not going to spend any possible revenues from the privatization process. They are to be used to repay the state debt and offer collateral on old debts. A positive, though minor point is the positive though reduced balance (1.1 per cent of the GDP). This is indicative of the necessary equilibrium attained between current revenues and expenditures, net the interest payments on the state debt.

The legislative basis for the functioning of a National Office of Accounts which is to supervise the spending of government resources is still non-existent. In this context, Parliament and its Committees prove to be in an uneven position from the viewpoint of information supply and processing as compared to the executive branch (including the Ministry of Finance and the BNB) which affects the quality of the parliamentary supervision.

ANNEX

TABLE 1

CONSOLIDATED GOVERNMENT BUDGET - BASIC INDICATORS

(IN PER CENT OF GDP)

	1990	1991	1992
1. Budget Revenues	54.5	42.7	36.3
2. Total Budget Expenditures	63.7	58.5	49.6
3. Total Deficit (l-2)=Financing (7+8)	-9.2	-15.8	-13.3
4. Unpayed Interests on Foreign Debt	4.3	11.9	9.0
5. Cash Deficit (3-4)	-4.9	-3.9	-4.3
6. Cash Budget Expenditures (2-4)	59.4	46.6	40.6
7. Foreign Financing, Inclusive of Negative Net Balances Inclusive of Unpayable Interest on Foreign Loans From Devalued Negative Balances	3.3	10.4	7.6
	4.2	11.9	9.0
	-	- 1.8	-2.5
8. Internal Financing - Net (A+B) A) Net Government Securities B) Net Bank Financing	5.9	5.4	5.7
	1.5	2.8	1.6
	4.4	2.6	4.1
9. Total Current Expenditures (2-10)	60.6	56.7	47.9
10. Capital Expenditures	3.1	1.8	1.7
11. Total Interest	9.5	18.7	14.4
12. Primary Budget Balance [1-(2-11)]	3.1	2.8	1.1
13. Subsidies	14.9	4.1	1.9

Source: Ministry of Finance

TABLE 2

CONSOLIDATED GOVERNMENT BUDGET REVENUES STRUCTURE AND ITS GDP SHARE

	1990		1991		1992	
	total revenues	GDP	total revenues	GDP	total revenues	GDP
Total Revenues	100.0	54.5	100.0	42.7	100.0	36.3
Inclusive Total	80.8	44.1	90.2	41.5	95.9	34.8
Tax Revenues LDirect Taxes	41.9	22.9	50.6	21.7	44.1	16.0
1. Profit Tax 2. Levvied Taxes on the Population - Inclusive of Overall Revenue Tax	33.7	18.4	42.3	18.1	36.1	13.1
	8.2	4.5	8.3	3.6	8.0	2.9
	7.7	4.2	8.1	3.5	7.8	2.8
II. Indirect Taxes 1. Turnover Tax 2.Excise Tax 3. Customs Duties and Fees	18.4	10.0	20.2	8.6	22.5	8.2
	7.5	4.1	8.8	3.7	9.8	3.6
	9.1	5.5	8.7	3.7	10.7	3.9
	1.8	0.4	2.7	1.2	2.0	0.7
III. Social Insurance Receipts	20.5	11.2	26.4	11.3	29.3	10.6

Source: Ministry of Finance

TABLE 3

CONSOLIDATED GOVERNMENT BUDGET EXPENDITURES STRUCTURE ACCORDING TO THEIR FUNCTIONS AND ITS GDP SHARE

	1990		1991		1992	
	total expen-ditures	GDP	total expen-ditures	GDP	total expen-ditures	GDP
I. General State Administration	3.2	1.9	3.9	1.8	3.6	1.5
1 .Executive and Legislative Bodies and General Administrative Bodies	-	-	2.8	1.3	2.5	1.0
2. Science	-	-	1.1	0.5	1.1	0.5
II. Defense and Security	8.6	5.1	9.0	4.2	10.1	4.1
1. Defense	7.1	4.2	6.3	2.9	6.6	2.7
2. Police, Fire Dept. and Security	-	-	2.3	1.1	3.0	1.2
3. Judiciary	-	-	0.4	0.2	0.5	0.2
HI. Education	7.7	4.6	12.5	5.8	12.5	5.1
IV. Health Care	6.0	3.6	9.2	4.3	10.1	4.1
V. Social Security and Social Care	22.5	13.3	31.1	14.5	32.1	13.0
1. Pensions	15.7	9.3	20.6	9.6	20.8	8.5
2. Relief	5.8	3.4	9.1	4.3	9.9	4.0
3. Social Care	1.0	0.6	1.4	0.6	1.4	0.5
VI. Housing Construction, Development and Utilities	4.7	2.8	3.5	1.6	3.5	1.4

TABLE 3 (continued)

	1990		1991		1992	
	total expen-ditures	GDP	total expen-ditures	GDP	total expen-ditures	GDP
VII. Leisure, Sport, Physical Culture, Culture Incl. Culture	2.2	1.3	2.2	1.0	2.1	0.8
	-	-	2.0	0.9	1.8	0.7
VIII. Economic Services-Total 1. Fuels and Electricity 2. Agriculture and Forestry, Hunting and Fishing 3. Mining and Mineral Resources, Instrial Production and Building Construction 4. Transportation andCommuni-cadons 5. Other Economic Services, Incl. Commerce, Hotel and Restaurant Industry	36.2	21.5	13.9	6.5	12.6	5.1
	1.5	0.9	6.7	3.1	1.7	0.7
	14.4	8.5	0.9	0.4	1.7	0.7
	8.3	4.9	0.9	0.4	0.8	0.3
	2.7	1.6	2.1	1.0	3.0	1.2
	9.3	5.5	3.3	1.6	5.4	2.2
IX. Other Cash Expenditures Interest - on Foreign Debt Outstanding - on Domestic Debt	8.9	5.3	14.7	6.8	13.5	5.5
	8.9	5.3	14.4	6.7	13.3	5.4
	7.7	4.6	0.9	0.4	2.9	1.2
	1.2	0.7	13.3	6.3	10.4	4.2