

THE FISCAL POLICY OF BULGARIA IN THE CONTEXT OF THE EU MEMBERSHIP

The fiscal policy of Bulgaria is revealed with regard to the progress made in the process of compliance with the EU requirements for membership and for the preparation for Bulgaria's entry in the EMU. The paper underlines the main trends of fiscal performance that has been an outcome of the Europeanization. Fiscal policy's contribution to the ongoing restructuring of the Bulgarian economy is discussed in the following main aspects: 1) changing the role of government in providing public goods and services; 2) reforming the public revenues and expenditures structure and policies in order to make efficient the use of public resources; 3) better management of public spending policies and improvement of public accountability of the public finances.

On the basis of comparative analysis the paper outlines the problems and the prospects of the fiscal policy with regard to the Bulgaria's preparedness for the entry in the European Monetary Union. Conclusions are drawn as regards: 1) the main factors and trends of the financial restructuring of the public finances; 2) evaluation of the process of the Europeanization of the public finance management.

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The fiscal policy of Bulgaria has undergone important changes as a result of the preparation for accession to the EU and the ongoing changes since joining the EU in 2007. Due to the discipline achieved in the last decade after introducing the Currency Board regime in 1997 and the compliance with the EU requirements the public finances management has become instrumental for achieving higher economic growth and macroeconomic stability.

The contribution of the public finances policies to the economic growth has been brought to the fore front by a number of developments over the present decade contributing to positive changes in the level and composition of public expenditure and its financing via higher revenues and budget surpluses. Fiscal policy has set growth promoting incentives for the domestic private sector and foreign investments. It has made more efficient use of public resources. The macroeconomic stability has been supported by stable and sustainable public accounts. Due to Bulgaria's accession to the EU the fiscal discipline has been increased considerably.

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The coordination of Bulgaria's fiscal policy with the EU requirements has contributed to: a) the improvement of the effectiveness and the efficiency of the public budget process; b) the implementation of medium term budget programming within the framework of the Convergence programmes's requirements; c) the sustainability of high economic growth.

The fiscal policy has contributed to the ongoing restructuring of the Bulgarian economy in the following main aspects: 1) changing the role of government in providing public goods and services; 2) reforming the tax and social security systems in order to create incentives for the private sector and make efficient the use of public resources; 3) better management of public debt, including the sustainable governance of the external payments.

The institutional framework of the fiscal policy and its compliance with the EU requirements

Bulgaria's preparation for accession has been an important stage in the development of the contemporary institutional framework of the public finances as the environment within which the fiscal policies operate. This institutional framework has been redefined to promote better markets' functioning in compliance with the good practices and experiences of the co-ordinated budget policies of the EU member-states since 2001 when the accession negotiations with the EU started. The changes that have been introduced have been contributing to the adequate transition to a fully fledged functioning of markets by the introduction of rules for the transparency of the budget process, legislation for public procurement requirements, public aid regulation, requirements for public management accountability through the improvement of the public management and control systems in Bulgaria.

An important factor for the fiscal policy development has been the implementation of the set of requirements for the compliance with the EU accession and the convergence criteria of the EMU. Two phases of the progress to compliance with the EU requirements may be distinguished. During each of them the institutional framework for Bulgaria's public finances has undergone profound changes and its rapid implementation has not been an obstacle to economic growth though it has had some adjustment costs and socially unpopular consequences (for instance the reduction of the employed in the public sector in order to raise the efficiency of public expenditure, the difficulties with the reform of the public management and control system as well as the transition to the decentralized extended system of governance of the European funds, etc.).

The fiscal policy has involved measures which aim at stimulating economic growth, investment activity and employment. It has been targeted at improving the effectiveness of the structural adjustment of the economy by re-allocation of public resources towards priority fields and enhancing the quality of public finances. Thus the changes in the institutional framework of the fiscal policy have played and still have to perform a significant role in the overall design of the macroeconomic policy mix. Further improvement of the quality of public finances through enhancement of

the strategic planning systems, the adherence to tight budgetary constraints by all economic agents both in the public and private sectors, and the effective control over the appropriate, expedient and provident spending of the available budget resources remain the main principles of the fiscal policy's institutional framework.

In the pre-accession phase the compliance with the EU requirements in the area of public finances has been important with regard to:

1. the closure of Chapter 11 (concerning the exclusion of the direct resort of the government for public debt financing by the Central bank);
2. the requirements of the Chapter 24, 28 and 29 of the negotiations for accession (concerning the regulation of Bulgaria's joining of the EU customs union, the indirect taxes, the EU own resources system, the public financial management and control systems for national budget resources and EU funds, the protection of the euro and the fight against money laundering and irregularities and fraud, the multi-annual budget programming, etc.);
3. improving the transparency of public expenditure by the introduction of centralized system of management of budget resources and establishment of the treasury Single Account system.² The systems of SEBRA(system for electronic budget payments) and RINGS (Real time Interbank Gross Settlement) at the Bulgarian National Bank are in full compliance with the EU requirements and member states good practices for coordination of national budget policies.

² The main goal is to concentrate all payments within the first level spending unit (FLLSU), and thus to centralize the funds into the Single Account and streamline the payment procedure. The Ministry of Finance sets spending limits on the first level spending units' accounts in the Bulgarian National Bank (BNB) for carrying out aggregated control of public expenditures. Since 18 June 2000 all budgetary, extra-budgetary and suspense accounts in BGN at the BNB have been centralized in the Treasury Single Account system. A framework agreement was concluded with 21 commercial banks linked for servicing the accounts and payments of the spending units of budgetary appropriations. A new system for electronic budget payments (SEBRA) was developed and introduced to manage and exert a computerized control over payments ordered by the spending units. All the FLSU and their subordinate divisions were included in the system step by step until the end of 2001, 2500 spending units all together. In 2002 the system was further improved. Since 05.08.2002 the central government transfers to the municipalities and the payments have been put through SEBRA, as per paragraph 19 item 12 of the State Budget Law of Republic of Bulgaria for 2002. By the end of 2002 the introduction of RINGS (Real time Interbank Gross Settlement) in the BNB took place and the whole banking system and its connection with the Single Account and the SEBRA system. In 2004 the autonomous budgets, and particularly the National Health Insurance Fund, the Bulgarian National Television, the Bulgarian National Radio, the state universities, the National Social Insurance Institute and the Teacher's Pension Fund were included in SEBRA on a step-by step basis. As of 17.10.2005 in compliance with paragraphs 23, item 4 of the Law on the State Budget for 2005 the Judiciary accounts were included in the SEBRA. SEBRA and RINGS are in full compliance with the EU requirements and member states good practices for coordination of national budget policies.

The second phase of Europeanization of the institutional framework for the public finances has started since 2007 with Bulgaria's EU membership and continues onwards. The Europeanization at this phase is aimed at achieving the compliance of the national public finances policies with the fulfillment of the EMU membership criteria and the respective participation of Bulgaria in achieving the goals of the EU policies. The first Convergence Programme of the Republic of Bulgaria (2006-2009)³ was submitted to the European Commission at the start of the country's full European Union membership from 1st January 2007. The Convergence Programme of the Republic of Bulgaria replaces the Pre-accession Economic Programme implemented in the period of accession of Bulgaria to the EU. In the future, after the accession of Bulgaria to the eurozone, the Convergence Programme will be replaced by a Stability Programme. As the Convergence programme is upgraded annually already three Convergence programmes have been instrumental for the public policy management.

The present Convergence Programme (2008-2011)⁴ has been elaborated in compliance with the requirements stemming from the process of multilateral fiscal surveillance within the framework of EU macroeconomic policies coordination. It addresses the sustainability parameters of the fiscal policy of the country according to the recommendations of the Stability and Growth Pact. It contains the analysis for the previous and the current year, as well as forecasts for at least the following three years.⁵ It outlines the policies whose implementation would allow a sustainable achievement of the Maastricht criteria for Eurozone membership. The policies defined in the Programme are closely linked to the National Reform Programme and the National Strategic Reference Framework of the Republic of Bulgaria.

The fiscal policy's contribution to the macroeconomic stability

Within the long-term strategy for Bulgaria's entry in the EMU the fiscal policy is of primary importance for the compliance with the criteria of stable public finances. The implementation of the goals of the Convergence Programme of the Republic of Bulgaria (2007-2009) has been revealed in the annual national budget planning within the priorities set in the Three Years' Budget forecast for the period 2008-2011.⁶ The priorities and directions of a medium-term budgetary objective for (2007-2010) have been instrumental for setting further implementation of fiscal policy changes on the track of pragmatic oriented structural adjustment of public

³ Convergence Programme (2006-2009), December 2006.

⁴ Convergence Programme (2008-2011), November 2008.

⁵ It covers the following main topics: 1) medium-term budgetary objective, represented by a balanced budget or a budget surplus, in order to avoid the risks of excess budget deficits; 2) main assumptions concerning the future developments of employment, economic growth, inflation, etc.; 3) an assessment of policy measures, by which the objectives set in the Programme are expected to be achieved; 4) a sensitivity analysis of budgetary and debt stances of the country with respect to changes in the assumptions concerning the economic variables; 5) medium-term objectives of monetary policy and their influence on price stability and the stability of the exchange rate.

⁶ Convergence Programme of Republic of Bulgaria (2007-2010), November 2006.

finances. The introduction of the flat tax of 10% as well as the ongoing reform of the social security system have created tax incentives for investments and stimulate economic growth. On the side of the public expenditure policy the progress achieved in the adequate implementation of programme-oriented public spending policies at the Republican level and further sustainability of local budgets through municipalities' public expenditure have also contributed to higher growth.

Real GDP growth reached 6.2% in 2007 and 7.1% in the first half of 2008 driven by domestic demand mainly. Investments in fixed capital grew in real terms by 21.7% in 2007 and 22.7% in the first six months of 2008, accelerating from 14.7% in 2006. The share of national savings in GDP rose from 13.5% at the end of 2006 to 15.6% at the end of the first half of 2008. However, as a result of the intensified investment activity, national savings covered only 40.4% of the capital expenditures made by the economic agents in the last 12 months, in comparison with 42.6% in 2006.

This dynamics was entirely generated by the private sector as the savings-investment balance of the government has improved marginally during this period. Almost 80% of investments growth in 2007 was concentrated in the following sectors: real estate, renting and business activities, manufacturing, production and distribution of electricity, construction, and trade. These sectors (excluding manufacturing) remained efficient and attracted investments in 2008 as despite the reduced liquidity on a global scale they absorbed half of all investments in the first six months of 2008 contributing for about 90% of their growth.

The expectations for the period 2009-2011 may be for further deterioration of the external environment and slowdown of the growth of the Bulgaria's main trading partners. The strongest negative impact of the world financial crisis on the processes in the real sector of the economy is expected to take place in 2009. The impact of the economic recession and the global financial crisis on the Bulgarian economy may not be further aggravating in a medium term prospect as Bulgaria is still and may remain in the periphery of the crisis. If the recovery of the growth in the world economy and, in particular, in the EU economies will be in 2010-2011, the higher the expectations for Bulgaria's sustainable macroeconomic growth may be.

The main impact through which the world financial crisis is expected to affect the Bulgarian economy is through the reduction of aggregate demand and lower foreign capital inflows. Though the negative impact from the crisis on the Bulgarian economy will be considerably weaker in comparison to the big European economies, the fiscal policy is of utmost importance for preserving economic stability and counteracting existing imbalances.

As anticrisis fiscal measures since the autumn of 2008 have been under consideration, there are efforts to strengthen the fiscal reserves and the provision of adequate and prudential fiscal stimuli. These may become much more necessary to counteract the difficulties to be encountered, for example because of expectations for higher unemployment, diminishing orders for the enterprises that are export-oriented etc. Nevertheless there is a persistent official public policy's caution of maintaining the budget surplus as extremely important in the crisis times for the

monetary stability of the Currency board, though it is much debated by some Bulgarian economists that favour either budget equilibrium or running into budget deficit in order to render greater public spending possibilities and thus to raise demand.⁷

The most important change for 2009 refers to the planned buffer to limit the non-interest expenditures and transfers of the republican budget, which has been raised from 7 to 10%. The restriction refers also to the capital expenditures and the reserve for unexpected and urgent expenditures. The possibility for implementation of an additional investment programme, financed by the reserve for public investment and potential reduction of the budget surplus by up to 1% of GDP, has been removed in the approved by the parliament budget law for 2009. The level of the planned budget surplus was retained at 3% of GDP to cushion any possible underperformance of the fiscal revenues. The non-interest expenditures and the transfers under the republican budget may be reduced further if the underperformance of the consolidated fiscal revenues reaches a level that may lead to a negative budget balance of the consolidated fiscal programme.⁸

Main factors for the sustainability of the fiscal policy are the good macroeconomic indicators of the country, the presence of considerable reserves and buffers in the economy due to the continuous prudential nature of the policy of maintaining fiscal surpluses, the strict control of the responsible institutions over the country's financial system, and the continuing structural reforms in the country.

Due mainly to unfavourable external environment, the economic growth in Bulgaria as foreseen in the Convergence programme is expected to slow down from 6.5% in 2008 to 4.7% in 2009. This moderation is expected to be a result of lower domestic demand mainly as the highest drop is expected in terms of investments growth. Nevertheless, the economic growth will remain high and in view of the expected developments in the EU economies the growth differential with the average EU growth rate will increase slightly, i.e. the real convergence process of the Bulgarian economy will continue.

The sustainability of solid public finances, maintenance of public budget surplus and further improvement of the role of fiscal policy for the economic development is targeted at the achievement of *nominal macroeconomic convergence* with the EMU. On the road of preparation for entry in the Economic and Monetary Union (EMU) the fiscal policy has been designed to support the achievement of convergence of the main macroeconomic indicators to the Maastricht criteria especially the criteria for solid public finances and the convergence level of inflation.

⁷ Angelov, I. Bulgaria needs a managed floating exchange rate regime. – In: Central Banking, Quarterly Journal, Vol XIX, N 1, August 2008; Ganchev, G., Ch. Nikolov. Social strategies for the Budget surplus. – In: [www.redhouse-sofia.org/bg/projects/p-debates/surplus in crisis?](http://www.redhouse-sofia.org/bg/projects/p-debates/surplus%20in%20crisis?), 20 November 2008.

⁸ Republic of Bulgaria, Government Budget Law for 2009. See also: The Addendum to the Convergence Programme (2008–2011) of the Republic of Bulgaria.

Originally in the Bulgaria's Strategy for the adoption of the euro (approved in 2005) the entry in the EMU was foreseen for year 2010. In the spring of 2007 Bulgaria has applied for joining the ECM II. Yet higher inflation rate and the need to improve the functioning of the markets have delayed the access to the EMU II. The global financial crisis has also brought some uncertainty to the issue as the recession has worsened and thus new entries in the EMU are becoming an issue of higher involvement for providing financial and monetary stability.

The Convergence Programmes of the Republic of Bulgaria and The Three Years' Budget forecast for the period 2008-2010 have been under close surveillance for the first time in the Convergence Report of the European Central Bank as of May 2008.⁹ Their implementation serves the needs of the process of coordination and multilateral surveillance of economic policies of EU Member States. The Convergence Programme as policy instrument has introduced to the national budget procedures the discipline of setting the targets of:

1. a medium-term budgetary objective, represented by a balanced budget or a budget surplus, in order to avoid the risks of excess budget deficits;
2. after proper analysis setting national priorities concerning the future developments of employment, economic growth, inflation, etc.;
3. a description of economic policy measures, by which the objectives set in the Programme are expected to be achieved;
4. a sensitivity analysis of budgetary and debt stances of the Bulgarian economy with respect to changes in the assumptions concerning the economic variables;
5. medium-term objectives of monetary policy with regard to the sequence with the fiscal policy and evaluation of their influence on price stability and the stability of the exchange rate.

Under the Currency Board regime there is absence of proper monetary policy of the Bulgarian Central bank (the only instrument available being the minimum requirements for reserves of the banks with the central bank). The fiscal instruments serve an important role in striking the right balance of the budget policy impact on aggregate demand and reducing its pro-inflationary expansion. Debt levels and developments are also strictly observed and the indicators so far are better than the convergence EMU criteria. The government debt level as of the end of 2007 amounted to 5162.8 million EUR or 17.9% of GDP. By the end of the 2008 it is expected to decrease further by about 3 percentage points, as a result both of the reduction of the nominal debt and the expected GDP growth. The end-year projection of the debt level is based on the envisaged reduction of the amount of the newly-issued domestic government securities and on the early repayments of about 300 million EUR of World Bank debt carried out during the year 2009.

⁹ ECB, Convergence Report, May 2008, p. 35-36.

The present higher level of inflation differentials in Bulgaria as compared to the macroeconomic criteria for the EMU are still at hand though there has been considerable reduction of the inflation rate in 2008. However, as these differentials are rooted still in structural asymmetries, the cost of adjustment to EMU membership still remains to be borne until fulfilling the convergence criteria for the inflation (See the attached Table: “Overview Table: Economic Indicators of Convergence” for comparison with other EU countries).

The restrictiveness of the fiscal policy thus is serving the anti-inflationary goals though at the same time fiscal surpluses may be considered as a result of higher taxes. Therefore the stance of the fiscal policy has been oriented towards designing the tax structure which may be providing reduction of income taxes and corporate taxes and keeping the proportional sales taxes comparatively high but servicing the needs of creating incentives for the economic actors and bringing revenues for the government budget.

The overall impact of taxes on the economic growth may be considered as contributing incentives for growth. As a result of the carried out tax reforms in compliance with the preparation for accession to the EU Bulgaria has experienced clearly trends of raising the productivity of labour much higher than the wage increase. Thus tax incentives have increased private investment as well as the inflow of foreign direct investments as the efficiency of the economy has been improved.

Compliance to the fiscal rules of macroeconomic convergence still provides the national government with a definite room for manoeuvre in order to prepare to join the EMU.

The proponents of early EMU membership of Bulgaria contemplate the realization of expected expansionary stabilization effects, associated with lower interest rates and direct transition from fixed rate of the Bulgarian lev to the euro adoption. On the side of the business circles even there has been strong demand for transition to the euro as soon as possible as a safe way of governance of the economy in the global crisis. On the other hand, the public authorities and those who opt for a more cautious approach to the adoption of euro, maintain that the achievement of the convergence criteria for the entry in the EMU is necessary in order to reach better structural adjustment. Besides there is a need to comply with the discipline of the EMU and the EU membership obligations of Bulgaria. The process of adjustment is to be perceived also as one of gaining experiences in better sequencing of fiscal and monetary policies with anti-inflationary stance. In this field there is a great need of better understanding the EU and the EMU policies which proves the need and the role of further preparation work to be done for the entry to the Eurozone.

As experiences of EMU member states have shown, this process may last also after the entry to the EMU, and some authors argue that the experience in the EMU has amply demonstrated that nominal convergence may barely make a country fit for the

single currency.¹⁰ At times of the global financial crisis the issue of the freedom of manoeuvre of the fiscal policy of the EMU countries becomes crucial as anticrisis governance of public finances is burdened with specific issues in each country. According to some authors¹¹, if the Stability Pact can no longer function as a credible European surveillance, member states should set their own rules on fiscal discipline and invest in institutions and tools. To exit the stalemate of the global crisis all EU countries should be participating in the fiscal stimulus packages, and it should be up to the most indebted and the weakest to commit, in return, to take drastic belt-tightening measures once growth resumes.

The correct fiscal policy at the time of global crisis is neither to put the brakes on nor to freewheel but to spend public money efficiently in order to boost the economy and, at the same time, commit just as seriously to saving and improving reserves. Creating liquidity buffer in order to overcome the credit crunch is one of the possible contributions of the fiscal policy in the anti-crisis governance. Fiscal discipline thus goes entirely hand in hand with the better preparedness for adoption of the euro. The Bulgarian fiscal policy is based on adequate rules of fiscal discipline but their implementation may be further improved. It is necessary to pay higher attention to the administrative capacity of the public institutions and the legislation and the tools which can guarantee that the public interest is protected through efficient governance of public revenues and expenditure. This is the only basis for the fight against corruption which is one of the issues to be tackled by the public governance of the budget policy implementation.

The specific measures, proposed by the Bulgarian government to contain the adverse effects of the world financial crisis on the Bulgarian economy basically do not change the priorities of prudent fiscal policy.

The Convergence Programme of Bulgaria for the period (2008-2011) sets priorities within the framework of the Stability and Growth Pact of the EMU thus providing further support for stability-oriented domestic fiscal policies. Along the lines of specifying medium term fiscal targets the fiscal performance is expected to rely upon further reform of the public sector and of the more efficient provision of public goods and services. The strategic targets are set to meet the challenges of:

1. supporting the “acceleration of the convergence of the real incomes’ level in Bulgaria to the EU average incomes’ level”;
2. meeting the challenges of the unfavourable trends of demographic development in Bulgaria as regards the problems of the aging of the population and the outflow of qualified labour force;

¹⁰ De Grauwe, P. Living with the Euro: A Provisional Balance Sheet. – In: Tsoukalis, L. (ed.) Governance and Legitimacy in EMU (Florence: European University Institute), 2005.

¹¹ Jean Pisani-Ferry. We need a proper Stability Pact. – In: Le Monde, 12 December 2008 (<http://www.bruegel.org>).

3. functional and operational reform of the Budget management in order to develop the capacity for absorption of the EU funds by adequate implementation of the EU policies, and the Structural funds;
4. providing adequate conditions for participation in the European structures and EU common policies.

Bulgaria is not only a recipient of the EU policies. It has encountered difficulties during the preparation for accession but the experiences gained are good enough to join the integration process on equal terms with other EU new member states. Yet there is still much work to be done to become a member state contributing to the reform process in the EU, as regards:

- the ongoing reform of the EU budget as regards the own resources system of the EU, the financial control and management systems of public finances and the EU funds;
- the reform of CAP and its proper transposition with regard to the changing external and internal state of the agriculture as a main sector of the Bulgarian economy that can be contributing to raising the efficiency of the investments and labour and be supply responsive only if further reform is carried out;
- the reform of the financial sector regulation as global crisis response of the Eurozone and the EU;
- the pending needs of the highly indebted third world countries, etc.

There is a good reason to believe that the participation of Bulgaria in the process of deepening the integration may come through the sustainability of the good practices and results achieved thus far in the public finances governance. In order to improve the level of conceptualization new policies' approaches and operational implementation and improvement of the effectiveness of the EU policies there is a need of improving the transparency of the public governance and developing further national policy approaches adequately reacting to own national problems. Some aspects of further policy concern include:

- 1) Implementing the EU policies in the effort to attain EU common priorities and targets by contributing with active national policies (Explicitly made recommendation for the need of "national policies" in the ECB 2008 Convergence Report for Bulgaria) as regards labour market for marginalised social groups and infrastructure and transport development as needs neglected so far);¹²
- 2) After the failures due to cases of irregularities, fraud and corruption in the implementation of the pre-accession funds, Bulgaria has to meet the challenge and to invest efforts in the creation of adequate administrative and financial

¹² ECB, Convergence Report, May 2008, p. 35-36.

control and anticorruption transparency policy in order to prepare for the absorption of the EU funds.

- 3) Improve the administrative capacity and the economic efficiency in order to achieve better utilization of the EU Structural funds and to carry out successfully the Operational programmes in the respective fields of operation. As seen from the Fiscal Framework (2007-2010) the total revenues account for 44% of the GDP and the total expenditures are forecasted to reach 40% of the GDP. By 27 October 2008 a small progress of achievement of the goals and measures of the operational programmes (OPs) could be reported – the fulfilment of the financial commitment for the period 2007-2008 on signed EU funds contracts, co-financed under the Structural Instruments, represents 29% of the annual programme. The portion of the signed contracts under OP “Transport” is 54% of the annual financial commitment; the share of the signed contracts under OP “Administrative capacity” is 118%; the utilisation of the funds under OP “Technical assistance” stands at 109%. In other areas, such as OPs “Environment”, “Regional development” and “Competitiveness”, contracting procedures at the total amount of over EUR 400 million are expected to be completed by the end of the year. Therefore, the fulfilment of the annual financial commitment of the operational programmes will result in transfers from the EU Structural Instruments to the Bulgarian economy of more than one billion Euro by the end of the year 2008.

Table 1
The Fiscal Framework of Bulgaria for the Period 2007-2010 (million BGN)

	2007	2008	2009	2010
Total revenues	21377.6	27192.3	30246.8	33365.3
(% of GDP)	39.0	44.1	44.2	44.2
Total expenditures	20357.6	24711.0	27408.8	30217.4
(% of GDP)	37.1	40.0	40.0	40.0
Contribution to the EU Budget	634.4	659.9	813.3	918.3
(% of GDP)	1.2	1.1	1.2	1.2
Total expenditures plus the contribution to the EU Budget	20992.0	25370.9	28221.1	3135.7
(% of GDP)	38.3	41.1	41.2	41.3
Balance	385.6	1 821.4	2 024.7	2 229.6
(% of GDP)	0.7	3.0	3.0	3.0

The Changing Structure of the Budget Revenues and Expenditures upon Bulgaria's Joining the EU may be revealed both on the revenue and the expenditure side of the Republican Budget. In all mentioned below items of the Budget structure important changes are under way with regard to their Europeanization.

The Republican Budget Revenues

- Revenues from personal income (flat 10% tax since 2007)
- Social security contribution (the formula 12)

- Revenues from corporate income tax (10% tax since 2007);
- Income from indirect taxes (VAT, customs revenues, excise duties become involved with the EU own resources system);
- Other revenue items.

The Republican Budget Expenditures

- Government Public Consumption;
- Government Public Investment;
- Government transfers;
- Government interest payments;
- Government other expenses (administration wages, etc.)

The changes in the Bulgaria's Budget revenues policies and tax harmonization with the EU Law have started since the pre-accession adjustment in the following aspects and they are still under way:

- 1) phased increase of the excise duties – continuing in year 2009;
- 2) introducing changes in the VAT collection by law amendments after 2007; for 2009 Government plans for improving the VAT return procedures in favour of the companies is looked upon as an anticrisis measure of the Government expected to be helping the liquidity problems of the businesses;
- 3) Implementation of the EU Common Tariffs in compliance with the EU Common Trade Policy: the Bulgarian business is extremely quick to react to any earlier announced tariffs' increase by the European Commission (for instance, as sugar tariffs were expected to increase since the 1st November in the 3 months preceding this date the import growth of sugar is considerable, which is indicative of the high degree of adjustment of the business to the EU rules).

As regards *Budget expenditures'* policies the following changes have been introduced and applied as Europeanization is under way:

1. 3% fiscal surplus approved as a permanent threshold of fiscal sustainability under the Currency Board since 2007;
2. Limitation of the redistribution function of the Republican Budget up to 40% of the GDP (main sectors beneficiaries of the state Budget are set to be including: the human capital investment; raising the productivity of labour; the agricultural sector; infrastructure and environment development);

3. Acknowledgement of the European public goods by: rationalising and modernisation of the administration, modernisation of defence and security system as NATO membership of Bulgaria stipulates as well as providing for internal affairs and national security, healthcare, social policies and state aid in compliance with the EU law;
4. Besides the changes in the structure of the separate types of budget expenditures, the budget reform is to comply with the recommendations of the European institutions as regards the reduction of current budget expenses at the account of increasing the capital expenditures.

Example: In 2008 ECB Convergence Report there is a specifically underlined recommendation that budget expenditures have to bring to strong national policies in sectors lagging behind EU average level.

The trends in the budget revenues in 2008 are indicative for the effectiveness of the fiscal policy.

Tax revenues have increased due only to the rising revenues of the custom duties (increased by 50%) and excise duties (by 21.7% increased revenues) combined by reduced revenues from VAT due to less transactions (VAT rate of 20%) but as well as due to a moderate rise of about 6.5% of the revenues from the corporate and the personal income tax. The Government intention for 2008 and year 2009 budget has been sustainable and prudential with regard to the risks of falling revenues in the future if global crisis persists: there are no grounds for any reduction or differentiation of the VAT and the excise duties are to keep on rising.

As regards Non tax revenues they increased considerably by mid-2008 due to some repayment of Irak's debt but it might not be possible to rely upon such source in the future.

There is also a new source of revenues in 2009 – the raising of the tax value that is to be taxed on property transactions.

The Budget expenditures in 2008 have also been changing though some trends are to be more cautiously observed as the impact of the global crisis may weaken the revenues from VAT and excise duties and thus the fiscal policy should be more prudential. There has been some unfavourable trend by mid2008: the greatest increase is registered by the Government subsidies – 86%.

- Current expenses are 7.6% above the level of the first half of 2007.
- The growth of public investment is only 13.6%, and the size for the 7 months of 2008 amounted only to 27.1% of the foreseen by the Law for the 2008 Budget. The reason for this is related to the failure to co-finance EU funded projects as well as the EU funds were suspended on a number of capital investment programmes like ISPA.

- Interest payments are reduced by 8.5%, because of reduced repayment of external debt. The size of the contribution to the EU budget is equal to 36.4 million BGN.
- The surplus of the cash saldo of the consolidated budget by the end of July achieved 4.22 billion BGN. Thus being by 74.4% bigger than in 2007. The revenues raised by 24.4% reaching 16.4 billion BGN, expenditures increased by 12.7% reaching the sum of 11.8 billion BGN.
- The primary and the internal saldo reach the sum of respectively 4.7 и 4.6 billion BGN.

The initial impact of the EU membership is not disturbing the revenues' adequacy to expenditures of the Government as the following changes have occurred:

First, there is an increased amount of revenues of excise duties.

Second, custom duties are reduced as a budget revenue because they as are being due to the Own resources of the EU budget.

Third, reduced VAT income and revenues for the Budget as Bulgaria's joining the Internal market changes the charging of the transactions (the reduction is between 10 and 30%).

As a whole a sustainable impact on the Republican Budget of Bulgaria has been evident due to the following changes as a result of the EU compliance:

- European excise duties are higher and revenues are higher – there has occurred a redistribution at the cost of taxing specific goods;
- EU impact on the spending of public money – overall regulation, public accountability and control is improved;
- Specific European public goods are acknowledged – thus the priorities for public money spending are definitely a breakthrough in the post transition period.

The Bulgaria's standpoint to the EU budget reform

Bulgaria's fiscal policy is fully compatible with the co-ordination of the policies of all member states. Some of the main achievements and issues have been already discussed above. Bulgaria is for retaining the nationally specific corporate taxation and may not be in favour of the introduction of EU common corporate tax base in medium term. There is still no public unified opinion on the need of newly to-be-introduced European tax in line with profederalistic approach to the EU budget reform. The compliance with the EMU criteria is considered as prerequisite for further achievements of the EU membership agenda for Bulgaria.

The forecasts for Bulgaria's contribution to the EU Budget (2007-2013) underline the fact that the budget expenditure as co-financing to the EU funds may remain considerably low in case the absorption of EU funds is not improved considerably. An increase in the Government consumption may boost domestic demand and raises GDP by almost 1.01% as a primary effect. The fiscal expansion stimulates production and investment (though still awaited is higher capital investment not only subsidies). The anticrisis re-orientation of fiscal policy must observe the risks of the higher inflation in order to reduce it to the convergence criteria.

As regards further Europeanization of Bulgaria's fiscal policy some new priorities of the EU Budget 2009 must be taken into consideration in the national programming. It is possible to complement the goals the Bulgarian national fiscal policy with new ideas and targets. The EU Budget in 2009 has been setting the priorities of the investing more in economic progress by:

Creating Jobs, innovations, growth:

- 60 billion EUR total for Competitiveness and cohesion.
- Investment in environment by the EU budget is on the rise:
 - total funds for environmental targets exceeds 10% of the budget, 14 billion EUR;
 - green investment in different areas boosted by 17.3% (aside from Cohesion/ rural development).

Greening the EU Budget expenses is to include the following aspects:

- enterprise: eco-innovation (+18% increase);
- energy and transport: environmentally friendly transport (+5% increase);
- environment: LIFE+, biodiversity, climate change (+8% increase);
- programmes against deforestation; sustainable energy solutions and energy efficiency.

Some specific areas that are relevant and of specific interest for Bulgaria include the following areas of public interest:

- investment in research and development;
- development and stability for rural communities;
- management of natural resources;

- citizenship, freedom, civil society;
- creating institutions and capacity for the implementation of the EU funds;
- EU funds for infrastructure and sustainable energy solutions.

Conclusion

The fiscal policy in the future is still to be reconsidered and improved as public efficiency and accountability is still to be improved. The fiscal policy has contributed to the economic growth of Bulgaria as well as to the progress of the nominal macroeconomic convergence with the EU. Nevertheless the need of further improvement of the public finances' contribution to achieving the goals of the Stability and Growth Pact and the Lisbon strategy of the EU make it necessary to improve further the specific choice of the diverse fiscal instruments and objectives in order to support better investment, innovation and growth with regard to the *real macroeconomic convergence* with the EMU.

Bulgaria's fiscal policy has to develop further instruments for the implementation of the Lisbon strategy and for macroeconomic convergence with the EMU. We may consider the present state of economic turmoil and of unsettled ideas about the broad lines of world financial crisis governance and the EU anticrisis policies as a challenge to be encountered by the fiscal policy of each member state as well as at the EU level. As the English Nobelist James Meade wrote in 1974: "The present state of economic turmoil and of unsettled ideas about the broad lines of economic policy makes it suitable, as it was in the years of the post-war reconstruction, to reconsider the basic philosophy of our economic society."¹³

¹³ Meade, J. The mixed economy: the intelligent Radical's guide to economic policy. Cambridge University Press, 1974.