



Center for Economic Analyses
Malgorzata Markiewicz

LGU Borrowing in Romania, Bulgaria and Macedonia

LGI/OSI Sponsored

Case study on Bulgaria

Legislative steps

1991

- Constitution – Bulgaria is a country with local self government
- Local Self-government and Local Administration Act

1995

- Concept for administrative territorial reform – not implemented

1998

- Amendment to the law on administrative division – replacement of 9 regions with 28 new regions

2001

- Local Government Forum to deal with permanent deficits, non-transparent and unstable system of transfers and a backlog in municipal investment

2002

- Fiscal Decentralization Working Group established with resolution of the Councils of Ministers. It produced Concept for Fiscal Decentralization and Program for 2002-2005

2003

- Municipal Borrowing Working Group – Municipal Debt Act adopted in 2005

2005

- FDWG replaced with National Council for Decentralization, new Decentralization Strategy for 2006-2015 and Program for its implementation for 2006-2009

Structure of the local governments

28 regions and 264 municipalities

- **Regions:** deconcentrated administrations of the central government, Governors appointed by the Council of Ministers
- **Municipalities:** local self-government, Municipal Council and Mayor elected by the population, mandate – 4 years

6 NUTSII regions established to carry out regional policy after the EU accession

Expenditure responsibilities

	2005
Municipal expenditures/ GDP	6.5
Municipal expenditures/ consolidated budget expenditures	16.4
Municipal investments/ GDP	1.2
Municipal investments/ municipal expenditures	19.1**
Municipal investments/ public investments	16.9*

- Arrears
- Costing standards for mandated services (capital costs)

Revenue assignment

- Revenue sources: own, shared, transfers and grants
- Lack of taxing power – share of local taxes/ revenues were decreasing, dependence on transfers, frozen level of local taxes
- Fees – full costs coverage
- Tax collection transferred to the local level since 1 January 2006
- Shared taxes: CIT and PIT till 2002, then only PIT (full amount)
- 2006: new competence – suspend illegal constructions and impose penalties

Intergovernmental transfers

3 types of subsidies

1. General complementary subsidy (financing of government delegated activities) – complements PIT revenues
2. General adjustment subsidy (for financing local activities) – for municipalities with revenues from local taxes per capital below the national average
3. Investment subsidies – up to 2002 no rules, limit on local capital expenditures to own revenues (lifted in 2003)

For national investment projects (ad hoc)

For local projects – based on economic parameters, transformed into a general subsidy in the end of the year, investment funding capabilities not considered

Regulations on borrowing (1)

- Municipal Debt Act provides a comprehensive legal framework for municipal borrowing
- Council makes decisions
- Long term borrowing only for capital expenditures and refinancing
- Current liabilities to suppliers are not counted as municipal debt
- Debt may not be pledged by municipal property
- Borrowing in foreign currencies without any additional approval
- Reporting
- No regulation of insolvency
- Loans from the budget for pre-financing of the EU projects

Regulations on borrowing (2)

Limits on debts

- Annual payments \leq 25% own revenues + equalization grant under the last audited report
- Nominal value of the municipal guarantees \leq 5% of the same amount

If the limits are exceeded – no right to incur new debt or guarantees

No limits on the size of outstanding municipal debt

Limit on general government debt – 60% of GDP

No explicit guarantees provided by the government

Borrowing in practice

	2002	2003	2004	2005*
Consolidated state debt (% GDP)	53.2	46.1	38.9	31.3
Municipal debt (% GDP)	0.1	0.2	0.2	0.4

- 10 successful bond issues

Borrowing in practice

Demand side

- Lack of protection of the investors rights
- No active secondary market
- Lack of information on investment risk
- Dependence on transfers
- Collateral – revenues are not accepted
- Preference to finance revenue generating projects instead infrastructure
- High liquidity of the market (banks and pension funds)
- Tax stimulus in place

Supply side

- Borrowing costs
- Limited assistance for small borrowers
- Disclosure of information
- Preference for banking credit

Main conclusions

- Decentralization in a half way: 80% of local budget revenues controlled by the state – constitutional change is badly needed. Non transparent and non predictable system of transfers
- Lack of stable rules for capital subsidies does not allow to plan investments
- Institutional framework accelerates the reforms
- Monitoring system in not operating
- No regulations on insolvency