

**THE 1991 BUDGET AND SOME  
POLICY IMPLICATIOIS FOR 1992**

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## The Deficit

The budget deficit has alternative measures and respectively different magnitudes. The international classification system (Government Finance Statistics) offers several definitions of a budget deficit that can be applied according to the actual economic environment of the country and the specific problems facing the fiscal policy. The following measures of a deficit are relevant for Bulgaria: primary, domestic, cash, overall and public sector borrowing requirements (PSBR).

The primary deficit is calculated as a difference between total revenues and total non-interest expenditures. The domestic deficit is defined as a sum of the primary deficit and the paid domestic interest (with a negative sign). The cash deficit consists of the domestic deficit and the paid foreign interest. The overall deficit encompasses the cash deficit and the unpaid but due foreign interest and responds to the case of Bulgaria after the announcement of the moratorium over the foreign interest payments in March 1990. The public sector borrowing requirements (PSBR) summarizes the needs for credit to cover the cash deficit, amortization and net foreign financing. In 1991 a specific negative item in the foreign financing was the settlement of old debts to the former CMEA countries.

The State Budget Laws of 1990 and 1991 were adopted following the existing in our country budget classification characterized by revenues containing borrowing and expenditures including amortization, i.e. financing is distributed in the current revenues and outlays so that the budget is always in balance. In 1991 however the domestic borrowing requirements of the budget were classified below the line and the deficit approved by the law responded to the definition of PSBR.

In 1991 the State Budget Law was revised twice by the Grand National Assembly. The first Budget Law published on February 22 determined that the budget deficit should not exceed Lv 8,500 mln and should be covered by issues of government securities. The revised Budget Law was published on August 2 and its deficit was defined Lv 8,473.1 mln and had to be financed by central bank credit and government securities in equal parts. The conditions for the both types of borrowing were not specified in the law. It turned out to become an important omission especially concerning the terms about the central bank credit since the Central Bank Law, adopted in June, states that the BNB "can disburse short-term credits (advances) to the government repayable in three months and not later than the end of the calendar year". The antinomy in the laws was resolved in favour of the Budget

Law and the three month bank credits granted by the central bank (BNB) to the budget should be converted into long-term loans.

The short-term financing of the budget deficit raised a lot of problems since **it was not caused by momentary disturbance of the economy and the fiscal system. The deficit was generated by the inefficient structure and organization of budget revenues and expenditures, aggravated by the economic depression and the enormous foreign liabilities of the country.** The years 1990 and 1991 have not marked radical changes in the organization of the budget revenues and expenditures and that has hampered the attempts of the budget to influence positively the economic performance.

It is convenient to apply the different definitions of a budget deficit from the international classification as an instrument to explain the actual stance of state finances in 1991 on a quarterly basis.

**TABLE 1**  
**1991 BUDGET DEFICITS**

(mln.lv.)

	JAN-MARCH	JAN-JUNE	JAN-SEPT	JAN-DEC (preliminary est.)
PRIMARY DEFICIT	131.4	2068.0	2184.4	4893.1
DOMESTIC INTEREST PAID	141.2	2564.4	4301.3	7409.0
DOMESTIC DEFICIT	-9.8	-496.4	-2116.9	-2515.9
FOREIGN INTEREST PAID	116.3	204.6	485.6	1311.6
CASH DEFICIT	-126.1	-701.0	-2602.5	-3827.5
FOREIGN INTEREST UNPAID	3198.0	6184.0	9055.0	15239.0
OVERALL DEFICIT	-3324.1	-6885.0	-11657.5	-19066.5

The primary deficit discloses the efficiency of the budget revenue and expenditure structure. It is also called non-interest deficit and does not include any interrelations of the budget with banks and foreign countries. According to the revised Budget Law the primary deficit is positive Lv 3,810.6mln., or the budget can afford its current expenditures by its current revenues (capital expenditures are also included). The quarterly implementation of the budget preserved the positive sign of the primary deficit and at the end of the year it might reach Lv 4,893.1mln. It looks like as if the budget structure is efficient since it runs excess revenue.

Specific for 1991 were both the enormous increase in revenues from the profit tax on financial institutions (the growth rate is 519.2 percent in

respect to 1990, while the growth rate of total revenue is 152.2 percent) and the boost in interest payments to the domestic bank system (a growth rate of 2316.5 percent to 1990). **The positive primary deficit has not been enough to cover the growing interest payments and respectively the domestic deficit is negative.** The revised Budget Law states a domestic deficit of Lv -2,550.1mln. The implementation of the budget retains its negative sign and it would be about Lv -2,515.9 mln at the end of the year.

The negative domestic deficit is a more proper measure of the inefficient budget structure. The increased revenues from profit tax on financial institutions (due to the high spread between interest rates on deposits and on credits) offset the slump in profit tax from the nonfinancial enterprises, but concerning the budget, that growth was insufficient to cover the high interest payments. **The primary deficit might have been negative if receipts from profit tax on financial institutions have remained at its level of the previous years.**

The domestic deficit explicitly shows the inefficiency of the budget structure. The cash deficit contains the interest payments of the country to foreign creditors. The cash deficit is Lv -3,952.6ml according to the revised Budget Law and the foreign interest payments are Lv 1,403mln. As of September 1991 only Lv 485.6mln foreign interest was paid and the cash deficit did not differ from the domestic deficit substantially. About two thirds of the actual payments of foreign interest has been carried out in the last quarter of 1991 and its total amount sums up to Lv 1,311.6mln at the end of the year, a little less than the law states. Respectively, the cash deficit would be less, too, about Lv -3,827.5mln.

As the primary deficit is not a good indicator of the fiscal stance, so the cash deficit does not reflect the total foreign indebtedness of the country. In the several programs, worked out together with representatives of the IMF, the overall deficit includes all due interest payments. The amount of the unpaid interest is Lv 15,239mln and if it were paid the cash deficit adopted in the Budget Law should have been Lv 19,196.6mln. **No matter that the interest due was not paid during that year, it should be paid in the future. Obviously, if the existing inefficient structure of budget revenues and expenditures is preserved, it would not be able to afford these payments otherwise than through new foreign debt.**

The public sector borrowing requirements give a more general definition of a budget deficit. They include the cash deficit, domestic amortization payments and net foreign financing. **The deficit adopted in the revised Budget Law is the PSBR of Lv -8,473.1mln.** But this deficit again is

less meaningful since it partially expresses the foreign liabilities of the country. There are amortization payments of Lv 1,767mln that are not to be paid during the year.

The project of 1992 budget law envisages a positive primary deficit Lv 2,353.2mln, domestic deficit Lv -6,680.1mln, cash deficit Lv -9,168.7mln and PSBR Lv 17,952.8 mln (the PSBR includes cash deficit, repayments to the domestic bank system and net foreign financing). The overall deficit is Lv -28,356.7mln and the anticipated interest refinancing Lv 19,188mln.

### The Financing

Financing is the next item closely related to deficits.

**TABLE 2**  
**1991 FINANCING**

(mln.lv.)

	JAN-MARCH	JAN-JUNE	JAN-SEPT	JAN-DEC (preliminary est.)
CASH DEFICIT	-126.1	-701.0	-2602.5	-3827.5
FINANCING	126.1	701.0	2602.5	3827.5
FOREIGN FINANCING	-1517.6	-1924.6	-1679.5	-1098.3
Credits from abroad	0.0	0.0	0.0	0.0
Repayments from foreign states	50.2	80.2	449.2	1474.5
Other receipts	0.0	364.9	372.8	0.0
Amortization	-104.1	-112.5	-126.2	-149.3
CMEA settlement	-1458.6	-2088.9	-2215.5	-2304.5
Loans to foreign states	-5.1	-59.4	-61.4	-119.0
DOMESTIC FINANCING	1643.7	2625.6	4282.0	4925.8
NBB credits (net)	780.0	1550.0	2907.0	4236.5
Loans from extrabudgetary accounts	79.8	134.2	496.0	736.0
Counterparts BFB	1700.0			
Government one-year bonds (net)	422.8	422.8	419.8	-150.0
Three-month treasury bills (net)	0.0	448.3	514.8	1827.4
State enterprises' bad loans				-4128.0
Balance	361.1	70.3	-55.6	703.9

In 1991 the most important source of financing was the deferment of interest and amortization payments concerning the foreign debt, respectively Lv 15,239mln and Lv 1,767mln. The remaining part of the foreign financing is negative both quarterly and as of end of year. The foreign financing adopted in the Budget Law is Lv -3,538mln, at the end of the year

it is reported Lv -1,098.3mln. The difference comes from the following two items -- amortization payments and disbursements of credits to other countries, which should have been respectively Lv 1,650mln and Lv 418mln according to the law but the implementation was Lv 149.3mln and Lv 119mln actually paid.

The greatest share (nearly 90 percent) in the negative cash foreign financing took the repayments connected with the settlement of old debts with the former CMEA countries to the amount of Lv -2,304.5mln. Fortunately at the end of the year the inflow of repayments from other countries increases and reaches the level of Lv 1,474.5mln. As a whole for the year, but not in the first three quarters, the negative foreign financing has not brought forth the basic needs of budget borrowing.

As of end of March 1991 the foreign financing was Lv -1,693.9mln. It rose to Lv -2,961.8mln at the end of June and reached Lv -5,851.6mln at the end of September. Not until the last quarter of the year a great increase in repayments from abroad was reported. Their amount for the fourth quarter became Lv 1,025.3mln. **Therefore during the year the main financial sources have been domestic -- central bank credits, issues of three month Treasury bills and non-interest credits from extrabudgetary accounts.**

The domestic financing structure was changing during the year. As of end of March the share of central bank credits was 47.4 percent and 25.7 percent was the share of government bonds issue. (The one-year bond issue was carried out in two portions. In December 1990 the receipts were Lv 356.5mln and were counted as a revenue to the 1990 budget. In January 1991 the receipts were Lv 422.8mln). As of end of June the share of central bank credits was 59.03 percent and the share of the TBills was 33.2 percent. At the end of September the central bank credit share reached a high value of 68 percent and the TBills share fell down to 21.8 percent. At the end of the year, thanks to the alleviation in the foreign financing owing to the inflow of repayments from abroad the domestic financing has achieved its Budget Law structure: the central bank credit share is 49.8 percent and the TBills share is 41.5 percent (including the TBills to BFB of Lv 1,7mln), the rest are non-interest credits from extrabudgetary accounts.

The problem of financing the budget deficit in the current year has been solved by central bank credits and issues of short-term TBills. But these ways of covering the deficit has risen new problems for the future. The credits granted to the budget by the BNB are short-term (three months) and according to the BNB Law they have to be repaid not later than the end of

the calendar year 1991. By theory, it is likely to happen in two cases. First, if the budget deficit is due to incidental delay in payments of regular taxes but till the end of the year they can be collected and will compensate for the deficit. Second, If the budget receives additional financial resources from abroad. **In 1991 neither the reasons for the deficit were transient, nor were found foreign credit resources.** That presumes rescheduling of the bank credits in long-term loans.

The central bank financing of the budget deficit raises the question about the sources BNB has used to disburse the credits. The monthly comparison of the credit allotment and the increase in currency in circulation on the accounts of the BNB outlines the direct relation between them and especially the fact that money growth has overrun the disbursement of the credits. **That means that the automatic refunding of the budget accounts has been still in practice.** An exemption is the bank credit of Lv 1,329.5mln (the last tranche of central bank credits) assigned in November as it was connected with the expected repayments of the one-year bonds issued in 1990.

**TABLE 3**  
**BNB CREDIT TO THE BUDGET AND CURRENCY IN CIRCULATION IN BNB**  
**(increase)**

(mln.lv.)

	1991											
	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII
BANK CREDIT TO THE BUDGET	0	0	780	770	0	0	357	600	400	0	1329.5	0
CLAIMS ON CENTRAL GOVERNMENT (NET)	0	0	547	698	-392	-83	1200	591	-5374	0	1329	0
CURRENCY IN CIRCULATION (BNB)	-28	453	-23	0	0	461	500	336	275	659	1407	2302

The conclusion is that **the money growth at the end of November (growth rate of 146 percent in relation to December 1990) can be directly related to the central bank credits granted to the budget.** If the economy were in equilibrium the rate of money growth would have been equal to the rate of inflation. But in 1991 for our country it was just a component of inflation. **Therefore it might be claimed that the budget deficit financed by**



**central bank credits has generated inflation to the level of 46 percent (the total consumer price index at the end of the year is 573.7 percent) or it comprises 9.7 percent of the growth in the consumer price index at the end of 1991 related to December 1990.**

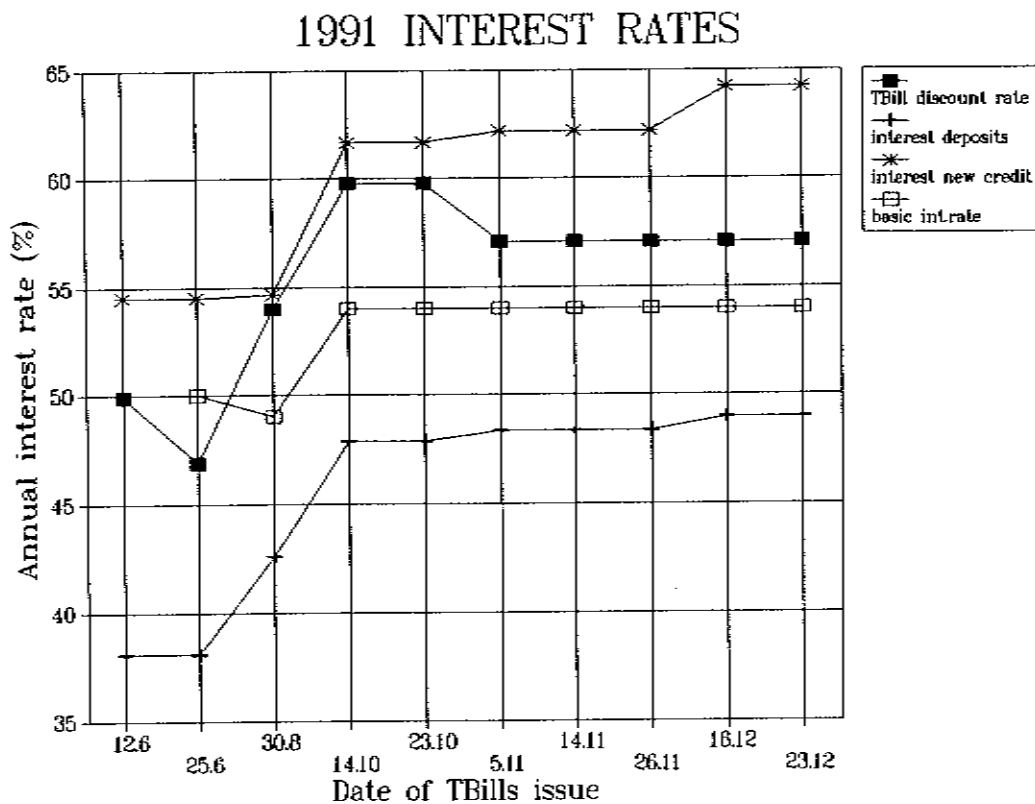
If, however, we take under consideration the amount of the unpaid foreign interest and amortization the public sector borrowing requirements should have been Lv 25,479.1mln according to the Budget Law or 18.4 percent of the gross domestic product in 1991 (a preliminary estimation of the GDP is Lv 138bln). If a central bank credit is assumed to be the only alternative to finance that deficit the growth of currency in circulation on the accounts of BNB should have been 290.9 percent as of end of year and the increase in the consumer price index, other things equal, would have been 718.6 percent. Of course, in the case of inconvertible domestic currency and enormous deficit related to foreign liabilities such way of financing is meaningless since it rather concerns foreign reserves, not printing domestic money.

The issue of short-term Treasury bills is the second source of funds for the budget but it has played a dubious role. In 1991 the receipts from the one-year bond issue are Lv 422.8mln while the repayments are Lv 843.1mln. The difference between the current receipts and the current expenditures concerning the servicing of the one-year bonds issue equals an additional need for credit. The TBills issues in 1991 will affect in the same way the 1992 budget.

There were two issues of three-month TBills in June at the nominal sum of Lv 381mln and Lv 122mln and discount rate of 11.1 percent and 10.5 percent, respectively. The issue in August was at Lv 75.5mln face value and a discount rate rising to 11.9 percent. There were no issues in September. The last months of the year recorded an active issue policy of the Ministry of Finance. There were two issues in November at nominal value of Lv 605.5 mln and Lv 141.5mln at a discount rate of 13 percent. In November the issues were three at total nominal value of Lv 929mln and a discount rate of 12.5 percent. In December the issues were two at total nominal value Lv 490mln and a discount rate of 12.5 percent. The annual balance of the TBills issues reveals net receipts of Lv 1,827.4mln and liabilities for 1992 of Lv 2,165mln. **As the budget deficit is of a permanent nature and there are no alternative sources of funds for its coverage the issue of short-term TBills taken by itself looks like a rolling down snowball of incurred liabilities.**

The efforts of the Ministry of Finance to attract more clients for its TBills forced it to rise up the discount rate and to worsen its borrowing conditions. Since commercial banks bought the TBills the Ministry of Finance

had to bear in mind the level of interest rates on new credits rather than on deposits in deciding on the discount rates. A recalculation of the discount rate on TBills in terms of an annual interest rate and a comparison with interest rates on new credits, deposits and the basic interest rate gives the following results.



The first two issues of TBills are at a discount rate one percentage point lower than the basic interest rate. The discount rates of the August and October issues are significantly higher and nearly reach the level of interest rates on new credits. But making the TBills more attractive becomes quite expensive for the budget considering that it can receive credits from the central bank on the basic interest rate, i.e. 4 percentage points less than the discount rate on the TBills.

The only positive feature of the TBills is their low risk in an environment of high inflation. In the last quarter of the year the BNB began to accept TBills as a guarantee for lombard credits granted at the basic interest rate. As of the end of year the ratio of the TBills deposited at the BNB is 58.9 percent of the total nominal value of TBills before maturity. In December 1991 the BNB began to rediscount TBills at the basic interest rate plus 1 percent annually.

Rather different is the nature of the TBills imposed on the Bulgarian Foreign Trade Bank (BFB) at the end of the year. They were the instrument to legalize the fact that throughout the whole year the BFB has been financing budget liabilities related to differences in the exchange rates used in the trade with the USSR and the former CMEA countries.

Another problem in 1991 was the transformation of bad loans accumulated by the state enterprises into a government debt thus easing the accounts of the commercial banks. The Decrees of the Council of Ministers NoNo 319 from 19.9.1991 and 244 from December the same year determined the form of a long-term bonds issue of Lv 4,128mln by which the conversion can take place. The conditions of the bonds issue consist of the obligations of the budget to pay twice a year an interest at the level of the basic interest rate for the current period and to start repaying them in 1997 by drawn lots. The total sum of bonds issue represents 4 percent of the state enterprises' liabilities to the banks and 7 percent of their liabilities in leva.

As a whole the selected ways and sources of financial funds resulted in accumulating government debt to the bank system of Lv 22,092mln in the form of bank loans, TBills and bonds. If the basic interest rate remains at its level of 1991 (54 percent annually) and the government debt is discounted by it the primary deficit in the following ten years should be Lv 12,090.4mln if the government intends to serve its liabilities accurately. Of course the falling down of the basic interest rate will better the conditions for repaying the debt.

There are no changes in the ways of financing the budget deficit in the project for the 1992 budget. About 60 percent of the financial funds are presumed to come from bank credits and 40 percent through TBills issues.

### **The Revenues**

Budget revenues include current tax and non-tax (charges, fines, forfeits, etc) receipts and do not include borrowing according to the international classification.

The profit tax, turnover tax, excises and social security contributions represent nearly 90 percent of the total. In 1991 both rates and incidence of all taxes were changed.

In 1991 the profit tax rate was equalized for all enterprises (before that year it was differentiated from 15 percent to 95 percent to profits) and now it is 40 percent. At the same time there are tax payments of the similar kind -- a municipal profit tax (10 percent to profits) and contributions to the "Melioration fund" (2 percent) and the total profit tax rate is considered to

be 52 percent to profits. An exemption of the rule is the profit tax rate for the State Savings Bank (80 percent) and the State Insurance Institute (50 percent). The profit tax rate for the BNB is 80 percent and following the Bulgarian National Bank Law the tax is paid no later than four months after closing the calendar year. In 1991 the BNB paid its profit tax in advance. From mid-year another practice was adopted -- the BNB deducted from its profit tax liabilities the interest that the budget has to pay to the bank.

The profit as a category has lost its clear outlines in comparison to the straightforward definition of previous years and swiftly eroded as a tax base. One of the reasons for that was the introduction of a new Accounting Law and the more liberal terms for calculating the taxable profit. In 1991 the true nature of the socialist enterprises functioning on the basis of state property became explicit. Their objective is not profit but wage maximization.

The second Budget Law amended the profit tax revenues from Lv 22,888mln to Lv 19,276mln including a decrease in profit tax revenues from non-financial enterprises from Lv 17,409mln to Lv 12,048mln and a smaller increase in profit tax revenues from financial institutions from Lv 5,478.8mln to Lv 7,228.4mln. The preliminary estimation of the profit tax receipts from non-financial enterprises is about Lv 10,000mln and from financial institutions Lv 8,469.3mln.

The relative share of profit tax from non-financial enterprises in total revenues fell down because of the narrowing tax base. In the last five years it has reached a maximum value of 33.97 percent in 1989. In 1990 its share has shrunk to 28.40 percent. In the first quarter of 1991 the share of the profit tax from the non-financial enterprises (including municipal profit tax) is 23.71 percent, for the first half of the year it is 26.08 percent and as of end of September -- 29.73 percent.

The share of profit tax receipts from financial institutions doubles from an average of 6 percent for the years before 1991 to 13.86 percent in 1991.

In 1990 the total share of profit tax revenues was 34.15 percent and in 1991 owing to the boost in receipts from financial institutions would reach 45.3 percent.

The project of 1992 budget affirms the tendency of diminishing profit tax from non-financial enterprises. However, a Decree of the Council of Ministers No 27 from February 1992 has been adopted with the aim to offset the negative influence on the budget of the decline in receipts from profit tax. According to the Decree the state enterprises should give a half of the profit remaining after profit tax payments again to the budget but on an extrabudgetary

account. The accumulated funds should be used to cover government liabilities on bad loans of state enterprises, for granting non-interest financial aid and giving guarantee for other bad loans that can arise in the meantime.

The turnover tax has always been a stable source of budget revenues. In 1988 the tax rates and the incidence of the tax were changed resulting in a double decrease in revenues but the decline was completely offset by the introduction of excises. Until 1990 the turnover tax and the excises represented about 20 percent of total revenues. Their share dropped in 1990 to 17.16 percent but in 1991 it again raised up to 18 percent owing to a new law. The projections for 1992 envisage a rise in the share of the turnover tax and the excises. The indirect taxes have a broader and more stable tax base than the profit tax.

In 1991 the rates of the social security contributions were changed. The average rate now is 37 percent to the wage bill. Their share in total budget revenues shifted from 16 percent in 1987 to 18.34 percent in 1990 and 16.8 percent in 1991 (the budget expenditures for social security of government employees are deducted from the total sum of receipts from social security contributions).

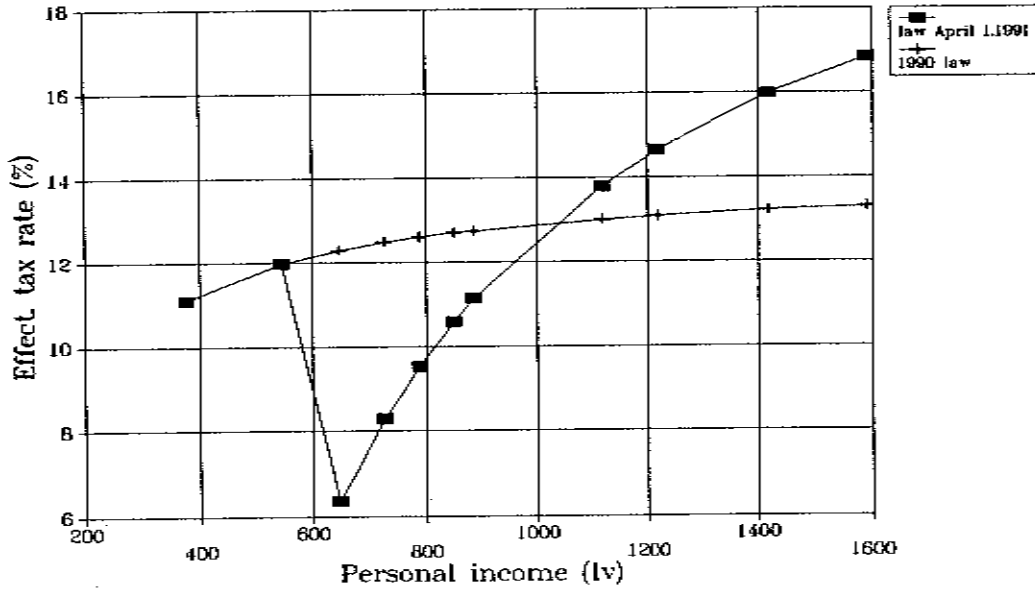
The state enterprises are the only ones regularly paying their social security contributions. In 1991 the wage bill became relatively smaller due to growing unemployment though in nominal terms it was rising. So far the level of the social security contributions has remained unchanged in spite of the rise in the rates. In 1992 a substantial increase in the receipts is anticipated and there is an increase in their share of 6.1 percentage points in comparison to 1991.

Next comes the income tax. In the developed countries it constitutes the main source of funds to the budget because of its broad tax base -- all kinds of individual income. In our country its share in total revenues was about 6 up to 7 percent in the period before 1990. In 1990 the average wage increased by 31.75 percent in relation to the average wage of 1989 and as the tax schedule was not changed the income tax receipts increased to 8 percent in total budget revenues.

From April 1991 a new Income Tax Law was introduced and respectively the income tax receipts decreased twice. As of end of March 1991 the share of the income tax in the total is 12 percent, in the second quarter it drops down to 6.33 percent, in the third quarter it is 7.38 percent. The calculation of the effective average tax rates according to the existing up to April 1 1991 schedule and according to the new law scheme discloses the difference between them. (The effective average tax rates are estimated

according to both schedules on the basis of the actually received average monthly wage ). In September 1991 the level of the average wage became high enough to equalize the tax receipts following the two different schemes and after that month the new law accomplishes more revenues.

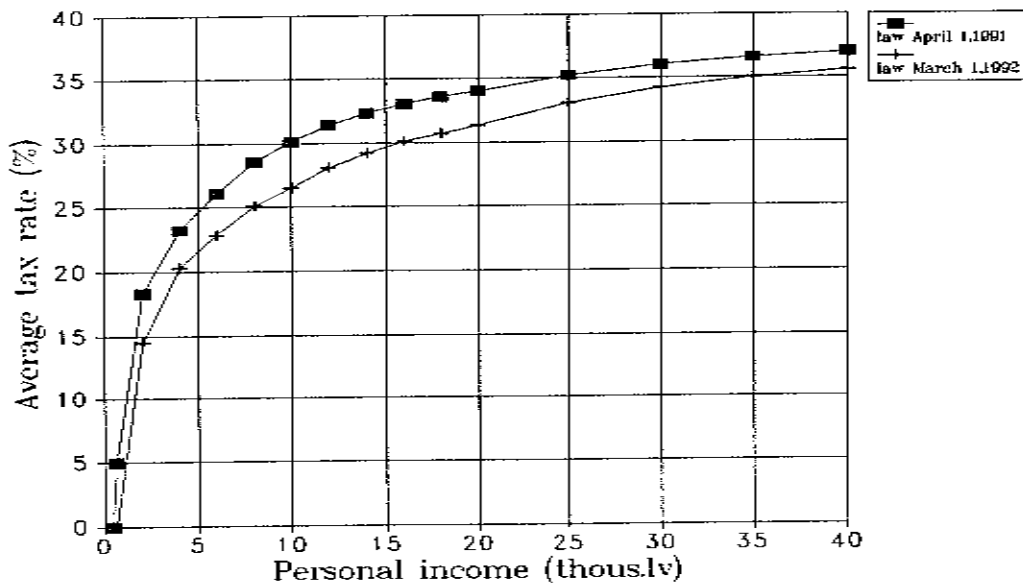
1991 EFFECTIVE TAX RATES



In 1991 the average annual wage has grown up by 152.63 percent while the receipts from income tax have grown by 144.2 percent as a result of the Income Tax Law.

In March 1992 a new Income Tax Law was introduced and the average tax rate is again reduced.

1991 AVERAGE TAX RATES



The new Income Tax Law is a mechanical compilation of a payroll and a profit tax.

The relative share of non-tax revenues drifts down from 22.4 percent in 1987, 18.9 percent in 1990 and 7 percent in 1991. Charges were not revised after the liberalization of prices. At the same time the practice of absorbing all free financial resources of the state enterprises and accumulating them as non-tax revenues of the budget was suspended. But the opportunity of rising additional revenues from operations with state or municipal property by lending or selling it was omitted.

In 1991 the budget revenues were relatively less than in 1990. In 1990 the index of the nominal budget revenues in comparison to 1989 was 103.86 percent and the GDP deflator was 126.2 percent (the real revenues decrease by 18 percent to 1989). In 1991 the index of the nominal revenues is 256.8 percent and the GDP deflator is 347.7 percent (the real revenues decrease by 26.14 percent in comparison to 1990).

The conclusion is that the main reason for the budget deficit is the fall down in tax revenues due to narrowing the base for nearly all taxes -- profit tax and social security contributions, and the decrease in income tax rates. **The normal and efficient functioning of the budget presumes a new tax structure founded on stable and flexible tax system.**

The Value Added Tax (VAT) can successfully replace the turnover tax and to a great extent the profit tax too. It has an extremely broad tax base. All activities can be taxed by the VAT and its introduction will enforce the running of a precise accounting documentation and accurate registration of all transactions. In other words, the VAT is tax not only with a broad and stable base but it is an instrument to cut down the shadow economy.

The individual income tax can become a major source of budget revenues if the system of assessment, collection and control is changed radically. The income tax is not only a source of budget revenues but it also can fairly regulate the level of disposable income.

**It is necessary to define accurately the tax base of the income tax and to include all types of income like wages, pensions, social aid and to adopt a level of non-taxable income (it may be related to level of the social minimum) determined differently in relation to the members of a household.** It would be necessary to deduct some expenditures afforded by the individual income. For instance, a certain percent of the expenditures for education and health. The payroll tax will remain

as a source of incessant and stable flow of funds for the budget. The tax administration will return extra tax payments. If income is under its non-taxable level the budget can replenish the gap by paying to the individual the so called negative taxes. Regularity in tax payments may depend on the size of the income.

The income tax exists in different variants and can be applied according to the definite economic environment of every country. The now existing income tax system should be replaced inevitably by a definitely new scheme of collecting that tax if the budget intends to rise its efficiency.

A problem of extreme importance for our country is the maintenance of the social security system. The expenditures are growing fast but an increase in rates is not the right solution. **Higher rates of the contributions coinciding with no changes in other taxes will endanger the economic performance of all firms that pay the social security contributions.** A temporary settlement of that problem is to adopt three different rates according to the three different types of expenditures carried out through the "Social Security Fund": pensions, family allowances and social aid on the basis of the Decree for Stimulating Birthrate, income maintenance in the case of illness. If no programs for limiting the expenses are launched, it would be useful to determine differentiated rates and to make the deficits explicit.

The need for changing the tax system initiates from the nature of the budget expenditures but again there are no attempts to change the tax system in 1992 budget projection.

### The Expenditures

1991 is a year of important rearrangements in the structure of budget expenditures. There is a significant increase in the relative share of interest payments (about seven times), of social aid and pensions and wages to government employees. There is a huge drop in the share of capital expenditures (twice) and subsidies to the state enterprises (three times) in the structure of expenditures .

The share of domestic interest in the current expenditures of the budget has been nearly a zero up to 1990 and abruptly jumps up to 11.4 percent in 1991. **In spite of the rapid increase in interest payments their amount did not offset the devaluation of the government debt due to inflation.**

The Debt/GDP ratio in 1990 is 35.4 percent. In 1991 the ratio of debt plus interest to GDP becomes 21.3 percent (Debt/GDP ratio is 16 percent in



1991). The ratio Debt/Budget revenues also falls down from 67.4 percent in 1990 to 49.1 percent in 1991 including interest. (The Debt/Revenues ratio is 37.8 percent in 1991).

The increment of the share of paid foreign interest has started in 1988. Its maximum value is 7.71 percent in 1990. It drops down to 2 percent in 1991 -- a level maintained for years before 1988.

The purchases of goods and services include the operating and maintenance of government administration and basic social services concerning health, education, public utilities, culture and art, science, defence, public order and safety. Their share has been about 40 percent of total non-interest expenditures. In 1991 it rises up to 50 percent because of the increase in wages of government employees. There are no other substantial changes in the other components of this group.

The second group consists of government transfers including subsidies to the state enterprises, pensions and social aid. The share of that group in the budget expenditures has been about 50 percent. In 1991 it changes quarterly from 53-54 percent to 40 percent at the end of the year.

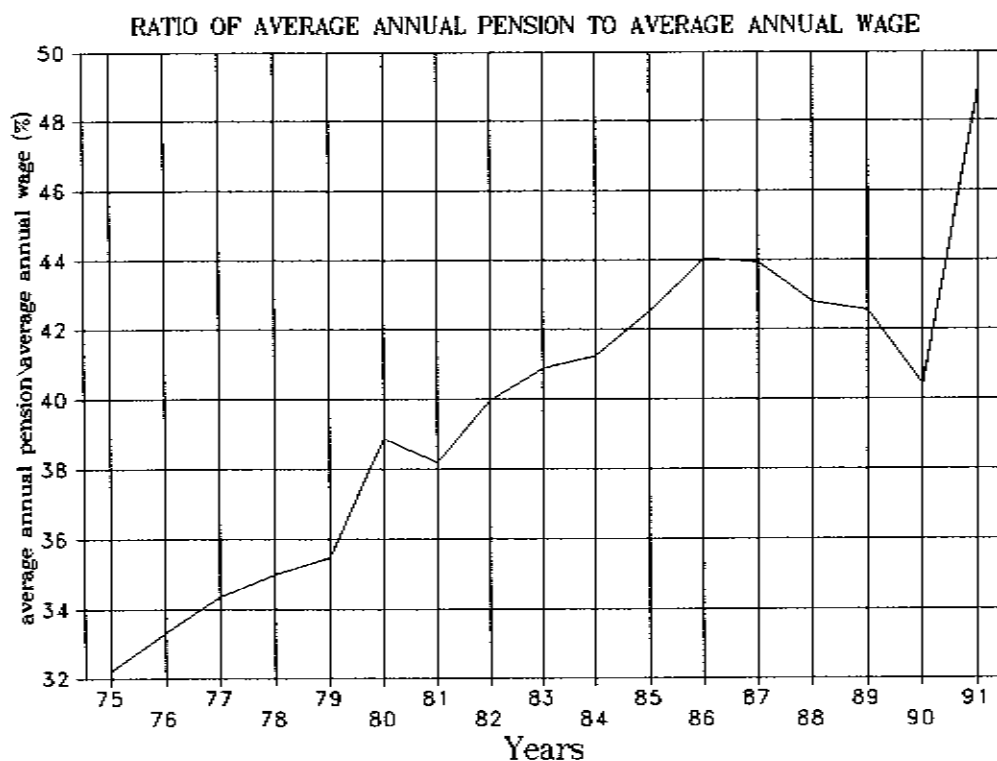
There are structural changes inside the group of transfers related to **an increase in pensions and social aid and a fall down in subsidies.**

The share of pensions in total current expenditures is rising steadily from 14.1 percent in 1989 to 14.8 percent in 1990 and reaches 19.1 percent in 1991. The share of social aid is growing from 7.22 percent in 1989 and 5.94 percent in 1990 to 7.3 percent in 1991. The subsidies erode to 8.3 percent in 1991 being about 30 percent up to 1990 and 25 percent in 1990.

The changes in transfers should be analyzed more closely. Subsidies are paid directly by the budget and differ in their nature from the other transfer payments which are carried out through the social security network.

The nominal decrease in subsidies coincides with the price liberalization in 1991. The comparison between subsidies and real GDP is a more precise measure of their role in the economy. In 1990 the ratio of nominal subsidies to nominal GDP is 14.8 percent. In 1991 the ratio of nominal subsidies to real GDP (GDP of 1991 at 1990 prices) is 13.5 percent. The conclusion is that **the real decrease in subsidies is 1.3 percentage points. That means no change in the subsidies/GDP ratio in comparison to previous years.**

The share of pensions nearly tripled in 1991 related to 1990. The ratio of the average annual pension to the average annual wage changes significantly.



In 1990 the ratio between the average annual pension and the average annual wage is 40.4 percent. In 1991 it is already 48 percent. The monthly fluctuations in the ratio calculated for 1991 is due to the irregular payment of compensations to pensions.

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Since September a new system of labour negotiation has been introduced and the ratio of average monthly pension to average monthly wage decreases following the wave of increasing wages. In November the ratio has already reached 35.9 percent (the calculation of that ratio in December is not indicative because of the seasonal effect). The existing ratio of average pension to average wage is lower than its level in the 1980s (about 40-44 percent) and is at the level existing in the 1970s.

Another view concerning the evaluation of the adequate level of pensions argues that the relation of average pension to social minimum should be considered a more precise benchmark. Anyway the average wage is certainly an "equilibrium" between personal income and personal outlays and respectively it represents a normal level of consumption and can be used in estimating the dynamics in average pension. In 1991 the gap **between minimum and maximum pension became narrower and respectively the**

**ratio of the minimum pension to the average wage is nearly equal to the ratio of the average pension -- a situation that has never been before.**

The pegged level of pensions in the last quarter of 1991 allowed to lower the share of transfers in total non-interest expenditures from 55 percent to 40 percent at the end of the year.

The system of pension payments in our country is based on the pay-as-you-go principle (i.e. the accumulated funds are spent during the current year). What is worst, it is not separated from the other forms of social assistance though it is definitely different in nature.

Future expenses on pensions can be estimated on the basis of the serious demographic forecasts that are devised permanently. According to steady trends in demographic structure different activities can be undertaken to prepare the pension system to meet the changes. **Though from the mid-1970s it was approved that the decreasing birth rate will cause in the future an aging of the population, a Decree for Stimulating Birth Rate was adopted (with an ambiguous effect) instead of a comprehensive restructuring of the social security system. In consequence the expenditures of the "Social Security Fund" have grown up because of rising family allowances and other income maintaining outlays for mothers with children under two years old.**

The system pay-as-you-go is applied in government pension scheme in other countries as well. The evaluation of its functioning is positive if the age structure of the population shows a great share of relatively (according to the retirement age) young people. This system is based on an unwritten contract among generations stating that younger will make provisions for the retirees.

When changes in birth and death rates lead to an aging of the population this system becomes inefficient. Under that social security schedule those who enter the labour force should support a growing group of retirees without there being a sufficiently strong support group when they themselves reach retirement. The public retirement insurance system gets less attractive to the younger generation. A system based on interest bearing long-term deposits becomes more appropriate in the situation of aging population.

The changes in the social security system must involve a differentiation in rates related to the specified outlays and the independent organization of the pension system. Obviously a part of the expenditures should be afforded directly by the budget.

The income maintenance expenditures resulting from the Decree for Stimulating Birth Rate increased four times in 1991 in comparison to 1990.

But as already exists a tendency of slowing down the birth rate and the expenditures should decline in the future.

The income maintenance expenses related to absence of work because of illness have already changed after the sharp increase in unemployment. It is easy to limit them by administrative acts.

So the major item in the "Social security Fund" are expenditures for pensions and **the most important steps in reorganizing the social security system is to restructure the pension system.**

The capital expenditures diminish from 10.67 percent in total expenditure in 1987 to 5.22 percent in 1990 and 4.4 percent in 1991. Their share has never been under 10 percent for the period before 1987 and the low share of the last few years will cause disturbances in the maintenance of the long-term assets for all budget organizations.

The project of the 1992 budget preserves the existing tendencies in the structure of budget expenditures. The share of interest payments is the same (13.8 percent), the share of pensions and social aid grows up (from 27.2 percent to 32.1 percent), the share of subsidies goes on falling (from 8.52 to 4.89), the share of purchases of goods and services remains the same (about 50 percent)

### Conclusion

The analysis of 1991 budget implementation proves that there were no significant changes in budget revenue and expenditure structure. The two exceptions are the entrenchment of capital expenses caused by the economic depression and the decline in subsidies related to the price liberalization. The ratio between government purchases of goods and services and transfers have not changed. So is the structure of the tax system that have functioned well in other socioeconomic environment but is not adequate to the market economy.

In 1992 the design of a basically new tax system must inevitably be launched together with the changes in retirement insurance system. That will alleviate the functioning of the budget in 1993 and will create favorable conditions for reorganizing the system of budget expenditures. Making the budget more flexible and efficient is the task of 1992.

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