

**REPORT**  
**MONITORING THE REFORM**  
**TOWARDS FISCAL DECENTRALIZATION**  
**IN 2005**

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## I. PREFACE

This is the third report analyzing and assessing the reform towards fiscal decentralization. It has been prepared according to the Fiscal Decentralization Program with the technical assistance of the United States Agency for International Development (USAID) and the Local Self-Government Initiative. The purpose of this Report is to assess not only the results of the reform in 2005 but also the results achieved in the entire three-year period since the launching of the Fiscal Decentralization Program.

The study is based on the data published in the regular annual reports on the implementation of the national budget and the local budgets, the annual accounting reports and information on arrears in the payments of municipalities in the 2002-2005 period. It uses the databases of the Ministry of Finance and the National Association of Municipalities in the Republic of Bulgaria (NAMRB).

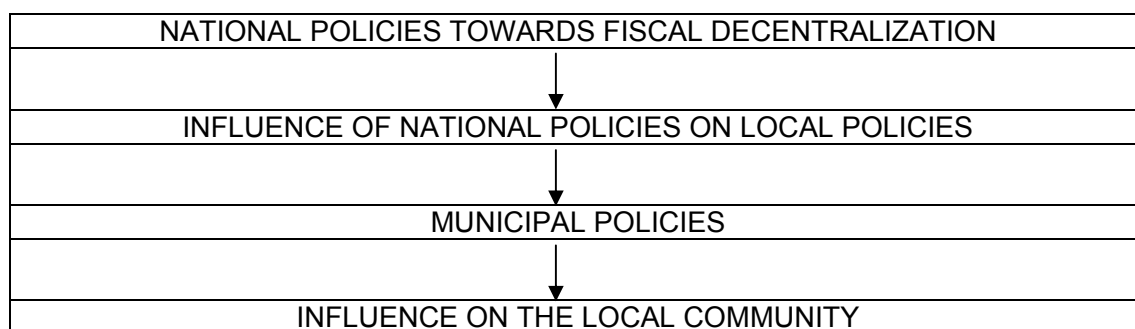
**The purpose of the reform towards fiscal decentralization is to provide public services in quantities, of a quality and at prices corresponding to the needs and affordable to the people, on the basis of long-term balancing of municipal expenditure responsibilities with stable revenue sources and effective civil control.**

This purpose can be achieved by raising the quality of the relations between the central and local authorities. They are the object of the national policy towards financial decentralization, which finds expression in **a process of transferring resources, powers and responsibilities from central to local structures.**

This process should result in the **pursuance of a more balanced and efficient municipal policy**, conducive to the achievement of the goals of the reform: a responsible local governance providing public services adequate to the needs of the people.

This logical scheme of the reform towards fiscal decentralization is presented in the following table:

**Table 1. National and local policies in achieving the goals of the reform**



The monitoring covers registration of the state of the different policies, analyses and assessment of the changes and their direction.

The subjects of monitoring are:

- The results of the policy of fiscal decentralization;
- Changes in the financial state and the way of functioning of the local authorities;
- Public opinion on the results of the municipal policy pursued.

The indicators used in the analyzing and assessing the level reached and the changes in these spheres have been approved by representatives of the central and local authorities in the Working Group on Fiscal Decentralization.

The purpose of this Report is to study the policy towards fiscal decentralization and its influence on the financial state and the services provided by the municipalities.

## **II. QUALITATIVE CHANGES AND THEIR INFLUENCE ON THE ATTAINMENT OF THE GOALS OF THE REFORM TOWARDS DECENTRALIZATION**

### **1. Implementation of the Concept and the Program of Fiscal decentralization**

#### **1.1. Assessment of the implementation of the Concept of Fiscal Decentralization**

The main goal was more or less achieved in the 2003-2005 period. This is evidenced by the improved financial state of the municipalities compared to the period before the reform. The total of their arrears has decreased dramatically. Different mechanisms have been proposed for a quicker and more efficient overcoming of their indebtedness. The municipal councils are now determining the size of the local fees and the prices of the services, proceeding from local solvent demand.

At the same time the reform has so far failed to establish the necessary connection between the people and the local self-government bodies elected by them. Municipalities should seek a greater involvement of the population in public discussions of the municipal budgets.

The Concept formulates seven sub targets:

- Sub target 1: Granting revenue and expenditures management powers to the public level closest to the people according to the principle of subsidiarity;
- Sub target 2: Expenditure responsibilities corresponding to the revenue sources;
- Sub target 3: Maximum consideration by the municipalities of the preferences of the people in determining the type, range and resources of municipal public services and their efficient provision.
- Sub target 4: Developing and increasing the powers of the municipalities in financial management and strict observation of financial discipline.
- Sub target 5: Balance between the free exercising of local choice and the need of financial stability at national level in securing certain standards of the services.
- Sub target 6: Transparency and equal treatment of public sphere agents by the state;
- Sub target 7: Equal access to resources in securing a minimum level of public services

The sub targets further develop the main target by envisaging activities within the competence of both the national decentralization policies and the local self-government authorities. The general conclusion is that the sub targets have to a great extent been achieved. This refers above all to Sub target 5 – balance between free local choice and financial stability at national level and Sub target 4 – competent financial management and discipline. Considerable progress was made in 2005 in the achievement of Sub targets 6 and 7 – transparency and equality in the treatment of public sphere agents and securing resources for maintaining a minimum level of public services.

#### **1.2. Assessment of the implementation of the Financial Decentralization Program**

The table below shows the results achieved in the course of the reform since the launching of the program and in 2005 in particular. The study is made by main groups of revenue and expenditures of municipalities.

<b>Performed/Achieved</b>	<b>Development of the reform in 2005</b>
<p>1. Revenue -1.1 Transfers - 1.1.1 Shared taxes</p> <p>Municipalities receive proceeds from the Tax on the Income of Natural Persons, which is the main source for financing State-delegated activities.</p>	<p>Nothing has changed from the situation at the launching of the reform. The idea for transforming the patents tax into a local tax and its regulation by the Local Taxes and Fees Act was not realized in 2005.</p>
<p><b>1. Revenue - 1.1 Transfers - 1.1.2 Complementary subsidy</b></p> <p>Introduced in 2003. Complements the shortage of shared tax in the municipalities to reach the standard level of delegated activities.</p>	<p>In 2005 the State honoured its commitment to provide 100 per cent of the subsidy but the statutory provision for it to retain 10% remains in force.</p>
<p><b>1. Revenue – 1.1 Transfers - 1.1.3 Adjustment subsidy</b></p> <p>Introduced in 2003. Its minimum is regulated by the Municipal Budgets Act and cannot be lower than 10% of the reported own revenue of all municipalities for the previous year.</p>	<p>The legislative regulation of the minimum of this subsidy entered into force at the beginning of 2005. It has grown steeply – from 35 million leva in 2004 to 70 million leva in 2005. Work has started to improve the mechanism of distributing the adjustment subsidy.</p>
<p><b>1. Revenue - 1.1 Transfers - 1.1.4 Capital expenditures subsidy</b></p> <p>Its total size is fixed by the central government in the National Budget Act following negotiations with the NAMRB. The subsidy for environment projects is determined by the Ministry of Environment and Waters and the Ministry of Finance.</p> <p>The distribution mechanism is based on three criteria: population size, number of population centres and area.</p>	<p>The capital expenditures subsidy under the 2004 National Budget Act was 59 million leva and it grew to 85 million leva in 2005.</p> <p>For the first time in 2005 the National Budget Act provided for the distribution of additional funds for capital expenditures (17 million leva). There are still investment funds distributed by the branch ministries in the course of the fiscal year. The obligation of the municipalities to divide the revenue from the subsidy between delegated and local activities in a correlation of 60:40 introduced in 2004 was revoked in 2005.</p>
<p><b>1. Incomes - 1.1 Transfers - 1.1.5 Other transfers</b></p> <p>These are programs of the central government reported as transfer and expenditures on municipal budgets.</p>	<p>There are no changes in the regulation and planning, receiving and spending of target subsidies received by the municipalities through transfer accounts. The scope of the funds received through transfer accounts was broadened in 2005.</p> <p>The municipalities have no powers in using these funds. They do not plan the transfers they receive and the funds are recorded officially as an increase in the revenue and expenditure sides of their budgets.</p>
<p><b>1. Revenue - 1.2 Own 1.2.1 Taxes</b></p> <p>Local taxes are regulated by the Local Taxes and Fees Act. Their base and size are determined by the State. The distribution of the revenue is on a source basis.</p>	<p>When the reform was launched there were five local taxes. By 2005 one tax – the road tax was eliminated, and another – the inheritance tax, was greatly reduced.</p> <p>The elimination of the road tax was compensated by a subsidy.</p> <p>The Constitution of the Republic of Bulgaria has</p>

	<p>not been amended to give municipalities greater powers in local tax size determination and full powers in determining the size of municipal fees.</p> <p>The tax on real property has not been updated. The new tax base was adopted in 2005 and entered into force in 2006. It updated the assessed value of property.</p> <p>The gradual transfer of the administration of local taxes to the municipalities is also in line with the reform.</p>
<p><b>1. Revenue - 1.2 Own - 1.2.2 Fees</b></p> <p>The type of these fees is regulated by the Local Taxes and Fees Act (LTFA). The prices of services unregulated by this Act are determined by the municipalities. The municipalities formulate their local policies in Ordinances under the LTFA.</p>	<p>Since the beginning of 2003 the municipalities have had full powers in the administration of the services for which they collect consumer fees.</p> <p>The Bulgarian Constitution has not been amended which prevents the municipalities from regulating the types of services for which fees are charged.</p>
<p><b>1. Revenue – 1.2 Own – 1.2.3 Non-tax</b></p> <p>These are revenue and income from municipal property management and sale, concessions, fines, donations, etc. The municipalities have full powers in planning and administrating these revenues and in using them for the respective local priorities.</p>	<p>The considerable growth of the non-tax revenue of municipalities is due to changes in the legislative environment guaranteeing the powers of the municipalities and not binding greater non-tax revenue to reduced transfers in the following year.</p> <p>Slow process of the transformation of state property into municipal property. It is necessary to broaden the scope of municipal concessions.</p>
<p><b>2. Expenditures - 2.1 Delegated activities</b></p> <p>Under Article 34 (2) of the Municipal Budgets Act, the State finances the activities it delegates to municipalities by reassigned state taxes and general complementary subsidies. The total sum of the funds for delegated activities is determined according to adopted and evaluated standards.</p>	<p>The State has clearly defined its responsibilities for the services delegated to the municipalities and introduced clear mechanisms in their evaluation and financing.</p> <p>A municipality administration staff size was adopted in 2004.</p> <p>The pace at which expenditures standards are updated is lagging behind price growth – in the case of fuel prices, for instance.</p>
<p><b>2. Expenditures - 2.2. Local Activities</b></p> <p>Municipalities have full powers in determining, planning and managing the spending of funds on local activities. The size of the funds depends on the own revenue of the municipality and the adjustment subsidy.</p>	<p>The municipalities are broadening the range of local activities. This is due to the faster growth of own revenue funds and the steep increase in the size of adjustment subsidies.</p> <p>There are incentives to increase own revenue and own revenue increase does not lead to a decrease in the subsidy. At national level there is an automatic link and adjustment subsidies increase automatically at the rate of the increase of the own revenue of municipalities.</p>
<p><b>3. Crediting</b></p> <p>Amendments to the Municipal Budgets Act established common rules for crediting municipalities clearly defining current and investment crediting and admissible sources of financing.</p>	<p>A Municipal Debt Act was drafted in 2004 and passed in 2005.</p>
<p><b>4. Deficit</b></p>	<p>In 2004 there was a considerable decrease in</p>

	<p>arrears but in 2005 they retained their level and even marked a slight increase. The number of municipalities winding up their fiscal years without a deficit is growing.</p> <p>In 2005 municipalities were extended funds for settling arrears in payments on state-delegated activities.</p> <p>In 2005 an interdepartmental group started drafting a mechanism for providing financial assistance to municipalities in financial dire straits, assisted by the Local Self-Government Initiative and with the participation of representatives of the Ministry of Finance and the NAMRB.</p>
<b>5. Investment</b>	<p>2005 registered a steep increase in investment. The share of investment reached 17.91% of the total size of municipal budgets. Municipalities are increasing their investment using mainly their own revenue.</p> <p>The policy adopted in 2004 for setting aside funds for co-financing municipal projects continued in 2005 with a considerable increase in the amount of these funds. There are clear rules regulating the distribution of the funds among the municipalities formulated jointly by the NAMRB and the Ministry of Finance.</p>

As mentioned above 2005 marked the completion of the **Financial Decentralization Program**. The general assessment is that most of the planned 37 measures have been implemented. The main unimplemented measures are:

Measure	Responsible institution	Term
Amendment of the Constitution of the Republic of Bulgaria giving municipal councils the right to determine the local taxes.	National Assembly (political consensus)	2003-2005
Change in the approach in providing for the capital expenditures of municipalities: for state-delegated activities - through state standards; for municipal activities – through target subsidies.	Ministry of Education and Science, Ministry of Labour and Social Policy, Ministry of Culture, Ministry of Healthcare, Ministry of the Environment and Waters, Ministry of Regional Development and Public Works, NAMRB, Ministry of Finance.	September 30 2003
Development of a methodology for the distribution of funds for repairing the municipal road network among the municipalities.	Ministry of Regional Development and Public Works, NAMRB	March 31, 2004
Drafting legislative regulations taking into account the peculiarities of the Municipality of Sofia – an Act on Sofia (Sofia Municipality).	Ministry of Regional Development and Public Works, NAMRB. Sofia Municipality	2003-2005

## 2. Major Changes in the Legislative Environment

A Municipal Budgets Act was passed in November 2003. Amendments to the Act were passed in 2005 prompted by the passage of the Municipal Debt Act.

A Local Taxes and Fees Act was passed in December 2002. The amendments made to it in 2004 provided for the elimination of the road tax<sup>1</sup> and restricted the scope of the inheritance tax. They entered into force at the beginning of 2005. The amendments made it possible to update the tax base on immovable property at the beginning of 2006.

#### 2005 National Budget Act

In 2005, too, the National Budget Act provided for 100% financing of expenditures on state-delegated activities.

The obligatory distribution of capital subsidies in a 60% to 40% correlation between state and municipal activities respectively, introduced in 2004, was revoked in 2005.

In a separate appendix the 2005 National Budget Act provided for an additional 17 million leva target subsidy for capital expenditures to be distributed among the municipalities and granted in the presence of a budget surplus. This is an example of transparency in state transfers.

Target funds were allocated in the central government budget for co-financing concrete projects of the municipalities (from the Social Investment Fund, Beautiful Bulgaria and others). These funds increased from 1 million leva in 2004 to 7 million leva in 2005.

Unlike in 2003 the carryover balance at the end of 2004 and 2005 accumulated as a result of more efficient spending was brought forward to the next year to be used for purposes chosen by the municipal councils provided the municipality had no arrears and unpaid bills (§ 31(6) of the Transitional and Final Provisions of the 2004 National Budget Act and § 32 (5) of the Transitional and Final Provisions of the 2005 National Budget Act)

The 2005 National Budget Act made it possible for municipalities to sign contracts on collecting revenues from local taxes and household waste disposal fees.

Amendments were adopted to the Tax Procedure Code and to the Local Taxes and Fees Act transferring the administration of local taxes and household waste disposal fees to the municipalities as of 2006, which is a precondition for a higher collection rate and an increase in own revenue.

The Corporate Income Tax Act. The rate for activities carried out by the municipalities under Article 2 of the Act was reduced from 4% to 3%.

In 2005 the VAT and other taxes on sales paid to municipal budgets amounted to 23 million leva.

The Municipal Debt Act. This Act was passed in 2005 and entered into force in 2006.

Numerous **acts of subordinate legislation, directly related to the reform towards fiscal decentralization** were passed in 2003–2005. These include:

The distribution of the activities in the two groups and the determination of the standards of the delegated services is proposed on an annual basis by an interdepartmental group of representatives of the respective branch ministry, the Ministry of Finance and the NAMRB. It is approved by a Council of Ministers Decision<sup>2</sup>

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<sup>1</sup> The amendment to the **Roads Act** introduced a vignette system for trucks which partly deprived the municipalities of revenue from road tax in 2004

<sup>2</sup> See Council of Ministers Decision 612/12.09.2002, Council of Ministers Decision 743/29.10.2003 and Council of Ministers Decision 1045/30.12.2004.



Since the distribution outlines the range of the powers and responsibilities of the state and the municipalities in providing the respective services, it should be based on the principle of subsidiarity. Actually, however, in most cases the distribution of delegated and local services is determined by the financial capacity of the municipalities instead. In some cases limited own resources restrict local powers in the management of services.

The determination of the standards in the 2003-2004 period was characterized by the following peculiarities:

Decrease in expenditures on standards.

In 2004 standards were updated by a percentage lower than the inflation rate and in 2005 they were not updated at all. This resulted in a shortage of funds provided to the municipalities through standards.

Introduction of standards for new services in education (for doctor's offices at schools and for pre-school classes for six-year olds);

Additional funds received by the municipalities in the course of the year created problems in the planning and reporting of the municipal budgets. These funds fall mainly into two groups:

**Additional transfers from the Executive Budget** entered as an increase in subsidies – general complementary, general adjustment and target subsidies for capital expenditures distributed among the municipalities in implementation of statutory acts.

**Revenue from transfer accounts.** In addition to the funds allocated in the local budgets, in the course of the year the municipalities receive funds they have been allocated in the budgets of the central departments. They are received via transfer accounts (under § 61, §62 and §64). The municipalities do not plan this revenue and the funds are entered automatically as an increase in the revenue and expenditures sides of their budgets (Paragraph 9 of the Transitional and Final Provisions of the 2005 National Budget Act). In the period under review, revenues from such transfers grew from 6.5% in 2004 to 6.9% in 2005.

### 3. Taxonomy of local powers and responsibilities

The period under review saw a steady trend of faster growth of the municipality's own revenue. This resulted in a growing share of own revenue in the municipal budgets from 22.5% in 2002 (the year preceding the reform) to 32.5% in 2005. At the same time there was a considerable increase in the carryover balance at the end of the year - from 1.2% in 2002 to 7.3% in 2005.

The share of state transfers kept shrinking. It decreased from 63.3% in 2004 to 57.3% in 2005. This is due to the faster growth of own revenue.

A more comprehensive qualitative analysis reveals slight differences in the powers of the local authorities both regarding their own revenue and regarding state transfers.

**Table 2. Powers of the municipalities regarding their own revenue**

Own revenue	Type	Base	Rate	Relief	Planning	Administration
Local taxes	CA	CA	CA	CA	<b>LA</b>	<b>LA</b>
Local fees	CA	<b>LA</b>	<b>LA</b>	<b>LA</b>	LA	<b>LA*</b>
Other non-tax revenue	LA	LA	LA	LA	LA	LA

\* As of 2006 the municipalities acquired the right to administrate revenue from household waste disposal fees which in 2005 accounted for 63% of the revenue from local fees.

The Table shows that the legislative changes have considerably broadened the powers of the municipalities in respect to their own revenue. However, they still lack fundamental powers in respect to local taxes and the possibility to determine the type of local fees.

**State transfers.** Table 4 shows the powers of the central and local authorities in determining the size and the way of distribution of state transfers.

**Table 3. Taxonomy of the powers regarding state transfers to the municipalities**

Type of transfer	Share of the transfer	Rule in determining the overall size					Distribution mechanism				
		a*	b	c	d	e	a	b	c	d	e
General complementary subsidy	26%		X					X			
Adjustment subsidy	7%		X						X	X	
Subsidy for capital expenditures	8%				X				X	X	
Revenue from Natural Persons Income Tax	46%		X					X			
Overcollection of Natural Persons Income Tax	1%		X						X		
Other transfers	12%					X					X

\* determine the stability of legislative regulation and the possibilities for the central authorities (CA) and the local authorities LA to influence the decision-making process. The letters from a to e stand for:

- a. with the assent of the local authorities
- b. permanent law
- c. negotiations between the central and the local authorities
- d. annual law
- e. Ad hoc by the CA

As can be seen from the Table, **the total amount** of almost all transfers is regulated by permanent laws (80%). An exception to this rule is the target subsidy for capital expenditures the size of which is determined on an annual basis by the National Budget Act.

Another exception is the subsidy received by the municipalities via transfer accounts. As already mentioned above, these funds are planned in the budgets of the central departments and are extended to the municipalities. The latter have no powers concerning these funds and they are even entered automatically in their budgets, without a decision of the Municipal Council (§ 9 of the Transitional and Final Provisions of the 2005 National Budget Act).

The state transfers are distributed among the municipalities according to set mechanisms in implementation of statutory acts and State-delegated activities are financed on the basis of adopted and evaluated standards.

**Municipal Expenditures.** Table 4 shows the powers of the central and the local authorities in determining, planning and distributing municipal expenditures in the course of the

financial year. The analysis of the data shows that the central authorities have greater powers in determining and planning wages and expenditures by functions, and the municipalities have greater powers in determining and planning maintenance and capital expenditures. The municipalities have comparatively greater powers in the redistribution of maintenance expenditures. In the other groups of expenditures their influence is partial or weak. Positive tendencies have been registered in the course of change regarding the carryover balance (2004), the distribution of the capital subsidy (2005), and possibilities for changing investment projects and for transferring expenditures from one activity to another within the framework of the function in services delegated to the municipalities, etc.

**Table 4. Taxonomy of the powers on municipal expenditures**

Types of expenditures	Determination	Planning	Powers of the LA in the redistribution of expenditures
Wages Fund and insurance	CA, LA	CA, LA	Weak
Maintenance	LA, CA	LA, CA	Great
Capital expenditures	LA, CA	LA, CA	Partial
Expenditures by functions	CA, LA	CA, LA	Partial

### III. QUANTITATIVE ANALYSIS AND ASSESSMENT OF THE POLICY TOWARDS FISCAL DECENTRALIZATION

#### 1. Results of the policy of fiscal decentralization

##### 1.1. System of Indicators

The analysis and evaluation of the policy of fiscal decentralization is based on key indicators presented in the Table below. They measure both the level and the changes in the distribution of public resources, powers and responsibilities.

**Table 5. Indicators in analyzing and evaluating national decentralization policies.**

Indicators	State	Change
A. Municipal expenditures	Correlation to the Gross Domestic Product (GDP)	Year-on-year growth
B. Municipal expenditures	Share in the Consolidated National Budget (CNB)	Year-on-year growth
C. Own revenue of the municipalities	Share in total revenue	Year-on-year growth
D. Municipal revenue determined independently by the local authorities	D.1. Share in own revenue D.2. Share in total revenue	Year-on-year growth
E. Expenditures on which the municipalities have full powers	Share in total expenditures	Year-on-year growth
<i>F. Viability of municipal revenue</i>	F.1. All revenue; F.2. Own revenue; F.3. State transfers	Year-on-year growth corrected by the inflation rate.
G. Capital expenditures of the municipalities	G.1. Share in all municipal expenditures; <i>G2. Share in the capital expenditures in the</i>	Year-on-year growth

## 1.2. Analysis and evaluation of the separate indicators

The first two indicators in Table 6

### A. Correlation of municipal expenditures to GDP;

### B. Share in municipal expenditures in CNB

correlate municipal expenditures to the GDP and the CNB. They give the most general picture of the distribution of financial resources and the responsibilities in providing public services between the central and the local authorities. Table 6 shows that there is centralization in providing public services.

**Table 6. Municipal expenditures in the GDP and in public expenditures**

	2003	2004	2005
GDP (in millions of leva)	34,546.6	38,275.3	41,948.1
CNB (in millions of leva)	14,068.8	15,199.0	16,678.5
Municipal expenditures (in millions of leva)	2,179.3	2,335.7	2,694.3
Share in the CNB in the GDP	40.7%	39.7%	39.7%
Share in municipal expenditures in GDP	6.3%	6.1%	6.4%
Share in municipal expenditures in CNB	15.5%	15.4%	16.2%

In 2005, for the first time since the launching of the reform towards fiscal decentralization there was an increase in the share of municipal expenditures in the GDP and in the CNB.

The conclusion is that the downward trend was reversed in the third year of the reform.

### C. Share of own revenue in total municipal revenue

This is a key indicator of the financial independence of municipalities. The results of the analysis show that the growth of own revenue is faster than the growth of other municipal revenue. At the same time the share of state transfers is dropping as in 2003 the state stopped financing social assistance and in 2004 it stopped financing municipal hospitals. The combination of both factors resulted in an increase of the share of own revenue in total municipal revenue - from 30.5% in 2004 to 32.5% in 2005.

### D.1. Share of municipal revenue determined independently by the local authorities in the municipalities' own revenue;

This indicator shows the extent to which the own revenue of municipalities meets European criteria formulated in the European Chart of Local Self-Government. As already mentioned above, in Bulgaria municipalities have no powers in determining local taxes. From this point of view, the indicator shows how non-tax revenue relates to the sum of own revenue (tax and non-tax).

The survey showed an increase in this share from 72.6% in 2004 to 73.9% in 2005. This is the result of the faster growth of revenue from the management of municipal property and sales than of local taxes. The partial elimination of road tax deprived the municipalities of this type of revenue and resulted in a comparatively small growth in local tax revenue in 2004 which decreased its share in the total revenue from 9.1% to 8.9% in 2004 and 8.5% in 2005. In 2004 the municipalities were compensated for the partial elimination of the local

tax by a transfer of 13.5 million leva. In 2005 the compensation subsidy reached 43.7 million leva. The next steps in raising the value of this indicator pass through amendment of the Constitution granting the local authorities the right to determine the base and the rate of local taxes.

#### D.2. Share of municipal revenue determined independently by the local authorities in the total municipal revenue

This indicator provides a more accurate picture of the powers of local authorities regarding their revenue base. In 2003 this share increased to 21.6%, mainly as a result of the greater local powers over local fees. In 2004 it continued to grow reaching 23.7% and in 2005 it amounted to 24.0%. This indicates greater financial independence of the municipalities.

#### E. Share of expenditures over which the municipalities have full powers in the total expenditures of municipalities

It is generally accepted that expenditures on which municipalities have full powers cover local services and co-financing of state-delegated activities. In 2004 there was an improvement of this indicator: from 41.0% in 2003 to 45.3% of all expenditures. In 2005 this share reached 50.9%. The increase in the share of these expenditures is due mainly to the faster growth rate of the municipalities' own revenue.

#### F. Vitality of Municipal Revenues

Table 8 presents the main groups of municipal revenues characterizing their vitality for the 2002-2005 period.

##### F.1. Total Revenues:

##### F.2. Own Revenues:

##### F.3. State transfers

The data show that 2005 saw a large 7.2% growth of municipal revenues compared to the previous year. This dynamics was a consequence of the changes in the size of both the state transfers and the own revenues of municipalities. The state transfers, regardless of their big size, dropped continuously. The own revenues increased at a relatively high rate that led to lasting positive changes in the structure of revenues. As a result of this the own revenues/state transfers ratio changed from 51.6% in 2004 to 56.8% in 2005. It should be taken into account that the state transfers include subsidies and transfers from the central-government budget and budgetary/extrabudgetary accounts.

**Table 7. Main Groups of Municipal Revenues**

	Level (000 000 leva)*			Growth (%)	
	2003	2004	2005	2004/2003	2005/2004
Types of revenues					
State transfers	1 493.2	1 529.1	1 481.5	2.4 %	-3.1 %
Own revenues	691.3	788.7	842.2	14.1 %	6.8 %
Total revenues	2 256.0	2 414.7	2 587.4	7.0 %	7.2 %

\* The levels of revenues for 2004 and 2005 are adjusted to inflation

#### G.1. Share of Investment Expenditures in Total Expenditures

In 2005 the size of the investment expenditures of municipalities marked a steep increase. They reached 482.6 million leva or 17.9% of total expenditures of municipalities. This

compared to a share of 11.5% in 2004. This was mostly due to the mobilizing of adequate own resources on the part of municipalities.

The amount of the additional target subsidy for capital expenditures was increased. In 2004 the municipalities got additionally over 60 million leva to cover outstanding payments, for capital expenditures inclusive. In 2005, apart from the central-government budget allocation of 17 million leva, the municipalities received some 30 million leva.

### G.2. Share of Municipalities in the Capital Expenditures of the Consolidated Budget

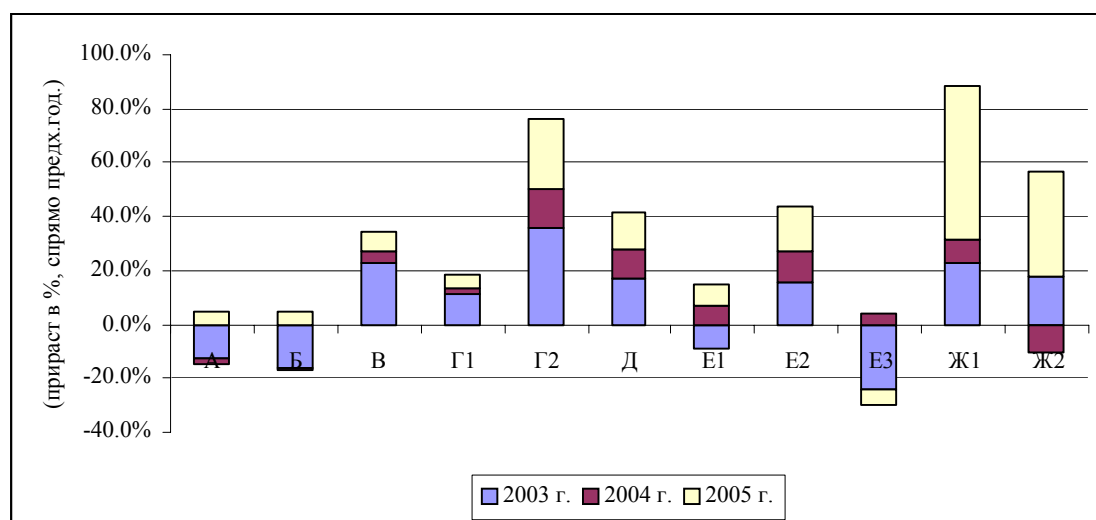
This indicator gives an idea of the distribution of investments among the levels of management in the public sphere. The figures of the table below show an increase in the size of the municipalities' spending for capital expenditures and, in 2005, growth of their share in public investments.

**Table 8. Share of Capital Expenditures of Municipalities in Public Capital Expenditures**

	2003	2004	2005
Capital expenditures of municipalities ('000 000 leva)	240,5	269.1	482.6
Capital expenditures – public sector ('000 000 leva)	1 241 .2	1 556.3	2 044.7
Share of municipal in public capital expenditures	19.4%	17.3%	23.6%

The comparative analysis of the hitherto results showed a growth of all indicators apart from the state transfers, which could be considered as a positive result. (Figure 1)

**Figure 1. Dynamics of Indicators, Characterizing the National Policy towards Fiscal Decentralization**



(growth in % compared to the previous year)

## 2. Financial Condition of Municipalities

The change of the factors of the environment, i.e. of the national policy towards fiscal decentralization exerts an effect on municipal authorities. This effect, combined with the local managerial factors, forms the financial condition of municipalities.

The following indicators of the financial condition of municipalities are followed:

**Table 9. Indicators for analysis and assessment of the financial condition of municipalities**

Indicators	Condition	Change
H. Budget deficit/surplus	H.1. Revenues minus expenditures (including outstanding ones) per one inhabitant	Growth as at the previous year
	H.2. Share of deficit/surplus in total revenues	Growth in report year as at the preceding one
I. Growth of own revenues per one inhabitant		Year-on-year growth
J. Outstanding obligations	J.1. Share of municipalities' outstanding obligations in total ones	Year-on-year growth
	J.2. Share of municipalities' outstanding receivables in total ones	Year-on-year growth
	J.3 Municipalities' outstanding receivables/outstanding obligations ratio	Year-on-year growth

The analysis presents data both at national level and for the groups of municipalities, according to the population. Seven groups are formed as follows:

**Table 10. Groups of Municipalities, According to the Size of the Population**

Groups of municipalities	Number of municipalities	Relative share in the number of municipalities	Relative share of the population
1. Sofia	1	0.4%	16.6%
2. Over 100,000 inhabitants;	12	4.5%	26.3%
3. 50-100	21	8.0%	17.8%
4. 30-50	18	6.8%	8.1%
5. 10-30	113	42.8%	24.1%
6. 5-10,000 inhabitants	70	26.5%	6.1%
7. Below 5,000 inhabitants	29	11.0%	1.1%
<b>Total (Bulgaria)</b>	<b>264</b>	<b>100.0%</b>	<b>100.0%</b>

Apart from the presentation by groups, the analysis is also focused on extremes: the ten best and worst performing municipalities, respectively, according to each of the indicators.

**3.1. Municipal deficit/surplus** (Revenues (budget+outstanding receivables) – expenditures (budget+outstanding obligations))

The indicator is calculated as a difference between municipal revenues and expenditures. The latter are set as a total of budget expenditures and outstanding obligations.

It should be noted that the notions of deficit and surplus are used although they are not the most precise. Thus, for example, the surplus is often a sum that the municipality has not managed to disburse given that certain funds are contributed at the end of the year. Actually, this is surplus as the deficit is rather over-expenditure.

At national level, municipalities posted surplus of 187.2 million leva by the end of the year, some 20 million leva up as from 2004. It was set as difference between a surplus of 214.8 million leva of 209 municipalities and a deficit of 27.6 million leva in the remaining 55 municipalities. The average surplus and deficit per one inhabitant were 31.9 leva and 25.6 leva, respectively. This is indicative of deteriorating indicators for 2005.

**Table 11. The differences by groups are presented in the table below:**

Groups of municipalities	Surplus/deficit (in leva per one inhabitant)	including			
		Surplus		Deficit	
		(leva/inhabitant)	Number of municipalities	(leva/inhabitant)	Number of municipalities
1. Sofia	32.9	32.9	1	0.0	0
2. Over 100,000 inhabitants	29.5	37.1	9	-99.0	1
3. 50-100,000 inhabitants	11.8	22.1	17	-21.9	5
4. 30-50,000 inhabitants	21.0	26.8	16	-15.3	3
5. 10-30,000 inhabitants	23.4	32.6	91	-16.9	22
6. 5-10,000 inhabitants	22.3	36.1	51	-13.5	18
7. Below 5,000 inhabitants	42.8	58.3	24	-13.1	6
<b>Total (Bulgaria)</b>	<b>24.0</b>	<b>31.9</b>	<b>209</b>	<b>-25.6</b>	<b>55</b>

The data show that, apart from Sofia, each group consists of municipalities with surplus and deficit. The compensated result is positive for all groups of municipalities. Compared to the previous year, there was an increase of the compensated surplus in the largest municipalities: Sofia and the ones with population of over 100,000 inhabitants. However, the latter group also includes Pernik Municipality, which is the only one with deficit but ranks second in the country after Bobovdol. The size of the deficit increased in all groups but in the municipalities with population of 5 to 10,000 inhabitants.

According to the data, a lower number of municipalities had a larger average surplus (in 2004 the municipalities numbered 214 and the average surplus was 27.3 leva/inhabitant). The average deficit also raised up to 25.6 leva/inhabitant compared to 20.4 leva/inhabitant in 2004. This gives grounds to draw a conclusion about a widening differentiation among municipalities in regards to this indicator.

**Table 12. Top ten municipalities with highest surplus/deficit in 2005**



Top ten municipalities with highest surplus (in leva/inhabitant)			Top ten municipalities with highest deficit (in leva/inhabitant)		
6606	LUKI	556.0	6001	BOBOVDOL	-134.4
5206	NESSEBUR	279.2	6404	PERNIK	-99.0
5101	BANSKO	272.7	5113	HADJIDIMOVO	-64.8
5208	PRIMORSKO	264.0	7107	NEDELINO	-61.2
5808	SHABLA	216.0	5304	BYALA	-51.7
5108	RAZLOG	205.5	7611	HASKOVO	-35.2
7312	KOPRIVSHTITSA	158.2	7608	STAMBOLOVO	-33.7
6617	KOUKLEN	114.4	5606	KRIVODOL	-30.0
6607	MARITSA	96.5	6905	SILISTRA	-28.3
7109	SMOLYAN	87.7	7603	LYUBIMETS	-28.2

The comparison of the ten municipalities with largest surplus, respectively, largest deficit also showed an increase of differences between municipalities. In 2004 the Luki Municipality had the highest surplus of 438.4 leva/inhabitant. In 2005 this municipality had a surplus of 556.0 leva/inhabitant. The municipality with highest deficit in 2004, Bobovdol, also increased it from 127.0 leva/inhabitant to 134.4 leva/inhabitant the following year.

There were new municipalities in both groups for 2005. Half of the municipalities with surplus were new: Bansko, Shabla, Razlog, Kouklen, Maritsa and Smolyan. Mizia, Zlatograd, Opaka and Borino dropped from the list of municipality with deficit.

### 3.2. *Municipalities' obligations* (Deficit/municipal revenues)

The deficit, compared to the municipal revenues, give an idea of its weight. Only municipalities having budget deficit were taken into account upon calculations within this indicator. Its average level for the country was 7.7%, marking an increase compared to 2004 (6.3%).

The data of table 14 show that the smaller municipalities had lower obligations. All groups, apart from the second one, had a level of obligations below the country's average. Only one municipality, Pernik, accounting for 36% of the deficit of all municipalities, lifted the national level and set the exceptionally high indicator for the second group. Compared to 2004 Pernik doubled the level of its deficit (20% in 2004).

**Table 13. Level of Obligations by Groups of Municipalities**

Group	Obligation
1. Sofia	0.0%
2. Over 100,000 inhabitants	-40.6%
3. 50-100,000 inhabitants	-6.7%
4. 30-50,000 inhabitants	-5.1%
5. 10-30,000 inhabitants	-5.3%
6. 5-10,000 inhabitants	-3.2%
7. Below 5,000 inhabitants	-2.2%
<b>Total (Bulgaria)</b>	<b>-7.7%</b>

The table presents the top ten municipalities with highest obligations in this country. It can be seen that almost all of them feature on the table about the above indicator.

**Table 14. Top Ten Municipalities with Highest Level of Obligations**

No	Municipalities	Obligations
6404	<b>PERNIK</b>	-40.6%
6001	<b>BOBOVDOL</b>	-32.8%
5113	<b>HADJIDIMOVO</b>	-17.2%
7107	<b>NEDELINO</b>	-15.9%
7611	<b>HASKOVO</b>	-10.7%
6614	<b>STAMBOLIISKI</b>	-10.5%
5606	<b>KRIVODOL</b>	-9.8%
7603	<b>LYUBIMETS</b>	-8.8%
6905	<b>SILISTRA</b>	-8.4%
6509	<b>PORDIM</b>	-7.1%

According to the results of the analysis, compared to 2004, three new municipalities, Krivodol, Silistra and Pordim, were among the top ten replacing Opaka, Mizia and Zlatograd. Of the remaining municipalities only Haskovo reduced the level of its obligations from 11.1% to 10.7%. The obligations of all the rest increased.

#### *1. Growth of Own Revenues*

At national level, the increase of own revenues in 2005, compared to 2004, in absolute figures was 119.4 million leva as growth of own revenues of the equivalent of 154.0 million leva was reported in 167 municipalities while there was a drop of 34.4 million leva in 97 municipalities. Largest was the increase of own revenues from non-tax revenues, which amounted to 86.8 million leva.

<b>Structure of Utilization of Own Revenues</b>						
Indicators	2004		2005		Change 2005/2004 (leva)	Change 2005/2004 (%)
	Level of utilization (leva)	% of total own revenues	Level of utilization (leva)	% of total own revenues		
<b>1. Tax revenues</b>	<b>224,659,122</b>	<b>27.3%</b>	<b>245,529,327</b>	<b>26.1%</b>	<b>20,870,205</b>	<b>109.3%</b>
including						
- Property tax	224,635,131	27.3%	239,690,823	25.5%	15,055,692	106.7%
- Excise duties	4,242	0.0%	1,803	0.0%	-2,439	42.5%
- Other taxes	19,749	0.0%	5,836,701	0.6%	5,816,952	29,554.4%
<b>2. Non-tax revenues</b>	<b>589,694,400</b>	<b>71.8%</b>	<b>676,524,544</b>	<b>71.9%</b>	<b>86,830,144</b>	<b>114.7%</b>
including						
- Property revenues and income	79,527,968	9.7%	100,058,390	10.6%	20,530,422	125.8%
- Fee revenues	320,327,834	39.0%	344,585,503	36.6%	24,257,669	107.6%
- Revenues from sale of property	111,144,388	13.5%	213,967,212	22.7%	102,822,824	192.5%
- Concession revenues	2,379,008	0.3%	3,748,033	0.4%	1,369,025	157.5%
- Revenues from fines	23,067,635	2.8%	20,678,238	2.2%	-2,389,397	89.6%
- Other revenues	56,553,833	6.9%	16,493,981	1.8%	-40,059,852	29.2%
- Collected and contributed VAT and other taxes on sales	-3,306,266	-0.4%	-23,006,813	-2.4%	-19,700,547	695.9%
<b>3. Aid and donations from the country and abroad</b>	<b>7,178,399</b>	<b>0.9%</b>	<b>18,919,316</b>	<b>2.0%</b>	<b>11,740,917</b>	<b>263.6%</b>
<b>Total own revenues</b>	<b>821,531,921</b>	<b>100.0%</b>	<b>940,973,187</b>	<b>100.0%</b>	<b>119,441,266</b>	<b>114.5%</b>

During both years the share of revenues from fees in the total own revenues was largest, followed by property tax and revenues from sale of municipal property. The considerable exceeding of the target revenues from other taxes as at 2004 was due to the road taxes paid in 2005. In 2004 funds, submitted by the Enterprise for Management of Environment Protection Activities for ecological facilities, were reported as revenues but since 2005 they have been reported as transfers. This accounts for the fact that the other revenues in 2005 were lower compared to 2004.

The own revenues grew by an average of 26.4 leva per one inhabitant and the reduction was 14.4 leva.

Groups of municipalities	Growth/reductio (in leva per one inhabitant)	Including			
		Growth		Reduction	
		(leva/ inhabitant)	Number of municipalities	(leva/ inhabitant)	Number of municipalities
1. Sofia	30.0	30.0	1	0.0	0
2. Over 100,000 inhabitants	9.3	19.8	8	-9.3	4
3. 50-100,000 inhabitants	3.9	13.7	13	-14.1	8
4. 30-50,000 inhabitants	10.0	17.8	12	-6.8	7
5. 10-30,000 inhabitants	21.5	41.3	74	-18.9	39
6. 5-10,000 inhabitants	6.6	26.1	43	-23.7	27

7. Below 5,000 inhabitants	0.4	32.8	16	-35.1	13
<b>Total (Bulgaria)</b>	<b>14.5</b>	<b>26.4</b>	<b>167</b>	<b>-14.4</b>	<b>97</b>

The data show that, apart from Sofia, each group consists of municipalities with growth and reduction of own revenues but the compensation result is positive for all groups of municipalities. The biggest growth of own revenues was reported in the group of municipalities with a population of 10 to 30,000 inhabitants and below 5,000 inhabitants - 41.3 leva/inhabitant and 32.8 leva/inhabitant, respectively, which was considerably exceeding the country's average. Only the groups of municipalities with population of 50-100,00 inhabitants and 30-50,000 inhabitants reported growth below the country's total average.

In the group of small municipalities (below 5,000 inhabitants) there was considerable difference between municipalities given that, within it, 17 municipalities reported a considerable growth of own revenues per one inhabitant while the other 13 municipalities of this group reported considerable reduction as from the previous year.

#### Ten top municipalities with highest growth/reduction of own revenues in 2005

Ten top municipalities with highest growth (leva/inhabitant)		Ten top municipalities with highest reduction (leva/inhabitant)	
1	SVOGE	449.1	
2	BANSKO	416.8	
3	KAVARNA	286.0	
4	RAZLOG	230.8	
5	SHABLA	229.8	
6	NESSEBUR	199.7	
7	KOUKLEN	174.1	
8	PRIMORSKO	171.9	
9	CHELOPECH	141.2	
10	ELIN PELIN	140.6	
1	CHEPELARE		-136.9
2	YAKOROUDA		-112.7
3	CHAVDAR		-105.1
4	BELOSLAV		-93.4
5	BYALA (Varna Region)		-92.8
6	ETROPOLE		-86.8
7	OPAN		-79.1
8	GULUBOVO		-74.1
9	GORNA MALINA		-70.9
10	ROUZHINTSI		-63.7

The municipalities of Nessebur, Kavarna and Primorsko also reported highest growth of own revenues in the preceding year. The other municipalities were new in the ranking as their growth was mostly due to an increase of non-tax profits, sales of assets inclusive.

#### J. Outstanding Obligations

By the end of 2005 the outstanding obligations of municipalities amounted to 47,914.3 million leva, as they were highest in regards to local activities. They were some 5 million leva up as from 2004 but also 30.7 million leva down compared to 2003.

One of the reasons for the existence of obligations was the still inadequate revenue basis. The processes of administration of local taxes and fees having begun in 2005 is expected to contribute to an increase of tax compliance by municipal budgets and broaden the tax proceeds base. Another reason for the existence of outstanding obligations was the large amount of outstanding receivables, mostly from rents of property and concessions. Besides, court claims have been filed in regards to many of the outstanding obligations. In 2005 the drafting of a mechanism for financial assistance of municipalities experiencing

financial difficulties was launched and it was completed in 2006 with the adoption of an Ordinance on the Terms and Procedure for Financial Assistance of Municipalities Experiencing Financial Difficulties. It was used to provide financial assistance to municipalities, meeting certain criteria, and, parallel to this, the municipalities drafted rehabilitation programmes containing concrete measures that would result in reduction of the outstanding obligations and lasting stabilization of their financial condition.

#### J1. Share of outstanding obligations in total obligations of municipalities

Regardless of the reported increase of outstanding obligations in 2005, the share of outstanding obligations in the total obligations of municipalities has been decreasing for some years now. This share was 32.3% in 2003, 18.5% in 2004 and in 2005 it went down to 12.3%. This is an indicator for improving financial condition.

#### J2. Share of outstanding receivables in total receivables of municipalities

An increase of the share of outstanding receivables in the total receivables was observed here. In 2004 it was 19.2.% to reach 23.6% in 2005. Apart from the existence of outstanding receivables from leasing of property there were also such from enterprises in bankruptcy. It was reported that one of the reason for the existence of outstanding receivables from taxes and fees was the low social status of the population in certain municipalities and its impossibility to pay them.

#### J3. Municipalities' outstanding receivables/outstanding obligations ratio

The increase of outstanding receivables also results in an increase of their share in the outstanding obligations. In 2003 this share was 30.4%, in 2004 it was 82.3% and in 2005 it went down to 77.8%.

With view of more active following of the real effect of the process of fiscal decentralization, the established system of indicators is open, i.e. it is subject to continuous improving and updating with new indicators. Pursuant to the Ordinance on the Terms and Procedure for Financial Assistance of Municipalities Experiencing Financial Difficulties, the three indicators set by it have to be included in the approved system of indicators. Data of the annual statements for 2004 and 2005 were used to calculate them. The three indicators were:

- The ratio of net outstanding obligations of the municipality and the sum of its own revenues, the subsidies/transfers from the central-government budget (without target transfers/subsidies from the central-government budget for capital expenditures) and the state transfer of retained tax under the Taxation of Natural Persons Act was not to exceed 5 per cent; calculations were made separately for 2004 and 2005 and it was accepted that the municipality complied with the criterion given that the ratio exceeded 5 per cent for both years;

- Available budgetary funds at the municipality (without target and external funds) had to be less than its net outstanding obligations as at the end of 2005.

- The ratio of net outstanding obligations of the municipality in regards to local activities and the sum of its own revenues and the subsidies/transfers from the central-government budget to the local activities (without the target transfers/subsidies from the central-government budget for capital expenditures) by the end of 2005 had to exceed 30 per cent.

A municipality meeting at least two of the criteria and having a rehabilitation programme approved by the Municipal Council qualified for financial assistance under the central-government budget in line with the terms, procedure and deadlines of the Ordinance.

The municipalities meeting the criteria of the Ordinance were:

<b>MUNICIPALITY</b>	Ratio of over 5% between the net obligations and the sum of own revenues, central-government budget subsidies (without the capital subsidy) and the transfer under the Taxation of Natural Persons Act as at the end of 2004 and 2005 <b>I criterion</b>	Available budget funds not covering the net outstanding obligations at the end of 2005 <b>II criterion</b>	Ratio of over 30% between the net outstanding obligations in the local activities and the sum of the own revenues and the central-government budget subsidies for local activities (without the capital subsidy) as at the end of 2005 <b>III criterion</b>
GOTSE DELCHEV	no	yes	no
KRESNA	no	yes	no
SIMITLI	no	yes	no
STROUMYANI	no	yes	no
HADJIDIMOVO	yes	yes	yes
YAKOROUDA	no	yes	no
BOURGAS	no	yes	no
KAMENO	no	yes	no
MALKO TURNOVO	no	yes	no
POMORIRE	no	yes	no
PRIMORSKO	yes	no	no
AVREN	no	yes	no
BYALA	no	yes	no
VULCHI DOL	no	yes	no
DEVNYA	no	yes	no
DULGOPOL	yes	yes	no
BELOGRADCHIK	no	yes	no
VIDIN	no	yes	no
DIMOVO	no	yes	no
BOROVAN	no	yes	no
KRIVODOL	no	yes	no
MEZDRA	no	yes	no
MIZIA	yes	yes	yes
SEVLIEVO	no	yes	no
ARDINO	yes	yes	no
KURDJALI	yes	yes	no
MOMCHILGRAD	yes	yes	no
BOBOVDOL	yes	yes	yes
KOCHERINOVO	no	yes	no
RILA	no	yes	no
VURSHETS	no	yes	no
BATAK	no	yes	no
PANAGYURISHTE	no	yes	no
SEPTEMVRI	no	yes	no
KOVACHEVTSI	no	yes	no
PERNIK	yes	yes	yes
RADOMIR	no	yes	no
GOULYANTSI	no	yes	no
PORDIM	yes	yes	no
KARLOVO	no	yes	yes
PEROUSHTITSA	no	yes	no
RODOPI	no	yes	no

STAMBOLIISKI	yes	yes	yes
KOUBRAT	no	yes	no
DVE MOGILI	no	yes	no
TSENOVO	no	yes	no
ALFATAR	no	yes	no
DOULOVO	no	yes	no
SILISTRA	no	yes	no
BANITE	yes	yes	yes
BORINO	no	yes	no
DOSPAT	no	yes	no
ZLATOGRAD	yes	yes	yes
NEDELINO	yes	yes	yes
CHEPELARE	no	yes	no
PIRDOP	no	yes	no
CHIRPAN	no	yes	no
OPAKA	no	yes	no
LYUBIMETS	yes	yes	no
MINERALNI BANI	no	yes	no
SIMEONOVGRAD	no	yes	no
STAMBOLOVO	no	yes	no
HASKOVO	yes	yes	no
KAOLINOVO	no	yes	no
<b>Total</b>	<b>16</b>	<b>63</b>	<b>9</b>

### 3. Provision of Municipal Services

There are two types of criteria characterizing the provision of municipal services:

- Regarding the distribution of resources and responsibilities between the central and executive bodies;
- Regarding the efficiency of services.

The specific indicators, adopted by the Working Group on Fiscal Decentralization, are presented in the table below.

**Table 15. Indicators for Analysis and Assessment of Municipal Services Provided**

Indicators	Condition	Change
K. Reached level of provision of municipal services	Ratio of expenditures for local and delegated services	Year-on-year growth
L. Scope and level of educational services	L.1. Share of municipal education expenditures in public ones	Year-on-year growth
	L.2. Municipal education expenditures per one student	Growth as at the previous year

	L.3. Share of school graduates in total number of enrolled students by levels of education	Year-on-year growth
	L.4. Share of students pending training in number of enrolled students	Year-on-year growth
M. Level of services in culture	Share of municipal culture expenditures in public ones	Year-on-year growth
N. Level of services in healthcare	Share of municipal healthcare expenditures in public ones	Year-on-year growth
O. Level of services in social activities	Share of municipal expenditures for social activities	Year-on-year growth

There were not data for the L.3 and L.4 indicators and due to this analysis was not made. L.2 indicator, Expenditures for education of one student, had to be treated carefully. It showed the efficiency of training but, on the other hand, lower expenditures per student could be due to maintained lower quality of education.

#### K. Ratio of expenditures for local and delegated services

In terms of quantity, the difference between this indicator and indicator E of the group of indicators about the national policy for fiscal decentralization, equalled the size of the additional funds allocated for the delegated services. In 2004 the reported additional expenditures on delegated services made using municipal revenues amounted to 25.2 million leva. In 2005 this sum increased up to 45.7 million leva as the additional funds extended for education (16.9 million leva) and social activities (6.3 million leva) accounted for the largest share. As a result of the changes in the financial relations between the central and local authorities in 2004 the share of local services grew up to 44.3%, as against 54.7% for services delegated by the state. In 2005 local expenditures almost reached the level of the ones for delegated services as the ratio was 49.2% to 50.8%. This is indicative of the development of the financial independence of municipalities.

#### L.1. Share of municipal education expenditures in public ones

This indicator provides an idea of the distribution of resources and responsibilities within one of the public sectors – education. In 2004 the share of municipalities in the total consolidated expenditures for education was 57%. In 2005 this share dropped down to 54.4%. This gives grounds to draw the conclusion that the decentralization of services in the sphere of education does not yield good results.

#### L.2. Municipal education expenditures per one student

The analysis was confined to the expenditures for general education schools as far as they were most frequently made and all municipalities could be included in the comparison. For the country, as a whole, one student of a general education school cost the municipalities 719.1 leva in 2003, 824.4 leva in 2004 and 888.7 leva in 2005. The differences among the municipalities by groups presented are shown in the table below.



**Table 16. Expenditures per one student in the general education schools by groups of municipalities**

Group	Expenditures per one student in leva			Change (in %)		
	2003	2004	2005	2004/2003	2005/2004	2005/2003
1. Sofia	766.8	817.5	854.1	6.6%	4.5%	11.4%
2. Over 100,000 inhabitants	653.8	741.5	806.3	13.4%	8.7%	23.3%
3. 50-100,000 inhabitants	710.6	803.5	887.0	13.1%	10.4%	24.8%
4. 30-50,000 inhabitants	723.4	837.4	894.1	15.8%	6.8%	23.6%
5. 10-30,000 inhabitants	748.9	889.3	955.3	18.8%	7.4%	27.6%
6. 5-10,000 inhabitants	779.1	940.3	1001.0	20.7%	6.5%	28.5%
7. Below 5,000 inhabitants	870.2	1210.2	1191.7	39.1%	-1.5%	36.9%
Total (Bulgaria)	719.1	824.4	888.7	14.6%	7.8%	23.6%

The data show that, as a whole, the smaller the municipality the higher expenditures per one student were: in all three years under review these expenditures were biggest in the group of small municipalities. The rate of increase of expenditures in 2004 was much higher compared to the following year. 2005 saw most tangible increase of the expenditures per student in the group of municipalities with population of 50-100,000 inhabitants. There was a decrease only with small municipalities compared to 2004.

**M. Share of municipal culture expenditures in public ones**

The ratio of expenditures for public services of the central and local authorities in culture in 2005 was 63.2%:36.8%. The share of municipalities was 34.5% in 2004 and 31.2% in 2003. This gave grounds to draw the conclusion that there was decentralization of services in the field of culture.

**N. Share of municipal healthcare expenditures in public ones**

In the field of healthcare the share of municipal expenditures was 12.8% in 2004, to reach 6.2% in 2004 6.4% in 2005. The reduction was due to the termination of funding of municipal hospitals in 2004.

**O. Share of municipal expenditures for social activities in public ones**

In 2005 the expenditures for social activities by municipal budgets accounted for some 7% of total municipal expenditures and included expenditures for social benefits and compensations pursuant to adopted decisions of municipal councils, expenditures, related to the temporary employment programmes as well as expenditures for welfare establishments. In 2005 the expenditures for welfare benefits and compensations increased compared to the previous year from 4.7 million leva in 2004 to 4.9 million leva in 2005. The other expenditures for social activities dropped from 189.8 to 182.3 million leva due to the curtailing of expenditures within temporary employment programmes. This also reflected on the share of municipal expenditures for social activities in the public ones, which dropped from 11.5% in 2004 to 10.3% in 2005.

**IV. CONCLUSION**

The conclusions of the monitoring of the reform in the fiscal decentralization are summarized in four groups.

### 1. Qualitative changes

The 2005 contributions may be presented in the following areas:

#### Positive changes:

- The rule for regulating the overall amount of the adjustment subsidy entered into force;
- A Municipal Debt Act was adopted;
- Increase of the funds for assisting municipalities, having won externally-funded projects;
- The municipalities have powers to administer local taxes and fees;
- Lifting of the restriction in the distribution of the capital subsidy;
- A decision was taken to update the real estate tax as of the beginning of 2006;
- Increase of the number of municipalities using debt instruments;
- A growth of the own revenues to the amount of 119.4 million leva was observed year-on-year;
- The relative share of local activities increased from 44.3% in 2004 to 49.2% in 2005.

#### Non-implemented changes

- The practice of compensating municipalities for the removed road toll continued instead of setting a new own source of revenues;
- The municipalities were not given powers to plan the expenditures for delegated services, according to their own priorities;
- The total amount of the target subsidy for capital expenditures was not regulated by law;
- Municipalities were not granted powers in regards to the revenues obtained through transfer accounts
- The law-stipulated retention of 10% of the complementary subsidy was not changed. The municipalities would get it by the end of the year given that the national budget target for the balance has been met.

The **Fiscal Decentralization Programme** was completed in 2005. In general, the prevailing part of the 37 measures has been fulfilled. Following are some of the more important non-implemented measures:

Measure	Organizations in charge	Term
Amending the Constitution of the Republic of Bulgaria with view of granting municipal councils the right to set themselves the local taxes.	National Assembly (political consensus)	2003 - 2005
Change in the approach for the provision of the capital expenditures of municipalities: for state activities – through the state standards; for	Ministry of Education and Science, Ministry of Labour and Social Policy, Ministry of Culture, Ministry of Healthcare, Ministry of Environment	30 September 2003

municipal activities – through target subsidies.	and Waters, Ministry of Regional Development and Public Works, National Association of Municipalities in the Republic of Bulgaria, Finance Ministry	
Drafting of methodology for distribution of the funds for repair of the municipal road network by municipalities.	Ministry of Regional Development and Public Works, National Association of Municipalities in the Republic of Bulgaria	31 March 2004
Drafting of statutory instruments taking into account the peculiarities of Sofia Municipality - Capital City Act (Sofia Municipality).	Ministry of Regional Development and Public Works, National Association of Municipalities in the Republic of Bulgaria, Sofia Municipality	2003 - 2005

## 2. Qualitative changes

- The tendency of a drop of municipal expenditures in the gross domestic product and the consolidated national budget was stopped.
- Enhancement of the structure of revenues. Increase of the own revenues;
- Positive changes in the share of revenues and expenditures in regards to which municipalities are entitled to take decisions.
- The share of investment expenditures and attracted funds increased at highest rate.

## 3. Financial Condition

The main characteristic features of the financial condition of the municipalities in 2005 were as follows:

The differences among the financial condition of municipalities increase. By the end of 2005 the municipalities posted a surplus of 150 million leva (on a compensation basis) marking a slight increase compared to the 136 million leva surplus in 2004. Unlike the preceding year, however, there was an increase of the outstanding obligations, of the size of the surplus and deficit among municipalities and of the number of municipalities with budget deficit. Following the considerable drop of obligations in 2004, the following year saw restoration of the 2003 levels. The obligations of the two municipalities with largest debts, Pernik and Bobovdol, again reached a share of 40% plus in revenues.

All municipalities marked a 7.5% increase of expenditures compared to 2004. With view of comparing the data, the expenditures were adjusted to the 2004 and 2005 inflation. In 2004, 154 of a total of 264 municipalities posted growth of expenditures. In 2005 they increased by 29 up to 183 municipalities.

Apart from Sofia, the average municipalities (with some 30,000 inhabitants) were also successful in 2005. They increased their financial resources at a faster rate. In 2004 the small municipalities improved considerably their financial condition.

**The main conclusions about the policy and changes towards decentralization in 2005 are as follows:**

A. Big positive change. All qualitative indicators improved. Most considerable was the increase with attracted funds and investments.

B. Considerable part of the measures, set in the 2003-2005 Fiscal Decentralization Programme, were fulfilled.

C. Positive changes in the financial condition of municipalities. There was a tendency of an increase of the differences among municipalities.