

# Global Challenges and Sustainable Development in the Bulgarian Public Sector

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**Summary:** The slowing rate of economic growth in global, regional and national aspects poses a challenge to the stability of the public finance and the integrity of its economic and social functions. In order to achieve its strategic goals for building a competitive, knowledge-based economy Bulgaria should make investments in human capital, which for its part involves sustainable development of the public sector. The data about its current condition show that the gap between our country and the average European level is considerable, and the convergence processes – slower and with unsatisfactory cohesion effect. One of the reasons for that is the discrepancy between the politically announced priorities in the spending policy and the specific budget parameters. The idea of better balance between the stabilizing macroeconomic functions of the budget and its role as a factor for sustainable development of the public sector has been promoted. With regard to this, restructuring, which focuses on investments in human capital and knowledge-based economy, has been proposed.

**Key words:** public sector, public expenditure, sustainable development.

**JEL:** E62; H10; H50.

## 1. Criteria for Sustainable Development of the Public Sector

The conceptual framework implies that sustainable development of the public sector should be considered as more comprehensive and involving the stability of the public finance. The latter is a means of achieving economic, social and political objectives for which the society has delegated rights to the government to transfer part of the scarce resources from the private to the public sector. Its condition and development are based on a number of indices, which reflect the availability of resources, the quantity and quality of commodities and services, it supplies to the population. According to the sustainability criteria:

- 1) The resources in the public sector, within the country's economic opportunities, should increase so that the activities should meet the needs of today's generations and conditions are to be created for constant satisfaction of the needs of the future generations. This implies that the optimum size of the public sector should be reached, and within it – a balance between the current maintenance of activities and investments with long-term effect, which is to meet the established demographic, economic and social tendencies and the common strategies and policies adopted by the European Union;
- 2) In structural terms, sustainability presupposes both consistency and flexibility of the policies in terms of budget receipts and outlays, adjustment

to the challenges of global, regional and domestic origin; forecasting the direct and indirect effects of various risks and the respective compensatory and buffer mechanisms used to avoid them. Financially, the requirement for sustainability calls for a reasonable and balanced fiscal policy in order to avoid the transfer of debt burden to the future generations;

3) In terms of the functional (economic, political and social) mechanisms, sustainability is observed when the tax burden and the benefits for the end beneficiaries are distributed in accordance with the social justice principles and, without diminishing the stimuli for utilizing factors of production, provide conditions for reducing both the income and the social inequality, reducing poverty and encouraging the social inclusion processes. The sustainable development of the public sector should be seen as an element of the common strategy and as a premise for its successful implementation, since without government intervention, the market processes would generate flaws with unpredictable large-scale consequences.

The *new global challenges* relate to unfavourable changes in the macroenvironment and to the demonstrated political will to comply with the rigid budget constraints. The slowing down in the growth rates of the world and European economies results in slight corrections in the macroeconomic framework of the Bulgarian 2009 budget. The budget was drawn up with forecast GDP growth rate of 4.7 %, defined by the business and the experts as too optimistic. It is more likely that the growth rate will not exceed 1.5 % and growth in unemployment and shrinking in domestic demand will affect adversely the budget revenues. There is political will for more active intervention in the real economy and in the financial markets should extremely unfavourable events occur. It is the Government's intention to resort to the fiscal policy in order to counter the imbalances in the economy (mostly the Current account deficit)

by maintaining the Consolidated Government Budget in surplus of not below 3 % of GDP and a maximum level of budget expenditure – not more than 40 % of GDP.

Other challenges relate to *attaining strategic goals*, where Bulgaria is part of the Common European Policy. The Lisbon objectives require our cooperation in creating a competitive, knowledge-based economy, which is a very complex task, directed at labour-market reforms, reforms in education, science and research, information technology. Their achievement requires higher government investments in the human factor and, as a whole, in conditions, generating long-term growth factors. We are strongly politically and financially committed to the Joint Inclusion Memorandum – JIM and the resulting tasks in the National Action Plan on Social Inclusion.

In addition to the global challenges there are some internal ones, related to the deteriorating demographic structure, which suggests that we cannot rely on quantitative increase in the workforce, but there certainly will be an increase in the expenditures on health care, pensions, social security benefits and social care. The educational structure of the population gives rise to more reasons for alarm; the high percentage of early drop-outs; the high percentage of young people in the 15 – 25 age bracket who do not go to school or work; the high percentage of long lasting unemployment within the otherwise low coefficient of general unemployment; the regional differences in poverty and its ethnic profile; the increased rate of illnesses and deaths from cardio-vascular and cancer diseases; exacerbating ecological problems, the condition of the infrastructure etc.

The global challenges, combined with the internal state of the public sector and its capacity to solve (or not) the problems, present a real threat to the fiscal stability, and in more general terms – to the sustainable development as a

whole. It is well known that the restructuring reforms in this sector started late, they were conducted inconsistently with varying intensity and contradictory effects, without the support and approval of the majority of the electorate. The declared social commitments, their inclusion in strategies, programmes and action plans have not yet given the results, which can be the ground for positive assessments in terms of enhancing the efficiency of public resources utilization.

## 2. Level and Dynamics of the Public Expenditure

Since 1998 the country's GDP has been constantly increasing and the achieved macroeconomic stability has created prerequisites for a sustainable increase in the public sector resources. We can base our judgement about the ratio between the rates at which the public spending and the GDP change on the value of the elasticity of the public expenditure coefficient.

Periods of accelerated growth in the public expenditure compared to the GDP growth alternate with periods of slower growth. The reason for that could be the excessive utilization of the budget as an instrument for expedient fiscal policy to counter the cyclical development. But the period under consideration is characterized by economic growth (though with varying intensity), which suggests that there is no conceptual framework to define the goals and priorities in the different public sector activities.

Given the diverse character of the activities in the public sector, the strategies and policies are developed by the sector and functional ministries, but the financing of either of them cannot be carried out without their interrelationship within the consolidated fiscal programme. It is based on a combination of policies, which set out the specific priorities and fields of influence. Amendment 3 to the Report on the Law on the 2009 Government Budget of the Republic of Bulgaria defines 7 policies, which the Ministry of Finance follows. Among these are the policies on: budget revenue; national debt; encouraging the participation of our country in the globalization processes; safety, stability and cooperation worldwide etc. The spending policy is not independent and should be considered as an inherent element of the "Sustainable and transparent public finance" policy, whose aim it is "to try and find a correlation between the resource allocation and the set strategic goals and collecting higher value added when providing public services to citizens". The sustainability of the public finance is primarily seen as a current financial stability and avoiding fiscal imbalances as a counter measure to established economic imbalances. Consequently, the value added should be the result of appropriately channeling the limited resources to activities, which in time will bring higher profits to society than the expenditures incurred.

Along these lines, it is only logical to ask the question about the extent of government intervention in the economy, about whether the public sector is large or small. It is a commonly accepted opinion that we can judge about this

Table 1. GDP elasticity of public expenditure in Bulgaria

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009*
Coefficient of elasticity	1.93	1.32	0.64	0.82	1.54	0.66	0.94	0.63	1.44	0.81	1.60

\* *project*

Source: Ministry of Finance

from the share of government expenditures of the GDP. A comparison between the expenditures structure of GDP in Bulgaria and the average in EU illustrates the following:

In comparison with the remaining EU countries, the final consumption expenditure in Bulgaria has the highest relative share of GDP; the final consumption expenditure of government is among the lowest, and the gross capital formation – among the highest. This confirms the primary importance of the private investment initiative as a major growth factor. According to this data Bulgaria has more moderate (compared to the other EU countries) participation in the final utilization of the GDP and it will remain unchanged in the next two years. In total, it earmarks less money for government expenditure, both in absolute terms and as a relative share, which is due to the depicted fiscal and social model.

The share of government expenditures in the GDP in Bulgaria is considerably smaller in

comparison with the EU indices. It is known that the government expenditures are indicative of the resources, necessary for providing public services and social transfers and thus the welfare at both social and individual levels is formed (for certain social groups these represent the single source of welfare). Their level and structure are in response to the global challenges, they represent the condition for attaining the strategic goals of the Common European Policy.

As it can be seen from Table 3, the government expenditures in our country by absolute value are about 12.5 % of the average level in EU27, and to compare it with 2002, when they were 8.8 %, this ratio has changed by only 4 points.

In order to draw a comparison, we can point out that in 2007 GDP per inhabitant in Bulgaria was 18 % of the same index for EU27. It becomes obvious that the convergence processes in terms of public sector financing have fall behind the ones in the economy as a whole. The expected shrinking in the budget revenue will not lead to

Table 2. GDP by final consumption expenditure\*

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Final consumption expenditure of households and non-profit institution serving household											
EU27	58.7	58.8	58.5	58.5	58.3	58.4	57.9	57.3	57.4	58.5f	58.2f
Bulgaria	69.2	69.5	71.1	70.3	69.3	70.2	70.4	69.1	68.2	67.8f	67.8f
Final consumption expenditure of general government											
EU27	19.8	19.9	20.4	20.8	20.7	20.8	20.7	20.4	20.8	22.1f	22.6f
Bulgaria	17.9	17.4	18.1	19.0	18.4	18.0	16.6	16.2	16.3	16.4f	16.6f
Gross fixed capital formation (investment)											
EU27	20.6	20.2	19.6	19.4	19.6	20.0	20.7	21.3	21.1	19.5f	19.0f
Bulgaria	15.7	18.2	18.2	19.3	20.5	24.2	25.9	29.8	33.4	28.8f	27.7f

\* exclude Net export

Source: Eurostat

Table 3. Total general government expenditure

	2002	2003	2004	2005	2006	2007
Euro per inhabitant						
EU27	9 562	9 797	10 136	10 544	10 951	11 392
Bulgaria	845	918	1 018	1 111	1 193	1 421
% of GDP						
EU27	46.8	47.4	46.8	46.9	46.3	45.8
Bulgaria	40.3	40.3	39.7	39.2	36.4	37.8

Source: European Economic statistics, 2008 edition, Eurostat, p. 169.

the forecast growth in revenue, which creates conditions for insufficient financing of the public sector industries and activities.

### 3. Priorities of the Expenditures Policy

The adopted conceptual framework and the specific parameters of 2009 budget indicate

that it will remain an instrument for implementing a restrictive stabilizing fiscal policy – a policy, which has been typical of Bulgaria since 1997. The structure of the budget expenditures also remains conservative, as it can be seen from the following data.

The most important characteristic of the budget is the planned budget surplus amounting to 3 % of GDP. The achieved balance between revenue

Table 4. General Government revenue and expend (in % of GDP)

Consolidated state budget	2003	2004	2005	2006	2007	2008	2009*
<b>Expenditure</b>	<b>40.6</b>	<b>39.1</b>	<b>38.9</b>	<b>37.2</b>	<b>39.1</b>	<b>40.0</b>	<b>40.0</b>
<b>Expenditure by group (in % of GDP)</b>							
<b>Revenue and Benefits</b>	<b>40.6</b>	<b>40.8</b>	<b>42.0</b>	<b>40.8</b>	<b>42.6</b>	<b>44.1</b>	<b>44.3</b>
<b>Surplus</b>	<b>0.0</b>	<b>1.7</b>	<b>3.1</b>	<b>3.5</b>	<b>3.5</b>	<b>3.0**</b>	<b>3.0**</b>
I. General public services	3.2	2.9	3.0	3.1	3.5	3.2	3.4
II. Defense and safety	5.2	5.1	5.1	4.8	5.3	5.0	4.8
III. Education	4.3	4.3	4.2	3.9	3.9	4.2	4.1
IV. Health services	4.9	4.6	4.7	4.1	4.2	4.2	4.2
V. Social protection	13.9	13.5	13.1	12.6	12.0	12.3	12.6
VI. Housing and community amenities	1.4	1.5	1.7	2.0	2.4	2.5	2.7
VII. Recreation, culture and religion	0.8	0.8	0.8	0.8	0.9	0.7	0.7
VIII. Economic activities and services	4.8	4.7	4.7	4.4	4.7	6.1	6.1
IX. Other expenditure	2.1	1.8	1.6	1.3	2.2	2.2	2.1

\* project

\*\* the difference of 1.1 % for 2008 and of 1.3 % for 2009 is the share of the contribution paid out to the EU budget

Source: Ministry of Finance

and expenditure in 2003 was a remarkable success, especially given this year's budget deficit, which on average for the EU is 3.1 % of GDP. Maintaining budget surplus over the last five years ranks our country among "the leaders" in the Community, and we should also mention the decrease in the gross national debt to below 20 % of GDP (it is 58.7 % of GDP in the EU27 on average). The existence of a budget surplus in macroeconomic context is a safeguard against an unfavourable situation, and due to such a surplus buffers can be created against negative shocks. Under the conditions of an expected decrease in the growth rate, this means that the impact of the built-in stabilizers should be evaluated both in terms of revenues, and in terms of expenditures.

The existence of a budget surplus can be seen as a result of conducting efficient tax policy, which was facilitated by the implemented reforms. Equally, this surplus may be the result of a conservative expenditures policy, i.e. these are resources, which can be targeted at financing with priority public activities, which have proved their importance to the development of the human capital and the knowledge-based economy. Unfortunately, this budget confirms the trend that Bulgaria has one of the lowest shares of social expenditures (education, health, social security, culture) amounting to about 20 % of GDP, compared to the European countries, where these expenditures exceed 30 %. This differs from the declared social commitments about including in the labour market those groups, which are exposed to poverty risk and providing access to rights, resources, commodities and services to those who need them. The percentage changes in the nominal transfers are usually officially announced (which at best partially compensate the accrued inflation), but no attitude is expressed on the issue of secured access for all citizens to contentious public services, such as health care.

It is doubtful whether the most important goal – to improve the quality of education – can be achieved, since the earmarked funds remain 4 % of GDP for the country. The expenditures on health and education in our country have one of the lowest relative shares compared to the average level in the Community, especially in comparison with some of the most developed countries, where expenditures on education amount to between 6 % and 7 % of GDP, and those on health care exceed 7 % (in Sweden, Denmark, and also in Portugal, Estonia and Latvia). There are differences with respect to expenditures on social security, whose share of GDP in our country is by 5 points lower than the average for the EU25 and in comparison with some other countries (Luxembourg, Sweden) the gap is even greater, since in these countries the expenditures exceed 25 % of their budget<sup>1</sup>. The other European countries earmark considerable financial resources for Research and Experimental Development (R&D). According to Eurostat data, on average for the EU27, they are 1.84 % of GDP, while in Sweden they are 3.8 % and in Finland – 3.45 %. The 0.48 % of GDP spent on R&D ranks Bulgaria at one of the last places according to this index. Investments in human capital have not become a priority of the government policy yet. Spending on Human Resources as a relative share of GDP in Bulgaria amounts to 4.51 %, while the average in the EU25 exceeds 5 % and in some member states (Denmark) it is even higher than 8 %.

The continuous growth in funds for economic activities and services is indicative. An absolute increase by 18.8 % in comparison with the previous year and reaching a relative share of 6.1 % of the GDP for the country is projected. Their amount ranks them second to spending on social security; this is twice more than all financial resources for housing, public utilities and amenities and protection of the

<sup>1</sup> Eurostat, Statistics in focus. Economy and Finance, 11/2006.

environment; and this is considerably more than the expenditures earmarked for health care or education. Nearly half of these funds (47 %) have been earmarked for transport and communication, a third – for agriculture, forestry, fishing and hunting. There is a tendency towards increasing subsidies for non-finance enterprises by 30.2 %. Whether the financial resources for these sectors are effectively and efficiently spent becomes evident from the unsatisfactory condition of the transport infrastructure and the quality of transportation services. The subsidizing of inefficient activities has a high opportunity cost and puts off problems in time rather than solving them.

The increase in the amount of *public investments* is one of the 2009 budget priorities, and it is stated that these should not be below 7 % of GDP. This is a necessary measure, considering the fact that expenditure on acquisition and acquired tangible fixed assets in the public sector has decreased as a relative share of their overall amount in the country's economy. The tendency towards decapitalization in the public sector started in the first years of transition to market economy and has been exacerbating due to shortage of financial resources and channeling them mainly to the current support of activities within it. It is alarming that this process continued after 2004 and the consequences will be hard to overcome in the short period.

The increase in the amount of public investments during the current budget year has led to restructuring the expenditure with an increasing

share of capital expenditure at the cost of decreasing share of current expenditure. In 2008 the ratio between them (within the non-interest expenditure) was 17 % : 83 %, in 2009 this ratio should be 21 % : 79 %. There is also an opportunity for additional transfer from current to capital expenditure in order to create a fiscal buffer in the event of unfavourable developments and should the need for a general decrease in expenditure arise, this transfer must be in the field of current expenditure, not the capital ones. The forecast absolute growth in the capital expenditure by more than 20 % in comparison with the previous year will provide resources for the development of the public road and railway infrastructure. A possibility exists for an additional investment programme amounting to BGN 1 billion financed with reserve funds and a possible decrease in the budget surplus by up to 1 % of GDP (in absolute terms – about BGN 700 million). The implementation of these opportunities would encourage the processes in building a modern public infrastructure, mainly to meet communication needs.

#### 4. Conclusion

Viewing the 2009 Government Budget of Bulgaria in terms of the strategic goal – providing sustainable growth in the public sector, shows that:

1. Nominal fiscal stability has been guaranteed, but the opportunities for tax revenue in terms of indirect and direct taxes alike have been

*Table 5. Expenditure on acquisition and acquired tangible fixed assets in Public sector (in % of Total Expenditure on acquisition and acquired tangible fixed assets)*

	2003	2004	2005	2006	2007
Expenditure on acquisition of tangible fixed assets	25.4	20.9	19.0	15.7	13.8
Acquired tangible fixed assets	24.0	19.4	18.1	12.9	10.8

Source: *Statistical Yearbook, NSI, 2009, p. 186.*

overestimated. A real danger exists that this stability might be disrupted due to recession trends in the economy through the performance of the built-in stabilizers. A number of current expenditures have been underestimated, mostly the ones in the social sphere and willingness has been demonstrated for their additional decrease in the event of unfavourable economic situation. The European practice shows that in times of crisis there is an increase in the social transfers, while every restrictive decision results in political instability.

2. The Report on the 2009 Government Budget Bill outlines four priorities in the expenditure policy. The greatest importance is attached to improving the quality of education and creating better opportunities for young families. The data about the amount and the structure of the government expenditure show that the focus is not on this priority, but on another one – the government investments in the public infrastructure actively utilizing the public-private partnership mechanisms. Given the host of unsolved institutional problems in implementing the contract system, this will most probably be a process of reverse transfer of funds from the public to the private sector with a conflicting economic and social effect, which will prolong over time.

3. Restructuring the essence of the public expenditure has not been envisaged and there are no signs suggesting an increase in the productive expenditures on investing in human resources and in the knowledge-based economy, which will play a modest role in building competitiveness. Corrections in the financing of the ongoing investment projects will be called for in the process of implementing the budget programme and this will require resources, which could be utilized to solve the tasks ensuing from the Lisbon Strategy. Postponing these decisions will slow down the convergence processes and Bulgaria's joining the European social model.

4. The assertion that Bulgaria will meet the global economic challenges in a much better condition than some other European countries is based on the standard macro indicators for fiscal stability and mostly on the existing budget surplus. There is an increase in the social and individual needs satisfied by public sector activities, which requires a sustainable increase in resources, the society earmarks for its development. Restructuring in terms of giving up inefficient expenditure and expenditures, which are not typical of the state is to be carried out simultaneously and priority should be given to channeling funds to investments in human capital and the knowledge-based economy. **VIA**