



The First in Line: Is Bulgaria Going to be the First Country Punished under the EU’s New Financial Rules and How to Avoid It

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- *The Commission is worried about the statistical performance of Bulgaria and is going to send a mission to Bulgaria to check budgetary rules and the provisions for statistical reporting*
- *The government goal of balanced budget was gradually forgotten as a “small” deficit was allowed in the 2009 budget and a similar option was envisaged for 2010 too and Bulgaria managed to quickly erode the good impression from last year.*
- *Bulgaria’s current budget methodology not just provides opportunities for the government to distort data – it stimulates the authorities to do so.*
- *As the EU has now developed much stricter rules and higher penalties, Bulgaria should be careful not to become the first country to which these measures would be applied.*

At their last meeting on the June 8, the EU finance ministers (the so-called ECOFIN Council) decided to strengthen the budgetary rules and the provisions for statistical reporting on the state budgets and the budget deficits. On the same day, the Commissioner for Economic and Monetary Affairs Olli Rehn announced that “the Commission was worried about the statistical performance of Bulgaria and was going to send a mission”. The two events are interlinked.

Strengthening of the discipline

It has been evident for years that some EU Member States manipulate the data about their budgets (some of them even became Eurozone members thanks to such tricks). At the same time, these and others Member States have had persistent budget deficits. So far the EU lacked the political will to intercept such vicious practices.

After the onset of Greece’s de facto bankruptcy and the decision for its 110 billion euro bailout, such political will gradually started to emerge. The pressure for further strengthening of the discipline increased even more after the EU Member States agreed on a 1 trillion rescue package. Going out on a limb and risking real money, the Member States now have a strong incentive to tighten the discipline, so that the Greek scenario does not repeat itself and they don’t lose this money.

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The more serious problem, however, has to do with the increase of the budget deficit. Last year the government claimed that it wanted to achieve a balanced budget and was praised by foreign media and EU institutions alike. On the whole, Bulgaria made the impression that together with Estonia it is among the most disciplined and fiscally stable Member States.

The transition from a balanced budget to a huge deficit happened in a matter of few months. This is the reason why no one can predict whether this trend will not be continued in the following months either.

The strengthening of the discipline does not only involve a stricter application of the SGP provisions on budget deficits and national debts, but also an enhanced control over the government statistics about the budget data. In order to achieve the desired effect, the European institutions will have to "play tough" and make sure that the new rules will be obeyed. In other words, they need one undisciplined Member State to use for "naming and shaming" purposes. Just as Bulgaria was the first Member State to see its allocated structural funds suspended, so it might also become the first Member State to bear the consequences of the application of the stricter fiscal rules. Unfortunately, recently Bulgaria has been giving plenty of good reasons for that.

Ambiguity coupled with an explosive deficit increase

The government has been giving out signals that came across as quite ambiguous to foreign observers. Members of the Bulgarian government (including the Prime Minister) repeatedly stated that Bulgaria has also been "lying", just like Greece. In addition to this, the government announced that it has signed contracts for over 2 billion levs, for which there is no secured funding. However, only about 660 million of the worth of these contracts was actually accounted for in the 2009 budget. Now, when you keep talking about 2 billion and you only account for one third of this sum, logically the question arises what happened to the rest and when will they be accounted for (and whether this will not result in a higher deficit).

At the end of 2009 the government assured the EU institutions and other foreign observers that we have a balanced budget for 2009. At the beginning of January a deficit of 1.9% of GDP for 2009 was indicated in the convergence program. However, the real data published in April showed a deficit of 3.9% of GDP. The country that claimed to have the best fiscal policy in the EU suddenly turned out to have not just deficit, but excessive deficit.

The more serious problem, however, has to do with the increase of the budget deficit. Last year the government claimed that it wanted to achieve a balanced budget and was praised by foreign media and EU institutions alike. On the whole, Bulgaria made the impression that together with Estonia it is among the most disciplined and fiscally stable Member States. In the case of Estonia this policy led to an entry in the Eurozone, increased foreign investment, lowering of the interest rates and a potential for a quick recovery. Bulgaria, however, managed to quickly erode the good impression from last year.

The goal of balanced budget was gradually forgotten. A "small" deficit was allowed in the 2009 budget. A similar option was envisaged for 2010 too. In the beginning of 2010, the government has already been talking about a bigger deficit. In March the budget deficit has increased dramatically and the government started to prepare "anti-crisis measures" to compensate for the gap. A decision was taken to reduce the ministries' spending first by 10% and then by 20% as a pledge for a stable budget policy. In the revised budget submitted later to the parliament however, the planned deficit reached almost 5% of GDP.

The transition from a balanced budget to a huge deficit happened in a matter of few months. This is the reason why no one can predict whether this trend will not be continued in the following months either.

The government just does not demonstrate that it can keep up its own promises in regard to the budget. But it demonstrates that very often it changes its promises – to an extent that it is difficult to trust them.

The Bulgarian and the European budget methodology

Because of these, and an array of other reasons, the government should adopt the European system of accounts (ESA95) and should publish the budget data every month.

If the European system is used, the above mentioned opportunities for budget distortion become impossible. According to the European methodology, all due sums are reported in the budget, no matter if these sums have or haven't been paid. This will also remove the stimuli of the government to delay payments to companies.

As it became clear with the budget data for 2009, Bulgaria's budget methodology can be easily manipulated – in a way that it creates a wrong representation of the budget balance. For example:

- If the government delays payments to companies, this according to Bulgaria's budget methodology brings about "improvement" of the budget.
- If a contract is signed, which commits the government to paying a certain sum, according to Bulgaria's methodology this is not reflected in the budget!
- If the government does not return the due VAT to the companies, this also distorts the picture and is registered as an improvement of the budget;
- If the National Health Insurance Fund does not pay to doctors, hospitals, pharmacies and suppliers – this also "improves" the budget according to Bulgaria's budget methodology.

What is more, Bulgaria's budget methodology not just provides opportunities for the government to distort data – it stimulates the authorities to do so. This is because by delaying one or another payment, the government may report "improvement" in the deficit. This is a problem because it gives a wrong idea for the actual state of the budget, reduces the pressure for reforms and increases the pressure for spending.

Last year and in the beginning of this year, when Bulgaria was supposed to have a balanced budget, there was a huge pressure for additional spending and the government bowed to it (trade unions, lobbyist groups, professional groups, some ministers, even the president demanded more money to be spent). If the real situation of the budget was known at the time, it would have made it much more difficult to allow pressure for additional expenditures. It would have made clear that a request for more spending would be very harmful, and alternatively, there would have been much more public pressure for cutting costs and for continuation of reforms.

Because of these, and an array of other reasons, the government should adopt the European system of accounts (ESA95) and should publish the budget data every month. If the European system is used, the above mentioned opportunities for budget distortion become impossible. According to the European methodology, all due sums are reported in the budget, no matter if these sums have or haven't been paid. This will also remove the stimuli of the government to delay payments to companies.

In addition, in the revised budget the government should plan a lower budget deficit and aim at achieving a level lower of 3% of GDP in 2010 and to balance the budget in 2011. If the current revision is adopted, with the much more increased deficit, it is highly possible that an excessive deficit procedure will be opened. The EU now developed much stricter rules and higher penalties. Bulgaria should be careful not to become the first country to which these measures would be applied.



European
Policies
Initiative

Open Society Institute – Sofia

POLICY BRIEF

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JUNE 2010

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