TAXATION IN BULGARIA

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In this set of papers we compare the fiscal systems of several European countries. This chapter is dedicated to the Bulgarian fiscal system.

We are mostly interested in four aspects of the fiscal system:

1. The structure of taxation in terms of % of GDP for various taxes and contributions;
2. The taxation structure as described by the Implicit Tax Rate (ITR) as % of taxable income on labor, capital and consumption;
3. Administrative complexity of fiscal systems in terms of bureaucratic procedures and required human resources in man-hours;
4. Level of fiscal decentralization, i.e., fiscal autonomy of local government entities with respect to the central administration.

Because of the European nature of the comparison, we mainly exploit international databases: this will enhance the homogeneity and thus the comparability of the data. There are two main sources of fiscal data for European countries:

- Eurostat, which publishes data spanning for at least a decade about tax levels, ITR levels, deficits, debt, expenditures, and much more;
- The World Bank's "Doing Business" report estimates the administrative complexity of the fiscal systems around the world.

In Bulgarian case there is no comprehensive data within the OECD database, as Bulgaria is still not a member of OECD. This means that the otherwise useful OECD data on local autonomy cannot be used for Bulgaria and we shall construct our own estimates based on Eurostat data.

Taxation: definition

Money owed to the government can be classified in a variety of ways. Usually they are classified as taxes (general taxation, such as income taxes or VAT), fees (tax for a service, such as waste disposal) and compulsory contributions (for pensions, health, etc.). In this paper we consider all of these compulsory payments to the government as taxes without distinctions.

In this paper we are mostly interested in distinguishing mainly between taxes which impinge upon consumption (indirect taxes) and labor/capital (direct taxes). Bulgarian fiscal policy is highly dependent on indirect taxation, which differs from the old EU member states where direct taxation is usually dominant. This will be shown as we explore the fiscal structure and the importance of the main sources of revenue.

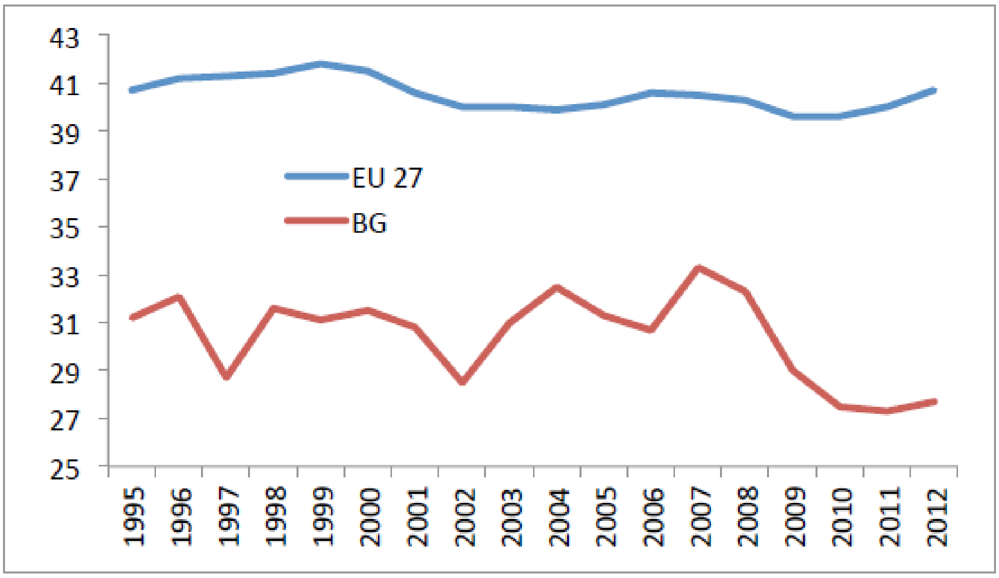
Most taxes on consumption come in the form of VAT and excise duties. Taxes on labor are retirement or unemployment or insurance contributions and personal income taxes as paid on labor income. Taxes on capital are wealth taxes, including taxes on real estate, corporate income/profit taxes, and taxes on personal income as paid on capital income. The section on Implicit Tax Rates uses Eurostat data and classification has been done by Eurostat, and is uniform across countries.

Levels of taxation

This section shows the evolution of tax receipts as a percentage of GDP in the last years. Total tax receipts, including contributions, and receipts from specific taxes such as VAT or income taxes are shown. Data are provided by Eurostat in the "Main national accounts tax aggregates" database.

Figure 1 shows the total tax receipts as percentage of GDP in Bulgaria in the last years, as compared to the average EU-27 level, as reported by Eurostat, from 1995 to 2013. Bulgaria is traditionally collecting around 1/3 of its GDP in taxes, which is far behind the average levels in the EU. After the crisis (2008-2009) tax receipts significantly decreased as a portion of GDP. This however was a macroeconomic effect, as incomes, profits and consumption suffered, while there were no taxes being lowered of any sort. In addition, after the EU accession in 2007 Bulgaria is more and more dependent on EU subsidies (mainly financing capital expenditures), thus even if tax receipts are lower, public redistribution stays relatively the same.

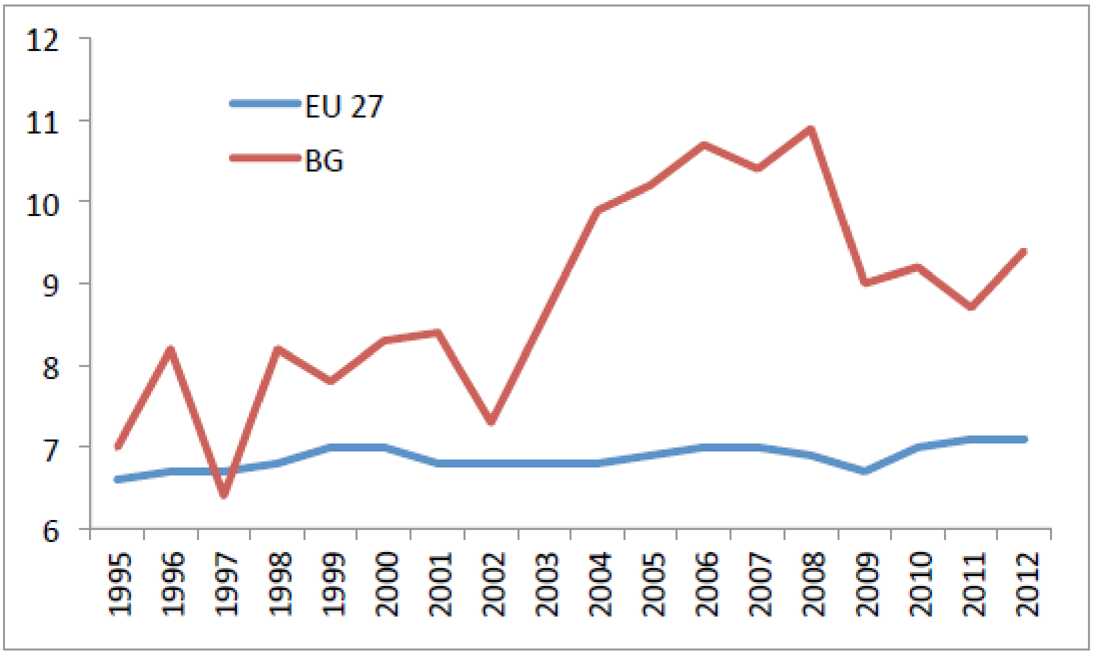
Figure 1 – Total tax receipts as % of GDP (1995 – 2012)



Source: Eurostat

Figure 2 shows VAT receipts in Bulgaria as compared to the average EU-27 level. Bulgarian tax system is mainly oriented towards taxing consumption and VAT receipts are the most important source of revenue for the budget, reaching above 10% of GDP, which is much higher than the average EU level. The effect of the crisis is clearly visible after 2008, with VAT receipts decreasing and still staying below the pre-crisis levels.

Figure 2 - VAT receipts as % of GDP (1995 - 2012)



Source: Eurostat

Figure 3 shows the importance of the excise duties for the Bulgarian budget, as receipts from excise duties are reaching more than 5% of GDP or twice as much as the average EU levels. Excise duties in Bulgaria are increasing every single year after the EU accession, mostly because of EU harmonization policies, which is supporting their upward trend when it comes to revenues as a portion of GDP.

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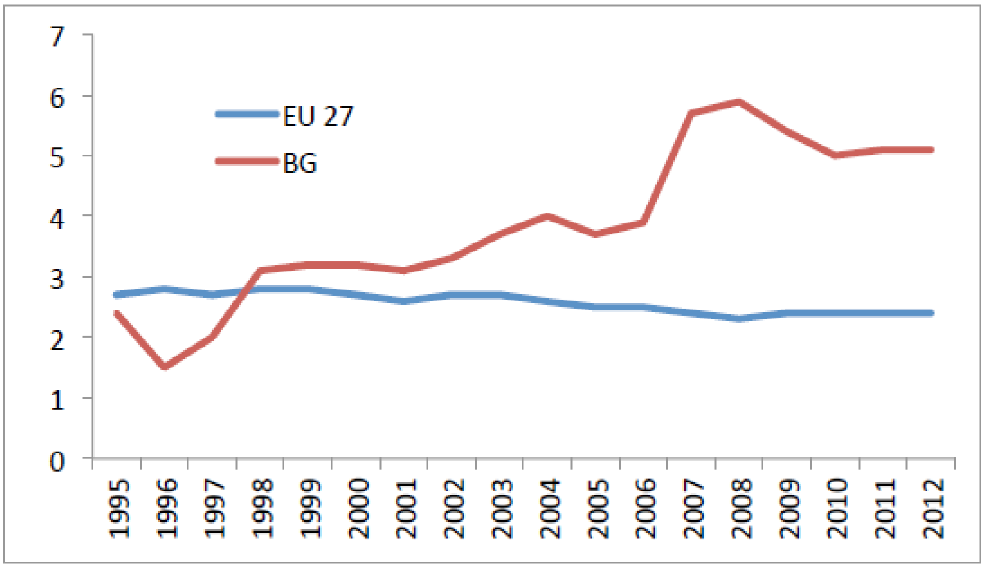
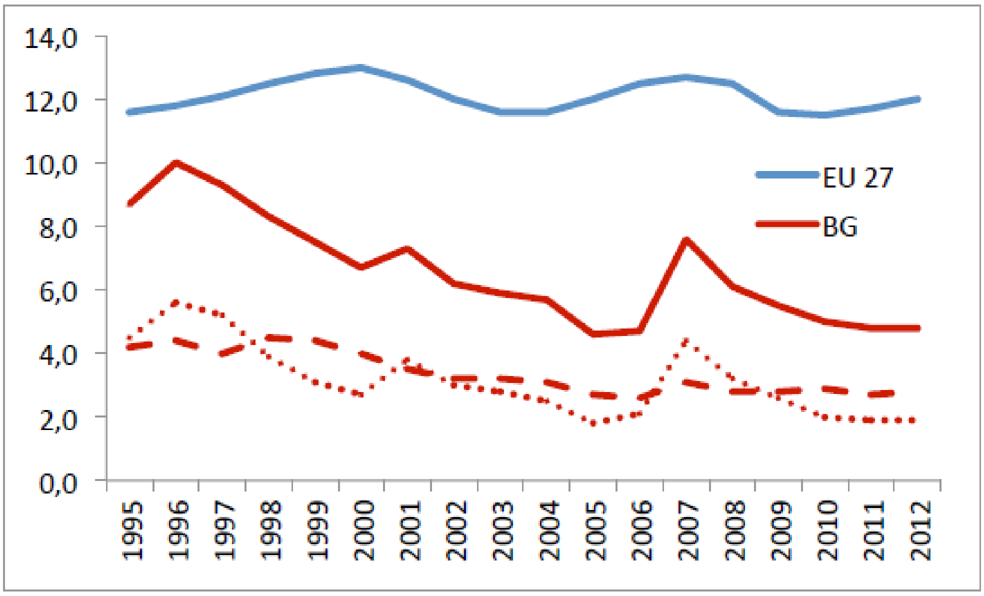
Figure 3 – Revenues from excise duties as % of GDP (1995 – 2012)



Source: Eurostat

Figures 4 shows receipts from taxes on income in Bulgaria as compared to the average EU-27 level – personal income taxes (dashed), and corporate income/profit taxes (dotted), all as fraction of GDP. Comparative personal and corporate data are not available for the EU. It is clear that the role of the income/profits taxes in Bulgaria is far below the EU average. Also the receipts from personal income taxes are relatively stable in the last 10 years, being around 3 percent of GDP, while the corporate taxes are suffering after the crisis, with profits being depressed.

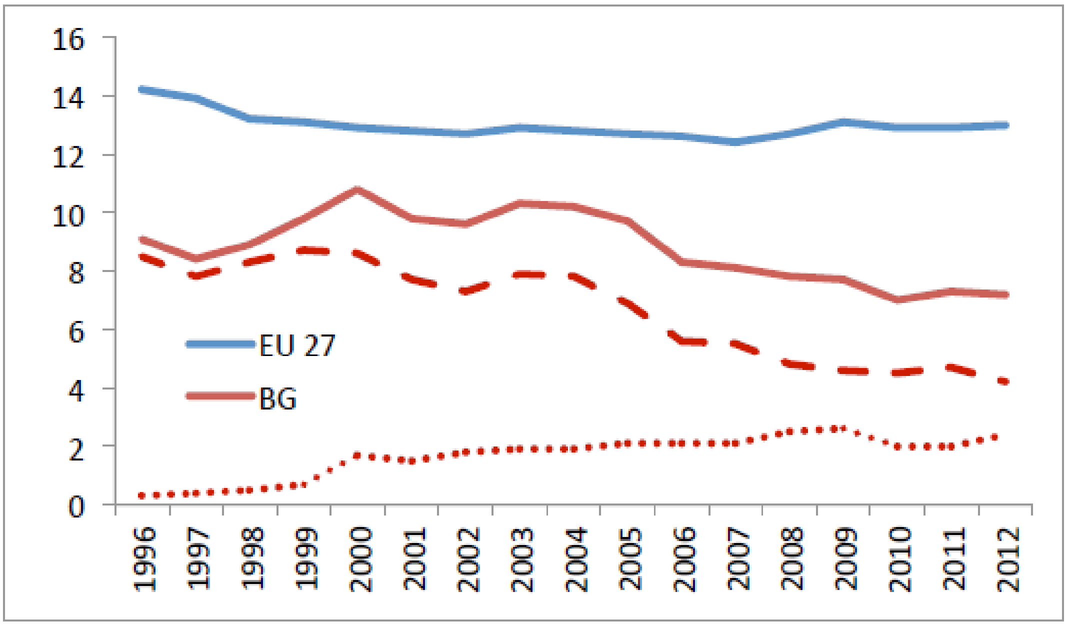
Figure 4 – Receipts from taxes on income % of GDP (1995 - 2012)



Source: Eurostat

Figure 5 shows receipts from social contributions in Bulgaria as compared to the average EU-27 level. Revenues from social contributions as portion of GDP in Bulgaria are falling in the last 10 years, staying far below the average EU levels. While it is evident that most of the contributions are paid by employers, whereas employees pay a much lower fraction of total contributions, there is a general tendency towards a balance between those two.

Figure 5 – Social contributions as % of GDP (1996 - 2012)



Source: Eurostat

The data presented here supports the argument that the fiscal policy in Bulgaria is mainly oriented towards indirect taxation or taxing consumption, that is VAT and excise duties – tax receipts from both are much higher than the EU average as compared to the GDP. On the other hand, direct taxes – income taxes and corporate taxes plus social contributions, are falling behind the EU average levels. However, these figures show tax receipts as percentage of GDP, whereas a more relevant measure of the tax burden would be to show tax receipts as percentage of the relevant tax base: what is the fraction of consumption, labor income and capital income which goes in consumption, labor or capital taxes? This is the question which Implicit Tax Rates try to answer.

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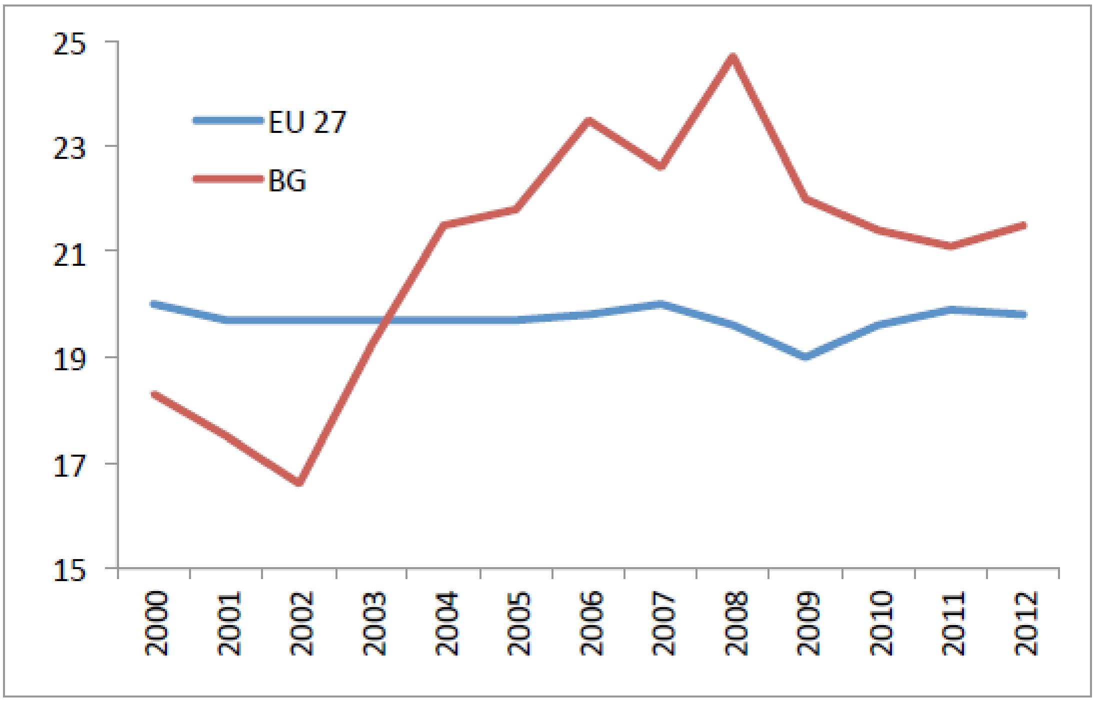
Implicit tax rates

Implicit tax rates (ITR) are provided by Eurostat for consumption, labor and capital. The relevant database is "Implicit tax rates by economic function".

ITR on consumption is the fraction of consumption expenditures which go in taxes. ITR on labor is the fraction of labor income which is owed to the government. And finally, ITR on capital is the fraction of capital income which goes in taxes. Unfortunately there is no data for ITR on capital for Bulgaria, thus we will focus on consumption and labor.

The ITR on consumption in Bulgaria is above the EU average since 2003, as shown on Figure 6. The gap was wider before the crisis (2008), but after that the ITR on consumption in Bulgaria decreased. Obviously the data for Bulgaria is much more volatile and dependent on the economic cycle than the EU average.

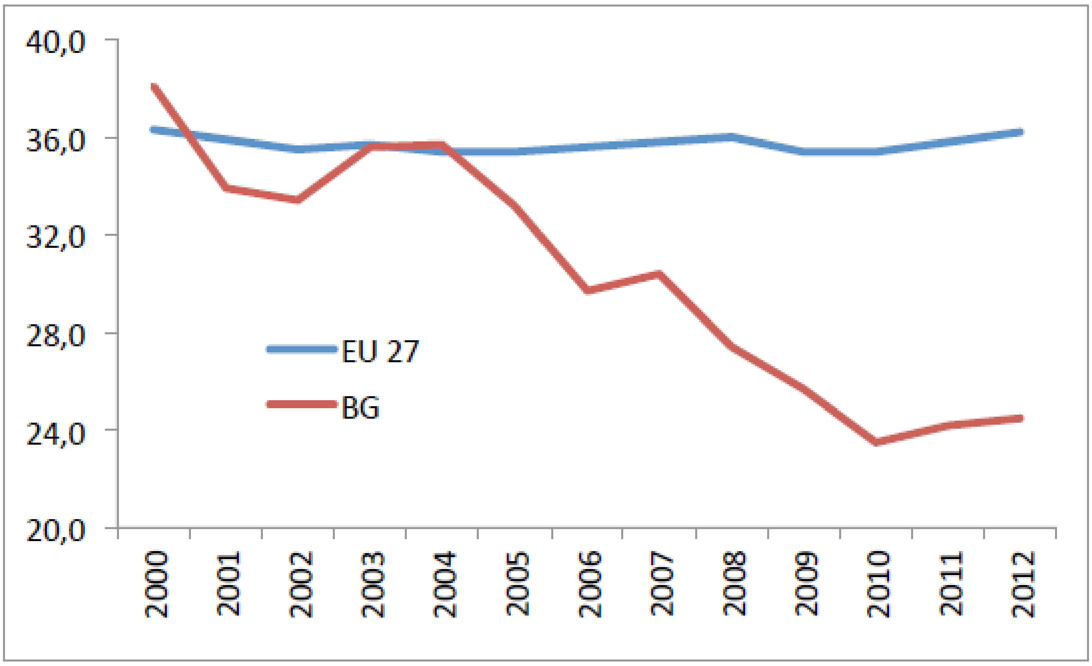
Figure 6 - ITR on consumption (2000 - 2012)



Source: Eurostat

The ITR on labor in Bulgaria is decreasing in the last more than 10 years and is far below the EU average as shown on Figure 7. Again this proves that the Bulgarian tax system was severely restructured in the beginning of the century and at present is mainly oriented towards taxing consumption, while taxation on labor and also capital is of less importance.

Figure 7 - ITR on labour (2000 - 2012)



Source: Eurostat

Administrative burden of fiscal procedures

The additional costs incurred by corporations and households because of tax receipts are not the only costs related to the fiscal systems. Paying taxes takes time, requires a certain number of administrative procedures, and may require additional resources, such as those incurred to have the services of accountants.

Especially for small firms, huge fixed costs incurred in the process of paying taxes may be a severe obstacle to efficiency and competitiveness. Given the large number of small enterprises in the Bulgarian economy, the potential costs are significant. Such additional cost (administrative burden) usually leads to corruption.

Table 1 shows the World Bank's Doing Business data on Bulgaria regarding the subfield of the index called Paying Taxes. The Doing Business index ranks economies against several dimensions related to public policies and services related to the quality of the environment in which businesses operate. The “Paying Taxes” sub-index is of course mostly interested in the fiscal system as it applies to corporations.

Table 1 – Paying Taxes, Bulgaria (Doing Business report)

Country	Ranking	Procedures	Time	Total Tax Rate
Bulgaria	81°	13	454	27,7
OECD High Income	-	12	175	41,3

Source: Doing Business 2014

While the total tax rate is lower than the OECD high income countries and the number of procedures seems to be almost the same, Bulgaria is facing serious problems in actual time spent to comply with administration. This is the main problem as it comes to operating business in Bulgaria – taxes may be low and administrative procedure may be adequate on paper, but in practice it takes too much effort and time to comply with the rules, meaning that it is most costly that first appears. This leads to corruption and undermines competitiveness.

Taxation and federalism

Governments are divided in levels, which is important to note when one is investigating the fiscal policy of a particular country. In Bulgaria (politically and administratively) there are three main levels: central government, districts and municipalities. However, from pure fiscal point of view there are just two main levels: central government and municipalities or local budgets.

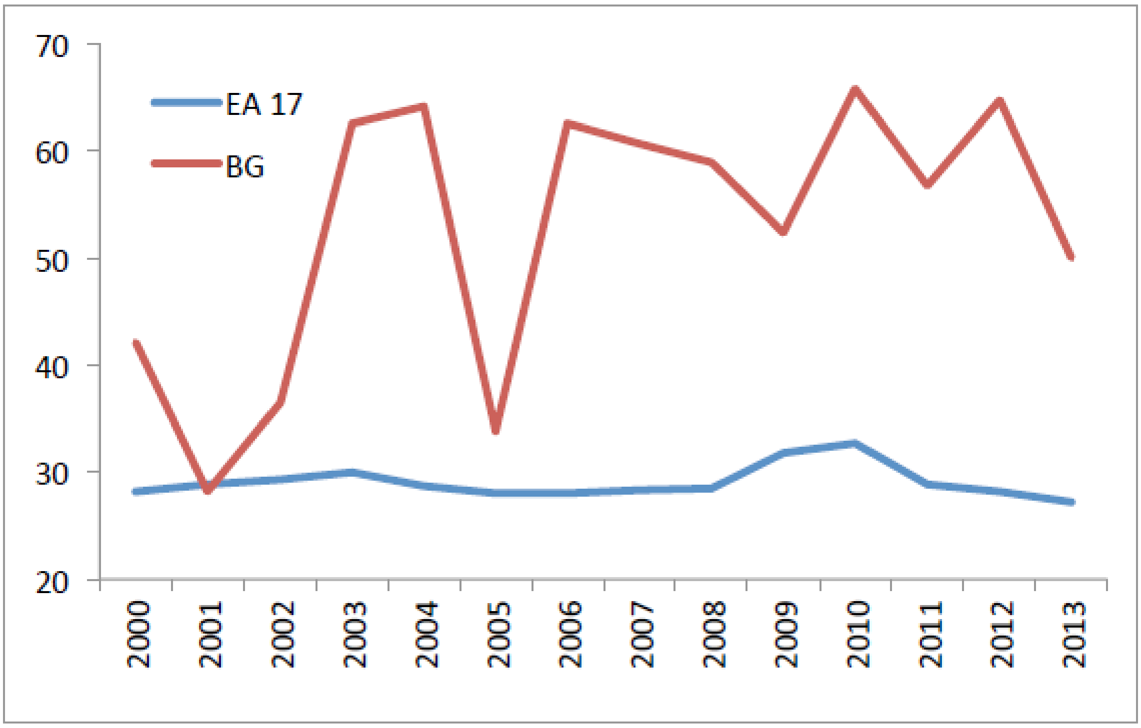
Local governments (municipalities in Bulgarian case) may be more or less autonomous, and this will influence their behavior: the more they are autonomous, in that local expenditures are met by local taxes, the more local voters will be interested in efficient and thrifty local institutions; the less they are autonomous, the less incentives the voters will have to check the inefficiencies of local governments, which will prefer to use public expenditures to obtain more votes at no cost for local tax-payers. The end result at the aggregate level of these incentives may be a bloated and inefficient public sector.

In simple words, funding local governments with centrally-originated transfers will create moral hazard, shifting the costs of public expenditures at the local level to the general tax-payer. In addition this leads to a dependency of the local budget and breaks the link between the local economy (employment, investments, etc.) and the local budget. This creates the wrong incentives, as local authorities are focused on getting more transfers, and not creating better business environment or attracting investors. In Bulgaria this is exactly the case, as municipalities are mainly focused on absorbing EU subsidies and not so much concerned with the problems of the local economies.

The OECD database cannot be use to determine the autonomy of the local budgets in Bulgaria, as Bulgaria is not a member of OECD and there is no comparative data. Nevertheless we can use the Eurostat data to compose a fiscal autonomy index that is comparative and gives the general picture.

Central, state and local governments and social security funds are called S1311, S1312, S1313 and S1314 in the Eurostat database. An approximate index of fiscal autonomy of the local governments can be computed as the ratio of the sum of capital and current transfers from the central to the local governments and the expenditures of the local governments. Despite the limitations of the index, as moral hazard may depend more on the rules behind transfers than to the aggregate level of handouts, such an index is far better than nothing in assessing the "federalism" of government expenditures and tax receipts.

Figure 8 – Fiscal autonomy index (Bulgaria & EA 17, 2000 - 2013)



Source: Eurostat

The figure shows that fiscal transfers to local governments in Bulgaria represent more than 50% of local expenditures, thus the budgets of the municipalities in Bulgaria are highly dependent of the central government and not of the local taxpayers. There is also a huge gap between the EU average levels and the reality in Bulgaria, meaning that the dependence of the local budgets shall be cut by half in order to achieve EU levels. This means restructuring of tax policy and shifting direct taxation to the municipalities – something that is currently debated in Bulgaria.

Conclusion

Bulgarian fiscal system was seriously restructured in the beginning of the new millennium, following deep crisis and hyperinflation in the late 90s. In last 10 years, Bulgarian fiscal system is characterized by a few main features:

- ✓ Government redistribution (as shown by the total tax receipts) is below the EU average and in recent year the budget (mainly capital expenses) is getting more and more dependent on EU transfers;
- ✓ Bulgarian fiscal system is mainly oriented towards indirect taxes (taxing consumption), with revenues from VAT and excise duties being far above the EU average;
- ✓ Direct taxes in Bulgaria (income and profits) are relatively low compared to the EU average levels and don't play a significant role as it comes to tax receipts;
- ✓ Social contributions are the dominant burden on personal income in Bulgaria, with contributions paid by the employer still being higher than those paid by the employee;
- ✓ The data on the ITR shows that while the burden on consumption and labor in Bulgaria is relatively the same in the last years, there is a big difference compared to the EU average – ITR on labor in EU-27 is almost twice as high as the ITR on consumption;
- ✓ While the tax burden on business seems to be relatively low on paper (as tax levels and official procedures), the time needed to comply with the administrative rules in Bulgaria is really high, as shown by the Doing Business reports, meaning that there is a huge administrative cost and corruption;
- ✓ The fiscal autonomy on municipalities (local budgets) in Bulgaria is very low compared to the EU average levels, which creates dependency and moral hazard on the expenditure side.

We may conclude that while the fiscal system may seem to be in good shape – mainly because of the low taxes on income and profits, Bulgarian fiscal system faces serious challenges. Whatever the view on the tax system – direct versus indirect taxation, Bulgaria needs to restructure its fiscal system towards greater autonomy of local budgets (probably through directs taxation) and also ease the administrative environment, which is the main burden on businesses.

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