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PROBLEMS AND PERSPECTIVES OF FISCAL SECTOR IN BULGARIA

The article presents an analysis on the budget balance as a key indicator of the fiscal sector processes. The text considers different techniques for its funding - from the fiscal reserve and via government debt. Total government revenues and expenditures, with their respective structure and trend patterns, are revealed as determinants of the budget balance. It is on this basis that major problems in the formation of government revenues and expenditures, which illustrate the dynamics of the budget balance, are highlighted. The structure of public budgets is a focal point in the analysis, which helps elaborate on factors generating surpluses (government budget and relations with the EU) and deficits - the municipal and social security sectors. This perspective allows us to consider the total budget deficit as a result of the inability of government budget deficits and relations with the EU to cover the deficits of municipalities and social security. Finally the analysis concentrates on the structure and current issues with tax revenues. The economic effects of income taxes are brought to the fore, as it is believed that they directly affect economic activity and economic growth. A strategy presenting a step by step solution to the issues discussed throughout the analysis of the fiscal sector is put forth.

JEL: E62; G17; H20

The fiscal sector is fundamental to the interests of the state. Under the Currency Board it is a core instrument for managing the economy within the framework of the Stability and Growth Pact and the Law on Public Finance (to enter into force in the beginning of 2014). The fiscal sector, which has so far been able to successfully guarantee financial stability, is now being pressured from various parties: from the population - for raising salaries, pensions and compensation; from businesses - for reducing the social security tax incidence and for timely payments for programs and state orders; from the European Union - for contract compliance and maintaining financial stability. The development of both the Bulgarian economy and society in the near future is highly dependent on handling the various challenges in the fiscal sector.

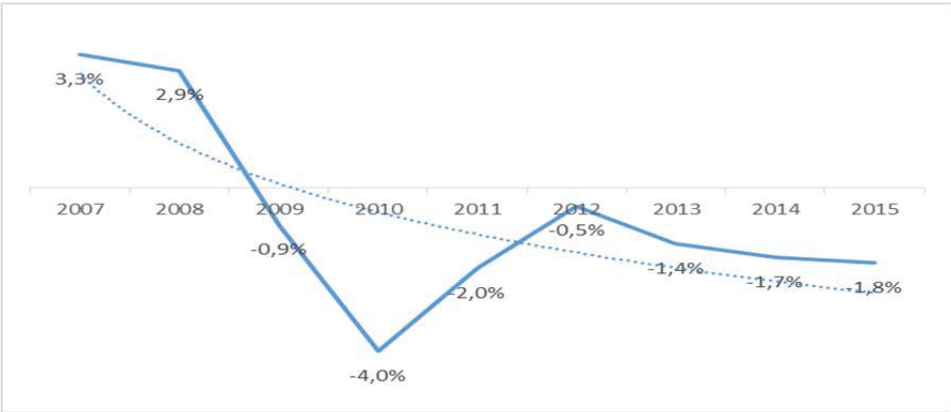
Budget Balance, Fiscal Reserve and Government Debt

The budget balance, which is a key indicator for processes in the fiscal sector, is essentially an outcome of the objective economic and social prerequisites of the Bulgarian economy and of the fiscal policy under way. Its dynamics for the 6-year retrospective period of 2007- 2012 outlines a negative general tendency — from a record high surplus in 2007 (3.3% of GDP) it edged down to 2.9% in 2008, only to become a growing deficit in the following 2009 and to reach -4.0% of GDP at the end of 2010, which exceeds the -3.0% threshold under the Maastricht Treaty and the Stability and Growth Pact by one third. In 2011 the deficit was lowered to -

2.1%, while at the end of last year it was merely -0.5% of GDP (fig. 1), which in absolute terms corresponds to an excess of government expenditures over government revenues of a little over 350 billion BGN.[1]

Figure 1

Budget Balance Dynamics 2007 - 2015 (in % of GDP)



Source: NSI, MF, forecast 2013 – 2015

In 2008 the growth phase of the global economic cycle, driven by bank credits and investment in real estate, which in Bulgaria led to real economic growth of over 6% per year[2], reached its end. The conclusion of the growth phase also terminated the ongoing, at the time, (passive) fiscal policy in Bulgaria of - growing budget surpluses (under the gradual decrease of the tax contribution rate), weak control over tax collection, growing fiscal reserve and decreasing government debt and rapidly growing government expenditures. Unfortunately neither the favorable development in both the world and European economies until the financial crisis outburst, nor the considerable resources controlled by the Bulgarian government were utilized for structural reforms in: the public administration, infrastructure, business environment, education, healthcare, energy and some sectors of the economy. Such resources were not used even for the complete repayment of the government debt, which could have potentially led to a more flexible fiscal policy in times of harsher economic periods.

Such periods occurred in 2009 when the decline in GDP of -5.5%, followed by an average annual real growth in the economy of less than 1% until the end of 2012 necessitated that the management of budget deficits be used as a key

[1] National Statistical Institute (Gross Domestic Product), Ministry of Finance (Consolidated Financial Programme), personal calculations.
[2] Euros/tat, Real GDP Growth Rate.

element in fiscal policy. The abrupt start of the unfavorable deficit trend was reflected on expenditures set out in 2009 for raising pensions, payment for non-critical investments in the energy sector and for substantial production of expensive electricity from renewable resources. These investments became payable from 2010 onwards and contributed to a -4% budget deficit.

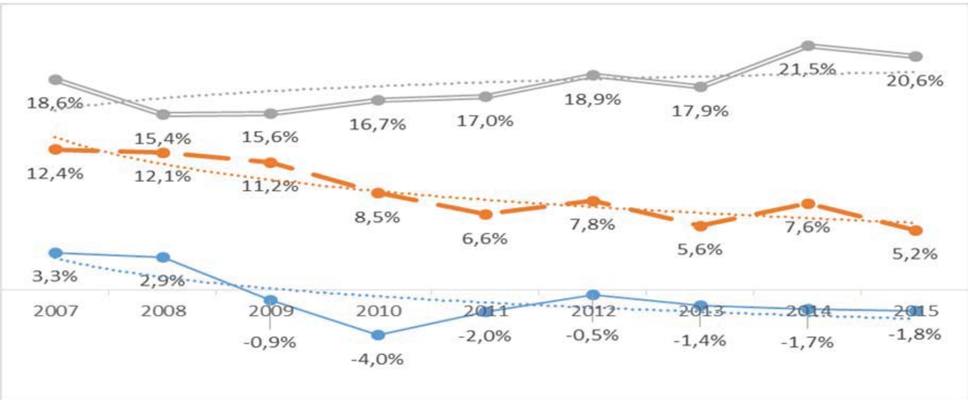
The fiscal policy from the past two years has soundly been concentrating on lowering and funding these deficits. The financial potential of the country was mobilized for that purpose, which included even the reserve of the National Health Insurance Fund, which was nationalized in the Law on the State Budget of the Republic of Bulgaria. New external debt was successfully issued at low cost with which older commitments were to be served, resources which were previously unavailable to the state.

The increase in expenditures at the end of 2009 and the consequent expenditures for covering budget deficits for the years 2010 and 2011 effectively lowered the level of fiscal reserves. After its record high of 12 billion BGN (in October 2008) the fiscal reserve started dropping. Following 2011 it was lastingly oriented towards a minimum threshold of the fiscal reserve of 4.5 billion BGN, despite certain partial drops below that value; in the cases when the fiscal reserve served as a temporary depot for newly issued government debt it slightly exceeded that minimum.[3]

Negative trends in the dynamics of the budget balance (the lowest curve in Fig. 2) and in the fiscal reserve (middle curve), which partially offset the economic consequences of the financial crisis in Bulgaria, are accompanied by a trend for increasing the government debt (the upper curve).

Figure 2

Budget balance, fiscal reserve and government debt 2007 - 2015 (in % of GDP)



Source: NSI, MF, forecast 2013 – 2015.

[3] Ministry of Finance (Fiscal Reserve).

The trend of increasing government debt is also unfavorable, despite its level being far lower than the threshold of 60% of GDP. This indebtedness is associated neither with a pronounced rise in GDP, nor with development of structural and capital potential, which normally ensure a more formidable future growth. Establishing modern road infrastructure is by itself a sound economic policy, but it is merely one element of the business environment, along with the high level of corruption, inefficient justice system, lower qualification of labor resources, political and legal unpredictability and others. Despite the fact that road infrastructure is being improved, Bulgarian economic growth is seriously obstructed in the long-run due to the lack of practically applicable consistent strategies for economic growth, upon which the potential of the nation could be built. On the other hand, under the currency board arrangement the risk of greater sovereign indebtedness is prone to be higher. This also contributes to the negative assessment of the policy for gradual increase in the internal and external government debt.

Although the relative share of government debt in GDP in 2007 is comparable to that from 2012, in absolute terms in 2012 it was more than 3.5 billion BGN greater than the respective value at the beginning of the period. In 2008 government debt retreated with about 0.5 billion BGN. Throughout 2009 this level was maintained, however the following years saw a steady advance in its level - with an average annual increase of 1 billion BGN, reaching 14.7 billion BGN in 2012.[4]

The protests from the beginning of 2013 are often concentrated on payment requests from the state and present a challenge to the current fiscal policy. In practice, however, the challenge is far greater as firstly the prospects for growth in the Bulgarian economy by 2015 are quite bleak,[5] and secondly - the expenditures have already been generously planned — for instance in Budget 2013 they increase with roughly 11% against their growth of 4% for the past three years, while their respective budget deficit has been planned at a level of -1.4% of GDP, which was -0.5% in 2012.

There are two possible scenarios for the development of the budgetary expenditures by 2015. The first one (the populistic one) envisages a substantial increase in public spending in response to people’s requests. Such an increase, however, would not be backed up by a respective growth in government revenues. Considering the structure of the Bulgarian economy this outcome would be achievable only by means of raising the tax burden. Such course of action is highly unlikely in a situation of permanent protests, given that the population will effectively bear the tax burden. Thus government expenditures may grow only at the expense of increasing budget deficits (beyond the 3% threshold set in the Maastricht Treaty and the Stability and Growth Pact), which on their part may be funded solely by further expanding the government debt. A trade-off between the

[4] Ministry of Finance (Annual Review of Government Debt).
[5] Ganev, 2013, p. 15.

low indebtedness of the state and the related financial stability would either breach, or change the Law on Public Finance, which foresees a 2% threshold for government debt[6], it would also trigger an excessive deficit procedure against Bulgaria on the part of the European Commission, it would raise the price of the external Bulgarian deficit, could potentially lead to realizing accumulated negative potentials in the economy (such as intra-firm indebtedness) and would lead to the return of the International Monetary Fund in the Bulgarian fiscal policy. In general, one simply cannot claim that by granting money to those who need it the situation of the Bulgarian economy would be improved. Only when applied to appropriate investments, rather than consumption, would policies on public expenditures be truly successful in achieving rapid economic growth, contracting unemployment etc.

The other, constructive scenario, supported herein (see Figure 1 and 2), anticipates retaining expenditures and budget deficit to the 2% threshold envisaged by the Law on Public Finance, and initiating the necessary structural reforms even in today's much more unfavorable conditions. Measures for increasing government revenues based on current tax sizes are included in the fiscal policy sector. Some steps towards enhancing tax collection have already been taken by creating electronic links between companies and the National Revenue Agency (NRA), trying to heighten the revenue administration's control, gradually refining the substantive and procedural tax and social security legislation, as well as through reforms in the NRA and the Customs Agency which are already under way. These measures can be successful only if they are supported by the political will to include all persons liable for levies in bearing their burden. On the other hand, measures for enhancing the efficiency, control and transparency in utilizing public revenues are also necessary. Some increase in public debt is likely to occur in this scenario with respect to the forecast horizon, however, long-term policy ought to be optimally conservative.

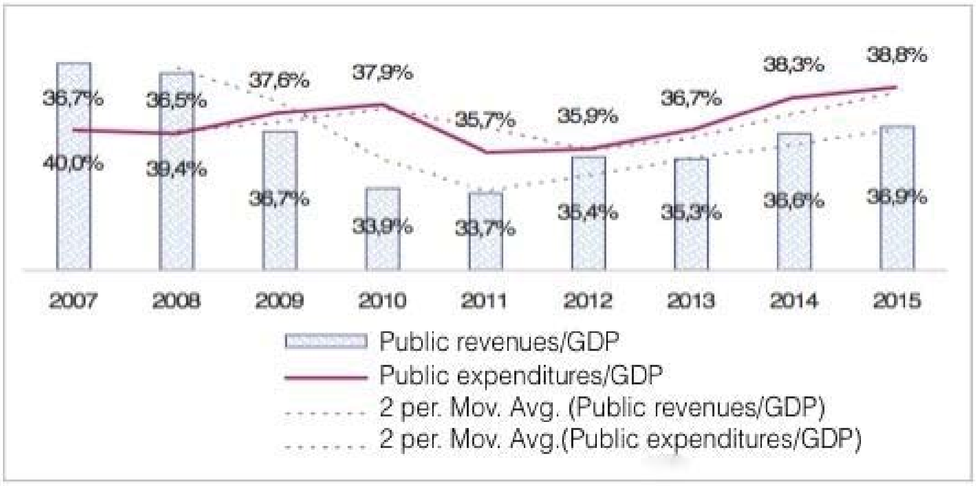
Size and Structure of Total Public Revenues and Expenditures

The economic consequences of the global financial crisis manifest in the fiscal sector in the form of plummeting *public revenues*, which fall from 40% of GDP at the beginning of the period to 33.7% in 2011, and afterwards mark a tendency for growth, which is expected to continue until the end of the forecast horizon, reaching 37% of GDP in 2015 (see fig. 3). In absolute terms public revenues advanced from 24 billion BGN in 2007 to approximately 27.5 billion BGN in 2012, which indicates a growth of 15%, corresponding to an average annual rate of 2.7%.

[6] Law on Public Finance, art. 27 (4).

Figure 3

Redistribution of the government budget 2007 - 2015 (in % of GDP)



Source: NSI, MF, forecast 2013 – 2015

Public expenditures are as a general rule more conservative than public revenues, as they are the result of political, social and contractual commitments of the state, and unlike public revenues they do not result primarily from the economic situation (levels of consumption, import, profits, income, and others). This peculiarity manifests in a non-monotonous contraction of the relative share of public revenues in GDP up to around 34% for 2011 and its gradual increase, which is expected to reach 39% of GDP. In absolute terms expenditures grew from 22 billion BGN in 2007 to 27.8 billion BGN in 2012, i.e. by around 26%, which corresponds to an average annual rate of 4.7%.[7]

The policy of growing budget redistribution will continue in the years to come, and the relative share of public revenues will permanently exceed the relative share of public expenditures in GDP.

In the structure of expenditures on the Consolidated Fiscal Program (CFP) for the last year one may distinguish the huge share of expenditures for social security (43%), which has seen an increase (see the arrow in Table 1) of a staggering 8 percentage points (p.p.) since 2007. In 2012 these expenditures were 2.3 times higher than those for salaries in the state, the relative share of which has not changed, and were 2.7 times higher than the allowance expenditures, with a relative share dipping by 4 p.p. from the respective expenditures six years ago. The decline in the

[7] National Statistical Institute (Gross Domestic Product), Ministry of Finance (Consolidated Fiscal Programme), personal calculations.

share of capital expenditures of -4% p.p. from its before-crisis level in 2007 is quite disturbing, in 2012 it was merely 13% from the total state expenditures. The maintained low level of the relative share of subsidies (4%) and interest rates (2%)[8] in 2012, however, is favorable.

Table 1

Relative share of public expenditures by type for 2012 (in %) and change since 2007 (in p.p.)

	Salaries	**Allowance**	**Subsidies**	**Interest**	**Social security**	**Capital expenditures**	**EU installment**
2012	19%	16%	4%	2%	43%	13%	3%
Change since 2007	0%	-4%	1%	-1%	8%	-4%	0%

Source: MF.

The distribution of expenditures by type is conservative and cannot be drastically changed from one period to another. The current distribution is the result of respective distributions from previous periods, the state, prospects and structure of the expenditures as well as of the expenditure policy priorities. Table 1 reveals its major limitations and potentials. The *growing expenditures for social security, which also present a limitation to all other priorities*, are a core determinant in this policy. They ought to be realized with a little over half of the expenditures earmarked for government spending. However, expenditure policy prospects are too limited due to an expected increase in the relative share of expenditures for social security, the cause of which includes: the unfavorable demographic situation, emigration, the low level of pensions and the electoral potential of retirees, growing unemployment and others.

Maintaining the relative share of expenditures for salaries at a level of around 20% would be regarded as successful, especially considering the requests for their increase, which would only be possible if the level of state administration were reduced. Taking into account the fact that such intentions are regularly articulated but never actually carried out, does not give any rise for hope that this will happen in the future, especially with the current level of unemployment and the not so favorable prospects for its contraction.

The share of allowance expenditures in 2012 has lost ground compared to its levels of 2007 and reveals one of the potentials for public expenditure restructuring. Some necessary steps towards its realization include the completion of the privatisation process as well as an increase in control and introduction of new technologies.

The fiscal policy of transferring economic problems to the future is implemented not only in line with the growing government debt (see above), but also in the form

[8] Ministry of Finance (Consolidated Fiscal Programme).

of contracted share of investment expenditures, which consequently leads to a shrinkage in the future economic growth basis. In 2012 the share of government and municipal expenditures for investment and current consumption were respectively 23% and 77% of total expenditures (table 2). This translates to an expansion of the relative share of consumption (and a decrease in the relative share of investment) with 3 p.p. for the government, and for municipalities - to a consumption expansion (decrease in investment) with a little over 5 p.p.[9]

Table 2

Share of current and capital expenditures for 2012 (in %)
and change since 2007 (in p.p.)

	Current expenditures - government	**Capital expenditures - government**	**Current expenditures - municipalities**	**Capital expenditures - municipalities**
2012	77,3%	22,7%	77,2%	22,8%
Change since 2007	3,1%	-3,1%	5,4%	-5,4%

Source. MF.

The sole way to overcome the complex problems of the Bulgarian economy is to achieve rapid economic growth while maintaining its financial stability, and investments are a key tool in this process. A rather negative fact is that at the end of 2012 under the budgetary framework of over 9.4 billion EUR of European funds (including investments) the share of both government and municipal investments fell compared to the accession year, during which such generous opportunities did not exist. In practice the utilized European funds at the end of 2012 were a little over 30% of the budgetary framework, which supports this conclusion.[10]

The structure of public revenues is highly dependent on the structure and dimensions of the levies, as well as the opportunities for utilizing European funds. The taxation policy during the retrospective period was conservative despite the annual (mainly technical) changes in the laws on taxes and securities and the revenue structure was stable. In 2012 the tax system provided more than half of all revenues (58%), despite a slight decline of 2 p.p. in its share relative to 2007, while the social security system provided 20% of revenues. Non-tax revenues and allowances (mainly from the EU) made up approximately 20% of total revenues, the share of the former edged down by 2 p.p., while the latter advanced with 4 p.p.

[9] Ministry of Finance (Central Government and Local Budgets).
[10] Ministry of Finance (Consolidated Fiscal Program) and EU Structural Funds (Operational Programs Implementation).

Table 3

Relative share of public revenues by type for 2012 (in %) and change since 2007 (in p.p.)

	Taxes	Securities	Non-tax revenues	EU allowances
2012	58%	20%	13%	9%
Change since 2007	-2%	0%	-2%	4%

Source. MF.

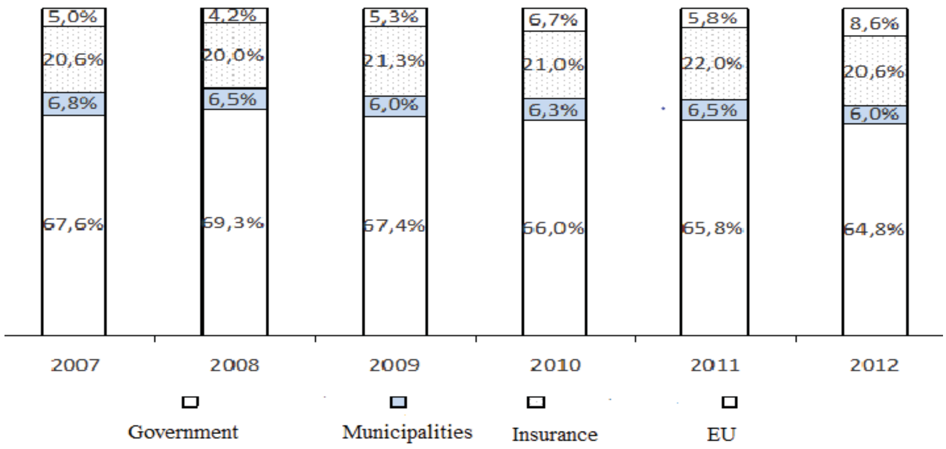
The share of security revenues is sound, as they are due under labour and civil contracts.[11] In the year of accession, allowances (mainly from the EU) were relatively low. By 2012 they doubled, reaching the not particularly significant 2.3 billion BGN, which roughly doubled their share in total revenues (from about 5% to approximately 9%), which was at the expense of the share of tax and non-tax revenues.

Budget Structure Analysis

The development of the budget structure is a central tendency in the fiscal sector, reflected in the dynamics of the shares of the government, the municipal sector (municipalities), the sector of social care and financial relations with the EU in total revenues and expenditures

Figure 4

Revenue structure – government, municipalities, social security, EU 2007-2012 (% of the total state revenue)



Source. Ministry of Finance.

[11] Ministry of Finance (Social Securities).

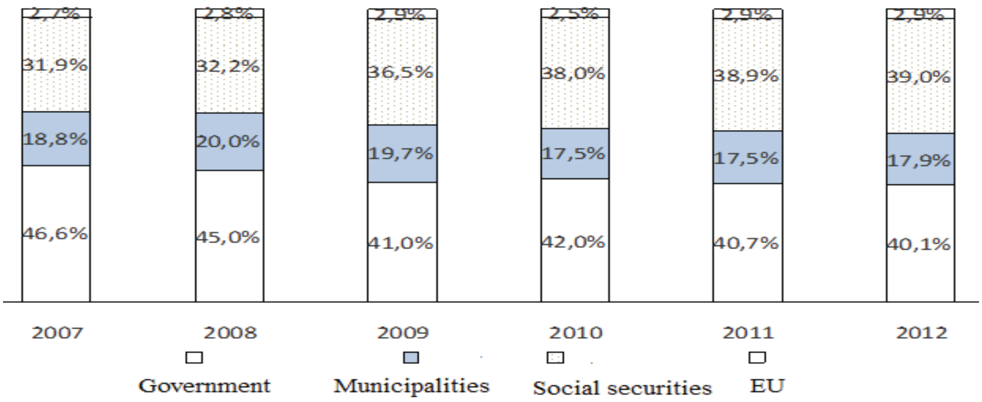
The total state revenues in 2012 are contributed by the government with approximately 65%, municipalities – only 6%, social security – slightly less than 21%, EU aids - less than 9% (see fig.4). Although this structure is comparatively stable, it clearly presents a tendency for decreasing the government contribution and increasing the EU share in relation to state financing. The municipal contribution share is observed to be constantly low.

During this period the government revenue was increased by 11%, social security – by 14%, EU aid – by 85%, whereas the municipal revenue has risen only by 3%.[12]

Given that EU aids result largely from government ordinances, the above-mentioned structure and dynamics give a notion about a sustainable centralized structure of public revenues which gives the government power related to their distribution. Although local authority (municipal councils and the mayor) is elected by the sovereign, it does not have any strong economic management basis, which is independent from the government. The fiscal decentralization which was widely proclaimed over the past ten years has not happened yet, nor is there any even slight tendency for implementing it. Revenue structure did not change even in 2008 when the patent tax was introduced and municipalities increased their right in collecting and determining the amount of local taxes and fees. The municipalities' own revenues previously and currently are too insignificant.

Figure 5

Expenditures structure – government, municipalities, social security, EU 2007-2012 (% of the total state expenditures)



Source. Ministry of Finance.

In 2012 the government implemented only 40% of the state expenditures, i.e. far less than a half, despite the conducted national domestic and foreign policy, and

[12] Ministry of Finance (Data from consolidated fiscal program)

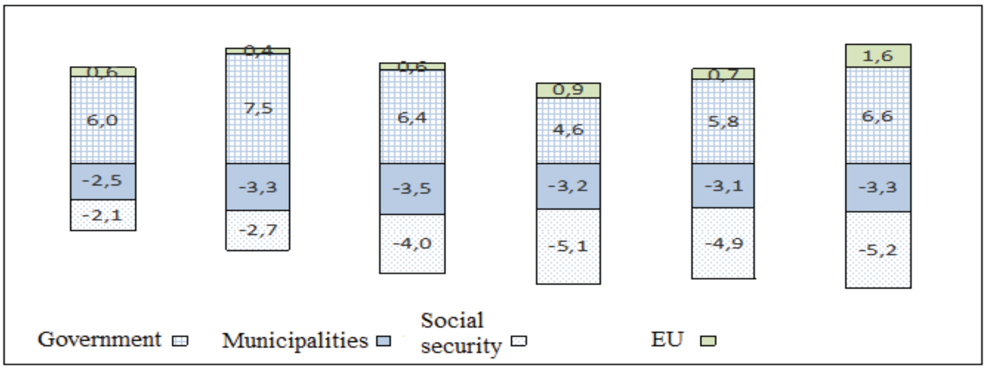
although that it is expected to improve the welfare of citizens (Fig. 5). The share of expenditure on social security and welfare is only about 1 percent lower than that of the government, although the social security revenue as a part of the total revenue is more than three times lower. Similarly, the share of municipal expenditures is also around 3 times higher (18%) than its revenue share. The share of Bulgaria's contribution to the EU budget is less than 3%, i.e. about 3 times lower than the share of revenue from EU aids.

Significant trends are observed in the dynamics of the expenditures structure of government, municipalities, social security and the EU compared to those revealed in revenue structure. The share of government spending declined by 4.5%, that of municipalities around – 1%, while the share of social security increased slightly above 7%. While the social security expenditures in 2007 were just over BGN 7 billion, up to current 2012 they are slightly above BGN 10.8 billion, i.e. for a period of six years they have increased 54% which corresponds to an average annual rate of 9% (given that growth rate of the revenue from social security is less than 3% annually)[13]. *This highly intensive growth of social security spending combined with their multi-billion dollar amount represents the greatest threat and challenge to the fiscal policy in Bulgaria.* Moreover, these expenditures actively deprive the state of resources for conducting other policies. Each attempt to increase pensions, maternity and unemployment benefits, etc., which is not preceded by measures to increase revenues of the social security system will further reduce the already limited chances of achieving significant economic growth and wealth in Bulgaria.

The aggregate effect of the above trends leads to the following picture of the balance of the four major fiscal institutions in the country (Fig. 6).

Figure 6

Structure of annual balances – government, municipalities, social security and EU aids 2007-2012 (billion lv)



Source. Ministry of Finance.

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[13] Ministry of Finance (Data from consolidated fiscal program).

Increasing surplus of the government and those of financial relations between Bulgaria and the EU funded billions chronic deficits of the sector of municipalities and social security. Since 2009 the surplus, despite growing, has been insufficient to finance the constant deficit of the municipal sector (average for the period BGN -3.2 billion) and actively growing deficit (1.5 times more) of social security draws up fiscal reserves (which potential is already exhausted) and growing government debt. Possible policy options for this unfavorable trend are grouped in two scenarios.

Scenario of public interest is associated with an increase in the expenditures of the insurance sector in response to public demands and continuing the policy "carrot and stick" to the municipalities at the expense of increasing debt, thus postponing solutions of the problem in the future.

Constructive scenario requires synchronized fiscal policy, unpopular and difficult reforms conducted in hostile environment. Firstly, a reform in the social security system that affects both revenues and expenditures must be made in order to limit the growing deficits which are generated chronically. The first step is to make an obstruction of "leakage" associated with disabled persons, to review early retirement, to gradually equalize the retirement age between men and women, to increase the retirement age and to lower the administrative costs. In case it is unavoidable, the social security contributions should be gradually increased. If these steps are integrated in a common strategy it will limit deficits and release available resources to pursue structural reforms. A consensus is required on the degree of decentralization of the municipal sector and its eventual support with adequate own revenues. A solid administrative reform is required, associated with a decrease in the number of employees and an increase in their salary, professional requirements and control over it. Hence if it is impossible to reduce the share of expenditures for salaries, the reform should be at least neutral thereto. A tax system reform is required, preserving the burden and improving its economic effects.

Tax revenues and economic effect

Tax revenue structure in 2012 shows the share of indirect taxes (VAT and excise duties) about 70% of tax revenue (Table 4), while income taxes cover about 24%. Customs duties and other (including all local taxes) remain at 7%. This structure has been relatively stable over the period since 2007. At the beginning it indicates shrinking the share of VAT - around 1% at the expense of an increase in excise duties with slightly more than 2%, as well as diminishing the share of taxes on profits – above 3% and simultaneously raising the share of personal income taxes with 2%.[14]

[14] Ministry of Finance (Data from consolidated fiscal program).

Table 4

Share of state revenue by type 2012 (%) and change from 2007 (%)

	Tax on profit	Income taxes on natural persons	VAT	Excise duty and road tax	Custom duties and tariffs	Other taxes
2012	9,3%	14,4%	44,8%	25,4%	0,7%	5,3%
Change since 2007	-3,4%	1,9%	-0,9%	2,4%	-0,6%	0,5%

Source. Ministry of Finance.

The increased share of the revenue from excise duties is mainly due to several times growth in their size. It is difficult to determine the extent of contribution of increased control measures and to combat smuggling because of contradictory information. In absolute terms, the excise duties during the period have increased by BGN 732 million while the twice VAT has risen by BGN 553 million.

The share of taxes on profits has gradually declined since 2008, when it was over 13% of tax revenues and this trend directly coincided with the outbreak of the global financial crisis. In absolute terms, the revenue from these taxes in 2012 is by BGN 354 million lower than it was in 2007, as opposed to revenue from personal income tax being higher by BGN 489 million which explains their enlarged share in the total tax revenues.

Unlike other EU countries that increased their tax rates in response to the financial crisis, Bulgaria followed a consistent policy of keeping them. A new tax on insurance premiums was introduced but its proceeds were insignificant (BGN 22 and 26 million for the last two years). In addition, a tax on interests from deposits accounts in commercial banks was also introduced but it had an insignificant effect on the revenue. Stimulation of business and investment income taxes must be positively assessed because in this way the country maintains its tax advantages, which do not lead practically to the necessary growth rate of domestic investments and do not attract a significant flow of foreign capital. Nevertheless they are a positive element of the business environment that would otherwise be associated primarily with problems – ineffective and underdeveloped judicial and administrative system, a lot of licensing regimes, corruption, bureaucracy, declining employee qualification, poor work discipline etc.

Along with maintaining low rates of income tax, their structure does not change which makes them inadequate to the challenges of the economic crisis, particularly in stimulating real investments. A few examples are sufficient to illustrate the subject.

Personal income from employment (by contract) is taxed at 10%, while income from capital (ownership in joint-stock company) - 10% corporate tax and after that with 5% tax on dividends, i.e. an effective tax rate of 14.5%. Once the factor "capital" is loaded with 45% bigger tax burden than the factor "employment", how Bulgarian and the international community could realize that investments in real business or in other words economic growth are desirable? In addition, the fact is that 60% of the security burden falls on the business (capital) and only 40% on employees (labor). What must be done is to remove the tax on dividends in order to equalize the tax burden on labor and capital. The ceased process of adjusting the security burden between employers and employees should be continued. Here the meaning is not about proactive tax and social security policy aimed at stimulating investment priority but to equalize the tax burden on both factors in the economy as well as to create market conditions for economic players to choose equally their income. Another argument is that in a period of recession tax on dividends has an additional negative effect on economic growth because it prevents the removal of the capital from inefficient enterprises (branches) and investing them in more effective (ex. from construction to light industry). This imbalance is observed for a second consecutive year as declared multimillion salaries which are too exotic for the Bulgarian economy. Logically, it is explained by the avoidance of tax on dividends by "dressing" of distributed profits as multimillion incomes. The third argument for eliminating the tax on dividends is that it leads to an imbalance between investments in financial instruments: income (dividends) from shares is taxed while interest and discount bonds are not. Investment in the business (equity) or those (mostly) in government bonds will lead the Bulgarian economy out of the economic crisis? Fourth but not last argument for the removal of this tax is that its contribution to tax revenue is insignificant, which makes such a political decision relatively cheap and realistic. During the implementation of the strategy "Europe 2020" National Reform Program (including updating its April 2013) for small and medium enterprises (SME) provides a role as "main engine of economic growth for creating employment and to stimulating innovations in the country" while the government has the task to ensure them suitable business environment for development (p. 46).[15] Here comes the logical question of whether the fiscal policy supports them?

Let's look at the taxation of small businesses (sole traders and freelancers). Sole proprietorships are excluded from the general tax base[16] and unlike to workers (10%) or owners of capital companies - 14.5%, their final tax is the integer 15%. If we add the risk for unlimited liability and tax base formation in accordance with Corporate Tax Act, i.e. comparable administrative price with capital corporations, we can conclude without exaggeration that registered proprietors are the most underprivileged among all the others. The taxable income of freelancers is calculated as their factual income less fixed percentage expenses (most commonly 25%) and after than the annual tax base is formed by subtraction of social and health securities and is included in the general tax base. Let us imagine an architect (in the countryside) who worked on two projects in the year of the economic crisis and received a total fee of BGN 6000. He paid office fee BGN 3000, salary of associate person BGN 3,000 plus BGN 700 insurance, BGN 1800 for means of livelihood and social security

[15] See program edition from 2011, p.39, 69, 72, 88; April 2012, p. 31-33.
[16] It is envisaged under Income Taxes on Natural Persons Act.

BGN 1,000. His taxable income for this year is BGN 4500 (75% from BGN 6000) and the tax base BGN 3500 (BGN 4500 less BGN 1000 paid for his insurance). Consequently, he has to pay tax at an amount of BGN 350. It remains unclear why after his financial calculation this year BGN - 3500 loss, he has to pay additional tax BGN 350 (the loss becomes BGN -3850). Although there are many problems faced by tax policy which concern primarily the effects of taxation structure of income and profits, as well as their low overall collection, the Bulgarian fiscal policy has so far been a huge success

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Experience in the development of Bulgarian economy over the past 15 years shows that financial stability is a necessary but insufficient condition for economic growth and prosperity. The fact that the country went through upstream speculative bubble in the global economy that had led to the financial crisis and to the painful economic consequences, does not mean that economic growth is possible without targeted structural reforms. It was not the financial stability and enviable low income taxes that is the reason for the poverty in Bulgaria but the fact that the painfully achieved stability was not followed by structural reforms that should create a favorable environment for business and life.

In fact, the fiscal sector is at the beginning stage of a long-term risky trend for systematic growth of public debt. Some possible positive actions that fiscal policy faces in medium term are:

- defending fiscal stability;
- European funds and programs may create potential economic growth while maintaining balance in public finances which is why the fiscal policy should more effectively and actively support the process of their absorption;
- a reform in the social security system is needed to limit its deficit which will free up available resources for implementation of structural reforms;
- the financing of the municipal sector should be reviewed and strengthen with its own resources which will reduce the governmental obligation towards it;
- it is necessary that the policy-makers should conduct a policy for increasing collection of taxes in order to include all obliged persons to bear their weight;
- both structure and economic effects of income taxes should be improved while their size is constant in order to stimulate real investments and business; it is essential to reconsider the role of the tax on dividends in Bulgarian tax system;
- politicians should continue the reform in public administration in order to achieve lower expenses and increase its efficiency.

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