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MUNICIPAL DEBT AND FINANCIAL SUSTAINABILITY OF THE LOCAL SELF-GOVERNANCE

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ABSTRACT

Debt is an outstanding liability that has arisen as a result of past events. The initial cause of debt is the break of the balance between income (R) and expenses (C), namely $R<C$. Municipal debt is public debt. Municipalities are the bodies of local self-governance, which is an integral part of local state governance. Local self-governance is a part of the general state governance and includes this public administration, whose competence spreads only throughout the local part of the economic territory, with the exception of the local agencies of the social security funds. **The goal** of this study is to analyse and evaluate the debt of the municipalities in Bulgaria during the period of economic crisis and insufficient funding of the public sector. **The methods** being used are the method of expert evaluations, analysis and synthesis, as well as the method of comparison. **The results** that are derived indicate that there is a tendency towards an increase of public debt, measured as a ratio of intermunicipal debt and the municipality's own income, including the total equaling funding **The conclusions** from the study cannot detect with certainty the cause for the increase of municipal debt.

Key words: municipalities, budget, indebtedness, own income, fiscal imbalance

INTRODUCTION

Acquired debt is an outstanding liability as a result of past events. Municipal debt is public debt. Municipalities are the bodies of local self-governance, which is an integral part of the general state governance and includes the public administration, whose competence covers only the local part of the economic territory, with exception of local agencies of the social security funds. Municipal debt occurs when the balance between its own income and local expenses is broken. Under the conditions of limited income competences and increasing expectations towards local self-governance, debt assumes a more important place in the funding of municipal activities.

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MATERIAL AND METHODS

In order to achieve the set goals and fulfill the specific tasks, we used **traditional methods**: analysis and synthesis, comparative method, induction and deduction, **and specific methods**: mathematical-statistical and expert evaluation methods.

RESULTS

Municipal debt is a part of the consolidated state debt. It is notable that that share of municipal debt against GDP, in average for the countries of the EU – 27, is 6.1 of GDP. By comparison, the central debt represents about 75% of GDP. In order to perform this analysis, the member states can be arranged into three conditional groups, in accordance with the share of municipal debt against GDP **(Table 1).**

Table 1. *Grouping of the EU – 27 countries according to the level of municipal debt*

Group	Share of municipal debt against GDP in %	States
First group	Below 3 % of GDP	Malta, Greece, Bulgaria, Cyprus, Lithuania, Slovenia, Luxembourg, Slovakia, Romania, Czech Republic
Second group	Between 3 and 6 % of GDP	Austria, Ireland, Estonia, Hungary, Spain, Poland, Belgium, United Kingdom, Germany, Latvia, Portugal
Third group	Above 6 % of GDP	Finland, Denmark, Sweden, Italy, France, Netherlands

Source: Processed data from Eurostat (1)

In **Figure 1** the ratio of central to municipal debt is visualised as well.

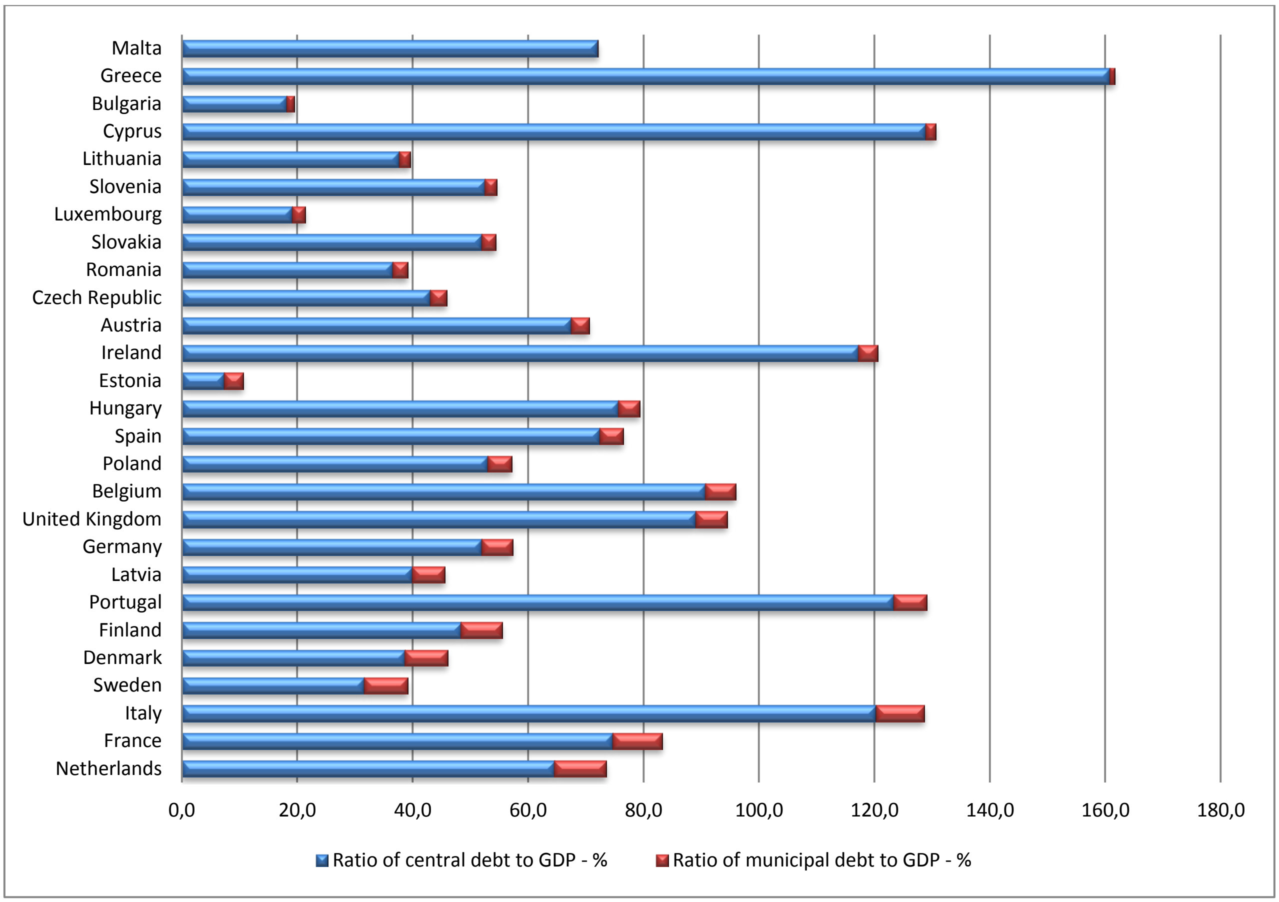

Figure 1. Ratio of central and municipal debt

The amount of the municipal debt in Bulgaria as of 31 December 2012 is BGN 974.8 million (2), which represents 1.3% of GDP. The structure of the municipal debt according to the nationality of the creditors is presented in **Table 2**.

Table 2. *Structure of the municipal debt in Bulgaria for the first quarter of 2013 per residents*

Type of debt	Value in millions of BGN	Share - %
Internal municipal debt and municipal warranties	471.3	48.3
External municipal debt and municipal warranties	503.5	51.7
Total	974.8	100 %

Source: Summarised data from the Ministry of Finance (2)

In the external municipal debt, the greatest share falls under the debt acquired through contracts and loans – BGN 340.3 million, after which is the debt acquired through emissions of municipal obligations – BGN 110.9 million, liabilities on commercial credits – BGN 12.3 million, interest-free loans from the central budget – BGN 5.8 million and the liabilities per financial leasing (over 2 years) – BGN 1.6 million **(Figure 2).**

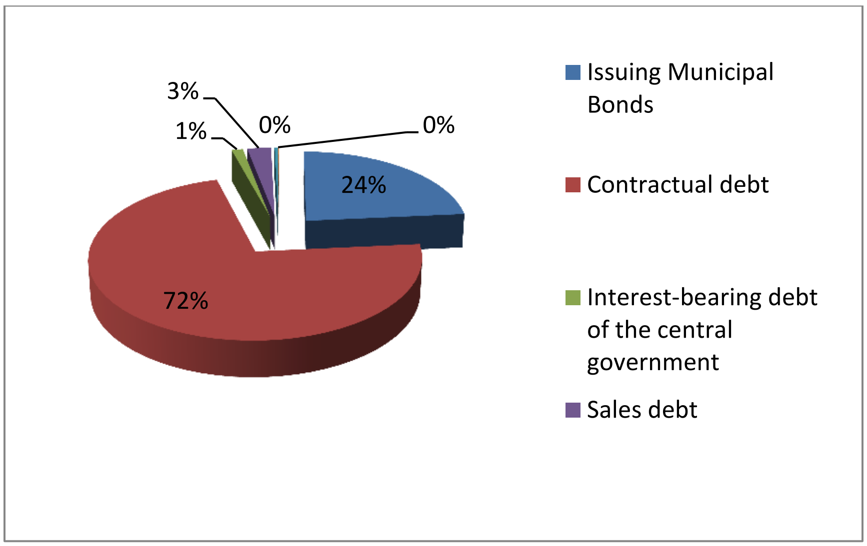

Figure 2. General structure of the municipal debt per types of debt for the first quarter of 2013

From the figure it is evident that the least used means of debt financing is municipal warranties, which amount to a mere BGN 0.3 million.

The liabilities per contracts for municipal loans are fully predominant in the external municipal debt as well – BGN 503.5 million. State statistics indicate that there are no liabilities towards non-residents (non-residents are all institutional units (households, corporations, government agencies, etc., which can own their own material or financial assets, as well as to perform the respective transactions), whose centre of economic activity is not within the territory of the respective country) from municipal warranties.

In order to achieve the set goal, we use derivative values, reflecting the amount of municipal debt in the context of the policies of financial sustainability. Financial sustainability is of major importance under the conditions of a financial-economic crisis, leading to difficulties in the financing of public debt. According to the rating system of the municipalities in Bulgaria (2), the amount of the debt reflects on the following production parameters of financial sustainability:

- *The amount of debt, as a percentage of own income and the balance funding as planned* – shows what part of the own income and balance funding is used to pay the municipal debt. Using debt to finance the activity up to a certain level can be accepted as relatively profitable for the municipality. This occurs from the fact that the norm of regaining from capital invested in various municipal assets is usually greater than the interest rate of the credits it received;

- *Share of delayed debt from own income and balance funding per plan* – this parameter characterises the municipality's capacity to meet its delayed liabilities within the current year. The dynamics of the delayed debt reflect the short-term tendencies with regard to the municipality's financial stability. This parameter evaluates the effective management of debt, which is integral to risk management and the efficiency of he systems or financial management and control in municipalities. It is assumed that the lower share of delayed debt indicates a better capability of the municipality to pay its delayed liabilities.

After summarising all categories of parameters (parameters for financial independence, financial sustainability, efficiency, investment activity) the municipalities were grouped in five primary groups **(Table 3).**

Table 3. *System for grouping municipalities in accordance with their transitive capacity and indebtedness*

Well balanced	Own income fully covers municipal expenses	No
Balanced	Short-term fluctuations in balance of own income – municipal expenses	No
Well developing	Own income does not cover municipal expenses	Yes. Moderate
Consolidating	Own income does not cover municipal expenses	Yes. Potentially dangerous
Unbalanced	Own income does not cover municipal expenses	Yes. Dangerous. There are clear tendencies towards increase of debt and payment delays.

The categorization allows each municipality to be evaluated thoroughly and then compared to other municipalities.

As of the month of March 2013, only one municipality received the grade of "Well balanced." This was the municipality of Chelopech. It consists of only one populated area – the village of Chelopech with a population of 1754. The municipality has gone five position forward within an year. Financial independence expressed through the balance "own income – local expenses" is 328% (the own income covers 3.3 times the necessary funds for local activities), and along with that there is no municipal debt. This high financial autonomy is strange and the reason for it could be income, which was a one-time or temporary event.

The "Balanced" group includes 4 municipalities – Nesebar, Shabla, Panagyurishte, and Chavdar. The coverage of local expenses with own income in these municipalities varies between 150% and 257%. This high autonomy is compensated with null debt in two of the municipalities (Panagyurishte and Chavdar) and moderate debt in the municipalities of Nesebar and Shabla. In the latter two municipalities, the debt, measured as a share of own income and the balance funding is 24% at the municipality of Nesebar, and 7.2% at Shabla.

The "Well developing' group features 140 municipalities, of which:

➢ Three municipalities with key national importance and large population – Stolichna, Varna and Plovdiv. The coverage of local activity expenses in them varies between 97% (Stolichna) and 122% (Varna). Debt, measured as share of own income and balance funding is respectively: Stolichna municipality – 87.6%, Plovdiv – 39.7 % and Varna – 51.2 %;

➢ Twenty-four municipalities s major local significance and population of more than 50 000 people. The coverage of local activity expenses with own income is within 49.8 –137.4 %. Debt, measured as a share of own income and balance funding, varies between 0 % and 70 %;

- Thirty-six municipalities with population between 20 000 and 50 000 people. The coverage of local activity expenses with own income is within 50 – 139.6 %, and the debt, measured as a share of own income and balance funding, varies between 0 % и 78.3 %
- Fifty-nine municipalities with population between 6000 and 20 000 people. The coverage of local activity expenses with own income is within 52 – 147.2 %, and debt, measured as a share of own income and balance funding, varies between 0 % and 86.4 %;
- Eighteen municipalities with population below 6000 people. The coverage of local activity expenses with own income is within 37.3 – 130.4 %, and debt, measured as a share of own income and balance funding, varies between 0 and 57.9 %.

The "Consolidating" group includes 117 municipalities, which are predominantly with populations between 6000 and 20 000 people (63 municipalities), as well as some with a population of less than 6000 people (38 municipalities). From these data we can draw the conclusion that this is the group of small municipalities, which have problems with their income potential. The group includes several large municipalities as well (with population over 50 000 people), which also experience similar difficulties. These are Vidin, Kyustendil and Karlovo. The coverage for local activity expenses with own income is within 8.8 – 88.4 %, and debt, measured as a share of own income and balance funding, varies between 0 and 150.2 %.

Only two municipalities fall into the last group, "Unbalanced" – Rakitovo and Borino. They are small municipalities. Their own income cannot cover even half of the local activity expenses, and debt (measured as a share of own income) varies between 122.6 % (Rakitovo) and 282.2 % (Borino).

DISCUSSION

Municipal debt in Bulgaria is among the lowest for Europe – 1.3% of GDP. This low indebtedness should not be viewed as a positive phenomenon. Local communities' expectations increase all the time and the municipalities face the challenge of expanding their expenses at rates greater than the rates of increase of their own income capabilities. Acquiring municipal debt will ensure the expansion of the provided local services in quantity and quality. The development of a municipal finance rating system methodology makes a good impression. Data, through which the units of local self-governance are categorized, are announced for the first time. It is possible to draw a number of evaluations with regard to the problems of financial decentralization. Unfortunately, this methodology does not include any quality of life parameters. Thus a situation occurs, in which a municipality with an exceptionally high income potential takes the first place, yet it is logical to ask about the actual volume of local activities. Are they sufficient in quantity and quality?

Again we reach the conclusion that municipalities are very different with regard to their income potential. It is also necessary for the registry of municipal debt (maintained by the Ministry of Finance) to be absolutely public, without requiring permissions and transcripts in writing. A unified system for current accounting of monetary fulfillment of municipal budgets should be built up. Thus, accurate and reliable information can be received in real time, not only on municipal income, expenses and transfers, but also on the values of municipal debt.

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