



TOPICAL RESEARCH AND HIGHLIGHTS

IMPACT OF THE COVID-19 CRISIS ON PUBLIC FINANCES

(PUBLISHED AS PART OF 'ECONOMIC REVIEW',
VOL. 1/2020)



BULGARIAN NATIONAL BANK

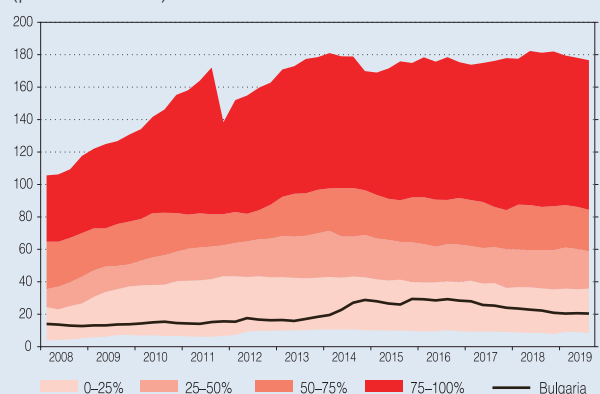
Impact of the COVID-19 Crisis on Public Finances

As a consequence of the COVID-19 crisis, a significant deterioration in the budget balance may be expected resulting from the operation of automatic stabilisers and the extra discretionary government expenditure implemented after the introduction of state of emergency on 13 March 2020. Potential adverse effect on public finances could materialise in terms of a possible increase in government interest expenses under the scenario of a more lasting upward trend in Bulgarian government securities yield, stemming from increased volatility of financial markets and investor flight to so-called safe securities issued by countries with the highest credit rating. Such a result could arise from the need to issue a new debt for maturing government debt refinancing, budget deficit financing or fiscal buffer build-up. Given the favourable initial conditions on public finances in Bulgaria, including interest rates on government debt reaching historical lows in March 2020, prevailing share of government debt at fixed interest rate and maturity over 1 year, and low level of government debt and net financial obligations (see Chart 1), this channel would have a limited negative impact on Bulgaria's fiscal position.

Chart 1. Initial Conditions on Public Indebtedness, Liquid Financial Assets and Long-term Government Securities Yields

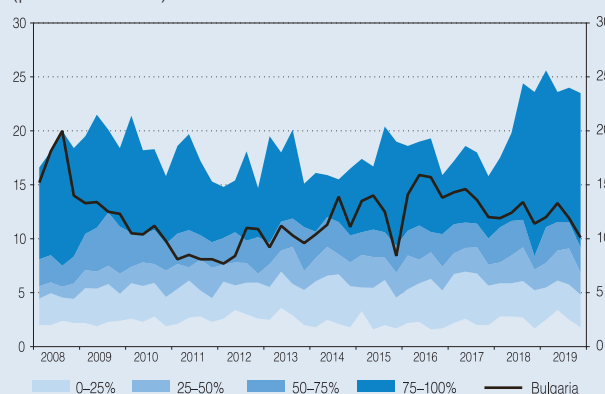
General Government Consolidated Debt: Quartile Chart Based on EU Countries Data

(per cent of GDP)



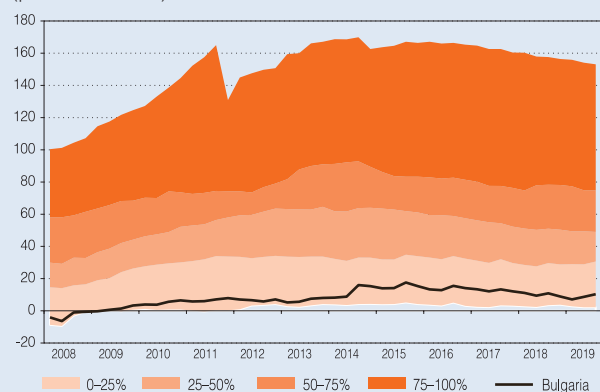
General Government Liquid Assets¹: Quartile Chart Based on EU Countries Data

(per cent of GDP)



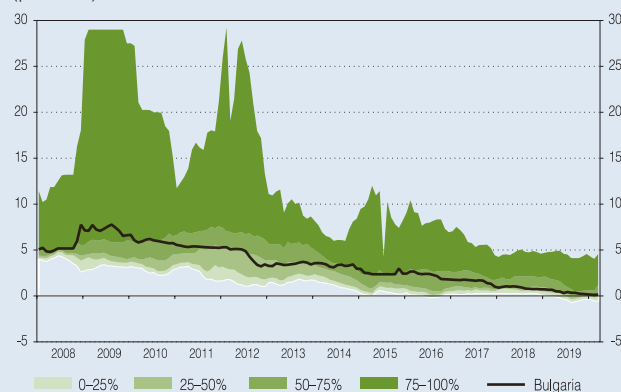
General Government Net Debt²: Quartile Chart Based on EU Countries Data

(per cent of GDP)



Ten-Year Government Securities Yield: Quartile Chart Based on EU Countries Data

(per cent)



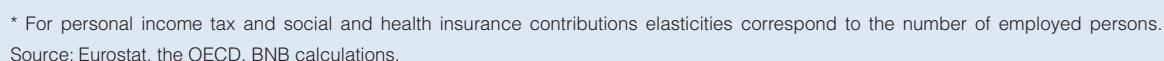
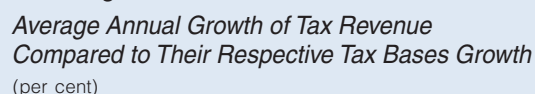
1 Liquid assets of the general government sector include cash and cash on deposits.

2 Net debt is defined as the excess of consolidated debt over the liquid assets of the general government sector.

Source: Eurostat, the MF, the BNB.

The projected fall in employment, income, household consumption, investments and deterioration of firms' and self-employed financial situation will have a negative impact on budget revenue. Reflecting the subdued economic activity, revenue from all categories of taxes is expected to decline depending on current elasticity of each tax revenue with respect to applicable tax bases. The last available estimation of long-term tax revenue elasticities in Bulgaria in 2014¹ suggests that elasticities of direct and indirect taxes are close to one, and below one only in terms of the change in social insurance contributions to average labour income growth. Concurrently, in 2019 and five years earlier the tax revenue growth exceeds that of their respective tax bases, which indicates an improvement in tax collection in addition to the positive budget effects of certain income and social security policies (see Chart 2)². EC regular report estimates³ show that the gap between theoretical VAT receipts and VAT receipts actually collected (the VAT gap) contracted from 25 per cent in 2009 to 13 per cent in 2018, improving by 9 percentage points only in the 2014–2018 period. Despite this positive trend, within a short horizon tax revenue collection is likely to deteriorate as in 2009 when revenue shortfalls accompanied the fall in economic activity. Another factor that could be influencing the stronger decline in indirect taxes is the significant drop in oil prices observed in the first months of the year.

*Cyclical Budget Components' Elasticities
(According to the OECD Report of 2014)
and Their Relative Share in GDP*

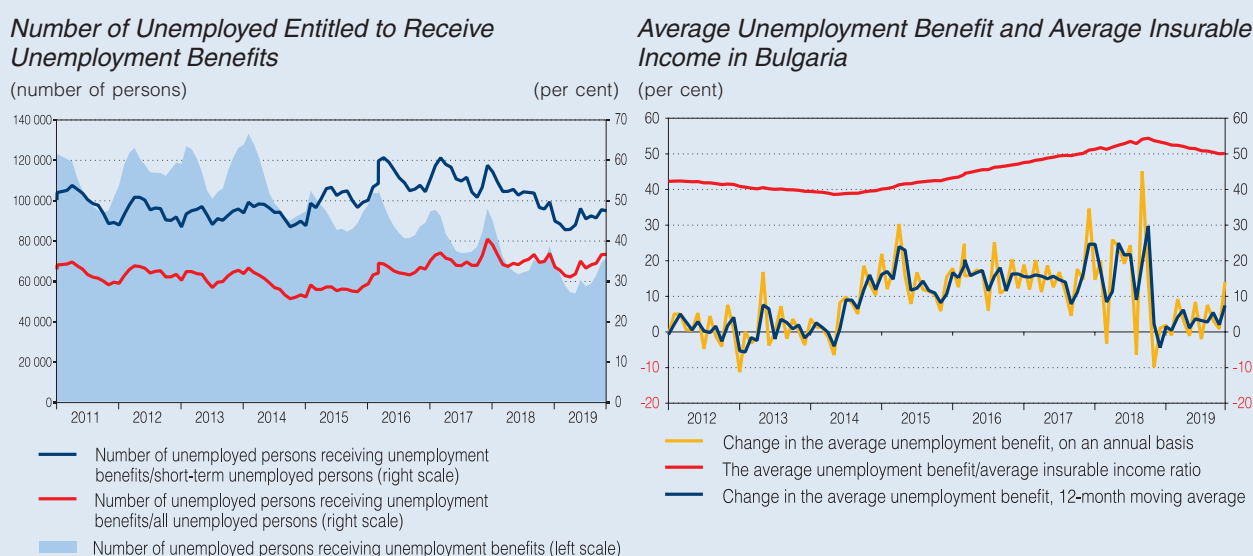


³ See European Commission (DG TAXUD) (2013): 2013 Report: Study to quantify and analyse the VAT Gap in the EU-27 Member States, September 2013 and European Commission (DG TAXUD) (2019): Study and Reports on the VAT Gap in the EU-28 Member States: 2019 Final Report, September 2019.

A significant part of non-tax revenue will be adversely affected due to the expected severe downturn in public services as a result of COVID-19 containment measures, rental and dividend income, which the State and local authorities collect⁴. The crisis caused by the COVID-19 pandemic is most likely to have a negative impact on funds absorbed by beneficiaries outside non-government sector due to their limited ability to provide necessary co-financing.

On the expenditure side of the budget, the main effects will impact social payments. Restrictive measures imposed by most of the economic activities in Bulgaria coupled with weakening external demand lead to a contraction in labour demand, with the quarantine imposed on individuals limiting labour supply. Such a negative impact on the labour market should be reflected mainly in the implications on budget expenditure for unemployment benefits; however, other social payments, including disability benefits and pension benefits upon a possible early retirement, may be expected to grow. The growth in budget expenditure for unemployment benefits depends on the scope of insured persons in the Unemployment Fund and the average amount of unemployment benefits. On average, 62.9 thousand persons have received unemployment benefits for 2019, comprising 45.7 per cent of short-term unemployed and 33.9 per cent of all unemployed. Over the recent years the average unemployment benefit related to average insurable income posted an increase, with the ratio coming to 58.3 per cent on average for 2019 (see Chart 3)⁵.

Chart 3. Basic Parameters Determining Budget Expenditure for Unemployment Benefits



Source: the NSI, Employment Agency, BNB calculations.

Under a no policy change scenario, adverse effects of containment measures to halt the spread of COVID-19 on the budget would be limited to the operation of automatic stabilisers. A number of discretionary measures were taken aiming at mitigating the economic impact of COVID-19 measures. The first part of these measures, which are expected to be in the total amount of BGN 0.7 billion, is intended to provide the necessary additional funds for the operation of healthcare and other key public services in the context of COVID-19 pandemic. The second part of measures, totalling BGN 1.8 billion, is aimed at supporting households and firms financially most affected by

⁴ In the Convergence Programme of the Republic of Bulgaria (2020–2023) the effect of discretionary policies to remit or reduce rents payable on state-owned and municipal properties and that of revenue forgone from tourist tax and various fees is estimated at BGN 100 million (0.1 per cent of GDP).

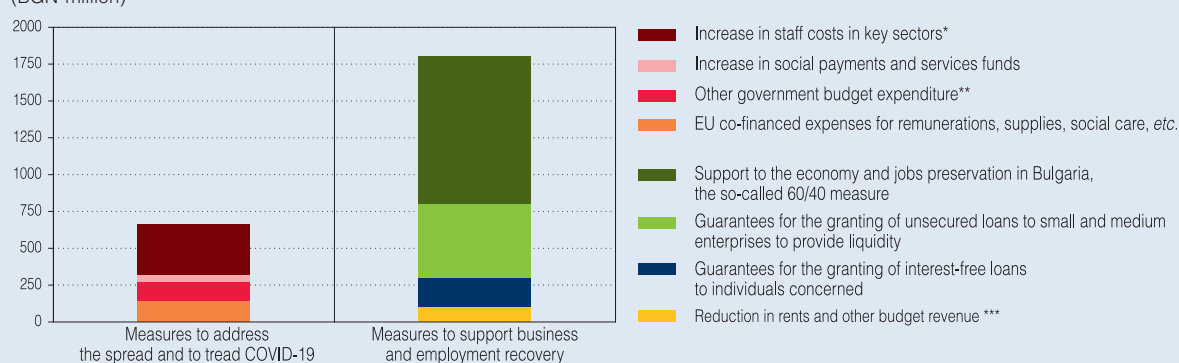
⁵ The daily cash benefit for unemployment is 60 per cent of average insurable income for which contributions have been paid during the 24 months prior to suspension of social insurance. The amount of benefit must be at least the minimum amount and not larger than the maximum daily amount set out each year by the State Social Security Budget Law (BGN 9.0 and BGN 74.3 for 2019 respectively).

COVID-19 containment measures. Chart 4 summarises the adopted discretionary measures on these two strands based on the information in the Convergence Programme of the Republic of Bulgaria (2020–2023). The vast majority of the expenses on the first strand are additional remuneration costs in healthcare and internal security. Most of the expenditure on the first strand are planned to be financed by the limitation of other government budget expenditure or by unused EU funds. Therefore, these measures should have a limited negative impact on the budget balance. It is more difficult to assess the effect of these measures on Bulgaria's economic activity as far as they replace other national budget expenditure and programmes supported by EU funds. By mid-May there is still uncertainty about the size of the measures which will be implemented in case of extended period of epidemic situation. If the measures are prolonged, the size of these expenses would be higher and probably would lead to a further deterioration in the budget balance.

The second strand of measures is intended to support firms and households affected by COVID-19 containment measures. Among them, the measure to preserve jobs in Bulgaria through subsidised employment (the so-called 60/40 measure) is expected to be of the highest amount of BGN 1.0 billion. The efficiency of this measure determines and influences to a larger extent the operation of the automatic stabilisers in the budget related to unemployment benefits paid. Another instrument aimed to boost businesses and employees are the loans to firms and individuals guaranteed by the Bulgarian Development Bank for which BGN 0.7 billion are projected in the form of expanded capital of the state-owned bank⁶. In implementing the second strand of measures, there is also uncertainty surrounding the expected negative effect on budget and their efficiency for smoothing the pandemic effects on economic activity. The uncertainty stems from the unknown duration of the COVID-19 crisis, on the one hand, effective from the coverage and timely implementation of the various programmes, on the other.

Chart 4. Measures to Address the Impact of COVID-19

(BGN million)



Note: The chart shows only the measures finally approved by the government by 28 April 2020. EU co-financed measures for short-term schemes for employment and supporting liquidity in small and medium enterprises by different financial instruments are not included in the total amount of BGN 0.7 billion. Additional financial instruments that would be financed by the European Investment Fund and other programmes under which the beneficiary is the Fund Manager of Financial Instruments in Bulgaria are not included.

* including financial resources necessary for front-line workforce in fighting the spread of the virus: healthcare professionals and employees in the public order, security and defence sectors.

** including expenditure for disease prevention and containment measures, replenishment of the state reserve, distance learning etc.

***including effects from lower rents for the use of state-owned or municipal property, decreases in tourist tax revenue, real estate tax, usage fees for markets and auctions, technical services and kindergarten fees.

Source: Convergence Programme of the Republic of Bulgaria (2020–2023).

⁶ Funds allocated to capital increases of the Bulgarian Development Bank are likely to be recorded as a financial transaction according to the methodology for cash-based accounting and the EASA 2010 methodology for accrual-based accounting. These funds will likely not affect the budget balance on a cash and accrual basis.

THE SCULPTURAL COMPOSITION BY KIRIL SHIVAROV DEPICTING HERMES AND DEMETER ON THE SOUTHERN FAÇADE OF THE BULGARIAN NATIONAL BANK BUILDING IS USED IN COVER DESIGN.