

**ANALYZING LOCAL
GOVERNMENT
FINANCES**

Prepared for

East European Regional Housing Sector Assistance Project
Project 180-0034
U.S. Agency for International Development, ENI/DG/LGUD
Contract No. EPE-C-00-95-001100-00, RFS No. 452

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April 2000
UI Project 06610-452

INTRODUCTION

What is the purpose of this document?

This document presents concepts and techniques that are useful in analyzing the system of local government finances in a specific country. It focuses on three key questions:

- ✓ *What* expenditure responsibilities and sources of revenue are assigned to local governments
- ✓ *How* local governments carry out these expenditure responsibilities and how they raise or receive their revenues
- ✓ *Who* makes the critical decisions that affect the quality, quantity and cost of local government services

Who should read this document?

This is a document primarily for practitioners focused on the system of local government finances in the countries of central and eastern Europe, although many of the concepts and techniques are applicable to any system of local government finances.

What should the reader hope to obtain from this document?

This document will help the reader develop an objective, detailed and factual description of the system of local government finances in a given country. As such, it provides a sound basis on which to evaluate the system of local government finances in a given country.

The final section of the document includes a practical exercise based on two hypothetical country profiles. This exercise provides an opportunity for the reader to test his or her understanding of the analytical concepts and techniques.

What are the limitations of the document?

The focus of this document is on analysis, not evaluation. It provides very limited subjective guidance on what constitutes a “good” or “sound” system of local government finances. To assist the reader, the document quotes applicable principles from the Charter of Local Self-Government adopted by the Council of Europe. Otherwise, the assumption is that the reader knows or has access to the theory and concepts of fiscal decentralization, such as those provided in the field of fiscal economics.

ANALYZING LOCAL GOVERNMENT FINANCES

A. LOCAL RESPONSIBILITIES

Overview

A useful way to look at the functions and responsibilities of local governments is to consider the answers to three key questions:

What? Analyzing the regulatory, service and investment responsibilities assigned to local governments

How? Analyzing how the delivery of local services is organized

Who? Analyzing decision making regarding the quality and quantity of services to be provided

The first question - "what..." - relates to decisions on what regulatory, service and investment responsibilities have been assigned to local governments. Underlying this apparently simple question there are some very complex and challenging issues.

The second question - "how..." - relates to the alternatives available to local governments for organizing the delivery of the services assigned to them.

The third question - "who decides?" - looks at issues that go to the heart of local self-government and autonomy. At issue here is the relationship between the local and national levels of government and between local and national policies and priorities.

STEP 1
**WHAT? ANALYZING THE REGULATORY, SERVICE AND INVESTMENT
RESPONSIBILITIES ASSIGNED TO LOCAL GOVERNMENTS**

1. How have the functions and responsibilities inherent to local government been defined?

Guiding principles of the Charter of Local Self-Government:
Article 4.2

Local authorities shall have full discretion to exercise their initiative with regard to any matter which is not excluded from their competence nor assigned to any other authority.

Are the functions and responsibilities identified in a law? Is the definition clear? Has it been respected in practice? Have local functions and responsibilities been amended in practice through other laws, such as the annual State budget law, or laws dealing with specific sectors (such as water, the environment or education)?

There are many possible variations, including

- The first is a definition of the functions and responsibilities that is very broad. For example, the law may state that local governments may perform any function of local interest that has not been reserved for the national government by law. This creates an implicit mandate to perform any function deemed to be of local interest, as long as there is no national legislation to the contrary.
- The second is a definition of the functions and responsibilities that is very narrow. For example, Macedonian municipalities may only perform specific functions described in the basic local government law, as further defined in other, more detailed legislation. In this case, the degree to which local governments have a mandate depends on the relation between the general and specific laws dealing with local functions and responsibilities. This approach tends to produce a narrow definition of local responsibilities.
- The third is a combination of these two. It defines local functions and responsibilities as falling within certain areas specified in a basic law, but allows broad discretion to local authorities in these areas. This is the case of Poland, where the law provides a list of local functions, but uses general language that provides a broad mandate to local governments in these specific areas.
- The fourth is the case where existing local government legislation is largely silent on the definition of local functions and responsibilities, leaving it up to some other process to address this question. This is the case of Romania where *de facto* it is the annual state budget law that establishes local functions and responsibilities.

The key in all four cases is whether local functions and responsibilities are “sufficiently rooted in legislation,” that is, that these functions are legally certain and clear, not *ad hoc*.

Explanatory Note:¹ Think of local authorities as political entities acting in their own right to promote the general welfare of their inhabitants. If this is so, then it is important that they have the right to exercise their initiative in fields of action that have local implications and are not assigned to some other level of government. The general rules under which they may act in such cases may, however, be laid down by law. If it is necessary to establish a clear legal basis for the actions of local authorities, this can still allow for local discretion in specified areas.

When there is more than one level of local government in a country, then it is important to consider local responsibilities for each level separately.

2. What are the inherent functions of local governments?

Guiding principles of the Charter of Local Self-Government:
Article 4.3

Public responsibilities shall generally be exercised by those authorities which are closest to the citizen. Allocation of responsibility to another authority should measure the extent and nature of the task and the requirements of efficiency and economy.

Guiding principles of the Charter of Local Self-Government:
Article 3.1

Local authorities shall have the right and ability to regulate and manage a substantial share of public affairs under their own responsibility.

2.A What are the specific types of functions that are under the “own responsibility” of local governments?

Note that the principle refers both to regulatory and direct service functions. These are the activities that local governments are free to undertake of their own initiative.

¹ *Explanatory Report on the European Charter of Local Self-Government*, Council of Europe, Strasbourg, 1986, page 12.

2.B What is the scope of local authority in those areas that are under their own responsibility?

Do local governments have legislative authority? That is, can they establish policies, adopt rules and set standards? This might be the case, for example, with urban planning. Can they regulate a private activity, require permits and issue licenses? This might be the case, for example, with certain local business activities or with activities of private sports, entertainment or cultural clubs and facilities.

With regard to services, are local governments responsible for all aspects of the service or is their authority only over certain aspects of the service? For example, are they responsible for providing, maintaining and operating school buildings, but have no say in defining the academic curriculum? Does it include only the operating expenses related to a service or are local governments also responsible for investments in facilities and equipment?

Is all this clear and explicit or is it open to interpretation?

3. Can the national government delegate to local governments the performance of certain functions assigned to the national level?

There are two basic considerations here:

How much discretion do local authorities have in performing delegated functions?

Guiding principles of the Charter of Local Self-Government

Article 4.5

Where powers are delegated to them, local authorities shall to extent possible be allowed discretion in adapting their exercise to local conditions.

Generally, the reason for delegating a specific function is that local authorities can contribute their more detailed knowledge and understanding of local needs and priorities. This would argue for allowing a certain degree of local discretion in implementing delegated functions. For example, if local authorities are responsible for maintenance of primary schools, they also should have the discretion to establish their own maintenance schedules. They would be responsible to the local community for the condition of the schools.

If the intent is simply to pay for certain expenditures through the local budget, without allowing any discretion at the local level, it probably is best not to think of this as a delegation of functions. Actually, in this case the local authorities are providing an administrative service for the corresponding ministry.

How does the delegation of functions take place?

Is the function delegated to all local governments or only to some based on considerations of size or capacity. In the Czech Republic, for example, there are some 80 “delegated municipalities” among the more than 6,400 municipalities. They are the only ones that perform functions on behalf of the national government. All other municipalities must turn to one of the delegated municipalities for specific services, such as issuance of building permits. This approach is the exception. Generally, delegated functions apply to all local governments.

Do local governments have the option to accept or not a delegated function? This was the case in Poland with certain education functions. Each *gmina* was free to decide it if wanted the delegated responsibilities. The *gmina* also had to demonstrate that it was prepared to perform the function properly. Again, this approach is the exception. Generally, delegated functions are mandatory for local governments.

Are local governments consulted prior to any delegation of functions?

STEP 2
HOW? ANALYZING HOW THE DELIVERY OF LOCAL SERVICES IS ORGANIZED

4. What authority do local governments have to organize the delivery of local services?

Guiding principles of the Charter of Local Self-Government
Article 6.1

Local authorities shall be able to determine their own internal administrative structures in order to adapt them to local needs and ensure effective management.

Once you have identified what service and investment responsibilities have been assigned to local government, the next set of questions look at the alternative modes available to local authorities to organize the delivery of local public services.

Questions to consider include:

Do local governments have the authority to establish their own organization to deliver the services? Or, are they simply responsible for covering the expenses of an existing organization. Do they have the authority to establish a separate corporate entity to perform the service? What is the nature of these corporate entities? Are they a special type of public entity or can they simply be commercial companies?

Examples of types of local service providers in countries of central and eastern Europe:

Czech Republic

Czech municipalities may create a new legal person by resolution. There is no separate legislation defining local public corporate entities.

Macedonia

This country has a special law on local public enterprises.

Romania

Local governments may establish either public corporate entities or commercial companies under the commercial code.

Do local governments have the authority to organize the delivery of services in cooperation with other local governments? This is an option that is particularly useful to smaller jurisdictions that may find it inefficient or uneconomic to establish their own individual organization to provide a specific service. How does this work? Is it simply a local choice?

Guiding principles of the Charter of Local Self-Government
Article 10.1

Local authorities shall be entitled in the exercise of their powers to co-operate with and form consortia with other local authorities to carry out tasks of common interest.

Are local governments authorized to provide the services through a third party, that is, another organization that is not linked to it in any way? This can take several forms:

- By buying the services from another local authority - Is this simply a local option? Does it require special approvals?

This is a frequent practice in both the Czech Republic and Latvia, where one municipality will pay another municipality to take their children who are in primary schools, for example. This also is a frequent practice in the U.S., where a small city might contract for water services with a county. It is an option that is particularly helpful to the smaller jurisdictions.

- By privatizing the services, that is, turning over responsibility for all or part of the service to a third party - What types of entities are eligible? It is customary to think of this in terms only of private firms. Are NGOs eligible? Are public enterprises from other local jurisdictions eligible?

What affects the degree of autonomy is the extent to which local governments are empowered to apply the particular mode of delivery that they believe is best suited to local needs and the extent to which they are free to decide which one to adopt. These are questions that you need to address clearly and specifically.

STEP 3
WHO? ANALYZING DECISION MAKING ON THE QUALITY AND QUANTITY
OF SERVICES TO BE PROVIDED

The process of determining local service and investment responsibilities and autonomy is not limited to questions “what... and how”. Often, the question of “who” is addressed separately from the other two and leads to confusion and unclear division of authority and responsibility between the national and local levels of government.

Even when local governments have extensive service and investment responsibilities, and even when they have great latitude to decide how to organize the delivery of those services and the implementation of those investments, there is still one final set of issues to address that often prove to be the most difficult of all. Who really decides what quantity of services to provide and of what quality?

Some key questions to consider are:

5. Are some of the functions assigned to local governments shared or do they overlap with those of other levels of government?
- 5.A Do national service standards or rules apply in specific areas of local responsibility?

Does sectoral legislation impose service quality or quantity standards on local governments that have a direct impact on the services they provide? For example, legislation on water resources may authorize a particular national ministry to set minimum standards for water quality that apply to all providers of potable water, including those operating under local authority. Legislation in the area of education may authorize the ministry of education to set standards on the maximum number of students per classroom. If local governments are responsible for construction of schools, this standard would limit their discretion in deciding the appropriate number of schoolrooms required in their community.

Alternatively, are there sectoral or regional service or investment plans that set standards or that require review and approval of local service and investment plans by a higher level of government?

Examples from central and eastern European countries:

This is a practice that may be fully justified if the objective is to set uniform standards nationally in areas deemed to be of significant national interest. Accession to the EU will bring with it many such standards. For example, there are EU directives that require that member countries adopt and enforce quality standards for potable water, as well as for air quality. In anticipation of having to meet these directives, the Czech Republic adopted very strict air and water quality standards, including provisions for heavy fines for non-compliance, that applied to municipal water, heating and transport services. This has

imposed a heavy burden on local authorities that have made extensive investments to bring their services into compliance with the standards.

5.B Do national standards and rules in the area of public administration apply to local governments?

Standards and procedures in the areas of human resources and public finance can have a significant impact on local services. Personnel decisions are ones in which often there is a shared authority or in some cases a complete loss of local autonomy. Single national wage scales and restrictions on hiring and firing employees that apply to local government employees can have a big impact on local services.

Examples from countries in eastern and central Europe:

Municipalities in Bulgaria have struggled to manage a work force in health and education under rules established by the national government. They are told how much to pay these employees, while also being restricted in deciding the type and number of persons to employ. This limits their ability to make decisions about the quantity and quality of health and education services in their community.

Guiding principles of the Charter of Local Self-Government:
Article 6.2

The conditions of service of local government employees shall be such as to permit the recruitment of high quality staff on the basis of merit and competence; to this end adequate training opportunities, remuneration and career prospects shall be provided.

The process involved in the management of public funds also affects the degree of local autonomy in managing services. For example, procedures requiring approval of local expenditures by a national ministry can easily lead to interventions that limit the decisions made by local authorities. The structure of financing (which will be addressed in much greater detail in Part B. of this document) also can affect the degree of local autonomy regarding decisions of service quantity and quality. For example, special purpose grants set minimum local expenditure levels. When they are insufficient or if they have a matching requirement, they force the local governments to allocate other local resources to the particular service, at the expense of the other services they might have preferred to fund.

Examples from countries in eastern and central Europe:

Since 1999, part of the general transfer to municipalities in Bulgaria has been re-allocated to a special purpose grant for social welfare. In addition, the annual State Budget Law determines specific expenditure priorities for local budgets. In Latvia, a special purpose grant is given to local governments to finance teachers' salaries.

5.C How are national rules and standards applied in the areas of local functions and responsibilities?

Guiding principles of the Charter of Local Self-Government:
Article 4.4

Powers given to local authorities shall normally be full and exclusive; they may not be undermined or limited by another central or regional authority except as provided by law.

Article 8.1

Any administrative supervision of local authorities may only be exercised according to such procedures and in such cases as are provided for by the constitution or by statute.

Explanatory Note:² In the interest of clarity and for the sake of avoiding any tendency towards a progressive dilution of [local] responsibility, [local] powers should normally be full and inclusive. However, complementary action by different levels of authority is required in certain fields and it is important that in these cases the intervention by central or regional authorities takes place in accordance with clear legislative provisions.

² Explanatory Report on the European Charter of Local Self-Government, Council of Europe, Strasbourg, 1986, page 13.

Guiding principles of the Charter of Local Self-Government:
Article 4.6

Local authorities shall be consulted, insofar as possible, in due time and in an appropriate way in the planning and decision-making process for all matters which concern them directly.

To the extent that the rules and procedures reflect objectives deemed to be of significant national interest, it is an acceptable practice to apply them to local governments. The underlying question usually is how it is done and whether the process of setting uniform national standards and rules takes into account the impact on local authorities. Part of the difficulty in addressing these issues is that they appear often in legislation dealing with a specific sector or subject, such as health, water resources, public finance or the civil service, and not in the legislation dealing with local government.

There are two provisions that can be important to local autonomy. Is the national government precluded from imposing standards or rules when there is no clear legal provision to the effect? At a minimum, national authorities should not have arbitrary authority to impose rules and standards on local authorities. Is it necessary to consult local authorities in advance regarding any standards that would have an impact in the areas for which they have responsibility? Has a specific mechanism or forum been established to consult with representatives of local governments?

Examples from countries in eastern and central Europe:

In 1993, Poland created a Joint Central-Local Commission, which includes representatives of each local government association and of the main Ministries with oversight on issues concerning local governments. Any proposed legislation, which will impact local governments, should be submitted to the Commission for review and comment.

Latvia's Union of Local and Regional Governments is the sole representative of local authority interests in the country and participates in annual discussions on the financing of local governments, which results in a Protocol of Agreements and Disagreements.

ANALYZING LOCAL GOVERNMENT FINANCES

B. REVENUES AND THE BUDGET

OVERVIEW

The subject of local finances includes the discussion of four topics:

Financial resources available to local governments

The local budget³

Execution of the local budget

Financial controls

The rules governing each of these four topics are important in determining whether the system of local finances meets the basic principles of the Charter of Local Self-Government (CLSG). A useful way to look at these topics is to consider the answers to three key questions:

What? Analyzing the financial resources assigned to local governments

How? Analyzing the management of the financial resources of local governments

Who? Analyzing decision making regarding the financial resources of local governments

The first question – *What?* - relates to decisions as to the types of financial resources that are assigned to local governments. The underlying question is whether local governments have adequate financial sources to carry out the responsibilities assigned to them.

The second question – *How?* - relates to the details of the administration and distribution of financial resources assigned to local governments, such as the basis on which revenues may be shared, transfers calculated or taxes collected. It relates as well to the process of preparing the local budget and of recording and reporting local revenues and expenditures. The underlying question is how the rules and procedures contribute to or detract from local autonomy and accountability

The third question - *Who decides?* - looks at issues that go to the heart of local government autonomy and accountability, while at the same time raising issues of macroeconomic financial balances between the national and local levels of government as well as among local governments. It relates as well to the process of adopting and implementing the local budget and of monitoring and auditing local revenues and expenditures. The underlying question is who really makes the key decisions affecting local financial resources and the local budget.

³ The local budget includes both local financial resources and expenditures. Part B will not discuss the classes of local expenditures, as these were addressed during the discussion of local functions and responsibilities. This part of the guidance document does look at the process of paying for expenditures and of recording, reporting, monitoring and auditing expenditures.

Annex 2 provides a series of worksheets that may be useful when analyzing the sources of revenues of local governments in a specific country.

STEP 1**What? Analyzing the Financial Resources Assigned To Local Governments**

Guiding principles of the Charter of Local Self-Government:
Article 9.4

The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.

Explanatory Note:⁴ Certain taxes or sources of revenues of local authority finance are, by their nature or for practical reasons, relatively unresponsive to the effects of inflation and other economic factors. Excessive reliance on such taxes or sources can bring local authorities into difficulties since the costs of providing services are directly influenced by the evolution of economic factors. It is recognized, however, that even in the case of relatively dynamic sources of revenue there can be no automatic link between the cost and resource movements.

The financial resources available to local governments may be analyzed according to their source, as follows⁵:

- a. Local taxes
- b. Local fees
- c. Other local sources of financing, such as donations or the proceeds from loans
- d. Shared national revenues
- e. Unconditional transfers
- f. Conditional transfers

When there is more than one level of local government in a country, then it is important to consider the types of financial resources for each level separately.

1. What are the sources of the own financial resources of local governments?

⁴ *Explanatory Report on the European Charter of Local Self-Government*, Council of Europe, Strasbourg, 1986, page 16.

⁵ The reader should refer to Annex A: Financial Resources - Definitions.

Guiding principles of the Charter of Local Self-Government:

Article 9.1

Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.

1.A What authority do local governments have to determine their own financial resources?

Do local governments have general authority to impose local taxes and fees, consistent with their own functions and responsibilities? If this is the choice, please move ahead to question 1.D., below.

Or, are local taxes and fees limited to those defined by law? If this is the choice, please continue with question 1.B., below.

1.B What own financial resources do local governments obtain from local taxes?

Examples of local taxes in countries of central and eastern Europe:

Hungary – Property tax on buildings, Property tax on vacant plots, Local business tax, Tourist tax, Communal tax

Poland - Property tax, Vehicle tax

Romania - Property tax (tax on buildings and land), Tax on revenues from real estate rentals, Tax on shows / entertainment

1.C What own financial resources do local governments obtain from local fees?

Examples of local fees in countries of central and eastern Europe:

<u>Service fees or charges</u>	<u>Fees for use of a public good</u>	<u>Fees for permits or licenses</u>
<i>Poland</i>		
water fee	market fee	construction permit fee
wastewater fee	mining fees	
solid waste fee		
<i>Romania</i>		
water fee	market fee	construction permit fee
wastewater fee	advertising fees	
solid waste fee	museum/ monuments fees	

1.D Are local governments permitted to borrow funds on the capital market to finance investment projects?

Guiding principles of the Charter of Local Self-Government:
Article 9.8

For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.

Explanatory Note:⁶ It is important for local authorities that they have access to loan finance for capital investment. The possible sources of such finance will, however, inevitably depend on the structure of each country's capital markets; procedures and conditions for access to these sources may be laid down by legislation.

The capacity for local governments to eventually have access to credit to finance investments depends in fact on many parameters that are not directly part of local finances. The main components, which help to build a functioning municipal credit market, include:

- stable macroeconomic conditions;
- stable and predictable intergovernmental fiscal flows;
- reliable and timely disclosure of local government financial information;
- credit analysis performed either by lenders and/or third parties; and,
- different types of collateral that can be provided to reduce credit risk.

1.E What other sources of own financial resources do local governments have?

There are other possible sources that might be made available to local governments. This can include, for example, the use of local surplus property to raise revenue through leasing, renting or outright sale. Are local governments allowed to keep surplus cash in interest bearing accounts to generate additional revenues? Can they participate in commercial ventures and derive income from the profits of these ventures?

⁶ Explanatory Report on the European Charter of Local Self-Government, Council of Europe, Strasbourg, 1986, page 17.

Examples of other own local revenues in countries of central and eastern Europe:

Hungary

Rent from municipal property (municipal housing, municipality-owned shops, buildings, land); Revenue from sales of municipal property (land, buildings, other assets); Interest income from bank account deposits.

Poland

Rent from municipal property (municipal housing, municipality-owned shops, building, land); revenue from sales of municipal property (land, buildings, other assets); Interest income from bank account deposits.

2. What financial resources are available to local governments from national sources?

Inevitably, local governments depend to a significant degree on financial resources that they obtain from national sources. Does this include financial resources provided directly to local governments through revenue sharing? If yes, please address question 2.A. Does this include financial resources from the State budget in the form of transfers? If yes, there are two general types of transfers, which you should consider. Please continue with question 2.B. to look at issues related to unconditional transfers. Then continue with question 2.C. to look at issues related to conditional transfers.

2.A Do local governments receive a share of certain national tax revenues?

How has revenue sharing been authorized? Is it in a separate law on local finances? Or, is it authorized each year as part of the national budget? This may have an impact on the stability of revenue sharing.

Examples of shared national taxes in countries of central and eastern Europe:

Hungary	Personal income tax - 15% direct share to villages, towns and cities
Poland	Personal income tax - 15% direct share to gminas Corporate income tax - 5% direct share to gminas
Romania	Wage tax - 40% share to villages, towns, and cities; 10% share to county councils and 10% share available to county councils to distribute as equalization grants within their area of jurisdiction
Bulgaria	Personal income tax – 50% direct share to municipalities

2.B. What unconditional transfers do local governments receive from the State budget?

Depending on what other financial resources have been allocated to local governments, there may be different reasons for providing unconditional transfers. One would be to ensure the financing of a basic level of service or of expenditure needs. These are general-purpose transfers. Another would be to address differences in local fiscal capacity and needs. These are equalization transfers or grants. The two types have in common the fact that the local governments are free to use the funds for any public purpose consistent with local government legislation. That is, there are no restrictions imposed by the national government in the use of the funds.

Guiding principles of the Charter of Local Self-Government:
Article 9.5

The protection of financially weaker local authorities calls for the institution of financial equalization procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility.

Examples of unconditional transfers in countries of central and eastern Europe:

Hungary	Normative subsidy
Poland	General purpose grants
Lithuania	Municipal budget subsidies
Romania	Equalization grants
Latvia	Equalization Fund

2.C What conditional transfers do local governments receive from the State budget?

Guiding principles of the Charter of Local Self-Government:
Article 9.7

As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provisions of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.

What is the purpose of these conditional transfers? What local government financing or policy issues are addressed by conditional transfers that would not already have been included in other financing parameters of the local government system? How are they calculated? What criteria are used?

Explanatory Note:⁷ Block grants or even sector-specific grants are preferable, from the point of view of local authority freedom of action, to grants earmarked for specific projects. It would be unrealistic to expect all specific project grants to be replaced by general grants, particularly for major capital investments, but excessive recourse to such grants severely restricts a local authority's freedom to exercise its discretion with regard to expenditure priorities. However, the part of total resources represented by grants varies considerably between countries, and a higher ratio of project-specific grants to more general grants may be considered reasonable, where grants as a whole represent a relatively insignificant proportion of total revenue.

Examples of conditional transfers in countries of central and eastern Europe directed essentially to the financing of capital investment projects:

Hungary	Targeted subsidy, Water fund, Environmental protection fund, Regional development fund
Poland	Grants from National and Voivodship Environmental Protection Funds
Latvia	Environmental Protection Fund

⁷ *Explanatory Report on the European Charter of Local Self-Government*, Council of Europe, Strasbourg, 1986, page 16.

STEP 2***How? Analyzing the Management of the Financial Resources of Local Government***

Once you have analyzed the types of revenue sources that are available to local governments, the next question address issues regarding how local finances are managed:

How is the administration of local taxes and fees organized?

How are the rules for sharing and distribution of shared national revenues or for unconditional and/or conditional national transfers determined?

How is the local government budget prepared?

How is local financial information recorded, disclosed and reported?

Step 2 addresses each of these questions in turn.

3. How are own local financial resources administered?

3.A How are local taxes administered?

Once the specific local taxes have been defined, issues related to the administration of these taxes need to be addressed. By administration of taxes, we include issues such as, who identifies the taxpayers, who collects the funds, who enforces the law in case of nonpayment.

Examples of administration of local taxes in countries of central and eastern Europe:

Hungary

The local government is responsible for administering its own taxes. This includes deciding on the taxes to levy, writing and passing implementing decrees, setting the local rate, defining the base and any local exemptions, preparing tax declaration documents, calculating taxes owed, identifying taxpayers, and collecting the taxes. Thus, the more than 1,800 Hungarian local governments who have levied local taxes have had to create a system to enter and check taxpayer information and tax declarations, control and audit tax returns, impose late payment fines and determine how taxes are to be paid.

Romania

In 2000, the law transferred responsibility for taxpayer identification, tax notification, collection and enforcement from the County offices of the Ministry of Finance to the local and county councils. The funds collected are transferred to the Treasury account of the local government.

3.B. How are local fees administered?

Once the local fees have been defined, the issue of the administration of these fees needs to be addressed. In considering the administration of fees we include issues such as, who issues the bills, who collects the funds, who enforces the law in case of nonpayment.

4. How are financial resources provided to local governments from the national government administered?

Guiding principles of the Charter of Local Self-Government:
Article 9.6

Local authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them.

This principle applies to the sharing of national revenues as well as to unconditional and conditional transfers. If there are no shared national revenues please continue with question 4.B.

Explanatory Note:⁸ Where redistributed resources are allocated according to specific criteria set out in legislation, the provisions of this paragraph will be met if the local authorities are consulted during the preparation of the relevant legislation.

4.A How are national revenues shared?

There are several issues to consider in this case. How is the local share determined? Is it based on where the tax is collected or on some other formula, such as per capita allocations of the total amount collected nationally? Are the rules on revenue sharing subject to modification each year as part of the national budget process?

Examples of shared national taxes in countries of central and eastern Europe:

Hungary

Local governments receive a direct share of 15% of the personal income tax (PIT), paid according to the residence of the taxpayer.

Poland

Local governments receive a share of 15% of the PIT, paid according to the residence of the taxpayer. Local governments also receive a share of 5% of the corporate income tax

⁸ Explanatory Report on the European Charter of Local Self-Government, Council of Europe, Strasbourg, 1986, page 17.

(CIT), paid according to the location of the enterprise. Companies with branch offices pay CIT to the local governments where the branches are located, proportionately to the number of people employed in the branches.

Romania

As of January 2000, local governments receive a share of the wage tax, with 40% distributed to cities, towns and villages, and 20% to counties, based on the territorial administrative unit where the activity economic is carried out. This is the third change in the tax sharing rules since the Parliament adopted the Law on Local Public Finances in 1998.

Czech Republic

A fixed percent of the wage tax is distributed to each municipality on a per capita basis.

4.B. How are unconditional transfers calculated and administered?

How is the amount that each local government will receive determined? Is there a formula? If so, are the criteria adequate, that is, do they reflect local conditions fairly and accurately? Is the information used in the formula readily available so local governments can perform their own calculations? Are the rules governing unconditional transfers subject to modification each year as part of the national budget process?

Examples of the process to allocate unconditional transfers in countries of central and eastern Europe:

Hungary

Normative subsidy - The criteria and amounts of the normative subsidy are defined each year in the State budget law.

Poland

General subsidy - The formula for calculation of the general subsidy is included in the Local Government Finance Law, and includes a compensation or equalization element for the poorest local governments.

Romania

The new equalization grant is created in the Law on Local Public Finance. The formula for distribution of the grant is determined in the annual State Budget Law.

4.C. How are conditional transfers calculated and administered?

The analysis of conditional transfers for specific local government expenditures considers national policies that are the basis for the conditionality, as well as the sources and amounts of financing available for such expenditures. Some questions to consider when analyzing conditional transfers include:

-
- S What are national and/or regional priorities that justify setting up conditional transfers?
 - S What are the financial conditions for eligibility for these funds?
 - S What are the technical conditions for eligibility for these funds?
 - S What kind of procurement rules must be followed?
 - S Who administers the funds, approves applications, and monitors the implementation of the project?
5. How is the local government budget prepared and presented?
- 5.A How is the local budget prepared?

This question affects both the revenue and expenditure side of the budget. On the revenue side the issues have to do with the extent to which the local government has access to sufficient information to prepare a forecast of all different sources of financial resources. For local taxes and fees the result depends often on who has responsibility for the administration. If it is not the local government, then the entity responsible for the administration must provide the information needed for the forecast to the local government. In the case of financial resources provided from national sources, the result depends largely on the transparency and stability of the rules governing revenue sharing and transfers.

On the expenditure side the issues have to do with how expenditure estimates are constructed. This may involve estimates based on standard norms that describe the volume and cost of all inputs (personnel, materials) required to perform a specific service. It may also involve estimates based on past history and on the analysis of demand and need for the services.

The bottom line is that the local budget is only as good as the information that goes into its preparation. When local governments lack the information they need, or when they are forced to accept estimates provided or mandated by others, the budget loses much of its value as a financial management tool. Under these circumstances it also is difficult to hold local officials accountable for their management of the budget.

Examples from countries of central and eastern Europe:

Czech Republic

Czech municipalities have complete information on local taxes and fees and receive reasonable estimates of revenue sharing and transfers from the Ministry of Finance. They are completely in control of expenditure estimates. In this sense, the municipal budget in the Czech Republic is an effective financial management tool.

Romania, Bulgaria

Although the systems of local government in these two countries are different, they share a common experience in the manner in which they prepare their budget. They receive reasonable estimates of own revenues from the Ministry of Finance, which has responsibility for local tax administration. However, they have no idea what resources they will receive from the national government. Also, estimates for expenditures in key areas, such as health and education, are out of their hands. In Romania also there is a tendency on the part of the Ministry of Finance to modify local expenditure responsibilities yearly. In Bulgaria, the annual State budget determines priority expenditure areas of municipalities. In effect, in both countries local governments cannot really prepare their budget until the State budget has been adopted. Often, this occurs several months into the budget year, further detracting from the use that the local authorities can derive from the budget.

5.B How is the local budget presented?

The two key issues regarding how the local budget is presented are universality and format or structure.

The first issue looks at whether there is a single consolidated local budget that shows all revenues and sources of financing as well all expenditures of the local government. The alternative is to authorize the use of “off budget” accounts for specific activities. Often, these activities generate their own revenues from fees that cover part of their costs, although the organization implementing the activity legally and financially is dependent on the local government. A related question is whether own revenues and the expenditures paid with those funds and the revenues from national sources and the expenditures paid with those funds are consolidated in a single budget presentation.

Examples in countries of central and eastern Europe:

Czech Republic

All Czech municipalities maintain a budget that shows all their own financial resources, as well as those received from the State and other sources of financing. This budget covers only part of the services and investments funded with those funds. A Czech municipality will have at least one “contributory” organization that is off budget. Most have more than one. Prague has several hundred. These can be anything from individual schools and health facilities to the local public transport system to other organizations that provide general services (street maintenance, cemeteries, asset management). The municipal council charters the organizations. Only the transfers from and to these contributory organizations appear in the budget of the municipality.

Macedonia

Municipalities in Macedonia have a “budget” which covers only the administrative expenses of running the local government. They also have several “funds” for specific activities, typically urban development and streets, financed with transfers from the State. These various budgets are not consolidated. They do not even follow a uniform presentation, which makes it very difficult to construct even an ad hoc consolidation. All services are provided by local public enterprises chartered under a special law for such entities. Each

has its own budget and accounts. These are separate corporate entities that operate independently. The municipality reviews an annual “program” for each enterprise. There is a legitimate argument in favor of maintaining separate budgets and accounts for the local public enterprises. However, the simple fact is that the lack of a consolidated budget including the municipality, the funds and the local public enterprises makes it virtually impossible to get a complete picture of the total cost of all the public services provided under the authority of the municipality.

Romania

All local and county councils maintain a budget that shows all their own financial resources, as well as those received from the State and other sources of financing. This budget covers only part of the services and investments funded with those funds. A Romanian local or county council will have at least one “local public institution” that is off budget. Most have more than one. Bucharest has several hundred. These can be anything from individual schools and health facilities to museums and sports facilities. Some local public institutions depend on more than one “budget center” which maintains a separate budget and accounts. In each locality there also are several public enterprises, called *regia* following the French model they emulate. They depend on their own fee income, although several receive subsidies from the local or county budget. Each *regia* has its own budget and accounts. These are separate corporate entities that operate independently. There is a legitimate argument in favor of maintaining separate budgets and accounts for the *regia*. However, the simple fact is that the lack of a consolidated budget including the local or county council, the local public institutions and the *regia* makes it virtually impossible to get a complete picture of the total cost of all the public services provided under the authority of the local or county councils.

The second issue has to do with the format or structure of the budget. Actually, there are two separate considerations. The first is whether there is a uniform budget structure that all local governments in the country must adhere to. The second is whether the structure of the budget includes separate sections for current revenues and expenditures and for capital financing and investments.

5.C How are revenues and expenditures recorded and reported?

There are three separate issues here - accounting, financial reporting and public access and information standards and practices. Issues regarding accounting and financial reporting standards are highly technical and complex. The idea is to be aware of the need to provide financial information that is timely, accurate and complete. As in the case of the budget format, there also is a question whether there are uniform national standards. Otherwise, this is an evolutionary process that will take time. Standards regarding public access are a question of public policy. The basic issue is what information must be provided to the public, when and in what form.

STEP 3

Who? Analyzing Decision Making Regarding the Financial Resources of Local Governments

What financial revenues are made available to local governments, how they are administered and how the local budget process works are all important considerations. The relevance of these decisions to local authority and autonomy cannot be appreciated fully until it is clear who makes the key decisions regarding these and other aspects of local finances.

6. Who makes the key decisions regarding local taxes and fees?

6.A Who makes the key decisions regarding local taxes?

Guiding principles of the Charter of Local Self-Government:
Article 9.3

Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.

Explanatory Note:⁹ The exercise of a political choice in weighing the benefit of services provided against the cost to the local taxpayer or the user is a fundamental duty of local elected representatives. It is accepted that central or regional statutes may set overall limits to local authorities' powers of taxation; however, they must not prevent the effective functioning of the process of local accountability.

The key decisions regarding local taxes are who sets the tax base and the tax rate? If these are truly local taxes, then by definition there must be some local discretion in determining the tax liability or assessment. This may involve some authority to set the tax base or rate or both.

The issues regarding the tax base include how it is defined, how it is revalued, who revalues. Tax bases that are not fixed, but evolve with economic activity and income tend to ensure a steadier level of income to local governments. If the local government taxes are based on fixed tax bases, which require reevaluation, a specific formula or system would need to be defined to ensure some type of (almost) automatic reevaluation. If a Parliamentary or Ministerial decision is required for tax base reevaluation, there is a risk that the political decision will not be taken (as has happened in Albania and Romania), and the level of local government revenues will not keep pace with the evolution of their costs.

⁹ Explanatory Report on the European Charter of Local Self-Government, Council of Europe, Strasbourg, 1986, page 16.

The issues regarding the tax rate are more varied. Is there a national tax rate, applicable to all local governments? Is there a maximum tax rate, or a range of rates from which each local council can determine the rate to be applied in its jurisdiction? This is a common situation. Do local councils have the right to establish local exemptions and/or deductions for hardship cases or in cases of special local interest?

Examples of authority to determine local taxes in countries of central and eastern Europe:

Hungary

Hungarian local governments have been given the choice among four local taxes - property tax, business tax, tourism taxes and communal taxes. They are defined in the Law on Local Taxes of 1990 (amended in 1992 and 1996). These taxes are not obligatory, but must be instituted by a decision of the local council. The Law on Local Tax sets the maximum or ceiling rate for each type of tax. The local council, when choosing to levy a local tax, can set any tax rate up to but not exceeding the ceiling rate.

As the base for the local property tax, local governments have the option to adopt either the area (in m²), or the property value, defined as the "corrected sale value" (50% of the estimated sale value) tax base. The property tax on buildings can be applied to housing and to non-residential buildings. The land tax is applied to vacant plots in the urbanized area only. The tax base for the business tax is the turnover of enterprises, that is receipts minus VAT. For the tourism taxes there are two alternative forms. One is a fixed tax per person / per night for stays of more than 48 hours. The other is a property tax on vacation homes and tourist accommodations. In the case of the communal tax there also are two options. One is a personal communal tax with a lump sum payment for taxable objects (such as an apartment). The other is a business communal tax, with a lump sum payment per employee.

The rule is that the same object cannot be taxed twice, so if a local government decides to impose the property tax on residences, it cannot at the same time levy the personal communal tax. A town could simultaneously levy both types of tourism taxes, but if there is already the property tax on residences, it could not also opt for the tourism tax on vacation homes.

Poland

The law sets a maximum rate. Local governments may vote the maximum rate, or a tax rate below the maximum. Local government may also determine local exemptions or deductions for hardship cases. (Note: Calculations of part of the general subsidy (unconditional transfers) are based on fiscal revenue potential, according to the maximum rate. Local governments cannot try to set a lower tax rate in the hope of receiving more revenues from the general subsidy.)

Romania

The base for the property tax is the value per square meter of buildings and the "footprint," based on historical construction costs. A recent change to the Law on Local Taxes and Fees has raised the tax base values by decree, by a factor of 30. (Note: The value of the

base for the property tax had been set in 1994-95, and not been changed until 1998. This is an example of the problems, which arise when a fixed tax base is not reevaluated on a regular basis according to fixed rules or formulas). A single rate is set for building and property taxes, but local governments may adjust this rate upward or downward by up to 50 percent.

6.B Who makes the key decisions regarding local fees?

The key issues regarding local fees are two. The first regards who adopts the method used to calculate the amount of the fee. In some cases this may involve a formula or algorithm. The second is who approves the actual amount of the fee, if there is no formula or if the formula does not produce a single calculated amount. If these are truly local fees, then by definition there must be some local discretion in determining the amount of the fee. This may involve some authority to determine the method for calculating the fee or the actual amount of the fee or both.

Some of the questions to be answered include:

Is there a single method applied uniformly in the country for calculating specific local fees? If so, does the method allow local discretion to make adjustments to reflect local conditions? Or are local councils given authority to determine the method and amount for specific local fees? Are local decisions subject to review by an outside body, such as a regulatory commission?

Examples of fee setting authority in countries of central and eastern Europe include:

Romania

Rates for fees for use of public goods and for permits are set in the Law on Local Taxes and Fees. Local governments may adjust some of these rates upward or downward by up to 50 percent. Fees for public services, such as water, are adopted by the local or county council, but must be approved by the Competition Commission. They cannot include a provision for amortizing investments. The exception is for water authorities, which have borrowed from the EBRD, as this was a requirement of the loan agreement. The fact that this possibility is not open to other municipalities considerably hampers their ability to raise additional funds for investment in water and wastewater systems, for example.

Bulgaria

Rates for use of public goods and permits are set in the Local Taxes and Fees Act. The rates for fees are set within a scale of rates. The municipal council sets fees for public services such as solid waste collection, water, and heating. The setting of the sanitation fee is based on the principle of cost recovery, and can include investment expenditures. Recent legislation on water and energy efficiency has also incorporated the notion of setting service fees based on principles of cost recovery, including for investment.

7. Who makes the key decisions regarding the local budget and its implementation?

7.A Who has the authority to adopt and amend the local budget?

It is very likely that the local government has the basic authority to adopt and amend its own budget. The issue really is to what extent that authority is constrained by other considerations. The first question is whether the local budget depends on the national budget? If so, does approval of the local budget have to wait for approval of the national budget? Similarly, do the amendments to the local budget have to wait for amendments to the State budget?

The second question is whether the local budget is reviewed by the national government before it is adopted. This review may be related to requests for funding from national sources.

Finally, are there certain basic budget standards that the local government must meet which limit its discretion? For example, there may be a requirement for a balanced budget, that is, one in which revenues and expenditures are balanced.

Examples of budget procedures in countries of central and eastern Europe include:

Czech Republic

Czech municipalities have complete authority to adopt and amend their budgets. The only constraint they face is the requirement for a balanced budget. There is no prior or subsequent review by the national government of the local budget.

Bulgaria, Macedonia

In both countries, budget approval is tied to the national budget. Further, the Ministry of Finance reviews the budgets in draft before they are adopted. In the case of Bulgaria this review nominally is to determine the gap between projected revenues and planned expenditures that are to be covered by transfers. In practice, this leads to a dialog regarding planned local expenditures. In Macedonia, the review is to verify that the local budget conforms to spending limits imposed by law. The Ministry of Finance also looks at planned personnel decisions to confirm that they conform to national regulations. In 1998, the Constitutional Court ruled that the Ministry of Finance had no authority to review local budgets.

Romania

Until 1998, local budgets were tied to the State budget. If the budget year began, local and county councils received interim authorization from the Ministry of Finance to initiate spending based on a monthly equivalent of 8.75 percent of prior year expenditures. This restriction applied as well to expenditures to be funded from local taxes and fees. Also, the local governments had to submit their draft budget to the Ministry of Finance for review. The new Law on Local Public Finance changed all this beginning in 1999. However, the Ministry of Finance has continued many of the old practices, although it no longer is clear that they have the authority to do so.

7.B Who has authority to implement the local budget?

As with approval and amendment of the budget, the question regarding budget implementation is not whether local governments have the basic authority, but to what extent that authority is constrained or limited. The first question is who has control over local cash management. That is, are local governments authorized to decide where to keep their cash deposits? Or are they required by law or regulation to keep them in a particular institution, usually the State treasury? Are local governments authorized to earn interest on these deposits?

A related question has to do with the approval of expenditures. Are local expenditures subject to prior review and approval by the national government before any payments are made? Do those restrictions apply to all local expenditures or only to those funded with resources provided by the national government?

Some examples from countries in central and eastern Europe include:

Czech Republic

Czech municipalities are free to open accounts in any bank to deposit their funds. They may also place their funds in short-term investments where they can earn interest. The municipalities approve their own expenditures. There is no outside review or approval, even for expenditures funded with resources from the national government.

Macedonia

Until 1995, municipalities in Macedonia were authorized to keep their funds in interest bearing accounts in commercial banks. They then were required to keep the funds in the central bank, the National Bank of Macedonia, which effectively means that the deposits and payments are managed through the central payment agency - ZPP. They are now required to keep their funds with the State treasury, but this provision has not been implemented fully. Also, it is not clear to what extent these rules apply in practice to the resources managed through the off budget "funds." Municipalities appear to have complete authority to approve their own expenditures and make the corresponding payments.

Romania

Local and county councils in Romania must keep their funds in the State treasury, where they do not earn interest. This requirement applies to all funds, including those from local taxes and fees. The Ministry of Finance has refused to heed repeated requests by local officials to be allowed to maintain their own accounts in commercial banks, as they could up to 1994. The local and county councils appear to have complete authority to approve their own expenditures and make the corresponding payments.

8. Who determines the overall level of financial resources available to local governments?

Guiding principles of the Charter of Local Self-Government:

Article 9.2

Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.

Explanatory Note:¹⁰ The legal authority to perform certain functions is meaningless if local authorities are deprived of the financial resources to carry them out.

All the discussion so far in this document has centered on the analysis of individual sources of financial resources for local governments. This has included both own resources composed mainly of local taxes and fees. It also includes additional funds made available from national sources through revenue sharing and transfers. Is the sum of resources from all the sources adequate to meet local needs? The remaining issue to consider regarding local financial resources is who makes the key decisions that determine the total amount of these resources.

What are the key decisions? On the one hand, local authorities themselves have a role to the extent that they have discretion to set the value of local taxes and fees. On the other hand, national authorities have a role to the extent that they decide the overall pool of resources to make available through revenue sharing or transfers.

8.A What is the responsibility of local governments to determine the overall amount of own financial resources?

Note that the question in this case has been rephrased to look at the issue of responsibility. By definition, if there are local taxes and/or fees, then local governments have some level of authority to determine the overall revenues they receive from these sources. The key question is whether they have to face the consequences of the choices they make in this area. For example, what effect would lower local taxes have on the level of transfers from the national budget? If the transfers grow to compensate for lower revenues from local taxes, then the local governments are free to avoid their share of the responsibility for making sure that total revenues are adequate to their needs.

¹⁰ *Explanatory Report on the European Charter of Local Self-Government*, Council of Europe, Strasbourg, 1986, page 16.

8.B Who determines the overall pool of financial resources from national sources that will be available to local governments?

This is a discussion of the total financial resources made available in any given year in the aggregate to all local governments from national sources, not of the amount each individual local government will receive. Often this is referred to as the pool of resources available for local governments through revenue sharing and transfers. The decisions regarding this aggregate amount are made at the national level. The question is who decides and how.

The most important consideration is whether this decision is made explicitly, that is, if the size of the pool is identified as part of the annual national budget process. If there is an explicit discussion of the issue then there are two important considerations. The first is whether associations representing local governments have an opportunity to comment on the proposed size of the overall pool of national resources they are to receive as a group. The second is what criteria are to be used in determining the size of the pool.

It is clear that local governments in all of central and eastern Europe rely and will continue to rely on financial resources from national sources to a very high degree. Therefore, the decisions made at the national level that determine the overall pool of national resources made available to local governments through revenue sharing and/or transfers are extremely critical to the success and viability of the system of local finances.

9. Who makes the key decisions regarding access to and use of credit by local governments?

It is recognized that in the interest of public debt management certain restrictions may be placed on use of credit by local governments, but which still allow them a measure of local decision-making authority. The key questions to look at, include but are not limited to:

- S For what purpose(s) may local governments borrow?
- S Are there specific guidelines for long-term and short-term borrowing?
- S Does access to borrowing include the ability to issue bonds?
- S Are there borrowing or debt service limits?
- S What are permitted sources for collateral for loans?
- S Are there requirements to inform the State of borrowing by local governments?
- S Are local governments required to obtain authorization from the State for all proposed credit or for certain types of borrowing?
- S Are there specific rules for settlement and repayment in the case where a local government is unable to meet its repayment obligations?

ANALYZING LOCAL GOVERNMENT FINANCES

C. PRACTICAL EXERCISE

Country Profiles

Annexes 3 and 4 describe the expenditure responsibilities, sources of revenues and other financial parameters in hypothetical countries A and B. Although many of the examples included in these two country profiles exist in one or another country of central and eastern Europe, neither profile describes the system of local government in a specific country in that region. Neither profile is meant to be good or bad. Each has characteristics that are positive and negative.

The two profiles follow the format of the worksheets for expenditure and revenue assignments included in Annexes 1 and 2. Only those items that apply to the profile are included. Thus, some of the line items from the worksheets may be missing. The profile describes the situation as it exists in the current year. Where terms are bracketed by quotation marks, these are meant to represent actual language used in the applicable legislation. Where boxes in the profile are left empty, this is meant to indicate that there are no provisions related to the topic in the legislation or in existing regulations.

Case study

The National Local Government Association represents a majority of the local governments in the country. Recent elections brought to power a coalition Government that promised to “strengthen local democracy” in the country. The new coalition also is pledged to maintain strict fiscal discipline. The NLGA is preparing to enter into a dialog with the new Government, which takes office in a month.

You are employed in a non-profit research institute. The institute has been retained by the NLGA to develop recommendations on key reforms to the current system of local government finances. These will become the agenda for the dialog between the NLGA and the new Government. Your job includes the following specific tasks:

- ✓ To develop a prioritized agenda of reforms to the current system of local government finances. The NLGA wants a clear justification for the reforms you are recommending and for their rank order.
- ✓ To develop a list of the strong points of the existing system that should be retained and reinforced.
- ✓ To identify any aspect of the current system of local government finances that might be affected by a tight fiscal policy.

ANNEX 1

Worksheets - Responsibilities

Worksheet 1.1 – Global or Generic Allocation of Responsibilities

Function	Administrative	Service	Investment	Regulatory
Agriculture				
Cemeteries				
Community Development				
Culture				
Education				
Health				
Housing				
Local Economic Development				
Local Public Administration				
Local Public Infrastructure Services				
Parks				
Public Safety				
Public Works				
Sports				
Social Assistance				
Urban Development				

Worksheet 1.1 - Specific or Partial Allocation of Responsibilities

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
Agriculture				
- Artificial insemination units				
- Pest control				
- Veterinary clinics				
Cemeteries				
Community Development				
- Community centers				
- Community organizations				
- Community services				
Culture				
- Houses of culture				
- Libraries				
- Museums				
- Other				
Education				
- Pre-school				
- Primary				
- Secondary				

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
- Vocational				
- University				
- Hostels, dormitories				
Health				
- Primary health clinics				
- Hospitals				
- Specialized Health Facilities				
Housing				
Local Economic Development				
- Markets				
- Small and micro business				
- Tourism				
- Other economic				
Local Public Administration				
- City hall, local administration				
- Civil registry				
- Other				

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
Local Public Infrastructure Services				
- Heating				
- Gas				
- Solid waste				
- Transport				
- Water				
- Waste water				
Parks				
Public Safety				
- Fire				
- Natural Disaster				
- Police				
Public Works				
- Bridges				
- Flood control, storm drainage				
- Public lighting				
- Streets, roads				
Sports				
- Recreational facilities				

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
- Sports clubs, teams				
- Stadiums				
Social Assistance				
- Children				
- Elderly, retirees				
- Handicapped				
- Income support				
- Other Subsidies				
- Unemployed				
Urban Development				

Worksheet 1.2 – Illustrative Content by Column

Administrative responsibilities:

- Full/All
- Personnel all
- Payroll
- Beneficiary selection/identification (primarily for social assistance)
- Records management (civil registry)

Service responsibilities:

- Full/All (E.g. Establish service parameters, provide service to local community)
- Full/All (E.g. Collection and disposal/treatment of waste water or solid waste)
- Operating support grants (e.g. for community organizations, sports clubs)
- Partial (e.g. Only maintenance & operation of facilities, such as buildings used for health clinics or schools)

Investment responsibilities:

- Full/All
- Facilities (e.g. school buildings, stadiums)
- Equipment
- Site development (for housing or local economic development)

Regulatory responsibilities:

- Full/All
- Licenses (for markets, businesses, vehicles, drivers)
- Permits (for construction, land development)
- Regulations, plans (for local economic development, urban planning, housing)
- Rates, tariffs, fees (for infrastructure, regulatory functions such as permits, local public administration services)
- Concessions

ANNEX 2

Worksheets - Revenues

Worksheet 2.1 – Local Sources of Revenues

Revenue Sources	Establish Tax Base	Establish Tax Rates	Administer Tax Rolls	Collect Taxes	Enforce Taxes
LOCAL TAXES					
- Communal tax					
- Gift tax					
- Inheritance tax					
- Property tax on buildings					
- Property tax on land					
- Real estate transaction tax					
- Tourism tax					
- Vehicle tax					

	Establish Method to Calculate Fee	Approve Fee schedules		Collect Fee	Enforce Payment of Fee
LOCAL FEES					
<i>Fees related to a service</i>					
- Heating/ hot water					
- Gas					
- Mass transit					
- Solid waste					
- Street lighting					
- Taxis					
- Water					

	Establish Method to Calculate Fee	Approve Fee schedules		Collect Fee	Enforce Payment of Fee
<i>Fees for use of a public good</i>					
- Advertising space					
- Business signs					
- Cemeteries/burial					
- Entertainment / spectacles					
- Use of public spaces (sidewalks, squares, parks)					
<i>Fees for permits</i>					
- Building construction or reconstruction					
- Car registration					
- Drivers license					
- Fishing license					
- Hunting license					
- Land development					

OTHER REVENUES	OWN LOCAL	Yes/No				
- Foreign donations						
- Local donations/ gifts						
- Interest on deposits and investments						
- Fines and penalties						
- Profit from local companies						
- Proceeds (lease, rent, sell) from local property						

Worksheet 2.2 – National Sources of Revenues

OTHER OWN LOCAL REVENUES	Yes/No		
- Foreign donations			
- Local donations/ gifts			
- Interest on deposits and investments			
- Fines and penalties			
- Profit from local companies			
- Proceeds (lease, rent, sell) from local property			
SHARE OF NATIONAL REVENUES	Yes/No	Percent Local Share	
- Income tax on individuals			
- Income tax on enterprises			
- Excise taxes			
UNCONDITIONAL TRANSFERS	Yes/No	Method of Allocating	
- General purpose			
- Equalization			

CONDITIONAL TRANSFERS	Yes/No	Method of Allocating
- Environment		
- Roads		
- Regional development		
- Other (specify)		

ANNEX 3

Country Profile A

Country Profile A - Allocation of Responsibilities

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
Agriculture				
- Veterinary clinics	Local governments responsible for payroll based on uniform national public sector wage scale. Ministry of Agriculture has full authority over all personnel decisions in the clinics.	None	None	Ministry of Agriculture regulates all veterinary clinics in the country
Cemeteries	Full	Operate in accordance with national standards established by law		National Law on Cemeteries defines uniform national standards
Culture				
- Houses of culture	Local governments pay for all operating expenses. Ministry of Culture negotiates wages with unions.	Operate in accordance with Ministry of Culture standards		Ministry of Culture regulates activities of all cultural facilities in the country.
- Libraries				
- Museums				

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
Education				
- Pre-school	Local governments pay for all operating expenses. Payroll is based on uniform national education sector wage scale. Ministry of Education has full authority over all personnel decisions in the local schools.	None	None	Ministry of Education has full authority to determine all education sector standards and to establish teaching curriculum.
- Primary				
- Secondary				
- Hostels, dormitories	Local governments pay for all operating expenses and pay basic maintenance allowance to students.	Full		Ministry of Education establishes amount of basic maintenance allowance for students
Health				
- Specialized Health Facilities	Local governments pay for all operating expenses of facilities for handicapped. Payroll is based on uniform national health sector wage scale. Ministry of Health has full authority over all personnel decisions in the facilities.	None	None	Ministry of Health regulates activities of all facilities for the handicapped in the country.
Housing	Full regarding public	Implement at the local	Full	Ministry of Public

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
	housing.	level the national housing program as established by the Ministry of Public Works and Housing		Works and Housing is responsible for developing national public housing policies and programs
Local Economic Development				
- Markets	Full	Local governments operate their own markets		None
- Other economic	General law on local government says local governments are responsible for “promoting local economic development.”			
Local Public Administration				
- City hall, local administration	Full. Payroll is based on uniform national public sector wage scale.	Full		Full
- Civil registry	None	None	None	None
Local Public Infrastructure Services				
- Heating	Local governments appoint Board of Directors of district heating companies	Local government in agreement with district heating companies	Full	
- Gas	Operated by national gas monopoly			

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
- Solid waste	Local governments have the authority to determine how to provide local solid waste collection services	Full with regard to solid waste collection. May contract with private firms for services.	Full	Ministry of the Environment responsible for regional solid waste dumps
- Transport	Local governments appoint Board of Directors of public transport companies	Local government in agreement with public transport companies	Full	
- Water and waste water	Local governments have the authority to determine how to provide local water and sewer services	Local government in agreement with service provider as determined by local government	Full	Ministry of Health regulates potable water standards.
Parks		Full regarding "local" parks	Full regarding "local" parks	
Public Safety				
- Fire	Unified national fire company operates under control of Ministry of Defense			
- Natural Disaster	Local governments disburse funds authorized by the State budget in the event of for a specific emergency	Local governments manage any disaster relief programs that may be budgeted for a specific emergency		Ministry of Interior and Ministry of Defense develop disaster relief plans and programs

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
- Police	Unified national police operates under control of the Ministry of Interior			
Public Works				
- Bridges	Local governments pay for all operating and maintenance costs of "local" facilities	Full regarding "local" facilities		None
- Flood control, storm drainage				Ministry of Agriculture has full authority over all water resources in the country
- Streets, roads				None
Sports				
- Recreational facilities	Local governments pay for all operating and maintenance costs of "local" facilities	Full regarding "local" facilities		
- Sports clubs, teams	Ministry of Education authorizes and regulates operations of all sports clubs and teams in the country			
- Stadiums	Full regarding "local" facilities. Most stadiums in larger cities deemed to be of "national" interest	Operate "local" facilities in accordance with Ministry of Education standards		Ministry of Education regulates operations of all stadiums in the country

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
Social Assistance				
- Elderly, retirees	Local governments pay for all operating and maintenance costs of homes for the elderly			National Social Insurance Agency operates uniform national pension program
- Income support	Local governments process payments of basic family subsidy			Ministry of Labor and Social Protection has full authority over all income support programs
- Other Subsidies	Local governments process payment of subsidies for housing			Ministry of Public Works and Housing establishes uniform national subsidies for housing
Urban Development		Local governments develop urban plan in accordance with standards and procedures established by the Ministry of Public Works and Housing		Ministry of Public Works and Housing reviews all local urban plans

Country Profile A - Local Sources of Revenues

Revenue Sources	Establish Tax Base	Establish Tax Rates	Administer Tax Rolls	Collect Taxes	Enforce Taxes
Local Taxes					
- Communal tax	Set by law	Within range set by law	Local function	Local function	Local authority to set penalties
- Property tax on buildings	Set by law	Set by law	National function	National function	National function
- Property tax on land					
- Real estate transaction tax					
- Tourism tax	Set by law	Set by law	Local function	Local function	
Local Fees					
	Establish Method to Calculate Fee	Approve Fee schedules		Collect Fee	Enforce Payment of Fee
<i>Fees related to a service</i>					
- Heating/ hot water	Uniform national	Local governments approve and National Energy Commission concurs		District heating company	District heating company Service cut-offs must go through courts
- Gas	Under full authority of national gas monopoly				

- Public transport	Uniform national	Local governments approve	Local public transport company	
- Solid waste	Based on full cost recovery	Local governments approve	Service provider	Service cut-offs must go through courts
- Street lighting	Included in communal tax			
- Taxis	Uniform national	National function	Taxis	
- Water and sewer	Uniform national based on full cost recovery	Local governments approve	Local water and sewer company	Local water and sewer company Service cut-offs must go through courts
	Establish Method to Calculate Fee	Approve Fee schedules	Collect Fee	Enforce Payment of Fee
<i>Fees for use of a public good</i>				
- Advertising space	Local function	Local function	Local function	Local function
- Business signs				
- Cemeteries/burial	Set by law	N/A		Local function
- Entertainment / spectacles	Local function	Local function	Local function	Local function
- Use of public spaces (sidewalks, squares, parks)				
<i>Fees for permits</i>				
- Building construction or reconstruction	Set by law	N/A	National function	

Other local sources of financing					
- Foreign donations					
- Local donations/ gifts	Yes				
- Interest on deposits and investments	No				
- Proceeds (lease, rent, sell) from local property	Yes				
- Profit from local companies	Yes				
- Credit	Only loans for investments of "local significance"	<p>Two-thirds majority of Local Council must approve loans. May pledge revenues from local taxes and fees as guarantee. Ministry of Finance has been reviewing all proposed new loans by local governments to verify compliance with "national policy." Only loans to date have been guaranteed by the Government.</p> <p>Context: The Government has been unable to reach an agreement with the IMF because it has been unable to agree on overall targets for reducing the budget deficit. The Government has been issuing bonds denominated in its own currency to finance its deficit spending. Domestic banks have purchased most bonds.</p>			

Country Profile A – National Sources of Revenues

Share Of National Revenues	Yes/No	Percent Local Share
- Wage tax	Yes	25% of wage taxes paid by persons employed in each local jurisdiction
- Other taxes	Yes – VAT	15% of total national revenues distributed on per capita basis
Unconditional Transfers	Yes/No	Method of Allocating
- General purpose	No	N/A

- Equalization	Yes	Added to share of wage tax so that all local governments receive on a per capita basis a share equivalent to at least 25% of average national per capita wage tax collection
Conditional Transfers	Yes/No	Method of Allocating
- Environment	Yes	For specific investment projects approved by the Ministry of the Environment
- Roads	Yes	Per capita share of national road tax, but may be used only for specific investment projects approved by the National Road Fund
- Regional development	No	N/A
- Other (specify)	Yes for education	Must be used to pay payroll in local schools

Country Profile A – Other Financial Parameters

Local government legislation	Content	Status
General Law on Local Government	Establishes expenditure responsibilities and main revenue sources of local governments in general terms. Law provides for a prefect appointed by the Government in each district. The prefect has the authority to challenge local government decisions that “are contrary to the law.” Any decision that has been challenged remains suspended until resolved by the courts.	Requires simple majority in Parliament to amend the law
Law on Public Property	Transfers to ownership of local governments all property associated with the performance of their functions. Some assets, including most of the infrastructure, are considered part of the “public patrimony and are inalienable.	Implementation has proceeded quickly. Most local public utility companies have been corporatized and their assets transferred to local governments.
State budget law	Annually establishes expenditure responsibilities and main revenue sources of local governments.	
Financial Management	Content	Status
Budget Process	Based on calendar year. Tied to State budget. Local governments must approve their annual budget by December 15 of the prior year. If State budget has not been approved by January 1, local government budgets are suspended and operations continue on the basis of rules issued by the Ministry of Finance. Local governments must keep all their funds in accounts in the State Treasury.	The State budget has been approved after January 1 in all recent years. MoF rules have limited local spending to a <i>pro rata</i> share of actual expenditures in prior year.

Budget Structure	Uniform national structure for "General Local Budget." Has separate sections for all revenues and for all expenditures. Separate budgets for revenues and expenditures from Environment and Road Funds.	Same in recent years
Cash management and disbursements	Local governments must keep all funds in an account at the State Treasury. Disbursements are processed through the State Treasury. Local government may carry over any year-end surplus in the General Local Budget. Any surplus in the special fund budgets may be carried over, but only for approved project expenditures into next year.	Unified State Treasury implemented in current year
Financial reporting model	Accounting is strictly cash based. Uniform codes and structure used by all levels of government. Primary purpose of reporting is to show conformance with budget.	Rules issued by the Ministry of Finance. Modified slightly each year, but basically has remained the same in recent times.
External audit and oversight	Court of Accounts reviews all local government expenditures on a random basis. This may include pre-audit of certain expenditures. Prefect may challenge specific expenditures if deemed not to be "in accordance with the law."	Same in recent years

ANNEX 4
Country Profile B

Country Profile B - Allocation of Responsibilities

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
Cemeteries	Full	Full	Full	
Culture				
- All "local" cultural functions	Full	Full	Full	Ministry of Culture issues minimum standards that apply to all cultural facilities in the country.
Education				
- All pre-university education	Local governments pay all operating and maintenance costs of local public school facilities	None	Full regarding local public school facilities	Ministry of Education has full authority to determine all education sector standards and to establish teaching curriculum.
- Hostels, dormitories	Local governments pay for all operating and maintenance expenses of hostels	Full	Full	N/A
Health				
- Specialized Health Facilities	None	None	None	All national

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
Housing	Full regarding public housing.	Full	Full	
Local Economic Development				
- Markets	Full	Full	Full	Full
- Other economic	General law on local government says local governments are responsible for “promoting local economic development.”			
Local Public Administration				
- City hall, local administration	Full	Full	Full	Full
- Civil registry	Local governments in large cities operate civil registry	None	None	Ministry of Justice has full authority of norms and procedures for civil registry
Local Public Infrastructure Services				
- Heating	Local governments appoint Board of Directors of district heating companies	Local government in agreement with district heating companies provide the service	Full	National environmental law establishes air quality standards and penalties for non compliance
- Solid waste	Full with regard to solid waste collection. May contract with private firms for services, subject to concurrence of Ministry of Health	Designated service provider	Full	Ministry of the Health responsible for inspecting solid waste collection services Ministry of the

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
				Environment responsible for regional solid waste dumps
- Transport	Local governments appoint Board of Directors of public transport companies	Public transport companies	Full	Ministry of Transport and Communications sets basic service standards for public transport
- Water / waste water	Local governments appoint Board of Directors of public water and sewer companies. May contract with private firms for services, subject to concurrence of Ministry of Public Works and Housing	Designated service provider.	Full	Ministry of Health regulates potable water standards. Ministry of Agriculture has full authority over all water resources in the country
Parks	Full regarding "local" parks	Full regarding "local" parks	Full regarding "local" parks	
Public Safety				
- Fire	Full	Full	Full	

Function	Administrative Responsibilities	Service Responsibilities	Investment Responsibilities	Regulatory Responsibilities
- Natural Disaster	Local governments pay operating costs of local civil defense offices	Local governments manage any disaster relief programs that may be required		Local governments coordinate disaster relief plans with Government
- Police	Full regarding local traffic and security in local public facilities	Full regarding local traffic and security in local public facilities		Ministry of Interior establishes standards for local police staff
Public Works	Full	Full	Full	
Sports	Full	Full	Full	
Social Assistance				
- Elderly, retirees	Local governments pay for all operating and maintenance costs of homes for the elderly	Full	Full	National Social Insurance Agency operates uniform national pension program
- Income support	Local governments pay full operating costs of local social assistance offices	Full regarding selection of beneficiaries and processing of payments		Ministry of Labor and Social Protection has full authority over all income support programs
Urban Development		Local governments develop urban plan and issue land use and building permits		Ministry of Public Works and Housing reviews all local urban plans for conformance with regional plans

Country Profile B - Local Sources of Revenues

Revenue Sources	Establish Tax Base	Establish Tax Rates	Administer Tax Rolls	Collect Taxes	Enforce Taxes
Local Taxes					
- Communal tax	Initially set by law. May be adjusted by local government to reflect inflation	Within range set by law	Local function	Local function	Local authority to set penalties
- Property tax on buildings	Initially set by law. May be adjusted by local government to reflect inflation	Within range set by law	Local function	Local function	
- Property tax on land					
- Real estate transaction tax					
- Tourism tax	Initially set by law. May be adjusted by local government to reflect inflation	Within range set by law	Local function	Local function	

	Establish Method to Calculate Fee	Approve Fee schedules	Collect Fee	Enforce Payment of Fee
Local Fees				
<i>Fees related to a service</i>				
- Heating/ hot water	Uniform national	Local governments approve National Energy Commission concurs	District heating company	District heating company Service cut-offs must go through courts
- Gas	Under full authority of national gas monopoly			
- Public transport	Uniform national	Local governments approve National Public Services Regulatory Agency concurs	Local public transport company	
- Solid waste	Uniform national	Local governments approve	Service provider	Service cut-offs must go through courts
- Street lighting	Included in communal tax			
- Taxis	Uniform national	National function	Taxis	
- Water and sewer	Uniform national	Local governments approve National Public Services Regulatory Agency concurs	Local water and sewer company	Local water and sewer company Service cut-offs must go through courts

	Establish Method to Calculate Fee	Approve Fee schedules		Collect Fee	Enforce Payment of Fee
<i>Fees for use of a public good</i>					
- All	Local function	Local function	Local function	Local function	Local function
<i>Fees for permits</i>					
- Building construction or reconstruction	Local function	Local function	Local function	Local function	
Other local sources of financing					
- Foreign donations	Yes				
- Local donations/ gifts	Yes				
- Interest on deposits and investments	Yes				
- Proceeds (lease, rent, sell) from local property	Yes				
- Profit from local companies	50%				
- Credit	Yes	<p>Two-thirds majority of Local Council must approve any credit operation. May pledge “own” revenues as guarantee. Ministry of Finance review required for foreign credit operations. Total debt may not exceed 20% of “own” revenues.</p> <p>Context: The Government has signed an agreement with the IMF that includes a commitment to limit new foreign sovereign borrowing. The National Gas Monopoly is preparing to issue bonds in the Euro market to finance an expansion of its gas distribution network.</p>			

Country Profile B – National Sources of Revenues

Share Of National Revenues	Yes/No	Percent Local Share
- Other taxes	Yes – VAT	15% of total VAT collected locally
Unconditional Transfers	Yes/No	Method of Allocating
- General purpose	Yes	Not determined
- Equalization	Yes	Yes, “to address differences in local fiscal capacity”
Conditional Transfers		
- Environment	Yes	For specific projects approved by the Ministry of the Environment

Country Profile B – Other Financial Parameters

Local government legislation	Content	Status
General Law on Local Government	Establishes expenditure responsibilities and main revenue sources of local governments in precise terms.	Requires two-thirds majority in Parliament to amend the law
Law on Local Taxes and Fees	Authorizes local governments to determine local taxes and fees within a given range. Authorizes local governments to adjust tax base for inflation.	Last amended three years ago.
Law on Public Property	Transfers to ownership of local governments all property associated with the performance of their functions, including infrastructure.	Implementation has been slow because of disagreements on inventory of property to be transferred. Most local public utility companies are still “state enterprises” that have not been corporatized.
State budget law	Annually establishes rules for allocating both the general purpose and equalization transfers.	Method of allocation has been modified yearly in recent times.
Financial management		
Financial management	Content	Status
Budget Process	Independent of State budget. Local governments must approve their annual budget by December 15 of the prior year. Local governments must submit their draft budget in April to the Ministry of Finance with a justification for the general purpose and equalization grant requests.	Ministry of Finance has been issuing “spending ceilings” to the local governments in the course of their annual review of the draft local budgets. These ceilings are consistent with the targets of the IMF agreement. The spending ceilings are enforced through the allocation of general purpose and equalization transfers.
Budget Structure	Uniform national structure. Has separate sections for all revenues and for all expenditures. Operating and capital expenditures shown separately. Any financing shown “below the line.”	Current structure adopted following agreement with IMF

Cash management and disbursements	Local governments must keep all funds in an account at the State Treasury. Disbursements are processed through the State Treasury. The State Treasury sequesters any year-end surplus.	Current structure adopted following agreement with IMF
Financial reporting model	Accounting is strictly cash based. Uniform codes and structure used by all levels of government. Includes both income and expense and balance sheet statements. Primary purpose of reporting is to show conformance with budget.	Rules issued by the Ministry of Finance. Modified slightly each year, but basically have remained the same in recent times.
External audit and oversight	Court of Accounts reviews yearly all local government expenditures.	Same in recent years