



The Fiscal Decentralization Initiative
for Central and Eastern Europe

Fiscal Equalization in Slovenia

by
Brigita Repar

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Executive Summary

The local government act allows for the creation of two tiers of local government in Slovenia: municipalities and regions. From January 1, 2003, there are 193 municipalities in Slovenia. Out of 193 municipalities, there are currently 92 that fail to fulfill the basic criterion on the number of inhabitants (population 5,000) required for creating a municipality. Municipalities may also have subsections (local, village, or district communities), whose funding and functions are defined in the charter. Despite the Constitution and the acts that allow for the establishment of regions, no regional governments have yet been created.

The Constitution, the establishment of the municipalities and municipal boundaries act, the local government act, the municipal financing act, the public finances act, the accountancy act, and secondary legislation to these acts regulate the operation of local governments. Municipal functions are defined in the Local Government Act. The municipalities are responsible for regulating matters of local importance in almost all areas of public concern. The Local Government Act merely lists the tasks of municipalities, while individual sectoral laws determine the specific assignment of tasks.

Municipal tax revenues are divided into two groups: those pertaining to the state and municipalities, and those to municipalities alone. Local authorities have relatively little power to introduce taxes. The majority of non-tax revenues pertained solely to municipalities, but some were split between the state and municipalities (revenues from concession fees for gambling, administrative fees, compensation for environmental degradation). The non-tax revenues pertaining entirely to municipalities are set by the municipalities on the basis of laws.

Capital revenues and grants are not very important revenues for the municipalities. However, municipalities can obtain special grants from the national budget for investment purposes and for current expenditure.

Transfers to local government go to municipalities from the national budget in the form of general grants

and specific grants. Municipalities get general grants from the national budget for funding the local appropriate expenditures. Appropriate expenditure is the level of funding with which the municipality can ensure its constitutional and legal functions. The National Assembly sets the level of appropriate expenditure per inhabitant, by approving the annual budget.

Any municipality that fails to cover its appropriate expenditure is entitled to funding from the national budget in the form of the financial adjustment. Every municipality that fulfills these legal provisions receives funding from the national budget. The financial adjustment is not an earmarked revenue for the municipalities. In 2003, such funding was received by 164 of the 193 municipalities (85 percent), of which just one had city status.

Changes in the system for financing municipalities should move in the direction of increasing municipalities' own revenues and consequently reducing the number of municipalities that receive financial adjustments from the national budget.

Introduction

Recent Reform History

With the establishment of a socialist Yugoslavia in 1945, local governments, established before the Second World War, were entirely abolished. The influence of Soviet political arrangements meant that local authorities were merely branches of central power in local units. After 1950, Yugoslavia attempted to liberate itself from the Soviet form of socialism and established self-management as the leading idea of socialism. The system of self-management enabled Yugoslavia, uniquely among socialist countries, to establish a certain degree of autonomy for local communities. Communes operated as the first level of the state administration.

In Slovenia, 62 municipalities-communes were created. The average size of municipalities was 32,500

residents and 326.7 km². Approximately 80 percent of all tasks performed by commune bodies were of a state character. Local tasks, i.e., services satisfying the common needs of residents, had to be transferred to the so-called local communities. There were over 1,200 local communities in Slovenia, and they were established in almost all large settlements. Local communities were substitutes for self-governing municipalities. The commune system was a kind of interface between the state administration and the local government. Matters of state administration and matters of local government were conducted under the same regime and were mutually inseparable, so there was no division into own and transferred responsibilities of municipalities. This system was abolished in 1994, and in reality local government did not function in Slovenia in the period between 1945 and 1994.

Slovenia became a sovereign independent state in 1991. The new foundations and legal grounds for the operation of municipalities were established in the Constitution, which was adopted in 1991. Nevertheless, Slovenia retained the communal system until 1994. At that time, the first reforms in the new state took place in the area of public finances. The system of collection of contributions through self-managing interest communities was abolished and a uniform tax system was introduced (e.g., Personal Income Tax Act).

Prior to the reform of the state administration, municipalities also performed administrative tasks. With the state administration reform, performance of all administrative tasks defined by local statutes under the Acceptance of State Functions Act, were taken over by the state after December 31, 1994.

In 1993, with the adoption of the Local Government Act, municipalities were formed in Slovenia as self-governing local communities. Pursuant to the Act on the Establishment of Municipalities and the Determination of their Territorial Boundaries, 147 municipalities (including 11 urban municipalities) were established on January 1, 1993. Forty-five new municipalities were created on January 1, 1999, and one on January 1, 2003, so currently there are 193 municipalities in Slovenia. The process of creating new municipalities is ongoing. Seventeen new municipalities will be created on January 1, 2007, for a total of 210 municipalities in Slovenia.

Municipalities are established and their territorial boundaries determined by statute after a preliminary referendum. Municipalities thus are established pursuant to the Act on the Procedure for the Establishment of Municipalities and the Determination of their Territorial Boundaries, and the criteria for their establishment laid by the Local Government Act.

The most important issues that remained to be resolved on the area of establishing local government are:

- Creation of new municipalities: There are many municipalities in Slovenia and some of them are very small. These small municipalities were established without respect for any criteria set by law for founding new municipalities. Small and fiscally weak municipalities generate a very small proportion of revenues from their own sources, and consequently depend to a great extent on the financial adjustment funds from the state budget. A particular problem is the municipality subsections that have legal entity status, as often these are the very entities that the requests for new municipalities concern. The solution is to change the criteria set by law for founding new municipalities. They were changed by the Local Government Act this year. On January 1, 2007, there will be 17 new municipalities.
- Establishing regions as the second tier of local government: The second tier of local government, envisaged both in the Constitution and in the Local Government Act, has not yet taken shape. The largest problem with creating regions is that the Constitution states that the regions should be founded on the basis of independent decisions by municipalities. Amendments to the Constitution allowing regions to be founded on the basis of an act of law were adopted this year.

Local Competencies: Own and Delegated Functions

Municipalities are the basic self-governing local communities. Within the framework of the Constitution and laws, municipalities autonomously arrange and perform their affairs and execute tasks transferred to them by statute. After prior consent from the municipality, the state may transfer to a municipality the performance of individual tasks within its competence, provided that it also provides funding. Self-governing local communities are entities of public law with the right to possess, acquire, and dispose of all types of property.

The territory of a municipality comprises the territory of a settlement or of multiple settlements, linked by the common needs and interests of their inhabitants. Municipalities must be capable of satisfying the needs and interests of their inhabitants and of performing other tasks in accordance with statutes. Municipalities shall be deemed to be capable of satisfying the needs of and

performing the subsequent tasks in their territory, if the following services are provided in a municipality:

- a) Eight-year primary education (full primary school),
- b) Primary healthcare for residents (health center or clinic),
- c) Supply of essential goods (shop with food and mixed goods),
- d) Public utilities (supply of drinking water, drainage and treatment of waste water, electricity supply),
- e) Postal services,
- f) Financial services of a savings bank or bank,
- g) Library (general-educational or school), and
- h) Premises for administrative activities of local communities.

Pursuant to the law, municipalities must have at least 5,000 inhabitants. Exceptionally, municipalities may also have fewer than 5,000 inhabitants for geographical, border-proximity, nationality, and historical or economic reasons.

Due to uniform spatial and urban planning arrangements, satisfaction of communal needs, and planning of development, urban municipalities are established on the territory of towns. An urban municipality is a dense, compact settlement or settlements linked into a unified spatial organism and an urban area linked by the daily migration of the population. Towns may acquire the sta-

tus of an urban municipality if they have at least 20,000 inhabitants and at least 15,000 jobs (at least half of them are tertiary and quaternary activities), and if they are the geographic, economic, and cultural centers.

The functions of urban municipalities are not different from the tasks of other municipalities. In practice, no tasks beyond the provisions of the Local Government Act are transferred to them. The Capital City Act is in the process of preparation.

Composition of local government expenditures is presented in Table 1. below.

Subdivisions of municipalities (local, village, or district communities) may be established on the territory of a municipality. The territories of subdivisions are determined by municipal statute. Subdivisions of municipalities might be, but not necessarily, legal entities. Municipal statutes may transfer to subdivisions the implementation of the following tasks:

- a) Local public services (e.g., cemeteries and funeral services),
- b) Maintenance of local roads and other public spaces,
- c) Management of property, intended for the needs of the local population, and
- d) Promotion of cultural and other social activities.

Municipal Tasks

The scope of self-governing local communities' activities is defined by the Constitution of the Republic of Slovenia: "The competencies of a municipality comprise

Table 1.
Local Government Expenditure by Functions (COFOG Classification)

| | SIT Million | | | Percent | | |
|-----------------------------------|----------------|----------------|----------------|---------------|---------------|---------------|
| | 2001 | 2002 | 2003 | 2001 | 2002 | 2003 |
| General public services | 36,821 | 44,370 | 43,855 | 15.18 | 16.22 | 15.08 |
| Defense | 827 | 784 | 746 | 0.34 | 0.29 | 0.26 |
| Public order and safety | 4,813 | 5,169 | 5,366 | 1.98 | 1.89 | 1.85 |
| Economic affairs | 56,918 | 57,955 | 60,027 | 23.47 | 21.19 | 20.64 |
| Environmental protection | 13,964 | 20,343 | 23,947 | 5.76 | 7.44 | 8.23 |
| Housing and community amenities | 28,313 | 29,100 | 31,174 | 11.67 | 10.64 | 10.72 |
| Health | 3,347 | 3,657 | 3,784 | 1.38 | 1.34 | 1.30 |
| Recreation, culture, and religion | 25,096 | 28,458 | 29,950 | 10.35 | 10.40 | 10.30 |
| Education | 60,187 | 69,852 | 76,987 | 24.85 | 25.54 | 26.47 |
| Social protection | 12,228 | 13,834 | 14,970 | 5.04 | 5.06 | 5.15 |
| Total expenditures | 242,514 | 273,522 | 290,806 | 100.00 | 100.00 | 100.00 |

Source: Republic of Slovenia, Ministry of Finance.

local affairs which may be regulated by the municipality autonomously and which affect only the residents of the municipality.” The Constitution also states that municipalities may perform other tasks transferred: “With the prior consent of the municipality or wider self-governing local community, the state may by law vest specific duties within the state jurisdiction in the municipality or wider self-governing local community, if the state provides financial resources for this purpose.”

Thus municipalities may perform (i) original tasks and (ii) transferred tasks. The original tasks are governed independently by the municipalities and they only affect the residents of the municipality. Transferred tasks are assigned from the central state to the municipalities by law.

Original Tasks of Municipalities

Original tasks of municipalities are stipulated in Article 21 of the Local Government Act. Municipalities autonomously perform local tasks of public importance (original tasks) stipulated by the general acts of the municipality or by statute. Original tasks are financed from the revenues of local communities stipulated by the Municipal Financing Act, and from financial adjustment from the state budget. Transferred tasks are funded by the state from the state budget. To meet the needs of their residents, municipalities perform tasks listed in Appendix 1.

Municipalities are autonomous in the implementation of tasks for which they are competent pursuant to sectoral statutes. If a municipality fails to implement tasks from their original competence in accordance with the law, the competent ministry shall, pursuant to Article 90a of the Local Government Act, draw their attention to this fact and propose implementation of the tasks.

If the municipality fails within the specified interval to implement such tasks, the ministry is obliged to implement individual tasks within the competence of the municipality directly at the expense of the municipality, where failure to do so would risk the onset of harmful consequences for the lives or health of people, for the natural or living environment, or for property. Since the existing system of municipal financing provides municipalities with a high degree of autonomy in the allocation of available resources of the municipal budget, it is difficult for the state to act in the manner described.

Transferred Municipal Tasks

Pursuant to Article 24 of the Local Government Act, the state may, with the prior consent of municipalities,

transfer by statute individual tasks to municipalities within the competence of the state. These transferred tasks can be more rationally or efficiently performed within municipalities, particularly in the areas of public suburban transport, working times of hospitality outlets, implementation of tasks in the area of environmental encroachment and construction of structures and geodetic services, and the provision of public networks of gymnasiums, secondary and vocational schools and public healthcare services on the secondary level, which may be transferred to municipalities.

Laws may stipulate that individual state tasks can be transferred to all municipalities, to urban municipalities, to municipalities on specific territories, or to individual municipalities. The grounds and conditions for the performance of individual tasks within the competence of the state by municipalities shall be stipulated by laws.

Laws also may stipulate that the performance of state tasks can be transferred to municipalities provided that all municipalities, all urban municipalities, or that all municipalities on a particular territory agree. Municipalities should be given prior consent, if they submit to the National Assembly an initiative for the performance of individual tasks within the competence of the state.

The National Assembly is obliged, prior to the adoption of a statute whereby the performance of individual tasks within the competence of the state is transferred to municipalities, to obtain the prior consent of the municipalities. The state also provides appropriate funds to municipalities for the performance of transferred tasks. In practice, these statutory provisions have not been realized.

Regions

Pursuant to Article 73 of the Local Government Act, regions shall be established, changed, or abolished by statute, pursuant to a decision of municipal councils adopted by a two-thirds majority of all members. Referenda may be held regarding the decision of the municipal council. Article 74 of the Local Government Act assigns regions the following tasks:

- a) construction and maintenance of public utilities, energy, transport, and other infrastructure facilities, and functioning of relevant activities of broader significance;
- b) construction and maintenance of facilities and provision of human services (education, culture, healthcare, social welfare, etc.) which are of importance for the development of the region and which are

not part of the mandatory tasks of the state in such areas;

- c) disposal of household and other waste, control and processing of waste water, other forms of environmental protection through facilities of regional capacity;
- d) promotion of economic development, particularly agriculture, small business, and tourism, in their territories; and
- e) organization and maintenance of activities, services, and facilities through which they can provide assistance to municipalities in the performance of their tasks and in strengthening local governance within the municipalities.

To date, regions have yet to become established as the second tier of local government in Slovenia. But Slovenia is increasing the pace of activities aimed at establishing the regional level of local government. Action already is taking place within the Slovenian government to prepare systemic legislation that will allow the establishment of the regions. In 2001, the basic premises of the Regions Act were set out. Last year, individual ministries kept track of tasks that could be transferred to the regions from the central level. These tasks also should be evaluated financially, but so far this action remains unfinished.

There is a wide range of possibilities regarding the actual number and size of the regions. It also remains undecided when the Regions Act will enter into force. The regions should function as larger self-governing local communities with their own offices and bodies and thus, like municipalities, they should operate independently of the state.

In the area of creating regions as the second tier of local government, the principle solution is dependent on amendments to the Constitution of the Republic of Slovenia that are to be adopted by the National Assembly. In 2006, the Constitution was changed, and pursuant to amendments to the Constitution of the Republic of Slovenia, the regions will be created by law. Their number and size are unknown yet.

Number and Size of Local Governments

Slovenia had a population of 2,002,360, as of December 31, 2003. The average size of municipalities is 10,375 inhabitants, but in Slovenia there are large variations in

size of municipalities (Table 2.). Some of them are very small, with less than 2,000 inhabitants (12 percent, with only 1.5 percent of all inhabitants). Nearly 60 percent of municipalities have a population between 2,000 and 10,000 inhabitants, but only with 27 percent of the total population. One-quarter of the municipalities is in the range of 10,000–50,000 inhabitants, where nearly half of all inhabitants live. Three municipalities (1.5 percent) on the territory of towns (Ljubljana, the capital of Slovenia; Maribor; and Kranj) have more than one-fifth of all inhabitants.

Table 2.

Number of Municipalities by Population Size (2003)

| Number of inhabitants | Number of municipalities | Proportion of municipalities (percent) | Proportion of population (percent) |
|-----------------------|--------------------------|--|------------------------------------|
| Less than 999 | 6 | 3.13 | 0.17 |
| 1,000–1,999 | 18 | 9.37 | 1.35 |
| 2,000–4,999 | 68 | 36.98 | 11.89 |
| 5,000–9,999 | 46 | 22.40 | 15.44 |
| 10,000–49,999 | 52 | 26.56 | 49.63 |
| 50,000–99,999 | 1 | 0.52 | 2.63 |
| More than 100,000 | 2 | 1.04 | 18.89 |
| | 193 | 100.00 | 100.00 |

Source: Republic of Slovenia, Ministry of Finance.

Legal Fiscal Autonomy

Expenditure and Revenue-raising Authority

The Local Government Act merely lists the tasks of municipalities, while the specific allocation of tasks in individual areas between the local and central levels is determined by sectoral laws. For example: the Organization and Financing of Education Act, the Nursery Schools Act, the Primary School Act, the Social Security Act, the Healthcare Activities Act, the Exercise of the Public Interest in Culture Act, the Sport Act, the Commercial Public Services Act, the Environmental Protection Act, the Housing Act, the Public Roads Act, the Act on Protection against Natural and Other Disasters, and the Fire Brigade Act. Laws governing individual areas define the specific tasks and the implementation of which is within the competence of municipalities or the state.

Local government finances in Slovenia are characterized by the following aggregate figures (Table 3.).

Table 3.
Local Government Revenues and Expenditure in 2001–2003

| | Local Government | | | General Government | | |
|---|------------------|---------|---------|--------------------|-----------|-----------|
| | 2001 | 2002 | 2003 | 2001 | 2002 | 2003 |
| Total revenues in SIT million | 240,617 | 264,855 | 289,692 | 1,967,785 | 2,083,860 | 2,375,840 |
| Revenues as percent of GDP | 5.05 | 4.98 | 5.04 | 41.32 | 39.21 | 41.34 |
| Revenues as percent of general government revenues | 12.23 | 12.71 | 12.19 | 100.00 | 100.00 | 100.00 |
| Expenditure in SIT million | 242,514 | 273,522 | 290,806 | 2,030,978 | 2,239,883 | 2,454,309 |
| Expenditure as percent of GDP | 5.09 | 5.15 | 5.06 | 42.65 | 42.15 | 42.70 |
| Expenditures as percent of general government expenditure | 11.94 | 12.21 | 11.85 | 100.00 | 100.00 | 100.00 |
| Municipal expenditure per capita (in SIT) | 121,635 | 136,807 | 145,232 | | | |
| Exchange rate: SIT 239.64 = EUR 1 | | | | | | |

Source: Republic of Slovenia, Ministry of Finance. 2004. *Bulletin of Government Finance*. Vol. VI, No. 9. September.

Table 4.
Local Government Revenues by Type of Revenue

| | SIT Million | | | Percent | | |
|-----------------------|----------------|----------------|----------------|---------------|---------------|---------------|
| | 2001 | 2002 | 2003 | 2001 | 2002 | 2003 |
| Tax revenues | 145,117 | 164,578 | 178,827 | 60.31 | 62.14 | 61.73 |
| Non-tax revenues | 35,998 | 37,393 | 41,388 | 14.96 | 14.12 | 14.29 |
| Capital revenues | 9,216 | 12,847 | 13,636 | 3.83 | 4.85 | 4.71 |
| Grants | 731 | 992 | 1,221 | 0.30 | 0.37 | 0.42 |
| Transferred revenues | 49,555 | 49,045 | 54,621 | 20.59 | 18.52 | 18.85 |
| Total Revenues | 240,617 | 264,855 | 289,692 | 100.00 | 100.00 | 100.00 |

Sources of financing at the municipal level in Slovenia are stipulated by the Municipal Financing Act and certain sectoral acts. These laws also determine the ratio of sharing tax revenues between the state and local level (Table 4.).

Tax and various sectoral laws prescribe obligations regarding individual payments, i.e., as a rule the obligation to make various payments is stipulated by obligatory statute. Municipalities have very little competence in determining local taxes. Except in a few cases, municipalities have no competence in setting the tax base, tax rates, and tax exemptions, which means that they do not have direct power in forming their tax policy.

The only two taxes for which municipalities may determine the tax base and rate are compensation for the use of construction land (an important source of revenue for municipalities) and certain municipal taxes. They also can influence the tax base for the property tax and the tourist tax rate. Municipalities thus are able to directly influence the level of their revenues only for a minor

part of their tax revenues, while their influence on the remainder is only indirect in the creation or amendment of legislation.

As a rule, tax administration is a central government administrative service.

Property Ownership

The assets of a municipality shall be composed of intangible and tangible municipal property, financial means, and rights. A municipality must manage its assets with good economic sense. The release of individual parts of municipal assets only shall be permitted against payment of their full value, which shall become a part of the municipal assets unless a part of the assets is donated for specific purposes (humanitarian, educational, scientific, or research purposes).

Budgeting

In accordance with Article 17 of the Public Finance Act, the Minister of Finance must inform municipalities about

the basic economic starting points and assumptions for the preparation of the state budget (budget memorandum). The government adopts the budget memorandum in April of the current year. In recent years, Ministry of Finance also prepared the budget handbook for preparing municipal budgets and sent it to all municipalities.

By September 30, pursuant to the Municipal Financing Act, the government must determine and inform municipalities on the amount of the financial adjustment (general grants) for the following budget year. The calculation of the financial adjustment also shows data for the following budget year on own municipal revenues, which form the basis for the calculation of the financial adjustment.

The government also adopts the programs for measures and investments to be co-financed from the state budget at the local level (specific grants). Specific grants are part of the state budget's plan of development programs. They are constituent parts of the state and municipal budget and they are composed for a period of four years (by programs, by source of financing, and by years).

On the basis of these two adopted documents, municipalities have data on the expected funds, so they can prepare their own budgets. The government submits the draft state budget for the following budget year to the National Assembly by September 30 of the current year. Mayors submit proposed municipal budgets for the following budget year to their municipal councils within 30 days of submission of the state budget to the National Assembly. The National Assembly or municipal council must adopt the budget within an interval enabling the entry into force of the budget by January 1 of the budget year.

If the budget is not adopted within this interval, the financing of state and of municipal functions temporarily continues on the basis of the previous year's programmed budget. Pursuant to a mayoral decision, the period of temporary financing may last a maximum of three months. The municipal council may extend temporary financing to more than three months.

The government submits to the National Assembly a draft budget for two years. Mayors may also submit to the municipal council a draft budget with a proposal for the year thereafter, but only within their term in office.

Mayors submit their municipal budgets to the Ministry of Finance within thirty days of their adoption. Municipalities must inform the Ministry of Finance currently of the revenues and expenditures realized. Thus they must report by the fifteenth of the month to the Ministry of Finance on the prescribed forms data for

the period from January 1 of the current year to the end of the previous month. The Ministry of Finance temporarily suspends payment of the financial adjustment (general grants) to municipalities that fail to report data within the prescribed intervals and in the prescribed manner.

After the end of the budget year, mayors prepare a draft final account of the municipal budget for the previous year, and submit it to the Ministry of Finance by March 31 of the current year. Mayors inform the Ministry of Finance of the final account's adoption within thirty days.

Local Borrowing

Pursuant to the amendments to the Municipal Financing Act, municipalities may only borrow if the total level of existing indebtedness and the anticipated new indebtedness does not exceed 20 percent of the revenues generated by the municipality in the year prior to the year of borrowing. Municipal revenues are calculated without donations and transfer revenues for investments. The total payment of principal and interest in an individual year of payment may not exceed five percent of collected revenues.

Municipalities may also borrow to finance investments in the area of primary education, housing construction, water supply, disposal and treatment of waste water, and investments co-financed by the EU, assuming that the total level of existing indebtedness and anticipated new indebtedness exceeds 20 percent of the revenues generated in the year prior to the year of indebtedness without donations and transfer revenues for investments. The total payment of principal and interest in an individual year of payment does not exceed an additional three percent of the revenues generated without donations and transfer revenues for investments.

Municipalities may borrow by (i) issuing securities and (ii) taking loans. Municipalities may not borrow abroad. Municipalities may take long-term borrowing for investment if confirmed by the municipal council. Loan contracts are concluded by the mayor on the basis of the adopted budget and with the prior consent of the Ministry of Finance.

In accordance with Article 86 of the Public Finance Act, municipalities may also issue guarantees. The mayor, or a person authorized in writing by the mayor on behalf of the municipality, may sign guarantee contracts. Municipalities may issue guarantees only in accordance with Article 19 of the Municipal Financing Act to meet the obligations of public companies and public institutions of which they are the founders, but only up to a

maximum of five percent of the revenues generated in the year in which the guarantee is issued. Guarantees issued shall be included in the authorized level of indebtedness of the municipality.

Procedures for municipal borrowing are governed in the rules on the procedures for municipal borrowing. Municipalities may only take credits and loans from banks and funds whose activities *inter alia* include the issuing of loans.

The Ministry of Finance issues consent for municipal borrowing in two phases: (i) prior consent for borrowing and (ii) consent for the conclusion of contracts on borrowing. For loans or securities amounting to SIT 50 million or more, an independent financial and legal adviser should be appointed. The adviser should have the professional training and relevant experience in consulting activities in connection with the composition of calls for bids for borrowing, the selection of creditors, negotiations prior to the conclusion of a loan contract, and other necessary activities of the borrowing procedure. Exceptionally, the Ministry of Finance may require a municipality to appoint a legal and financial adviser for borrowing not exceeding SIT 50 million.

Prior to concluding a contract, the municipality must deliver to the Ministry of Finance the final version of the loan contract with its depreciation plan, copies of written offers from banks, and written reports by the legal and financial adviser on the evaluation of credit offers, the justification for the selection of the most favorable bidder, and the credit terms of the creditor selected, or, if advisers were not appointed, a report from the body that conducted the selection of the creditor and in which the elements of the basis of the selection are presented.

On the basis of these documents, the Ministry of Finance issues its consent to the municipality for the conclusion of a loan contract, in which it also stipulates an interval for the conclusion of a contract with the selected lender. Such consent forms a constituent part of the loan contract. Contracts concluded without the consent of the Ministry of Finance are null and void. Within ten working days after concluding a loan contract, the municipality must submit to the Ministry of Finance a copy of the concluded contract.

Due to uneven revenue flows into the budget, municipalities may take on liquidity debt, but only up to a maximum of five percent of the last adopted budget. Liquidity loans may last for a few days or even a few months. It is essential that municipalities pay off liquidity loans by December 31 of the year in which the liquidity loan was taken out or within the budget year.

Structure of Intergovernmental Finances

Tax Revenues

Own revenues account for over four-fifths of total revenues of municipalities (see Table 4.). That means the state covers only one-fifth of municipal budgets through grants (so-called financial adjustment). Tax revenues are the largest of total municipal revenues (60 percent to 62 percent).

Personal Income Tax

From this group of tax revenues municipalities are entitled to receive only a proportion of the personal income tax. Personal income tax is levied on six categories of income: income from employment, business income, income from agriculture, income from property (rental income, royalties, interest, and dividends), capital gains, and other income. Personal income tax is a source of revenues for the state and municipal budgets. Until January 1, 1999, municipalities received 30 percent of personal income tax; this share increased to 35 percent from January 1, 1999. Personal income tax has the largest proportion of total revenues of municipalities.

Property Taxes

Taxes on property are levied on: (i) immovable property (on buildings, leisure and recreation spaces, and compensation for the use of building land), and (ii) movable property (on the possession of floating structures), and as (iii) inheritance and gifts taxes.

The second most important source of tax revenues are property taxes, which with a few statutory exceptions, accrue entirely to municipalities. This group of taxes at a local level includes property taxes (on buildings and water-borne vessels) of natural persons, the inheritance and gift tax, and the tax on immovable property transactions. It also includes compensation for the use of construction land, which is one of the most important portions of municipal revenues. Compensation for the use of construction land is a type of property tax on land and buildings, owned or used by private and legal persons.

Taxes on Goods and Services

Taxes on goods and services, which in full or only in part, accruing to municipalities are: (i) taxes on special services (tax on lottery earnings), and (ii) other taxes on the use of goods and services (tax on water pollution and waste, tourist tax, municipal tax, fee for the maintenance of forest roads, connection fees, environmental taxes).

Taxes on goods and services accrue mostly to municipalities. Taxes on goods and services are modest sources of financing at the municipal level.

Non-tax Revenues

Non-tax revenues in municipalities are: (i) profits and revenues from property (revenues from the profits of public companies, interest, rental revenues, concession revenues, revenues on gambling); (ii) taxes and administrative fees; (iii) fines (fines, compensation for degradation and usurpation of space); (iv) revenues from the sale of goods and services; and (v) other non-tax revenues (municipal contributions, self-contributions, contributions, supplementary payments by residents).

Most non-tax revenues accrue in full to the municipality, while some are pursuant to statute and divided between the state and the municipality (revenues from concessions on gambling and other concessions, administrative fees, compensation for degradation and usurpation of space).

Capital Revenues

Capital revenues in municipalities are: (i) revenues from sales of fixed assets, (ii) revenues from sales stocks, (iii) revenues from land sales and intangible assets.

Grants and Transferred Revenue

Grants in municipalities are domestic and foreign grants.

Transferred revenues in municipalities stem from: (i) the state budget, (ii) other local budgets, (iii) the social security funds, and (iv) other extra-budgetary funds. Transfers from the state budget are the most important of all transferred revenues.

Equalization Measures

Municipalities are eligible for funds from the state budget in the form of (i) general grants and (ii) specific grants. Municipalities may obtain specific grants from the state budget for investment expenditures and current expenditures. During 2001–2003, transfers from the state budget to the local level represented 18.5–20.5 percent of total local level revenue. Pursuant to the provisions of Articles 20 to 28 of the Municipal Financing Act, municipalities are entitled to transfers of funds from the state budget:

- i) In the form of a financial adjustment for financing of appropriated expenditures, calculated pursuant to Article 20a of the Municipal Financing Act, and

- ii) For co-financing of individual measures and investments, where in accordance with the law or other legislation there is a special central government interest for their development.

General grant

Municipalities are entitled to financial adjustment from the state budget calculated on the basis of (i) the amount of appropriated expenditures per capita and (ii) municipal own revenues.

Appropriate Expenditure

Appropriate expenditure is the level of funding through which municipalities can ensure the implementation of their constitutional and statutory tasks. Appropriate expenditures per capita are determined by the National Assembly during the adoption of the state budget for the fiscal year. If a new municipal task is determined by sectoral laws, the appropriated expenditure per capita should be increased.

The amount of appropriated expenditure for an individual municipality is determined by correcting the appropriate expenditure per capita with the ratio of the surface area, length of local roads, number of inhabitants under 15 years of age, and number of inhabitants over 65 years of age for the population of the individual municipality against the state average.

The amount of appropriate expenditure for an individual municipality is thus calculated as follows:

$$PP_i = (0.70 + 0.05 \times C_i + 0.05 \times P_i + 0.16 \times M_i + 0.04 \times S_i) \times ZP \times O_i$$

Where:

PP_i is the appropriate level of funding to finance local requirements in an individual municipality;

C_i is the ratio between the length of local (municipal) roads per capita in the individual municipality and the length of local (municipal) roads per capita in the country as a whole;

P_i is the ratio between the surface area of the individual municipality per capita and the surface area of the state as a whole per capita;

M_i is the ratio between the proportion of persons under 15 years of age within the overall population of the municipality and the average such proportion for all municipalities in the country as of January 1 in the year, in which the level of appropriate expenditure is determined for the following year;

S_i is the ratio between the proportion of persons over 65 years of age within the overall population of the individual municipality and the average such proportion for all municipalities in the country as of January 1 in the year, in which the level of appropriate expenditure is determined for the following year;

ZP is the appropriate expenditure per capita;

O_i is the number of persons with permanent residence in an individual municipality as of January 1 in the year, in which the level of appropriate expenditure is determined for the following year according to the data from the central population register.

The base sum of all coefficients is 1.00. In municipalities where the seat of the municipality, prior to the Act on the Establishment of Municipalities and the Determination of their Territorial Boundaries came into force, did not have the status of urban municipalities, a coefficient of 0.74 is used instead of a coefficient of 0.70, so there the total sum of coefficients is 1.04. In the calculation for urban municipalities, a coefficient of 0.78 is used instead of a coefficient of 0.7, so that the total sum of coefficients is 1.08.

Own Revenues

Own revenues of municipalities taken into account in the calculation of the appropriate expenditure and financial adjustment of individual municipalities are:

- Personal income tax;
- Inheritance and gift tax;
- Tax on lottery winnings;
- Tax on immovable property transactions;
- Administrative fees;
- Special tax for the use of gaming machines outside casinos;
- Property tax;
- Compensation for the use of building land;
- Tourist tax;
- Municipal taxes (fire protection tax, concession fees from *gambling*);
- Fees (fees for the maintenance of forest roads);
- Compensation due to change of purpose of agricultural land and forests;

- Compensation and damages for the degradation and usurpation of space and environmental pollution;
- Administrative revenues; and
- Revenues stipulated by other acts (concession for water **services** or railways)

All of these revenues accrue to municipalities in the amount stipulated by law or other act on their introduction. In recent years, some of these revenues were abolished by sectoral laws (special tax for the use of gaming machines outside casinos, compensation due to the change of purpose of agricultural land and forests). Some of them are not taken into account in the calculation of the appropriate expenditure and financial adjustment.

Municipalities are entitled to 35 percent of the revenues from personal income tax. Revenues from personal income tax are allocated to individual municipalities in the proportion between the personal income tax assessed on taxpayers with permanent residence in the municipality and the personal income tax assessed on all taxpayers on the basis of data from the penultimate year. The Ministry of Finance determines the ratio.

The Ministry of Finance, in cooperation with individual municipalities and the tax administration, determines the extent of own revenues for individual municipalities. Tax and non-tax payments stipulated by law are included in the calculation. If the law does not stipulate the rates, the average rate is taken into account. Some municipal revenues are calculated at the estimated and not at the actual level (for example, compensation for the use of land for construction). This means that the difference between the estimates and the actual generated revenues is not included among the municipal revenues, which are taken into account in the calculation of the appropriate expenditure, and these funds remain with the municipality.

Own revenues of municipalities, which are *not* taken into account in the calculation of appropriate expenditure and financial adjustment of municipalities, include:

- a) Interest on deposits;
- b) Revenues from repaid deposits, credits, and letters of guarantee;
- c) Rent from housing and commercial premises;
- d) Revenues from property sales;
- e) Other property revenues;

- f) Revenues from the purchase and sale of securities;
- g) Municipal contributions;
- h) Self-contributions, and;
- i) Other revenues from residents for co-financing of specific tasks and obligations at the local level.

Exceptionally, revenues from self-contributions may be taken into account in the calculation of the own revenues of a municipality, pursuant to a resolution of the municipal council. In practice, no municipality reports self-contributions.

Financial Adjustment

Financial adjustment is a general grant from the state budget to which individual municipalities are entitled, representing the difference between the calculated level of appropriate expenditure and the estimated own revenues of the municipality. Municipalities autonomously dispose of the funds received as financial adjustment. Municipal revenues for the calculation of appropriate expenditure and financial adjustment are only criteria for the calculation of a municipal financial adjustment.

The government of the Republic of Slovenia, at the proposal of the Ministry of Finance, determines the amount of the financial adjustment for the following budget year, and informs municipalities thereof by September 30 of the current year. During the fiscal year when own municipal revenues calculated for the appropriate expenditure of the municipality deviates by more than two percent from the estimates used as the basis of financial adjustment, the government of the Republic of Slovenia informs the municipality of the new amount of the financial adjustment by September 30 of the current year.

The government of the Republic of Slovenia determines a lower amount of financial adjustment for municipalities if the level of realized own revenues was lower than initially estimated. Those municipalities where the amount of own revenues is greater than initially estimated, are obliged to repay financial adjustment funds already paid out by the state budget by December 1 of the current year. In the event that a new amount of financial adjustment is determined for a municipality at a lower level than the initial amount, only the difference to which the municipality is entitled is paid back by the end of the year.

After the end of the budget year, the Ministry of Finance determines the final level of pertinent funds of the financial adjustment for an individual municipality on the basis of the actual, realized own municipal rev-

enues. The amount of the surplus or deficit determined from the previous year is paid by September 30 of the current year from the funds of the financial adjustment determined for the current year.

Funds for financial adjustment are paid to municipalities in twelve installments by the twentieth day of the month. Funds from financial adjustment may not be seized for the payment of liabilities due to borrowing, compensation under court rulings, and compensation under the Denationalization Act.

Specific Grants

Additional funds may be provided to municipalities from the state budget for co-financing individual measures and investments where, in accordance with the law or other regulations, there exists a special national interest. Municipalities may only use funds for the specifically allocated purposes.

The level of additional funds for the co-financing of individual measures and investments is determined on the basis of the ratio between the amount of actual, realized personal income tax per capita of the individual municipality for the previous year and the amount of the personal income tax per capita realized in the Republic of Slovenia. On the basis of this criterion, individual municipalities are entitled to additional funds for individual measures or investments at the following rates (Table 5.).

*Table 5.
Personal Income Tax Equalization*

| If the amount of personal income tax per capita realized in the municipality compared to personal income tax per capita realized in the state is: | then the municipality is entitled to additional funds amounting to: |
|--|--|
| Up to 50% | 70% |
| From 50% to 70% | 60% |
| From 70% to 90% | 50% |
| From 90% to 110% | 40% |
| From 110% to 130% | 30% |
| From 130% to 150% | 20% |
| From 150% | 10% |

On the basis of this criterion, municipalities are entitled to additional funds for (i) investment and (ii) financing of bilingualism and implementation of the constitutional rights of Slovenia's Italian and Hungarian nationalities. The level of additional funds from the state budget may also be determined on the basis of criteria from public tenders.

Specific Grants for Investment

Municipalities are entitled to additional funds for investment from the state budget if a special interest for their development exists. A municipality can start with the investment on the basis of the decision of the competent ministry. The competent ministry must, prior to the issue of the decision, obtain the consent of the Ministry of Finance. The method and procedure for the issuing of consent are prescribed by the rules on issuing consent for financial construction investment projects of municipalities.

Municipalities are entitled to additional funds for investment provided from the state budget within the budget item of the different ministries in the following areas: primary and pre-school education, sport, culture, and healthcare. Municipalities may also receive funds from the state budget for investment in other areas: economy, agriculture, municipal activities, education, and culture.

Specific Grants for Current Expenditure

On the basis of the ratio between the amount of actual, realized personal income tax per capita for an individual municipality for the previous year and the amount of actual, realized personal income tax per capita in the Republic of Slovenia as a whole, stipulated in the Municipal Financing Act, municipalities are entitled to funds from the state budget for current expenditure in the area of financing bilingualism and the implementation of the constitutional rights of Italian and Hungarian nationalities.

On the basis of criteria from public tenders published by the competent ministries, such ministries may also allocate to municipalities funds for other current tasks (for example, in the area of agriculture). The competent ministries and the municipalities conclude contracts, on the basis of which funds from the state budget in the budget items of the individual competent ministries are transferred to the municipality.

All these equalization mechanism significantly decrease the differences among wealthy and poor municipalities (Table 6.).

Table 6.

Local Governments Revenues Per Capita by Quartile

| Municipalities by quartile | in SIT | |
|------------------------------------|--|--|
| | Total revenues per capita without equalization | Total revenues per capita after equalization |
| Poorest 25% municipalities | 49,097 | 110,954 |
| Next poorest 25% municipalities | 73,914 | 124,878 |
| Next wealthiest 25% municipalities | 93,175 | 138,798 |
| Richest 25% municipalities | 146,088 | 189,831 |
| Total | 90,354 | 140,959 |

Conclusion

The main areas where reforms are underway are the creation of new municipalities, the system for financing municipalities, the creation of regions, and the system of financing regions.

Acts regulate the procedure for establishing municipalities and for changing their boundaries to be carried out once in the period between regular municipal elections. This creates pressure every four years for new municipalities to be founded, even if the criteria set out by law are by-passed. A particular problem is the municipality subsections that have legal status, as often these are the very entities that request the establishment of new municipalities.

So the major problem in the area of local public finances is the large number of municipalities, which have the same functions and sources of income irrespective of their size, and which entails differing financial capacities for the individual municipalities. Given that the fiscal strength of municipalities varies greatly, within the existing system of municipal financing some municipalities are heavily dependent on the financial adjustment funding from the national budget. Should they have a greater proportion of local tax revenues, it would reinforce the fiscal strength of municipalities.

Another reason for creating new municipalities is that the existing municipal financing system, since it was established in 1995, has undergone several changes because of decisions of the Constitutional Court. It has destroyed the original concept of the law. On the basis of the current system of financing in all Slovenian municipalities, in which their own sources do not cover the level of planned expenditures, municipalities are entitled by law to financial adjustment funds from the national budget.

Every municipality that fulfills these legal provisions receives funding from the national budget, irrespective of the level of funding for appropriate expenditure it acquires through its own revenues. In theory, this means that a municipality that did not have any of its own revenues would receive all of its funding from the national budget. In practice, such cases do not occur, but certain small and fiscally weak municipalities generate a very small proportion of revenues from their own sources, and consequently depend, to a great extent, on the financial adjustment funds from the national budget.

It is true that municipalities do not have much influence on setting the level of tax revenues, with the exception of real estate tax. The level of these revenues is formulated almost entirely by the municipalities and taxation is very different from municipality to municipality. The solution is therefore not seen in delegating greater responsibility to municipalities in setting the level of taxes and defining taxpayers, but more in the introduction of a uniform system of some taxes, particularly real estate tax, because the differences between municipalities are too great.

Given these additional problems, a new system of real estate tax is also under preparation; it will unify the system of levies and make the tax compulsory for all the municipalities. Through a single valuation criterion (market value) and uniform criteria for defining the subject of taxation and those liable to pay tax, the taxation will cover all real estate of the same type and all taxpayers irrespective of their legal status. This will allow municipalities to use the tax as an instrument of fiscal and

planning policy, via the possibility of the municipality influencing the value of real estate in its environment and via the possibility of the independent setting of the tax rate within the legally defined framework.

Indisputably, it is necessary to find an approach to generate greater original revenues for municipalities, perhaps including non-tax revenues, naturally in accordance with their responsibilities and obligations towards citizens and the state. It is necessary also to change the distribution of the existing amount of personal income tax among municipalities also to achieve horizontal equalization.

The second tier of local government envisaged both in the Constitution and in the Local Government Act has not taken shape yet. The biggest problem with creating regions is that the Constitution states that the regions can be founded on the basis of independent decisions by municipalities. For this reason, in practice, they will never be established, as their interests are different.

Amendments to the Constitution, allowing regions to be founded on the basis of a law, are under preparation. The expert bases for drafting a regions act are also already under preparation, and will define the regional functions either as original or transferred functions. Hereby, financial assessments must also be prepared so that the Finance Ministry will be able to draft a financing of regions act. Given that, it will also be necessary to build a system for financing the regions in line with their defined responsibilities, and to coordinate it with the system of municipal finances on one hand, and the system for financing the state on the other.

Appendix 1. Municipal Functions and Tasks

- a) Management of municipal property.
- b) Securing the conditions for the economic development of the municipality, and tasks in the area of hospitality, tourism, and agriculture.
- c) Planning of spatial development; in accordance with the law, tasks in the area of environmental encroachments and the construction of structures; and providing public service of management of building land (buying and selling land for building).
- d) Creation of the conditions for housing construction, and ensuring an increase in the social rented housing fund.
- e) Within the scope of their competencies, arrangement, management, and provision of local public services (for example: water supply, removal of waste water, removal of waste, organization of cemetery, and funeral services).
- f) Promotion of social security services for pre-school care, basic child and family protection, and the socially excluded, disabled, and elderly.
- g) Protection of air, ground, and water sources; protection against noise; collection and disposal of waste; and other environmental protection activities.
- h) Arrangement and maintenance of water and energy supply facilities.
- i) Creation of the conditions for adult education, important for the development of the municipality and the quality of life of its residents.
- j) Promotion of educational, information-documentation, social, and other activities on their territories.
- k) Promotion of the development of sports and recreation.
- l) Promotion of cultural-artistic creativity, enabling access to cultural programs, securing general-educational and library activities, and in accordance with the law, concern for cultural heritage on their territories.
- m) Construction, maintenance, and arrangement of public roads, public paths, recreational, and other public spaces in accordance with the law; traffic arrangements in the municipality; and other tasks of municipal public order.
- n) Supervision of local events.
- o) Organization of municipal public order service and concern for public order in the municipality.
- p) Concern for fire safety and organization of rescue services.
- q) Organization of assistance and rescue in the event of natural and other disasters.
- r) Organization of cemetery and funeral services.
- s) Determination of misdemeanors and fines for misdemeanors that violate bylaws; performance of inspection supervision of the implementation of bylaws and other acts governing matters within their competence, unless otherwise laid down by law.
- t) Adoption of the statute of the municipality and other general acts.
- u) Organization of the municipal administration.
- v) Arrangement of other local matters of public significance.