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New system of financing public administration in Slovakia

1998, M.E.S.A 10

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Foreword

The first stage of the work on the long-term project „ New system of financing self-government in Slovakia" was focused on the analysis of the development in financing tasks that were in the responsibilities of local self-governments in the period of 1991-1995. In the second stage, we outlined the principles that might be considered in public administration financing reform, in which intermediate tier of self-government had been included - regional self-government. In this stage, we assumed the change in the distribution of competencies among individual components of public administration, the alteration of existing rules in financing public administration and we altered the proposed system of financial equalization.

The change in the system of financing is an inseparable part of public administration reform. Its purpose is, primarily, to increase accountability of individual tiers of public administration in developing the country, to bring transparency into the existing system, to enhance effects of principles of motivation, solidarity, and justice, stabilization of rules and the environment, rationalization of public administration expenses, progressive reduction in the proportion of redistribution of resources within public budgets. The change should help to create conditions conducive to the reduction of tax burden for citizens of Slovakia.

The hitherto applied system of financing public administration has not created sufficient prerequisites for cities and communities to fulfill their self-governing functions. Local self-government has restricted powers, minimal responsibility for public services, the crucial problems of public service provision are addressed at central government level, municipalities are more and more subordinated to the economic and political interests of the central state.

The correction in order to increase direct financial responsibility of local and regional self-government calls for more transparency in subjects having the competencies and financing public tasks, the reduction of interference of upper tiers of public administration, not only from spatial aspect but from the aspect of economic and political objectives. We are convinced that instead of over-centralized management, Slovakia needs a more decentralized system of public administration that would take account of regional needs, based on the agreement between individual components of public administration.

It is becoming evident that efficient behavior cannot be prescribed by norms, laws. It is necessary that representatives of particular levels of public administration be directly accountable to their electors for the performance of public tasks. The fact that financial decentralization is a „topical issue" in the whole of Europe is underlined by the resolution adopted by the Conference of European Ministers responsible for local self-government (1996) and the document adopted by the Council of Europe in 1996, concerned with the European Charter of Regional Self-government. In both of these materials, strengthening of competencies and financial provision of local and regional self-government and increasing direct control of public expenditure by citizens are unequivocally endorsed.

Within the second stage of our work (1996), our results were presented and discussed at 10 seminars, that took place in all regions of Slovakia. About 600 persons, representing mainly self-government, participated in them. Subsequently, several discussion events took place which brought several positive comments to the proposed principles. This resulted in the completion and partial reworking of the 1996 proposal.

The core idea of our work is the change in the mechanism of financing public administration in the wake of its complex reform. Within the proposal, we attempted to accommodate the on-going world, and particularly European trends, that entail globalization of space, unification processes, and on the other hand, rising significance of regions in the process. It is apparent, that the whole process should end in a reform of the fiscal system, defining the relations between public administration, fiscal policy, and social policy, associated with substantial reduction of the role of state within the country.

We maintain that the recommendations of new mechanisms in financing public services can contribute to these essential changes in the area of public sector.

Viktor Nižňanský
M.E.S.A. 10

1 Reasons for the change of the system

Citizens of the Slovak Republic are permanently aware of the negative effects of centrally organized system of provision and financing public services. The status quo can be attributed to the period of transformation, which the Slovak Republic is undergoing, but since this phenomenon is not representative solely of countries of Central and Eastern Europe, it is necessary to search for causes also in the system of public affairs administration, i.e. in its organization and methods of financing.

It is generally acknowledged that the provision of public services to citizens of a country cannot be left fully to the market. In many areas of services, the interference of public administration, to a lesser or greater extent, is necessary. The question is, which are public services, who should provide these public services (state administration or self-government) and at which level (local, regional, central).

The current state in Slovakia reveals that central level secures, directly or through its territorial bodies (Regional and District Offices) approximately 90% of all public services to citizens, with their funding being decided exclusively at central level. Regional Offices are mainly „ expeditionary units" for financial resources of the state budget, without decision-making power to essentially affect their actual amount and destination. Regional self-government has not yet been instituted and local self-government has very limited possibilities to decide about the scale and content of most of the important public services (education, heal care social affairs, culture, transport,…).

The current distribution of responsibilities for public services entails growing problems in their provision. Similarly to other countries with similar model of public administration, in the Slovak Republic as well, it is becoming evident that the centrally organized model of provision of public services is becoming one of significant political problems.

<u>Following are its main drawbacks :</u>

◊ limited amount of information which the central government has at its disposal (therefore its decisions are always a compromise and cannot be easily anticipated)
◊ restricted ability to control the reaction of private sector to decisions of central government
◊ restricted ability of central government to control the bureaucratic apparatus at all levels of state administration
◊ restrictions stemming from political base of governmental decisions
◊ absence of direct link with and the feed-back about the needs of communities in the area of public goods and provision of these goods.

The sustained problems incessantly induce discussions about the need to change the existing system, which negatively affects the political stability of the country, which is so important for a successful economic development and for increasing the quality of living standards for its citizens.

<u>The change of the system should bring about:</u>

◊ increased efficiency of functioning of public sector

◊ and allow for a differentiated approach to provision of public goods
◊ greater justice in financing public goods
◊ increased responsibility of local and regional self-government for the provision of public services.

Strengthening of financial autonomy of self-government must be a component part of the change. Self-governing bodies should be given greater discretion in setting rates of taxes and fees, as well as in setting prices for local and regional services. Strengthening the independence of self-government, however, brings with it also the need to increase its financial responsibility. That means also a more detailed verification of actual needs of citizens on the part of elected officials of self-governments, as well as increased accountability in financial and property management. Among other things, it entails a more responsible approach in addressing the needs of citizens through taking loans by a community, city or a region. It also calls for an orderly monitoring of results achieved in budgetary policy and increasing cost/efficiency of spending.
Equally important within the process of bringing about change, is to consider mechanisms that will alleviate the impacts of natural competition between individual self-governments. If this was not the case, disparities in the capacity to offer public goods between regions, cities and communities might grow. This phenomenon might mean not only destabilization of settlement structure (see the present call for „Municipalization") but it would also act negatively within the equalization system.

The change of the system should bring increased transparency to public resources management by minimizing administrative interventions, which should be limited to the control of lawfulness and constitutionality.

It is necessary to anticipate that public services expenses will increase (particularly social service expenses, and expenses on environmental protection and refuse disposal) .The extreme increase in public consumption or stabilization of growth can be affected by increased citizens participation in its implementation, be it in the stage of decision-making related to their provision, or greater co-participation in their coverage.

The distinction as to which goods will be provided privately and which publicly, or whether the form of providing services for citizens (public good, private good, mixed good) and the proportion of representation of sectors should be in the responsibility of local or regional self-government, should be part of systemic change.

At any rate, the change of the existing system will only make sense, if the new system brings an increase of efficiency in spending public funds, accounting for specificity of communities, towns and regions, if it is more equitable in relation to tax-payers, more transparent, creates conditions for greater participation of citizens in providing public services and increases the measure of responsibility that self-governments have in increasing the quality of living standards of citizens of the Slovak Republic.

In this process, all levels of public administration have to contribute to restricting deficit of public spending, so that future generations do not have to bear the burden of spending which present generations benefit from.

<u>Among the principles of the new system are:</u>

◊ to define services that will continue to be provided from public funds

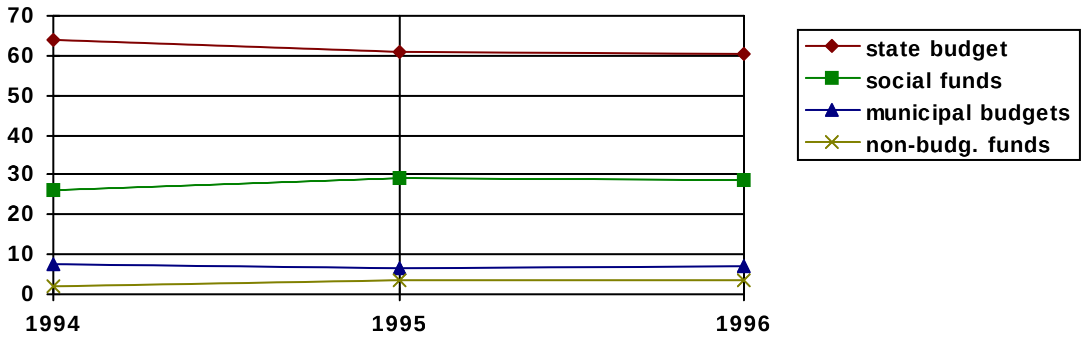
◊ to leave the decision about the measure of participation in services, funded by public and private sector (so-called mixed goods) within the responsibility of self-governing institutions in those public and mixed goods, which will have local and regional character
◊ to distribute responsibility for the provision of public services among individual levels of public administration applying the following principles :
 * a public service will be provided by that level on which provision is most efficient
 * in case several levels participate in one service, the service will be in the responsibility of the upper tier of public administration
◊ to distinguish „expenses" connected with the operations of a public service and expenses incurred by the increased number of consumers (investments), since the size of municipality, region is an issue of political decision-making, made by relevant politicians and should not become a handicap for other municipalities, regions
◊ respectfully institute a fully developed regional self government
◊ to support financial autonomy of local and regional self-government and to supply measures through which local and regional self governments can make their economic activities more attractive in the territories which they administer
◊ to enhance justice and transparency in managing public funds
◊ to reduce administrative challenge of public budgets
◊ to introduce an equitable system of financial equalization.

2.0 ANALYSIS OF MUNICIPAL BUDGETS IN 1991 - 1996

2.1 The relation of municipal budgets to public budgets

In most advanced countries municipal budgets comprise not an insignificant proportion of public budgets. The proportion of municipal budget expenditure in public budgets in Slovakia ranged from 6.7 to 7.6% in 1994 - 1996. (Fig.1)

Fig.1
The Development of the share of public budgets expenses (%)



Source: State closing accounts

The development since 1994 reveals a slight decrease of the state budget share in public expenditures and an increase of the share of social other non-budgetary funds.

From the aspect of self government (apart from the development in the share of municipal budgets) , the development in the share of non-budgetary funds is of interest, since part of these resources gets into municipal budgets. The funds' expenses, from which finances flow also into municipal budgets should take account of particular disparities in provision of public services and should form a kind of support element in financing public services.

Fig.1 shows the increase in the volume of expenses of these funds against the volume of state budget expenses. The ratio increased from 3.3% in 1994 to 5.64% in 1996, in favor of non-budgetary funds.

A disadvantage of grants which are provided to municipalities from some funds is a need to submit the project, or an application, which often significantly burdens municipal budgets, particularly small municipalities, when these revenues are not easily anticipated. Particularly in a situation when priorities in awarding grants (designated or territorial) are not clearly defined. A weakness of the current system lies also in the fact that in many cases it affects the direction of own municipal resources, because municipalities do not pursue development objectives on the basis of comprehensive concepts, along time steps, but proceed according to where, how, and for what, a grant can be obtained. Simultaneously, the current system suffers from clientelism and political protectionism.

2.2 The development of the relation of the state budget and municipal budgets

In the years 1993-95, a significant disparity arose in the relation between the growth of the GDP, tax revenues of the state budget and tax revenues of municipal budgets. While over the course of these years the rate of tax revenues of the state budget was increasing faster than the rate of GDP growth, the development in tax revenues of municipal budgets showed a reversed trend, which suggests restrictive measures on the side of the state in relation to local self governments.

A turning point occurred in 1996, when the ratio of tax revenues of the State Budget and municipal budgets changed but this was also the year when, for the first time, the growth of state budget tax revenues did not achieve the tempo of growth of the GDP, while there was an increase of tax revenues in municipal budgets.

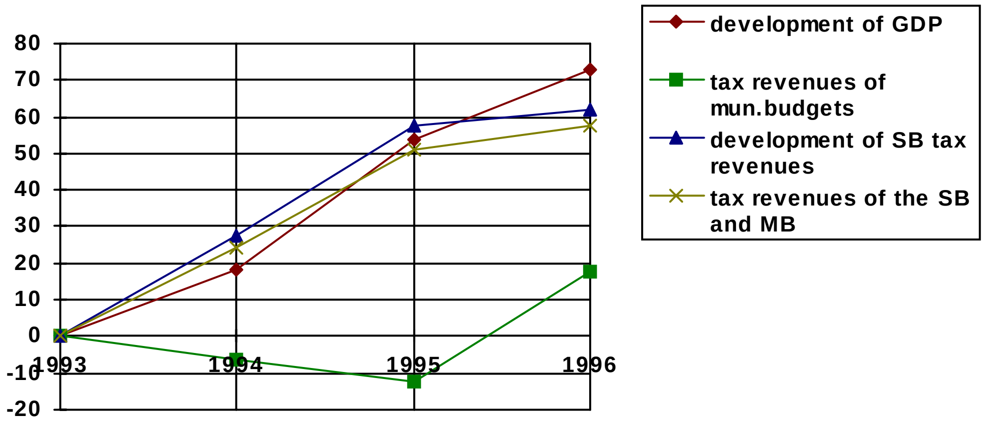
<u>There may be several reasons of this change</u> :

- increased proportion of unpaid taxes, particularly in indirect taxes, was due to a slower growth of tax revenues of the state budget, as well as an increased proportion of tax dodgers that did not pay income tax of legal entities, different forms of taxation relief, tax frauds but also due to excessive tax burden
- tax system is inflexible in its response to changes in the economic situation
- a stronger bond of municipal budgets, to the most stabile tax collected (tax on dependent activities and functional perks) enables self governments to have more stabile revenues
- increased real estate tax collection by local self governments.

These facts also suggest that the state cannot tackle the problems of its institutions with tax dodgers, the problems of the tax system. At the same time, by putting selected tax subjects at an advantage since 1996, it transferred the burden of maintaining macroeconomic results to the citizen directly (income tax of natural persons, VAT, consumer tax) and indirectly through municipalities, which burden the citizen with increased real estate tax and higher local fees (Fig.2).

Fig 2

The relation of the GDP development and the development of tax revenues of the state budget and municipal budgets, change against 1993 (%)



The ratio of state budget revenues and those of municipal budgets did not significantly change over the period between 1993 and 1996 since no substantial competencies were officially devolved from the state to local self government. In spite of it, state institutions under the pressure of lack of resources, leave the responsibility for functioning of different establishments in education, health care, transport on local self governments, without it being adequately accounted for in the share of local self governments in nationally collected taxes.

Municipalities, under the pressure of public, participate in financing these state tasks, whereby they get in controversy with the law, since the state can transfer its functions to municipalities only by law and with financial coverage. If this is not the case, municipalities must not finance state tasks, because they are obliged to enhance its property by law. (Table 1)

Table 1

Comparison of shares of municipal budget revenues and the state budget revenues in the total tax revenues

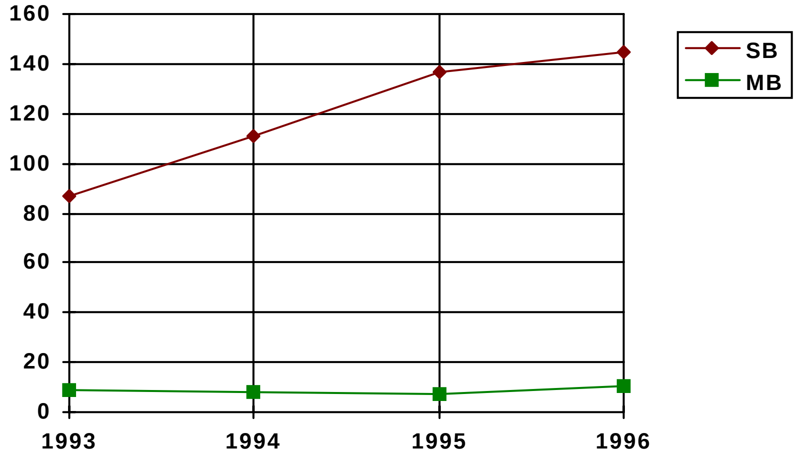
data are in %	**1993**	**1994**	**1995**	**1996**
municipal budgets share	11,40	12,60	12,00	13,30
state budget share	88,60	87,40	88,00	86,70

Source: State closing accounts

By 1995 tax revenues of the state budget were increasing, while the tax revenues of municipalities were decreasing ; in 1996 the change occurred, which meant that the tempo of tax revenue growth of the state budget slowed down and, on the other hand, for the first time since 1993, the year to year growth in tax revenues of local self government is evident (Figure 3).

Figure 3

Development in tax revenues of the state budget and municipal budgets



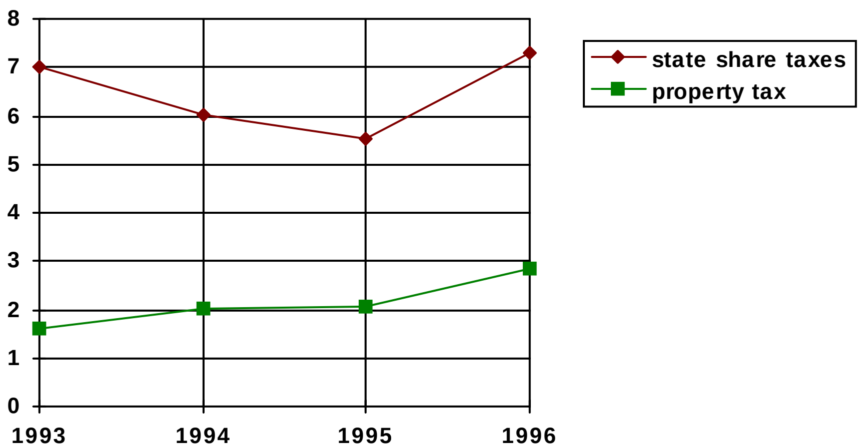
Source :state closing accounts 1993 - 1996

An increase in the total volume of state shared taxes accounted partially for the growth in tax revenues of local self governments, which municipalities acquired from the state budget, and particularly, the steady growth of revenues from real estate tax collections. It must be stressed, however, that the increase in the volume of state shared taxes is not sufficient to cover the growing expenses associated with the development in inflation and various macroeconomic measures, also due to the fact that municipalities finance tasks for which state should be fully responsible.

While municipal budget revenues from real estate tax increased by 77.6% over the years between 1993 and 1996, the proportion of state involvement of the state budget measured by the proportion of state shared taxes in municipal budgets reached an increase of 3% in 1996 over 1993. In other words, the increase in tax revenues of the state budget for 1993-1996 (approx. 66%) did not practically show in the volume of state shared taxes designated for local self governments, which points to a significant restriction by the state in relation to municipal budgets and is also the cause of increased indebtedness of local self government (Figure 4).

Figure 4

Development of municipal budget revenues from state shared taxes and real estate tax (in billion SK)

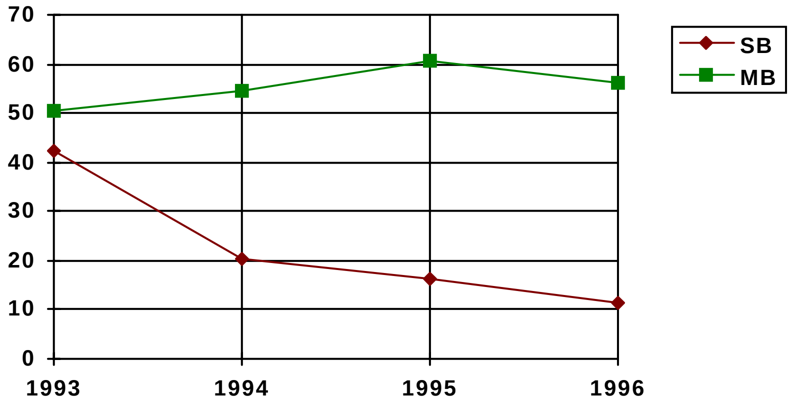


Source : State closing accounts 1993 - 1996

The development of the share of municipalities in state taxes could also confirm that the effects of macroeconomics are reflected at local level with some delay. To see if this rule holds for Slovakia will only be possible upon seeing the balances in the following years. The restriction by the state and the development of inflation for 1993-1996 entailed a decrease in the real value of the share of self government in state shared taxes, which could not suffice to meet the necessary needs, and by far could not be sufficient to cover progressively increasing additional responsibilities which municipalities fulfilled also because they were not fulfilled by the state institutions (in education, transport, social affairs, culture, health care,…) For the above reasons, by 1995 the proportion of non-tax revenues in municipal budgets had been increasing.(Fig.5)

Figure 5

Development in non-tax revenues



Source: State closing accounts 1993 - 1996

The strengthening of tax revenues of the state budget occurred also at the expense of municipal budgets. Municipalities were forced to secure lacking resources from other than tax revenues (proceeds of property sales, issuance of bonds, loans,…).

The decrease in the volume of non-tax revenues in 1996 can be attributed to exhausting the reserve of suitable property, decreased strength of self government and thus also lower credit ratings of municipalities for getting loans from commercial banks, as well as to the growth of debt service.

2.3 Analysis of municipal budgets in 1991-1996

2.3.1 Total revenues of municipal budgets

In the years 1991 - 1995, the proportion of own and other revenues in total revenues of municipal budgets was increasing. In 1995, there was a decrease in the share of municipalities in so-called state shared taxes and the proportion of state subsidies to municipal budgets increased. Since most subsidies from the state are designated for specific purpose and with the exception of those for self governing functions and public municipal transport, there are special allocation rules applicable by state designated funds, the development means weakening of economic and political independence of self government.

The slight decrease in the proportion of other revenues in 1996 is partly due to the increased volume of grants from designated funds to municipal budgets but also due to halted growth of revenues from property sales and a decreased financial capacity of municipalities, which is important in getting loans. (Table 2). The decreased proportion of own and other revenues in the total revenues of municipal budgets points to a growing dependence of local self governments upon other financial resources (loans, bonds, the state budget).

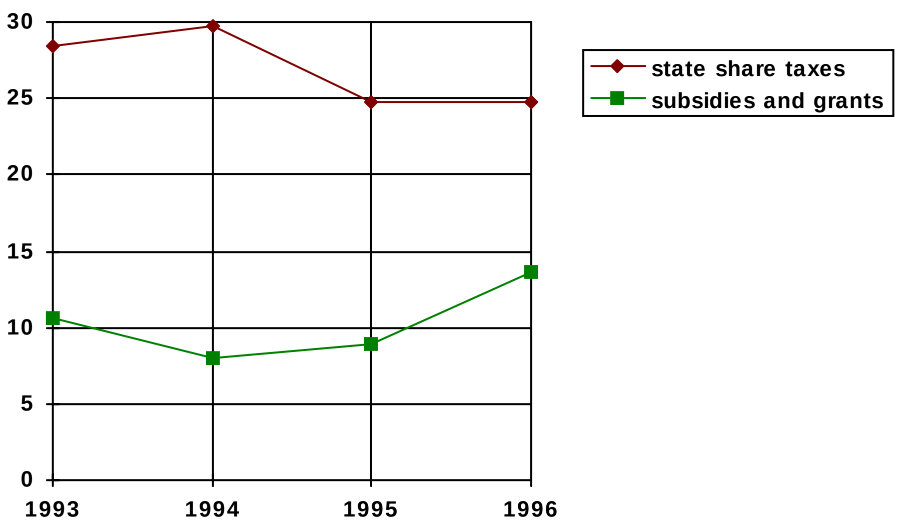
Table 2
The structure of revenues of local self governments (mil. Sk)

year	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**
subsidies	7978,0	6586,0	2226,5	1615,8	1997,2	3450,0
% share	**49,34**	**31,93**	**10,62**	**8,05**	**8,96**	**13,57**
state shared taxes	2157,0	4197,0	5972,4	5972,4	5501,6	6280,0
% share	**13,33**	**20,35**	**28,49**	**29,76**	**24,74**	**24,70**
subsidies + taxes	10135,00	10783,0	8198,9	7588,2	7498,8	9730,0
% share	**62,67**	**52,28**	**39,11**	**37,81**	**33,7**	**38,2**
own + other rev.	6038,0	9844,0	126767,1	12484,4	14737,2	15694,0
% share	**37,33**	**47,72**	**60,89**	**62,19**	**66,3**	**61,8**
total revenues	**16172,70**	**20627,0**	**20966,0**	**20072,6**	**22235,9**	**25424,0**

Source: State closing accounts 1991 - 6

The trend of increased proportion of designated subsidies in the budgets of local self governments is in contrast with the trends seen in most successful countries of Europe where there is a clear effort to strengthen independence of self-governing institutions in using public financial resources. That means that emphasis is laid on growth of the proportion of own revenues but also of non-designated (bloc) grants and subsidies (Figure 6).

Figure 6
Development of the share of subsidies and grants in municipal budgets and participation in state shared taxes (%)



Source: State closing accounts

The development within which the state is more and more getting rid of its responsibility for municipal budgets while retaining the decision-making power in redistributing substantial proportion of tax revenues is reflected in the territory by increased regional disparities and the disparities between urban and rural settlement. The sensitivity of the issue can best be seen in the fact that no advanced country in Europe has as yet come up with a radical „ growth in independence" of municipal budgets. At the same time, the comparison with several European countries reveals to what extent the administration of public affairs is centralized in Slovakia and the low level of responsibility local self governments have in the provision of public services to their citizens (Table 3).

Table 3

International comparison of the share of municipal budgets revenues from the state budget (taxes, subsidies and fees) in total revenues of municipal budgets (%)

	Denmark	Sweden	Fin.	Fran	SRN	ČR	S93	S94	S95	S96
taxes + fees.	38,9	45,0	40,0	50,0	64,1	50,5	44,5	47,7	38,4	35,2
subsidies	42,7	26,0	30,0	20,0	22,4	21,5	7,5	5,4	5,4	4,8
total	81,6	71,0	70,0	70,0	86,5	72,0	52,0	53,1	43,8	40,0

Table 4

Development in subsidies to municipal budgets

thousand Sk	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**
non-designated	974,4	201,7	211,0	216,1	218,3	250,0
in %	**12,2**	**3,1**	**9,5**	**19,9**	**11,1**	**7,3**
designated	7005,3	6379,9	2015,1	870,9	1758,9	3200,0
in %	**87,8**	**96,9**	**90,5**	**80,1**	**88,9**	**92,7**
total	7979,7	6581,6	2226,0	1087,0	1977,0	3450,0

Source:: State closing accounts of the SR 1991 - 6

2.3.2 Subsidies

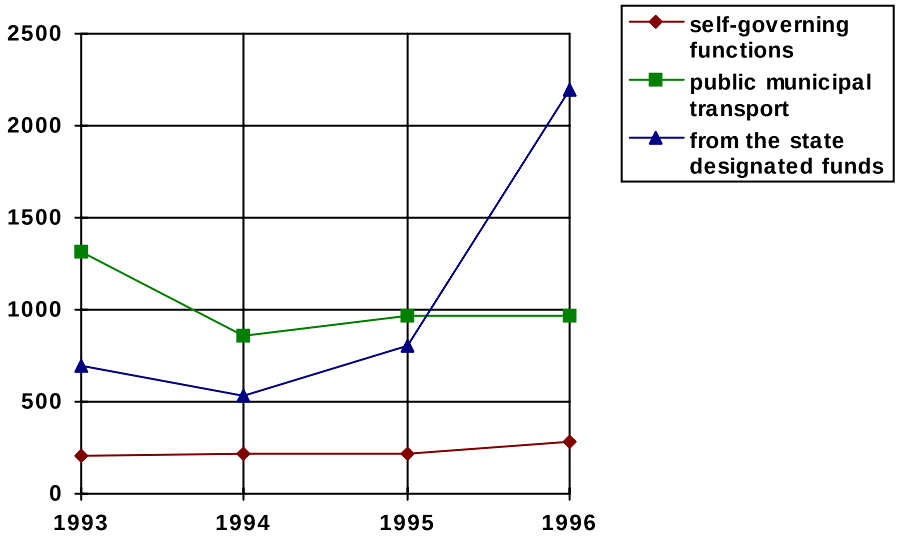
Table 4 shows the development in subsidies from the state budget and state designated funds to municipal budgets.

As will be clear from the development trend in the ratio of non-designated and designated subsidies, while the volume of subsidies for local self governments is growing, the measure of directing the use of subsidies from the state designated funds is growing, too. From the aspect of efficient use of subsidies it can be considered a positive development which, however, requires clear criteria of distribution of subsidies to be defined (transparency and justice), and, specially, the demonstration of the efficiency of their use, in capital subsidies, in particular.

On the other hand, this trend shows clearly that the state paternalism is growing, as well as the state intervention in self government of municipalities, by distorting economic conditions of self government (Figure 7).

Figure 7

Development in the volume of individual subsidies to municipal budgets



Source : State closing accounts for 1993 - 1996

From the aspect of public service provision, the figure shows an illogical development in subsidies for public municipal transport, particularly when the number of cities participating in the subsidy has gradually grown. This approach of the central government causes increasing problems in public municipal transport.

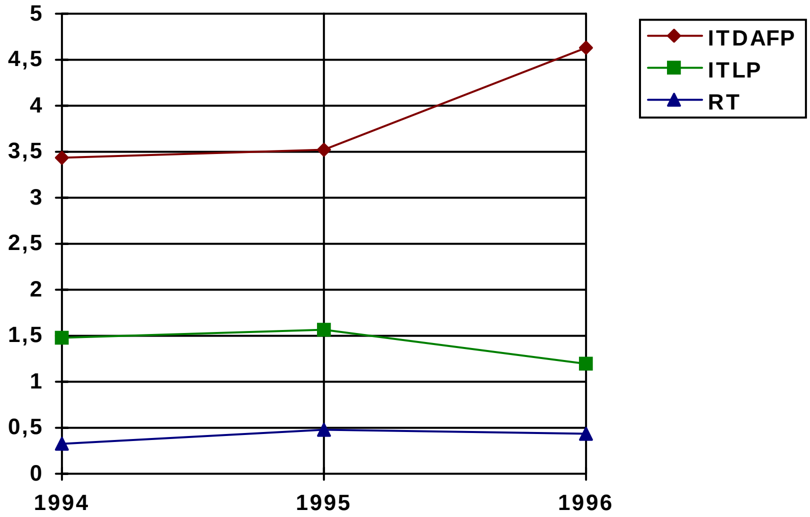
We may conclude that subsidies do not fulfill the role of a systemic financial equalization of different tax capacity of towns, communities and regions but address only individual interests of self-governing institutions. This approach is distorted by diverse criteria within individual state designated funds, non-conceptual distribution of subsidies within the whole territory of Slovakia and also by the administrative complexity of the total redistribution mechanism.

2.3.3 Shares in centrally collected taxes

As will be seen from Figure 8, the proportion of state shared taxes in the total volume of municipal budgets has shown a decreasing trend since 1994, with the decisive proportion representing by revenues from income tax on dependent activity and functional perks, which in 1996 comprised 74% of the total volume of state shared taxes (income tax of legal persons being 19%, road tax 7%, respectively).

Figure 8

Development of the share of individual taxes in total revenues of municipal budgets from state shared taxes



Source: State closing accounts for1994 - 1996

ITDAFP= income tax on dependent activity and functional perks
ITLP = income tax of legal persons
RT= road tax

A serious flaw of the system of local self-government's participation in central taxes is in its instability, (the annually changing proportion in the taxes with the exception of the road tax), as well as the fact that municipalities learn about the actual volume as late as the end of the year (December), when the state budget is definitely approved for the next year.

The distribution criteria of state shared taxes for allocation in individual city and community budgets do not fully meet their redistributing role, that would accommodate the relation between generating the tax and its use also because they do not account for geographic differences within regions of Slovakia. The criteria should both take account of the element of solidarity and motivation, while the two elements should be as well balanced as possible .

We maintain that using single criterion in redistributing income tax on dependent activity (population) is insufficient, since it does not account for increased expenses for self-governing functions in those cities and communities where working places are located. Equally, it stands to reason to review the criterion of the seat of the business entity - in distributing the share of self government in income tax of legal persons, since it does not accommodate localization of production facilities outside the seat of the firm. Even the distribution of the road tax according to the population does not account for the essence hidden in its title and the way it should be used for, as stipulated by law, i.e. the maintenance and repair of local roads.

2.3.4 Own and other revenues

In 1993-95 the proportion of own and other revenues of municipal budgets was steadily increasing. The year 1996 was a year when the proportion showed no increase and the proportion in the total revenues of municipal budgets for the first time dropped.

As for the structure of own revenues, over the course of 1993-1996, revenues from real estate tax, local fees and raised loans grew, while the revenue from sale of property, sale of shares and so-called other revenues (revenues from non-budgetary resources, financial management interest, and other non-tax revenues) showed a declining trend since 1996, with business activity of municipalities not playing a decisive role within self-government revenues.

All the given tendencies point to a growing tension of the budgets of local self governments, particularly to increasing current (real estate tax) and future (property sale, loans, sale of shares) tax burden of citizens of communities and cities. (Table 5).

Table 5

Development in own and other revenues of municipal budgets (in billion Sk)

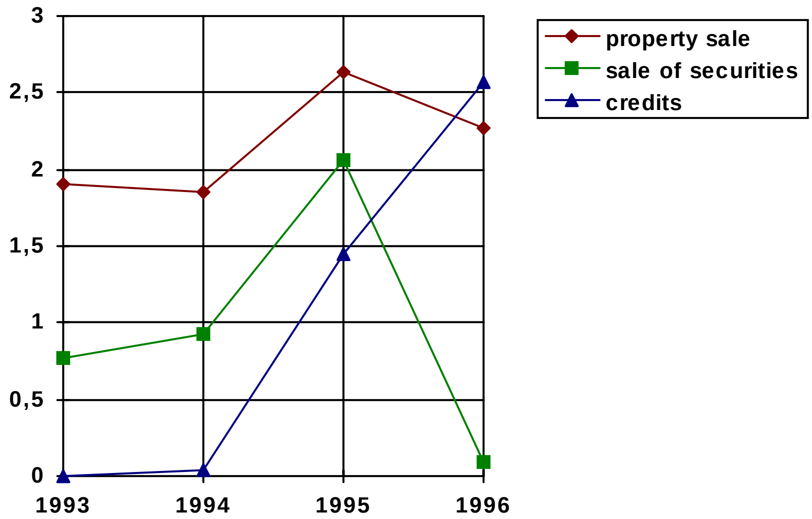
year	1993	1994	1995	1996
real estate tax	1,61	2,03	2,06	2,86
fees	0,79	0,82	0,96	0,96
business activity	1,75	0,02	0,02	0,06
sale of stocks	0,77	0,92	2,06	0,09
sale of property	1,90	1,85	2,63	2,27
loans		0,04	1,45	2,57
other	5,95	6,84	6,99	6,88

The proportion of property sales and loan raising plays a more significant role within the revenue base of municipal budgets. In 1996, it comprised approx. 30% of own and other revenues. Given the scarcity of own resources and in view of the non-compliance of the state to carry out its tasks, in 1995 municipalities turned increasingly to their own property and took up more loans.

From the aspect of the capability to raise other resources, it is interesting to compare revenues from property sales, the sale of stocks and from loans (Figure 9).

Fig. 9

Development in municipal budget revenues from sale of property, stocks and loans (billion Sk)



Source: Balances of revenues and expenditures of municipal budgets for 1993-96

Since1994, municipalities had to raise funds from the sources that are not readily reproducible or are not reproducible. In 1995, revenues from sales of property and stock comprised a considerable part. As can be seen, in 1996, in a large portion of local self-governments these possibilities had been exhausted and the largest proportion of these revenues was comprised of loans.

The fact that municipalities had to sell property under pressure, i.e. under unfavorable conditions, is practically an irrevocable loss. Another factor playing a role is the fact that the price of considerable volume of municipal property is still regulated by central power regulations (e.g. the housing fund, but also upper limits on real property taxes and local fees).

Another negative consequence of the current development is the fact that local self governments have to render many public services to citizens from the resources gained by sale and lease of property, loans and bonds, due to insufficient tax resources and revenues from local fees. It might be accepted if expenses were not covered also for services that under current system of distribution of responsibilities should be provided by state administration.

2.4 Analysis of municipal expenditure for 1991 - 1996

2.4.1 Non-investment and capital expenditures

Local self-government non-investment expenditures have been steadily increasing since 1991. However, this growth was only nominal. In 1991 - 1996, the rate of inflation was approximately 62,5 % , i.e. the value of non-investment expenditures of local government budgets for 1996 in 1991 prices amounted to 8,376 billion Sk, which was the level of 1991. That means that in reality, the actual value of non-investment expenditures dropped in 1996 by 37,5 %.

Capital expenditures revealed a much worse development. These were steadily decreasing in the period of 1992 - 5. Only in 1996 there was an increase in capital expenditures which could be attributed to property sales, sales of stock, raising loans and issuing bonds. Nevertheless, the real value of capital expenditures amounted to a lower sum in 1996 when taken in 1991 prices.

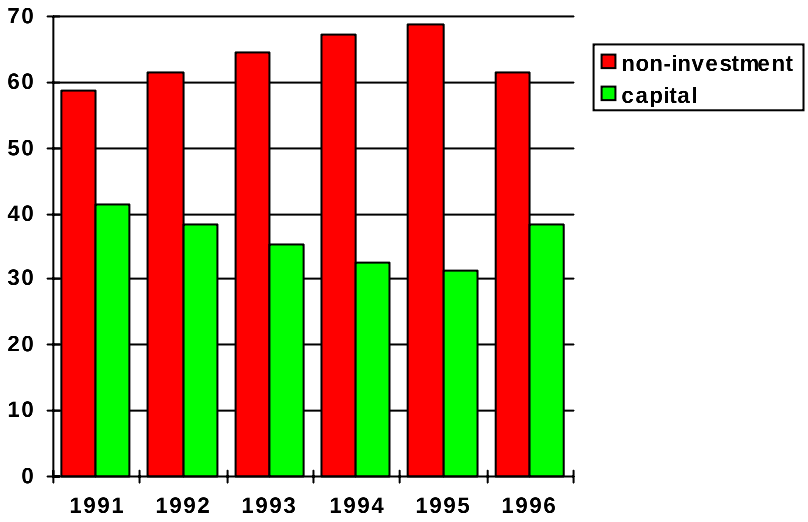
Table 6

Non-investment and capital expenditures of local government budgets (in mil. SK)

	1991	1992	1993	1994	1995	1996
non-invest. outlays	**8377**	**12123**	**12716**	**12860**	**12971**	**13402**
capital outlays	**5923**	**7547**	**6583**	**6237**	**5882**	**8387**
total outlays	**14300**	**19670**	**19299**	**19097**	**18853**	**21789**

Fig. 10

Proportion of capital and non-investment outlays of local self governments



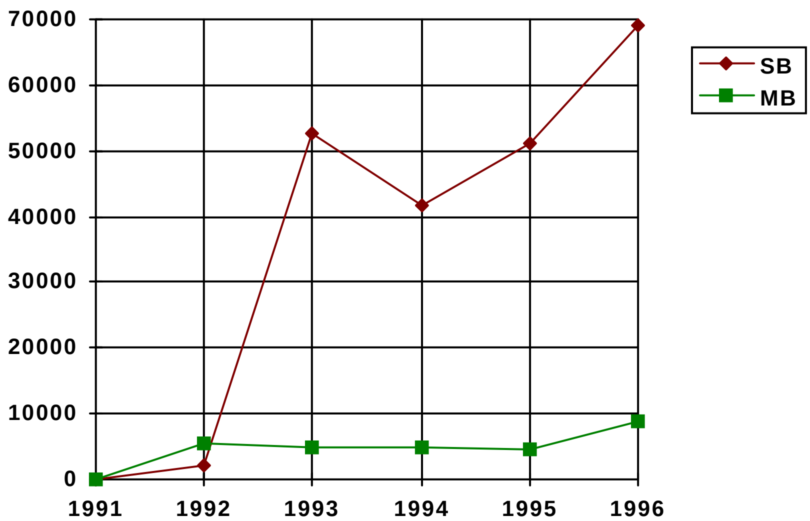
Source : ŠZÚ 1991 - 1996

It will be clear from Figure 11 that local self governments managed to maintain the absolute volume of expenditure in spite of the inflation until 1995 on the level of 1992, which was not the case of state institutions. In 1996 local government expenses soared.

There may be a number of reasons for this:

- intolerable growth in the volume of tasks self government carries out
- price growth in provision of public services
- citizens pressure on development programs and politically motivated decisions of local councils in response to the pending election.

Fig.11
The comparison of the state administration rate of expenditure and that of self government against 1991 (mil. SK)

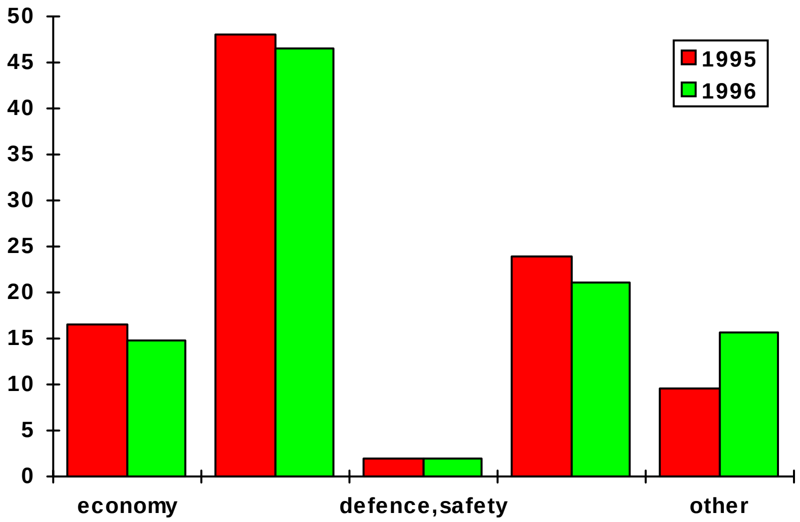


Source: State closing account 1991 - 1996

2.4.2 Expenditures of local governments by budgetary groups

The structure of expenditures by budgetary groups did not change substantially for the period of 1995 and 1996. There is some decline in the proportion of expenses on economy (transport, municipal road repair and maintenance) and on social services (social infrastructure). On the other hand, there were increased expenses on financial and technical services (Fig. 12). A decreased proportion of expenses on administration in 1996 when compared with the situation in 1995 is also worth noting.

Fig.12 Comparison of expenditures of self governments by budgetary groups (96)

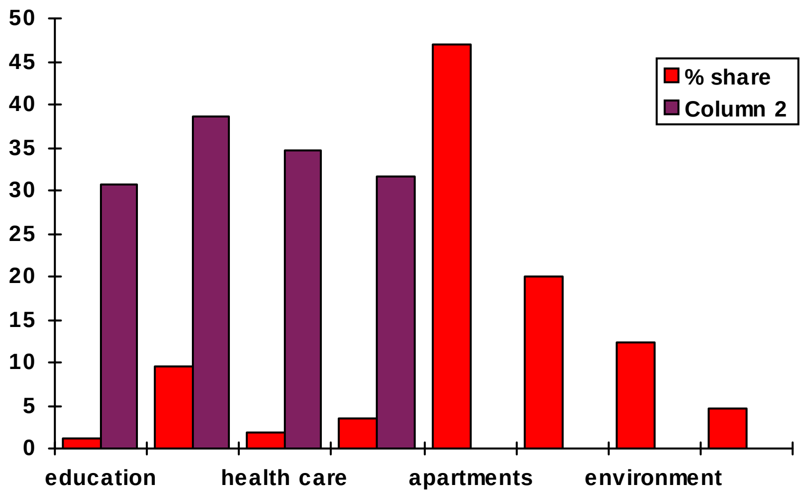


economy- social services - defence, safety - adminsitration -others

The budgetary group of social services and activities for citizens is the major item of the expenses. In 1996 local government expenses in this chapter amounted to 11,146 billion SK. Following was the proportion of individual items:

Fig. 13

Social services and activities for citizens, 1996 (education -local culture - health care - sport - apartments - public transport - environment - others)



Source: budgetary control of local self governments, , MF SR

The figure shows that from the aspect of public tasks for citizens, actually 50% of all expenses of local governments are directed to housing management. Central institutions by interfering in and regulating the relations in housing management (whether positively - subsidies for heating, or negatively - rent regulation, setting selling price for apartments, price regulation of real property), they actually affect a significant part of local self-government responsibilities, which can be considered a negative phenomenon from the aspect of self government.

The proposal for the system of financing self government relies upon :

- principles of public administration reform, known as „*župa*“ variant, which recommended to strengthen significantly the position of self-government institutions
- resolving particularly revenue side of the budget and the redistributing mechanisms of taxes, because we regard the side of expenses to be the responsibility of relevant self government, as a result of agreement between citizens - electorate and their representatives, councilors of individual tiers of public administration
- discretion of self-governing subjects in the scope and content of public goods rendered
- independence of public goods offered from tax and social policies, while it should hold that the sum of resources tax payers are ready to designate for public goods equals the volume that can be used for their provision.

3.0 A NEW SYSTEM OF FINANCING SELF GOVERNMENT

The tax reform of 1993 meant the introduction in the Slovak Republic of a tax structure, which is used in most countries of Europe. The change brought more transparency in taxes, reduction in their number and changes to ways of collecting them.

The on-going public administration reform, however, brings up constant disputes in distribution of public responsibilities between individual elements and levels of public administration. Centralist model of administering public affairs prevails, which is incapable of responding differently to the needs and demands of tax payers and is thus one of the causes of failures of central governments (the reasons have been referred to in the foregoing part).

Provision of public services comprises their own costs as well as the costs incurred by organizing public services, i.e. it is closely connected with the public administration structure, division of responsibilities and the system of financing.

■

3.1 Public administration competencies

In public administration reform it is necessary to define goods that have a nature of private task (private goods) and those which are a public matter (public goods).The transformation of the society to date has not contributed at all to defining the content of these sectors in Slovakia. Consequently, basic distortions in the proportionality between public administration, business and third sector continue to prevail.

If public administration reform is to be something more than just an instrument of power for politicians, if the objective of the reform is also cost efficient use of citizens’ taxes, the distinction of private and public goods is a necessity.

Since there are two criteria that help define private and public goods (consumption and exclusiveness), it will be clear that there are also so-called mixed goods. Even in the case of these goods, public administration in Slovakia excessively interferes with their provision, which decreases the effectiveness of their performance.

It is evident that the measure of involvement of public sector and its intervention in private goods will depend upon the philosophy and policy of the representatives of the country, whom citizens have elected in the country's leadership. Nevertheless, in countries which are democratic, oriented to the market economy, and which have different organization of public administration, no major differences arise upon changing the government, in understanding of the scope of public goods, even if „left and right" governments take turns in being in power.

Rational division of labor and provision of public administration and its financing play a significant role in this stability. Lack of clarity in the relations is reflected in the increasing costs of services for citizens, which citizens feel as taxpayers and also consumers in the quality of service rendered. Many times a monopoly position of subjects of public administration hinders increases in quality and the reduction of price through the pressure of competition.

A speedy completion of transformation of ownership and the devolution of responsibility of the state for most economic activities to private, cooperative and partly also communal sector is a decisive prerequisite for rationalization in public consumption. The following approach is considered here:

- forestry privatization + transfer in communal ownership
- agriculture privatization + transfer in communal ownership
- power industry privatization with state and self-government interest
- housing fund privatization + social housing in communal sphere
- transport infrastructure privatization + regional self government + state (railways)
- health care privatization of selected activities and pharmacies + communal sphere
- education privatization + communal and regional sphere
- culture privatization + self government
- spas privatization + and self government
- telecommunications privatization + state interest
- road network municipal and regional self government + state (system of motorways)
- water management local self government + state (resources) + privatization

The objective is :

- to reduce the level of provision of private goods by public sector
- to curb intervention of public administration in private goods
- reduction of state administration cost
- defining competencies for state administration and self government and their individual tiers.

In our following considerations on mechanisms of financing public and mixed goods, which remain in the responsibility of public administration, following principles are pursued:

1. the role of the state (central government and local state administration) should be restricted to
   - ensuring independence of the country in dealings with external world
   - ensuring internal order (legislation, security, education)
   - protection of rights and freedoms of the citizen
   - social legislation
   - creating conditions conducive to healthy economic environment (monetary, tax policies)

2. all the remaining functions should be transferred to local and regional self government
3. competencies of particular tiers of self government should be original, in the event that the both local and regional self government would be involved in a task, the functional responsibility will belong to regional self government.

Following tasks are assumed for local self government:

- **economic functions**
  - management of own and entrusted moveable and real property
  - investment and business activity
  - issuing binding positions on starting businesses by legal and physical persons
  - setting up, dissolving and control of local undertakings
  - support for private and third sector
  - preparing , approving and controlling of the budget
  - local taxes and fees administration
  - setting rates for local taxes and fees
  - design and approval of local development program and the position to regional development program
- **territorial planning and construction**
  - commission and approval of territorial planning documentation
  - issuing planning permission
  - building control (construction police)
  - responsibility for esthetics and layout of the municipality
- **local services and environment**
  - public lightening
  - funeral services, cemeteries, houses of mourning
  - communal refuse management, sewer service
  - water, gas and electricity supply
  - administration of public spaces
  - local roads maintenance
- **housing**
  - construction, administration and maintenance of municipal apartments
  - preparation of territory for housing construction
- **transport**
  - building and administration of local roads
  - municipal public transport
- **water management**
  - construction, administration and maintenance of aqueducts and water objects
  - construction, administration and maintenance of sewer objects and network
  - municipal treatment plants
- **education**
  - setting up, closing and economic management of kindergartens, primary schools, general leisure-time school education, basic art schools, language schools
  - approving and removing directors of institutions
- **culture**
  - keeping local chronicle
  - establishing, managing and closing local libraries, museums, galleries, cultural centers, theaters, orchestras, artistic ensembles, observatories, public halls, cinemas and amphitheaters …
  - protection and care for cultural monuments and historical objects
- **health care**
  - construction, maintenance and administration of nurseries
  - local health centers, out-patient clinics, hospitals
- **social care**
  - establishment, administration and maintenance of homes for the elderly and children, nursing care
  - provision of support and social cash benefits
- **internal administration**

  - organizational structure of the office
  - issuing generally binding regulations
  - citizens register
  - registry acts
  - authentication of personal documents
  - organization of citizens referendum, organization of election
  - data collection and data processing on municipality
- **public order**
  - municipal police
  - civil defense
  - fire protection

Following will be the tasks of regional self government:

- **economic functions**
  - drawing up , approving and controlling the budget
  - elaborating and approving regional development program
  - elaborating and approving economic development instruments
  - setting and approving regional differential tax surcharge
  - setting and approving regional fees
  - financial equalization
  - regional self-government property management
- **territorial planning and construction**
  - committing and approving planning documentation for the region
  - committing and approving projects of regional nature
  - binding positions to supraregional intends
  - coordination of local development intends
- **transport**
  - construction, maintenance and administration of I - III category roads
- **education**
  - establishing and administering secondary vocational schools, comprehensive schools, colleges, specialized schools, training facilities, apprentice schools
  - establishing and administering universities
- **health care**
  - establishing and administering regional outpatient clinics, hospitals and facilities
  - support for private facilities
- **culture**
  - establishing and administering regional libraries, museums, galleries
  - establishing and administering theaters and puppet theaters, observatories, zoological gardens
- **social care**
  - establishing and administering supraregional facilities
  - support for local facilities
- **internal administration**
  - organization of offices
  - issuing generally binding regulations
  - collaboration in elections and referendum
  - regional information collection and data processing
- **public order**
  - regional police

3.2 Proposed change in the rules of financing self government

One of the objectives of the reform of public administration financing in Slovakia is the compatibility of the rules and principles with those applied in European countries.

Among these principles are :

- increased financial accountability of local and regional self governments so that their indebtedness does not excessively grow, which would pose a threat to their autonomy
- increased transparency of public expenditures which will allow to reduce administrative acts, improve ways of control, which should in harmony with the provisions of the European Charter of Local Self Government be directed towards ensuring compliance with the law and the constitutional principles
- ensuring standardization in proposed budgets and their assessment
- ensuring that self governments have their own fiscal potential, because only then can they enjoy financial autonomy
- complete independence, within laws, in setting fees and surcharges for local public services
- ensuring elimination of excessive differences between rates determined because these excessive differences may lead to distortions in competitiveness
- in the event of temporary centralization of cash flow management, the maturity must be accurately monitored not to jeopardize solvency of local self government or develop difficulties in cash flow.

The proposed changes concern the tax system, the tax destination, the tax capacity, the change of the structure of self-government budgets and the definition of the level of debt.

3.2.1 Changes to the tax system

We recommend the following two changes:

1. In direct taxes, namely in the income tax of physical persons.

   CURRENTLY THE TAX CONSISTS OF TWO ITEMS:

- tax on dependent activity and functional perks, this is a state shared tax, which is a revenue of the state and municipal budgets
- tax on other activity, which is exclusively a revenue of the state budget

We recommend that this income tax of physical persons be divided in two parts and call the tax on other activity a business tax.

2. We propose to include current local fees in the tax system and rename them as local taxes, since basically they are not fees in the strict sense of the word.

   After this change local taxes will comprise:

   - business tax
   - property tax
   - tax on alcohol and tobacco products
   - tax on dog
   - tax on use of public space
   - entertainment slot machines tax
   - selling machines tax
   - tax on permit of entry in historical part of a city
   - accommodation capacities tax
   - tax on advertising
   - tax on admission
   - tax on spa and recreational fee
   - tax on environmental pollution
   - tax on using apartment or a part thereof for other than living purpose

3.2.2 Change in the tax destination

The proposed changes of dividing competencies between individual tiers of public administration require that their financing be secured. In relation to the increased level of autonomy that is demanded for local and regional self government, we propose the following changes to the tax destination:

- exclusive state budget revenues will be : VAT, international trade tax, customs, import charge
- exclusive revenues of regional self government will be the differential surcharge to taxes
- exclusive revenues of local self government will be: business tax, property taxes,
- among state shared taxes, following taxes are recommended: legal persons income tax, tax on dependent activity and functional perks, road tax, consumer taxes and ecological taxes.

The change in the tax destination relating to business tax is proposed with the aim to create conditions and ensure the preparation of the territory for business activity, which causes local self government direct and indirect burden on environment, investment participation in the implementation of technical and social infrastructure and operating costs. Simultaneously, it also represents linkage of the revenue side of local self government with the business activity in its territory.

The change in the tax destination in other property taxes (on inheritance, gift, release and transfer) stems from the close link between the transactions and local self government.

3.2.3 The change in the tax capacity

Increasing financial independence of local and regional self government, as well as the need to increase direct responsibility of these tiers of public administration for public services provision to citizens requires to give these institutes also the necessary instruments. Tax capacity is one of these instruments. Basically, there exist two possible approaches:

- to enable introduction of local taxes
- retain a firm structure of taxes and allow for differentiation in the rates .

<u>We recommend :</u>

- to apply unitary tax structure
- on regional level to allow the application of a surcharge to state shared taxes up to a certain amount
- on local level, to retain discretion in the upper limit of local taxes and fees
- that the surcharge on regional level be the revenue of regional self government .

The objective of the change is to achieve the distribution of responsibilities for tax burden of citizens between all tiers of public administration and to increase the autonomy of regional and local self government in decision making about the quality and the scope of public services provided.

3.2.4 Changes in budgetary rules and budgetary classification

In order to meet generally valid principles of budgeting: annual preparation and approval of the budget (administrative), feasibility and truthfulness, completeness and uniformity, possibility to be publicized, and transparency, current rules have to be altered .

<u>In this respect our proposal would concern primarily:</u>

- redistribution of taxes and the system of payment
- the budgetary structure.

3.2.4.1 Redistribution of taxes and the system of payment

A new division of competencies, the establishment of regional self government and a clear separation of state budgets, regional and local self-government budgets arising from the requirement of political and economic responsibility of individual institutions, calls for a change in the flow of taxes, which are denoted as so-called state shared taxes.

The flow should be as simple and efficient as possible. It should not threaten solvency of the relevant tier of self government (or state) only because there are delays in payments due to administrative reasons.

The current implementation of the budget is not good. The principal problem lies in the fact that the budget is not regarded as an economic tool but only as an administrative tool. The system prevails, when the ministries and administrators of budgetary chapters in the state budget specify approved tasks and limits for their subordinate elements. These elements draw up their own budgets, but the information on them is not available to the Ministry of Finance of the SR. The current system entails:

- the state budget's deficit
- high cost of the system
- weaknesses of institutional nature
- insufficient guarantees for not exceeding disposable resources
- inconvenient information system
- subjectivism of the officials that have a tendency to use up all the resources with no regard to efficiency.

The current system also causes delays in payments to local budgets, which results in increased insolvency of cities and communities and the loss of their independence. Therefore, a change of the entire system of public finance administration is inevitable.

Within the framework of complex decentralization efforts the division of public finance administration into two financial administration groups, is seen as part of fiscal decentralization, namely:

- the group of state financial administration
- the group of self government financial administration.

For the sake of rationalization of the entire system of public finance, we recommend that the collection of tax revenues be implemented through the network of tax revenue offices that would also effect redistribution of tax revenues to both groups, on the basis of clearly defined rules in the act on budgetary rules and the act on financial equalization.

The reason for dividing one financial complex (state) into two, is the different way of administering public affairs, the different nature of competencies proposed for the state and those for self government (local, regional), the different possibilities to control them and, particularly, the different opportunity for direct citizen participation in decision making about how public finance, particularly taxes whose taxpayers they are, will be used.

The group of state financial administration would work in a system of state treasury, which will allow not only to use public finance more efficiently, but also to respond more flexibly to the actual situation in the financial system, and particularly to control the cost efficiency of spending.

The group of financial administration of self governments would work in the same way as at present, i.e. each municipality, each region is a self-governing unit, whose representatives are accountable to their electorate for the territorial development, for fulfillment of tasks they are responsible for. A component part of their tasks is to manage, as efficiently as possible, the property of the self-governing unit, i.e. its finances as well. There is no need therefore for the state, that had been established by the citizens and self governments, to take over that task of supra-municipal and supra-regional nature, and intervene with their financial system. The principle of solidarity, which is subject to political consensus, must be addressed in a different way, such as thorough financial equalization, enacted always for a certain period.

<u>We propose the following principles:</u>

- that collection of taxes (even differential surcharges) be implemented through the network of tax revenues offices
- that tax revenues of individual tiers of public administration be, based on financial equalization act, distributed to the accounts (of the state, regional administration, municipal administration) from the revenue office
- that the state financial administration work in the system of state treasury
- that self-governing financial administration be obliged to provide information on budgets and their final financial statement to the MF SR, which swill summarize both groups.

3.2.4.2 Budgetary structure

<u>We recommend to introduce two budgets:</u>
- administrative (current) and
- asset (capital) budget.

The reason for it is to make financial flows and control transparent, to clearly separate kinds of revenues, introduce a financial equalization system, and a possibility to define the measure of debt, as well as to create conditions for the introduction of the system of so-called state treasury.

The administrative budget would be approved for the period of one fiscal year and should always be a surplus budget or at most a balanced one. We pursue the generally accepted rule that municipal and regional self government should not resort to borrowing in covering cost of their current (administrative) budget. This can be achieved much more readily if there is a special accounting management (administration of the budget) as well as by having the objectives for balancing the budget of major public services set out.

The administrative budget revenues will be comprised of local taxes and fees, state shared taxes, financial equalization revenues, and revenues from surcharges.

The administrative budget expenditures will comprise wages and contributions, current maintenance expenses, interest down payments and depreciation .

The capital budget is proposed to be drawn up as a capital investment plan. Its draft will be prepared for the period of one election term (4 years), it will be reviewed every year and the changes to it will be justified. In drawing it up, foreign capital can also be used, because through it, values are gained, whose progressive loss is off-set by depreciation.

The capital budget revenues will comprise asset sales and rental, loans, bonds, current budget surplus transfers, capital investment subsidies.

The capital budget expenditures will comprise long-range asset profits, i.e. investments in infrastructure of the municipality, region, the purchase, down payment of credit principal, provision of loans and transfers to the administrative budget and the contingency fund.

3.2.5 Defining the level of debt

The current trend of increased indebtedness of public budgets calls for introduction of a mechanism that would regulate the measure of borrowing, despite the fact that it would present an intervention in the independence of individual tiers of public administration.

<u>There are several reasons for this step:</u>

- communities, cities, regions but also the National Council of the SR, are public law institutions representing citizens during the term in office
- the measure of debt should not only represent the will of present councils and commercial banks, since these are often projects that exceed election terms or life of a generation
- the indebtedness has a long-term impact upon the quality of life of a country, region, city or community and potential carelessness in financial policy may result in increased dependence upon the creditor and the loss of sovereignty
- setting the rate of indebtedness will preclude small communities, cities or regions to take up enormous loans and guarantee this debt by taxes raised by rich cities, communities and regions through the mechanism of equalization.

Defining the limits to the debt raised, will force communities, cities, regions but also the state to respond to unfavorable economic development in the country by cuts of expenditures, increases of cost efficiency of their own outlays.

<u>We recommend following principles in defining the rate of debt of the public budget:</u>

- not to allow municipalities to raise loans for financing current expenses of public goods
- not to raise loans for individual investment plans but rather to support expenditure part of the capital budget
- to define maximum rate of debt by the relation between the administrative and the capital budget and to do it in such a way that would allow public administration to manage to pay the debt service from the administrative budget
- the period of repayment of the credit should not exceed the service life of relevant facilities (investments).

3.2.6 The change of the fiscal year

Irregular replenishment of public budgets, concentration of expenditures in the end of the year, identification of actual revenues only after tax returns have been filed, but also e.g. provision for operations of public services objects (heating period), capitalization of agricultural production … are all reasons for considering change of the fiscal year for public budgets.

We recommend that the fiscal year to begin on April 1, and end on March 31 of the following year. This shift would allow to better assess the opening positions for the following budgetary period and at the same time to avoid regulatory interventions in the budgetary items at the most inconvenient time (heating period, Christmas time…) by SR Ministry of Finance.

3.2.7 Changes in the criteria for distributing state shared taxes

The objective in changing criteria for dividing state shared taxes in favor of municipalities and regions is an effort to enhance equity and motivation of individual tiers in raising the quality of environment. Simultaneously we are committed to linking raising of taxes with their use, i.e. the principles that the current simple criteria do not provide. Although by introducing new criteria there will be a more significant differentiation in revenue side of municipal budgets linked primarily to the size of community or a city, the proposed way of financial equalization will alleviate extreme disparities in economic strength between communities, cities and regions.

We propose that institutions of public administration participated in state shared taxes in a discriminate way:

- income tax of legal persons and the road tax (vehicle tax) shall be a revenue of the central, regional and local level
- consumer taxes shall be the revenue of central and regional level
- income tax of physical persons on dependent activity and functional perks shall be a revenue of regional and local level of self government
- ecological taxes shall be a revenue of regional and local level of self government.

INCOME TAX OF LEGAL PERSONS

We recommend that this tax has a basic flat rate. We also propose that regional level should have discretion to apply differential surcharge whose maximum amount will be fixed by law.
The reason is to prevent unjustifiable competition between regions that could be reflected in a very differentiated burden for businesses. Since the tax rate and surcharge are closely related to the level of salaries, services, but also the quality of environment, extreme disparities might lead to destabilization of settlement and regional structure of Slovakia.

In defining individual percentage share for different tiers of public administration a principle should be pursued to strengthen the share of local and regional budgets. The reason is to achieve as close a linkage as possible of the revenue side of self-government budgets and the businesses operating in the territory, which they administer.

THE CRITERIA OF DIVISION OF STATE SHARED TAXES BETWEEN INDIVIDUAL REGIONS, CITIES AND COMMUNITIES

We propose the following criteria for sharing taxes :

- number of population („adjusted"), as it is done at present
- number of employed in the community, city (compensation for taxpayer seat)

The proposed change is based on the assumption that the currently applied criterion (of seat of taxpayer) does not account for the existence of detached productions, firms, outside the settlement where the legal person is registered. The communities or cities which are seats of these detached workplaces carry the burden without this burden being accounted for in the revenue side of their budgets. Moreover, each community or city where job opportunities arise, contributes not only to generating the GDP but also participates in the development of employment within the state.

In defining the weight of criteria in the total amount, we recommend to give preference to the criteria of the number of population. It follows mainly from the requirement of temporary accommodation of negative residues of the past, the consequences of centrally planned economy and the settlement system of centers, which unjustly preferred only selected part of settlements and put countryside at a significant disadvantage.
The entire differential surcharge is the revenue of the regional budget.

INCOME TAX ON DEPENDENT ACTIVITY AND FUNCTIONAL PERKS

The omission of the state budget from redistribution of this tax stems from the fact that the job opportunities are created exclusively in the territories of municipalities. The share of regional self government is justified by the fact that only a minimal number of economically active population commutes to work outside the boundaries of the region.

The purpose of this change when compared with the situation to date (the omission of central level of public administration) is to strengthen the revenue side of regional and local self government. In spatial allocation of public goods to local and regional level, the financial burden of self governments for provision of public goods will increase in social infrastructure, which arises from or is determined by the principle of solidarity.

CRITERIA OF DISTRIBUTION AMONG INDIVIDUAL REGIONS, CITIES AND COMMUNITIES

We propose the following criteria:

- number of population („adjusted“), as at present
- number of the employed, newly proposed criterion that should account for not only the economic strength of the territory concerned, but also the active employment policy and creation of conditions for new job opportunities on the side of local self government.

We recommend to give preference to the criterion of the number of population, the reason being identical with that in respect of the income tax of legal persons.

ROAD TAX

We recommend that the road tax be subject of the same collection as other state shared taxes.

THE SHARE OF THE STATE BUDGET AND SELF GOVERMENT BUDGETS

The essential principle in distributing the road tax is the responsibility for the network of roads, based on the distribution of competencies. We assume central level to have responsibility for motorway network, regional self governments for other, nowadays state roads, and the local self government for local roads. The criterion of distributing the tax will be the length of roads, which puts at an advantage local level, particularly countryside population.

THE CRITERIA OF DISTRIBUTION AMONG REGIONS, CITIES AND COMMUNITIES

In distributing the relevant volume, we propose to apply two criteria:

- number of population, as at present
- the length of roads administered

Instead of dividing among individual levels, we recommend to use also the criterion of the number of population. The reason is to avoid excessive preference of countryside areas, in per capita calculation, over the territories with concentrated mass apartment construction, which comprised as much as 90% of houses built in the 1970s and 1980s, a which had to comply with mandatory density of built up land and standardized share of roads per apartment. This criterion simultaneously eliminates the fact that statutory cities (Bratislava, Košice) fully maintain and administer roads in their territory (except for motorways) without the existence of the state road administration, as is the case with other districts.

CONSUMER TAXES

We recommend to determine a unified flat rate for individual kinds of consumer taxes. The revenues from consumer taxes are differentiated according to regions, thus we recommend to leave greater part for the state budget. Equally, for transition period, we are more inclined to flat share than to one that is selective, by particular kinds of consumer taxes. However, the possibility to differentiate the share for central and regional levels by particular kinds of consumer taxes is not excluded .

CRITERIA FOR THE SHARE OF REGIONAL BUDGETS

WE RECOMMEND TO APPLY TWO CRITERIA:

- number of population
- size the region
-

The reason to apply the two criteria is in a more equitable capitalization of the differences between regions, where the population is the criterion for the tax on beer, wine, alcohol, tobacco products and the area of the territory of the region is the criterion for tax on hydrocarbon fuels and lubricants. The recommended ratio is 70% :30%.

ADJUSTED NUMBER OF POPULATION

In distributing tax shares, or in subsidizing self-government budgets, many countries use so-called adjusted number of population, according to the size category of municipalities. The adjustment of population expresses that inhabitants of different size categories do not carry the same weight.

In our proposal we do not consider this approach for the purposes of redistributing, since we deem the size of a city primarily a political decision of the self government, which has a chance in a democratic society to affect it directly.

3.2.8 THE CHANGE IN THE SYSTEM OF SUBSIDIZING

SUBSIDIES FOR SELF-GOVERNING FUNCTIONS

CURRENTLY SELF-GOVERNMENT BUDGETS GET STATE BUDGET SUBSIDIES FOR:

- carrying out self-governing functions in municipalities of up to 3000 population
- contribution for municipal public transport in Bratislava, Košice, Prešov, Žilina and Banská Bystrica

The remaining cities and communities with the population over 3000, do not get any subsidies from the state budget.

It is recommended here that the current system of subsidies for self-governing functions and municipal public transport is replaced with the application of a new mechanism - financial equalization (applying its horizontal and vertical elements), after proposed changes have been implemented to the tax destination, changed ratio in state shared taxes, application of discretion to levy differential surcharge at regional level, elimination of the upper limit to local taxes and fees.

INVESTMENT SUBSIDIES

To support the development of capital investment activities in the territories of communities and cities, we recommend to retain investment grants in place and temporarily introduce investment subsidies in water management and social welfare. Both these elements would be applied both at central level and regional level.

The sources of investment subsidies and grants will be tax revenues of individual levels of public administration, foreign grants, foreign support funds, domestic and foreign private resources.

The investment grants from the state budget or regional self government shall be provided, subject to principles defined by law. A clear strategy for territorial development (municipality, region), defining cost efficiency of the investment or its social benefit set out in the given territorial development documentation will be preconditions for the provision of the grant. Another precondition for a chance to be awarded a grant will be participation of the given territorial unit in financing the project (minimum 20%). The investment grants will be provided from Regional Development Fund (at national level) or from the Local Development Fund (at regional level).

In transition period, we recommend to consider also the introduction of two specialized subsidies in water management and social welfare where:

- in water management, there would be two distribution criteria: the number of population and the size of the territory (region or municipality)
- in social welfare, we recommend one criterion, namely the number of citizens aged over 60.

3.3 A PROPOSED WAY OF FINACIAL EQUALIZATION

The change in the system of financing public services, as part of the complex public administration reform (territorial and administrative division, competencies, financial mechanisms) will likely need at present some measure of solidarity, which, should not at any rate act against the other principles of the general reform of financing public services, i.e. against the principles of subsidiarity and motivation.

Over the recent decade, financial equalization, i.e. redistribution of tax revenues, has become part of the budgetary rules in most European countries. There are several reason for it. Among them the need to protect cities, regions against enormous increases in poverty tied with crime, protection against enormous increases in operating costs, which make communities, cities and regions ever more increasingly dependent upon the state and the private subjects. Another reason is the slow down of economic growth, due to decreased investments, operating cost increases of cities and communities but also an effort to balance emigration in „more advantageous“ regions, with lower tax and fee burden or higher quality of services. The financial equalization is additionally a necessary prerequisite for decentralization and democratization of public administration.

The financial equalization (at local and regional level) fulfills four major functions:

- ***fiscal*** , increasing the volume of municipal financial resources in the event that tax revenues do not cover socially acceptable minimal expenditures on public consumption
- ***redistribution function,*** correction of different tax capacity
- ***territorial - political function,*** covering increased costs connected with different municipal tasks in the structure of settlement, i.e. creating prerequisites for reducing disparities in social and economic level of municipalities or regions
- ***economic***, using municipal budgets in ensuring the stability of the country.

The objective of the reform in financing public services in many European countries and the introduction of the so-called horizontal equalization, in particular, was brought about by an effort to reduce disparities in the level and quality of provision of public services between weak and strong regions, cities and communities.

Until reforms have been introduced, local and regional governments in many countries had to manage rationally the disposable finances. The indebtedness of communities, cities and regions did not comprise significant amounts, since there was a slogan upheld: „ those who have lower tax burden, have adequately lower expenses“. The difference in the economic capacity and thus also in the quality of services provided was taken for granted, stemming from a number of other factors (production, personnel, natural).)

On the other hand, numerous analyses abroad showed that financial equalization did not always bring the anticipated strengthening of the economy in the regions, which gained the support, just the reverse, in regions that gained by this reform a significantly larger share in taxes, debt was growing more steeply, than in the regions that contributed towards this equalization. Per capita expenditure in public administration increased. In most countries, this process still prevails. In other words, an effort to achieve equal standards in poor and rich regions resulted in greater indebtedness of poor regions..

The reason for a greater growth of indebtedness in poorer regions is the effort to ensure public services of equal quality as is the case in richer regions. This essentially political contest, stems from the conviction that nobody will eventually be taken accountable for the enormous debt of the city, community or region and even the state.

Richer regions do not regard this system of excessive solidarity (leveling) to be equitable, since they actually pay for being able to increase their tax capacity as well as the rate of redistribution of finances through skillful policies.

Among the principles of financial equalization, that might allow to avoid several examples of negative experience of European countries should be:

- the introduction of a unitary system for the whole territory of the Slovak Republic, defined in the act on financial equalization
- orientation of financial equalization only towards the so-called current self-government expenses, i.e. towards fulfilling self-government functions stipulated by law, since it concerns the money of tax payers and their use in other municipality , in other region
- transparency of the system, as it has to be feasible in the political process

- definition of the optimal level of equalizing different tax capacity, so that it does not level too excessively the tax capacity of the rich and the poor
- to fix the volume and scope of subsidies for self-governing functions
- the resources of financial equalization should not be designated as to the purpose
- reducing the rate of redistribution of taxes
- as component part of the system, to define the upper limit of debt for public budgets
- to orient financial equalization to the inhabitant of a territorial unit.

The rate of financial equalization results from the change in the economic conditions in the country but is also subject to constant changes for political reasons. It is therefore necessary to analyze the system at certain intervals and adapt it to a new situation.

It is crucial to define the optimum measure of equalization. Financial equalization should ensure necessary finances to communities and cities to enable them to carry out self-governing functions but should not annul the diversity in the financial capacity of municipalities, resulting from their independence. Where financial equalization would cover at 100% these differences, territorial self governments would lose interest in using their potential and would fully rely upon equalization mechanisms.

The amount of equalization is subject to control of the institution of public administration, that provided it, therefore it holds from the aspect of territorial self government that, the higher the rate of equalization, the lower the measure of financial independence (autonomy).

We propose that financial equalization be derived from the tax capacity of the territorial self government, which will be assessed on the basis of the approved final financial statement of the account for the preceding fiscal year.

Our proposed financial equalization would consist of the following items:

- ***horizontal financial equalization***, within which the regions with greater tax capacity will contribute to weaker regions, or cities and communities with higher tax capacity to cities and communities with lower tax capacity. That means, that the horizontal financial equalization at state level would not have an impact upon the state budget, or at regional level, would not affect the regional self-government budget.

- ***vertical financial equalization,*** within which the state budget will contribute to the regions with low tax capacity, or the regional self government will contribute to municipal self governments with low tax capacity. That means that the vertical financial equalization will have an impact upon the state budget or the regional self-government budget.

The mechanism of the financial equalization will unequivocally be defined in the act on financial equalization, which should be effective at least over the course of one election term.

We propose self-government institutions to receive financial equalization resources in two payments : as an advance payment at the outset, and the after payment in middle of fiscal year or quarterly.

3.3.1 HORIZONTAL FINANCIAL EQUALIZATION

The main objective is to fulfill the element of solidarity, i.e. the alleviation of disparities in economic capacity of the regions or cities and communities.

The state budget or the regional self-government budget do not participate in the horizontal financial equalization between regions or municipalities.

We propose that the mechanism of horizontal financial equalization at central or regional level was composed of the following steps:

1. The average tax capacity of the region (municipalities) will be calculated for the preceding year.
2. A horizontal equalization fund will be raised as a percentage proportion of the tax capacity of the region or the municipality
3. Two-fifth of the fund will be distributed among all regions or municipalities according to the number of population.
4. The adjusted tax capacity of the regions or municipalities will be calculated.
5. On the basis of the rate of financial equalization stipulated by law, (% of the average tax capacity in the SR or the region) it will be determined whether there are sufficient resources in the Horizontal Financial Equalization Fund.
    5.1 If not, then the resources will, be divided among municipalities under the fixed percentage of the tax capacity, according to the number of population.
    5.2 If yes, then the remaining three-fifth are distributed among the regions, municipalities up to a fixed percentage of the tax capacity, and if there are resources still available, the remainder will be distributed among all regions, communities, according to the number of population.

Those regions that after horizontal financial equalization will not achieve the average percentage of tax capacity, stipulated by law, can apply for a support from the Vertical Equalization Fund. It will then be at the discretion of self-governing regions or municipalities, whether they will opt for the way of increasing their own revenues or will apply for support, at the expense of control of cost efficiency of its financial management from the side of the state or the regional self government.

We propose that the Fund of Horizontal Equalization for regional self governments be administered by the Ministry of Finance (later the State Treasury) and the Horizontal Equalization Fund for local self governments within the region, be administered by the financial administration of the relevant regional self government (later the State Treasury).

3.3.2 THE VERTICAL FINANCIAL EQUALIZATION

The aim of vertical financial equalization is to raise the capacity of municipalities and regions to carry out their self-governing functions where even after horizontal financial equalization they do not have sufficient financial resources to carry out their mandatory tasks. The vertical financial equalization is applied only after horizontal financial equalization.

The role to additionally strengthen the revenue side of the budgets through vertical financial equalization, equalizing the situation among regions of the SR will be adopted by central government (the Regional Financial Equalization Fund), and in equalizing the situation among municipalities within a region, by the regional self government (Local Financial Equalization Fund). The sources of the funds will be tax revenues of the state budget or the tax revenues and the differential tax surcharge of the regional self government. The relevant institutions of public administration will from their own budget provide a contribution, upon the application of the relevant regional self government, or relevant local self government.

The efficient use of the resources provided from the resources of vertical financial equalization is subject to the control by the relevant level of public administration (central government or regional self government).

The mechanism of calculating the volume of the financial resources, for which a municipality or a region can apply, will be defined by the act on financial equalization, which we propose as follows:

1. Tax capacity of a municipality or the region will be calculated, after horizontal financial equalization, i.e. for the purposes of vertical financial equalization, the tax capacity of a municipality (region) equals the sum of revenues of local taxes, state shared taxes and the revenues of the horizontal financial equalization.
2. The average tax capacity of municipalities in the region is calculated, (with equalization among municipalities) or regions in the state (with equalization among regions).
3. We propose that the municipalities (regions), whose tax capacity is under the average in the region, (the state), are entitled to vertical financial equalization of up to 50 % of the difference between their capacity and the average in the region (the state).

Appendixes

Appendix 1

The scheme of the proposed relations between the state, regional and local budgets.

Taxes and other own revenues

Regional investment fund **STATE BUDGET**
capital expenses/ current expenses/ VEF

Regional horizontal equalization fund

Taxes and other own revenues

Local investment fund **REGIONAL SELF GOVERNMENT BUDGETS**
capital expenses/ current expenses/ VEF

Regional horizontal equalization fund

Taxes and other own revenues
MUNICIPAL BUDGETS
capital expenses / current expenses

VEF - Vertical equalization fund

Appendix 2

A summary calculation of the change of tax revenues of individual levels of public administration

We based our estimation of the impact of the change of the distribution of competencies in the model calculation of revenues for different levels of public administration on the following principles :

1. the distribution of responsibilities between the state administration and self government and between municipal and regional tiers of self government is based on the criteria given under point 3.1.
2. in line with the principles given under 3.2.1, tax system will be revised
3. the change in the tax destination and the tax capacity, as described under 3.2.2 and 3.2.3;
4. the shares of individual levels of public administration in the state shared taxes will be as follows:

<u>Income tax of legal persons</u> :	
state budget	50 %
regional budgets	30 %
local budgets	20 %
<u>Income tax on dependent activity and functional perks:</u>	
regional budgets	40 %
local budgets	60 %
<u>Road tax</u>	
state budget	10 %
regional budgets	40 %

local budgets 50 %
Consumer taxes
state budget 70 %
regional budgets 30 %

5. The estimate of current expenses for ensuring the competencies handed over by the state administration to self government:
   - education 23 billion Sk
   - health care 3 billion Sk
   - culture 3 billion Sk
   - social affairs 6 billion Sk
   - safety 3 billion Sk
   - administration 4 billion Sk

   i.e. total 42 billion Sk
6. The current expenses of local self government for carrying out current responsibilities are approximately 14 billion Sk (1998 estimate)
7. For 1998, current expenses of Regional Offices amounting to around 38 billion are assumed (education, health care, culture, social affairs , transport,…).

Following is the proportion of current expenses of state, regional and local budgets at present:

	billion Sk	%	level of public administration
state budget	128,6	70,0	central
regional budgets	38,0	20,8	regional
local budgets	14,0	9,2	local

Source: Draft state budget for 1998, author's estimate

By the devolution of competencies to self government, the financial needs to cover current expenses will soar from around 14.0 billion to around 52 billion Sk. Under our proposed changes of tax destination and the changed share in taxes, individual institutions of public administration will participate in tax revenues of the SR as follows (the calculation is applied on the anticipated revenues in 1998):

kind of tax	**state budget**	**regional budgets**	**local budgets**
on dependent activity and functional perks.	0	8 552	12 828
on business activity	0	0	5 500
on income of legal persons	13 875	8 325	5 500
withholding tax	8 000	0	0
on property	0	0	1 100
VAT	64 250	0	0
consumer taxes	17 010	7 290	0
on international trade and transactions	14 200	0	0
road tax	200	700	900
total (mil. Sk)	**117 535**	**24 867**	**25 878**
% proportion	**69,8**	**14,8**	**15,4**
other local taxes	0	0	5 000
total (mil. Sk)	**117 535**	**24 867**	**30 878**
% proportion	**67,8**	**14,4**	**17,8**

Appendix 3

Comparison of the impact of changed criteria on tax capacity of municipalities

The model solution is applied on the selected territory of Trenčiansky Region, represented by 25 municipalities of the following size categories: cities and communities of up to 5000, 2000, and 500 population. The data have been obtained from individual Municipal Offices, from statistical data, from the state financial statement for 1996 and from our own calculations..

The purpose is to compare the current system of redistributing state shared taxes among individual municipalities and our proposed change of the criteria.

Our calculation was based on the following assumptions:

- the scope of competencies remains as to date
- the share of municipal budgets in centrally raised taxes in 1996 was according to the national account as follows:
  - tax on dependent activity and functional perks 4 636 058 000.-Sk
  - legal persons income tax 1 200 408 000.-Sk
  - road tax 425 701 000.-Sk
- registered number of employees, total (1996) v SR 1 487 686
- SR population 5 378 932
- length of local roads 18 742, 70 km
- calculation of the volume of state shared taxes according to the proportion of individual criteria:
  - tax on dependent activity and functional perks:
    - 70 % according to population 603,32 Sk / 1 inhabitant
    - 30 % according to number of employees 934,94 Sk / 1 employee
  - tax on income of legal persons:
    - 60 % according to population 133,90 Sk / 1 inhabitant
    - 40 % according to number of employees 322, 78 Sk / 1 employee
  - road tax
    - 50 % according to population 39,57 Sk / 1 inhabitant
    - 50 % according to podľa km of roads 11 356,4 Sk / 1 km

	LTF	**S1**	**M1**	**S2**	**M2**	**S3**	**M3**
Trenčín	27 476	66 517	114 880	93 993	142 356	1597.-	**2418.-**
Stará Turá	5 330	10 980	18 075	16 310	23 405	1535.-	**2203**.-
Nemšová	1 449	6 600	7 626	8 049	9 075	1319.-	**1487.-**
Trenč. Teplice	6 660	4 722	6 778	11 382	13 438	2472.-	**2919.-**
average cities	*40 915*	*88 819*	*147 359*	*129 734*	*188 274*	*1618.-*	*2347.-*
Trenč. Teplá	1 146	4 147	5 179	5 293	6 325	1426.-	**1703.-**
Horná Súča	953	4 235	3 614	5 188	4 567	**1436.-**	1264.-
Dolná Súča	798	1 517	2 946	2 315	3 744	830.-	**1342.-**
Trenč. Stankovce	9 800	2 670	2 845	12 470	12 645	4655.-	**4720.-**
Trenč. Turná	1 571	2 761	2 578	4 332	4 149	**1724.-**	1651.-
Podolie	1 409	2 138	2 203	3 547	3 612	1713.-	**1744.-**
communities 2-5 thous .population.	*15 677*	*17 468*	*19 365*	*33 145*	*35 042*	*2024.-*	*2139.-*
Omšenie	1 027	1 635	1 743	2 662	2 770	1372.-	**1428.-**

Krajné	2 989	2 021	2 339	5 010	5 328	2815.-	**2993.-**
Chocholná	990	1 600	1 723	2 590	2 713	1622.-	**1699.-**
Beckov	1 309	1 480	1 573	2 789	2 882	2042.-	**2110.-**
Trenč. Jastrabie	789	1 240	1 226	2 029	2 015	**1664.-**	1653.-
communities 1-2 thous. population	*7 104*	*7 976*	*8 604*	*15 080*	*15 708*	*1908.-*	*1988.-*
Skalka n/V	464	1 064	1 010	1 528	1 474	**1566.-**	1510.-
Zem. Podhradie	491	780	653	1 271	1 144	**1596.-**	1437.-
Veľká Hradná	336	710	656	1 046	992	**1536.-**	1457.-
Zamarovce	235	646	548	881	783	**1362.-**	1210.-
Modrová	492	515	539	1 007	1 031	1986.-	**2034.-**
communities 0,5-1 thousand	*2 018*	*3 715*	*3 406*	*5 733*	*5 424*	*1589.-*	*1503.-*
Horňany	292	390	467	682	759	1814.-	**2019.-**
Štvrtok n/V	197	379	331	576	528	**1694.-**	1552.-
Nová Lehota	491	280	446	771	937	2834.-	**3445.-**
Petrova Lehota	57	215	161	272	218	**1308.-**	1048.-
Višňové	98	214	212	312	310	**1545.-**	1485.-
communities of up to 500 population	*1 135*	*1 478*	*1 617*	*2 613*	*2 752*	*1869.-*	*1968.-*
total	**66 849**	**119 456**	**180 351**	**186 305**	**247 290**		
weighted average						**1702.-**	**2258.-**

Legend :

LTF	local taxes and fees
S1	revenues from state shared taxes according to current criteria
M1	revenues from state shared taxes according proposed criteria
S2	LTF + S1
M2	LTF + M1
S3	tax capacity per capita under current criteria
M3	tax capacity per capita under proposed criteria

Although the sample used cannot be considered representative of the whole Slovakia, it is possible to observe in the comparison of application of current criteria and the proposed criteria of redistribution of state shared taxes, some change in the tax capacity of cities and communities, within the structure of size categories of municipalities.

If the objective of the reform of financing public administration is equity on the first place, then it is necessary for the system to account for:

- share of individual cities and communities in the economic development of the SR
- increased requirements for provision of public services in larger communities and cities
- provision of numerous public services in cities for the benefit of citizens of the countryside, while the system of financial equalization will subsequently alleviate extreme disparities between municipalities and regions (the element of solidarity in our proposal).

<u>ON THE MODEL CALCULATION ONE CAN OBSERVE:</u>

ĩ **Increase in the tax capacity of the territory as a whole**

By changing distribution criteria of state shared taxes, the tax capacity of the assessed territory has been increased by approximately 61 million SK, i.e. on average by 557 SK per capita.. It points to the current injustice of the system which does not account for the economic strength of cities, communities and regions (in our case, measured by the parameter of the number of employees), or the density of road network (in our case measured by length of roads).

When compared to the total tax capacity of cities and communities in Slovakia which is around 2000 SK per capita, the selected territory of Trenčiansky region, will achieve by changing the criteria an average tax capacity of 2258 SK, i.e. a tax capacity exceeding the SR average by approx. 13%.

2 Strengthening tax capacity of cities

The increased tax capacity is due to general increase of the capacity of the selected territory, as well as the change of criteria. By changing the criteria, the current injustice will be eliminated, when the cities fulfilling significantly more public tasks than communities were achieving under average values in their tax capacity when calculated per resident.(residing citizen) The argumentation for the current system that the cities have more other resources at their disposal will not hold out, because those so-called other resources are either private, or derive from sale of property and capital assets, i.e. they are resources which are not to cover current expenses, to provide public goods.

3 The change in the proportion of tax capacity of individual size categories of municipalities

In 15 cities and communities out of 25, tax capacity has been increased. While the current criteria put at an advantage small communities, in particular, the change in the criteria will benefit cities and communities (regardless of size), which dispose with job opportunities..

In spite of the overall increase of the tax capacity of the assessed territory, in communities of up to 1000 population, in particular, tax capacity has been decreased. We may assume that it happened in favor of cities and communities with job opportunities within the region but within Slovakia as well. This is not such a negative trend as it may seem at first sight. Our other analyses
(see the first stage of our work: Economic conditions for the functioning of self governments in Slovakia, MESA 10,1995) revealed that the need of current (operating) per capita costs, which are taxes, grow with the size of the city. Municipalities of up to 5000 population need more resources to cover capital costs, i.e. the costs that should be covered by taxes only to limited extent (paying back interest or support investment subsidies).

APPENDIX 4

Comparison of the current and the proposed system of financing local self government under unchanged competencies

The model solution is applied on 25 cities and communities of Trenčiansky region of all size categories. The data have been obtained from relevant Municipal Offices, statistical data, the 1996 state closing account and own calculations

The objective is to compare the currently applied system of municipalities' share in tax revenues, including subsidies for self-governing functions and our proposed system, including the new way of financial equalization of different tax capacity of municipalities. In this calculation we do not assume new competencies to be devolved to self government.

Our calculations are based on the following assumptions:

- the data on local taxes and fees (LTF), the volume of state shared taxes (S1) as in Appendix 2
- subsidies for self-governing functions for municipalities with the population of up to 3000 are derived from the approved results of budgetary management of municipalities
- new criteria of distributing state shared taxes valid as in Appendix 2
- the data on the number of inhabitants, the number of working opportunities and the length of local roads , as in Appendix 2
- in the financial equalization we assume a mandatory transfer of 10% of the municipal tax capacity to the Horizontal Financial Equalization Fund
- the upper limit for financial equalization is 70% of the average tax capacity in the territory
- the municipalities that even after horizontal financial equalization will not achieve 70% of the average tax capacity in the territory will be eligible to partial reimbursement (50%) from the Vertical Financial Equalization Fund of the region. The remaining lacking resources will have to be provided from their own resources or they will have to economize.
- in the calculation, the mechanism referred to in chapters 3.3.1 and 3.3.2 is applied.

Impact of horizontal financial equalization on individual municipalities :

town community	**LTF**	**S1**	**TCA**	**N1**	**N2**	**TCH**	**VEF**	**TCH-TCO**
Trenčín	1 423 560	2418	2402			**2402**		- 16
Stará Turá	230 405	2203	2190			**2190**		- 13
Nemšová	90 750	1487	1481	573 500	476 000	**1559**	49 000	+ 72
Tr.Teplice	134 380	2919	2898			**2898**		- 21
Tr. Teplá	63 250	1703	1695			**1695**		- 8
Horná Súča	45 670	1264	1260	1138 000	283 000	**1338**	428000	+ 74
Dolná Súča	37 440	1342	1337	664 000	218 400	**1415**	223000	+ 73
T.Stankov.	126 450	4720	4681			**4681**		- 39
Tr.Turná	41 490	1651	1643			**1643**		- 8
Podolie	36 120	1744	1735			**1735**		- 9
Omšenie	27 700	1428	1422	297 000	152 000	**1500**	73 500	+ 72
Krajné	53 280	2993	2972			**2972**		- 21
Chocholná	27 130	1699	1691			**1691**		- 8
Beckov	28 820	2110	2097			**2097**		- 13
Tr.Jastrabie	20 150	1653	1645			**1645**		- 8
Skalka	14 740	1510	1503	70 000	71 400	**1575**		+ 65
Z.Podhradie	11 440	1437	1431	114 600	62 500	**1510**	26 000	+ 73
V.Hradná	9 920	1457	1451	84 000	53 500	**1530**	15 000	+ 73
Zamarovce	7 830	1210	1206	239 000	51 000	**1285**	94 000	+ 75
Modrová	10 310	2034	2023			**2023**		- 11
Horňany	7 590	2019	2007			**2007**		- 12
Štvrtok	5 280	1552	1545	10 000	10 000	**1575**		+ 30
N.Lehota	9 370	3445	3420			**3420**		- 25
P.Lehota	2 180	1048	1046	110 000	17 000	**1126**	46 700	+ 78
Višňové	3 000	1485	1479	19 000	15 800	**1557**	1 800	+ 72
FHV (Sk)	2 354 450			3319 100	1412670			
2/5 FHV	941 780							
3/5 FHV	1 412 670							

70 % DS			**1575**					
FVV (SK)							957000	

Legend : TC - tax capacity ,
TCO - tax capacity original, i.e. on the basis of new criteria of tax distribution
TCA - tax capacity adjusted by deducing 2/5 of the share deposited in the Fund
TCH - tax capacity after horizontal equalization
N1 - financial needs to supplement to 70% of the average tax capacity
N2 - financial resources allocated to municipalities that did not achieve 70%-average because the remaining 3/5 did not cover the need
VEF - request from the vertical equalization fund in the region (50% of TCH - 70%-average)

The amount of deposit in the Fund as well as the rate of financial equalization is subject to political agreement and subsequent legislation. The model calculation with 10% deposit, equalization from both Funds to 70% of the average tax capacity has been selected because in our view:

- The degree of solidarity should support motivation and not the other way round.
- We deem crucial the control of financial resources provided

APPENDIX 5

Comparison of current and proposed system

Comparison of tax capacity of cities and communities according to present and proposed system (including horizontal financial equalization SK per capita) shows that:

- the change of the system (i.e. the change of the criteria and the mechanism of horizontal financial equalization) will place at an advantage cities and communities that are economically stronger, regardless of size category
- within the selected sample in 10 cities and communities tax capacity will increase and in 15 municipalities it will decrease, when compared to the existing state with only 5 municipalities revealing a greater tax capacity decline than 10%
- the difference between the municipality with the weakest tax capacity and that with the strongest, will be reduced by 7%, with more significant differentiation occurring among municipalities within the interval.

	current system	**proposed system**	**difference SK**	**difference (%)**
Trenčín	1597	2402	+ 805	+ 50
Stará Turá	1535	2190	+ 655	+ 43
Nemšová	1319	1559	+ 240	+ 18
Trenčianske Teplice	2527	2898	+ 371	+ 15
Trenčianska Teplá	1474	1695	+ 221	+ 15
Horná Súča	1491	1338	- 153	- 10

Dolná Súča	956	1415	+ 459	+ 48
Trenč. Stankovce	4792	4681	- 111	- 2
Trenčianska Turná	1794	1643	- 101	- 6
Podolie	1780	1735	- 45	- 3
Omšenie	1372	1500	+ 128	+ 9
Krajné	2904	2972	+ 68	+ 2
Chocholná	1706	1691	- 15	- 1
Beckov	2130	2097	- 33	- 2
Trenč. Jastrabie	1753	1645	- 108	- 6
Skalka	1697	1575	- 122	- 7
Zem. Podhradie	1722	1510	- 212	- 12
Veľká Hradná	1668	1530	- 138	- 8
Zamarovce	1470	1285	- 185	- 13
Modrová	2106	2023	- 83	- 4
Horňany	2002	2007	+ 5	0
Štvrtok	1867	1575	- 292	- 16
Nová Lehota	3040	3420	+ 380	+ 13
Petrova Lehota	1475	1126	- 349	- 24
Višňové	1728	1557	- 171	- 10

APPENDIX 6

The impact of change in competencies on tax capacity of cities and communities

The model calculation is based on the assumptions given in Appendix 3, with greatest account taken in tax revenues of devolution of competencies from state administration to self-government and the associated change (Appendix 1).

Note: For the calculation of the share in tax on business (local tax), the ratio of the number of working opportunities has been used, since the revenues of individual municipalities were not available.

	MD	**MD per capita**	**PD**	**PD per capita**	**Total**	**Tot. per capita**
Trenčín	164 509 000	2794	259 896 800	4415	424 405 800	7209
Stará Turá	31 885 000	3000	49 576 000	4665	81 461 000	7665
Nemšová	9 534 000	1563	20 767 000	3404	30 301 000	4967
Trenč. Teplice	15 380 000	3341	18 521 000	4023	33 901 000	7364
Trenč. Teplá	7 255 000	1954	14 052 000	3784	21 307 000	5738
Horná Súča	2 953 000	817	9 582 500	2652	12 535 500	3469
Dolná Súča	2 498 000	895	7 735 000	2772	10 233 000	3667

Tr. Stankovce	11 800 000	4405	7 614 000	2842	19 414 000	7247
Trenč. Turná	3 121 000	1242	6 842 500	2723	9 963 500	3695
Podolie	2 819 000	1361	5 828 000	2814	8 647 000	4175
Omšenie	1 552 000	800	4 577 000	2359	6 129 000	3159
Krajné	5 089 000	2859	6 139 000	3449	11 228 000	6308
Chocholná	2 155 000	1349	4 567 500	2860	6 722 500	4209
Beckov	2 589 000	1895	4 195 000	3071	6 784 000	4966
Tr. Jastrabie	1 474 000	1209	3 250 000	2666	4 724 000	3875
Skalka	1 096 000	1123	2 686 000	2752	3 782 000	3875
Zem. Podhradie	491 000	617	1 680 000	2111	2 171 000	2728
Veľká Hradná	621 000	912	1 724 000	2532	2 345 000	3444
Zamarovce	235 000	363	1 395 000	2157	1 630 000	2520
Modrová	814 000	1606	1 416 000	2793	2 230 000	4399
Horňany	742 000	1973	1 252 000	3329	1 994 000	5302
Štvrtok	304 000	894	850 500	2501	1 154 000	3395
Nová Lehota	941 000	3460	1 142 000	4198	2 083 000	7650
Petrova Lehota	57 000	274	424 000	2040	481 000	2314
Višňové	168 000	832	533 500	2642	701 500	3474
Total	**270 082 000**		**436 246 500**		**706 328 500**	
Weighted average		**2467**		**3984**		**6451**

The calculation of tax capacity:

From the table follows:

- The share of local taxes in total revenues is 38%.
- The tax capacity of the „poorest municipality“ is approximately 30% of the tax capacity of the strongest municipality.
- 20 out of 25 municipalities are under the threshold of the average tax capacity

Horizontal financial equalization:

- Horizontal financial equalization fund (10% of tax capacity) 70 632 850.-SK
- 2/5 of the Fund 28 253 140.-SK
- 2/3 of the Fund 42 379 710.-SK

	TCO	TCA	N1	TCA+N1	N2	RTC
Trenčín	7209	6951		6951	208	7159
Stará Turá	7665	7407		7407	208	7615
Nemšová	4967	4709		4709	208	4917
Trenčianske Teplice	7364	7106		7106	208	7314

Trenčianska Teplá	5738	5480		5480	208	5688
Horná Súča	3469	3211	4 061 000	4335	208	4543
Dolná Súča	3667	3409	2 583 000	4335	208	4543
Trenčianske Stankovce	7247	6989		6989	208	7197
Trenčianska Turná	3695	3437	2 257 000	4335	208	4543
Podolie	4175	3917	865 000	4335	208	4543
Omšenie	3159	2901	2 782 000	4335	208	4543
Krajné	6308	6050		6050	208	6258
Chocholná	4209	3951	613 000	4335	208	4543
Beckov	4966	4708		4708	208	4916
Trenčianske Jastrabie	3875	3617	875 000	4335	208	4543
Skalka	3875	3617	701 000	4335	208	4543
Zemianske Podhradie	2728	2470	1 485 000	4335	208	4543
Veľká Hradná	3444	3186	782 000	4335	208	4543
Zamarovce	2520	2262	1 341 000	4335	208	4543
Modrová	4399	4141	98 000	4335	208	4543
Horňany	5302	5044		5044	208	5252
Štvrtok	3395	3137	407 000	4335	208	4543
Nová Lehota	7650	7392		7392	208	7600
Petrova Lehota	2314	2056	474 000	4335	208	4543
Višňové	3474	3216	226 000	4335	208	4543
average TC		**6193**				
70 % of average TC				**4335**		

Legenda

TCO	tax capacity original
TCA	tax capacity adjusted = TCO - 2/5 HEF
N1	financial need up to 70 % TCA
TCA+N1	tax capacity after supplementing it to 70% of TCA
N2	equal distribution of the balance of HEF to all municipalities
RTC	resulting tax capacity, i.e. after horizontal financial equalization

Conclusions:

- 10 %-deposit of municipalities according to their tax capacity is sufficient to supplement it to 70% of the TCA
- the advantage of horizontal financial equalizations will be used by 15 out of 25 cities and communities
- the difference between the weakest and the strongest municipality as to its tax capacity will be significantly reduced
- tax capacity of the weakest municipality at TCO is 30% of the strongest municipality
- tax capacity of the weakest municipality at RTC is 60% of the strongest municipality
- the increase in tax capacity of the „poorest“ municipality is thanks to HEF, 96%.

APPENDIX 7

The principles of the act on financial equalization

<u>The objective of the act is to define:</u>

- the revenue base of local and regional self-government
- the relations between the state budget and municipal and regional self-government budgets
- the relations between regional and local self-government budgets
- the mechanism of financial equalization
- the maximum possible rate of debt.

The preparation and the approval of this law in the event of decentralization is, in accordance with this study, a necessity. The adoption of the law will have an impact upon a number of other laws and implementing regulations. Their judgment has not been subject of this study.

Stabilization of conditions in financing public administration and the possibility to apply long-range financial planning in self-governing institutions are also seen as the aim of adopting such a law.

The principles referred to below are based on the principles of devolution of competencies, as suggested in this study. We feel that it is necessary to emphasize that municipalities and after their constitution also self-governing regions, participate significantly in generating the gross domestic product, they are employers, investors, investing in infrastructure, whereby they create conditions to increase the standard of living for citizens and for businesses, they are operators of social facilities. The transfer of mandatory tasks on self-government means for them an increased burden, which they cannot cope with without getting control over significantly higher revenues of their own.

1. Revenues of the state budget, regional budgets and local self-government budgets

1.1 Revenues of the state budget

Principle 1

Non-shareable revenues of the state budget are:
on the administrative account:
- value added tax
- tax on international trade
- customs
- import or export surcharge
- withholding tax
- transfers and penalties, administrative fees

on capital account :
- credits taken by the Government of the SR
- revenues from repayment of credits and loans provided and from sales of securities, subject to other laws
- revenues of central bodies and bodies of local state administration from the organizations under their jurisdiction
- proceeds of sale of state securities
- proceeds of sale of property
- transfer from the administrative account.

Principle 2

The revenues of the administrative account of the state budget are :
- 50 % share in income tax collections of legal persons
- 10 % share in the road tax
- 70 % share in revenues from consumer taxes

1.2 Revenues of regional self- government budgets

Principle 1

Non-shareable revenues of regional self government are:

on the administrative account :

- differential surcharge to nationally collected taxes, whose amount will not exceed 5% of the basic tax rate
- transfers, penalties, administrative fees

on capital account :

- credits
- revenues from repayment of credits and loans
- proceeds of securities, and from sale of securities
- proceeds of sale of property, payments (fees)
- transfer from the administrative account

Principle 2

Revenues of the administrative account of regional self government are:

- share in 30 % of the income tax collected from legal persons
- share in 40 % of the income tax collected on dependent activity and functional perks
- share in 40 % of the road tax collected
- share in 30 % of consumer taxes collected
- share in % of ecological taxes

criteria and their ratio for distributing the share among individual regional self governments are:

kind of revenue (tax)	number of inhabitants	number of employees	length of roads administered	area of territory
on dependent activity and functional perks.	70 %	30 %		
of legal persons	60 %	40 %		
road tax	50 %		50 %	
consumer tax	50 %			50 %

Principle 3

The revenue of the administrative account of regional self government are resources from the Horizontal Financial Equalization Fund of up to 70% of the adjusted average tax capacity of the SR regions.

Principle 4

The revenue of the administrative account of regional self government are resources from
the Vertical Financial Equalization Fund of the state budget, subject to the rules given in this law.

Principle 5

The revenue of the capital account of the regional self government are lump sum and designated subsidies from the Investment (Regional) Development Fund, subject to the regulations given in this law.

13 Revenues of local self government

Principle 1

Non-shareable revenues of local self government are :
on the administrative account :
- business tax
- property taxes
- local taxes
- transfers, penalties, administrative fees

on the capital account :
- credits
- revenues from repayment of credits and loans
- proceeds of sale of property
- proceeds of sale of securities
- payments
- transfer from the administrative account

Principle 2

The revenues of the administrative account of local self government are:
- share in 20 % of income tax collected from legal persons
- share in 60 % of income tax collected on dependent activity and functional perks
- share in 50 % of the road tax collected
- share in ecological taxes

with the criteria and the distributing ratio for individual local self governments as follows:

kind of revenue (tax)	number of inhabitants	number of employees	length of roads
from dependent activity and functional perks.	70 %	30 %	
of legal persons	60 %	40 %	
road tax	50 %		50 %

Principle 3

The revenue of the administrative account of the local self government are resources from the Horizontal Financial Equalization Fund of up to 70% of the average tax capacity of municipalities of the region.

Principle 4

The revenue of the administrative account of local self government are resources from the Vertical Financial Equalization Fund, subject to the regulations given in this law.

Principle 5

The revenue of the capital account of local self government are resources from the Investment Fund of the region, subject to the regulations given in this law.

2 Outlays of regional and local self government

Principle 1

Administrative budget outlays of self government comprise:
- wages and contributions
- ordinary maintenance expenses
- repayment of interests (or principals)

- depreciation
- transfers to horizontal equalization funds
- transfer to the Vertical Financial Equalization Fund (regional self government)

Principle 2

Capital budget outlays of self government comprise:

- capital expenses
- acquisition of assets
- provision of credits and loans
- alt. repayment of the principal
- transfers to the administrative budget and to funds (regional self government investment development fund)

3 The rate of debt

Principle 1

The maximum rate of debt in public administration is determined in a way which allows the municipality, region, central government to get indebted to the extent it is able to pay the debt service from the administrative account.

Raising financial equalization funds

Principle 1

The Horizontal Financial Equalization Fund (further HEF) is raised nation-wide by the self-governing regions and, at regional level, by local self government from the resources of the administrative budget. The amount of the deposit is 10% of the tax capacity of the territorial unit for the preceding fiscal year.
The HEF volume is depleted every year. The way of using it is stipulated by this law under part 5. HEF will be administered within the system of the state treasury by the regional treasury.

Principle 2

The Vertical Financial Equalization Fund (further VEF) is raised by the central government within the state budget and by regional self government, within its own budget. The sources of the VEF are the revenues of the administrative account. The VEF volume depends upon the decision of the NC SR (Parliament) or upon that of the Regional Council. The VEF does not to have be depleted within the fiscal year. The way this fund is disbursed is stipulated by this law under part 6. VEF shall be administered at central level within the system of the state treasury, at regional level, by regional self government.

Principle 3

The Investment Development Fund (further IDF) is raised by the central government within the state budget and by the regional self government, within its own budget. The sources of the fund are revenues of the capital accounts. The volume of IDF depends upon the decision of the NC SR or that of the Regional Council. The fund does not have to be disbursed by the end of the fiscal year. The IDF shall be administered at central level by the system of the state treasury and at regional level, by the self government.

The IDF is divided into two parts:

- lump sum investment subsidies, to which every territorial self governing unit is entitled and their award is effected on the basis of the number of inhabitants and the size of the territory, their amount being influenced by the volume earmarked.
- designated investment subsidies, the award of which depends upon the investment plan submitted, the judgment of its efficiency and compatibility with the development strategy of the upper territorial unit, with a proviso of minimum 20(50) % cost- sharing.

5̰̃ Horizontal financial equalization

<u>Principle 1</u>

Horizontal financial equalization is done on two separate levels:

- between self-governing regions
- between local self governments within the self-governing region.

<u>Principle 2</u>

Horizontal financial equalization resources derive from individual regions, or cities and communities and therefore this equalization does not pose a burden to the state budget in the first place, and the budget of the relevant region, in the second.

<u>Principle 3</u>

The contribution of regional or local self government to the HEF represents 10% of their tax capacity in the preceding year.

<u>Principle 4</u>

The right to use resources of the HEF arises to regional or municipal self governments in the event when their adjusted tax capacity does not reach 70% of the average within regions or within the region.

Adjusted tax capacity = the original tax capacity + a share from 2/5 HEF divided according to the number of inhabitants.

<u>Principle 5</u>

The maximum amount of the contribution from the HEF is given on reaching 70% of the average adjusted tax capacity of the SR regions, or cities and communities in the region, with the following allocation mechanism:

- 2/5 of the HEF are calculated
- the ratio of 2/5 per capita is calculated for the territory of the SR or region
- each municipality gets its share from 2/5 HEF according to its population
- average tax capacity is calculated
- municipalities having lower tax capacity than 70% of the average will get equalization up to 70% of the average from the remaining 3/5 of the HEF.

<u>Principle 6</u>

If the HEF resources are not sufficient to cover the needs, the remaining 3/5 of the HEF will be divided among the municipalities having lower tax capacity than 70% of the average of adjusted tax capacity according to the population of these municipalities.

Principle 7

If after supplementing to 70% of average tax capacity, there are still resources available in the HEF, they will be divided among all municipalities according to their populations.

Principle 8

The resources of the HEF shall be provided to municipalities in two installments (at the beginning and in the middle of the fiscal year).

6 Vertical financial equalization

Principle 1

The state guarantees a percentage from its own actual revenues for the preceding fiscal year to raise the VEF.

Principle 2

Regional self-government guarantees a percentage from its own revenues for the preceding fiscal year to raise the VEF.

Principle 3

A regional or local self-government has a right to draw resources from the VEF only provided it even after horizontal financial equalization does not achieve 70% of the average adjusted tax capacity of regions or cities and communities in a region.

Principle 4

The VEF resources can be drawn only up to 70% of the average adjusted tax capacity.

Principle 5

Accepting resources from the VEF automatically entails complex control of financial management (administrative and capital accounts) of the region or municipality by the Ministry of Finance or the financial administration of the region.

Principle 6

VEF resources will be provided to the self-government once quarterly.

Principle 7

In the event that local self-government wishes to participate in the VEF of the state and there are sufficient resources in the fund, similar disbursement conditions apply.

TERMINILOGY

Municipal autonomy

is characterized by competencies of the municipality stipulated by law, the Constitution. The law or other legal regulation defines precisely the scope of matters which fall exclusively or prevailingly within the competencies of a municipality, they are tasks belonging to the scope of own responsibilities.

Tax
is a transfer of financial resources from private to public sector, defined as mandatory, non-designated payment to the public budget, stipulated by law, periodically recurring at time intervals (e.g. every year) or in respect of the same circumstances (e.g. transfer of real property).

Direct tax
is paid by physical or legal persons from their own revenues, according to their actual revenue or property situation and its payment cannot be transferred to other subject (income tax, property taxes).

Indirect tax
is paid and collected in prices of goods, services, with the subject making the tax transfer, not paying it from his own income. The taxpayer of this tax is the eventual consumer (physical person, state, municipality), the tax in his respect is calculated, collected and transferred to the state by the payer - producer, trade business, importer etc. at his own liability. (consumer taxes, VAT, customs).

State shared taxes
are taxes which are revenues of at least two subjects of public administration.

Tax capacity of a municipality
the sum of revenues from local taxes, state shared taxes and revenues from horizontal financial equalization, with their weight being subject to differentiation according to the pursued objective, for example:

local fees	1.0
tax on land	2.0 (municipalities with lower quality of soil being put at an advantage because they get higher equalization)
tax on structures	1.5 (municipalities with less built-up area at an advantage by getting higher equalization)
tax on trade license	3.0 (small municipalities at an advantage, getting higher equalization)
state share taxes	1.0

Tax capacity of a region
the sum of state share taxes and revenues from horizontal financial equalization.

Differential surcharge
a surcharge to nationally set rate of direct tax limited by law which is set by regional self-government and is the revenue of the regional self-government.

Democracy - direct
represents a possibility for citizens to directly participate in state power decision making, through such forms as referendum, plebiscite and option.

Democracy - indirect
(representative) is a mediated citizens participation in state and self-governing power through elected representatives, in representative democracy citizens are its source and elected representatives are its bearers.

Municipal economy and communal economy
are two different terms as to their scope and content

- municipal economy is the economy of a territorial unit of different ownership subjects (municipality, state, private businesses, citizens)
- communal economy builds on communal ownership and comprises municipal property, financial
and budgetary relations and mobilization of municipal resources.

Financial guarantee
is participation of municipalities stipulated by law in revenues from taxes collected by the state, regions and municipalities.

Financial capacity of a municipality
the sum of revenues from local taxes and fees, state shared taxes, subsidies and financial equalization.

Financial capacity of a region
the sum of revenues of differential surcharge, revenues from state shared taxes, subsidies and financial equalization.

Financial equalization - vertical
a mechanism of dividing tax flow from upper-tier administrative unit to lower-tier administrative unit on the basis of defined criteria, e.g. from the state budget to regional budgets, or from the regional budget to the municipal budget.

Financial equalization - horizontal
a mechanism of redistributing tax resources within one level of public administration, e.g. equalization of tax capacity between regions of the SR or equalization of tax capacity between municipalities within a region.

Fiscal decentralization
represents setting limits for decision making at sub-central level by strengthening power and responsibility of lower-tiers of public administration in providing and financing public goods, it is a process of purposeful distribution of tasks among individual subjects of administration having financial impacts.

Vertical Financial Equalization Fund (VEF)
is raised by the central government and regional self-government. The sources are revenues of the administrative budget. The way the fund is used shall be given in the Act on financial equalization (draft principles of the law are given in Appendix 6 of this study).

Horizontal Financial Equalization Fund
is raised at state level by self-governing regions and at regional level by local self-government through mandatory transfer from the administrative budget. The amount of transfer and the mechanism of disbursing the fund will be stipulated in the Act on financial equalization (draft principles of the law are given in Appendix 6 of this study).

Charter
- European Charter of Local Self-government is an international document of methodological nature for the formation of local self-government systems, adopted on October 15 1985 in Strasbourg
- European Charter of Regional Self-government is an analogous document for regional self-government, discussed at the session on July 2-4 1996.

Inter-communal cooperation
is in accordance with the law, a form or a means to address those problems of further development of municipalities which cannot be implemented or are not financially viable to implement from the aspect of efficiency only in one municipality and entails joining with another municipality or legal entity with the purpose to implement an activity.

Competencies - original
are tasks of self-government in their own scope of responsibility that are guaranteed to municipalities by the Constitution and subsequent laws as their mandatory matters (stipulated by law) and as voluntary matters (which municipalities carry out at their discretion in the form of services to citizens).

Competencies - devolved
are tasks of state administrative nature which are devolved to the municipality from the bodies of state administration by law and comprise so-called transferred scope of responsibility.

Communal policy
is a set of activities focused on purposeful provision of economic and social development of a particular community specified as a village, city or region and in its implementation is tied to the performance of bodies of self-government.

Local policy
is tied to a particular territorial unit (locality) and contains in the policy implemented through local bodies of self-government or state administration, with the participation of territorially engaged businesses, local initiatives, citizens and their interest associations.

Municipality
is a local administrative unit representing functional linkage of original municipalities in unified settlement - geographic and economic units with a system of centers and catchment territories, it is the result of the process of creating settlements of optimal size.

Municipalization

is a process of forming municipalities, i.e. the process of amalgamating municipalities, accompanied with the loss if identity and the name of municipality.

Obligation
is a kind of security, a bill of debt, effective until a fixed date by which it must be bought from the bearer, with an interest set in advance, and serves to raise supplementary resources, it is thus a form of credit.

Fee
is a monetary equivalent for services provided by public sector. It is designated, voluntary and irregular. Local fees paid into the budget of municipalities are not fees in the right sense of the word. They have all the attributes of local taxes and are also called local taxes abroad.

Subsidiarity principle
means that the powers (competencies, finances) are delegated bottom up from the citizen, through municipality, region to the state, with only those powers being delegated to higher level that cannot be efficiently provided at a lower level.

Stimulation principle

means that a municipality or a region and their self-governing bodies enjoy systemic and substantive prerequisites for purposeful management, guidance and influence of public goods provision at their level, with the participation in tax (financial) yield, of a locality.

Solidarity principle
is based on the guaranteed right in the Constitution for every citizen to enjoy equal rights and the right to the provision of essentially comparable volume and quality of services provided by public administration without regard to whether he lives in a small community or a city.

Regional self government
for the purposes of this publication, the intermediate element between municipal and central government.

Municipal budget - administrative (current)
is drawn up for one fiscal year as a balanced budget, comprises tax revenues, fees, non-designated subsidies and financial equalization revenues.

Municipal budget - capital (asset)
is drawn up for individual projects, as a rule, for the duration of the election term, its revenues being the proceeds of sale of property, designated subsidies, credits, bonds, transfers from contingency funds, and the administrative budget.

Adjusted number of inhabitants
on the basis of size category of municipality, setting a coefficient, by which cities are put at an advantage that carry out also supra-municipal functions. In this way, tax and fee burden of the citizens that live in them is adjusted.

Public good
is a good, in which the consumption is non-competitive, the consumer cannot be excluded from its consumption and the margin cost for consumption of each additional consumer is null.

Private good
is a good, in which consumption is competitive, and the exclusion of the consumer is possible.

Mixed good
is a good, in which consumption can be excluded and is non-competitive or cannot be excluded but is competitive.

Public sector
is that part of economy in which the decisive role is played by the public administration (self government and state administration) at all levels (municipal, regional, central).

Public administration
represents institutionalized system of bodies of self government and the state administration, which in mutual collaboration provide for the administration of public matters.

- self government is one of basic principles and manifestations of a democratic social system, representing free participation of citizens of the state in administration of public matters. Its institutions are elected by citizens and these directly or indirectly participate in the execution of public matters, which are, by law, in the functional responsibility of local or regional self governments.
- state administration is an activity of the state through territorial units, connected with the organizational, executive and ordering activity, in accordance with the effective legislation, whose scope and content of implementation is given by social interests.

Tiebout hypothesis
holds that the competition between communities will result in such goods and services that citizens want and that they will be produced efficiently. Citizens select the level and the quality of public goods by selecting the community they wish to live in. Public goods users' mobility creates space for achieving higher effect from decentralization, primarily of local public goods.

WHAT WERE SR GOVERNMENT RESOLUTIONS IN THE STRATEGY OF FINANCIAL POLICY IN RELATION TO SELF GOVERNMENT?

1. To reduce direct financial transfers within public budgets and to cover the needs of municipalities through a system of their own revenues and through state shared taxes.
2. To review transfer obligation to the state budget of municipal self government from the proceeds of rental and sale of real property.

1. To retain the tax structure, whose yield is redistributed between the state budget and municipal budgets.
2. To review the criteria of redistributing state shared taxes and differentiate more significantly the share of municipalities in tax revenue in favor of municipalities, where it is being raised.
3. To restrict setting up of further state funds, review justification and functioning of the existing funds.
4. To prepare new criteria for division of subsidies from the state budget for execution of self-governing functions.
5. To create conditions for decentralization of substantive tasks onto the level of regions and municipalities, with concurrent definition of financial sources and coordinate institutional and legislative efforts.

TEN COMMANDMENTS OF LIBERALISM:

1. You shall reduce state expenditure.
2. You shall squeeze inflation.
3. You shall cut taxes.
4. You shall develop private provision.
5. You shall liquidate minimum wage rates.
6. You shall privatize state enterprises.
7. You shall introduce flexible employment.
8. You shall shorten unemployment benefit.
9. You shall open new markets.
10. You shall liquidate state monopolies.

Taken over from Le Nouvel Observateur and OS 97/98.

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