REFORM OF FINANCING OF MUNICIPALITIES IN SLOVENIA

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Abstract

The article presents a comparison of the Slovenian Financing of Municipalities Act, which had been in force since April 20062, and the new act, which entered into force on 1st January 2007[2].The main question asked is how the changed formula for calculating the appropriate expenditure and the capitation introduced affect the financing of municipalities. The primary hypothesis is that the change introduced would positively affect the share of own revenues in the appropriate expenditure of the majority of municipalities, that the influence of financial equalisation would decrease and that the financial independence of municipalities would increase. Concurrently, the extent of municipal financial surpluses that have not been regulatory treated until this change would decrease. The results, presented in this article, confirm the suggested hypothesis that was proven by past data and a simulation of the new situation.

Key words: appropriate expenditure, financial equalisation, capitation, municipality diversity index surplus, Slovenia.

1 Introduction

The first forms of local self-government in Slovenia were already present in medieval times; of course, they were first formed in cities. The long period under Austro-Hun-

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[1] All statements and opinions expressed in this article are exclusively those of the author and are presented here on his own behalf.

[2] The financing of Municipalities Act which entered into force in April 2006, is a so called consolidated version of the act. The act in question covers all amendments and modifications then in force (of the base act from 1994, amendments and modifications from 1998 and 2005). Hereinafter, reference is made to the said act; as its parts were created at various times, this is appropriately defined.

garian rule and events that took place during the period of absolutism, when there was no local self-government at all, and their continuation after the March revolution of 1848 left a big mark. In that period, local self-government at a higher or wider territorial level did not exist. The St. Vitus Day Constitution[3] of 1921 provided for municipalities, districts and authorities in the sense of three levels of local self-government that were, at the same time, territorial units of the country. The imposed constitution[4] of 1931 transformed local self-government and defined local communities in two ways, as municipalities and as banovinas. The 1933 Municipality Act stipulated that a municipality had to have at least 3,000 inhabitants. In the area of the then Slovenia, not including the Primorska region, the number of municipalities was reduced from 1241 to 469.

In the Federal People's Republic of Yugoslavia, the Soviet model was used at first to a great extent, but in 1952 local self-government was introduced - municipalities and districts. The year 1955 saw the introduction of a system of communes (municipalities) or the so called communal system. In Slovenia, 62 municipalities were established. On the basis of the new constitution in 1991[5] we were supposed to once again have the kind of municipalities common around Europe and elsewhere in the world (Šmidovnik, 1995).

Thus, from 1991 there were 62 municipalities, 3 special socio-political communities, 1,203 local communities and 5,955 settlements in Slovenia. Thanks to the reform and the introduction of local self-government,147 municipalities were established in 1995. This number has been constantly growing and at present Slovenia has 210 municipalities.

This process has had a great impact on the financing of municipalities, which was displayed in the low financial independence of municipalities. The core problem has mainly inhered in the method of dividing personal income tax, which increased the discrepancies among the municipalities in the extent of self-funding. A few urban and economically strong municipalities were able to generate substantial surpluses, but the majority of municipalities suffered large deficits with regard to the appropriate expenditure calculated to ensure the realisation of the duties and functions stipulated by law. The government dealt mainly with the deficits of the majority of municipalities and acted by usingfinancial equalisation[6]. However, it did not set about resolving the issue of surpluses generated in certain municipalities, or try to explain why such surpluses occurred at all. According to simulations performed by the Ministry of Finance and the Government Office for Local Self-Government and Regional Policy, this situation would only be aggravated (internal source).

Financial equalisation by central government had to increase as well. In 2006, therefore, the reform of financing of municipalities aimed at changing the trend described was undertaken. Above all though, it was supposed to increase the financial independence of the majority of municipalities and reduce the substantial differences among them.

[3] Kingdom SHS (Kingdom of Serbs, Croats and Slovenes).

[4] Imposed constitution of 3rd September 1931 which assigned King Alexander several powers and was passed with a slight majority by the government.

[5] The Constitution of the Republic of Slovenia/URS/(OG 33/91-I, 42/97, 66/00, 24/03, 69/04, 69/2004, 69/04).

[6] Own tax revenues are: real estate tax, tax on trading in real estate, inheritance and gift tax, taxes on profits from lotteries and gaming and other taxes if so provided by law regulating such a tax.

The second part of this article presents an analysis of the 2006 Financing of Municipalities Act– consolidated text[2], which was amended at the end of 2006, and of the formula for the calculation of appropriate expenditure. Also presented is the significance of personal income tax, compensation for the use of building sites (NUSZ) and other revenues among the overall municipal revenues.

The third part presents the 2007 Act on Local Finances, which entered into force on 1st of January 2007 replacing the Financing of Municipalities Act. The main solutions of this new model are presented: the new formula for the calculation of appropriate expenditure, capitation and the calculation of a municipality's capitation revenues, as well as the co-financing of certain duties and functions.

The third part also presents an assessment of the new model for financing municipalities in 2007 and 2009, as well as the situation following the transitional period in 2012.

The main solutions and goals of fiscal policy are presented in the conclusion. Information is provided about the main obstacles and constraints, as well as the intended results. Particular attention is also drawn to local self-government, organized only at one level, and the realistic need to organize a second level or to organize regions.

2 Assessment of the 2006 Financing of Municipalities Act

When taking into account the provisions of the 2005 Local Self-Government Act, several task groups, part of the original municipal jurisdictions, can be identified. They are also known as statutory or mandatory tasks since all municipalities must fulfil and perform them in accordance with the law. These task groups are performed by municipalities to meet the needs of their inhabitants:

- Enabling all forms of municipal economic development.
- Management of the municipality's assets.
- Regulation and management of and providing for public services.
- Regulation of public utility services: waste collection, green space management, public utilities management.
- Construction, maintenance and regulation of local public roads, public paths and other public surfaces.
- Promotion of housing development and support for the increase of the social welfare housing fund.
- Support for welfare services.
- Promotion of educational, tourist, cultural and other activities in its area.

The 2005 Local Self-Government Act stipulates additional duties and functions for urban municipalities that refer to urban development and enable the functioning and integration of all urban functions. This forms an urban, municipal, transport, spatial and regulatory totality. Under a city's original jurisdiction falls everything related to the city's operation: concern for urban transport facilities and urban public buildings, use of urban space, concern for urban energy management, public utility services and similar.

With the 2005 Local Self-Government Act only the fundamental municipal duties and functions were defined. This allowed municipalities to define as its duties and functions those tasks not arising from statutory and other national regulations. In this, a municipality had to take into account its size, population and financial, administrative and organisational capabilities. Described above are self-governing or non-mandatory municipal duties and functions.

Besides duties and functions (part of compulsory and non-compulsory municipal jurisdictions), municipalities can also perform individual duties and functions from state jurisdiction, i.e. delegated tasks. The delegation of state tasks to municipal jurisdiction is only possible with the prior consent of the municipality and on condition that the appropriate means for their implementation are provided by the state. The average ratio of mandatory to non-mandatory self-governing municipal duties and functions is approximately 70:30. In this period, from 2000 to 2005, there were almost no or very few duties and functions delegated by the state.

Prior to the preparation of the 2007 Act on Local Finances, an analysis of the system of municipal financing in force was carried out by the Government Office for Local Self-Government and Regional Policy (internal source). The main findings of this analysis showed that local self-government's share of public expenditure was relatively low, around 5% of GDP. Slovenia is a centralized unitary country with a two-tier structure, since only municipalities exist besides national authorities. Local self-government's small share of GDP and changes in the period between 2001 and 2005 are shown in Table 1.

Table 1 Local self-government units' expenditure in Slovenia (in million euro)

	2001	**2002**	**2003**	**2004**	**2005**
GDP	19,780	22,016	23,663	25,849	27,421
Local self-government expenditure	1,012	1,141	1,214	1,297	1,372
Per cent of GDP	5.12	5.18	5.13	5.02	5.00

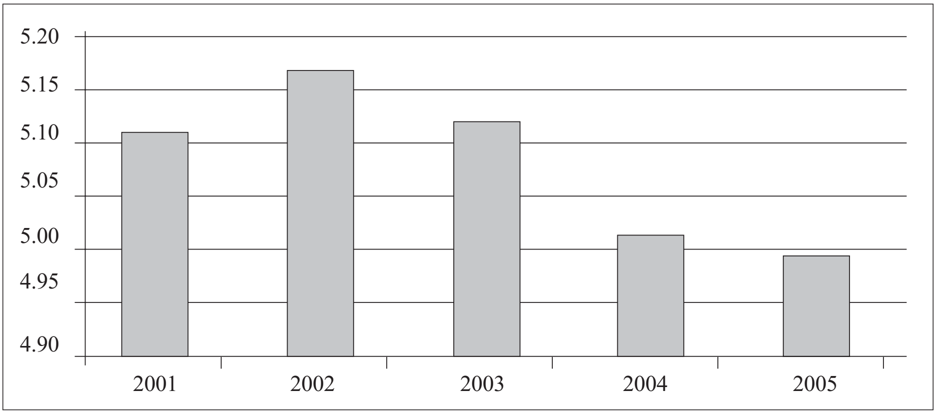
Note: On 1st January 2007 Slovenia joined the euro area. The conversion rate was 239.64 tolars for 1 euro
Source: Bulletin of Public Finance (MF, 3/2007)

Between 2003 and 2005 there was a trend towards decreasing local self-government expenditure as a proportion of GDP (Table 1 and Figure 1).

The findings of the analysis also revealed great disproportions between own municipal revenues per capita. In 2005, personal income tax represented the biggest share of municipal revenues (77%), followed by the NUSZ - compensation for the use of building sites (10.8%)[7] (See Table 2).

[7] NUSZ - compensation for the use of building sites is a financial source derived from the socialist regime of the former Yugoslavia when most immovable property was socially owned. NUSZ was introduced in 1984 by the Construction Land Act (OG 18/84). Apart from having modest private property, individuals had the right to use immovable property (building land etc.). On this basis, NUSZ burdens the right and not the property. The foregoing is in contrast with fundamental developments in the area of socioeconomic relations and transition to a market system of,

Figure 1 Local self-government expenditure as a proportion of GDP (%)



Source: Own presentation

The main reason why 90% of all municipalities received financial equalisation in 2005 is the disproportionate distribution of own sources of financing, mainly personal income tax sharing. On average, financial equalisation amounted to 22.5% of the appropriate expenditure of all municipalities.

Table 2 Municipal own sources in 2005 in million euro

	Personal income tax	**Other revenues under Article 21**	**Revenues under Article 22**	**Total**
mill. euro	563.0	42.3	123.7	729.0
%	77.2	5.8	17.0 10.8 6.2	100

mill.	NUSZ – compensation for the use of building land	Other revenues
euro	78.8	44.9
%	63.7	36.3

Source: Ministry of Finance of the Republic of Slovenia and own calculation

mainly, property and private property. Until appropriate legislation on the taxation of immovable property is adopted, NUSZ will probably not be abolished since it is an important municipal revenue. Taxable persons are legal entities and natural persons

The model of municipal financing was introduced on 8th August 1998[2] and was derived from the principle that local public affairs should be financed through the municipality's own revenues. Sources of financing were[8]:

- 35% share of personal income tax,
- revenues from taxes and charges under Article 21,
- inheritance and gift taxes, taxes on winnings from lotteries and gaming, taxes on trading in real estate, administrative fees and duties, special tax on the use of slot machines outside casinos,
- taxes, charges, fees, reimbursements and compensations under Article 22; property tax, compensation for the use of building land, local tourist taxes, municipal taxes, various fees, indemnity for changes in the use of agricultural land or forest, indemnity and compensation for the damage to and pollution of the environment, administrative revenues, revenues defined by other acts.

The model for calculating appropriate expenditure and financial equalisation is the central point of the contents of the 2006 Financing of Municipalities Act. The model is based on a fixed average amount of funds per capita that allows an average municipality to perform all of its constitutional and legal responsibilities- mandatory, non-mandatory and delegated tasks, and is considered the appropriate expenditure of resources for the financing of local affairs of public importance.[9] The formula for calculating the appropriate expenditure under the 2006 Act was as follows:

$$PPi = (0.70 + 0.05 * Ci + 0.05 * Pi + 0.16 * Mi + 0.04 * Si) * ZP * Oi \tag{1}$$

Where by the following is understood as:

PPi - total appropriate expenditure of a municipality;
Ci - ratio of the per capita length of local roads and public paths in a specific municipality to the per capita length of local roads and public paths in Slovenia;
Pi – ratio of the per capita size of the municipality to the per capita size of Slovenia;
Mi – ratio of the share of the population under the age of 15 in the municipality's entire population to the average of this share Slovenia as of 1st January of the year in which the amount of appropriate expenditure is determined;
Si – ratio of the share of the population above the age of 65 in the municipality's entire population to the average of this share in Slovenia as of 1st January of the year in which the amount of appropriate expenditure is determined;
ZP – municipality's appropriate per capita expenditure. It is the same for all municipalities.

[8] The stated are municipal own sources. The difference between appropriate expenditure and municipal own sources is the financial equalisation exercised by the State

[9] In this period municipalities transferred funds from the programmes of mandatory tasks (pre-school education, primary education, culture, sport) or the so called social part of the budget to the economic part or investments. This resulted in the undermining of certain mandatory tasks and is one of the principal reasons for the change of the financing of municipalities in Slovenia.

Oi – number of inhabitants with permanent residence in the municipality according to data from the central population register as of 1st January of the year in which the amount of appropriate expenditure is determined.

The 0.78 leading coefficient was used for urban municipalities, 0.74 for municipalities with head offices in areas where former municipalities had their head offices and 0.70 for all other municipalities. The total sum of all coefficients is 1.08 for urban municipalities, 1.04 for municipalities with head offices in areas where former municipalities had their head offices and 1.00 for all other municipalities.[10] The foregoing means that municipalities with head offices in areas where former municipalities had their head offices were granted a 4% greater appropriate expenditure, and urban municipalities 8%, even though all municipalities have the same jurisdictions and tasks. These are the so-called universal duties and functions of a municipality.

ZP coefficient – appropriate per capita expenditure. The value of appropriate expenditure lacked an appropriate analytical-statistical connection with the costs of municipalities. Usually, the evaluation was made by the competent Ministry of Finance and aligned with inflation. It was determined in the National Assembly and depended, to a great extent, on the political interests of the parties or the ruling coalition.

Government analysis of the financing of municipalities between 2002 and 2005 showed great disparities between own municipal per capita revenues. The biggest part of municipal revenues is represented by personal income tax (on average 78%), a state tax which municipalities cannot influence. Because of the domicile principle of people liable to taxation, the distribution of personal income tax is disproportionate and reflects developmental differences (with an up to 60% deviation in the average value). The second biggest share of municipal revenues is taken from the compensation for the use of building land (10.5% on average). This is followed by municipal taxes (6.4%) and other revenues (4.8%). The disproportionate distribution of own sources of financing, mainly personal income tax with regard to its share in total own revenues, is the main reason why nearly 90% of municipalities, received financial equalisation in 2005 amounting to 17% of own municipal revenues or 22.5% of the total appropriate expenditure.

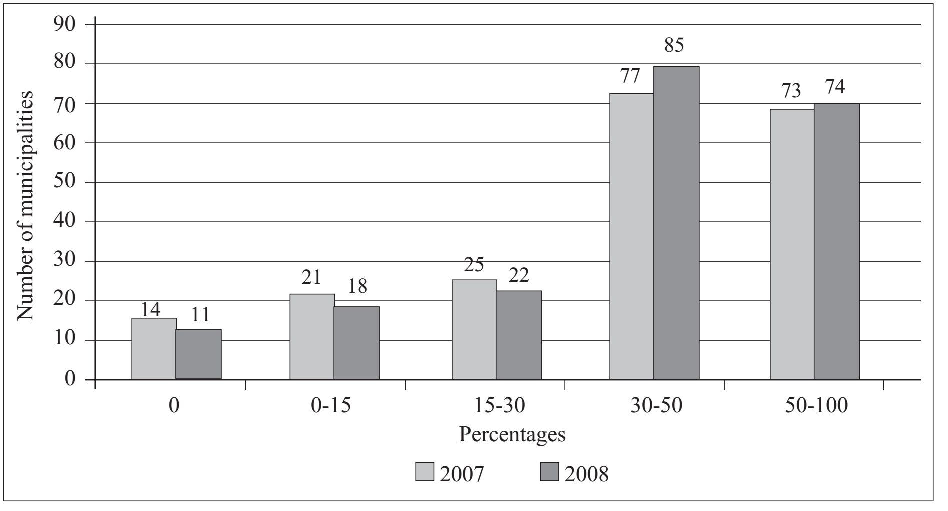
In 2006, more than 91% or 176 municipalities received financial equalisation and 64 municipalities received financial equalisation that exceeded their own revenues by more than 100% (in the case of the municipality of Hodoš even by 460%).

The increase in the number of municipalities that are increasingly dependent on financial equalisation (Figure 2) - which is more and more like an "annuity" from the national budget - means a loss of autonomy and has discouraged municipalities from acquiring their own revenues.

Table 3 and Figure 3 show that the estimated financial equalisation would increase from one year to the next while surpluses would decrease in those municipalities that were able to carry out self-financing. Concurrently, the number of self-financing munici-

[10] In 2002 there were 193 municipalities in Slovenia, 11 urban municipalities, 51 municipalities with head offices in areas where former municipalities had their head offices and 131 other municipalities. In 2007 the number of municipalities increased by 17 and now there are 148 other municipalities.

Figure 2 Evaluation of the financial equalisation with regard to appropriate expenditure (2006 Act)



Source: Own presentation

Table 3 Appropriate expenditure, financial equalisation and surpluses in municipalities in accordance with the 2006 Act in million euros

Year	Appropriate expenditure	Financial equalisation	Surpluses in independent municipalities	Number of independent municipalities
2002	682.9	141.9	100.5	27
2003	740.1	154.3	94.7	27
2004	779.4	161.7	81.7	24
2005	857.7	193.7	67.0	20
2006	899.4	202.8	69.1	17
2007	938.8	228.9	57.5	14
2008	987.3	256.3	51.8	11

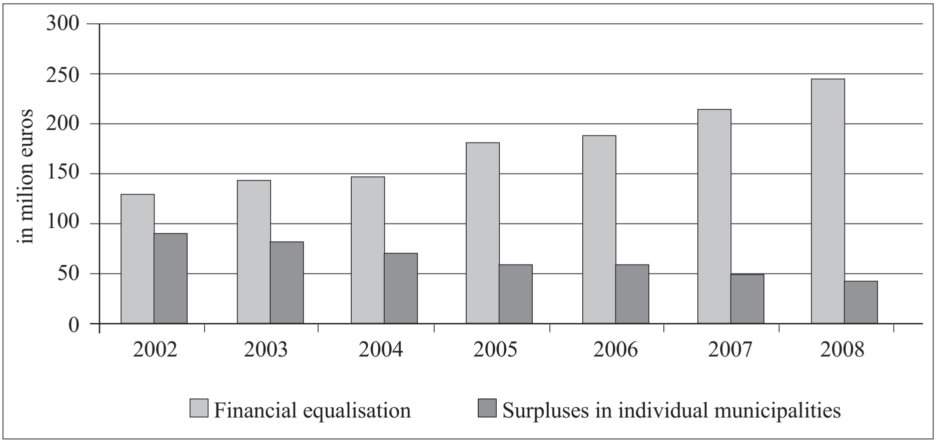
Source: Own calculation

palities would also decrease. The results for 2007 and 2008 have been obtained by simulation, while the results for previous years from 2002 to 2005 are based on actual data on information from the Ministry of Finance.

It is clearly evident that without amendments to the 2006 Financing of Municipalities Act, all municipalities would soon become the recipients of financial equalisation that would exceed 45% of the appropriate expenditure of municipalities.

On the basis of these findings, in 2005 the Government began reforming the financing of municipalities. The 2007 Act on Local Finances (OG 123/06) adopted at the end

Figure 3 Movements of financial equalisation and surpluses in municipalities (according to the 2006 Act if still in force)



of November 2006 provided a legal basis for a system of financing municipalities as of 1st January 2007.

Below, the fundamental solutions and intended results of the 2007 Act are presented. Special attention is given to the transitional period of five years and the expected results after this period when the 2007 Act will be fully implemented.

3 2007 Act on Local Finances

Due to the facts explained and the realisation that appropriate financial resources and a proper vertical fiscal structure are essential to the efficient operation of municipalities and significant in achieving decentralisation, it was necessary to change the system of municipal financing to ensure the following:

• financial resources proportional to municipal duties and functions

• local self-government financial autonomy

• reduced financial dependence on additional funds from the national budget.

The main changes introduced by the new act are in the changed equation for the calculation of appropriate expenditure. Greater emphasis is given to the coefficient Ci – the length of local roads and public paths and Pi – the size of the municipality, whilst the same leading coefficient is introduced for all municipalities. The new method of financing with the appropriate expenditure model only relates to the financing of those tasks which are stipulated by law - mandatory and delegated tasks. Financial sources not included in the system of appropriate expenditure are intended for the financing of self-governing tasks and the financing of a municipality's development programmes and investments.

3.1 Legislative principles

The 2007 act is based on the following principles of:

- *local self-government* - the right of municipalities to determine, independently and in accordance with the Constitution, the duties and functions that they are able to perform and finance independently in the interests of their inhabitants; performed on the basis of their regulations,
- *financial autonomy* – a municipality is financed through its own resources and may dispose of its funds freely,
- *commensurability* - financial resources are appropriate to a municipality's tasks,
- *equality* - the right of inhabitants to equal financing of tasks that municipalities must provide for their inhabitants pursuant to the law.

3.2 Sources of financing municipalities

In accordance with the 2007 Act, the sources of financing are:

- *own tax sources* – NUSZ - compensation for the use of building land (with the introduction of real estate tax, this replaced NUSZ), tax on water vessels, tax on sale of immovable property, tax on inheritance and gifts, tax on classical gambling.
- *other own sources* – fees, concessions, voluntary contributions, payments for public services, property income and additional co-financing funds from the national budget and EU funds.
- *municipal fees* – for the use of public areas for exhibitions and entertainment events, for advertising in public places, for parking in public places, for the use of public space for camping and other, if so stipulated by law.
- *relinquished revenues from the national budget-tax sharing*[11] – income tax or other taxes, as stipulated by law[12] and
- *borrowing*

The 2007 Act contains a model of financing or establishing appropriate expenditure that refers only to the financing of a municipality's duties - mandatory and delegated tasks and functions imposed by the Act. This financing is ensured through the municipality's capitation revenues, i.e. share of national taxes (personal income, property, profit of enterprise, etc.) which are remitted to municipalities from tax payment accounts. This is done directly and without intervention from the national budget, generally at least once a week. All other own sources of financing are intended for financing the municipality's *self-governing tasks* and its developmental programmes and investments.

[11] Municipalities are also financed through revenues which are, in compliance with the law, revenues of the national budget for the individual financial year and amount to the total appropriate expenditure. Taxes and the amount of taxes and revenues to be paid to municipalities are laid down by the act governing implementation of the national budget. The aforementioned revenues are deemed the own financing sources of municipalities.

[12] Whenever the word "law" is used it refers to law in general and when "act" is used it refers to specific acts.

3.3 Model of financing appropriate expenditure

The model of financing appropriate expenditure is based upon:

- *average rating* – average costs per inhabitant, calculated on the basis of data on a municipality's costs for financing *original or compulsory tasks*.
- *municipality's appropriate expenditure* – the appropriate scope of resources for financing a municipality's original or compulsory tasks.
- *municipality's total appropriate expenditure* – the total appropriate scope of resources for financing a municipality's original or compulsory tasks for a particular year, determined as a sum of the appropriate expenditures of all municipalities for a given financial year.
- *capitation* – a calculated share *per inhabitant* of relinquished national tax sources for the financing of *original or compulsory tasks*.
- *municipality's capitation revenue.*
- *financial equalisation*; in so far as a municipality's capitation revenue is lower than the appropriate expenditure, the difference is covered by *financial equalisation* from the national budget.
- *surplus offset.* In so far as a municipality's capitation revenue is more than 15% higher than the appropriate expenditure, the surplus difference above 115% of appropriate expenditure is recouped, so that 50% of the surplus is left to the municipality in question. The other 50% of the surplus above 115% of appropriate expenditure is recouped by reducing the relinquished taxes from the national budget. In accordance with the results of simulation calculations, the abovementioned will only be realised in the transitional period of five years, which is until 2012. After the transitional period, or after 2012, no municipality should have more than a 10% surplus above the appropriate expenditure.

3.3.1 Establishing appropriate expenditure

The system for establishing the appropriate expenditure for a specific municipality is based upon the premise that every inhabitant is entitled to an equal share of financing of those affairs (mandatory tasks) that are provided by municipalities in accordance with the law. The conditions under which a specific municipality provides such affairs must be taken into consideration; however, this must not interfere with the municipality's right to decide independently on financing tasks in its jurisdiction. That means that the system of establishing appropriate expenditure must not determine, in advance, a municipality's shares for financing individual tasks. Such a system would be in contradiction of the principle of a municipality's financial autonomy, as well as of the principle of the integrality of the budget. However, this does not mean that great deviations from the average costs can be compensated by increasing the appropriate expenditure and the financial equalisation. From this viewpoint it is very important to establish the appropriate amount of funds for financing mandatory tasks. If a municipality's own revenues allow for giving a particular task greater importance, this decision is, of course, completely autonomous while taking into consideration the legislation in force.

The proposed method for establishing the appropriate expenditure in the same manner for all municipalities also takes into account specific features of each municipality with regard to its population, size, length of municipal roads, inhabitants younger than 15 and older than 65. However, it does not determine, in percentages, the shares of appropriate expenditure intended for the financing of particular municipal tasks. These shares are the subject of methodology for determining the average rating, i.e. the appropriate scope of resources for financing a municipality's tasks, stipulated by acts in different fields, which will be specified by the government in a decree.

Average rating, which is the fundamental data item for establishing the appropriate expenditure of a particular municipality, total appropriate expenditure of all municipalities, the share of relinquished taxes and the capitation revenue of a particular municipality, will be determined by the Budget Implementation Act. It will be brought into line with associations of municipalities prior to that. Changes with regard to the 2006 Act:

- all municipalities have the same 0.61 leading coefficient,
- the formula for calculating the appropriate expenditure of municipalities is changed.

$$PPi = (0.61 + 0.13 * Ci + 0.06 * Pi + 0.16 * Mi + 0.04 * Si) * P * Oi \qquad (2)$$

Where:

PPi – municipality's appropriate expenditure;
Ci – ratio of the per capita length of local roads and public paths in an individual municipality to the per capita length of local roads and public paths in Slovenia;
Pi – ratio of the per capita size of the municipality to the per capita size of Slovenia;
Mi – ratio of the share of the population under the age of 15 in the entire population of the municipality to the average of this share in Slovenia as of 1st January of the year for which the amount of appropriate expenditure is determined;
Si – ratio of the share of the population over the age of 65 in the entire population of the municipality to the average of this share in Slovenia as of 1st January of the year for which the amount of appropriate expenditure is determined;
P – average rating;
Oi – number of inhabitants with permanent residence in the municipality according to data from the central population register as of 1st January of the year for which the amount of appropriate expenditure is determined.

The increase in the coefficient Ci means a greater adjustment of the appropriate expenditure of municipalities with regard to the costs municipalities incur. These costs include school transport, public utility infrastructure, road sweeping etc. and are all related to the length of local roads.

The average ratings for 2007 and 2008 (469.45 and 482.13 euros) are stipulated by the 2007 Act. The average ratings for 2007 and 2008 were determined on the basis of costs incurred by municipal budgets for duties and functions, stipulated by laws for particular fields, according to annual accounts for 2005.

The calculation was performed using a statistical method that took into account expenditures stipulated in the first paragraph of Article 11 of the 2007 Act. The average rating for the following years of the transitional period, from 2009 to 2012, will be calculated by the Ministry of Finance pursuant to a government decree that will specify particular duties and functions whose costs are taken into account in the calculation of the average rating, and the methodology for such a calculation. Our proposal for the calculation of the average rating for 2009 and beyond is presented in continuation.

3.3.1.1 Methodology proposal for the calculation of average rating

Our methodology proposal is intended for the calculation of average rating P_t for the budgetary year t. The calculation is made in June of the year *(t-1)*. The bases for the calculation are reports on municipal budgets' expenditures according to programme classification[13] (form P2) for the years from (*t-5*) to (*t-2*), i.e. municipal budgets' expenditures in 4 years. The average per capita value of costs- Str_a of all municipalities, incurred by duties and functions that municipalities must perform on the basis of legal jurisdictions for the chosen year *a* in the period from (t-5) to (t-2), is calculated using the formula:

$$Str_a = (\sum\sum Str_{ij}) / O \qquad (3)$$

Where:

$\sum\sum Str_{ij}$ - sum of all municipal costs (i) for performing duties and functions that municipalities must perform on the basis of their jurisdictions, stipulated by law for a particular programme area (j).

O - population of Slovenia as of 1st January of the year for which the average value of per capita municipal costs is calculated.

The adjusted average municipal costs per capita – *PStr*, which arose from performing duties and functions that municipalities must perform on the basis of their jurisdictions, stipulated by law for individual areas, for the entire analysis period from the year (*t-5*) to the year (*t-2*), is calculated using the formula:

$$PStr = \tfrac{1}{4} \sum(d_a Str_a) \qquad (4)$$

Where:

Str_a - The average per capita value of costs of all municipalities, incurred as a result of the duties and functions that municipalities must perform on the basis of their jurisdictions for the chosen year a in the period from (*t-5*) to (*t-2*).

d_a converter of municipal costs at current prices to the invariable base from the year a for the period between (*t-5*) to (*t-2*). The converter da is the inverse value of the price index for the observed year, with an invariable base in the year (t-2) (Ict-2). The coefficient value is published by the Bank of Slovenia.

The average rating P_t for the financial year *t* is calculated using the formula:

[13] Ministry of Finance processes data on municipal budgets expenditure using a programme classification.

$$P_t = PStr * Ic_{(t-2)/t} \pm \Delta Strx_t \tag{5}$$

Whereby the following is understood as:

PStr - adjusted average municipal costs per capita.
$Ic_{(t-2)/t}$ - *tk* expected rise in the consumer price index, based on information from the Bank of Slovenia, for the year in which the average rating is implemented.
$\pm\Delta Strx_t$ - expected increase or decrease in running municipal costs in the year t, incurred by the introduction or cancellation of duties and functions that municipalities must perform on the basis of their jurisdictions.

The estimated increase and decrease in running costs $\pm\Delta Strx_t$, is established by the ministry responsible for finances, in agreement with representative municipal associations.[14] Total appropriate expenditure of all municipalities in Slovenia – SPP – is calculated as the sum of appropriate expenditure of all municipalities or as the total scope of appropriate expenditure of municipalities for a given financial year.

3.3.2 Capitation per inhabitant

Capitation per inhabitant is calculated using the formula:

$$Gl = SPP/Oi \tag{6}$$

Where:

Gl - capitation per inhabitant;
SPP - the sum of appropriate expenditures of all municipalities or the total scope of appropriate expenditure of municipalities in Slovenia for a given financial year;
Oi - population of Slovenia.

A municipality's capitation revenue is calculated using the formula

$$Gli = Oi * Gl * (0.3 + 0.7 * Iro) \tag{7}$$

Where:

Gli - municipality's capitation revenue;
Oi - number of inhabitants with permanent residence in the municipality according to data from the central population register as of 1st January of the year for which the amount of appropriate expenditure is determined;
Gl - capitation per inhabitant;

[14] There are two acting municipal associations: Community of Slovene Municipalities (SOS) and Association of Slovene Municipalities (ZOS).

Iro - municipality diversity index, calculated using the formula: PPi/Gl, whereby PPi is the municipality's appropriate expenditure.

Part of the formula for calculating a municipality's capitation revenue is made up of a constant 0.3. The rest of the sum is composed of the coefficient 0.7, representing a 70% influence of the municipality diversity index as the product between the number of permanent residents in the municipality, as of 1st January of the relevant year, and the capitation per inhabitant in the country. The sum of both parts is multiplied by the number of permanent residents in the municipality and the capitation per inhabitant in the country.

3.4 Co-financing of individual tasks

The 2007 Act also provides for co-financing of individual tasks, projects and investments from the national budget through calls for tender, namely:

- co-financing of individual tasks and projects if wider public interest is established by law or a regulation, issued pursuant to law,
- co-financing of ensuring the rights of ethnic communities and the Romany community,
- co-financing of investments in local public infrastructure and other investments, relevant to the municipality's inhabitants:
  - once a year in the amount of 6% of the total appropriate expenditure (with a transitional period of 5 years) – investments planned in the municipal plan of development programmes (NRP),
  - according to ministerial programmes (national development goals) – once a year in the number of coordinated proposals of line ministries.
- co-financing of joint municipal administrations and promotion of municipal integration.

3.5 Transitional period

The 2007 Act stipulates a transitional period of five years, during which the new system of financing municipalities will gradually be introduced. Below, elements of the transitional period are presented in detail:

- The average ratings for 2007 and 2008 (469.45 and 482.13 euros) are stipulated by law. The average rating for the following years of the transitional period, from 2009 to 2012, will be calculated by the Ministry of Finance in accordance with a government decree that will specify particular duties and functions whose costs are taken into account in the calculation of the average rating, and the methodology for such a calculation. The methodology proposal for the calculation of the average rating is presented in part 3.3.1.1.

- Capitation in the transitional period from 2007 to 2012 is calculated by deducting NUSZ-compensation for the use of building land (collected in the whole country in the year before last), municipal tax revenue (increased by inflation in the relevant year) and the projected inflation in the relevant year from the total appropriate expenditure of municipalities.

In the transitional period, total municipal capitation revenues will be reduced by the share of own tax revenues as shown in Table 4.

Table 4 The share of own tax revenues

Year	% of NUSZ	% of own tax revenues[1]
2007	60	100
2008	48	80
2009	36	60
2010	24	40
2011	12	20
2012	0	0

[a] Own tax revenues comprise the tax on real estate, tax on real estate transfers, tax on inheritances and gifts, taxes on winnings from lotteries and other games of chance, as well as other taxes, if so defined by the law.

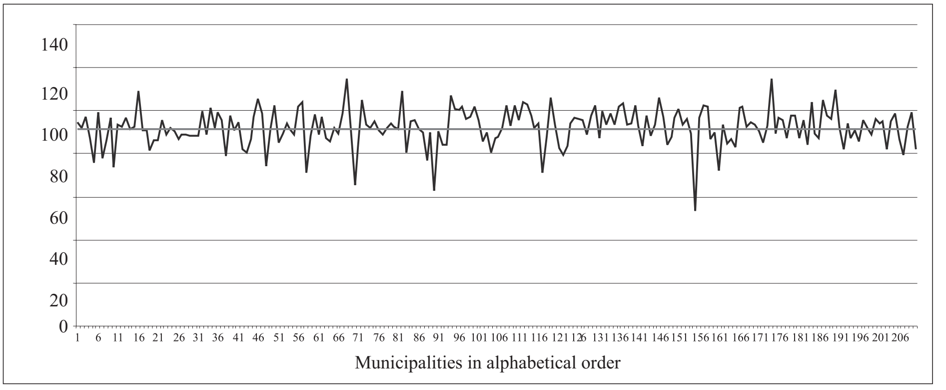
Source: Own presentation

The reduction will be based upon data on revenues from NUSZ and own tax sources in the whole country in the year before last, increased by inflation trends in the relevant periods. From the total amount of capitation so determined, revenues of a specific municipality or its share will be calculated. This means that even in the transitional period the actual municipal revenues from autonomous sources of financing will not be affected.

- Adjustment of the financial equalisation[15] for the previous year will be made by February of the current year at the latest.
- Cultural public institutions, established by municipalities, will be financed from the national budget until 1st January 2009, when municipalities will be given an opportunity to co-finance most of these institutions through regions (local affairs of wider interest) that are intended to start operating in accordance with the government and the National Assembly's work plan.
- The co-financing of home care assistants for the financial years 2007 and 2008 (over 0.35% of appropriate expenditure) is associated with the duty of the state to provide the means to perform duties and functions, vested in municipality from the state jurisdiction. Namely, orders on the right to a home care assistant are issued by departments of social security within the framework of public authorisation for the execution of duties and functions that fall under state jurisdiction. The material rights of a home care assistant, whose financing is delegated to municipalities wit-

[15] Adjustment of the financial equalisation means a harmonisation of estimated and actual municipal revenues and the difference-financial equalisation-which transferred to municipalities.

Figure 4 Estimates of the municipal own revenues in 2007 with regard to appropriate expenditure under the 2007 Act



Source: Own presentation

hout the appropriate means, are also stipulated by law and an order. In view of the fact that the competent ministry reached an agreement with municipalities and associations on the method of financing these rights, the law proposal of the ministry reflects this agreement. However, only for the period of two years in which the competent ministry is expected to delegate the decision on the right to a home care assistant and the provision of funds to regional jurisdiction. Funds for performing these duties and functions will be systematically provided within the framework for the operation of future regions.

3.6 Evaluation of the effects of the 2007 Act in 2007 and 2008

Under the 2007 law, in 2007 50% of municipalities would be self-financing, while 32% of municipalities would receive financial equalisation lower than 5% of the municipality's appropriate expenditure – which can also be seen in Table 5. Other municipalities would receive financial equalisation lower than 20% of the municipality's appropriate expenditure. Municipal surpluses are around 8.7% and financial equalisation is less than 1% of appropriate expenditure.

Table 5 Estimates of financial equalisation, surpluses and the number of independent municipalities for 2007 and 2008 in million euros

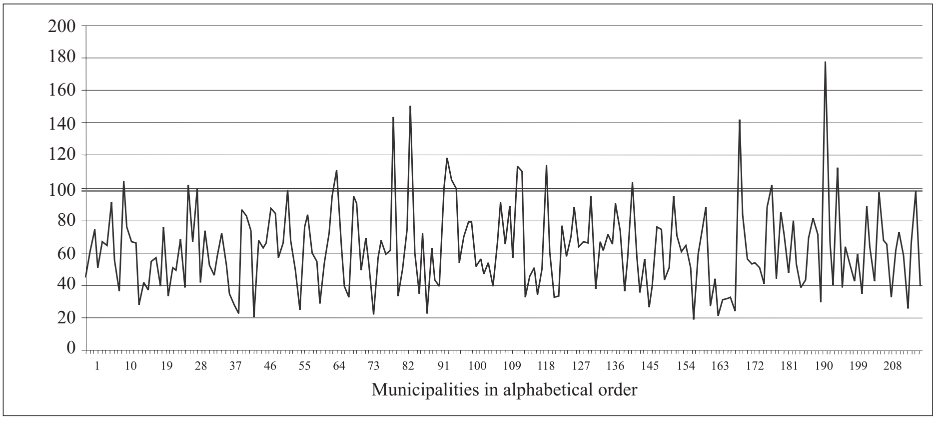
Year	Appropriate expenditure	Financial equalisation	Surpluses in independent municipalities	Number of independent municipalities
2007	936.1	9.2	81.9	106
2008	978.7	10.1	65.6	103

Source: Own presentation

Figure 4 shows municipal own revenues (jagged line) with regard to appropriate expenditure (straight line) under the 2007 Act. Compared to the 2006 Act the situation is much better. More than half of all municipalities are self-funding. Municipalities that receive financial equalisation no longer receive such great financial support from the state. Financial equalisation amounts to only around 1% of the appropriate expenditure of municipalities in comparison to 22.5% in 2005. Thus, the financial equalisation is not of the same significance and importance under the 2007 Act.

A substantial improvement is seen in municipal own revenues and, in particular, revenues are more evenly distributed. Departures from the appropriate expenditure are now ± 20% in comparison with the 2006 Act when they were ± 80% (Figure 5). Some municipalities also deviate from this, mainly large municipalities with low population densities.

Figure 5 Estimates of the municipal own revenues in 2007 with regard to appropriate expenditure in accordance with the 2006 Act



Source: Own presentation

The figure above shows municipal own revenues for 2007 in relation to the appropriate expenditure of municipalities. The straight line represents the appropriate expenditure in different municipalities and the jagged line represents municipal revenues with regard to appropriate municipal expenditure in percentages. As is clear from the graph, revenues in most municipalities are much lower than the appropriate expenditure. Of course, some municipalities stand out (14 in 2007), but they cover or even exceed their appropriate expenditure through personal income tax alone.

Also problematic is the derogation of municipal own resources from appropriate expenditure. In some municipalities own revenues can be lower than 20% of the municipality's appropriate expenditure or, on the other hand, revenues of a particular municipality can reach almost 180% of its appropriate expenditure.

The financial consequences of the proposed new system of financing of municipalities for 2007 have been evaluated at 20.2 million euros of additional funds and another 11.6 million euros for 2008.

By decreasing the share of municipal own revenues, intended for the financing of appropriate expenditure in the transitional period of five years after the implementation of the 2007 Act (Table 6), the share of relinquished revenues from the national budget for the financing of appropriate expenditure will be increased. From 2007, the revenue for appropriate expenditure will also include 60% of NUSZ or real estate tax and 100% of the tax on inheritance and gifts, tax on classical gambling, tax on sale of immovable property and administrative fees of municipal administrations (hereinafter referred to as: tax sources). The level of direct financial equalisation will remain approximately unchanged. In the transitional period between 2007 and 2012, the share of NUSZ and tax sources will gradually be released as the revenue for appropriate expenditure. In 2012, the NUSZ or real estate tax and municipal tax revenues will be left entirely to municipalities for their development and investment tasks.

The municipalities that will receive financial equalisation higher than 10% are: Hodoš, Bistrica ob Sotli, Bovec, Osilnica, Jezersko, Kostel, Luče and Solčava.

After the transitional period of five years, from 2007 to 2012, the surpluses and financial equalisation will be equalized and will represent 1.8% of the total appropriate expenditure of municipalities.

Table 6 Situation after the transitional period in 2012

	Self-financing municipalities	**Financial equalisation lower than 5% of PPi**	**Financial equalisation between 5 and 10% of PPi**	**Financial equalisation between 10 and 18% of PPi**
Number of municipalities	62	91	49	8
Percentage	(30%)	(43%)	(23%)	(4%)

Source: Own calculation

It is estimated that, after the five-year transitional period, municipalities will acquire almost 210 million euros for the financing of duties and functions laid down in their regulations and development plans. From this viewpoint, the new system of financing of municipalities is an important step towards the financial autonomy of local communities in Slovenia and the implementation of the European Charter on Local Self-Government.

Conclusion

The 2007 Act on Local Finances will improve self-financing of the majority of Slovene municipalities, decrease financial equalisation and thus the dependency on the national budget; this is mainly due to a more appropriate division of state taxes or capitation and a gradual reduction of surpluses over the appropriate expenditure. After the transitional period of five years, from 2007 to 2012, the surpluses and financial equalisation will be unified according to size and share and will each individually represent 1.8% of the total appropriate expenditure of municipalities.

The average ratings for 2007 and 2008 were determined on the basis of costs incurred by municipal budgets for duties and functions stipulated in laws for particular fields and according to final accounts for 2005. In future, the average rating will be based on the average cost of activities in the original jurisdiction or those activities that municipalities must perform. It is in this context that we submitted our methodology proposal for the calculation of the average rating.

Besides the described positive results for most Slovene municipalities, compared to the 2006 Act also had some negative effects on certain municipalities. It had a big negative effect on Mestna občina Ljubljana (Urban municipality Ljubljana) and a much smaller effect on the municipalities of Šempeter-Vrtojba and Trzin and the municipality of Log-Dragomer, newly established in 2007. All of these municipalities (apart from the new municipality Log-Dragomer) had relatively big surpluses over the appropriate expenditure in the past. In this new model according to the calculation of financial equalisation for 2007 carried out by the Ministry of Finance (internal source), all these municipalities also disclose surpluses over the appropriate expenditure in their budgets.

The main obstacle in the preparation and implementation of this reform lay mainly in the diversity of municipalities, with regard to population, size, economic development, etc. Also evident was the familiar difference between urban and rural areas.

Another important limitation, or, as the case may be, demand for rational reform, was the demand for sustainable fiscal reform and a gradual transfer of funds for self-governing tasks, especially for development and investment activities, to municipalities. Therefore, the transitional period between 2007 and 2012 is very important.

Several questions regarding the wide dispersal of Slovene municipalities were also raised - number of municipalities, population, etc. For example, the smallest municipality, Hodoš, has fewer than 400 inhabitants while the urban municipality of Ljubljana has almost 270,000 inhabitants. On the other hand, we were faced with the very centralized organisation of the country. That is why particular attention is drawn to local self-government, organized at one level, and the realistic need to organize the second level or to organize regions to bring about the necessary quality in activities within Slovenia and, even more so, in the European Union, while observing the principles of fiscal decentralisation. Further fiscal decentralisation and organisation of regions in Slovenia should be the subject of further studies.

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