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Financing Local Government in Theory and Practice: Short Lesson from Slovenia

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Abstract: With decentralisation, decision makers are closer to the results of their decisions. As such, local government is a feature of all EU states, despite many differences between them. An optimal model of local financing is hard to implement, due to high level of political infection, but main principles need to be followed. The model of local financing should lean on suitable vertical allocation of resources, adequate proportion of local revenues coming from own sources and relatively fair equalisation system. However, fiscal autonomy and local discretion over the form of municipal service delivery should not be neglected. This article studies the case of Slovenia.

Key words: fiscal decentralisation, local financing, fiscal federalism, public finance

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Introduction

When scholars talks about local government (LG in continuation), they often point to three basic values that the structures of LG may fulfill (Sharpe 1973, Stewart, Greenwood 1995): a) autonomy; because the existence of LG prevents over-concentration of political power and allows for different political choices in different localities, b) democracy; because LG encourages the active involvement of citizens in self-governance; c) effectiveness; because LG is efficient structure for delivery of services tailored to varying needs of localities.

With decentralisation, decision makers are closer to the results of their decisions, which is helpful in predicting the effects of decisions to be made and in turn supports

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effective allocation of resources. LG enables a better match of policies with local conditions and preferences. This supports effectiveness both objectively and subjectively (policies are closer to voters' preferences) and variation in solutions promotes innovation and diffusion of positive examples. LG is a feature of all EU states, despite many differences between them. Its importance has been strengthened by the adoption of the subsidiary principle in the Maastricht Treaty and by the EU Charter of LG.

Criteria for expenditure and revenue assignment: The principles discussed below are among the basic foundations of the fiscal federalism model. As Rattso (2002) notes, model is based on four key assumptions: a) LG is mostly responsible for the delivery of public goods; b) the base for local finance is provided by local taxes (those who pay also benefit), c) there is considerable social mobility; d) in the case of local services, the catchments area is close to the area of administrative jurisdiction, i.e., spillover effects are minimal.

The main principles of a decentralised system of public finance recommended by fiscal federalism theory are (Musgrave 1959, Oates 1999, King 1984):

a) The division of functions between central and LG is based on the subsidiary principle, which involves a considerable amount of fiscal and functional decentralisation. (LG spending to national GDP, although this measure creates several methodological and data problems), b) The allocation of functions takes into account the specific territorial organisation. If the structure is to diversified, with many, small units, the functional decentralisation cannot be broad. Small units will not be able to perform functions effectively, c) The 'golden rule' of the balanced budget (Dafflon 2002) is enforced by regulations. In short, the rule states that current spending should be financed exclusively from current revenues, while capital investment expenditures are financed from capital receipts, d) The system of local finance is transparent for citizens and LG has an autonomy to form the structure of local expenditures.

The most general classification of resources consists of three major categories, i.e. own revenues of LG (revenues allocated to LG unconditionally and for an undefined period and that LG has at least some discretion to decide upon these categories of revenue, transfers from the central budget in form of grants, borrowed resources, and shared revenues[1].

The model of local finance should conform to the following criteria: vertical allocation of resources should reflect the allocation of functions, a large proportion of local revenues should come from own sources, because this supports accountability, stimulates councilors and increases citizens interest in local activities, equalisation system which ensures that each unit is able to provide at least a minimal set of standard services (Buchanan et.al., 1999).

Principles of local taxation: There are various candidates for local taxes, and several criteria to help us choose appropriate mix for the country. Some of them are identical with requirements for good taxes in general, but others are specific to LG. The most important elements may be summarised as follow:

a) allocation of tax yields is proportional to allocation of functions. If we require that a large proportion of local revenues comes from own sources, we need a tax system that provides such an opportunity,

b) distribution of the tax base is even geographically. This ensures that differences between local authorities with high and low local tax bases are not overwhelming. For example, the tax base for the tax on exploitation of natural resources would be very unevenly distributed, while property taxes are much more even for every unit. If this condition were disobeyed, there would be differences between 'rich' and 'poor' units. Obviously, there is no tax from which yields are distributed in space in a perfectly even way, but some potential local taxes are better and some are worse from the point of view of this criterion,

c) tax is well defined in geographical space. With property taxes, for example, collection is very easy because every property is located in one unit. Similarly, personal income tax is not a problem, but the case is more complicate with corporate tax. If a company is registered in one city but operates and get income in several units, which should benefit from the tax? Even more complicated, if not hopeless, is VAT,

d) visibility of the tax. Certain taxes such as property tax or personal income tax are more visible than others, like VAT or excise tax. There is no doubt that visible taxes stimulate a LG's accountability,

e) tax base should be relatively immobile. Otherwise, taxpayers can easily migrate between jurisdictions causing excessive tax competition. Property tax or even personal income tax is better from that point of view than corporate income tax,

f) system of local taxes should not be too fragmented or too complicated. In some countries there is a large number of small local taxes, none of which brings very significant revenue to local budgets. The cost of tax collection in such a system is usually relatively high. A system like this is also unnecessarily complicated and non-transparent, reducing the accountability value of local taxation[2].

LG in different countries have different amount of discretion in deciding on rates of local taxes. Typically, a maximum tax rate or ceiling is set. This is for example the case in Italy (Fraschini 2002). In the UK the freedom to set local tax rates is indirectly limited through caps on the overall level of LG spending. In Sweden, LG that set excessively high rates may be 'punished' by the reduction of state grants. In Denmark LG are basically free to set rates. Whatever is the particular solution, in practice there is often a significant variation in rates between LG (Pedersen 2002).

Shared revenues: In general, by tax sharing we mean allocation of a part of the revenue from certain taxes to LG. In some cases each LG receives a fixed share of the tax yield collected within its category. In such a situation the shared tax is very similar to local taxes with a flat tax rate. In some other countries, the share does not depend on a local collection but is allocated on the basis of various criteria such as size of population. This is frequently the approach taken in CE Europe, especially where the share in personal income tax is concerned. Such a solution is closer to the general grant than to local tax, and sometimes is classified in that way. In some countries, instead of sharing taxes by origin or formula, locals are allowed to impose a surcharge on central tax. Usually personal income tax is subject to surcharging, when the tax base and administration are kept under central control. LG may levy a flat rate on the total amount of the central tax, as in Norway, or might build up its own policy (Denmark, Switzerland). In most cases legislation puts limits on the maximum local surtax rate in order to avoid harmful tax competition.

Grants and equalisation schemes: The basic of most grant systems lies in the willingness to reduce inequalities between units. The following are specific arguments for grants systems:

a) vertical equity: Sometimes the allocation of resources between tiers of government does not secure sufficient funds for LG. If such vertical imbalance is significant, the situation should be treated as a violation of fiscal federalism principles,

b) horizontal equity: Each citizen should have access to the same level of services for the same price (tax). If there were no equalisation, citizens in poor municipalities would need to pay higher taxes than citizens in more affluent units,

c) support for LG that provide services to more than their own residents. The catchments area of services can rarely be identical with the borders of geographical jurisdictions, especially in big cities, often providing many services (secondary education, street cleaning and lights or maintenance of local streets) not only for their residents, but also for many visitors,

d) securing national standard of services: Standards are especially important if LG are responsible for such services as education, health care or social welfare.

But there are also arguments against equalisation, like: equalisation is in conflict with the market allocation of capital, disturbs the natural variation of prices, makes conflict with local fiscal autonomy or adjust local policies to local preferences, equalisation is a disincentive for stimulation of local development and leads to dependency of some regions on external aid. The simplest mode of equalisation is equalisation of revenues. We take into account the local tax base but not actual local revenues, since LG may have different tax policies which influence the level of budget revenues. We realise that the tax base is unevenly distributed among geographical regions, and try to support units with the lowest tax base trough: a) vertical equalisation schemes in which 'the poorest' local budgets are supported by grants transferred from the upper tier (e.g. central government); b) horizontal equalisation in which less affluent local governments are supported by the richest jurisdictions of the same tier (often called a 'Robin Hood tax.')

Local borrowing as mentioned in the first section, the 'golden rule' of the balanced budget prescribes that local authorities should never create a deficit in the budget for the purpose of covering current costs. But the same rule allows prudent borrowing for capital purposes (inter-temporal projects, where costs of a project undertaken by a LG are incurred as soon as the project is implemented, but the benefits derived from the investment are spread out over a longer period, due to acceleration of local development, stabilisation of required budget resources, access to grants from EU and other funds, etc). However, there are also potential hazards related to local government borrowing, of both a microeconomic and a macroeconomic nature. There is a common agreement that borrowing in order to cover current expenditures is acceptable very rare and short periods to cover deficits arising from uneven cash flows within a budgetary year.

Autonomy in local financing: Financial decentralisation depends not only upon allocation of revenues and LG discretion to decide upon them. Even with these factors in place, local fiscal autonomy can be limited by regulations related to spending, financial planning and organisation of local services. In some countries, financial decentralisation is greatly limited by the number of standards which require allocation of centrally-defined resources to various functions. If these norms and standards are numerous, local autonomy in spending policies remains just an illusion. A major limitation may also result from central regulation of wages and salaries of municipal employees. Real autonomy may be also limited if local governments have no right to set charges for local services. In practice, artificially low fares, fees or other charges often force municipalities to allocate significant resources for subsidies to service delivery. A similar effect may limit decisions on the organisational structure of service delivery units. The most important aspect of financial autonomy is local discretion over the form of municipal service delivery. LG should be free to design the internal structures of municipal administration, to decide the number of staff employed, and to use alternative forms of service delivery (private and non-profit organisations) if so desired. Obviously, local autonomy over these areas is limited by general laws on competitive tendering, company law and non-profit legislation, tax laws, etc.

Slovenian System of Local Government Financing

With only one 'live' lower level of LG (municipalities), Slovenia belongs to the countries with a relatively low degree of decentralisation. Total share of local finance amount around 5 per cent of GDP or around 12 per cent of the general government (average in EU is around 26 per cent). In 2002 all local communities in Slovenia have gathered €1,1 bill. Although The Law on LG (Official Gazette of RS no.72/93, 74/98) allows creation of more level of LG (e.g. regions) no regions have yet been created[3]. There are currently 193 municipalities, but 95 fail to fulfil basic criteria, upon a 5.000 inhabitants represent a minimum for funding a municipality[4]. The municipalities vary greatly in terms of population (from 390 the smallest to 270.854 the largest – capital Ljubljana).

Table 1.: Municipalities in Slovenia According to the Number of Inhabitants

	<1.000	up to 5.000	up to 10.000	up to 50.000	up to 100.000	> 100.000
per cent of municipalities	3.1	46.1	22.8	26.4	0.5	1.0
number of municipalities	6	89	44	51	1	2

Local government functions and expenditures: According to The Law, a municipality is in a whole competent for local matters, which it can manage independently and concern the inhabitants (kindergarten, housing, community amenities, communal activities, environment, local road activities, etc). Tasks are financed by the local revenues and financial equalisation from the state budget. It can be asserted that in Slovenia exist formal distinction between original (own) functions that municipalities should perform according to The Law on LG and transferred tasks, but reality brings many constant struggles between central government and municipalities over task interpretation. The fact is, that tied financial situation, special in the field of health, education and some social services, causes some pretend ignorance who is responsible for what.

Analysis (Oplotnik, 2003) showed that there is a high degree of variability in expenditures among units. So, the average amount of local per capita expenditure is 522 €, though according to frequency distribution, only 40 per cent of units fit into group that deviate less than 10 per cent from average. Analysis showed that smaller units (by the number of inhabitants) confront with higher expenditures for administration (even more than 50 per cent of total budget) while larger units (e.g. urban municipalities) confront with higher expenditures for housing (up to 80 per cent more than smaller), communal activities (up to 25 per cent) and culture and sports (up to 40-80 per cent). Further research showed that considering the area criteria, spacious rural (special high alpine) units are more 'expensive' regarding economic activities (e.g. like road maintenance, agriculture, school transport, etc).

Main Financial Sources (own, assigned, shared, transfers)

Financial resources are of essential importance for the estimation of actual LG situation. Without resources, decentralisation is nothing more than an external appearance. To avoid risk of local bodies remaining without funds for their tasks, local financial resources should be defined in correlation with competences and some basics principles (sufficient degree of autonomy, ability to create own list of taxes that suit local specifics, etc). The absence of correlation between local specifics, tax structure and actual/normative expenditures can result in lack of resources, excessive government grants, foundation of non-rational units, 'flying paper' effects, etc.

The most important source of local budgets in Slovenia (around 42 per cent of total local revenues) pertain to shared tax (personal income tax), and property tax on unmovable property (around 9 per cent of total). Next to that municipalities dispose with some property, while general government provide them with some extra form of financial aid - financial equalisation (around 20 per cent of total). However, those resources sometimes are just not sufficient. Small units are often stricken by a low tax base and poor administration. Particularly remote rural municipalities, with small number of inhabitants, enterprises or any other sources from which they could draw appropriate revenues, are not capable of providing the necessary funds for their tasks.

In general, municipalities are financed according to Financing of Municipalities Act adopted in 1994. The central contents of the Act were determining amount of financing necessary tasks (appropriate expenditure) and criteria for financial equalisation, to balance the difference between units. In 1998, amendments to the Act were adopted according to the EU Charter of LG. The leading principle of valid Act is that LG in Slovenia are financed through tax revenues, non-tax revenues (as charges, fees, penalties, self and voluntary contributions) and revenues deriving from municipal assets and transfers/grants (for details see appendix).

The most burning problem of the current LG financial system is disproportional distributed volume of sources collected by municipalities. The latter together with previous discussed matters present a real merry-go-round story. For example, an average amount of operating revenues per capita by municipality is 391 € per one fiscal year, but divergence between the lowest and highest amount to seventeen times of the smallest (in 2002, 79 € was amount collected by the poorest municipality while the richest collected 1.400 € per capita). Frequency distributions analysis, regarding collected operating revenues, showed that only 34 per cent of them succeed to collect 80 per cent or more of average while the rest of 66 per cent failed to do it. Almost 21 per cent couldn't gathered even 50 per cent of the average. On the other side of the scale we can found tourist jurisdictions and economic strong urban municipalities (like Ljubljana, the capital and municipalities that border on strong urban units since the income tax is most important local tax in Slovenia and it pertain to the municipality where the tax payer has a permanent residence–'sleeping zones').

To explore level of financial autonomy of LG in Slovenia in continuation, LG revenues were divided into those, pertain to state and municipalities (shared taxes), those pertain to municipalities but the basis, rates and payers are determined by acts of law and are assigned to municipalities by the state (assigned revenues) and on those pertaining solely to the municipalities (locals have competence determining tax base, rate and exemptions) (own and partly own revenues). Within the total LG revenues in Slovenia, the major part is occupied by only one shared revenue, personal income tax, shared with general government. Income tax represent 42 per cent of the total local revenue and almost 70 per cent of local tax revenues. It is extremely disproportional distribute and represent a major cause of increasing horizontal in-balance. Further, assigned revenues represent only around 4 per cent of total revenues while own and partly own resources amounted for around 34 per cent. The rest 20 per cent pertain to transfers from the state budget (detailed data in appendix).

Own Revenues of Local Government

According to Article 22 of the Law we can determinate eleven categories of revenues pertaining to LG and that local authorities have some competence at prescribing rates, bases, etc (own tax revenues). Next to that into that category can be included some revenues defined by legislation, although they are not taken into considerations in calculations of appropriate expenditures level formula explained later. We can call them: own non-tax and capital revenues, like for e.g. capital revenues, participation on profits and income from property, rental incomes and incomes from concessions and business premises, self contributions, etc. As have already said, around 34 per cent of total LG revenue is collected through original LG revenues. Within own revenues, around 45 per cent pertain to own tax revenues and 55 per cent pertain to own non-tax and capital revenues. The most important own tax revenue is only one tax, named compensation tax for the use of building land and within category of total taxes it represent around 15 per cent.

Compensation tax for the use of building land (26-28 per cent of own revenues). This tax is predecessor of a tax on unmovable property that should be introduced in 2005. It is only real original municipal revenue where the level of tax is entirely formulated by the local authorities. It actually represent a real autonomy of LG and together with revenues of administration accounted for around 10 per cent of total local revenues. Unfortunately it has two pitfalls: a) it is poorly administrated due to incomplete land register and lack of local incentive to collect it, since this reduce their amount of fiscal equalisation received from the state, b) it is very disproportional distributed across the regions, since some LG haven't tax base or knowledge to collect it. Frequency distribution analysis showed, that only 28 per cent of municipalities are able to administer more than 80 per cent of average amount administer in Slovenia (34 € per capita per year) (Brezovnik, Oplotnik, 2003).

Other important own tax revenues (around 15-20 per cent of own revenues). Comparatively, the remainder of actual local autonomy represent only 9,4 per cent of total taxes pertaining to local authorities and only 5,2 per cent of total LG revenues. The only significant tax in group is Concession fee (tax) from special games of chance. Its pitfall is that pertains only to municipalities that have any gambling industry (25 municipalities). Other taxes in that group are group of taxes on disposal sale and licences, tourist tax, communal taxes, forest road maintenance tax, etc. Together with tax on unmovable property and Concession fee (tax) from special games of chance, group represent a hard-core of Slovenian LG autonomy level, which is frankly speaking low and it account for around 15-16 per cent of total LG revenues or around 25-26 per cent of total tax revenues.

Own non-tax and capital revenues (around 55 per cent of own revenues). Although the group of own revenues from municipalities assets, property rights and power to charge economic subjects, represent 55 per cent of total own revenues, it hardly deserves that name, since its distribution is again highly disproportional. Almost 61 per cent of units aren't capable to derive at least 50 per cent of average amount. Most of revenue pertain to wealthier units that inherited substantial assets after the reform of self-government. It has to be mentioned, that data on this category should be taken by some doubts, since they vary from year to year. Usually, the level of this revenue depends from current needs and plans: e.g. recently, the nine years elementary school system has been introduced and numerous municipalities had to raise some additional resources to invest in infrastructure. Some of them had to sell their shares in local companies. Another factor that significantly influences the ability of LG to earn some substantial revenue from this category is knowledge and inventiveness of locals. Many of local councillors, majors or other servants are just not adequately skilled to successfully cope with larger projects and budgets that demand specific treatment (e.g. PPP, public private partnership is very poor knew and used concept among local municipalities, similarly like usage of temporary capital markets instruments, etc) (Oplotnik, 2003).

Assigned and Shared Local Revenues

According to Articles 21, 22 and 23 of the Law, seven revenues over which local authorities does not have any competence, can be determined. Those sources are prescribed by legislation and only allocated (transferred) to the locals for their own, but unconditional use. At this point the real fiscal strength and autonomy of LG is lost and consecutively a substantial part of fiscal decentralisation rational. Nevertheless, in Slovenia this category represent a principal source of local government revenues and it accounted for around 46 per cent of total local revenues. Within this group, the majority is reserved for shared, personal income tax (91 per cent of the group and 42 per cent of total local revenues). The rest of the group is composed of: tax on real estate transactions, tax on movable property, tax on heritage and gifts, administrative fees and special tax on use of gambling machines.

Personal income tax is shared with general government at a ratio of 65: 35 in favour of the state, wile 35 per cent is allotted to the municipalities, based on place of origin. As a principal fiscal source is actually responsible for vertical and horizontal balance. Unfortunately, its disproportional distribution makes differences among the units even deeper every year, since around 60 per cent of municipalities fail to attain the average amount of 78 € per capita. Almost as a rule we can expect, that the highest amount is gathered by urban units and those bordering on them while the smallest pertain to already mentioned, politically founded units from north-east Slovenia (many times founded for the sake of more symmetrical regional development and also just to gain some additional political points on elections. Those municipalities to great extent depend on transfer payments from the state budget (even 95 per cent of total LG revenue).

Transfers and Financial Equalisation System

In order to achieve horizontal balance and that inhabitants in poor municipalities would have access to the same level of services for relatively same price, various instruments have been introduced in LG finance. Generally, every year around 20 per cent of total LG resources are acquired through vertical reallocation of funds, either directly from the state budget to local budgets through general grants (financial equalisation) or through special grants. In the period from 1998 to 2002, general grants accounted for between 65 per cent and 75 per cent of total transfers to low level government, while special grants accounted for between 25 per cent and 35 per cent. Also within this group of revenues, the differences between municipalities are considerable. According to frequency distribution analysis, only 25 per cent of municipalities received less than 20 per cent of their total budget funds from the state budget. Up to 49 per cent received 21 per cent to 50 per cent of their total budget funds from the state budget and almost 26 per cent of municipalities (50) more than 50 per cent of their total resources from general government funds. The highest proportion of their total revenues (up to 88 per cent) pertain to small municipalities from north-east area of the country.

General grants system of financial equalisation (around 70 per cent of transfers). Municipalities receives financial equalisation from the state for funding current expenditures, calculated upon formula of appropriate expenditure, determinate by The Act. Amount of appropriate expenditure should assure that LG legal tasks are carried out[5]. Municipalities which are able to cover the expenditure calculated by the formula of appropriate expenditure with revenues collected upon Articles 21-23 of the Act, are not entitled to financial equalisation. Only if municipality is unable to cover calculated amount of appropriate expenditure with their own resources, it can rely upon the state for financial equalisation. Financial equalisation is then the difference between the amount determinate by appropriate expenditure formula and the amount of municipalities' resources actually collected under mentioned Articles. In theory that means that a municipality that didn't gathered even a single € upon mentioned articles would receive all its funding from the general government budget. In practice such cases do not occur, but local authorities certainly are not stimulate to administer as much taxes as they could, or to strengthen its fiscal base since they are actually 'punished' with smaller amount of equalisation for such behaviour. In order to prevent that and to force local authorities to better administer own taxes, general government prescribed optimum level of collections. Currently, if local authorities fail to collect mentioned optimum, it is consider as it was collected during the appropriate expenditure amount calculation process. Described deviation is only one problem concerning the valid system of financial equalisation and it point out that local authorities are usually more political negotiators and lobbyists than experts knowing how to extract the optimum out of local environment.

Municipal policy on debts. Municipalities may only borrow on the basis of prior consent of the Ministry of Finance by issuing securities and taking out loans. They may not borrow abroad, except pursuant to the law. Municipalities may take on long-term borrowing for investment confirmed by the municipal council. Municipalities may only borrow if the total level of existing indebtedness and the anticipated new indebtedness does not exceed 10 per cent of the revenues generated by the municipality in the year prior to the year of borrowing, while the total payment of principal and interest in an individual year of payment may not exceed 5 per cent of revenues generated.

Final Suggestions and Some Critical Comment on Current System

Regarding great Slovenian diversity, it is hard to imagine finding some substation level of similarity among decentralised units. But, let us presume a fictitious (model) unit, representing a simple average of all municipalities in Slovenia. Such jurisdiction would extend over 105 km^2, it would have 72 km of local roads, 15.9 per cent of young people, 13.9 per cent of aged, 37.2 enterprises per 1.000 inhabitants, 0.39 employed per one inhabitant, it would collect 519 € of total revenue per capita in one fiscal year and spent around 522 € per capita, of which 37.5 per cent would be spent on investment and the rest on above listed common current expenditures. Next to that it would exercise around 9.9 per cent to 15.2 per cent of autonomy over its revenue raising capacity (tax power) but it would have a very low incentive to raise those revenues since that would decrease its amount of financial equalisation (general grant to alleviate horizontal imbalances) received from state budget. The latter would probably account for 8.8 per cent of total local revenues or 18.2 per cent of revenues collected according to The Law. Further, it would spent 25 per cent of its total income on education, 23 per cent on economic activities, 15 per cent on administration, around 10 per cent on social activities, etc.

As we have said this is only a presumption. In reality such model jurisdictions are extremely rare and many problems stated latter on steam from this fact and inadequately set boundaries of municipalities in Slovenia. Data shows a great diversity of current Slovenian municipalities according to their characteristics, collected revenues and responsibilities. Actually it is a question if setting more uniform jurisdictions (thus changing actual boundaries) would solve the problem of vertical and horizontal imbalance, but higher degree of autonomy, more suitable vertical tax structure and especially higher correlation with municipality characteristics would certainly lead toward that direction. According to recent analysis it is almost impossible to classify existent Slovenian municipalities in less than 6 to 8 clusters and consecutively expect that existing legislation would be able to assure satisfactory position for majority of them.

Most of the described discrepancies derive from: a) inappropriate set vertical tax structure allocated to LG and low level of local autonomy, b) current valid system of financial equalisation which should be changed, together with (in)appropriate expenditure formula determination (totally disincentive system for revenue mobilisation), c) absence of correlation between normative and actual expenditures and revenues, disregarding local features and tax base, d) politically enforced decisions to found some 'fictitious' units and the role of local officials, reduced at political bargains and lobbyism (also due to poorly skilled local servant).

Namely, neither current local tax structure (plus lack of degree of local autonomy) nor determination of appropriate level of local expenditures are not in adequate correlation with actual situation within decentralised units and their characteristics and abilities to employ local resources and derive sufficient income from its local tax base.[6] This cause a deviation from vertical and horizontal balance. Currently, units whose own income fail to reach the normative level of appropriate expenditure, are entitled to equalisation funds from the state. In 2002 such funding was received by 85 per cent of units, although self-sufficient units accounted huge surpluses (so no 'Robin Hood' concept in Slovenia). The main problem are ponders of correction factors that should determinate a significance of municipal specific, but they not. This causes higher or lower expenditures, although it is questionable if its possible embrace such a huge diversity in only one simple formula?

Current model should consequently be corrected at least at the field of revenues, changing the existing model in direction of increased LG own revenues (autonomy) and reducing number of units receiving equalisation funds and pointed toward determination of more adequate appropriate expenditures formulae. Policy reform should comprise some vertical system corrections since local authorities have no incentive to employ own resources and encourage local revenue mobilisation. Their current role of negotiators and lobbyists should be changed through higher degree of fiscal autonomy. Only through more autonomy they will be able to exercise their revenue raising power and show inventiveness, though skills of locals might be questionable. Some degree of responsibilities for situation should also be appertained to political pettifoggers, through which many irrational municipalities has been founded. Next to that, the level of education, knowledge and contemporary mentality of local servants should be improved, though there some local brain draining can be noted. Next to that, the municipalities should employ alternative financial resources, making a pace toward the market as a provider of property in public domain and as a subject of financing the development of infrastructure facilities. The instruments as concessions granting, various forms of public, private partnership and transformation of the municipal property haven't been widely applied concept. Current incentive instruments to encourage local revenue mobilisation are almost completely inefficient and absent since the municipality that increase tax administration effectiveness it is actually 'punished' by decreasing its 'fiscal adjustment position'. Till now it has turned out that 'pure altruism' to reduce total amount of 'adjustment funds' that state should transfer to the municipalities, is not real or frequent option.

NOTES

[1] This category is very popular in EU: LG shares in central taxes. Quite often, the locals receive a fixed percentage of *e.g.* personal income tax collected within its territory. This is not an own revenue, since LG has no discretion to decide upon the tax rate, exemptions, etc. On the other hand, it is also not a pure

central government grant. Regulations on shares are very diverse and for analytical purposes, it is convenient to treat it separately.

[2] In practice, most EU states have several local taxes. The United Kingdom, with only one local tax (currently based on property, although not in a typical, orthodox form), provides one of the rare exceptions to this rule. Countries differ from each other in how much local discretion is allowed in deciding upon local taxes. In most cases there is a maximal ceiling or bracket within which local government can make its own decision. However, in some countries LG are totally free to decide on the local tax rate. We can say that in EU are basically two models of local taxation: a) based on property taxes (there might be other local taxes, but property tax is the most important). The United Kingdom probably provides the best example, but France, Spain also fall into this category, b) based on local income taxes. All four Nordic countries provide good examples of this type of local taxation. One of a very few countries in Central and Eastern Europe that have decided to go in the direction of building local income tax is Croatia. There are some countries in which local governments may make a choice from among a wider set of available taxes. This is the case in Hungary, where local governments are entitled to introduce any or all of the following taxes: land parcel tax, building tax, communal tax on private individuals, communal tax on entrepreneurs, tourism tax and local business tax (Hogye 2000).

[3] The reason lies in fact that regions should be founded on the basis of independent decisions by municipalities. In practice they never come to rise, as given their differing interests, the municipalities failed to agree on founding regions.

[4] Many of those were politically enforced and created through provision that exceptionally, municipality may have fewer than 5.000 inhabitants (for reasons of geography, border location, ethnicity, history or economics).

[5] *Appropriate expenditure per inhabitant* is defined for each single year by the National Assembly, as an average amount of resources per capita and does not include funds for investments, but only necessary current expenses. The amount *for an individual municipality* is determined on the basis of a mathematical equation in which the appropriate scope of resources per inhabitant amounts to 70 per cent of resources, while correction factors amount to 30 per cent, all together multiplied by number of inhabitants in unit. The amount for individual unit is determined in such a manner that appropriate per-capita expenditure is corrected by the ratio between area, length of local roads, population under the age of 15 and population over the age of 65 in unit. The highest per cent of financial equalisation usually pertain to small, undeveloped municipalities in north east region that were founded outside of any economic rational, usually politically enforced. Such *'fictitious units'* actually don't have any true ability to derive income (fiscal strength). Due to inadequately set boundaries of some municipalities Slovenia is present-day faced with substantial deviation from true vertical and horizontal balance. On the other hand, such transfers represent some *'second best temporary solution'* to lead an active regional policy of more symmetrical economic development.

[6] For example:. small municipality St. Andrew in north east Slovenia has 1.285 inhabitants and real expenditure per inhabitant of 214 €. According to the Law it succeed to collect 71 € of taxes, fees and charges per capita. Fair financial adjustment would thus be around 143 € per capita or 200 per cent although existence of such decentralised unit it should be highly questionable. But in reality, municipality received 346 € of equalisation, since according to appropriate expenditure formula its expenditure should be 417 € per capita, instead of a real 214 €. On the other side, around 15 per cent of municipalities failed to cover their actual current expenditures through assigned amount of appropriate expenditures. Most discrepancies in negative side appears at *city municipalities* that confront with higher expenditures for spill-over, *i.e.* amenities pertaining also to migrations (students, workers, tourists).

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Appendix

Tabel A1.: Statistical Picture of Slovenian Municipalities (min-avarage-max)

	minimum	**average**	**maximum**
Inhabitants	390	10.376	270.854
area (km^2)	7	105	555
Local roads (km)	1	72	819
Enterprises per 1.000 inhabitants	20.7	37.2	175.8
Employed per inhabitants	0.10	0.39	0.88
Total revenues per capita (in €)	**363 €**	**519 €**	**1.482 €**
(% of total)	%	%	%
Current revenues	*11.9*	*75.2*	*98.8*
Tax revenues	9.4	60.3	87.8
Personal income tax	4.4	42.0	64.9
Property taxes	0.1	12.4	59.5
Taxes on goods and services	0.2	5.8	22.0
Non-tax revenues	1.8	14.9	74.9
Capital revenues	*0.0*	*3.8*	*23.4*
Transfers and grants	*0.0*	*20.6*	*87.9*
Financial equalisation (as a % of total)	(+) 54.1	8.8	495.5
Total expenditures per capita (in €)	**319 €**	**522 €**	**1.431 €**
(% of total)	%	%	%
Investment expenditures	*11.6*	*37,5*	*74.0*
Current expenditures	*26.0*	*62.5*	*88.4*
Education	4.4	24.8	61.9
Economic activities	6.1	23.5	55.8
Administration	7.6	15.2	45.6
Social activities	0.6	10.3	39.6
Environment	0.0	5.8	54.2
Housing and spatial development	0.0	3.0	57.0
Health	0.0	1.4	23.9
Social security	0.9	5.0	29.2
Civil and fire protection	0.6	2.3	23.8

Figure F1.: Frequency Distribution of LG Total Revenues Around Avarage

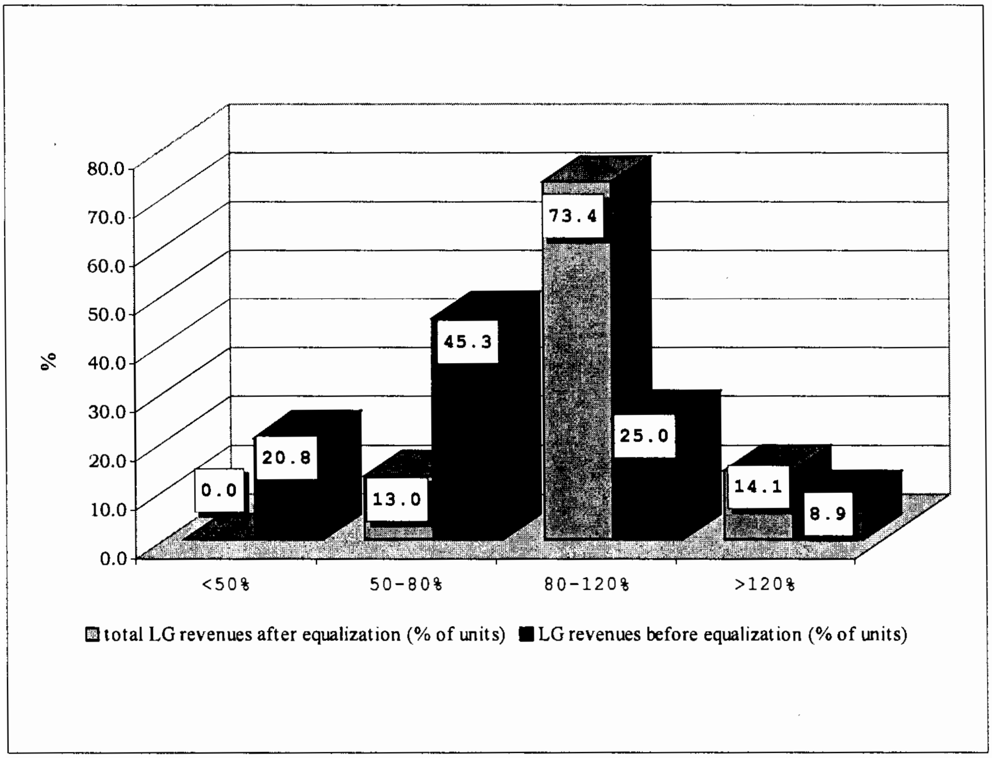

Table A2: Composition of Slovenian Local-Government Expenditures (official data for 2002)

Local government (LG)	**total**	**% in total**	**in mio of €**	**in % of GG**	**in % of GDP**
	2002	**2002**	**2002**	**2002**	**2002**
	bil.of SIT	in %	mil.of €	in %	in %
Total expenditures of LG	**242,52**	**100,00**	**1.116,65**	**12,32**	**5,31**
Current expenditures (also appropriate exp.)	**151,46**	**62,45**	**697,38**	**7,70**	**3,32**
Investment expenditures	**91,05**	**37,54**	**419,23**	**4,63**	**1,99**
Administration	**36,82**	**15,18**	**169,54**	**1,87**	**0,81**
Defence	**0,83**	**0,34**	**3,81**	**0,04**	**0,02**
Public security and fire protection	**4,81**	**1,98**	**22,16**	**0,24**	**0,11**
Economic activities	**56,92**	**23,47**	**262,08**	**2,89**	**1,25**
Agriculture, forestry, fishery and hunting	5,72	2,36	26,36	0,29	0,13
Energy feedstock (heat and gas supply system)	0,77	0,32	3,55	0,04	0,02
Traffic, road manitenance	26,28	10,84	121,02	1,34	0,58
Tourism and catering industry	2,34	0,97	10,78	0,12	0,05
Other economic activities*	21,87	9,02	100,70	1,11	0,48
Environmental protection	**13,96**	**5,76**	**64,30**	**0,71**	**0,31**
waste collection	2,54	1,05	11,70	0,13	0,06
waste water management	9,43	3,89	43,42	0,48	0,21
other environmental protection activities	1,99	0,82	9,18	0,10	0,04
Housing activity and spatial development	**28,31**	**11,67**	**130,36**	**1,44**	**0,62**
Health care	**3,35**	**1,38**	**15,41**	**0,17**	**0,07**
Recreation, culture and non-profit organisations	**25,10**	**10,35**	**115,55**	**1,28**	**0,55**
sport and recreation activities	8,89	3,66	40,92	0,45	0,19
cultural activities	14,03	5,78	64,60	0,71	0,31

other activities (media, non-profit organisations, etc)	2,18	0,90	10,03	0,11	0,05
Education	**60,19**	**24,82**	**277,13**	**3,06**	**1,32**
Social security, health and care contributions	**12,23**	**5,04**	**56,30**	**0,62**	**0,27**
Debt increase	**3,01**	**1,24**	**13,87**	**0,15**	**0,07**
Debt repayment	**2,26**	**0,93**	**10,38**	**0,11**	**0,05**

*small business, cemeteries, maintenance of streets, green areas, parks, etc...