Mingėlaitė D.,
lecturer
Mykolas Romeris
University,
Lithuania

Conference
participant,
National
championship in
scientific analytics

PROBLEMS OF FINANCIAL INDEPENDENCE OF MUNICIPALITIES

The article discusses a structure of municipal budget revenue. Municipal revenue is the most significant part of financial assets of municipalities and forms the financial foundation of local self-government. The paper analyzes the contents of the principle of financial independence of municipalities established in the European Charter of Local Self-Government (hereinafter referred to as the Charter), its transposition into the national law system and implementation in Lithuanian local self-government. Causes of decreasing financial independence of municipalities are discussed and their possible solutions are provided.

Keywords: local self-government, municipal finances, municipal revenue, public finances.

The Law on Local Self-Government of the Republic of Lithuania stipulates that "Local self-government means the right of an administrative unit or the territory of the State – a municipality – to freely and independently manage affairs in accordance with the Constitution and laws of the Republic of Lithuania via a municipal council consisting of representatives directly elected by the population, as well as via executive and other institutions formed by a municipal council" and "Municipality means an administrative unit of the territory of the State which has the status of a legal person and the right to self-governance guaranteed by the Constitution of the Republic of Lithuania and implemented via a municipal council" [1].

A conception of modern local self-government is also formulated in international legal acts. The European Charter of Local Self-Government adopted in 1985 defines local self-government as the right and the ability of local authorities, within the limits of the law, to regulate and manage a substantial share of public affairs in the interests of the local population [2]. The Charter grants the aforementioned right to councils or assemblies composed of members elected by secret ballot on the basis of direct, equal and universal suffrage. Seimas of the Republic of Lithuania ratified the Charter on 25 May 1999 without reservations, although the draft reservations had been prepared, for instance, a reservation regarding Article 9 of the Charter "Financial Resources of Local Authorities". Having ratified the Charter, Lithuania not only acknowledged the document but also undertook to implement its provisions.

The aim of this research is to analyze a structure of municipal revenue in Lithuania as well as the contents of the principle of financial independence established in the Charter, its transposition into the national law system and implementation in Lithuanian local self-government.

The tasks of the research:

To discuss the system of municipal revenue in Lithuania.

To analyze problems of the financial independence in local self-government of Lithuania.

The object of the research: the contents of the principle of financial independence of municipalities and its implementation in local self-government.

The methods of the research: the document analysis method (analysis of literary sources and legal acts regulating finances of local self-government); the statistical method (generalization and comparison of statistical data); the generalization method (conclusions of the article are formulated).

Article 127(1) of the Constitution of the Republic of Lithuania stipulates that the budgetary system of the Republic of Lithuania shall consist of the independent State budget of the Republic of Lithuania as well as independent municipal budgets [3]. The State budget revenue shall be raised from taxes, compulsory payments, levies, income from State property and other income. Taxes, other payments to the budget, and levies shall be established by the laws of the Republic of Lithuania.

The State budget funds are used for funding the needs common to the whole State. The municipal budgets accumulate funds for funding social, economic and other programmes of local significance and for supporting local self-government establishments and institutions. The collection of municipal budget funds is based on the necessity to fund the implementation of programmes of local significance.

Each of 60 municipalities establishes and approves its budget every year. Article 121 of the Constitution of the Republic of Lithuania establishes that municipal councils have the right, within the limits and according to the procedure provided for by law, to establish local levies and provide for tax and levy concessions at the expense of their own budget.

Legal bases of formation of the municipal revenue are as follows: the Constitution of the Republic of Lithuania, the European Charter of Local Self-Government, the Law on the Budget Structure of the Republic of Lithuania, the Law on Local Self-Government of the Republic of Lithuania, the Law on Methodology of Determination of Municipal Budget Revenue of the Republic of Lithuania, the Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets of the Republic of Lithuania of the relevant year, the Resolution of the Government of the Republic of Lithuania on Approval of Regulations on Establishment and Implementation of the State Budget and Municipal Budgets of the Republic of Lithuania, the Law on the Personal Income Tax of the Republic of Lithuania [4], the Law on Immovable Property Tax of the Republic of Lithuania, the Law on Inheritance Tax of the Republic of Lithuania, the Law on Land Tax of the Republic of Lithuania, the Law on Environmental Pollution Tax of the Republic of Lithuania, the Law on State Natural Resources Tax and the Law on Charges of the Republic of Lithuania.

The municipal budget revenue consists of tax and non-tax revenue and the state budget subsidies. Such revenue includes the following: municipal budget revenue received from taxes in accordance with laws and other legal acts (State natural resources tax, environmental pollution tax, personal income tax, immovable property tax, inheritance tax, land tax and charges);

income from municipal property (except income received in accordance with the Law on Privatization of State and Municipal Property); income of municipal budgetary institutions for provided services; fines received in accordance with the procedure established by laws; local charges; income received from public land and water bodies of public internal waters fund rented or granted for use and after the distribution of funds for plots of state land sold and rented for non-agricultural purposes carried out in accordance with the procedure established by the Government; state budget subsidies and other transferred funds; grants (monetary resources); income for balance of municipal funds in current accounts; loans; other income established by laws; payments credited to municipal budget revenue for disposal of fixed tangible and intangible assets.

As the State budget is an attribute of the state's sovereignty, so the municipal budgets are a security of independence and self-sufficiency of the municipalities. Local taxes are one of the main features of financial independence of the municipalities.

Tax and non-tax revenue can be relatively called as the own revenue of the municipalities, whereas subsidies are an amount of money allocated by the State the unused residue of which must be returned back to the State budget.

The own funds of Lithuanian municipalities do not fully answer their conception. In an ideal case the own funds are funds the formation of which fully depends on decisions of the local authority. Unlike municipalities in foreign countries, Lithuanian municipal budgets contain practically no such funds [5].

In addition, separate types of revenue (tax revenue, non-tax revenue and subsidies) have a different relative weighting in the municipal budgets. Tax revenue and subsidies form the largest part of the municipal budget revenue.

Lithuanian municipalities do not have sufficient fiscal independence and possibilities to collect funds necessary for their functioning, because the most important tax elements (taxation base, rates and tax credits) are laid down by Seimas. Taxes are administered by the State Tax Inspectorate under the Ministry of Finance of the Republic of Lithuania. Meanwhile, non-tax revenue which the municipalities are in the best position to influence forms only a very small part of the total municipal revenue and its significance is minor.

According to Davulis G. Lithuanian municipalities have very limited possibilities to regulate independent revenue as the majority of revenue is collected and redistributed to the municipalities in a centralized manner. This is the major factor of the lack of financial independence of local self-governments also known as fiscal centralization. This phenomenon contradicts to the objective of the majority of foreign democratic states to develop fiscal decentralization – transfer of the powers and responsibilities from the central government entities to municipalities – as much as possible [5].

This situation also contradicts to Article 9(3) of the Charter which states that part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate [2].

It should be stated that fiscal initiative and responsibility of municipalities are stifled and their financial activity becomes less effective due to the aforementioned reasons.

On the other hand, a few years ago certain progress was achieved in the implementation of the provisions of Art. 9 (3) of the Charter regarding local taxes imposed by municipalities. Some features of local taxes appeared in laws regulating taxes (land tax, immovable property tax, inheritance tax) credited to the municipal budgets. For instance, since 2007 municipal councils have been granted the right to set the rate of the immovable property tax within the range of 0.3-1 percent of the value of the immovable property. Moreover, a municipal council has the right to reduce the land tax, the immovable property tax and the inheritance tax or to exempt from these taxes at the expense of its budget.

The personal income tax forms the largest part of tax revenue of the municipal budgets (in some municipalities it accounts for more than 70 percent). According to the existing Law on Personal Income Tax of the Republic of Lithuania the basic 20 percent rate is levied on personal income [4]. 15 percent rate is applied to income from distributed profits and 5 percent rate is applied to income from individual activity, except income from professional services and income from securities, including income from derivative financial instruments. Moreover, a fixed personal income tax rate to be paid upon acquiring a business certificate is set. This rate is set by a decision of municipal councils and it cannot be less that the income tax which is calculated by applying the basic income tax rate valid during the relevant period to the amount of twelve minimum monthly wages valid on 1 October of the tax period preceding the tax period for which a business certificate is acquired. The fixed-rate income tax (15 percent at the moment) on income received from activities exercised under a business certificate is credited to the budget of the municipality within a territory of which the business certificate was issued.

Every year Seimas determines a personal income tax share for the municipalities when adopting the Law on the Approval of Financial Indicators of the State Budget and Municipal Budgets of the Republic of Lithuania of the relevant year. Thus, not the whole share of the personal income tax goes to the municipal budgets. For instance, Vilnius receives 40 percent.

Hence, although the Constitution of the Republic of Lithuania establishes that the municipal budgets shall be independent, the State limits their independence by fixing the size of municipal budget revenue.

In addition, during the last three years the Government and Seimas reduced municipal budget revenue derived from the personal income tax – for example, by 150 million Litas in 2009 and 260 million Litas in 2011 – without any legal presumptions. As stipulated in the Charter, Lithuanian municipalities have access to the national capital market for the purpose of borrowing for capital investment in accordance with the procedure established by the law. On the other hand, quite low borrowing ceiling is set for the municipal budgets. Only 85 percent is applied to the largest Vilnius City municipality, whereas in Estonia this indicator can be as high as 160 percent [6].

Both the personal income tax and property taxes, should it be allowed for the municipalities to regulate and administrate them, open up additional possibilities for the municipalities to establish their budgets in a more flexible manner taking into consideration the expenditure needs of the community [7]. On the other hand, legalization of the personal income tax as a local tax may also have adverse effects: it may encourage unwelcome inter-municipal migration of the population, impede the horizontal fiscal coordination processes, make the tax administration process more complicated or start "tax wars", etc [8].

During the last years the implementation of Article 9(4) of the Charter aroused a number of doubts. The aforementioned Article stipulates that the financial systems on which the resources available to local authorities are based must be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.

For several years the Association of Local Authorities of Lithuania has been trying to achieve that the provision of the Law on Methodology of Determination of Municipal Budget Revenue which limits the growth of independent predicted revenue of municipal budgets would be recognized as invalid. Limitations on the revenue growth of similar nature are applied neither to the state budget nor to other entities [6]. Such limitations on the revenue growth reduce the possibilities for the municipalities to stimulate the economic development, investments, creation of jobs, a level of wages in the region as well as the migration of the population and so on.

Local charges are an important source of revenues of the local self-government. It should be noted that according to Article 121 of the Republic of Lithuania municipal councils have the right, within the limits and according to the procedure provided for by law, to establish local levies. The existing Law on Charges of the Republic of Lithuania limits the rights of the local self-government to set monetary obligations of natural and legal entities. Moreover, it is not in conformity with the principles of the European Charter of Local Self-Government or the recommendations of the resolutions of the Council of Europe, thus, a new law on local charges is required. In the member states of the European Union municipal revenue from local charges accounts from 10 to 30 percent, whereas in Lithuania it is only 1 percent [6].

Hence, it is necessary to increase the financial independence of the municipalities in Lithuania and to bring it closer to the European level so that the municipalities could properly implement the interests of their communities.

Conclusions

The municipal revenue system consists of the following: tax revenue; non-tax revenue the State budget subsidies. Tax revenue and subsidies form the largest part of the municipal budget revenue. Meanwhile non-tax revenue which the municipalities are in the best position to influence forms only a very small part of the total municipal revenue and its significance is minor.

A level of fiscal decentralization in Lithuania is insufficient and lags behind the general European level. It is necessary to increase the financial independence of the local self-government when establishing the local budget and to develop the institution of local taxes (considering the possibility to give more powers to the municipalities to regulate and administrate local taxes) so that the municipalities could properly implement socioeconomic development plans at regional and municipal levels.

Limitations on the growth of independent revenue of the municipal budgets reduce the possibilities for the municipalities to stimulate the economic development, investments, entrepreneurship, creation of jobs, a level of wages in the region as well as the migration of the population and so on. Thus it is purposeful to abandon the limitations on any growth of the independent municipal budget revenue.

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