ECONOMIC CRISIS AND ENHANCED COMPETITIVENESS OF MUNICIPALITIES

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Abstract

The text deals with the issue of a conflicting relationship between state and municipal budgets in the Slovak Republic. It also focuses on the field of possibilities of local self-government financing in the context of current global economic crisis. Cities and towns must adopt rational measures and they are looking for reserves especially in effective economic management and that in income as well as in expenditure of their budget. Their properties should be sold and rented in a more transparent, economic and efficient way and they should also increase the efficiency of claim collecting.

Key words

Local Budgets, Economic Crises, Subsidiarity Principle, Rationalization, Efficiency, Cost-Effectiveness.

I. Introduction

The issue of local budgets has recently become a frequent source of conflict between local self-government elite and central management of Slovak economy. The core of the disputes appears to be, besides others, mainly the relationship between the state and local budgets. The matter of solving these disputes has been a current issue for a longer time period, yet, no political power after 1990 have come up with any comprehensive system of solutions in the field of self-government financing in Slovakia, such as what options of financing of local and regional policy are there for politicians to choose from in connection with the issue of relationship between central and local (or regional) budgets, and which of these rules are preferred or rejected by representatives of municipalities in Slovakia.

Modern liberal democracies, especially those of Western European character, have shown an increasing tendency of applying subsidiarity principle since the late 80-ies, which is closely connected with the exercise of municipal functions. The current trend in this field, that is to say, is primarily applying the basic principle of necessity to solve each new problem at the level it originated. Therefore, there

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2 MALČÍCKÁ (2010).
has been a process of not only the competency but also financial strengthening of municipalities and local authorities in Western Europe. A proof to this effort is the adoption of the European Charter of Local Self-Government, or of the European Charter of Regional Self-Government most recently. The aim of both the documents should be to harmonize the rules and regulations of the status of municipalities in participating countries, while the main characteristic is to strengthen their autonomy and independence of the central government.3

After the collapse of the non-democratic regime in Czechoslovakia in 1989, there were several changes to the system. Politicians were facing a complex problem of constituting a new model of public administration. There was a decision adopted in favor of dual model, and it was, therefore, inevitable to constitute territorial self-government and its authorities, in addition to local government authorities. This happened in 1990 by adoption of the Act of SNC No. 369/1990 of Law Code On Municipal Organization. Under the conditions set, this law allowed municipalities of the Slovak Republic to manage their assets and financial resources on their own. The Act on Municipal Organization defines self-government and its authorities as being significantly autonomous and independent, but it is just the economic situation of towns and municipalities which appears to create a real threat to the independence.

On the current issues in local government finance

Inconsistency of the Acts No. 523/2004 Coll. and 583/2004 Coll.4 The discrepancy is mainly a result of budgeting of the so-called competency financing conferred on territorial self-government, of the fact into what extent municipalities cannot even estimate the budget, and what the amount of financial resources is that they are going to receive for, at least, frequent expenses.

Competency disputes in relation to financing the so-called local communications (roads of the 3rd and 4th class), the Act on HTU5 enables for the tax on motor vehicles to be used for other expenses, such as road maintenance.

II. Relationship between the state budget and local budgets in the Slovak Republic

Dominance of the central government is, in connection with an analysis of position of self-government in Slovakia, confirmed by the fact that the fundamental relations

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3 Ibid.
5 Self-Government of Higher Territorial Units.
between the state budget and local budgets are annually defined by the law on state budget. Thus, self-government authorities are not only not charged to decide on their income, but they are also officially acquainted with the decision of the central government authorities as late as after approval of government budget proposal by the National Council of SR, thus, by the end of the calendar year the earliest. In principle, there are two basic areas of specification of revenue to self-government:

- amount and distribution of state budget subsidies,
- share in central taxes and method of their allocation to municipalities.

One of the indicators of the status of municipalities in the country is the indication of the share in budget revenue of local self-government and central state budget.

III. Proposals to adjust funding

There has been an economic analysis prepared at the request and according to the comments of the Association of Towns and Villages, which includes a large comprehensive treatment of public funding, which already considers the level of regional self-government by defining its functions. Basically, this theoretical reform is based on the following fundamental principles:

- of increased financial responsibility local and regional self-government authorities in order to prevent their excessive indebtedness endangering their autonomy,
- of increasing transparency of public expenditure to reduce administrative burden and to enable a better control of administrative actions in order to ensure compliance with the law and constitutional principles in accordance with the regulations of the European Charter of Local Self-Government,
- of standardization and evaluation of submissions of budget,
- of ensuring its own fiscal potential of municipalities, since this is the only possibility to reach their financial autonomy,
- of entire freedom of municipalities under law by setting fees and revenues for local public service,
- of ensuring elimination of excessive differences between the fixed rates, since these excessive differences may lead to distortion of competitiveness,
- in case of continuation of central management of cash flow, the repayment period must be monitored very precisely so as not to endanger financial solvency of local self-government and to avoid difficulties in cash flow.6

Interest in financially-legal regulation is annually increasing especially during the period of approval of state budget and municipal budgets. It is since a decision is then always adopted as to financial security of assets of a wide range of entities, and

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6 Ibid.
also as to requirements of the citizens, i.e. their satisfaction with providing for their needs and interests out of public resources accumulated out of their own contributions, as well, such as their taxes, fees and insurance premiums. This objective public interest in financially-legal regulation of a circuit of certain social relations also corresponds with the need of education in this field.

IV. Economic Crisis and Related Issues

Indications of economic recovery are still very fragile in the meantime. In the current situation, there is a large degree of insecurity with regard to the further development in global economy, length and intensity of the recession, and the recovery period is moving deeper and deeper into 2010. In relation to its structure, the Slovak economy is, nevertheless, dependent on recovery in external demand, which should be also contributed to by standard and non-standard measures of the European Central Bank (ECB). After Slovakia’s accession to euro zone, it is also representatives of the National Bank of Slovakia who participate in their decision making.

The crisis is not even avoiding municipalities. Several Slovak towns are getting to threats and collapse as a result of the economic crises and changes in legislation. Municipalities have already adopted money-saving measures where they can, but it is still insufficient. Not even the outlooks for the future appear to be satisfactory. Municipalities have started to use the fond reserves that had been created in recent years. The year seen to be of risk and troubles is 2010.

What next? Even further on, Slovakia continues to expect an increase in unemployment. The Club of Mayors of the Slovak Republic have drawn the attention to the fact that municipalities employ up to 180 000 people by means of various kinds of work ordered. If towns do not have money, they will not be able to afford to order great deal of work and activities, and also these people will remain unemployed. The club of mayors are of the opinion that the financial situation of the municipalities might be improved by a change of the regulations relating to allocation of money out of personal income tax – they would like up to 100 percent of this tax to be returned to municipal treasuries, while towns and municipalities would receive 75 percent, and the remaining 25 would be allocated to autonomous regions. Currently, 6,2 percent of the tax return is allocated to the state, towns and villages get 70,3 percent and regions 23,5 percent.

During the past years, this strong cash flow has helped municipalities finance the competencies conferred by the state and deal with their own development programs. This very November of 2008, the Finance Department of the Slovak Republic predicted an inter-annual increase of the tax collection by 18%. February prognosis of 2009, however, already predicts the tax collection to be lower than the November estimate of 7,5 %, and even this was a strongly optimistic prognosis.

The current development suggests that the situation is critical. On July 3, 2009, the Department of Finance of the Slovak Republic published a detailed prognosis relating to tax collection to the state budget, which includes a prediction of reduction of
taxes on personal income. The analysis implies that the original budget tax (in the total amount of EUR 1 398 015 000) is adjusted and constitutes only ca. 83.6% of the original budget. The question, even for them, however, remains if the tax is not even going to continue to decline below the level of 2008. In this case, even their budgets will have to be adjusted.

Shortfall of personal income tax is large. Recently, self-government in Slovakia has reduced the number of jobs by more than 25 thousand with that on one hand that municipalities save money, but they need help from the state, which should not have the form of one-time financial grant, but of taking systematic measures. Municipalities are willing to provide help for the Slovak economy that knows the solutions; they need legislative measures to be taken, though. One of the possibilities is that the state allows municipalities to take a higher loan. In addition to the changes in the law on local taxes, and on taxation of property, to be specific, municipalities come with the suggestion of introducing a new local charge into practice. This concerns a charge which would be invoked by investment by every large investor, e.g. by intervention in road infrastructure or housing, whereas a need will arise to build a school or a kindergarten. This charge would apply to specific things. Self-government authorities point out the inevitable step to continue with decentralization. The current crisis has also been caused by failure of central system and therefore, the more responsibility, powers and financial means municipalities will have, the more resistant the society will be to similar phenomena, such as the current economic problems. An active labor market policy must be directed towards achieving a higher efficiency of job search. This will require investment in the sphere of building and cooperation between public employment services, employment agencies and local self-government authorities. It will also be necessary to support cooperation between public employment services and companies. Similarly, it will be appropriate to invite other entities that could contribute to the development of programs considering the needs and ideas of employees and encourage them to remain in labor market. As to solving problems in labor market, social dialog should contribute more at the regional and sectoral level as well as the central level.

As an efficient thing to do may be to consider the introduction to practice of Public Private Partnership (PPP). This relates to a long-term cooperation in the sphere of financing projects in public and private sector by implementing projects in the public interest.

Furthermore, it may be pointed out that there are various other possibilities and ways how to help municipalities. Among them, there is also the possibility of applying in municipalities the amendment on budget rules of local self-government, which has enabled to use capital income for frequent expenses since March 1.

Economists generally agree that this does not represent a systemic solution, and that their effort would be to act pragmatically, i.e. “not to exploit capital resources”. Economic and accounting logic dictates that resources from the sale of assets shall serve primarily to acquire new or improve the existing capital. The situation, how-
ever, may be serious in the second half of the year, towns and municipalities may lack money for education or social affairs, and in this case, they will also have to use these resources.7

Table 1 Revenues and expenditure of municipal budget in SR (mil. SKK)

<table>
<thead>
<tr>
<th>Year</th>
<th>Tax revenue</th>
<th>Custom revenue</th>
<th>Subsidy</th>
<th>Total revenue</th>
<th>Frequent expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>10 569,4</td>
<td>21 026,0</td>
<td>1 745,4</td>
<td>28 785,5</td>
<td>15 198,8</td>
</tr>
<tr>
<td>1998</td>
<td>11 402,2</td>
<td>22 145,3</td>
<td>1 801,3</td>
<td>28 872,6</td>
<td>15 916,3</td>
</tr>
<tr>
<td>1999</td>
<td>11 608,5</td>
<td>20 818,4</td>
<td>1 786,0</td>
<td>27 343,5</td>
<td>16 777,0</td>
</tr>
<tr>
<td>2000</td>
<td>12 799,2</td>
<td>23 615,2</td>
<td>1 999,8</td>
<td>33 657,4</td>
<td>18 747,6</td>
</tr>
<tr>
<td>2001</td>
<td>13 992,3</td>
<td>25 214,3</td>
<td>2 270,0</td>
<td>37 718,1</td>
<td>19 873,3</td>
</tr>
<tr>
<td>2002</td>
<td>16 891,0</td>
<td>29 259,4</td>
<td>2 535,4</td>
<td>57 489,7</td>
<td>34 311,8</td>
</tr>
<tr>
<td>2003</td>
<td>17 798,4</td>
<td>31 023,8</td>
<td>8 178,8</td>
<td>70 323,4</td>
<td>49 648,8</td>
</tr>
<tr>
<td>2004</td>
<td>19 737,0</td>
<td>37 571,1</td>
<td>12 766,8</td>
<td>82 606,9</td>
<td>52 055,8</td>
</tr>
<tr>
<td>2005</td>
<td>36 453,2</td>
<td>57 126,3</td>
<td>19 056,1</td>
<td>106 643,6</td>
<td>56 103,5</td>
</tr>
<tr>
<td>2006</td>
<td>40 793,8</td>
<td>66 384,2</td>
<td>20 372,3</td>
<td>127 560,3</td>
<td>62 358,2</td>
</tr>
<tr>
<td>2007</td>
<td>43 444,2</td>
<td>63 436,0</td>
<td>21 308,1</td>
<td>128 188,3</td>
<td>66 172,6</td>
</tr>
</tbody>
</table>

Source: final state accounts for the years 1997 to 2007 DF SR

V. Conclusion

What can municipalities do if they want to extend their self-financing? Possible increasing of financial independence of municipalities and in this connection of their financial autonomy and extent of self-financing may be seen in these measures:

• of increasing the capital income of municipalities on basis of evaluation of its use by an appropriate property and land policy,

• of reducing frequent expenditure by rationalization of effort, e.g. by savings obtained by performance of some mutual public services with other entities, including other municipalities, by arranging for services with private sector, by creating public-private partnerships, by standardizing the costs, digitalized operations etc,

• of increasing taxation power of municipalities.8

Another possibility is, according to the Club of Mayors, an amendment to the budget rules. They are, primarily, going to look for solutions that would not want cash. These solutions rather consist in a change of rules enabling a future increase in

7 VEVERKOVÁ (2009).
8 ŽÁRSKA (2009).
revenues to regional treasuries. For example, towns could be given competence to relieve investors the immovable property tax payment at the start of their business. The situation is really serious and therefore, let us consider possible solutions. The economic slump causes extensive deepening of public finance deficit. And this may be, in principle, dealt with in the following ways:

• by drastic savings in public and state administration and self-government,
• by simple shifting income shortfall (especially that of tax revenue) and increase of expenditure (mainly obligatory arising as a result of new 50 up to 80 thousand unemployed) into the increase of public finance deficit,
• by combining both the above mentioned ways,
• by establishing a focal point of public procurement, whose task would be to implement procurement through electronic on-line exchanges. Again, no speculative construction. In practice, such a model of procurement has successfully worked even in conditions of Slovakian municipal sector. It has been successfully implemented by some towns.

In conclusion, the opinion of SCCI may only be agreed with. In order to increase the economic power of the country, SCCI recommends:

• to improve the budget discipline and responsibility of individual regions and other levels of government at the level of SR government and municipalities,
• to prevent violations of the law on state budget or passive response to fundamental changes in the field of budget revenue,
• to ensure the declared improved efficiency of government (to merge government departments, dissolve unnecessary state and public administrative institutions (e.g. NPF SR)),
• to ensure permanent reduce of costs at the level of government, but also municipalities,
• to follow up and ensure an effective development of public finance deficit continually even during the year,
• to prevent manipulation and corruption in the field of public procurement of state and public administration and self-government, to require an immediate personnel and even criminal sanction for violation of principles of benefits for procurers, to reinforce the controlling power of the Office of Public Procurement and to require its active operation consistently,
• to establish order in public procurement as a priority, to resolutely suppress enforcement of lobbying interests within the framework of the current legislation, in case of need even by amending the Public Procurement Act, specifically in the following fields of:
  • preference of producers to mediators,
  • quality assurance of supply,
• elimination of discrimination in the interests,
• removal of distortions in the process of evaluation and comparison of competitive tenders,
• substantial reduce of the use of time urgency by competitive bidding invitations, especially in the field of force majeure (wars, strikes, earthquakes and natural disasters),
• consistent verifying the credibility of the participants of public procurement to prevent participation in competitions of uncreditable persons, respectively those with unclear ownership structure,
• providing central procurement for all government departments and other agencies of state government and institutions for public administration,
• review of the activity of the Office of Public Procurement in order to improve its control activities, including the possibility of inferring responsibility in violation of public procurement rules.9

If we let us settle by the fact that growing public debt also relates to some other countries, this will only continue to the moment when the costs of servicing public debt become unbearable for Slovakia, i.e. when the current performance of the Slovak economy is not financeable any more. And so it will happen that the actual public debt will prevent “post-crisis” of economic growth. The costs of servicing public debt will absorb substantial economic resources that there will be a lack of for financing development of fiscal impulses. At 6% down public finance deficit in 2009 budget, we will lack approximately 4 billion Euros.

References

Act No. 583/2004 Coll. on Budgetary Rules of the Territorial Self-Government and on amendment and supplementation of certain acts as amended (Zákon č. 583/2004 Z.z. o rozpočtových pravidlách územnej samosprávy a o zmene a doplnení niektorých zákonov v znení neskorších predpisov).

9 TRANČÍK; VLČKO a kol. (2009).

