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Facultad Experimental de Ciencias
Departamento de Ciencias Humanas
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Institutional transformation of the financial basis of the local self-government

Serhii V. Boldyriev

The department of State Construction, Yaroslav Mudryi National Law
University, Kharkiv, Ukraine
sv.Boldyriev@ya.ru

Tatyana V. Steshenko

The department of State Construction, Yaroslav Mudryi National Law
University, Kharkiv, Ukraine
tv.Steshenko@ya.ru

Oleksandr O. Frolov

The department of State Construction, Yaroslav Mudryi National Law
University, Kharkiv, Ukraine
oo.Frolov@ya.ru

Anton S. Chyrkin

The department of State Construction, Yaroslav Mudryi National Law
University, Kharkiv, Ukraine.
as.chyrkin@ya.ru

Sergey S. Shestopal

Law Department, Vladivostok State University of Economics and
Service, Vladivostok, Russia
ss.shestopal@ya.ru

Abstract

The study investigates the institutional transformation of financial basis of the local self-government in the Czech Republic, Hungary and Poland via comparative qualitative research methods. As a result, the Czech Republic also failed to avoid a downturn, but since 2010, the economy has started to grow and, consequently, there has been an increase in GDP at 1%. In conclusion, local and regional development must be supported by planned finances, rather than by the financing of individual projects, specifically, financial instruments, the

structure and flexibility of which is consistent with the objectives of the integrated program of development of local self-government.

Keywords: Economic, Reforms, Financial, Basis, Government.

Transformación institucional de la base financiera del autogobierno local

Resumen

El estudio investiga la transformación institucional de la base financiera del autogobierno local en la República Checa, Hungría y Polonia a través de métodos comparativos de investigación cualitativa. Como resultado, la República Checa tampoco pudo evitar una recesión, pero desde 2010, la economía ha comenzado a crecer y, en consecuencia, ha habido un aumento del PIB del 1%. En conclusión, el desarrollo local y regional debe ser apoyado por las finanzas planificadas, en lugar de por el financiamiento de proyectos individuales, específicamente, instrumentos financieros, cuya estructura y flexibilidad es consistente con los objetivos del programa integrado de desarrollo del autogobierno local.

Palabras clave: Económicas, Reformas, Financieras, Bases, Gobierno.

1. INTRODUCTION

Initiated in the post-socialist countries of Central and Eastern Europe in the 1990s of the twentieth century the reforms of public administration were determined by the strategic goals of overcoming centralization of power, building a democratic society and ensuring a political course towards the European integration. The main directions of the relevant transformations were decentralization of public

authorities, deprivation of a strong hand of the state power over local self-government, building civil society. It ensures citizens' participation in public administration, limiting state interference in local affairs, creating a stable and transparent system for allocating national funds to local budgets, creating a developed model of regional governance in accordance with the EU requirements and implementation of the European standards of local self-government.

The purpose of the first stages (1990-1995) of the reform of public power was to build a strong base of local self-government, and provide it with financial resources to implement its own powers. The next steps were the administrative and territorial reforms (1995-2001), the purpose of which was to build a strong regional government with proper funding. During the relevant changes, the topical issues were insufficient financing of the local self-government and the problem of redistribution of funds between levels of public administration. The problem of filling the local budgets and state support for local government was sharply raised.

Poland is one of the Central and Eastern European countries with the transitional economy, which has achieved the greatest success in overcoming inflation and conducting a successful macroeconomic policy in the transformational period. The period of combating inflation in Poland can be divided into three parts: 1) the first stabilization programs in the early 90's (1990-1993); 2) the stage of controlling the offer of money and the exchange rate in conjunction

with the market instruments (1993-1998) (NAGAHISARCHOGHAEI ET AL., 2018). 3) the period of direct targeting of inflation (1998-2005). As N. Karlin points out, each of the three periods had its own inflation strategies, as well as its monetary policy goals and tools, and certain success in this process.

At each stage of the reform of the local self-government in Poland, much attention was paid to the issue of deepening the financial autonomy of the gminas. The implementation of the aforementioned reform of the administrative-territorial system and budget decentralization significantly promoted the affirmation of their independence.

Coordination of financial regulation issues was crucial for determining the boundaries of transformation at the local level. After structural and regulatory reform, financial reform was implemented, which resulted in the local government obtaining property and other sources of funding that ensured the existence of real power of these bodies, their economic independence, along with the ability to independently dispose of their available resources. Local governments gained the right to collect their own taxes, although this did not completely reduce their dependence on the center. The bulk of the financial resources of the local self-government bodies came from the state budget with a clear indication of their use. The share of tax revenues remaining at the local level, starting from 1990 was gradually decreasing and in 2001 it was only 5%. At the same time, almost one-

third of the local government bodies needed additional resources to fulfill the list of obligations increasing locally as a result of decentralization.

After 1990, the local authorities gained the right to own and dispose of property they inherited from the previous regime, in particular, their main assets were former state factories and enterprises. After the introduction of local privatization and depletion of commodity assets, the local authorities began to search for additional sources of funding.

2. METHODOLOGY

The Czech Republic is probably in the first place in the world in terms of the number of reforms of the local government financing system, begun since the destruction of the socialist camp in 1989. This creates many problems for the local development, as the instability of the financial system hinders not only daily management, but also the investment projects, not to mention the implementation of multi-year development strategies. According to the Polish expert in local finances BLAZEK (1999), the instability of the financing system of the local authorities also hinders cooperation with other organizations (BIRD & WALLICH, 1994).

After the fall of communism in 1989, the restoration of local financial autonomy became an important component of building a new democratic system at the local level. However, the problem of providing at least some financial autonomy to municipalities appeared to be particularly difficult to deal with. The structure of the system of financing of the Czech local self-government bodies can be described as if created by the method of tries and errors. The main causes of instability of local financing are: 1) significant horizontal fragmentation of the municipalities; 2) change of authority of the bodies; 3) reforms of administration at the regional level; 4) the inability to effectively reach the correct balance between the principle of solidarity and the principle of meritocracy (BLAZEK, 1994).

Between 1990 and 2001, at least four different approaches to reforming the financial system of local self-government were used in the Czech Republic. In 1990-1992, it was the first period. Due to the general lack of confidence in the centralized redistribution of resources, the newly elected local representatives made strong pressure on the central government, decentralizing a part of the tax revenues to local authorities (BLAZEK, 2002; TEJEDA & DOMINGUEZ, 2019).

The second period was during the years 1993-1995. In 1993, within the framework of the general tax reform, a radical reform of the financing of local authorities was carried out in order to increase the share of income within the jurisdiction of local authorities. The core of the reform was the decentralization of income from taxes on personal

incomes to local authorities. Accordingly, government subsidies were reduced. This reform led to significant disparities between the districts, and especially between the collection of taxes on personal income in municipalities because of significant differences in their tax bases. The system was quite complex, an important feature of which was a strong mechanism of equalization that operated in municipalities in certain districts, but it was envisaged that the state would finance the district level. On the other hand, the mechanism of equalization in areas with relatively small subsidies was insufficient and amounted to 2% of the total volume of local self-government revenues (JOURMARD, 2003).

The tax reform of 1993 laid the foundations for the further development of the municipal finance of the Czech Republic. Law No. 576/1990 On the Budget System provided for the following types of income that are directly received by the municipalities: revenues from communal property, enterprises and financial assets, real estate tax, the split of citizens' income tax, the share of income from the income tax on entrepreneurs who placed their enterprises on the territory of municipalities. In addition, municipalities obtained the right to receive administrative payments, credits and loans, subsidies from the state budget and state funds, subsidies from district state administrations.

The third period was during the years 1996-2000. This period began with the reforms in 1996 and lasted until December 2000. The reason for this reform by the Ministry of Finance was three factors. Firstly, revenues allocated to the local authorities grew faster than

revenues from the state budget. As a result, the share of the state budget shrinks while incomes remain unchanged. Secondly, there were significant distortions in the districts and even large imbalances in personal income taxes in the municipalities due to the features of the local economy (DEVAS, 1995). The central government noticed the differences that are incompatible with its purpose to guarantee the provision of the same level of public services in the whole territory of the state. In addition, the differences were considered unfair, as the local authorities had only limited rights to set the tax rate on property taxes, and they had no right to set the tax rate higher than the taxes on personal incomes. Thus, the municipalities could only affect their tax revenues to a small extent. Thirdly, the government was intended to encourage municipalities to more actively promote economic activity in their territories. The main element of the 1996 reform was the replacement of 40% of the revenue from the fast-growing tax on income from the population by 20% of the stagnation of income tax on entrepreneurs. At the same time, the criteria for distributing both of these taxes between the municipalities were changed to strengthen the national equalization mechanism. The influence of the system introduced in 1996 was multidimensional. Most of all, large cities were losing, but the smallest municipalities also were losing the same. At the same time, the size of the inequality among the districts in the calculation of tax revenues in 1996 declined, but then began, though less rapidly than before, but to grow again.

As a part of the reform of public administration and public finances, the cash flows of self-governing units were substantially changed. Legislation on own revenues of the territorial self-government established the following laws: Law No. 218/2000 On Budget Rules, Law No. 243/2000 On Budget Tax Distribution and Law No. 250/2000 On Budgetary Rules of Territorial Units. The forms of financial assistance were defined by Law No. 248/2000 On Support for Regional Development (JENNIFER, 2003).

During the early 2000s, the fourth wave of local finance reforms was introduced in the Czech Republic. In connection with the general disagreement with the previous model, the government again prepared a financial reform, which came into force in January 2001. This reform was characterized by systemic changes in the formation of the local budgets. The decentralization of power and redistribution of powers between the center and the regions was accompanied by a purposeful redistribution of finance. The reform covered 14 regions, but later the government decided to postpone the definition of regional incomes for one year more and temporarily finance them in 2001 by subsidies. According to the government data, the basis of the new system should be the elimination of acute and unjustified differences in the distribution of tax revenues, which municipalities will not have the right to influence. As a result, the new system is fully adhering to the principle of solidarity and relies on the equal distribution of income from personal taxes based on the per capita tax principle (CHYRKIN, 2019).

The reward for the municipalities that actively support business in their territory is the proposal of one of the deputies made during the discussion of this issue in Parliament. He proposes that municipalities receive a 30% share of income from income tax paid by entrepreneurs who are permanently resident in the city. Consequently, only 70% of income from this tax is subject to redistribution at the central level, where the share allocated to local authorities (i.e. 20.59%) is redistributed among the municipalities. This measure, obviously, is not a systemic solution, but only a temporary condition for ensuring at least some of the actions by the principle of meritocracy and certain incentives for encouraging local authorities to create favorable conditions for the employment of local people and local enterprises.

In January 2002, a fixed portion of tax revenues was fixed to the regions, which increased their resource base and made them more independent in resolving local issues. By mid-2002, a number of laws were adopted on the transfer of competences, ownership and personnel from district administrations to regions and municipalities. The expansion of the rights of the regions, the transfer of their social assets, primarily education and health care systems, to their balance in 2003-2004 was supported by the directing of funds flows from the state to local budgets, expansion of the base of filling the regional and local budgets.

Despite the fact that municipalities receive about 60% of their own sources of income, they are forced to spend is according to the

directions from the center. 75% of their income is intended to finance districts and make obligatory expenditures and only 25% is intended for those directly identified by the municipalities. There is also a big gap between the expenditure needs and the actual revenues of the municipalities. The manifestation of this is a rather significant vertical imbalance: the share of local government in the total revenues of the public administration sector is much less than in expenditures. This is due, in particular, to the fact that the legislative requirements are more suitable for large municipalities (FABIAN, 2017).

The reform led to a reduction in the share of state subsidies in the budgets of the local government and an increase in the role of tax splits. Local governments have considerable freedom in spending, but insignificant in income. This hindered the implementation of the decentralization process. After the entry of the Czech Republic into the EU (31.05.2004), changes to the tax system of the country conformed to the EU standards. This led to an increase in some taxes and fees, especially indirect taxes. Also, due to the entry of the Czech Republic into the EU, one of the main sources of the local budget revenues came from the structural and specialized funds of the EU.

3. RESULT

As a result of the changes made and the accession to the EU, the Council of Europe report for 2005 Transitional States informs that

over the past few years, the system of local self-government in the Czech Republic improved considerably, especially at the regional level. The regions made significant progress in deciding issues that were ignored by the central government, including education and health care.

The success of regional governance and greater autonomy enabled regional governments to make better use of their own resources. Currently, they control about 14% of their budgets, with the rest of the regional government acting as a representative of the state, directing funds to identified recipients. This means that a number of important regional initiatives cannot be realized due to lack of funds. The project is being discussed, which will increase the share of regions in the budget by 50%. The regions can keep only a small part of the collected taxes - 3%, while the new bill proposes to increase this figure five times.

The rules of financial management for the territorial self-government gradually stabilized. However, in the regions, taking into account the shortness of their existence, the principles of financing have not yet completely stabilized. Here we can expect relatively significant changes in the structure of their resources, in which tax revenues will play a more important role, thereby replacing the subsidies. Legislation regulating the financial management of municipalities was changed in 2008, increasing their financial autonomy. Municipal tax revenues are geographically tied to this municipality and consist of two taxes: property tax and corporate profit

tax. In 2005-2008, there was a slight increase in tax revenues in regional budgets, the system of taxation of small businesses was simplified.

Fiscal taxes are tax revenues from value-added tax, income tax and personal income tax. The criterion for allocating these taxes is the same: the state budget receives 69.68%, 8.92% goes to the provinces and 21.4% to the municipalities. The amount for each municipality is determined by its share in the national tax revenues in the conditions of this size category of the municipality and the number of inhabitants, the total population of the municipality and the cadastral zone of the municipal entity. The systems of fiscal distribution of taxes between the municipalities and the state, due to the fact that the tax revenues of the municipality include the most favorable tax revenues, lead to a relatively narrow parallel development of the tax revenue of the municipalities and the state.

A specific and important issue for the budgets of most municipalities is the method of financing delegated powers carried out by the municipalities. These authorities are delegated to the municipalities to varying degrees, depending on the type of municipality (I, II, III) and are mainly related to activities such as construction and registration. Today, the funding system for delegated powers is based on the use of exclusive forms of subsidies for the municipalities, conditioned by the type of activity and the number of population for whom the service is provided. However, the problem of objectification of the size of subsidies for this activity remains, since it

is necessary that subsidies not only promote, but fully cover the stated activity.

The 2008-2009 global crisis forced the government to partly limit government spending and the size of investment programs targeted at the local level. The Czech Republic also failed to avoid a downturn, but since 2010, the economy has started to grow and, as a result, there has been an increase in GDP at 1%. According to representatives of the Congress of Local and Regional Authorities, based on the report of the financial institution Dexia from 2011 the Czech Republic is among those EU countries where incomes of local self-government have increased at least as much as the country's GDP. It should be noted that in 2009 there was a decrease in taxes and duties divided by local authorities by 12%, followed by a slight improvement in 2010. At the same time, the Congress of Local and Regional Authorities continues to emphasize that the funding system in the Czech Republic remains unnecessarily centralized, and although the permanent financing of delegated tasks is invariably provided, the creation of a financial system in which local and regional authorities would be independent in determining local tax rates remains on the agenda.

4. CONCLUSION

During the 1990s and early 2000s, in spite of the resistance of adherents of the old nomenclature, radical changes in the organization

of public power took place in Poland, Hungary, and the Czech Republic. Corresponding transformations have touched on the financial system of local self-government. The countries under study completely rebuilt the economic basis of local self-government from central to decentralized, which made local self-government more independent from financial support from the state. The sources of local budget revenues and expenditures aimed at meeting local needs were clearly defined. Fiscal decentralization allowed the local public authorities in Poland, Hungary and the Czech Republic to fill the local budgets at the expense of their own income and thus, to solve local issues.

In the countries under study, in recent years, there has been a tendency to increase the tax potential of the territories, to increase the tax base and to increase the efficiency of their administering as the main source of budgetary resources of the local self-government bodies.

It is worth noting the experience of Poland, where, with the help of clear legislative consolidation of the sources of filling each budget, they are not in words, but in fact consolidated the principle of tax splitting, and now any city or village head knows that 40% of all personal incomes, 7% the income of all legal entities, 100% of the land tax is automatically kept at the local level, 15% of income is concentrated at the district level, 40% - at the regional level, and the rest goes to the state treasury. It is clear that under such conditions,

local self-government bodies are as much as possible interested in the migration of the population to their territorial communities, construction of enterprises, creation of investment sites, complexes, on which it is possible to release business completely for three years from taxation. Creating the most favorable conditions for people and businesses is the most important point of the development strategies of all local communities in Poland. Local governments in Poland have sufficient rights and budgetary resources and are able to influence the improvement of the quality of provision of public goods and services to the population.

Local and regional development must be supported by planned finances, rather than by the financing of individual projects, that is, financial instruments, the structure and flexibility of which is consistent with the objectives of the integrated program of development of local self-government. Funding for local self-government should be based on legal mechanisms, and should be flexible. Basing the decisions on finance on a legal basis promotes transparency and accountability, and flexibility is also needed in certain situations.

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