



THE ANALYSIS OF FINANCE SYSTEM OF LITHUANIAN LOCAL AUTHORITIES

Gediminas DAVULIS

Mykolas Romeris University
Ateities st. 20, LT-08303 Vilnius, Lithuania
E-mail: geddav@mruni.lt

Abstract. Realization of fiscal decentralization in the public economic sector of Lithuania and its correspondence to the principles of the European Charter of Local Self-Government are considered.

The principles and order of the structure of local authorities budgets, the significance of local authorities non-budgetary funds and their development in Lithuania are discussed. Municipal revenues, their structure and sources are described. Dynamics of local authorities budget revenues and expenses and their main components is analysed in the period of 1999-2005. The model of equalizing financial resources between Lithuanian local authorities as well as borrowing opportunities are discussed. The principle of programme budget is successfully realized in both on the state and local authorities level in Lithuania. The analyses of structure of local authorities budgeted revenues and expenses showed that principle of fiscal decentralization are not realized enough in the public sector of Lithuania. Structure of expenses of local authorities budgets is similar to that of countries of European Union. However the share of subsidies of state budget in the revenues of municipal budgets is too large. The borrowing opportunities of municipalities are not sufficient, too. These factors limit the financial independence of local authorities in Lithuania.

JEL classification G280, O310.

Keywords: finance of local authorities, fiscal decentralization, budgets of local authorities, non- budgetary funds.

Reikšminiai žodžiai: savivaldybių finansai, fiskalinė decentralizacija, nebiudžetinės lėšos.

Introduction

Development of democratic principles in European countries also stimulates decentralization processes in the sphere of state control by delegating ever greater part of public affairs management to local government institutions and enhancing thereby their significance in state control. The European Charter of Local Self-Government (1985) states that local government institutions make a basis for any democratic system. The fundamental principle of democracy is the right of citizens to participate in the management of public affairs and it can be put into practice most efficiently through local government institutions.

Local government means that local authorities, within the limits established by law, have the

right and capability to manage and control a part of public affairs in the interests of local population, taking the whole responsibility. Local authorities have the right to accomplish the functions delegated by central or regional authorities, at their own discretion and taking into consideration local conditions. These statements also refer to the economic sphere and their realization would allow an increase in the economic effectiveness of local government (Stiglitz, 2000; Fiscal Federalism and State-Local Finance, 1998).

The decentralization process, based on the mentioned principles, in the economic sphere takes the shape of the so-called fiscal decentralization. The fiscal decentralization is conceived as enhancement of financial independence of local authorities, by delimiting the functions of the local and central authorities in the public economic

sector, and by allocating appropriately financial resources to pursue these functions. The economic foundation of such decentralization is enhancement of the efficiency of the public economic sector. A centralized supply of standard goods disregarding a specific character of individual regions of a country and a variety of the needs of social groups conditions its inadequacy to the needs of society. In this case, decentralization of the public sector will stimulate economic efficiency by establishing more favorable conditions to supply public goods such that meet the consumers' needs best.

Thus, the economy of the public sector should be based on the following principle. These public goods in terms of which there is no distinct social differentiation, i.e., that is equally indispensable for the whole population of a country and in the production of which the scale economy effect widely manifests itself, should be supplied centrally. Meanwhile the public goods which expresses differentiated needs, i.e., is of benefit only to the local community, should be supplied on the local scale. Realization of this principle would allow a rational distribution of functions and appropriate financial resources among separate control levels and would ensure efficient functioning of the public economic sector.

The concept of fiscal decentralization, based on delimitation of the competence of central and local authorities, also influences an adequate public finance structure, in which each control level should have sufficient income sources to put into reality the functions assigned to it. This financial structure provides the ascription of tax sources and financial subsidies to local budgets as well as a borrowing opportunity to local authorities.

The distribution of taxes between central and local authorities levels is grounded by the fact that granting the power of the whole or a major part of taxation to the government is not effective, because fiscal independence and responsibility of local authorities is limited. In the European Charter of Local Self-Government it is indicated that local authorities (should) get at least a part of financial resources from local taxes and levies. On the other hand, granting of too much autonomy to local authorities may also be unacceptable in terms of macroeconomic stability and effective distribution of social resources.

1. The principle of fiscal decentralization and its realization in the public sector of Lithuanian's economics

At the present time there are 60 local government institutions in Lithuania whose self-gov-

erning right is secured by the Constitution and other laws of the Republic of Lithuania (LR). Despite that the political and administrative mechanism is decentralized in Lithuania, it is decentralization of public finances (fiscal decentralization) that raises some problems. Meanwhile the real self-government will be attained only in case an adequate decentralization has been realized in all other spheres, including the financial sphere. Actually, a self-governing institution is independent as much as it can freely dispose of the available financial resources. Based on decentralization principles of the political and administrative system of the country, the competence and functions of state and local government institutions have been delimited, however, these functions were redistributed and corrected more than once.

In the law on local government valid at present in LR (2000), local authority functions are strictly defined and according to decision making freedom they are divided into: independent, ascribed (insufficiently independent), state (relegated by state to municipalities for execution), and conventional. The first three are most important in terms of financial analysis. To perform the functions of local government, respective financial resources are necessary by which it could dispose to a higher or lower degree of independence, dependent on the group of functions performed. The LR laws on budget structure (2004) and on local government (2000) define their financial resources that could be split into tax and non-tax income and state budget subsidies. Local authorities may also use bank credits, take and give loans in the order established by law. All the financial resources of local authorities are counted up in local authority budgets that according to the LR Constitution and the budget structure law are independent, as well as in non-budgetary funds. The main municipal means are accumulated in local authority budget, whereas only a small share of them falls on non-budgetary funds. The origin of non-budgetary funds is related with the aspiration of local government to freely dispose of additional income not including it into the budget. Lately, however, the number and significance of non-budgetary funds are decreasing by consolidating them with the municipal budget and intensifying their check up. Utilization of non-budgetary means is usually not discussed by the common council, therefore their status is questionable.

The means accumulated in local government budgets may not be assigned to the purposes other than that ascribed by laws, to realize their functions and execute projects. Independent municipi-

pal functions are financed at most by tax-and non-tax income of local government. Execution of state and a part of ascribed functions as well as projects of the Seimas and Government are financed by state budget grants of special purpose.

In view of the fact that the European Charter of Local Government declares the right for local authorities to set up associations that advocate their interests, in 1995 the Association of Lithuanian local authorities was founded. This association encompasses all the 60 local authorities of Lithuania. The practice corroborated that the activity of the Association of Lithuanian local authorities had a positive influence on consolidation of the financial situation of Lithuanian local authorities.

2. Budgets of local authorities and the principles of their formation

The National budget of the Republic of Lithuania is comprised of the state budget and of independent budgets of local authorities. The latter have to be balanced. Lithuanian legal acts set the following kinds of budget receipts for local authorities:

- tax revenue comprised of taxes assigned to local authorities and part of common taxes set by law,
- non-tax revenue received from the property of a local authority, local levies, fines, and other non-tax sources,
- grants of the state budget, allotted for equalizing the differences of income and expenditure among local authorities and for performing the functions relegated by state.

The first two kinds of income can be relatively called as the own income of local authorities, while the third one is the sum of funds favoured by state, the unutilized balance of which is to be returned to the state budget at the end of a year. The own resources of Lithuanian local authorities do not quite correspond to their conception. In the optimal case, the own resources are that the raising of which completely depends on the decisions of local government, other than in foreign local authorities actually there are no such resources in the budgets of Lithuanian local authorities. Lithuanian authorities have limited possibilities to control this kind of resources.

The practice, that the state budget funds, unutilized by local authorities, are to be returned back to the state budget at the end of a year, has its own drawbacks. Such a practice compels local authorities to spend all the money remitted to them from the state budget, because at the end of a budgetary year the unutilized part of it will

be inevitably lost. This kind of expenditure of local authorities is not always economically reasonable. Presumably it would be more reasonable to leave the untapped state budget funds for local authorities if they plan to use them rationally.

As mentioned above, budgets of local authorities have to be formed without deficit, i.e., expenditure should not exceed revenues. In spite of the fact what part of budget income is its own, each local authority is under an obligation, set by law, to undertake functions committed to them. Appropriations for local authorities can be used only to carry out the state functions devolved by law to local authorities as well as to pursue the programmes approved of the common councils.

In case a local authority fails to balance its budget, according to the order set by the Government, (Decision No. 110 of LR Government, 2001) it can raise short-term and long-term inside or foreign credits. These loans may not exceed the norms set by law. The loans are permissible only in line with the decision of the common council and only in the case there is a lack of funds for:

- financing investment projects of a local authority (long-term loans),
- covering temporary shortage of money if the current asset is insufficient (short-term loans).

The general borrowing limits set by law for local authorities are as follows: for municipalities of large cities - Vilnius and Kaunas - 50%, and for the rest ones – 35% of the own budgetary resources approved of a local authority for the current year. The limit to finance investment projects is 3% of the same income set on proposal of the Association of Lithuanian local authorities since January 1, 2005. The Seimas of Lithuania has increased borrowing opportunities for smaller local authorities. The borrowing limits for local authorities which pursue investment projects financed from the EU resources were increased from 3% to 6%. This privilege was not granted to Kaunas and Vilnius municipalities, because their financial conditions are better as compared with the others.

The process of designing budgets of local authorities is rather complicated and it is regulated by some legal acts, e.g., (The law of the budget structure of LR, 2004; The law of the methods for determining local authority budgeted income, 2001; Decision No. 543 of LR Government, 2001). The draft budget is prepared by executive institutions of local authorities, i.e. by administration managers of local authorities. One of the main legal acts on the basis of which the budget of a local authority is formed is the Law on the budget structure of LR. It says that “draft budgets

are prepared by executive institutions of local authorities based on the budget structure and other laws and financial indicators of local authority budgets approved of the Seimas, on State statistics data, social and economic programmes, and on the programmes and draft estimates of budget appropriation managers of local authorities.”

Though the Seimas approves the state and local authorities budgets only for the current year, the state draft budget is designed for three years. This order of the budget structure ensures the succession of realization of the state strategy purposes. The state and local authorities budgets are based on the programmed principle as budgetary financing is allotted for pursuing the projects approved. The Ministry of Finance of LR prepares and coordinates the state budget. The Rules for the state and local authorities budget structure and execution (Decision No. 543 of LR Government, 2001) define that the Ministry of Finance provides macroeconomic and fiscal prognoses on the basis of which the Government confirms preliminary indicators of the National budget for three years. At the same time the maximal sum of appropriation from the state budget for 3 years is determined with regard to which the local authorities can plan their own budget.

On the other hand, in designing their draft budgets, the local authorities must observe the financial indices for local authorities budgets for a particular year approved of the Seimas. According to the law on the state budget structure, the Government must submit a draft of financial indicators for a particular year no later than 75 days before the end of the budgetary year. In turn, the Seimas has to approve it in two weeks before the end of the budgetary year. The same law states that the common councils of local authorities have to confirm their budgets no later than in two months after approving financial indicators of the state and local authorities budgets. Thus, rather strict time limits are set for local authorities to adjust and coordinate financial indicators of their budgets with that approved of the Seimas. If a local authority fails to confirm its budget before the end of the budgetary year, then at the end of the next year its activities are limited and it is permitted only to pursue successive obligations and to cover debts. However, the such of resources allotted for that cannot exceed 1/12 of the last year's budget. Thus, through no fault of a local authority, because a fortnight is too short a period to adjust the financial funds of a local authority but also excusion of their functions can be limited.

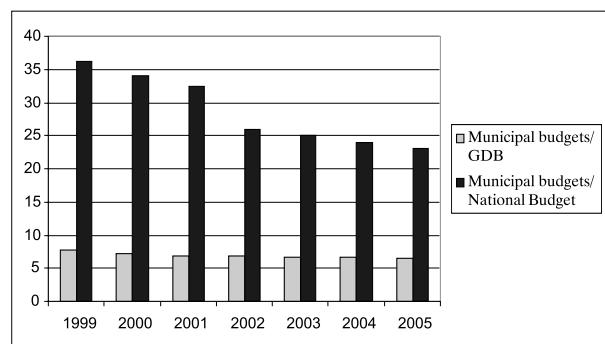
Following the requirements of the law, a local authority has to submit to the Ministry of fi-

nance not only approved budgets, but also the estimate of the privatization fund.

3. Estimation of the level of finance system decentralization of the country

When analyzing the financial system of local authorities, it is important to establish what is the level of finance system decentralization of the country. The level of fiscal decentralization of the finance system characterizes the independence degree of local authorities. The main decentralization criteria are the share of expenditure of local authorities in the gross domestic product (GDP) and in the national budget. Variation of both these indices, expressed by percents, in the period of 1999-2004 is illustrated in Chart 1. The share of local authorities expenditure in the national budget was constantly diminishing (in 1999, it exceeded 35%, while in 2004, it didn't reach 25%). However, this index is rather high and testifies a high degree of fiscal decentralization. The share of local authorities in the GDP was also diminishing, though slightly, i.e., from 7.6% in 1999, up to 6.2% in 2004. Opposite to the first index, this index shows a low level of fiscal decentralization in the finance system of the country.

Chart 1. Ratio of Expenditures of Municipal Budgets with GDP and with Expenditures of the National Budget (%) in 1999–2005



Source: [Data of the Ministry of Finance of the Republic of Lithuania].

Thus, the ratio of expenditure of municipal budgets with that of the national budget illustrates a high level of decentralization that can be reached in the countries of real self-government. Meanwhile the other index shows a great financial dependence of local authorities on the central authorities. This virtual contradiction can be elucidated by analyzing the revenues of local authorities budgets. The structure of revenues of local authorities budgets, i.e., the ratio between the state budget grants and their own revenues,

also reflects the financial independence level of local authorities. The analysis follows in the next section.

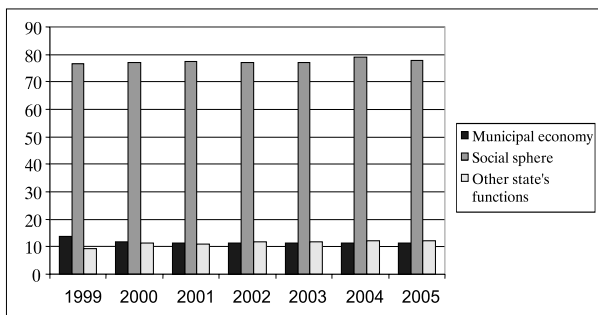
4. Expenditure and revenue analysis of local authorities budgets

The dynamics of local authorities budget expenditure in the period of 1999-2004 according to rough indicators is shown in Chart 2.

According to the provided data it is obvious that the largest share of municipal financial means is allocated to the social sphere. During 1999-2004, about 80% of municipal budget expenditures were allocated for socio-cultural institutions and measures thereof. The biggest share of financial means allotted for the social sphere is allocated for education. This tendency corresponds to tendencies other countries of EU. Less expenditure was allocated for other spheres and municipal economy and its shares in municipal budgets are rather constant.

All the three kinds of income-tax income: non-tax income, and subsidies – in local government budgets have a different comparative weight. Tax income and subsidies comprise the largest share of municipal budget income. Meanwhile non-tax income, which can be mostly influenced by local authorities, comprises but an insignificant share of all the income of local authorities and its significance is not great. Up till 2002, the largest share of municipal income was comprised of tax income which in 1999 totaled about 94% of the total budget income of local authorities.

Chart 2. Expenditures of Municipal Budgets (%) in 1999–2005

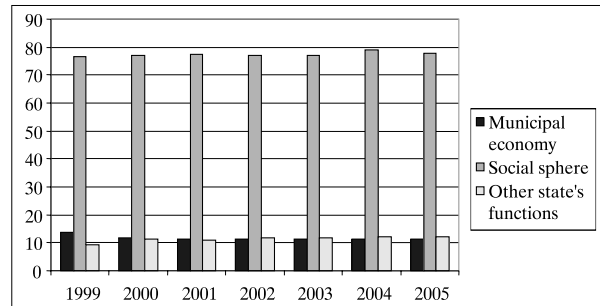


Source: [Data of the Ministry of Finance of the Republic of Lithuania].

Having changed the state policy in the financial sphere and passed the appropriate legal acts, since 2002 the share of tax income in municipal budgets has considerably diminished (up to 40%), whereas the share of state budget subsidies has

grown almost up to 60% of the total local government income. Since subsidies are related with more rigid obligations of local authorities, we can state that financial independence of local authorities has decreased, and fiscal centralism of the country increased (Chart 3).

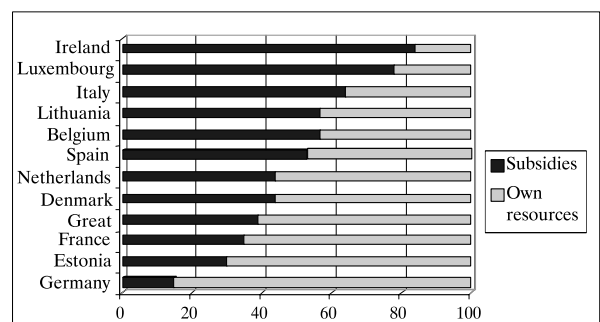
Chart 3. Revenues of Municipal Budgets (%) in 1999–2005



Source: [Data of the Ministry of Finance of the Republic of Lithuania].

So the volume of state grants for local authorities budgets has considerably grown since 2002 and it comprises the major share of revenues of local authorities budgets. Subsidies assigned to Lithuanian local authorities in the period 2002-2004 make up 57% on the average, i.e., more than half of their total revenues. This fact testifies rather a low level of fiscal decentralization in the country. However, in this respect Lithuania is not much an exception among other EU countries. (Finance, 2004). True, Lithuania differs a great deal from Estonia whose local authorities get hardly 30% of state subsidies make up about 15% of total municipal revenues. On the other hand, LR is approximately at the same level as Belgium, and, in this respect, she outstrips developed democratic countries such as Italy, Luxemburg, or Ireland (Chart 4).

Chart 4. The Average Ratio Between own Revenues and State Subsidies (in percents) of Local Authorities of Some European Countries



The analysis illustrates that decentralization is realized in Lithuania only on the administrative level, while financial independence of local authorities is not only undeveloped, but even constructed. Therefore decentralization in Lithuania should be treated rather as deconcentration, i.e., relegation of a part of state functions to local authorities, financing them thereby from the state budget. Fiscal decentralization, however, need not be treated as the undoubtful good, in order that it could be developed, local authorities should also be adequately ready. Meanwhile, in Lithuanian municipalities or local authorities there is rather a high level of corruption, and their capabilities to efficiently manage a local household are rather doubtful at the current moment.

We can conditionally divide tax income of local government into dividing subdivided tax, i.e., income tax of residents and taxes ascribed by laws to the budgets of local government - these are taxes on real estate, land, state land and water reservoirs of the internal state water fund, rent, stamp (up till January 1, 2001) inheritable property and market taxes.

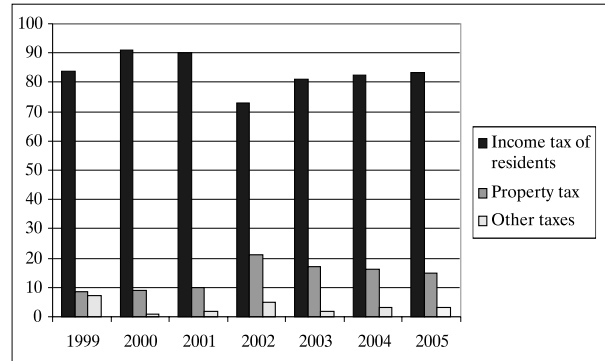
Territorial state tax inspections transfer to municipal budgets all tax revenue allocated to them. Meanwhile, the transfer of the shared income tax of residents is more complex. The practice of distribution of income tax of residents is determined by the law on the methods for determining local authority budget income.

Municipalities of Vilnius, Kaunas, Klaipėda, Palanga, Panevėžys, Šiauliai and Māžeikiai region are allocated only part of the collected income tax of residents which is indicated in the annex of the law on the methods for determining local authority budget income (2001). Other municipalities receive 100 % of the tax. In the above-mentioned 7 municipalities, where the revenues received from the income tax of residents for one person are higher than average, the deducted share of the income tax of residents is transferred to the State Treasury.

Article 9, part 3 of the European Charter of Local Self-Government 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". However, Lithuanian laws do not give the definition of local taxes. Taxes attributed to municipalities (except income tax for residents) may be regarded as local but the rights of municipalities to influence the amount of taxes are weak, they can only reduce tax tariffs or exempt from them on the account of budget. However, it does not play an important role in municipal budgets, because the essence of the problem is not the fact that municipalities have weak

rights to determine the amount of attributed taxes, but the fact that these taxes comprise a small share of municipal budget as it is illustrated in Chart 5.

Chart 5. Tax Revenues in Municipal Budgets (%) During 1999–2005



Source: [Data of the Ministry of Finance of the Republic of Lithuania].

The property tax is indicated separately in Chart 4, because it provides the highest income for municipal budget in comparison to other taxes attributed to municipalities. Though its share is constantly growing in municipal budgets, it does not exceed 10%.

The law, adopted by the LR Seimas on taxation of real estate used for commercial activities has expanded financial opportunities of local authorities. This law has become valid since 1 January, 2006. According to this law only the real estate used for commercial activity was taxed, while residential premises, garden homes the like were not taxed. The maximal limit of the tax rate is 1% of the property value. Local authorities have the right to diminish this tax or to exempt it at all, but this way they would decrease receipts in their budgets. In line with the law, all the income of this tax has to get into the budget of local authorities, and it may be rather considerable.

A more detailed analysis of expenditure and revenues of local authorities budgets is presented in (Davulis, 2004).

5. Principles of equalization of tax income of local authorities

After signing the Association agreement, Lithuania is committed to observe the Recommendation R(91)4 of the Committee of Ministers of the Council of Europe on "The Equalization of Resources Between Local Authorities (1995). Most important is to establish the system of local authority's financing which would allow us to equalize financial capacities of local authori-

ties in order to enable them to provide services of the same level, scope and quality. Recommendation of the Council of Europe highlights that, in order to estimate needs of financial means, it is necessary to take into account demographic, social, economic and other indicators of every municipality which determine the amount of municipal expenditure for different functions.

To implement the provisions of the Council of Europe recommendation, the Denmark's model of equalization of fiscal (tax) capacities between local authorities, which embraces equalization of expenditure needs, has been applied in Lithuania since 1998. The present model of equalization of fiscal capacities between local authorities is determined by the law on the methods for determining local authority budget income and it was applied for the first time when drafting the project of the Law on the Approval of the Financial Indicators of the State Budget and Municipal Budgets. Financial recourses transferred to the State Treasury by the municipalities - donors are used to equalize fiscal recourses of municipalities. As mentioned above, a certain percentage of income tax of residents transferred to the State Treasury does not originate from all municipalities but only from seven municipalities. Namely, this percentage of income tax of residents of seven municipalities - donors, which is transferred to the State Treasury, is redistributed to equalize the difference conditioned by the factors beyond the control of the municipalities in the income tax of residents and the structure of expenditure of the rest 53 municipalities.

Municipalities, which receive lower revenues than average from the income tax of residents for one person, get the support through the income tax of residence, which is in the State Treasury. The supported municipality gets an equal part/share of difference, which is comprised of last month's actual average revenue from the income tax of residents for one inhabitant in all municipalities and last month's actual revenue from the income tax of residents for one municipality's inhabitant. The share allocated to a municipality to equalize the income tax of residents is estimated according to the formulas in the law on the methods for determining local authority budget income

6. Subsidies for local government and borrowing opportunities

The main state budget subsidies are the general state budget subsidies and that for special purpose. In addition, if the Seimas or Government make decisions due to which income and

expenditure of local government budgets change, a compensation of the general subsidy from the state budget is granted. The order of counting, approval, and transference of all these subsidies to municipal budget is established in the law on the local government budget income determining methods. The general subsidy from the state budget is granted in case it has been forecasted a lack of means on the State treasury account necessary for local government budgets to equalize differences between income tax and expenditure structure of the residents of municipalities.

The greater share of state budget subsidies is comprised of special fiscal subsidies to finance the functions relegated by the state to local government. The size of subsidies to municipalities is approved by the law of financial indicator approval of the state budget and municipal budgets for a respective budgetary year. Relatively great volumes of special purpose subsidies limit financial independence of local government. The fact that objective appropriations comprise more than a half of municipal budget revenue testifies the establishment of fiscal centralization. Though legal acts in force declare independence of municipalities to draw up, approve and implement their budget, the reality is very different. State government does not take into account the fact that decentralization of government/public management is impossible without allocation of financial resources to every level of government because only financial independence insures complete self-government. Separation of budgets on the level of state, region and local authorities allows paying attention to direct functions without coordinating decisions with bureaucratic mechanism. The more appropriations from the state are allocated the stronger the doubling of functions and control over their implementation.

An opportunity to borrow is also one of the financial independence indicators of local government. The legal acts of LR provide such an opportunity for local authorities (Decision No. 110 of LR Government, 2001). Though the limits of municipal borrowing have been formally increased in recent years, in reality they did not increase, since municipal budget income by which these limits are calculated, decreased. However, namely long-term loans are the main source of means by which investment projects of local government are financed. Legalization of municipal securities emission would extend the opportunities for municipalities to finance investment projects. However, only the largest municipalities of the country could actually make use of such an opportunity.

The European Charter of Local Self-Government requires that financial resources of local authorities are proportional to their responsibility defined by the Constitution and laws. Municipal revenues are not adequate to expenditures for the implementation of independent municipal functions. Thus principles of financial equalization and concomitant financing are violated. The first principle is established in the article 9 of the European Charter of Local Self-Government: "Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and law" and financial system on which resources available to local authorities are based shall be of a sufficiently diversified nature to enable them to keep pace with the real evolution of the cost of carrying out their tasks. Principle of concomitant financing established in the recommendation nr. 79 (2000) and Nr. 87 (2001) of the Congress of the Local and Regional Authorities of Europe which highlights that: "when new responsibilities are transferred and/or delegated to local authorities, adequate financial resources to carry them out must also be provided". The investigation has shown that this principle is violated in Lithuania. Despite that the volume of public affairs, charged to be managed by local authorities, is constantly increasing, unfortunately, local authorities do not receive adequate financing. This fact is corroborated by constant debts of local government.

7. Non-budgetary funds of the state and local authorities and their development

Non-budgetary funds are a part of the state finance system. These funds are raised and controlled by organizations of various state control levels. According to control levels, non-budgetary funds in Lithuania are divided into state and local ones, i.e., that of local authorities. According to functional purpose, non-budgetary funds of local authorities can be divided into the funds of economic, social nature and that related with nature protection. Resources of non-budgetary funds are made separately from the budget out of revenues defined by various standard acts. Expenditures of these funds are of special purpose and may not be used improperly. Thus, the main purpose of non-budgetary funds is financing of objective means using special purpose discounts and other sources of funds. The presence of an objective purpose in raising revenues and planning expenditure is an advantage of these funds, because these are the resources meant for a particular domain that can be expanded or straitened by the very state control subject. Consequently,

the use of purposive funds enhances the self-dependence of local authorities. However, after proceeding to program budgeting of local authorities, this advantage diminishes. The activities of non-budgetary funds is regulated by the rules of funds approved of the common councils of local authorities.

Utilization of non-budgetary funds is estimated controversially. Some state that less regulated and less controlled non-budgetary funds can be used much more supply, operatively and more efficiently than budget means. Others maintain that utilization of non-budgetary funds weakens the financial discipline and establishes conditions to waste money out of control. Of late a tendency closer to the second case is observed in Lithuania.

In 1992, there were only 4 non-budgetary funds of state interest. However due to rather an alluring opportunity to manage resources here more liberally in comparison to that of the budget, ever more and more arguments emerged in favour of establishing a new non-budgetary fund. So in 1995, there were already 11 state non-budgetary funds and their number is uniformly increasing. In 1998-1999, the number of various non-budgetary funds and accounts amounts up to 30. Ever more increasing amount of funds caused a worry of the state authorities. All the more that with an increase in number of non-budgetary funds, the share of the National budget in the consolidated budget was decreasing as well. In 1999, only a little more than half (54.5%) of the total expenditures of the country was allocated through the national budget. Thus, almost half of the total expenditures of the country are in fact uncontrolled by state. This situation was altered a bit by the law of the LR budget structure of new edition, passed in 2000. It explicitly indicates that both taxes and other kind of levies can be reallocated only through the national budget, state social insurance fund and that of obligatory health insurance that are approved by particular laws, as well as the privatization fund and Ignalina's power plant exploitation stoppage fund the estimated resources of which are confirmed by the state budget law for a particular year. As a result only 4 non-budgetary funds remained in 2000. All the rest were eliminated or reorganized as special projects of the state budget.

The Amendment of the new LR budget structure law, passed in 2004 has increased the number of non-budgetary state funds again by legalizing the Rest (stabilization) and Cover funds. Therefore there are 6 non-budgetary state funds at present.

Since 1997, municipal non-budgetary funds have come into being. A local authority sets up

non-budgetary funds in its territory by decision of its Common council. Such a right is claimed by the LR law on self-government (2000), which says that the Common council of a local authority makes decisions on raising the special-purpose funds. Each fund of this kind has its own objective purpose and performs certain functions ascribed to it. The right, granted to self-government institutions to set up such funds, is interconnected with the responsibility for the fund to meet the requirements of usefulness, economy, and efficiency. Most frequently a fund is founded with a view to concentrate the means necessary to perform a certain function. The main source of the fund set to this end usually is the resources allocated from the budget of a local authority. These functions could also be successfully performed by using only the budget revenue, however, foundation of a purposive fund ensures a guarantee that constantly there will be a certain sum of money to accomplish these functions, and it will not be taken back at the end of the budgetary year. Also, this is a way to attract voluntary contributions of natural persons or legal entities and other receipts.

Redistribution of means between funds is often used as a source of revenues. Various funds are able to attract different amounts of resources. Some funds survive on the share of taxes, set by the Government or local levies which ensures rather constant revenues, others exist with the aid of voluntary contributions and other deductions from non-budgetary fund resources. This situation is due to that only a small share of municipal revenues can be treated as non-budgetary resources, and new powers to use tax- and non-tax revenues for the needs provided in the budget were not delegated to local authorities.

When founding a fund, the common council of a local authority approves the fund regulations by its decision. These regulations provide the fund founding objective and its purpose the founder, sources of means, the order of their remittance to the fund and utilization, terms of liquidation and outcome caused by that.

Thus, following the Law on local self-government in LR (2000), the common council of each local authority itself makes decisions on the foundation of non-budgetary funds in its territory. Since different local authorities can found different funds at their own discretion, we shall analyze non-budgetary funds only of the largest Vilnius city municipality. The Vilnius city municipality had founded quite a large number of non-budgetary funds, but the majority of them were liquidated in the course of time. Among the most

important non-budgetary funds of the Vilnius municipality are:

- the health fund, the resources of which are aimed at financing health care programmes of municipal residents as well as at supporting the organizations that defend public health interests;
- the nature protection fund, meant for financing nature protection means;
- the special-purpose fund, regulating the use of resources meant for State demesne plots of nonagricultural purpose as well as non-residential buildings and premises. The title of this fund defines its purpose and sources of means;
- the privatization fund, the main source of means of which consists of receipts received from privatization transactions. Resources of this fund are used for the lodging fund and maintenance of nonresidential buildings and premises, for financing investment and privatization projects, for expanding the city engineering infrastructure, supporting petty and middle business, and for financing overhaul and maintenance of the city.

All these funds were set up in 1998-199 and remained up till now except the special-purpose fund that was reorganized into the Vilnius city development fund in 2000 by the decision of the Vilnius city council. The most important of these budgetary funds is the privatization fund. The resources of which were constantly growing. As early as 1999, its resources made up more than half total resources (54%) of non-budgetary funds, 22% of total resources belonged to the nature protection fund, 17% to the special-purpose fund, and only 7% to the health fund. Non-budgetary funds of Vilnius municipality comprised about 10% as compared to the local authority budget, and in 2003 even 12%. So, not so poor resources were accumulated in non-budgetary funds of Vilnius city municipality.

Though the Law on LR budget structure of 2000 has drastically reformed state non-budgetary funds, such funds of local authorities are not mentioned in it. However, in the 2004 version of this law only the privatization funds of local authorities are directly validated. Since 2005 the Ministry of finance of LR has required from local authorities to submit only the estimate of the privatization fund together with the draft budget to be approved. It means that other non-budgetary funds of local authorities are not tolerated and must be eliminated or reorganized into special programmes.

8. The necessary decisions to improve the economy efficiency of local authorities

The research has proved that financial independence of Lithuanian local government is insufficient and lags behind the European level. On the other hand, fiscal decentralization is limited by objective reasons: the majority of the country's municipalities, compared to any European country, are small and weak financially, they could not do without state support, and not all our municipalities have a potential of sufficiently qualified specialists so as to effectively handle their financial resources. The level of corruption should also be taken into consideration. There are no doubts that after Lithuania has become a member of EU, financial independence of local government should extend up to some extent, taking into consideration the objective reasons indicated above, because too great decentralization may condition a non-uniform regional development of the country. We will have to inevitably carry out the requirements of the European Charter on local government: to legalize local taxes and to ensure adequate financing for the functions relegated by the state to local government.

The major factors for expanding financial independence of local authorities are: legalization of local tax institute, replacement of a part of special purpose subsidies by the general ones, by respectively distributing municipal functions, and expansion of borrowing opportunities for local authorities. At the same time, a corresponding financial control mechanism should be provided that will guarantee a rational use of municipal means.

Taxes assigned to local authorities at present, should be legalized as local ones. Maybe, their maximal amount should be limited by laws. Other kinds of tax ought also to be introduced, for instance, one of the major local taxes could be the property tax with a progressive tax rate the lower bound of which, i.e., the minimal size of property from which this tax is to be calculated, would be defined by law. Instead of dividing tax it would be more reasonable to introduce two-rate taxes. Determination of more flexible borrowing limits in view of the real situation and financial capacity would facilitate the development of financial independence of local authorities. For some of the major municipalities, e.g. Vilnius city municipality, a possibility of emitting municipal bonds should be legalized. Many large cities of European countries have such a possibility. This would offer another chance to execute and provide means necessary for municipal investment projects. We should also discuss an opportunity to take over

the experience of some foreign countries where municipalities form investment budget side by side with the current budget, which will accumulate the means for the implementation of long-term investment projects.

The necessary condition to improve the financial state of local government is utilization of the means of European structural funds to finance investment projects and to develop small and medium business. To use such an opportunity, the state should encourage and facilitate local authorities (e.g., by improving employee's qualification), and especially the local authorities themselves should be ready for that. However, the key reason, that limits the capacity both of the state and municipal budgets as well as opportunities to extend fiscal independence, is too liberal state policy especially in the sphere of taxes due to which too much money undeservedly fall on large capital, and the state loses opportunity to influence the growth of social welfare more considerably.

Conclusions

The principle programmed budget structure, realized in Lithuania both on the state and municipal levels, enabled us to reform the finance system of self-government. One of the outcomes of this reform is a radical decrease in number of non-budgetary municipal funds which allows us to strengthen the financial discipline of local authorities.

Though the Lithuanian policy in the financial field corresponds to the Chart rules of European local authorities, however the principle of fiscal decentralization and independence of local authorities thereby has not yet been realized on the level that would meet the requirements of self-governing. The objective reasons of that are a too high level of corruption in local authorities as well as insufficient competence of their institutions and officials. On the other hand, recently introduced law on taxation of real estate, used for commerce purposes, has expanded financial opportunities of local authorities because the tax falls namely on the share of their budgets.

References

1. *Constitution of the Republic of Lithuania*. Vilnius, 1996.
2. Congress of European Local and Regional Authorities. Recommendation 79 (2000) on "The Financial Resources of Local Authorities in Relation to their Responsibilities: A Litmus Test for Subsidiarity" <<http://www.coe.fr/cplre>>.

3. Congress of European Local and Regional Authorities. Recommendation 87 (2001) on “Local and Regional Democracy in Lithuania” <<http://www.coe.fr/cplre>>.
4. Decision No. 110 (January 31, 2001) of LR Government “On the Approval of Municipal and Local Authority Borrowing Order”. *State news*, 2001, no. 12–335.
5. Decision No. 543 (May 14, 2001) of LR Government “On the Approval of Forming and Executing Order State Budget and Local Authority Budgets”. *State news*, 2001, no. 42-1455.
6. *European Charter of Local Self-Government*. Strasbourg, 1985.
7. Finance. *Estonian statistics*, Tallin, 2004, no. 8, 152.
8. *Fiscal Federalism and State – Local Finance*. Edited by Jorn Rattso. Edward Elgar Publishing, Inc. Massachusetts, 1998.
9. Recommendations, Resolutions and Declarations of the Committee of Ministers 1999. Recommendation R(91)4 on “The Equalization of Resources Between Local Authorities”. Strasbourg: Documentary Information Section, 1995.
10. Stiglitz, J. E. *Economics of the Public Sector*. New York, London, Third ed. W.W. Norton and Company, 2000.
11. The Law on the Budget Structure of LR. *State news*, 2004, no. 4-47.
12. The LR Law on the Change of the Law on the Methods for Determining Local Authority Budget Income. *State news*, 2001, no. 94-3307.
13. The Law of LR on an Alteration of the Local Government Law. *State news*, 2000, no. 91-2418.

LIETUVOS SAVIVALDYBIŲ FINANSŲ SISTEMOS ANALIZĖ

Gediminas DAVULIS
Mykolo Romerio universitetas

Santrauka. Straipsnyje aptariama Lietuvos savivaldybių finansų sistema, jos struktūra fiskalinės decentralizacijos požiūriu bei jos atitikimas Europos vietos savivaldos chartijos principams. Aprašomi savivaldybių biudžetų formavimo principai bei tvarka, analizuojama nebiudžetinių fondų raida bei jų reikšmė savivaldybių finansiniam savarankiškumui. Nagrinėjama Lietuvos savivaldybių pajamų ir išlaidų struktūra bei jų dinamika 1999–2005 m. Aptariamas savivaldybių finansinių išteklių išlyginimo modelis, įdiegtas Lietuvoje, bei šalies savivaldybių skolinimosi galimybės. Atlikti tyrimai parodė, kad programinio biudžeto sudarymo principai sėkmingai įgyvendinami abiem, t. y. valstybės ir savivaldybių, lygiais. Tačiau savivaldybių biudžetų pajamų ir išlaidų struktūros analizė parodė, kad fiskalinė decentralizacija Lietuvos viešajame sektoriuje yra nepakankama. Nors šalies savivaldybių biudžetų išlaidų struktūra yra panaši kaip ir kitose Europos Sąjungos šalyse, tačiau valstybės dotacijų dalis savivaldybių biudžetų pajamose yra pernelyg didelė. Antra vertus, ir savivaldybių skolinimosi galimybės yra nepakankamos. Visi šie veiksniai riboja Lietuvos savivaldybių finansinį savarankiškumą. Straipsnyje pateikiamos rekomendacijos, kaip plėtoti savivaldybių finansinį savarankiškumą ir padidinti jų veiklos efektyvumą.

Gediminas Davulis – Professor, Dr., Department of Economics, Mykolas Romeris University, Vilnius, Lithuania. The main research areas: modelling and investigation of macroeconomic processes, public economics, management of processes in economy and transport, optimization methods applying in economics. Author of more than 80 scientific publications.

Mykolo Romerio universiteto Ekonomikos ir finansų valdymo fakulteto Ekonomikos katedros profesorius, habilituotas daktaras. Paskelbė daugiau kaip 80 mokslo darbų. Pagrindinės tyrimo sritys – makroekonominių procesų modeliavimas ir tyrimai, viešojo sektoriaus ekonomika, ekonomikos ir transporto vadyba, optimizacijos metodų taikymas ekonomikoje.