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FINANCING POSSIBILITIES OF THE LOCAL GOVERNMENT

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Abstract

There is a high diversity in the possibility of raising funds for municipalities; in particular the possible sources of revenue for financing the municipalities are high. There are certain ways of financing, which are represented in all municipalities, regardless of their economic structure, the number of people or the country in which there are. But there are certain ways of raising funds that are assigned or may be awarded only to a particular type of municipalities. These ways of funding depend on the geographic location of the municipality, the economic structure of the country, available natural resources in the municipality, the number of residents, business and economic development of the municipality etc. This paper is based on comparative analysis between possibilities and practices for financing the municipalities in the Republic of Macedonia and the countries in Europe, taking the practices for funding from the following countries: Serbia, Czech Republic, Germany, Slovenia and Bulgaria. The comparative analysis shows similarities and differences in the practice of financing municipalities in Republic of Macedonia and the countries of Europe, and its purpose is to recognize and implement practices for financing the municipalities from European countries in the municipalities of Republic of Macedonia.

Keywords: funding, municipalities, revenues, Macedonia, Europe.

Jel Classification: H71

INTRODUCTION

The practices and possibilities of financing municipalities are modeled on the legal framework that is established by the central government. That does not mean that certain municipalities are privileged and obtain greater funding, but that funding opportunities were being offered on the basis of the various conditions that exist in the municipalities. Municipality's population can be considered as one the conditions for funding

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opportunities of the municipalities (Josifov, Pamfil, and Comsa 2011). Municipalities that have a higher population will have more financial opportunities to realize higher revenues from personal income tax, if the tax is assigned to be collected and administered by the municipality. However, if the same tax is placed in the smaller municipalities, particularly municipalities that have fewer residents would not produce same effect. In that case, the revenue from this tax would be small in order to contribute to higher percentage in the municipality budget (Devas, Blore, and Slater 2004).

Geographic location also plays an important role in setting funding opportunities for municipalities. The municipalities that have tourist potential may charge additional fees for tourism. This can further increase the budget of municipalities. This tax would have no effect on municipalities that do not have tourist potential, i.e. the effect of this method of financing would not have achieved the desired outcome. Natural resources and their exploitation for various purposes can be an additional income and financial opportunity for some municipalities. The geographical location is closely connected with the transit potential of the municipalities, which can be exercised by using roads and transport services with the necessary infrastructure and having the type of tax that can be collected for their usage. Some more marginalized communities could not exercise the same amount of revenue from this kind of tax as the municipalities that have strategic transit areas (Bowman and Kearney 2009). Local government is presented as the government of difference, both responding to and creating differences between areas (Jones 2012).

1. LOCAL GOVERNMENT FINANCING PRACTICES

Certain municipalities can build on their financial capacity by offering favorable economic climate for business development. Besides corporate taxes and taxes on profits that may represent a way of financing the municipalities, they can receive additional help from companies that work in them, usually in the form of social care, employment, social responsibility, market expansion, increasing the quality of products and services offered etc. Those municipalities that do not have adequate facilities to attract investment and businesses in any branch will not be able to take advantage of these funding opportunities. According to theory, the meeting of financial needs of local self-government is supposed to be based primarily on the principle of resource proportionality to their tasks (Sun and Jung 2012).

Never the less there are municipalities that have their own property, acquired in different ways, which in itself is a good foundation for increasing financial capacity. Part of the property can be used as headquarters for the municipal administration, and some may be rented, whereby municipalities can earn income on that basis. Municipalities can also administer the collection of property tax and land use. Usually municipalities that are more exclusive, i.e. that offer high-quality public services and high standard of living, often charge higher rates of property tax. In this case the people, who have homes in this type of municipalities, further increase the inflows from property tax to the municipality. Municipalities that are under-populated or are in poorer economically developed areas, do not have the solution to charge higher property taxes, and thus to strengthen the financial capacity through this type of financing (Wallison 2009).

Various systems of regulation, different growth and development models and different economic systems contribute to a wide range of practices and funding opportunities for municipalities in European countries. However, despite the abundance

of national and international sources, performing an international comparison of the financial systems of local government can appear difficult, due to the great diversity of local politics in Europe (Dafflon 2002).

Several different counties were selected in this paper in order to compare and analyze the practices and financing opportunities of the municipalities of the European countries with the practices for financing the Macedonian municipalities. The criteria for selecting the countries which are taken into consideration in the comparative analysis are:

- a member of the founding of the European Union;
- two members of the European Union, which entered the Union in 2004;
- a member of the European Union, which is included in the Union with the last or penultimate wave of enlargement, and
- a country that has candidate status to join the European Union.

The process of selecting the countries for comparative analysis, also takes into account the geographical proximity of the countries with the Republic of Macedonia as a criterion for selection. However, preference will be given to the above mentioned criteria. Federal Republic of Germany (as one of the founders of the European Union) was selected as a Member State of the European Union, Czech Republic and Slovenia were selected as older EU Member States, Republic of Bulgaria as a newer member of the European Union and Republic of Serbia as a country with the same candidate status in the EU as Republic of Macedonia. Their possibilities and practices for municipal financing of these countries are compared with those of Macedonian municipalities, in order to see the differences and similarities between them and the possibility of their implementation in practice of funding Macedonian municipalities.

2. COMPARATIVE ANALYSIS OF MUNICIPALITIES' FINANCING IN THE REPUBLIC OF MACEDONIA AND OTHER EUROPEAN COUNTRIES

The conditions and opportunities used for funding the municipalities should represent an optimal structure of financial resources, which will lead municipalities to maximizing their income (Spearman 2007). The aim is to create a self-sustaining municipality, without being assisted by central government (except in the case of some capital investments that are of interest to the whole country). Thus the funds that would be earmarked for transfer from central government to local could be used for other strategic priorities of the state. Due to limited financial possibilities, more municipalities are directed to introduce various practices that can enhance their financial capacity. In addition a comparative analysis with the practices and ways of financing municipalities in countries that were previously elaborated namely Serbia, Bulgaria, Czech Republic, Germany and Slovenia is presented.

The analysis shows whether there is possibility for introducing the practices for financing the municipalities from the countries mentioned above into local government in Republic of Macedonia, in order to improve the financial situation of the Macedonian municipalities and strengthen their financial capacities.

The following table is an overview of the opportunities that are presented and practices for financing local government of countries that were taken into account in the comparative analysis, including the Republic of Macedonia.

Table 1. Possibilities of financing the municipalities in the European countries and the Republic of Macedonia

Sources	Bulgaria	Slovenia	Czech Republic	Serbia	Germany	Macedonia
Taxes						
Property Tax	X	X	X	X	X	X
Inheritance tax and gift tax	X	X	X	X	X	X
Turnover tax on real estate and rights	X	X	X	X	X	X
Income tax	X	X	X	X	X	X
Tax on motor vehicle ownership	X				X	
Tax on use of public goods		X		X	X	
Corporate tax		X	X		X	
Tax on games of chance	X	X				
Fees and compensations						
Utilities fee	X	X	X	X	X	X
Administrative fee	X	X	X	X	X	X
Fee for the use of farmable land for other purposes	X		X		X	
Fee for arranging construction land	X	X	X	X	X	X
Urban planning fee	X	X	X	X	X	X
Tourism see	X	X	X	X	X	X
Fee for usage of natural resources	X	X	X	X	X	X
Fee for usage of public goods	X		X			
Compensation for pet ownership	X	X	X	X	X	
Compensation for owning games of chance		X	X	X		
Compensation for ownership and usage of sea vessels	X	X		X	X	
Compensation for owning a parking space for motorized vehicle	X	X	X	X	X	X
Ecological fee		X	X		X	
Other sources						
Capital sources	X	X	X	X	X	X
Revenues from penalties	X	X	X	X	X	X
Ownership revenues	X	X	X	X	X	X
Donations	X	X	X	X	X	X
Grants	X	X	X	X	X	X
Transfers						
Transfers from central government	X	X	X	X	X	X
Transfers from other government levels	X	X	X	X	X	
Borrowing						
Domestic borrowing	X	X	X	X	X	X
External borrowing	X	X	X	X	X	X

Source: <http://documents.worldbank.org/curated/en/2013/09/19713014/south-east-europe-municipal-finance-review-local-government-finance-western-balkans> (accessed January 10, 2016), table 1.

Note: These data are based on World Bank Documents and Reports

The review of the funding sources of municipalities in the countries of Europe presented in the table 1 starts with the taxes as a financing source. The analyses show that Slovenian municipalities are far from being standardized to the extent that they would have equal needs with regard to their equal tasks and powers. This primarily shows the division of municipalities according to their demographic and geographic characteristics that are also the basis for calculating their appropriate expenditure directly associated with their costs (Oplotnik, Brezovnik, and Vojinovic 2012).

You can see from the table above that income tax, property tax, turnover tax on real estate as well as rights and inheritance and gift tax are represented as sources of funding of the municipalities in all of the selected countries. In fact, these taxes include most of the own financing resources of the municipalities. The tax on motor vehicle ownership is a source of revenue for local government in Germany and Bulgaria. This tax does not occupy a large percentage of the total tax revenues as municipal sources, but his share in municipalities own resources cannot be neglected. The tax on use of public goods is a source of income only for municipalities in Serbia, Slovenia and Germany. This tax involves using the roads, streets, parks, markets, libraries, parks, social housing and other public goods and services, which the inhabitants of the municipalities use. The taxes for using the parks, streets, markets represents a burdens is carried by all residents of the municipality, while others, such as using libraries, recreational and sports facilities, gardens and so on represent a more selective tax burden. This implies that only those residents that use these public goods carry the obligation of paying the tax. The introduction of this tax can significantly improve the current financial capacity of municipalities in Macedonia. The revenues from this tax vary depending on the number of population of the municipalities, and therefore cannot be consider a stable source of municipalities. However, the introduction of this tax can allow Macedonian municipalities an additional source of funds, and the possibility of using them to maintain and improve the quality of public goods and services.

Corporate tax is an additional source of funds for municipalities in Slovenia, Czech Republic and Germany (Abrahams et al. 1999). Besides the personal income tax, this is collected and administered by the municipalities of all aforementioned countries; corporate tax is also available for some of the municipalities as an additional revenue source. Corporate tax is considered a tax paid from the companies that are based in the territory of a municipality. Corporate tax is not part of the revenue sources of Macedonian municipalities, and its introduction would be economically unfounded. In that case, corporations in the Republic of Macedonia would have fallen under the principle of double taxation. This would lead to a decrease in the morale for achieving profits in corporations, which can lead to their willingness for exercising less profit, so most of the revenues will not go into the hands of the state. The only situation where it is possible thinking about introducing such a tax is if the central government would be decline its participation in collecting and administrating the corporate tax. In order to strengthen the financial capacity of municipalities of Republic of Macedonia by introducing this kind of tax, then it can be in the form of transfers from the central government to the local as a predetermined percentage of corporate tax administered and collected from central government. However, in this case, the percentage should be predetermined by appropriate parameters and criteria, and it should be noted that this solution should only be temporary, leaving space in the later stages of decentralization, to give this tax entirely local character as in some of the above mentioned counties.

The tax on games of chance is present in the municipalities of Bulgaria and Slovenia. This tax does not constitute a large source of finance for municipalities, and also is not considered to be a tax that municipalities can fully rely on stable funding. However, a certain amount of money would be welcome among municipalities from this kind of taxation, and therefore, this tax could be introduced in the framework of municipal financing in the Republic of Macedonia. The following is tabular and graphical representation of the movement in tax revenues of the municipalities of the countries covered in the analysis, from 2009 to 2013.

Table 2. Tax revenues as a percentage of total revenues of the municipalities by country: 2009–2013

Tax revenues	2009	2010	2011	2012	2013
Bulgaria	28,00%	33,00%	32,00%	34,00%	35,40%
Slovenia	45,60%	46,20%	48,80%	48,40%	48,50%
Czech Republic	56,40%	55,00%	58,13%	58,70%	59,10%
Germany	58,80%	58,70%	59,12%	62,90%	60,71%
Serbia	39,00%	38,00%	40,00%	40,00%	42,15%
Macedonia	18,20%	19,00%	17,32%	20,35%	20,45%

Source: <https://stats.oecd.org/Index.aspx?DataSetCode=REV> (accessed January 11, 2016), table 2.

Note: These data are based on OECD Statistics

Tax revenues of Macedonian municipalities are far below the level of tax revenue municipalities obtain in the selected European countries. The small number of tax revenue as a percentage of total realized revenues, suggests a weak financial capacity of municipalities in the Republic of Macedonia compared to other countries in Europe. Tax revenues represent the most stable source of funding for municipalities, their great variation annually can cause serious problems in the planning of resources and also on the municipal budget (Mullins and Pagano 2005). It can cause further problems in the financial capacity of municipalities, because they cannot rely on stable sources to finance their expenditures. Municipalities of Germany and the Czech Republic realize the most stable and highest income from tax revenues of the selected countries. Municipalities in Serbia and Slovenia exercise good percentage of tax revenue compared with the municipalities of European countries, taken into account in the comparative analysis of this paper. Also, the tax revenue of these communities is stable, which means that the municipalities of these countries can fully rely on tax revenues to achieve their expenditures. However, it should be stated that much of the taxes charged by municipalities are provided under a specific legal framework. The goal is not to allow too much freedom of self-determination in municipal tax rates and tax bases. Too much freedom can lead to the creation of mutual competition among municipalities that would eventually lead to setting lower tax rates, and thus attract more taxpayers. Such a situation would inevitably lead to a reduction in funds to municipalities and to a decline in the financial capacities of the same.

The non-tax revenues include fees, compensations and other revenues that municipalities administer and collect based on the public services they perform. Non-tax revenue usually occupies a much smaller percentage of total revenue compared to the tax. Therefore, municipalities cannot fully rely on them, but they are stable income and still have great importance in the structure of municipal revenue. The additional revenues that municipalities receive from non-tax revenue, further strengthens their financial capacities and thus they should make efforts to charge them efficiently and effectively thereof utilize their resources. The most common compensations and fees that

municipalities charge are utility fees, administrative fees, urban planning fees, tourism fees and fees for arranging construction land. Besides these, there are many other fees and compensations that municipalities charge. The types of taxes and fees may vary from municipality to municipality, mainly due to the system of local government, the geographical location of the municipality and the legal framework that is intended for municipal financing. Revenue that municipalities receive in respect of fees and compensations can be directly used to maintain and increase the quality of public goods and services.

Certain municipalities that have a large quantity of natural mineral resources realize additional revenues from the fee for the exploitation of the same. While other municipalities in which tourism is developed, realize additional revenue by the number of tourists who visit those municipalities.

Compared with the municipalities of European countries, Macedonian municipalities do not charge fees and compensations for using public goods such as streets, public parks, markets and other public goods of the municipality. By charging this kind of fees and compensations significant earnings would be pumped into the municipal budget, while reducing the need for some degree of central government transfers and making municipalities more financially stable (Serageldin 2008).

Municipalities in the Republic of Macedonia do not charge a fee for owning second hand motor vehicles. However, recent changes in the law saw that the residents in some municipalities charge appropriate compensations for use parking space for their vehicles. Unlike Macedonian municipalities, the municipalities of European countries, which were taken into account, charge fees or compensations for owning a motor vehicle as well as the fees for using parking space. Combined, the two charges can contribute to significant earnings given the number of affordable vehicles that are owned by the residents in the municipalities. Certain fees and compensations cannot be appropriately used to make a significant difference in municipal revenues. The effect can be negative from a social point of view, because it can be seen as an additional burden on the budget of municipality residents. Therefore it should be carefully decided on what compensations and fees will be charged by the municipalities.

Another fee that Macedonian municipalities do not charge, and is represented in almost all European countries is fee for withdrawal of agricultural use (fertile) land. Setting this kind of compensation would affect positively on the agrarian policy, making fertile land necessary for processing. On the other hand if the lands owners choose to use this land for different purposes they will be charged appropriately for the intended use and the municipality would receive revenues in the form of the fee.

Municipalities in the Republic of Macedonia can realize additional revenues from the fee for pollution, which is also present in most municipalities of the selected European countries. This fee may substantially fill the budget of the municipalities. This kind of fee or compensation can also be used to induce pollution awareness, mainly into the industrial sector which adversely affect the environment. The funds obtained on this basis can be used to improve the cleanliness and greenery in municipalities.

Additional fees and compensations that characterize the municipalities of European countries and are not included in the framework of the financing of the Macedonian municipalities include: the fee for owning a pet, the compensations for the sale of tobacco products, alcohol and alcoholic spirits, as well as the fee for using and owning machines

for games of chance. Inflows from these fees will be the same size as the aforementioned, further strengthening the financial capacities of the municipalities.

Transfers from central or local governments are overly used practices for financing municipalities in the European countries, as well as Macedonian municipalities. Taking into consideration the government level of funds coming to municipalities in the form of transfers, transfers can be divided into horizontal and vertical transfers. Vertical transfers are actually transfers of funds collected and administered by the central government. It is important to establish certain criteria for transferring funds to the municipalities. The most commonly used criteria for the allocation of transfers from central government to municipalities include: the size of the territory of the municipality, the number of inhabitants, the development needs of municipalities etc. The method for transferring funds from the central to local governments is vitally important, especially for setting certain equivalence between the municipalities, and allocating the funds where they are most needed. The criteria for transfer of funds in Republic of Macedonia are not adequately defined, leaving many municipalities with less obtained funds than necessary, especially in the area where they are most needed, namely economic and urban development.

Vertical transfers represent a redistribution of funds between municipalities to achieve adequate uniformity among them. In fact vertical equivalence assumes accurately identified needs for funds to municipalities, depending on different criteria such as number of inhabitants, the need for providing public services and products, territory, population density etc. According to these needs the needs for financial transfers are determined for each municipality in the current year. But due to the difference in the development of municipalities, some municipalities realize greater yields than others. The idea is to carry over a sufficient sum of funds from the more developed municipalities, in less developed municipalities which failed to make enough financial assets to meet necessary planned activities. If lack of funding still occurs again, despite transferring funds from developed to less developed municipalities, then the state intervenes with special 'grants' which should reduce or completely cover the financial gap of less developed municipalities. Never the less the vertical and horizontal transfers should also be limited, in order to rule out full dependence of municipalities from the state and other municipalities. In fact, the purpose of this type of financial equalization among the municipalities should be created according to their financial needs in order to enable them to fully level the quality of public goods and services. Doing so would reduce the migration of people from less developed to more developed municipalities. Municipalities which don't have enough resources to offer quality public services could be faced with a phenomena of losing their population to a more developed municipality, which will inevitably lead to further fall of their financial capacities.

The vertical transfer system can be applied to the local government in Republic of Macedonia. The need is great because of the uneven development of some municipalities and the concentration of most of the industry, economy and residents in particular municipalities. This practice will benefit only the less developed municipalities, but the goal is to help the municipalities which are unable by themselves to get out of the problems brought by the centralization of the economy and the inhabitants. Vertical transfers could help revitalize many of the municipalities that are slowly losing residents, leaving room for brighter future in terms of increasing their financial capacities and leading to the ultimate sustainability of all municipalities in the country.

Besides the basic types of revenues, municipalities realize income from additional sources, i.e. capital income, income from own activities, donations, revenue from fines and income in the form of 'grants', provided by various funds. However, these earnings are less stable than basic revenues, and therefore municipalities cannot fully rely on them. Unlike the countries of the European Union (in this case Bulgaria, Slovenia, Czech Republic and Germany), the municipalities of the Republic of Macedonia have less access to European funds. The amounts that are approved for development of municipalities in Macedonia by the European Union funds are far smaller than those determined for the municipalities of the countries of the European Union. European countries have specialized investment funds which provide additional funding to municipalities. The purpose of these investment funds is through close cooperation with the municipalities, to enable additional growth and strengthen their financial capacity. This type of investment funds are not yet founded in Republic of Macedonia, although their establishment would contribute to further strengthening the financial position of municipalities and reducing the need for central government transfers.

Borrowing presents additional source of funding for the municipalities. Borrowing of the Macedonian municipalities compared with other municipalities of European countries taken in consideration in the comparative analysis, is far smaller. Small borrowing reflects the weak creditworthiness of municipalities, as well as relatively weak ratings of municipal bonds. Therefore, the only solution for municipal borrowing in Republic of Macedonia is domestic borrowing. Weak creditworthiness of municipalities reduces the possibility of borrowing funds from commercial banks and additional funds. The inabilities of the municipalities to borrow additional funds, in a situation where they are in need of such funds, adversely affect their financial capacity, further reducing it. On the other hand the growing financial capacity of the municipalities will lead to increase of their creditworthiness, also increasing their ability for borrowing funds. However, privatization and subnational fiscal autonomy along with reforms to the banking system – restraining access to soft financing – may prove effective at improving fiscal balances among local governments (Crivelli 2012). The measurement of financial autonomy is a management tool in central government policy towards local governments (Oulasvirta and Turala 2009).

CONCLUSION

The comparative analysis of opportunities and practices for municipal financing between European countries and the Republic of Macedonia gives us a realistic picture of the sources of funding and expenditure structure of the countries of Europe Republic of Macedonia. Despite the differences in systems, organization of local government, delegated responsibilities by level of government, there are many similarities, which can lead to the possibility of selective application of practices and ways of financing the municipalities of European countries into municipalities the Republic of Macedonia. The summary conclusions presented below presents the funding practices that are taken from the experience of the municipalities of the countries in Europe, and can be used in municipalities of Republic of Macedonia. The implementation of some of the practices should lead increased financial capacity of municipalities and ultimately creating financially self-sustainable municipalities. Some of the practices that could be introduced

in the system of financing and financial management of the Macedonian municipalities are: introducing a fee for owning a used motor vehicle; introducing a fee for use of public goods (sidewalks, squares, streets, using retail and wholesale markets); introducing a fee for owning a pet; introducing a fee for withdrawing from the use or misuse of agricultural (fertile) land; introduction of a pollution compensation for economic entities; introducing a fee for the sale of alcohol, alcoholic spirits and tobacco products; establishing municipality investment funds; setting well-defined criteria for redistribution of funds from central to local government; set up an appropriate legal framework and common audit by the central government in order to create a successful and constructive financial equalization between municipalities; introduction of a system for the redistribution of resources to achieve horizontal equivalency among municipalities; and encourage indebtedness of municipalities by introducing preferential benefits for borrowing.

The utilization of all these practices from European countries listed above, can also lead to creating a greater economic burden for residents of municipalities. Therefore, there is a need for more thoroughly approach of the possibilities for introducing any of these practices and also further research on the impact of introduction of different practices for financing the municipalities of Republic of Macedonia. The introduction of fees and compensations should also take into consideration their social nature, the layer of the population which will be affected by them, the collection and payment rates and other vital information concerning the introduction. Introduction of new taxes could further burden the inhabitation of municipalities especially those receiving social care. Therefore, extreme caution should be taken while implementing any of the practices.

More important is the adoption and creation of an appropriate system for the redistribution of funds on horizontal and vertical levels of government in order to achieve adequate fiscal equality between them. Setting standards and criteria for allocating resources and appropriate legal framework are inevitable in establishing such a system. Without the appropriate elements set in place, redistribution will not contribute to creating horizontal equivalence which is the basic objective of introducing such a system. Establishing new sources of funding, and introducing an appropriate system for redistribution and horizontal equity among municipalities will lead to improved self-sustaining communities and greater financial capacity of municipalities.

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