

Sustainable Financing of Territorial Administrative Reform

Financial Consequences of Territorial Administrative Reform

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- Main focus on the financial consequences of the planned territorial reform, but several recommendations valid regardless the territorial reform is implemented
- Conceptual paper, in some issues supported by the pilot study in 3 rayons of Ivano-Frankivsk and 2 rayons of Luhansk oblasts
- Four major parts:
 - Nature of the territorial reform – benefits and threats, impact on territorial fiscal inequalities
 - Expenditure responsibilities
 - Revenue powers (land tax, tax on buildings, changes in PIT revenues allocation)
- Shape of the equalization formula

Main assumptions

- Some form of territorial amalgamation
- Parallel re-allocation of functions to lower tiers
- Election of rayon and oblasts heads, control of locally elected bodies over rayon/ oblast executives

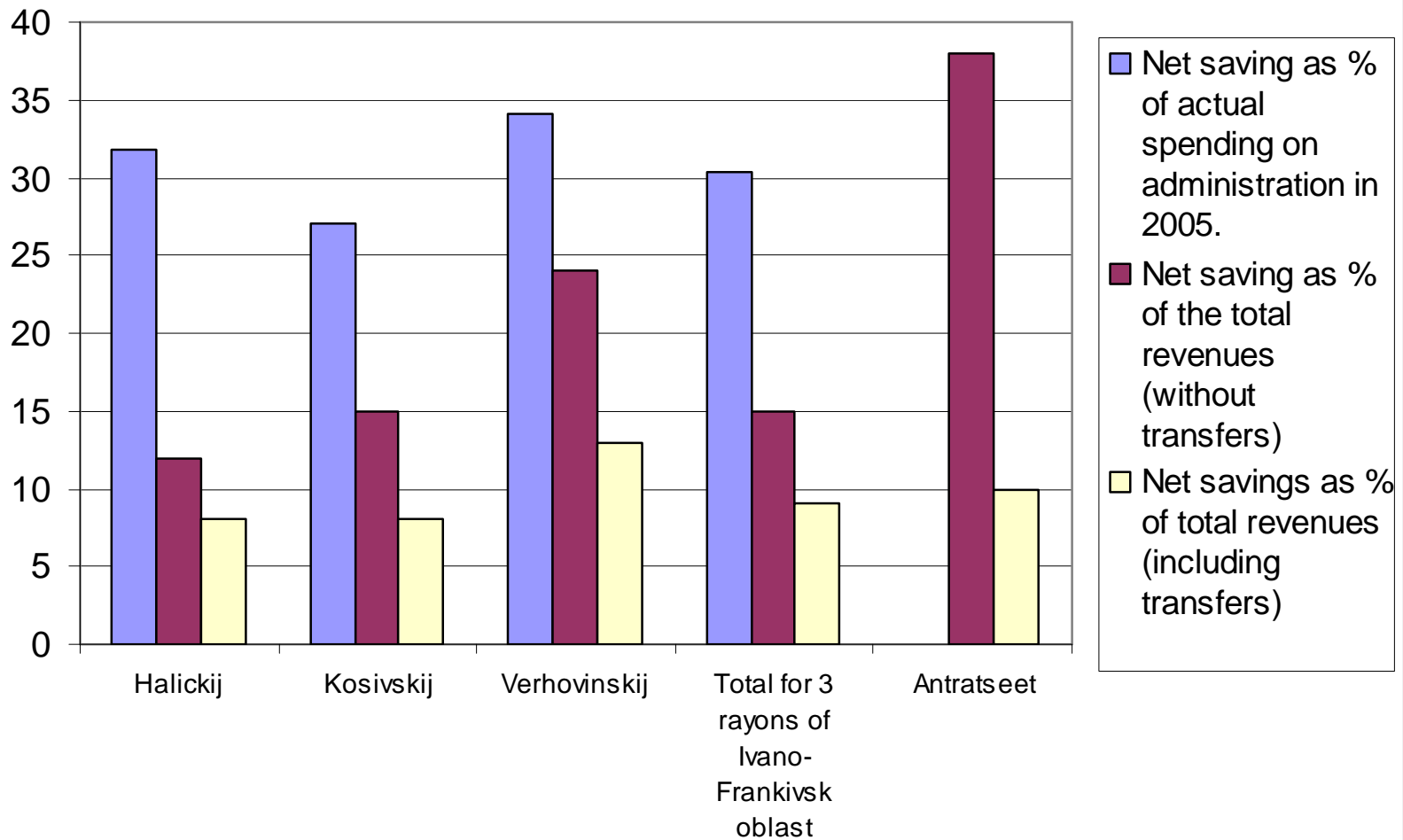
Territorial amalgamation

- Is amalgamation necessary?
 - Answer depends on what roles we want local governments to play
- Agreed process of amalgamation requires
 - Good data base
 - Consultation (European Charter), i.e. time
 - Good information strategy
 - Approach which maximizes potential benefits, but also which minimizes risks and potential negative consequences

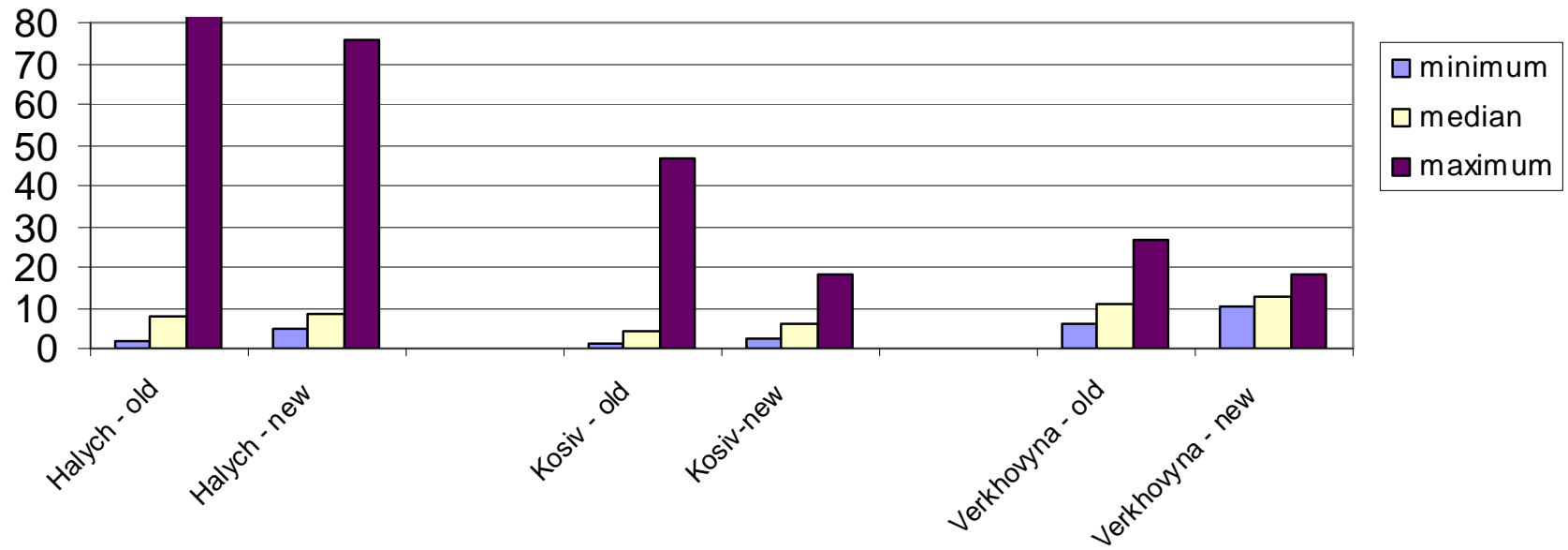
Benefits of amalgamation

- Economy of scale
- Allows to decentralize more functions
- Allows for more coherent planning (especially land-use planning)
- Indirect impact on local economic development
- Better qualified and skilled staff, better technical equipment for the local administration
- Reduction of income disparities

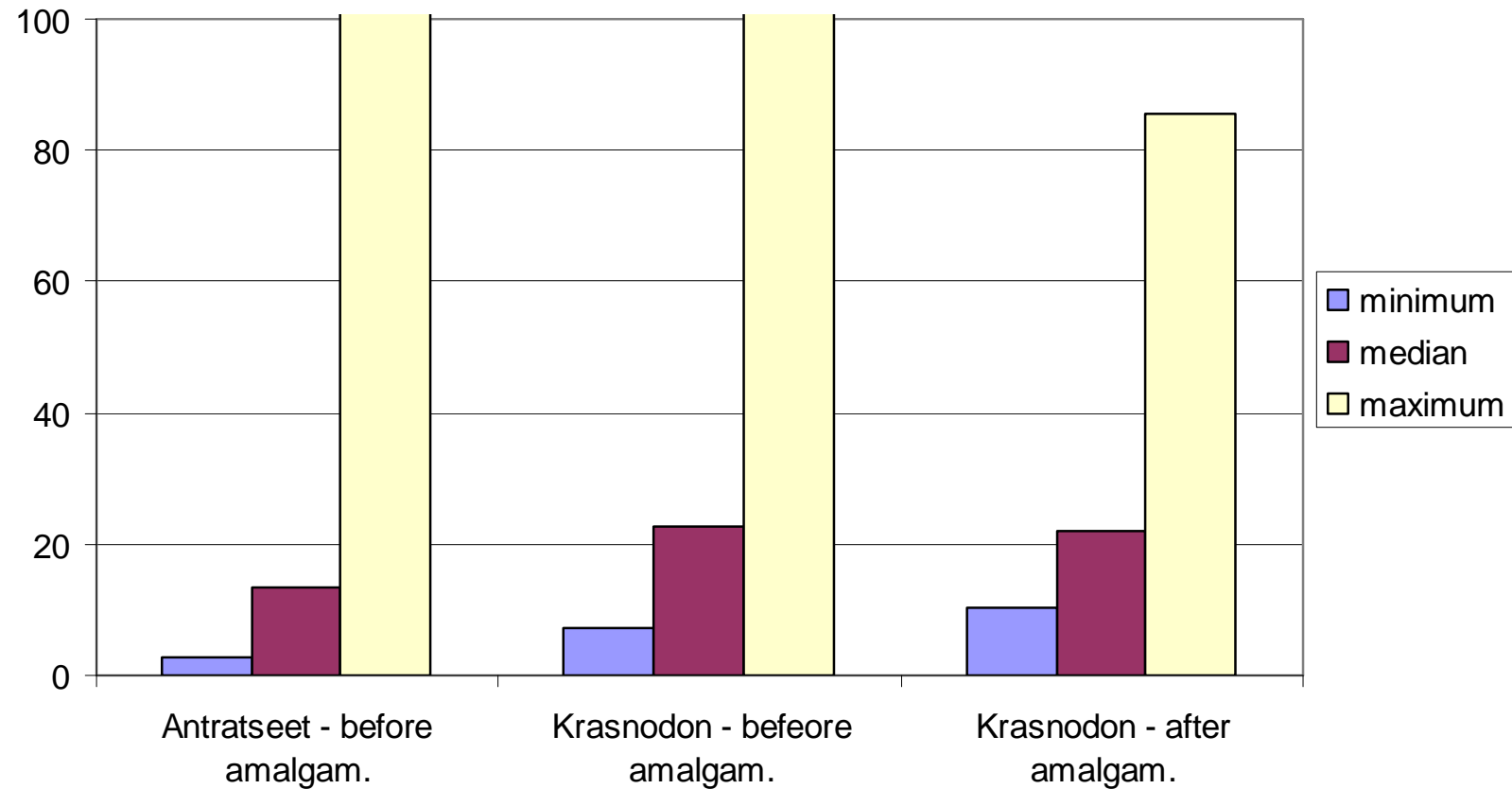
Simulation of saving in administrative spending as a result of territorial amalgamation



Potential revenues from land tax and agriculture tax per capita - old and new territorial organisation (3 rayons of Ivano-Frankivsk oblast, without payment arrears)



Per capita assessed revenues from land tax and fixed agriculture tax in pilot rayons of the Lugansk oblast (2005)



Impact on revenue distribution - conclusions

- Amalgamation would reduce disparities, although they would still remain considerable
- Case to discuss some equalisation of „basket 2 revenues”, but in a way which would not produce dis-incentive for revenue collection
 - Not a full equalization
 - Taking into account tax base not actual revenues
 - Taking into account „weighted population” in central cities

Typical fears of amalgamation

- Longer distance to local authorities (political and physical)
 - Yes, but more functions, which effectively brings government closer
 - Possibility of some „on wheels” functions of the community administration; e-governance as a perspective
- Domination of the major village (town) and political marginalization of others (protecting interests of small villages)
 - Majority system of election with one-councilor wards instead of proportional or „at large” majority elections
- Loosing identity of small villages
 - Symbolic forms of self-government (village leader) with consultative functions, and delegation of some local tasks

Allocation of functions

- Main assumptions:
 - Capacity of enlarged communities to carry out more functions
 - Full self-government status of rayons justify retention of some functions
- Increasing local flexibility by releasing many (often unrealistic) spending norms and standards and giving more discretion on levels and means of provision
- Promising radical development of service delivery facilities in every settlement undermines main assumptions of the reform

Main recommendations on major service sectors

- **Health**

- Transfer of additional functions to communities not recommended
- Creation of cities-oblasts may complicate management of specialised health care facilities
- Single level responsible for the health care worth to consider

- **Culture**

- Should be provided by various tiers
- Issue of local libraries integration

Main recommendations on major service sectors

- **Education**

- Primary and secondary provision may be realistic on community level, depending on the details of amalgamation – feasibility of management of secondary schools by hromada confirmed by pilot study in two oblasts
- Varied international practice – in Poland communities education up to 15 years old, in Bulgaria, Sweden – all schools, but in UK – all schools run by county
- Discretion in organizing school network; formula may provide incentives for particular solutions

Main recommendations on major service sectors

- Sport
 - Power to provide by communities but without setting standards
- Social Welfare
 - Non-specialised care to communities
 - In case of residential care encourage management by voluntary sector or associations of local governments
- Administration
 - More flexibility in terms of number and salaries of staff

Allocation of revenue sources

- For „basket 1“:
- More functions to communities requires shift of some revenues
- Land tax and (perhaps) part of PIT are the most obvious candidates
- Moving PIT-sharing from employment based to residence based
- More local discretion in setting tax rates (perhaps within „brackets“)

Allocation of revenue sources

- For basket 2: tax on buildings
- Not based on appraisal of market value, but on square meterage (see: Poland, Czech, Slovakia, Hungary)
- Rate diversified by type of usage (housing, commercial, industrial)
- Rate diversified by „type of location”
- Discretion of local government to set precise tax rates

Tax on buildings for hromada?

- 4 sources of data:
 - BTI – privatised stock, but inventory not everywhere completed
 - Zhek
 - City halls – private (not necessarily privatised) buildings
 - Form 1 of Pohospodarska kniha and form 3 of Alfavitna kniha domohospodarstw - source of information on rural areas
- Problems with data:
 - Incomplete
 - Fragmented
 - Rarely available in electronic format
- As a result – simulations on the next slide present under-estimated revenue potential

	Total – from residential properties	Total – from commercial properties	% of additional revenues to zahalnyj fond (without transfers)
Halickij	135,797 hryvna	NA	Median – 6,9% Minimum – 1,1 % Maximum – 22,7%
Kosivskij	516,233 hryvna	48,868 hryvna	Median – 18,7% Minimum – 2,4 % Maximum – 72,4%
Verhovinskij	61,431 hryvna	99,821 hryvna	Median – 15,0% Minimum – 11,8 % Maximum – 27,4%
Krasnodon	74,563 hryvna	985,463 hryvna	
Antratseet	147,164 hryvna	497,808 hryvna	Median – 9,7% Minimum – 0,8 % Maximum – 216%

Equalization transfer formula

- Need for simplification (especially to cover all three tiers) and stabilization of the formula
- Funding needs rather than network of institutions
- Eliminating discretionary „additional grants”
- Executing ban for inter-budgetary loans, which sometimes work in parallel to „formal” equalization mechanism
- Effective implementation requires radical change in nature and reduction of the number of spending norms and other elements of central regulatory framework
- Needs measured in relative not absolute terms (relation to the national average)

Equalization transfer formula – 1 step

- Education
 - Number of pupils with coefficient for population sparsity, settlement network
- Culture
 - Per capita with weight in favour of major centres (catchment area) and *regions with more historical heritage objects?*
- Health – not relevant, not decentralized to the community level, but should take age and gender structure
- Social services – number of elderly, orphans, invalids, *measures of poverty?*
- Most of other services
 - Per capita with coefficients for mountain areas

Equalization formula – 2 step

- All demand related information expressed in a single equation expressing overall expenditure needs of a local government relative to the national average need
- It makes formula easier to understand
- It strengthens the „general purpose” (not „specific purpose”) character of the transfer
- It rests on verifiable demographic profile of a local government

Data on hromada required for equalisation

- Number of population and population density – unproblematic
- Data technically existing but very difficult to obtain due to system of storage
 - Beneficiants of social services
 - Demographic data newer than 2001 census (age and gender structure)