



LOCAL FINANCE BENCHMARKING: A SHARED TOOL FOR IMPROVED FINANCE MANAGEMENT

Local Finance Benchmarking: a shared tool for improved finance management

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**LOCAL FINANCE
BENCHMARKING:
A SHARED TOOL
FOR IMPROVED
FINANCIAL
MANAGEMENT**

Strasbourg, 2015

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Foreword

Sound financial management at local level is key to improve the level and quality of local public services delivered to the population. In particular in times of crisis, using in most efficient way the local income sources and local property is an obligation for any local government official.

Local finance benchmarking (LFB) is a tool designed by the Council of Europe to contribute to improving local financial management and fiscal arrangements for local authorities in all European countries. It is based on two Recommendations of the Committee of Ministers, prepared after consultation with OECD, IMF and the World Bank. This tool has already produced good results in various other countries, such as Bulgaria, Greece, Portugal, Spain and Ukraine. Its implementation started in Eastern Partnership countries under the Council of Europe/European Union Eastern Partnership Programmatic Co-operation Framework for 2015-2017.

This Study was prepared by a team of international and local experts. National chapters of this study come up with concrete recommendations to overcome the existing drawbacks for LFB implementation. The preparation of this study is the first step of the project. It should lead to the preparation of national Benchmarks and their implementation on a pilot basis in 2016. It is expected that, like in most other countries where this tool was implemented, it will produce real-life reforms of local finance management not only in the pilot municipalities but also in other local authorities in the participating countries.

A national policy on promoting LFB and incentives to encourage local governments to reform their financial management practice, when appropriate in the light of the results of the implementation of this tool are important elements for the success of the reform of financial regulations and practice. Financial management benchmarking, which is not yet widespread in the region, needs to be encouraged by disseminating success stories from the region and beyond, thus exposing decision-making representatives from both the central and local level to these good practices and creating positive incentives for reforms.

I wish all the countries and voluntary municipalities involved all success in this undertaking.

Daniel POPESCU

Head of the Centre of Expertise for Local Government Reform of the Council of Europe

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Options for assessing local financial resources and financial management

SUMMARY REPORT

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September 25, 2015

Benchmarking local finances: an introduction

Benchmarking as a *management tool* is used primarily for diagnostic purposes. For businesses and public service organizations it helps to identify the areas of intervention and to prioritize development actions for better performance and increased efficiency. In public policy making benchmarking provides evidence for decision makers through scoring and ranking.

In local government finances and financial management this instrument *supports governments* both at national and local levels to identify the factors of (i) effective revenue raising, (ii) equitable intergovernmental fiscal relations, and (iii) efficient local financial management. The Committee of Ministers at the Council of Europe has developed recommendations on these areas for local and regional authorities. The scope of local government responsibilities and allocation of functions are important factors of fiscal decentralization, but they are not subjects to the recommendations.

Local financial resources and financial management are important issues for the Eastern Partnership (EaP) countries. Proper revenue decentralization and effective financial management can *solve national, country-wide problems*, so fiscal decentralization in these fields is not an objective in itself. Primarily they help to harmonize the public service performance with the local needs. It is important in the countries with limited economic resources and being affected by political conflicts, because properly designed intergovernmental fiscal relations make public resource utilization more efficient. Fiscal decentralization can contribute to macroeconomic stability and improve fiscal discipline, if the institutional framework is properly designed. Depending on a country's overall level of economic development it could decrease poverty and income inequalities. Political objectives of greater social sector investments, improved checks and balances are also promoted by stronger local democracy. Even national unity - an important national goal in some of the EaP countries - can be supported through asymmetric decentralization.

Aiming to reach these targets the Council of Europe's Center of Expertise for Local Government Reform has developed two sets of *Local Finance Benchmarking (LFB) toolkits*. Based on the Committee of Ministers' Recommendations from 2004/2005 these LFB instruments help to (i) assess the local revenue decentralization and financial management systems (country level benchmarking), and (ii) local government level benchmarking. The international LFB tool provides assistance to national policy makers in designing fiscal decentralisation, while the other one supports elected officials and the local administration for designing targeted municipal actions in using local financial resource and in financial management. Local Finance Benchmarking is based on external experts' diagnosis, so it is not a self-assessment tool. The benchmarks on financial resources and financial management use two types of assessment methods: surveys and indicators on local finances.

The thematic programme "*Strengthening institutional frameworks for local governance*" is part of a regional programme implemented by the Centre of Expertise for Local Government Reform, the Directorate General of Democracy (DG II), Council of Europe under the CoE/EU Eastern Partnership Programmatic Co-operation Framework in the period of 2015 – 2017. The main objective of this programme is to support the on-going process of local government reform in six participating EaP countries by focusing on the improvement of financial and human resource management of local administrations based on European standards and benchmarking processes.

The local finance benchmarking component of the thematic programme is planned to be implemented in *three stages*:

1. assessing the legal-regulatory framework in the six participating countries;
2. adapting the Council of Europe standard Local Finance Benchmarking toolkit to the specific national conditions for in-country and regional comparison;
3. implementing the adjusted local finance benchmarking tool at national and regional level in the EaP countries.

In the present first stage of the project, harmonized national country reports have been prepared on local government finances in each EaP country. They also made an initial assessment on the potential areas of local finance benchmarking and briefly discussed the options for LFB programme implementation. This report is based on the national country studies and compiled them into a comparative EaP regional summary report. Most of the data quoted here are from the country studies, unless otherwise indicated¹.

The objectives of this summary report are as follows:

- i. to discuss the common problems of using LFB toolkit at national level (EaP regional comparison) and locally (domestic comparison);
- ii. to identify the obstacles of LFB implementation and to formulate some recommendations to incentivize national and local governments to apply LFB;
- iii. to guide the future project partners in LFB toolkit adaptation.

The most important terms often used in this report refer to *Eastern Partnership* countries as a joint partnership of the European Union and six countries (http://eeas.europa.eu/eastern/index_en.htm). The *Programmatic Co-operation Framework* (PCF) hosting this theme is here: http://www.coe.int/t/dgap/localdemocracy/EAP/default_en.asp. All the *Local Finance Benchmarking project* related information is available on the Council of Europe website: http://www.coe.int/t/dgap/localdemocracy/Centre_Expertise/Local_Finance_Benchmarking/.

For the purposes of the LFB project we made a distinction between the two types of local governments, which are often used interchangeably in the EaP region: the elected local governments of various types (community, municipality, city, regional/district government) and the local/territorial units of the state, representing the national government. They might operate on the same administrative territory, managing local matters in parallel, but our aim is to specify the autonomous role of the elected local governments in local finances.

1. Authors of the country studies were Liana Aghabekyan (Armenia), Sabuhi Yusifov (Azerbaijan), Yuri Krivorotko (Belarus), Irakli Khmaladze (Georgia), Viorel Roscovan (Moldova), Vyacheslav Zubenko (Ukraine). Working on the country reports as individual experts they did not represent any institutions.

Chapter 1

Local government systems

Recommendations on local financial resources and financial management and consequently the Local Financial Benchmarks *do not deal with the structural issues* of local governance. So the critical components of local autonomy, such as the government tiers, municipal size and capacity, the locally managed public functions are not assessed by the LFB Toolkit.

However, indirectly they influence local revenue autonomy, the forms of intergovernmental transfers and the scope of local financial management. Size of local functions determines the scope and forms of fiscal autonomy. The unique relationship of local state government units and the elected local governments should be also taken into account for developing the actual indicators of fiscal decentralization and local finance benchmarking.

So proper information on the territorial-administrative structures and the locally managed public services is critical for adapting the Local Financial Benchmarks in the EaP region.

1.1. TERRITORIAL-ADMINISTRATIVE STRUCTURES

The only common feature of the six countries participating in the project is that they were all parts of the former Soviet Union. Since the break-up of the former SU they followed different administrative-territorial development patterns. Two of the largest countries, Belarus (population 9.4M) and Ukraine (43.2M), kept the three-tier administrative hierarchy, while the others have diverse forms of local governments and administrative structures. (Table 1)

Government tiers

Armenia (3.2M) and Moldova (3.6M) presently have two-tier systems: Moldova keeping the former ray-on-size local governments at the territorial level, while Armenia merging them into middle-tier governments (Marz).

Azerbaijan (population 9.5 Million) has a unique structure of single local government tier of cities, settlements and village municipalities. However, there is a parallel system of state administration both in the cities (11) and country-wide (59). In addition the nine regions of the national administration remained in place.

In Georgia (population 3.7M), following the two waves of decentralization reforms, presently there is only a network of first tier local governments (64 municipalities, 12 cities). Regional administrative structures are organized by the governors' offices and eight ministries.

Table 1. Administrative-territorial structure and local governments

	Region (Oblast)	District (Rayon)	Municipality, community,
ARMENIA		10 Marz and state government tier	915 hamaynq 49 urban communities 866 rural communities
AZERBAIJAN	9 regions Nakchivan AR	90 local bodies of state administration 70 districts	11 cities, 13 urban districts 73 city, 147 settlement and 1,387 village municipalities
BELARUS	6 Oblast 1 capital city	118 rayons	113 cities 90 urban settlements 1,159 rural settlements 23,251 villages
GEORGIA	governor offices ministerial regional units		64 municipalities (villages, towns, boroughs) 12 cities (districts)
MOLDOVA		32 rayons 2 municipalities (cities) ATU of Gagauzia	896 primaria (towns, villages)
UKRAINE	24 Oblast, 1 capital city, AR of Crimea; local state administration	460 rayons, 490 cities local state administration in rayons and cities of rayon significance	885 urban settlements, towns of rayon significance, 28,441 rural settlements

Local state unit vs. elected local government

For local government finances and financial management the relationship between elected local governments and the territorial-administrative units of national government is critical. The local branches of government offices and various ministries might interfere into the operation and management decision of elected local governments. This control and supervisory power might range from the soviet-style dual subordination of local government administration to supportive audit of autonomous and independent local executive branches. Relationship between the local state units and the elected local governments actually determines many aspects of revenue raising, budgeting and spending autonomy.

However, it is not part of the Recommendations on financial resources and financial management, because it is considered an internal, political matter. The lack of fiscal and administrative capacities of elected local governments is also a factor of state administration's involvement in local matters.

In this respect the scope of decentralization is significantly different in the six countries of the EaP region. (Table 2) The local government executive powers are rather limited in three countries, where local governments have two types: local units of state administration and elected local governments. This is the case in Azerbaijan, where the centrally appointed executive committees operate at district level with subordinated counterparts at settlement, village level municipalities.

Table 2. State and local executive powers

	State/national government representative	Local executive powers
ARMENIA	Governor (Marzpet) at regional level	elected Head of Community
AZERBAIJAN	Executive Committee (excom) in districts, subordinates in settlements, villages	Council chair elected from the councillors
BELARUS	Executive Committee overwriting elected govt. at Oblast, rayon, city, settlement levels; ministry control over elected govt.	elected council, without executive power
GEORGIA		elected mayor/Gamgebeli
MOLDOVA	rayon level state administration	elected council
UKRAINE	local state administration at Oblast, Rayon level	local state administration reporting to elected council

In Ukraine local state administration operates at Oblast and rayon level, while lower state administration reports to elected councils. This is the classical form of parallel local state and elected administrations. Executive Committees have even greater powers in Belarus, where they can overwrite elected governments' decisions at all the three levels of government. Elected councils lack any executive powers under

this scheme in Belarus (e.g. cannot open a bank account), so central government agencies control local governments effectively.

In Moldova local state administration exists only at the rayon level, but it is able to influence the first level elected local governments, due to their limited administrative and technical capacities. Local governments have more executive powers in Armenia, where the head of community is elected. However, at regional level the governors (Marzpet) are considered as representatives of the national government and they exercise executive powers, as well. In Georgia the elected mayor/municipal leader (Gamgebeli) has full executive powers at the local level.

Size and geography

Local financial capacity and intergovernmental fiscal relations are also influenced by the size and urban-geographical characteristics of local governments. (Table 3) The average size of the lower tier local governments is the smallest in Ukraine (1,500), Moldova (2,850) and in Armenia (3,500, with half of municipalities below population 1,000). These three countries of the EaP region have rather fragmented municipal structures. In Azerbaijan (5,900) and Belarus (6,351) average municipality size is moderate, while Georgia (49,000) is a country with a clearly amalgamated local government network.

Two of the smaller countries (Armenia, Georgia) have large capital cities, which dominate the municipalities with population share around one-third of the country. The capital cities are significant in Azerbaijan (25%), Belarus (20%) and Moldova (20%), but the urban structure is less concentrated. Ukraine, the largest country, has the most proportional urban structure: only 6.2% of the country's population is concentrated in Kyiv. In all cases the fiscal capacity of the capital cities is still exceptionally high, so they dominate both in revenue collection and municipal service management.

Table 3. Size of local governments

Country (population in Millions)	Average municipality size	Municipalities below pop. 1,000	Share of capital city population
Armenia (3.2)	3,500	48%	34%
Azerbaijan (9.5)	5,900	18%	25%
Belarus (9.4)	6,351	9.5%	20%
Georgia (3.7)	49,000 (34,000 w/o Tbilisi)	0%	30%
Moldova (3.6)	2,850	11.4%	22%
Ukraine (43.2, w/o 2.3 of Crimea)	app 1,500	n/a	6.2%

1.2. LOCAL GOVERNMENT FUNCTIONS

According to the widely used decentralization indicator (local budget in % of GDP), countries of the EaP region are less decentralized. Moldova (11.2%) and Georgia (5.4%) have the highest ratio, which is comparable to the European Union country average (11.4%) - excluding the regional (state) level expenditures of sub-national governments in the federal states of the EU.

In Belarus and Ukraine, due to the parallel state and local government functions, the exclusive local government functions cannot be specified. The ratio of total locally managed public budgets is higher, but this decentralization indicator is not comparable to the other country averages, which cover devolved functions of elected local governments, only.

Table 4. Scope of decentralization^{*/}

	Local expenditures in % of GDP	Share of local budget revenues in total budget revenues (%)	Share of local budget expenditure in total public expenditure (%)
ARMENIA	2.5	9.8	8.9
AZERBAIJAN	0.02 (transfers)	0.24 (overall state budget)	0.25 (overall state budget)
BELARUS	18.2	63.2 (of consolidated budget)	62.0 (of consolidated budget)
GEORGIA	5.4	17	
MOLDOVA	11.2	28.9	28.2
UKRAINE	14.3 (state and local budget expenditures)	31.1	

^{*/} in 2014, or the latest year available

The main issue of defining the actual local government competencies is to identify the delegated and the devolved local own functions. National constitutions usually list a wide range of decentralized public services. But the real municipal control over these services can be specified only by assessing all the components of service management: legal obligations, responsibilities in defining the service performance standards, autonomy in forming the service organization and in human resource management, financing rules, technical and legal supervision, etc.

All these factors could not be analysed in details by the country reports. For the LFB project purposes only the delegated and the own, local functions should be separated. Delegation means transfer of national public services to lower levels by providing the full amount of the necessary funds, but leaving no local discretion in spending. While the own functions are those devolved services and competencies, which are managed by the elected local governments. These mandatory functions and responsibilities are financed by the pool of funds available for local governments.

Indicators on the scope of decentralization showed that local governments have rather limited functions in the EaP region. They are typically basic administrative and communal services, some of them further specified as mandatory or optional ones. In some countries even these local government own functions overlap with the delegated local state responsibilities. So for example, in Azerbaijan or Belarus the local government service management autonomy is limited by the central executive organs. Local governments develop their own programs and they are responsible for a wide range of human and communal services. However, in practice these local government functions are jointly provided with the state administration and municipalities sometimes only pay salaries of the locally employed administrative personnel (Azerbaijan). The local own functions are often defined rather vaguely, such as the general responsibility for integrated development, planning, social protection, defence, etc. in Ukraine.

In the more decentralized countries, e.g. in Georgia, the exclusive and voluntary local functions are specified by law, while the delegated services should be contracted to the local governments (and they are only app. 5% of the total local budget). In Armenia the delegated (centrally funded) functions and the local own competencies (both mandatory and optional) are defined by the law on local governments.

In Moldova the main problem is the unclear assignment of functions among the three government tiers: service responsibilities are defined by different pieces of legislation, often not in a coherent and uniform way. Dual subordination of local administration formally does not exist, although national governments and rayons often intervene into local matters, as the first tier local governments (primaria) lack the proper management and financial capacities.

Chapter 2

Local government revenues

Expenditure assignment determines the basic rules of financing local governments. Wider local government functions require broader local revenue base with more diverse and stable revenue options. The local revenue autonomy is influenced by the relationship between the local state organizations and the elected local governments, as well. When the borderline between the state administration and the elected local governments is blurred, then the government decisions on revenue raising will not be clear, either. In this case the common pool of national taxes used at local level and the own revenues of the elected local governments are planned jointly and in the same country the proportions of these two locally used public revenues will be different by local governments.

In most of the EaP countries, because of the limited local government own functions and the national government control over elected local governments, the local revenue autonomy is low. Sub-national governments benefit from four main types of revenues: (i) own source revenues (taxes, user charges and other non-tax revenues), (ii) shared revenues (taxes, fines) and various (iii) intergovernmental transfers (subventions, subsidies, grant, equalization funds, etc.). Plus local governments might (iv) borrow, but loans and other forms of debt financing are not used widely in these countries.

Due to the mixed state and local government responsibilities and combined budgets, typically two types of revenue sources are used: own revenues and intergovernmental transfers, grants. Shared revenues are also used for financing local budgets, but they are often regarded either as own revenues or transfers. Shared taxes and fines formally exist in Armenia, Belarus, Georgia, Moldova and Ukraine, but those own source revenues, which cannot be influenced by local governments, might be also regarded as shared ones. On the one hand, shared revenues might work as transfers, such as in Belarus, where the PIT, VAT, business taxes are shared with the Oblast governments, which then reallocate them as transfers to lower tier governments.

Formally local (and locally used) budgets are funded by a mixture of all these types of revenues. (Table 5) However, real local revenue autonomy is not properly reflected by these proportions of own and shared revenues or transfers.

Table 5. Local revenues

	own revenues	shared revenues	grants, transfers	other	comments
ARMENIA	29.1%		48.5%	22.4%	Shared environmental payments are included in own revenues. Income and profit tax sharing ratio is 0%.
AZERBAIJAN	82%		14%	4%	
BELARUS (2013)	41%	29%	30%		Consolidated Oblast revenues; Budget law determines revenue sharing ratios with the Oblast
GEORGIA	29%	4%	67%		
MOLDOVA LEVEL I.	13%	14%	70%	3%	
MOLDOVA RAYON LEVEL	6%	24%	69%	1%	
UKRAINE	48%		52%		General Fund: all locally used budgets. Source of data: http://www.treasury.gov.ua/main/uk/doccatalog/list?currDir=212666

2.1. OWN SOURCE REVENUES

Local government revenue autonomy is determined by various factors. Firstly, by the local governments' power in setting the tax base, the tax reliefs (e.g. minimum thresholds, tax credits/deductions) and tax rates. Secondly, tax administration also influences local tax autonomy, as local tax collection is usually more effective, compared to the other model, when tax administration is national. When local governments have no power to decide what tax they levy, how tax reliefs are granted and which tax rates are used, then they have no real revenue autonomy. These revenues are regarded more as shared ones, even if localities are eligible for the total collected amounts. According to the OECD taxonomy, the local tax autonomy can be specified along the following categories of taxing powers:

- a. local government sets the tax rate and tax reliefs (consulting with the higher level government or not), (*the highest local tax autonomy*)
- b. local government sets the tax rate, within specified lower and/or upper limits
- c. local government sets the tax reliefs (tax allowance, tax credit)
- d. tax sharing, defined by the local government or by the legislation annually or for a longer period
- e. centrally set local tax base and rate (*lowest local tax autonomy*)

Local governments of the EaP countries are usually authorized to levy various types of taxes and they collect non-tax revenues, as well. The most typical local own source taxes are the various forms of *property taxes*. They are levied usually on residential property, agricultural and urban land or buildings and also on vehicles (the latter one in Ukraine).

The other more significant local revenue is the *tax on local businesses*: profit tax (paid by municipal enterprises in Azerbaijan), advertising fees (Armenia, Azerbaijan, Moldova), net sales tax (Belarus), single tax on small businesses (Ukraine). *Natural resources* are also taxed locally (Belarus, Georgia), or taxes are levied in the form of mining tax in Azerbaijan. There are other local taxes, such as on hotels, tourism taxes and dog tax, royalty, charges, parking fees and fines. These local taxes, often called nuance taxes, rarely produce significant local budget revenues.

User charges and tariffs are also local government revenues. However, elected local governments have limited autonomy in defining service charges. They are set at national level by various types of authorities: Tariff Council (central government agency) in Azerbaijan or by the ministry responsible for the specific service (Belarus). In other countries tariff setting powers are divided between national and local governments (in Ukraine with the National Communal Services Regulatory Commission) or only tariff ceilings are defined at the central level (Georgia). In Armenia the minimum and maximum charges are set by law (the central government), while local authorities regulate the actual tariffs within this range.

Capital revenues are partly influenced by the availability and form of local government property. In those local government systems, where municipalities have access to public property revenues from the sale of municipal assets, they are local receipts (Armenia, Georgia, Moldova, Ukraine). Even when current and capital budgets are formally not separated, revenues from sale, rent, leasing can be identified. However, all the capital revenues do not produce significant local revenues: in Belarus they comprise 0.71% of total sub-national revenues (in 2013). Local government could raise one-time revenues on their financial deposits, when they are allowed to open bank accounts outside the treasury system (e.g. Georgia). Dividends, other forms of return on public property (Ukraine), development fee are also local capital revenues.

Tax administration is usually centralized, which further limits the local own source revenue raising autonomy. In Belarus, Ukraine or even in the more decentralized Georgia local government have no competencies at all in tax administration and enforcement. Tax administration is local in Azerbaijan and Armenia, where the regional governments (Marz) collect and transfer information to the ministry.

Benchmarking own revenues

The country studies proved that local own source revenue systems can be used for benchmarking, both internationally and at the local level. Despite the fact that local governments have limited revenue raising autonomy and local tax administration is often centralized, some indicators of the standard Local Finance

Benchmarking toolkit might be adapted to the countries participating in the project. Perhaps not the most sophisticated components of the Recommendations on financial resources should be used (e.g. on fiscal neutrality, Rec. 16; Rec. 30), but specific technical aspects of local own source revenue raising can be measured.

The most important task will be to *separate real local government revenues* from the locally used by national government ones. These latter ones cannot be regarded as real own revenues, as elected local governments have no authority in defining the tax base, tax reliefs and in setting tax rates. They should be regarded as shared revenues, where different rules apply.

Proposed areas of local finance benchmarking: *own source revenues*

Scope of fiscal decentralization: national systems	Comparing local government financial resources, financial management
Fiscal equivalence: scope of own revenues; diversity of tax base	Local taxes: significant, stable, simple
Tax decentralization: autonomy in rate setting and defining tax reliefs	
Autonomy in own revenue raising: regulatory methods, stability of national tax policies	Tax system audited: collection rate, coverage of taxpayers
Procedures of national tax policy design: openness, consultation	Local tax policy design: sound, open, legal (approved by elected bodies)
Economic impact: neutral, limited distortions	Capital revenues: separated, used for capital investments
User charges: scope, limits on access to services, local autonomy in charge setting	User charges are comparable to costs, support to disadvantaged users
Tax administration: local vs. central, administrative capacities, standard litigation procedures	Local tax administration: collection is effective, costs of tax administration

2.2. MUNICIPAL PROPERTY

Ownership of assets is critical for local autonomy, so property management will be an important part of local finance benchmarks. In some EaP countries local governments have real autonomy in using their assets by selling, renting, investing, etc. (Armenia, Azerbaijan, Georgia, Moldova). In Georgia the assets used for core local government functions cannot be alienated, only rented. Local governments might benefit from the sale of state owned assets in Georgia and Ukraine: the receipts from asset sale are shared with local budgets.

In Belarus local governments have rather limited powers over the buildings, equipment used for providing municipal services. Here local property is part of the unified state ownership, so local governments have only management autonomy over these assets.

Proposed areas of local finance benchmarking: *municipal property, local assets*

Comparing local government financial resources, financial management
Local records on assets and liabilities
Organisational forms and management of local property

2.3. REVENUE SHARING

As it was already discussed five countries have explicit revenue sharing system. In Moldova, following the recent decentralization reforms, the personal income tax is shared with the rayon (25%) and the first tier local governments (75%) on an origin basis. It is a significant local revenue allocated by transparent methods. In Georgia shared revenue comprise 4% of local budgets: fees on mining (significant if concentrated, e.g. gold, mineral water), fee related to postponement of military service and other fines. They are regulated by laws, setting the sharing ratio (e.g. 60% of traffic fines is local) or allowing some discretion to local governments.

In Ukraine the corporate income tax is shared with Oblasts and personal income tax sharing ratios are differentiated by type of local governments on an origin base. It is part of the general fund, financing all locally managed public services. In Armenia only the environmental fines are shared with the local governments, effectively, the other shared revenues exist only on paper: the local sharing ratio is 0% in the case

of income tax, profit tax. In Belarus profit tax (50%) and VAT (30%) are shared with the Oblast governments. The total amount of shared taxes is reallocated among Oblast according to ratios set for five years. The shared revenues at Oblast level are reallocated among the lower tier local governments as part of the overall budgeting and planning process.

Proposed areas of local finance benchmarking: shared revenues

Scope of fiscal decentralization: national systems
Tax sharing is origin based, supporting local efforts to increase the tax base
Transparent sharing rules are set by law for a longer period
Shared taxes are not earmarked

2.4. INTERGOVERNMENTAL TRANSFERS

The Recommendations on financial resources focus on two aspects of intergovernmental transfers: (i) how fiscal equalization system is designed, and (ii) what are the rules of general and specific grant allocation. The equalization policies are evaluated along the following criteria: how the various factors of inequalities are taken into account (more specifically local fiscal capacity, spending needs, etc.), how rules and procedures of equalization are specified (whether they are transparent, stable, predictable, regulated). General purpose grants are preferred, which are allocated by diverse criteria, which cannot be influenced by the recipient local governments. Specific grants are used ideally for financing capital investments and delegated services, following similar allocation principles as the general grants (being objective, transparent, reflecting spending needs and financial capacity).

Fiscal equalization and grant allocation mechanisms in the EaP countries are very much influenced by the scope of decentralization and the overall local government characteristics. All the present models use various combinations of the following allocation techniques:

- a. take into account local expenditure estimates (needs) and/or own source revenues (e.g. property tax), shared revenues (PIT, profit tax);
- b. general, unconditional grants or earmarked specific subsidies, subventions are used;
- c. allocate basic (minimum) grants and sectoral subsidies;
- d. grant allocation is formula based or grants are negotiated with the higher level governments;
- e. allocation criteria are set by law or grants are allocated by ad hoc rules.

Table 6 summarizes the most important features of intergovernmental transfers in the six EaP countries. The first condition of an ideal grant allocation mechanism is to regulate how the total amount of intergovernmental transfer is defined. Fiscal equalization grant is specified as a ratio of consolidated state budget (min. 4% of year t-2) only in Armenia. In Georgia a similar regulation on grant pool is appropriated by targeting the minimum amount of local expenditures (as 4% of GDP).

The second key question is the way how grants are allocated among local governments. In Armenia, Georgia and Moldova the grant allocation is based on objective formulae. In Georgia the formula based, general purpose, unconditional equalization grant dominate the intergovernmental transfer system (73% of all the grants). Despite the arbitrary grant allocation process, some objective criteria are used for grant allocation in Azerbaijan, Belarus and Ukraine. They could be the old-style input norms or new type expenditure need based indicators, usually population number and per capita expenditures.

Specific grants are usually allocated under various names (subventions, donations, subsidies); in some countries they have the larger share among the intergovernmental transfers. They are typically allocated through the budget negotiation process, involving the middle-tier governments (Marz, Oblast).

As the actual grant design is part of the budgeting process, the Ministry of Finance and the sectoral ministries dominate the planning and grant allocation. Local government associations or other lobby organizations were not mentioned by the country studies. The revenue sharing and grant allocation mechanisms in the various autonomous territories of the EaP countries will not be subjects of local finance benchmarking.

Table 6. Intergovernmental transfers

	Fiscal equalization	Grant allocation
ARMENIA	Financial equalization grant (66%, 93% without Yerevan): unconditional for the administrative budget, larger part; Min. 4% of consolidated budget t-2 Formula based, differentiated by population size (pop. 300); per capita land and property tax; population size	Subventions (34%): concentrated in Yerevan: specific, non-matching for capital investments; Sectoral negotiations through Marz
AZERBAIJAN	Various forms: <i>donation</i> : general grant; negotiations based, but some indicators are used <i>subvention</i> : earmarked for specific projects	
BELARUS	Equalization of expenditures: formula based (per capita), but differentiated by Oblasts with protected items (salaries, housing costs, etc.) Oblast reallocation: discretionary, subjective Estimation of own source and shared tax revenue basket: $E_i - R_i = T_i$	Donations to welfare services (84%) Subventions (e.g. Chernobyl compensation), off-budget funds for social protection), capital transfers Sectoral targets: housing, health care Special fund for financial support of administrative-territorial units (expenditure needs based)
GEORGIA	Equalization transfer: min. municipal expenses 4% of GDP; city/municipality ratio is set; formula based, general purpose, unconditional (73%). $E_i - R_i = T_i$	Discretionary, earmarked: <ul style="list-style-type: none"> • transfer for delegated services (matching) (1%) • special transfer for major cases (0.5%) • capital transfer (25.5%) • Special State Funds: reserve funds, allocated by the Govt., President
MOLDOVA	Equalization grant allocated by per capita PIT, population number, area	Specific transfer for education, social transfers, administration Special extra-budgetary funds
UKRAINE	Basic subsidy for profit tax, PIT equalization at Oblast level Subventions: <ul style="list-style-type: none"> • basic subsidy • sectoral: social protection (needs based); education (formula based); vocational education and training; health care (formula) • capital investments • enterprise consolidation Reverse subsidy (horizontal equalization)	

Benchmarking intergovernmental transfers

All these characteristics of intergovernmental transfers can be used for comparing the national systems in the EaP region. Data are usually available, because grants are the most accurately reported elements of local budgets. Rules and procedures of grant allocation and planning are also well documented by the acts on local finances and the annual budget laws or other national government regulations.

The critical benchmarking issue will be to evaluate how national governments actually manage grant allocation. Objectivity in this case might disguise arbitrary ministerial decisions by using different norms and criteria for specific local governments (cities of various sizes, regions, economic and social characteristics). Regulations on capital cities might be politically biased and subjective, as well.

Proposed areas of local finance benchmarking: *equalization and grant allocation*

Scope of fiscal decentralization: national systems
Complexity of intergovernmental transfer: expenditure and revenue based equalization
Characteristics of grant allocation: <ul style="list-style-type: none"> • rule based or arbitrary; • transparent, understandable or too complex and managed internally by the administration; • stable, predictable for the local governments or often changing.
General grants vs. specific, earmarked grants
Objective measures are used for calculating expenditures needs and local fiscal capacity
Incentives created by the intergovernmental transfers: economizing on expenditures, increasing revenues

2.5. LOCAL BORROWING

Loans are rarely used by local governments in the EaP countries. Due to the highly centralized system of financing local governments, the local capital investments are usually funded by national budget donations and subsidies. These funds are allocated through sectoral planning and the comprehensive national government budgeting process.

Usually government's - primarily the Ministry of Finance or the ministry responsible for local governments (in Armenia) - consent is needed for local government borrowing and bond issue. (Table 7) Borrowing is limited to capital investment purposes and allowed on a long term basis only.

Low level of debt financing is partly explained by limited information and expertise on borrowing. Other obstacle of more extensive local government borrowing might be the lack of regulations on managing local overdue debt and the obscure accounting, reporting practices on municipal debt or debt service.

Table 7. Regulations on local borrowing

ARMENIA	Subject to Ministry of Territorial Administration and Emergency Situations approval. Borrowing for capital investment purposes only (except local government borrowing from each other for current expenditures). Only one loan at a time. Debt service <20% of local budget.
AZERBAIJAN	Borrowing from domestic banks only. Collateral should be local property. No national government responsibility. Lacking comprehensive regulations.
BELARUS	Debt (including guarantees) < 20% of local expenditures (except village housing and state controlled investment schemes). Debt service <15% local budget revenues (excluding transfers). State guarantees on bond issue. State bank buying local bonds.
GEORGIA	MoF consent of local borrowing. National public debt is limited to 60% of GDP. Borrowing for capital investments only. Loans from donors are repaid by the national budget.
MOLDOVA	Short term borrowing for current budget < 5% of total revenues; Loan repayment and guarantees < 20% of total annual revenues; Own source revenues are to be used for loan repayment. No national budget guarantees.
UKRAINE	MoF agreement on loans, guarantees. MoF register on local loans and guarantees. Borrowing for development purposes. No new loans for 5 years if a city failed to repay debt. Long term debt < 200% of development budget Debt service <10% general fund

The level of local government debt is regulated, either by limiting the total debt stock or/and by setting the level of annual debt services (flow). Debt, including guarantees, should be below 20% of local expenditures in Belarus, lower than 200% of development budget in Ukraine and in Moldova short term borrowing is limited to 5% of current budget. Debt service is regulated as percentage of local revenues in Armenia (20%), Belarus (15%, excluding grants), Moldova (20%) and Ukraine (10% of general fund).

Proposed areas of local finance benchmarking: *borrowing*

Scope of fiscal decentralization: national systems	Comparing local government financial resources, financial management
Loans are used for capital investments	Loans are used for financing capital investments
Loans are repaid by local revenues, user charges generated by the project	Short term borrowing for cash flow management only
No national government guarantees	Compliance with the national borrowing limits
Regulations on local borrowing limits are set	
Local government bankruptcy regulations or procedures are in place	

Chapter 3

Local financial management

3.1. THE RECOMMENDATIONS' FOCUS

Financial management is interpreted by the Recommendations primarily as the relationship between national and local governments. Recommendations for *central authorities* focus on the conditions of local fiscal autonomy in three main areas. Firstly, the overall framework of *budget* preparation, approval and implementation should be rule based.

Secondly, it accepts that there are *necessary limitations* on local financial management autonomy by the national government either serving the overall economic and fiscal policy objectives or supporting local governments for avoiding financial risks and keeping the financial health of local budgets.

As a general rule national government interventions should be consistent with the local autonomy (general, transparent intervention, based on objective criteria). Balanced budgets, separating current and capital expenditures without deep involvement in speculative investments should limit financial risks. Once local governments get into financial difficulties, the national government interventions for financial recovery should aim structural deficit, based on set rules and procedures.

Thirdly, financial *monitoring* system should serve both national and local needs. Monitoring has to be based on proper fiscal information and reports. It should also support the local governments' technical capacities.

Areas of benchmarking *local governments'* financial management primarily focus on *planning and budgeting*. It is a basic requirement to have local fiscal strategies, budgeting methods with performance targets for all local government units. *Budget procedures* should be open and properly regulated. *Budget implementation* has to be regularly evaluated, based on independent and transparent reports. Special control should focus on *commercial activities of local governments*, in the case of *issuing guarantees, using PPP schemes* and other commercial investments.

Country studies reported that local financial management practices are properly regulated. They usually allow wide-scale local autonomy in planning and implementing local budgets. However, detailed laws on financial management or other types of regulations do not necessarily identify the actual scope of local autonomy and the limits of national government's direct influence on local finances. So the Local Finance Benchmarks, focusing on the *real practices*, will assess the actual financial management systems.

3.2. LOCAL PLANNING AND BUDGETING

In all the EaP countries - with the exception of Belarus - local governments define their strategic priorities, prepare development plans or multiannual (2-4 years) budgets. Elected local governments have autonomous local budgets, which was especially emphasized by the report from Azerbaijan: local councils report to the executive committees, which are authorized to compensate for any cost increase and revenue decline during the fiscal year. In Belarus local budgeting is mainly an administrative process, implemented as part of the state budget planning procedure.

Funding mechanisms determine budgeting techniques: there is an expenditure norm based planning method with own revenue estimates at Oblast level in Belarus (reallocating the grants received); in Moldova, rayon governments influence community level budgeting methods, only. A simplified form of program budgeting is used in Georgia. In Ukraine, budget appropriations are also based on program evaluation, using standard MoF guidance.

There is a unified local budget in Belarus, while in other countries current and capital budgets are separated. In Armenia the "administrative" budget covers the current expenditures. In Georgia the local budgets

are also separated, even the relationship with arms-length service organizations is regulated, while donor funded investment projects do not go through the Treasury.

The budgeting process is clearly regulated (e.g. Azerbaijan, Georgia) and budgeting is a participatory process. It will be tested by the LFB surveys whether the typical forms of public participation, such as budget hearings, consultative committee (Armenia), publication of budgets through the local media exist on paper or in reality.

3.3. BUDGET IMPLEMENTATION AND SUPERVISION

Local governments have autonomy in implementing their budgets, establishing legal entities, managing reserves and leftovers. In Belarus, local governments seem to enjoy lower management autonomy, because executive committees intervene into local government financial management decisions.

Various organizational forms of legal supervision and administrative control have been established in the EaP countries. There are independent state audit organizations of various types: State Control Committee, Committee of Economic Control in Belarus, State Audit Office doing local government audit in every 3-5 years in Georgia. Beyond these specialized agencies the Ministry of Finance, tax offices, the State Fiscal Service of Ukraine and the line ministries are involved in auditing. In Armenia the regional authorities have limited powers to control and to audit localities, as the primary responsibility rests with the Ministry of Finance and the Chamber of Control/Audit. The national audit agencies mix monitoring and audit with technical support, e.g. in Georgia the Ministry of Regional Development and Infrastructure.

The actual LFB surveys will reveal the quality of disaggregated fiscal information (having national accounting standards in Azerbaijan, but providing poor fiscal information in Belarus); how effective are the conflict of interest regulations and whether local financial management capacities are enhanced.

Proposed areas of local finance benchmarking: *financial management*

Scope of fiscal decentralization: national systems	Comparing local government financial resources, financial management
Budgeting process, budget approval and implementation is regulated by law	Local strategies, multi-annual budget plans exist
Basic budget requirements are set and they operate effectively: balanced budget, separate current and capital budget	Budgeting methods support council decisions by providing analytical sheets, service performance information, consolidated reports on satellite organizations
Commercial activities of local governments are limited	Budgeting process is opened and participatory, allowing sufficient time for review
National government intervention in local budget planning and implementation is indirect, proportional and not excessive	Budget implementation is monitored and regularly evaluated
Rules and procedures of financial recovery are in place and operate effectively	Budget report is independently audited
Reliable budgetary information is available for the local administration and the general public	Internal audit system is in place and used
Monitoring system of local finances is in place	Relationship with the service organizations, commercial entities
Human capacity development needs are identified continuously	

Chapter 4

LFB implementation: obstacles and options

Local Finance Benchmarks were designed for comparing the scope of fiscal decentralization and assessing local revenue policies and financial management practices. The more decentralized a local government system, the higher benefits are expected from benchmarking. LFB helps policy makers at national level to identify the missing or poorly functioning elements of local government revenues and financial management systems. At the local level it can position a municipality - and indirectly qualify the local officials and managers – by comparing its performance to other local governments’.

All this information produced by the LFB project might be utilized also for promoting fiscal decentralization in countries where devolution is not highly supported, either for political or economic-fiscal reasons. Comparison with other countries will prove that public services might be delivered at a higher level and more efficiently in a decentralized setting. Local benchmarking might show to service users how effectively the local financial resources are managed and this way it will increase accountability of the elected local governments.

So LFB might help to overcome the hostility towards decentralization. It would demonstrate local governments’ role in public resource management for better service provision. Beyond this general argument for introducing LFB, there are four typical tasks during the project implementation.

4.1. CREATING INCENTIVES

The in-country local finance benchmarking very much depends on the interest and willingness of the targeted municipalities. In the rather centralized Belarus, where elected local governments have very limited financial management autonomy, they are not interested in any comparison. Competition among local leadership is driven more by political contacts and less by competence and management quality. Perhaps here the LFB might *draw the public attention* to the fact that even in a centralized environment there are significant differences among local governments. This indirectly could lead to some changes in regulations and make the allocation system more transparent and objective.

The other argument against LFB is that in a fragmented local government system (e.g. in Armenia) small size municipalities with limited administrative capacities are not able to perform properly. This issue of municipality size and low management capacity came up in other countries, as well (e.g. Azerbaijan).

A partial solution for this problem of lacking local capacities could be the *gradual introduction* of local level LFB. Larger municipalities are more interested in presenting their successful methods and they are more capable to compete with their peers (Azerbaijan). In Armenia and Ukraine the ongoing amalgamation reforms could be supported by introducing local finance benchmarking on a pilot city basis. In Georgia the present stage of the decentralization reform targets economic development (e.g. in the mountainous regions), which can be also supported by gradual development of LFB.

4.2. DATA AVAILABILITY

Local Finance Benchmarking surveys both at national and local level are based on evidences of various types. Legislation on local governments, tax revenues, annual budgets, budget codes help international comparison. While within one country the local government budget resolutions, tax regulations, local decrees on financial management, rules and procedures are needed for inter-municipal comparison. Beyond this legal information the actual compliance of these laws, the impact of local regulations are also assessed through interviews, administrative statistics, inventories, opinion polls and media sources. But the most

objective form of local financial assessment is through indicators using expenditure and revenue data from budget documents and reports.

These *fiscal indicators* and supporting information systems would be important by-products of the LFB project. They can be used for analysis, city marketing and presentation purposes, even if not all the local governments take part actively in the LFB projects. Nationwide, aggregate data show the status of fiscal decentralization and with time-series the short term trends in local government finances. The disaggregated data help to evaluate the service efficiency, revenue raising capacity, fiscal health of local governments, their policies in local economic development, etc.

Table 8. Datasets, information bases

ARMENIA	<i>Ministry of Territorial Administration and Emergency Situations</i> Local budget revenues - http://www.mta.gov.am/hy/budgetary-incomes/ Local budget expenditures - http://www.mta.gov.am/hy/budgetary-expenditure/ Local budget publicity - http://www.mta.gov.am/hy/budgetary-performance/ <i>Ministry of Finance</i> Local budget reports - http://minfin.am/index.php?cat=206&lang=1
AZERBAIJAN	Statistical Committee (electronically), Centre for Work with Municipalities; Associations of City, Settlement and Village Municipalities
BELARUS	Ministry of Finance: http://minfin.gov.by/ru/budgetary_policy/ http://minfin.gov.by/ru/tax_policy/ Oblast finance departments Database of the Ministry of Taxes and Tax Collection: http://nalog.gov.by/ru/ Treasury data, but confidential
GEORGIA	Ministry of Finance (Budget Dept.): disaggregated Treasury data Ministry of Justice (www.matsne.gov.ge): legal database State Audit Office (www.sao.ge)
MOLDOVA	Ministry of Finance, http://minfin.md/ro/BOOST/
UKRAINE	State Treasury of Ukraine (local offices) State Statistics Service of Ukraine (http://www.ukrstat.gov.ua/), local information is available upon request, which might be rejected

Governments of the EaP countries are able to produce macro, aggregate information on local finances. In Table 8 the most important sources of information are summarized. Aggregate fiscal data are usually accessible through public sources with the exception of Belarus. Municipal level information can be collected through the statistical offices, special disaggregated databases (e.g. the BOOST system in Moldova) or by requesting treasury data. This latter option might work by referring to the Access to Information legislation (e.g. Georgia) or by getting government (ministry) permission (e.g. in Ukraine, where budget execution data are not public).

4.3. POLITICAL SUPPORT

As local finance benchmarks produce external evaluation of fiscal decentralization policies and municipal financial activities, the LFB survey results are politically sensitive outputs of the project. If detailed data are made public in the election period, some local leaders might object to take part in the project.

In 2016, when the implementation of the LFB is planned to be launched, local elections will be held in Armenia in the autumn and parliamentary elections will be in Belarus and Georgia. So it should be taken into account that the partner national and local governments will be more sensitive towards the project findings in this period. It should be avoided that LFB reports are used for campaign purposes by any political forces.

In general, national government support and endorsement is needed in all the EaP countries for the successful implementation of the LFB project.

4.4. RAISING PUBLIC AWARENESS

The problems of lacking incentives and political sensitivity might be overcome by increasing the public awareness in the local financial management. If there is a local public interest on how local services are managed and how effectively municipalities are governed, then it will have impact on national and local leadership. LFB can help customer orientation and consequently will increase local accountability. In the least decentralized Belarus the public support can be achieved through CSO/NGO support, as think tanks are more cooperative than the national government agencies.

The present ongoing decentralization reforms might create a favourable environment for launching the LFB project in some countries. In Armenia the decentralization process could be accompanied by the introduction of the LFB techniques, disaggregated datasets and other information sources. In Georgia, where the amalgamation process has been completed by now, further decentralization reforms aim to boost the economy, where increased efficiency of local governments might be attractive target both for national and local governments. Similarly in Ukraine the administrative-territorial reform (amalgamation) and reform on intergovernmental fiscal relations are on the political agenda and their implementation can be supported and monitored by LFB.

4.5. POTENTIAL LFB PROJECT PARTNERS

The actual institutional partners of the future LFB are rather diverse. As it is summarized in Table 9, the government agencies responsible for local governments are the most obvious potential stakeholders of the LFB programme. They usually provide technical assistance and professional support to local governments, so the financial benchmarking could be one of the instruments offered by them.

Table 9. Potential partners for LFB project

ARMENIA	Ministry of Territorial Administration and Emergency Communities Finance Officers Association
AZERBAIJAN	Centre for Work with Municipalities, Ministry of Justice Associations of City, Settlement and Village Municipalities
BELARUS	CSO, NGO (think tanks) and support from international organizations
GEORGIA	Ministry of Regional Development and Infrastructure: model/standard for measuring the performance of sub-national governments National Association of Local Governments of Georgia (NALAG); Centre of Effective Local Governance and Territorial Arrangements (CEGSTAR: http://www.lsg.gov.ge/)
MOLDOVA	State Chancellery Ministry of Finance, Ministry of Regional Development and Construction Congress of Local Authorities of Moldova (CALM)
UKRAINE	Ministry of Finance of Ukraine, Ministry of Regional Development, Construction, and Housing and Communal Services of Ukraine Ministry of Economic Development and Trade of Ukraine Association of Ukrainian Cities Association of Ukrainian Towns

Alternatively the *local government associations* (Azerbaijan, Georgia, Moldova, Ukraine) would be also interested in both national comparison and in local benchmarking. Think tanks could provide the required expertise (e.g. the Community Finance Officers Association in Armenia) and might even host the program (in Belarus). Ministry support units, such as in Georgia the Centre of Effective Local Governance and Territorial Arrangements under the Ministry of Regional Development and Infrastructure, or in Azerbaijan the Centre for Work with Municipalities (Ministry of Justice) could be allies in promoting and implementing the LFB project.

Financial and technical support is expected more from international organizations and donors than from the national governments (Georgia might be an exception, as government might also assist the LFB project). So these potential partners should be also involved from the early stages of the project design and implementation.

Local Finance Benchmarking in Armenia

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Chapter 1

Political and administrative structure

Armenia obtained its independence from the Soviet Union back in 1991 and the successive years were those of radical reforms and transition to new political and economic systems. Within these reforms an important role was assigned to the establishment of local self-government system. The Constitution of the Republic of Armenia (RA), adopted in 1995, laid the first and most important legal base for this, guaranteeing local self-government in Armenia. Two other legal acts, the “Law on Local Self-government” and the “Law on Territorial-Administrative Division” followed after the adoption of the Constitution setting the framework and main principles of the system. The first local self-government elections were held on 10 November 1996, which is considered the official date of establishment of local self-government system in Armenia.

The RA Constitution stipulates that the territorial-administrative units of the country are the regions (marz) and communities (hamaynq). The overall territory of the country is divided into 10 regions (marzes) and the capital city, Yerevan. While the capital had a status of region originally, the amendments in the Constitution in 2005 changed the status of Yerevan, defining it as a community. The specifications of territorial administration and local self-government in the city are described in the “Law on Local Self-government in Yerevan”. Regions are in fact the second tier of government and state governance is being held there. As such, regional authorities are a part of the central government, implementing the regional policy of the central government and thus not having the authority to adopt their own budget and set taxes and fees. The respective central authority responsible for the development and implementation of regional and local policy is the Ministry of Territorial Administration and Emergency Situations of the Republic of Armenia.

The regions are further divided into urban and rural communities (municipalities). Communities are the lowest tier of government and local self-government is being held at this level. Communities consist of one or more settlements, but the settlements are not separate administrative units. Local self-government authorities are the Head of the Community and the Community Council. The Head of the Community is the executive authority and the Community Council is the representative body of government. Both the Head of Community and the Community Council members are elected for 4 years on the basis of majoritarian elections. The number of Community Council members depends on the population of the municipality and varies from 5 to 21 people. Yerevan as already mentioned above is a special case with proportional elections of local government authorities.

Nowadays, there are 915 communities in Armenia (866 rural and 49 urban), including the capital Yerevan. This number is large enough for a country with population of around three million people. As a result the average population per municipality is about 3500 people. Considering that the population of Yerevan is above 1 million, the average population per municipality (without Yerevan) is about 3000 people. 442 or 48% of the above mentioned 915 municipalities have a population of less than 1000 people, 197 or 22.7% less than 300 people, 75 or 8.6% - 301-500 people, 168 or 19.3% - 501-1000 people.

Population size	Number of elected local governments (municipalities)	Population
<300	197	37,241
301-500	75	30,472
501-1,000	168	115,453
1,001-10,000	432	1,106,887
10,001- 100,000	40	588,190
>100,000 (without Yerevan)	2	251,940
Capital city	1	1,107,817
Total	915	3,238,000

In addition the municipalities vary greatly by territory, number of population, geographic conditions, as well as by the socio-economic level of development, the financial and human resources. In spite of the mentioned differences, all the communities have the same powers and responsibilities by the law. Most of the above mentioned small municipalities obviously lack financial, human resources, appropriate infrastructures, and as a consequence are not capable to meet the mandatory powers and deliver the proper level of public services, which is in immediate conflict with the crucial interests of the population.

Chapter 2

Local government functions

As already mentioned above, all municipalities in Armenia, in spite of their size, population, resources, capabilities, etc. are given the same competences by law. Yerevan is the only exception and the scope of competences of Yerevan authorities substantially varies from that of the other 914 municipalities. However, though the city is regulated by a separate law, the separation of competences and responsibilities is similar to the others.

The competences (functions) of local self-government bodies are stipulated by the “Law on local self-government” and divided into two main groups: own competences and delegated competences. Own competences in their turn are divided into mandatory and optional ones. The list of own mandatory competences, as well as their implementation mechanisms, are regulated by the above-mentioned law. Though the law predetermines some optional competences as well, this list is not comprehensive and local self-government bodies are free to implement any activity which reflects the interests of community as optional competences. However, mandatory competences are prioritized and subject to primary implementation.

In addition to own competences of local self-government bodies, some of the state functions can be transferred to local authorities as delegated competences/responsibilities. In contrary with own competences which are funded by local budgets, the funds for delegated responsibilities are completely allocated from the state budget.

The functions of local self-government bodies can be clustered in the following 14 fields:

- 1. Rights of citizens and economic entities:** This group of own competences of local authorities include protection of rights and interests of the citizens and economic entities; registration of the population; regulation of assemblies. Within this field of competences the head of the community implements such delegated powers as determining tutelage and guardianship; organization of registration of civil status acts and ratification of testament in case of notary absence. Since 2013, under this cluster of activities a separate sub-group is added - public participation in local self-government. With this regard local authorities ensure the preconditions for citizens’ participation in local decision-making and organize public hearings and discussions on the most important local documents, including the community development plan and the annual local budget.
- 2. Finance:** The financial competences of local authorities include planning, development, approval, implementation and reporting of the community budget; setting the types and rates of local taxes, fees and charges within the higher and lower tax-rate limits; organization of collection of local taxes, fees, charges; ensure targeted spending of the budget; when agreed with the state designated agency (RA Ministry of Territorial Administration and Emergency Situations), make decisions on local credits, lending and issue local bonds.
- 3. Maintenance of public order:** In this field local authorities do not possess own responsibilities, but are in charge of the delegated power to require the support of police for implementing their responsibilities and can inflict administrative responsibility in the cases of breaking the law.
- 4. Regulation of public events:** Here the competences are limited to being informed of any public event happening in the community and in certain cases, set by law, to prohibit these events.
- 5. Organization of Defence:** Local authorities’ mandatory responsibilities in this field mainly cover the registration of military servants, while as optional functions they can support the social protection of the families of military servants and organize youth education events on military-patriotic issues.
- 6. Urban development and public utilities:** Mandatory own competences include the development and adoption of urban development plans, maps and documents; giving construction, re-construction and demolition authorizations; control of targeted use and protection of existing buildings; authori-

zation for external advertising; organization of the work of public utilities; organization and management of water, sewerage, irrigation, heating systems; organization of scavenging, renovation and landscaping. As optional competences local authorities can implement construction/ re-construction works of social buildings; organize protection and care of resort areas, etc.

7. Land-use: As mandatory competences local self-government bodies ensure the development of annual and four-year land sale plans; can sell or rent the land; prevent illegal land use. Within the optional responsibilities local authorities can improve the existing land.

8. Transportation: Local governments are in charge of maintenance and protection of intercommunity roads and organization of intercommunity transportation.

9. Trade and services: In this field local authorities give authorization for selling excise products; authorization for organization of trade, entertainment, gaming and lottery.

10. Education, culture and youth work: The main mandatory competence in this sub-category is organization and management of the activities of public schools, kindergartens, cultural houses, libraries. Within the optional competences local authorities can organize holiday or Remembrance Day events; support the preservation of cultural heritage; raise the role of youth in the community, etc.

11. Sport: In this field local self-government bodies organize the work of sport institutions in the community.

12. Labour and social protection: Local authorities are not given any own competences in this field, and the only delegated responsibility is the organization of local social support centers.

13. Agriculture and Veterinary: Local authorities' responsibilities include the operation, construction and renovation of irrigation systems; registration and authorization for having pets in urban areas;

14. Environment: The organization of protection of land, forest and water resources is a mandatory competence and as delegated responsibility local self-government bodies implement environmental protection and perseverance of local resources of pollution¹.

Overall, local authorities possess a quite broad range of competences by law. However in many cases local governments lack enough resources, including not only financial capabilities but also human potential, developed infrastructure, etc., which hinders the successful implementation of these competences and the provision of basic public services.

1. The list of competencies of local authorities is provided based on the "Law on Local Self-Government" (2002).

Chapter 3

Local government own and shared revenues

In parallel with the above-mentioned competences local self-government bodies are given the right to develop and adopt local budgets having the full responsibility for spending it. According to the Law on “Budgetary System” of Armenia there are two levels of budget in the country. These two levels together represent the consolidated budget. The first level is the state budget, the revenues of which are generated from the following sources: 1) Tax revenues, 2) Charges, 3) Official transfers, 4) Other revenues. The second level respectively is the community budget (local budget).

Local budgets consist of two parts, namely the administrative or current budget and the capital budget. The administrative budget revenues include the following sources:

1. Tax revenues, which in their turn consist of

- local taxes
 - land tax
 - property tax
 - hotel tax
 - parking tax

Hotel tax is not being charged currently due to lack of regulation in the field. This is to say, that this tax type was added among local taxes in recent years and the law which will regulate the details is still under discussion. The one called parking tax is more often considered as a fee and does not have considerable share in the local budget. The main sources of local own revenues are the land tax and the property tax.

- shares from state taxes and mandatory payments
 - shares from income tax
 - shares from profit tax
 - shares from environmental payments

Under this subgroup the law sets shares from income tax and profit tax as local revenues, but again in practice the communities do not benefit from this, as currently the share is set to 0%. The only shared source of revenue is currently the share from environmental payments. The share rate to be allocated from the central level to local governments is set by the central government.

- penalties and fines.

2. User charges

- State charges
 - Charges for registration of civil status acts
 - Charges for notary services

As described above, the mentioned activities are delegated responsibilities of local governments and therefore the revenues go to local budgets.

- Local charges, including mainly
 - Charges for authorisation of construction, re-construction, demolition,
 - Charges for authorisation to sell excise products,
 - Charges for authorization to organize trade, entertainment, gaming and lottery
 - Charges for authorization of external advertising,

- Charges for local transportation
- Charges for pets, etc.

Local charges are also among the main sources of local own revenues and an extensive list of local charges is set and regulated by the separate law on "Local Charges and Fees". A new concept paper on local charges and fees, as well as amendments to the mentioned law are currently under discussion in the government with the purpose of adding new charges in order to raise own revenues of local self-government units.

3. Other revenues including local fees, revenues collected from the leasing of local property, transfers from the central government for delegated responsibilities, deficit funding resources, including credits from the state budget and/or other municipalities, unused revenues of the administrative budget from the beginning of the year.

4. Revenues collected from selling local assets.

5. Official intergovernmental transfers (to be discussed separately below).

Overall, the current (administrative) budget can be spent for current expenditures related to own mandatory and optional competences of local government units; for delegated responsibilities; payments for current lending, as well as the lending expenditures to other local self-government units.

The main sources of the capital budget revenues are as follows:

1. Official transfers, including both the intergovernmental transfers from the state budget (capital subventions) and the ones received from other sources with the purpose of funding capital expenditures.
2. Revenues collected from selling local property (non-financial assets).
3. Deficit funding resources, which include loans from the state budget and other sources.
4. Other revenues, including unused revenues of the capital budget from the beginning of the year, as well as allocations to the capital budget from the reserved funds of the administrative budget, etc.

The revenues of the capital budget are mainly spent for the following expenses: capital expenditures for own mandatory and optional competences; credit payments and lending to other local self-government units. The structure of local government revenues is pictured in Annex 6.

As already mentioned above, the main part of local budget revenues is generated from local taxes i.e. land and property taxes. The RA "Law on local self-government" stipulates that the Head of the Community is submitting to the approval of Community Council the types and rates of local taxes, charges and fees, which means that local self-government bodies possess the autonomy of setting the tax base. However, the rates for both of currently existing local taxes are set by national legal acts, namely the laws on "Land tax" and "Property tax". One reason for this can be the fact that the above-mentioned laws have been adopted long before the existence of the local self-government system. Similarly the above discussed laws stipulate tax relief cases for both citizens and/or organizations. Local authorities, nevertheless, can set tax relief for both land tax and property tax, but the local relief sum for each tax cannot exceed 10% of the planned local budget revenues of the ongoing year. Thus, according to the Organisation for Economic Co-operation and Development (OECD) taxonomy of taxes, the Armenian local government units' authority for setting the tax rates corresponds to c.3. group. In other words local self-government units set tax reliefs, including tax allowances and tax credits.

In contrary to the case of land tax and property tax, local self-government bodies possess the autonomy for setting the rates of local user charges and fees. As already mentioned above, this field is regulated by the separate law on "Local Charges and Fees", which describes the types of both local charges and fees. However, it is important to note that the law also sets minimum and maximum limits for some charges and fees and only maximum limits for the remaining. Accordingly, within the defined tax types and rate limits, the local community council makes the final decision on setting the charge/fee rates.

3.1. TAX ADMINISTRATION

Tax collection has originally been considered as state responsibility and since their establishment local self-government bodies have been implementing the collection of land tax and property tax as a delegated responsibility from the state. Since 2009, tax collection, as well as the right for setting fines/penalties for late payments are given to local authorities as own mandatory competence.

Tax collection in the communities, especially in the rural ones, has been problematic for local self-government units for a number of years. First of all, the local governments inherited the local tax databases with huge debts (not paid land and property taxes) accumulated over the 90s. Besides, in rural small communities, which as mentioned above comprise the vast majority of all municipalities, the economic situation and living standards are often harsh and many families face difficulties for even paying the basic taxes. Moreover, as a result of socio-economic conditions, the level of migration is very high in many rural areas. Consequently, in many cases, households and families owning the land and/or the property do not actually live in that community to pay the taxes.

Nowadays, in spite of certain progress, tax collection is still not always smooth and remains an issue in many rural communities. The designated state agency of the field, RA Ministry of Territorial Administration and Emergency Situations, implements monthly the monitoring of local budget revenues and huge attention here is paid to tax collection rates. Regional governments (marz level) receive such data from each municipality on a monthly basis and deliver them to the Ministry. The monthly monitoring reports are open to public and are regularly published on the official website of the Ministry (<http://www.mta.gov.am/hy/budgetary-incomes/>)².

Practically, tax collection rates are often considered as a good indicator to evaluate both local self-government bodies and regional governments. For example, official annual evaluation of regional government authorities (Governors) is made by the Ministry and tax collection rates are among the evaluation criteria. Additionally, tax collection is a field where some communities show initiatives. For example, some local governments use mobile applications to send reminder for paying local taxes. Consequently, tax collection can be among the benchmark areas for communities (Annex 1).

2. A huge database containing monthly, quarterly and annual reports on local budget revenues and expenditures since 2008 is available on the official website of the Ministry of Territorial Administration and Emergency Situations and is regularly updated on a monthly basis. However, the information is available in Armenian language only.

Chapter 4

Intergovernmental transfers, fiscal equalization

Apart from own and shared revenues of municipalities, already discussed above, a considerable part of local budgets consists of transfers from the central government. In order to comprehend clearly the principles of intergovernmental transfers system in Armenia it is important to consider certain circumstances.

First of all, there are considerable vertical fiscal imbalances in Armenia. As already mentioned above, the majority of municipalities in the country are very small by the size of population. This generates problems in terms of financial resources. Despite the limited financial capabilities, all municipalities are given quite large scope of competences and as a result many local governments are not financially capable to meet their own responsibilities and provide proper level of public services. In other words, expenditure responsibilities of many municipalities exceed greatly their own revenues.

Secondly, there are also huge disparities between the municipalities. Particularly, municipalities in Armenia vary greatly not only in terms of population (for example, while the smallest municipality in Syunik region, called Qashuni, has a population of around 20 people, the city of Gyumri with around 200 000 inhabitants is 10 000 times bigger), but also of occupied territory, geography, natural resources and therefore of financial capacities and socio-economic level of development. In spite of all these disparities, all the municipalities, except the capital Yerevan, have the same powers and responsibilities by law. This is in immediate conflict with crucial interests of the population in these smaller and therefore weaker municipalities, taking into consideration that, regardless the part of the country where a person lives, one has the right for basic public services.

Thus it can be concluded that the funds from the central government are mainly transferred to the local government level considering the above-mentioned important factors. This is to say that on the one hand, the state government uses intergovernmental transfers with the purpose of decreasing this unevenness of revenues and expenditures. On the other hand, intergovernmental transfers in Armenia aim at reducing these huge horizontal disparities among the municipalities.

According to the RA Law on “Budgetary system”, as well as the Law on “Local Self-Government” there are two main types of transfers from the state budget to local budgets in Armenia.

- Financial equalization grants
- Other grants and subventions

The proportion of subventions and financial equalization grants in total amount of intergovernmental transfers is by far not balanced. Financial equalization grants have much bigger share in total intergovernmental grants compared with subventions. Moreover, it is the capital Yerevan that receives a considerable amount of subventions, while regions get much less (Annex 7).

4.1. SUBVENTIONS

Subventions are conditional transfers from the state budget to the local ones, with specific purposes. In most of the cases, by these transfers the central government of Armenia encourages capital investments in certain sectors, which are prioritized for that period of time. Subventions are directed exceptionally to the capital budget. Thus, these transfers are allocated to local governments with specific purposes and can be required back by the central government in case they are spent in a different way. In addition it is worth mentioning that subventions are non-matching transfers, as far as the municipalities who receive the subventions do not necessarily have to co-finance the programs.

The order of allocation of subventions from the central government to local governments is stipulated by the RA Government by the relevant decree from 2006. According to that, in order to receive subventions the heads of communities need to send appropriate applications to the regional authorities. Regional authorities send them to the state agency responsible for the specific sector indicated in the application, as well as to the RA Ministry of Territorial Administration and Emergency Situations after discussing and summarizing them. For example, if the municipality applies for a subvention in the field of education, the application will be sent to the Ministry of Education. As far as Yerevan is not included in any region, its applications are sent directly to the responsible agency and to the Ministry of Territorial Administration and Emergency Situations. After joint discussions these state bodies either confirm the applications, accordingly including the subvention expenses in their budget of the upcoming year and sending them to the Ministry of Finance for final confirmation, or reject them.

Thus, it can be concluded that the main decision-making actors here are the state agencies responsible for the field of the subvention applied, as far as they are the ones to decide whether the suggested expenditures (subvention) should or should not be included in the draft of their budget and, of course, the Ministry of Finance as state designated agency in the field of finance. Eventually the state budget is approved by the Parliament; therefore the Parliament is among the main decision-makers as well. Though the applications for subventions go through regional authorities, these authorities actually do not play a significant role, being responsible mainly for collecting and summarizing all the applications from their regions. However, as the total amount of subventions is not determined, it is very important to note that the chances to receive the subvention depend in great extent on the quality of the application. Taking into consideration that, as described above, the majority of municipalities, especially the rural ones, are often lacking capacities, including appropriate human resources, the bigger and comparably stronger municipalities have better chances to receive these transfers. Given that conditional non-matching transfers generally aim at encouraging certain policies, another reason behind that phenomenon might also be related with the Governments' priorities of encouraging the different policies in different regions of the country.

Thus, it can be concluded that there are no explicit criteria for assessing the applications and thereby accepting or rejecting them with regards of subventions. As a result, the decisions made by responsible state agencies can sometimes be subjective due to lack of clear regulations.

The major part of intergovernmental transfers in Armenia comprises financial equalization grants. In contrary with subventions, financial equalization grants are unconditional transfers from the state budget to the administrative part of local budgets. According to the RA Law on "Local Self-government" they are allocated with the purpose of harmonious development of all communities and there can be no restrictions on the directions of spending the money. Thus by financial equalization grants the central government aims at increasing the financial resources of the recipient municipalities, but local governments are free to decide on the directions of spending the money.

4.2. FINANCIAL EQUALIZATION GRANTS

The system of allocation of financial equalization grants is clearly regulated. The above-mentioned Law on "Local Self-government" stipulates the distributable pool of the equalization grants. First of all, according to this Law the total amount for a certain year to be transferred is calculated taking into consideration the consolidated budget of the second preceding budget year, and should be at least 4% of actual consolidated budget revenues. For example, the total amount of equalization grants for 2015 will be minimum 4% of consolidated budget revenues of 2013. This makes the system not only stable, but also predictable for local governments. Moreover, local governments start the local budgets' planning process right after having preliminary calculations of financial equalization grants for the succeeding year. It is worth mentioning that until 2011 the total amount of these grants has always been set at the minimum level of 4%. However, considering the influence of the financial crisis on the consolidated budget of 2009, the Government increased this ceiling to 4.6% for 2011 in order to at least keep the same total amount of equalization grants as in 2010. The same principle was applied for 2012. Given the importance of financial equalization grants for local budgets the Government thus softened the negative influence of the crisis on local budgets.

Further details on the distribution of equalization grants are defined by the RA Law on “Financial Equalization”. First of all the municipalities are divided into two main groups:

- 1) Municipalities with population of not more than 300 people
- 2) Municipalities with population of more than 300 people.

Besides, the following two criteria lay on the basis to calculate the amount of financial equalization grant each municipality will receive:

- a) The amount of per capita land tax and property tax (factor “a”)
- b) Population of the municipality (factor “b”).

All municipalities with population of less than 300 people receive equal amount of financial equalization grants. This amount is determined in the state budget of each year. Currently, since 2010 it is 3,500,000 AMD. The total amounts of grants allocated accordingly under factors “a” and “b” are also determined in the state budget for each year.

The amount of grants for the municipalities having a population of more than 300 people is calculated based on the above mentioned two factors. Particularly, factor “a” considers the level of per capita land tax and property tax of each municipality. Grants under factor “a” are for those municipalities whose level of per capita land tax and property tax is below the average of the country ($I < M$). The municipalities whose per capita level of land tax and property tax exceeds that of capital average ($M < I$) are not entitled to receive equalization grant under factor “a”. Accordingly the following formula is used for calculations:

$$A = (M - I) \times N \times F,$$

where

- A is the amount of equalization grant for a particular municipality, allocated under factor “a”.
- M is the average per capita level of land tax and property tax (including Yerevan, as the city is entitled to receive financial equalization grants under the same law).
- I is the per capita level of land tax and property tax of the particular municipality
- N is the number of population of the municipality
- F is the average regulatory factor.

The detailed formulas determining the calculations for M and F are also described by the same law.

The grants under factor “b” are allocated to all municipalities (with the exception of those with not more than 300 people) by dividing the total amount of grants under factor “b” to the total number of population of the country and multiplying that with the number of population of the particular municipality.

To sum up, the current system of determining and allocating financial equalization grants is thoroughly regulated, which makes the system predictable enough for local governments. In addition the system is rather straightforward and clear and thus ensures the overall transparency of allocation mechanisms of equalisation grants. However, time has revealed a number of weak sides of the system as well. First of all, this system of allocation of financial equalization grants lacks incentives for municipalities to raise their own revenues, as far as, for example, when having a higher level of per capita land tax and property tax they will receive less equalization grants. Moreover, there are no links between the level of public services delivered by local self-governments and the amount of equalization grants received (Movsisyan, 2007). This means that local authorities do not necessarily have financial incentives for providing better level of public services. Besides, the system focuses on local revenues only. Particularly, while considering financial capacities of the municipalities, their needs are not taken into consideration, as far as the calculation formulas do not include any components addressing the real needs and expenditure specifications of the municipalities (Movsisyan, 2007). Last but not the least, the current system of financial equalization foresees grants to all the municipalities, including the ones that are much richer compared to the others. For example, the capital Yerevan, where most of the economic activities of the country and around one third of all population is concentrated, receives a considerable share of all financial equalization grants. As a result

the disparities between the capital and other cities are not decreasing and hence the initial objective of horizontal equalization is not being met completely.

To address the above-mentioned drawbacks, the central government initiated a new approach towards the financial equalization grants system, by drafting a completely new law on "Financial equalization". Currently this draft is in the process of discussion and has passed the first review in the RA National Assembly.

Comparing to the existing system, the proposed one seems to address many of the weaknesses. Particularly it suggests the advantage of considering more factors (the distance from Yerevan and the regional center, the number of settlements in the municipality, access to infrastructures, etc.) instead of focusing on tax revenues and population only. Based on the mentioned factors, expenditure needs are calculated per municipality and per capita. Given the issue of small municipalities in the country, another advantage can be considered its particular attention to small municipalities, the consideration of the low level of own revenues in the local budgets and the income capacity of municipalities.

Administratively the process of allocation of financial equalization grants is in parallel with the State budget document approval. The Ministry of Finance is in charge of calculation and further distribution of these grants. The municipalities receive these allocations on a quarterly basis. Together with the state budget documents, the annexes on financial equalization grants are available in the database of the Ministry of Finance. Additionally the information on both subventions and financial equalization grants is also included in the local revenue reports available in the database of the Ministry of Territorial Administration and Emergency Situations mentioned above.

Chapter 5

Local borrowing

According to the Law on “Local self-government” local authorities, particularly the Head of Community when having the approval of the Community Council, can receive credits and lending with the purpose of local budget expenditure implementation. However, it is important to note that local authorities can receive credits and lending only in the case of prior approval by the state designated agency in the field i.e. the Ministry of Territorial Administration and Emergency Situations. Besides, the annual amount of credit expenditures cannot exceed 20% of the community budget. Each municipality can take a credit only after paying back the previous one and the credits can be allocated to the capital budget only.

In order to be able to take credits the municipality must have guarantees. As such guarantees can be considered only community budget revenues or RA Government guarantees. Practically, most municipalities, again as already discussed above, do not have enough financial resources to be considered for credits from commercial banks. Similarly, the Government rarely guarantees communities for taking credits. Moreover, the Ministry of Territorial Administration and Emergency Situations often does not encourage the municipalities to take bank credits due to previous unsuccessful experience of some communities. Another legal authorization or opportunity given to municipalities is issuing local bonds. However, likewise the credit system the issuing of local bonds remains on paper only.

An interesting practice of lending/borrowing exists among the municipalities. Local authorities can borrow from another municipality respectively when agreed with each other and the state designated agency. However it should be noted that such lending amounts are directed for funding current expenses and accordingly are reflected in the administrative (current) budget.

Overall the system of local borrowing in Armenia is quite vague and subject to further regulations and development. In practice only a few communities have capabilities for local borrowing.

Chapter 6

Local financial management

First and foremost local authorities are responsible for developing and approving the most important documents i.e. the community development plan and the community budget, thus setting strategic priorities for the development of community.

The community development plan is a 4-year strategic development document for any community. Once elected, the Head of the Community develops the draft of this document and submits it for approval to the Community Council members. The Council discusses the draft, can make changes, amendments and approves it. The community development plan is the main strategic document, which should reflect the community interests and set realistic and feasible goals. Its timeframe of 4 years is based on local self-government bodies' election term. This document should be the guideline not only for annual or shorter-term projects but also for the annual local budget. It is important to mention that, apart from the community development plan, the RA legislation does not stipulate any obligations for municipalities to have strategic development plans. Hence, the main strategic development document is the 4-year plan. However, a few municipalities (mostly big cities) have long-term strategic development plans as well.

The community budget is an annual financial plan of local revenues and expenditures aimed at the implementation of above-mentioned community development plan and competences of local authorities. Likewise the development plan, local budgets are also developed by the Head of Community and approved by the Community Council members. The Head of Community submits the budget draft to the Community Council for discussion as soon as receiving preliminary amounts of financial equalization grants for the succeeding year from the Ministry of Finance. Community council members can submit written suggestions and/or discuss them during the community meeting. In cases when such suggestions require additional expenditures, the Council members should also point out the corresponding funding sources. In cases when the budget is not approved by the Community Council by the beginning of the succeeding year, the expenditures are made according to the budget of the previous year. Additionally, the Head of the Community can suggest his/her resignation when the budget is not approved, and in case when the Community Council does not make decision on the resignation of the Head of Community within three days, the budget is considered approved.

During the budget preparation process the state designated ministry in the field i.e. RA Ministry of Finance, as well as regional authorities provide methodological and consultancy assistance to the communities. In addition, the mentioned authorities hold overall control over the budget procedure. Nonetheless, it is important to note that the control over community budget implementation is the responsibility of the Community Council. The latter is competent to check any budget activity, the quality and effectiveness of budget implementation and require reports on budget expenditures. Moreover, to ensure more specialized and effective control, Community Council members can involve professional auditing companies. These companies will be paid from the local budget.

As described above, local budgets consist of current or administrative and capital parts and the revenues for each part of the budget are stipulated by national legal acts. Apart from budget separation, the national legislation also defines other preconditions/standards for community budgets.

Particularly, the community budget must be balanced and the expenditures for each administrative and capital part cannot exceed the revenues of respective budget sections. In cases when the expenditures exceed the revenues, that is to say budget deficit emerges, the legislation suggests the sources of funding. These sources include local borrowing sources, the unused funds from the previous year, funds from selling local real estate, etc.

Local budgets also have reserve funds, which can be spent towards unforeseen expenditures or extra funding of planned activities. The amount of the reserve fund of the current budget can be 5-20% of the current budget. The one in the capital budget cannot exceed 30% of capital budget revenues. Here it is important

to mention that the unused funds from the reserve fund of the administrative budget can be transferred to the reserve fund of capital budget. However, the funds from capital budget cannot be directed to the administrative budget reserve funds, with the exception of special cases when these funds are transferred to cover the administrative budget deficit and are subject to return to the capital budget within the same budget year. Additionally, the cases of transfers from capital reserve fund to that of current budget must correspond to the regulations of RA Government on this issue. All reserve funds can be used exceptionally under Community Council decisions.

In the context of recent improvements of legislation in the field of local self-government particular attention is paid to citizen participation during the management procedures of both community development plans and local budgets. This is to say that, in order to ensure active public participation in the processes of planning and development, public discussion, implementation and control of 4-year community development plans and annual local budgets, local authorities establish a consultative body (committee). This committee consists of relevant specialists from the staff of local governments and community organizations, independent experts and other interested parties. The further details of committee activities are regulated by Community Council decisions.

Apart from the committee involvement, the Head of Community must organize public hearings and/or discussions on community development plan and community budget, before submitting the draft documents for discussion to the Community Council members. The Head of Community also provides the information on received suggestions, recommendations during the public discussions to the Community Council members.

The citizen participation regulations described above are in force only since mid 2013 and it is very hard to assess their practical implications. However, it must be noted that this is a huge step forward not only towards encouraging the citizens to be involved in local level decision-making, but also towards ensuring more transparency and accountability of such important documents as community development plans and local budgets. With this regard it is also worthy to mention that some communities have been organizing public hearings and discussions before 2013 voluntarily. Some cities even organize live broadcasting of local budget discussions through their online portals. Similar practices refer to budget reporting procedures. According to the Law on Local Self-government, the Head of the Community quarterly reports to the Community Council on the budget implementation. Before presenting the annual budget implementation, local authorities must organize public hearings and discussions; however, as already mentioned this is not yet always the case in practice. Meanwhile, some local authorities make a step forward by regularly reporting to their population about the progress and overall development of implemented projects, respective expenditures and planned activities. In such cases often the factor of Head of the Community plays a vital role.

Thus, such issues as the involvement of citizens in local decision-making, the access to important local documents, accountability and transparency of the local budget, the reporting practices can definitely be considered as potential areas for local benchmarking.

Conflict of interest issues are regulated to certain extent. For example, restrictions exist on Community Council members on occupying alternative positions. In particular, Community Council members cannot work in the same staff of local government, in community budgetary organizations, moreover act as directors, managers of such institutions; the Community Council member cannot be the Head of Community at the same time, neither work in state security and judicial bodies. In case of starting military service the Council member must resign during the upcoming Council meeting. However, in practice such cases of conflict of interest may arise as family relationships among heads of communities and Council members. This particularly will concern the smallest municipalities, where the population is so small, for example 20-30 people, that the whole population of the community is just one big family.

The above discussed issue is closely interrelated with local management capacity in general and local financial management capacity in particular. As pointed out above several times, almost half of municipalities are very small by population, which results in such serious issues as the lack of human resources. For that reason, very often local authorities do not have enough professionalism, educational and practical background for proper financial management. It is worth to mention here that the Law on "Local self-gov-

ernment” does not stipulate higher education among the criteria and preconditions for being head of a community. Likewise, no regular or mandatory trainings are organized for elected officials and the existing ones are mostly on ad-hoc basis and supported by international donor organizations. In contrary, the staff of local administration, particularly community servants (public servants) must participate in mandatory trainings once in every three years. These trainings follow specific training modules developed and approved by the central government in cooperation with academic institutions and are universal for all municipalities.

In general, local financial management can be considered problematic for many municipalities looking at it from various perspectives. However, in many cases this is an issue of lack of professional human resources especially in rural communities.

Administrative and professional control can be implemented over the competences of local government units. The administrative control is held on own and delegated responsibilities and is limited exclusively to legal control, i.e. the relevant authorities can only check whether the actions of local authorities correspond to legal acts or not. This is also called the legal control. Regional authorities (marzpets) are in charge of implementing the administrative control based on the annual action plan approved by the highest responsible authority (Ministry of Territorial Administration and Emergency Situations in this case). Professional control is implemented over the delegated competences also by the regional authorities. In the case, however, the highest responsible authority is the one responsible for the field, for instance, the Ministry of Environment in case of environmental issues.

Chapter 7

Implementation of LFB

Datasets on local budget revenues and expenditures are available both in the Ministry of Territorial Administration and Emergency Situations and in the Ministry of Finance. These databases are public and can be found on official websites of the mentioned ministries. Additionally some municipalities also publish their budget reports on the websites (the links will be provided in the Annex 5).

The main obstacles that can be faced for the implementation of the LFB are as follows:

- **Upcoming elections.** In the majority of municipalities local self-government elections are to be held in the fall of 2016. This may act as a hindering factor taking into consideration that local authorities may not be willing to get involved in additional initiatives and moreover might avoid the comparison with other municipalities. Furthermore, succeeding 2017 and 2018 are national election years respectively for the Parliament and the President. This also can hinder the initiation of LFB implementation, as the ruling government may not start any new project in the pre-election period.
- **Lack of incentives for local governments to participate in the future LFB programme.** In case if the involvement in LFB is organized on voluntary basis, most of the municipalities may avoid taking the additional burden, considering that they will not have clear incentives for this. Moreover the competition with other communities will also be risky for many municipalities.

The adaptation of the LFB toolkit in Armenia should be considered in the context of local self-government as well as the ongoing reforms in the field. As often discussed above, the majority of Armenian communities, especially the rural ones, are extremely small by population, lack enough infrastructures, financial and human resources and therefore are not capable to provide proper level of public services. Taking into consideration the above-mentioned, the LFB toolkit may be considered for urban communities for the beginning.

On the other hand the country is now undergoing large scale territorial-administrative reforms nowadays. Particularly the consolidation of municipalities is considered as the main option for addressing the above-mentioned challenges and therefore is in the top agenda of respective authorities. From one perspective these reforms may also obstacle the LFB implementation to some extent, given that the whole attention of the respective agencies, as well as the resources are directed to this particular target area. However, when looking at the issue from another perspective, it should be noted that consolidation reforms aim at strengthening the capacities of local governments and fostering local development. The selected pilot communities are set as priority development areas and the initiation of LFB in the newly established, already consolidated areas might be of interest to respective bodies. An option can be the adaptation of the LFB toolkit within the large scale ongoing reforms. Additionally, this may also help to raise public awareness and interest for the LFB toolkit.

The main state actor, potentially interested in the LFB implementation, will be the Ministry of Territorial Administration and Emergency Situations. However, NGOs active in the field of local self-government and local finance can also be regarded as potential implementers of the project.

ANNEXES

Annex 1. Summary of the proposed areas of benchmarking: local own source and shared revenues

National systems, level of decentralization: with references to Rec (2005) No. 1.-36.; 68.-72.	
General principles	
Area No.	Rec (2005). No. x
1. Local governments are entitled to own resources.	3
2. Resources of local authorities are not earmarked.	14
Local taxation	
Area No.	Rec (2005). No. y
3. User charges and fees are a considerable part of local own revenues	68
4. Central government sets maximum charges for essential services and minimum charges for convenience services	71
Local governments: with references to Rec (2005) No. 9.-31.	
General principles	
Area No.	Rec (2005). No. x
5. Compensation of financially weak communities	10
Local taxation	
Area No.	Rec (2005). No. y
6. Local governments do not have authority to set the bases for local taxes	17, 19
Fees and charges	
Area No.	Rec (2005). No. y
7. Within the set limits local governments set the rates for fees and charges	18
Other resources	
Area No.	Rec (2005). No. y
8. Tax collection (?)	

Annex 2. Summary of the proposed areas of benchmarking: fiscal equalization and grants

National systems, level of decentralization: with references to Rec (2005) No.37.-67.	
Financial equalization	
Area No.	Rec (2005). No.
9. The existing equalization system clarifies which local parties are eligible for financial transfers	44
10. Improvements in the system are considered to address the existing drawbacks.	47
Grants to local authorities	
Area No.	Rec (2005). No.
11. Local authorities are provided with appropriate information about the way in which equalisation systems works.	41

Annex 3. Summary of the proposed areas of benchmarking: local borrowing

National systems, level of decentralization: with references to Rec (2005) No. 73.-76	
Borrowing	
Area No.	Rec (2005). No.
12. Local authorities are not allowed to take out loans to finance current expenditure	74
Local governments: with references to Rec (2005) No. 30.-31.	
Borrowing	
Area No.	Rec (2005). No.
13. Local authority's access to borrowing is restricted, in order to limit the risk of non-repayment and to avoid decisions that would transfer an excessive financial burden to future generations	75

Annex 4. Summary of the proposed areas of benchmarking: financial and budgetary management

National systems, level of decentralization: with references to Rec (2004) No. 1.-43	
General principles	
Area No.	Rec (2004). No.
14. Local authorities are entitled to their own resources and freely dispose them in the exercise of their powers and responsibilities	1
Limitations on financial autonomy	
Area No.	Rec (2004). No.
15. There are established rules for drawing up, approving and implementing local budgets and for the supervision of their implementation	4
Fiscal estimation methods	
Area No.	Rec (2004). No.
N/A	
Financial risk management	
Area No.	Rec (2004). No.
16. Local authorities have the right to incur debts only for the funding of investment expenditure and not for current expenditure.	24
Local elected representatives and employees	
Area No.	Rec (2004). No.
17. It is not possible to delegate the adoption of the budget and the approval of the accounts to a committee or a body other than the local community council	5
Control	
Area No.	Rec (2004). No.
18. The external control procedure is defined by law and is limited to an examination of the legality of decisions.	28
Recovery of local authorities in financial difficulty	
Area No.	Rec (2004). No.
19. The central authority rarely guarantees the borrowings of local authorities.	34
Local governments: with references to Rec (2004) No. 44.-87.	
General principles	
Area No.	Rec (2004). No.
20. Local authorities develop and approve 4-year community development plan right after being elected	44

Information and openness	
Area No.	Rec (2004). No.
21. Public discussions, hearings on important local documents;	51,52
22. Encouraging citizen participation in local decision making	55, 56
Budget preparation	
Area No.	Rec (2004). No.
23. Local budget is prepared by financial unit of the municipal administration followed by prior discussion with respective field units	57, 58
Financial risk management	
Area No.	Rec (2004). No.
N/A	
Budget approval	
Area No.	Rec (2004). No.
24. Public discussions, hearing of budget draft are organized, in some cases even public broadcasting is available	73, 74
Budget implementation	
Area No.	Rec (2004). No.
25. Community council receives regular information on the budget implementation	76
Budget accounts	
Area No.	Rec (2004). No.
26. Accounts are submitted to the council within a reasonable time and the approval of the budget is debated	79, 80
Recovery of local authorities in financial difficulty	
Area No.	Rec (2004). No.
N/A	

Annex 5. Availability of information and data on local governments

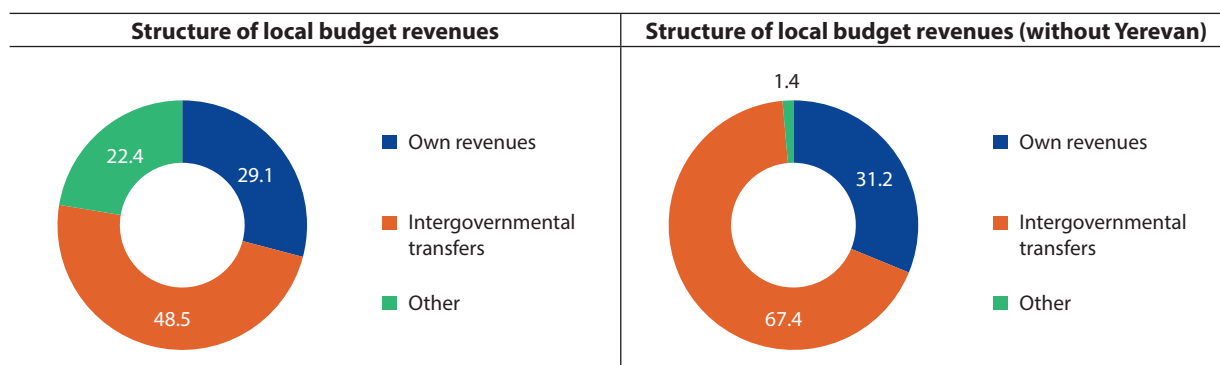
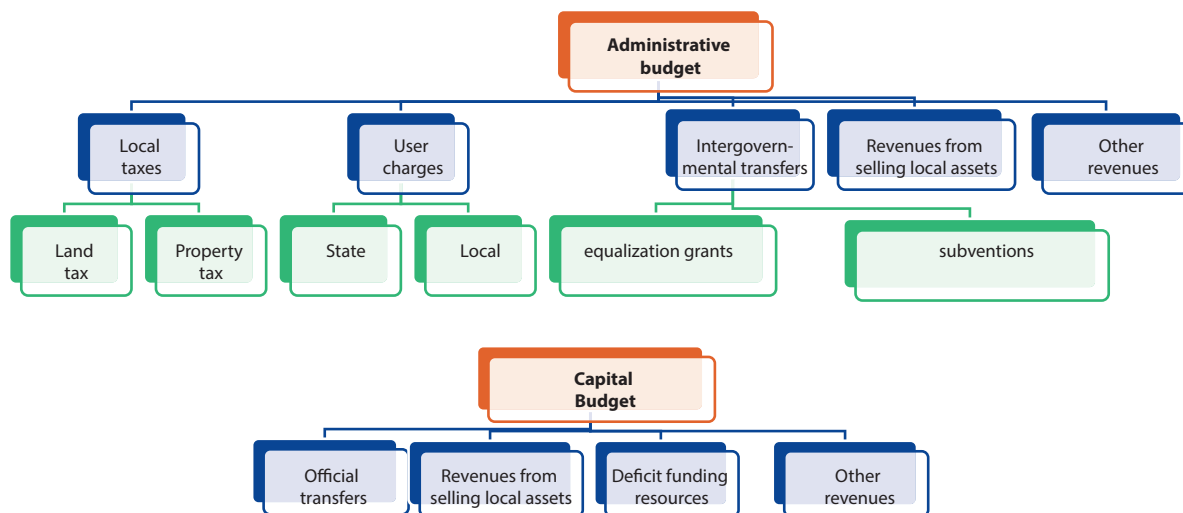
Ministry of Territorial Administration and Emergency Situations	
Local Budget Revenues	http://www.mta.gov.am/hy/budgetary-incomes/
Local Budget Expenditures	http://www.mta.gov.am/hy/budgetary-expenditure/
Local Budget Publicity	http://www.mta.gov.am/hy/budgetary-performance/
Ministry of Finance	
Local budget reports, including revenues, expenditures, deficits or leftovers and deficit funding sources	http://minfin.am/index.php?cat=206&lang=1

References, further readings, websites³

General information on local government system, as well as updates on new and recent development can be found on the website of the Ministry of Territorial Administration and Emergency Situations:	http://www.mta.gov.am/en/
A lot of publications, research studies, analytical reports concerning recent developments in local self-government can be found on the website of one of the most active local NGOs in the field - Communities Finance Officers Association:	http://cfoa.am/en/archives/category/publications-en

3. Many further readings, articles are available in Armenian language only and therefore are not included here.

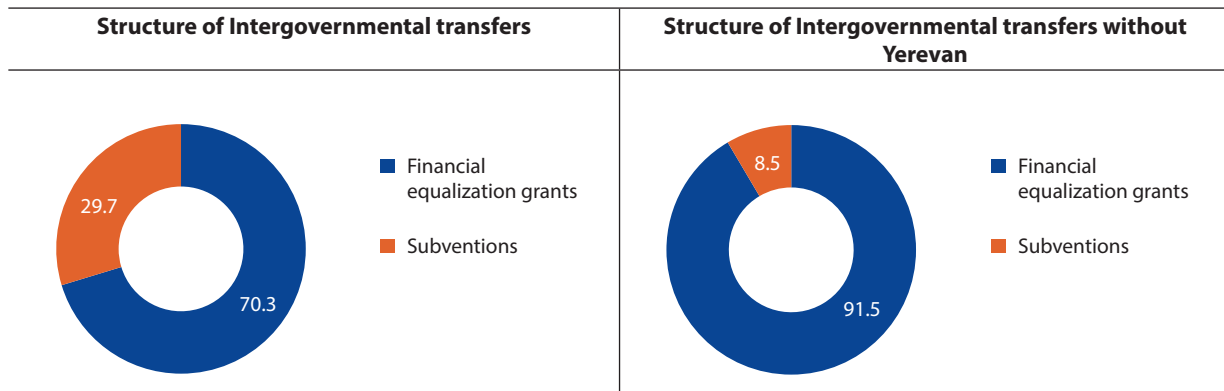
Annex 6: Structure of Local Government Revenues



	Own and shared revenues	grants, transfers	other	comments
ARMENIA	29.1%	48.5%	22.4%	Income and profit tax sharing ratio is 0% Separate data on shared revenues is not available. Environmental payments are included in own revenues calculations.

Source: Based on the data of the Ministry of Territorial Administration and Emergency Situations, 2014

Annex 7. Structure of intergovernmental transfers



Source: Based on the data of the Ministry of Territorial Administration and Emergency Situations, 2014

Annex 8. Scope of Decentralization in Armenia

	Local expenditures in % of GDP	Share of local budget revenues in total budget revenues (%)	Share of local budget expenditure in total public expenditure (%)
ARMENIA	2.5%	9.8%	8.9%

Source: Calculated based on data of the Ministry of Territorial Administration and Emergency Situations and the Ministry of Finance, 2014

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6. Government Decree on "Allocation of Subventions from the State Budget to Local Budgets", 2006
7. Ministry of Territorial Administration and Emergency Situations of the Republic of Armenia: Data on Local Budget Revenues, 2014 <http://www.mtaes.am/files/docs/940.pdf>, Information is translated from Armenian by the author (accessed on 18.08.2015)
8. Ministry of Finance: Data on GDP and Consolidated budget, 2014 <http://minfin.am/index.php?cat=41&lang=3>, (accessed on 18.08.2015)
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Local Finance Benchmarking in Azerbaijan

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September 25, 2015

Chapter 1

Political and administrative structure

The Republic of Azerbaijan is a unitary state. Except the Nakhchivan Autonomous Republic, there are no independent states within the republic. Nakhchivan Autonomous Republic is integral part of the republic. The autonomous status of Nakhchivan Republic is due to its location that holds geopolitical importance. The conflict with the Armenian Republic and the absence of any direct link with other territories of Azerbaijan leads to giving autonomy to Nakhchivan to manage its internal affairs. The fundamentals of the public structure of the Nakhchivan Autonomous Republic are defined by the Constitution of the Azerbaijan Republic. Nakhchivan Autonomous Republic is unitary according to its territorial structure and includes 7 administrative districts. Those administrative districts have the same powers as other administrative districts of Azerbaijan.

According to the Azerbaijan Republic Law on «Territorial structure and administrative territorial division», the administrative-territorial division of Azerbaijan consists of villages, settlements, regions and cities. These units were the basis for determining municipal territories in the Law on Municipal Territories and Lands. The territorial units are granted the status of a city, a settlement and village, depending on the number of permanent residents or the type of activity (household) of most residents, the social and economic development of the territory, the specialization of industry or socio-cultural infrastructure and public functions implemented in specific areas. Cities may be divided into administrative territorial units, in which case each unit comprises a separate municipality. Only two cities are divided into districts (Baku and Ganja). In these cities, district or settlement bodies of local executive authority are subordinate to the city executive authority.

According to the Constitution, local government in Azerbaijan is exercised both through local bodies of state administration and through municipal governments. Local bodies of state administration are regulated by the Constitutional Provision on Local Executive Authority and municipal governments by relevant laws.

Currently, there are 1 Autonomous Republic (Nakhichevan Autonomous Republic), 90 administrative-territorial units (including 66 regions (sometimes called districts), 11 cities and 13 urban districts) in Azerbaijan. Each region is comprised of one city and different number of settlements and villages). Each region has one central city with the same name + 11 cities makes 77 cities altogether. Two big cities (Baku and Ganja) have districts (urban districts) within them (11 in Baku, 2 in Ganja). Each of above mentioned administrative units have centrally appointed Executive Committees (excoms). Excoms of settlements and villages are subordinate to their region's excoms.

There is a one-tier municipal system in Azerbaijan, which means that there is no hierarchy among municipalities irrespective of the status of the administrative-territorial units, their fiscal capacity and the number of people living in their territory. All the municipal authorities are equally independent and have been established on the basis of the same principle (having an independent source of income, the same responsibilities and ownership of the right to their properties and order issuance) and countrywide general elections. Each municipality acts as an independent juridical entity, with neither horizontal nor vertical subordination.

Under the requirements of the Election Code, the number of municipal council members varies within the following range, depending on the number of population living in their territory:

Table 1. Number of elected councillors

Population	Number of Council Members
0–500	5
500–1,000	7
1,000–5,000	9
5,000–10,000	11
10,000–20,000	13
20,000–50,000	15
50,000–100,000	17
100,000–300,000	19

There are 73 city, 147 settlement and 1387 village municipalities, **1607** altogether in Azerbaijan. The latest reforms of unification were made just in line with the last elections in the end of 2014 and the number of municipalities reduced from 1718 to 1607. The analysis of municipalities grouped as per the number of population reveals that there are no municipalities with a population of 1000 citizens and below in 17 administrative rayons (regions or districts). The majority of municipalities in Azerbaijan have a population of 1000-5000 citizens, which increased from 46.8 per cent to 63.8 per cent in the aftermath of the latest amalgamation.

There are no such municipalities with 1000-5000 residents in the cities of Baku, Mingachevir, Ganja, Shirvan and Sumgayit. A change was also noticed in the number of municipalities with a population of more than 5000 residents, from 7.2 per cent to the final 17.9 per cent. While the people in the municipalities of Agstafa (86.2 per cent) and Agdam (85.7 per cent) exceed 5000 citizens, there are no such municipalities in Khizi, Shabuz, Ordubad, Gobustand and Yardimli districts. Only a small percentage of municipalities have more than 5000 citizens in the districts of Barda (1.5 per cent), Sharur (1.9 per cent), Agsu (3.1 per cent), Gadabay (3.2 per cent), Goranboy (3.9 per cent), Lerik (3.5 per cent), Zardab (3.7 per cent) and Tartar (3.4 per cent)

Table 2. Number of local governments

Population size	Elected local governments (municipalities)	
	Number	ratio
<999	314	18.3%
1.000-4.999	1097	63.9%
5.000-19.999	307	17.9%
Total	1.718	100.0%

The Centre for Work with Municipalities under the Ministry of Justice provides methodological support to municipalities as well as carries out administrative supervision over their activity.

Administrative control over the activity of municipalities is implemented to ensure that municipalities, municipal bodies and municipality officials (hereafter “municipalities”) follow the provisions of the Constitution and the Laws of the Republic of Azerbaijan, the decrees of the President of the Republic of Azerbaijan and the decisions of the Cabinet of Ministers of the Republic of Azerbaijan (and in the Nakhchivan Autonomous Republic, also the Constitution of the Nakhchivan Autonomous Republic and the decisions of the Cabinet of Ministers of the Nakhchivan Autonomous Republic), and to eliminate the cases of violation of legislation by municipalities. To ensure the implementation of administrative control municipalities should send a copy of the following adopted acts to the administrative control body (Centre for Work with Municipalities) not later than 15 days from the moment of their adoption:

- normative acts of the municipalities;
- acts on use of funds allocated from the state budget;
- acts on fulfilment of the property right on facilities in the municipal property;
- acts on implementation of one-time local taxes and fees;
- decisions reflecting results of the local public survey;
- acts resulting in expenses and financial liabilities for municipalities.

Chapter 2

Local government functions

According to the Provision on Local Executive Authority adopted on the 16th of June 1999, the Azerbaijan President establishes the regional branches of state administration, by designating their heads. These heads later appoint their own persons or representatives in the villages and settlements located within their boundaries. Local administration expenditures are funded out of the state budget. In brief, the executive tasks of local excoms are:

- Economic, social and cultural development;
- To coordinate activities between local self-governments and excoms;
- To implement both state programs assigned by the President of Azerbaijan and other local programs;
- To establish and dissolve local excom departments, services, enterprises and organizations.
- To arrange elections, referenda and public discussion as stipulated by the law.
- To prepare and submit proposals on local development to the appropriate executive bodies.

Local branches of state administration are directly subordinate and accountable to the central government and carry out its executive tasks regionally.

The status and jurisdiction of municipalities in Azerbaijan are determined by the Constitution and the Law on "Status of municipalities". Pursuant to Article 1 of the Law on "Status of municipalities", the local self-governance in the Azerbaijan Republic is a system that allows the citizens to resolve issues of local importance independently under the law and fulfil certain public affairs as specified in the Constitution (Article 144).

In Azerbaijan a municipality has its own property, local budget, and elected self-government body. Municipalities use the power given to them under the law to solve important local economic, social, cultural and ecological issues. Municipalities and their bodies are not included in the system of state bodies. State bodies and state officials are not permitted to implement local self-government. In other words, state bodies, both central and local, cannot intrude with the affairs of local governments.

They are directly responsible to the centre and implement competencies assigned to them by laws. They locally administer the state programs. However, most of the tasks with local character fall under their responsibility. Local executive authorities are not part of the municipal structure and do not control the work of municipalities. According to Azerbaijani legislation, municipalities can apply to the court if there is any interference in their work by such institutions.

The Milli Majlis (the Parliament) has adopted 17 laws that regulate functions of municipalities. The most important of these are the following: "Status of Municipalities", "Basis for Finances of Municipality", "Permanent and Other Commissions of Municipality", "Status of Municipal Councillor" and "Municipal Service".

The structure of municipalities and municipal bodies is determined by the municipal charter. The chairperson and where necessary a deputy chairperson are elected amongst the municipal councillors by open or secret ballot during the first meeting of the newly elected councillors. They are considered to be elected if they obtain a majority of the municipal members' votes.

Municipalities establish permanent or *ad hoc* commissions to examine and address issues that fall within their mandate, to assist in the implementation of municipal decisions, and to control the functioning of municipal enterprises and organizations. These commissions prepare programs on local social protection and social development, ecology, economic development, and local services. These programs are submitted to the municipal council and the public for discussion. Municipalities perform these local programs not covered by state programs. The central government adopts regional socio-economic development programs and implements them through Line Ministries and Local Executive Committees. These government programs involve the municipalities in their implementation.

Municipalities must adopt their own social and economic programs but they must not overlap with the state ones.

Local social protection and social development programs address issues in the areas of *education, health, culture, local infrastructure and roads, celebratory services, communication services, cultural facilities, and assistance to old, poor and sick people and children without parents.*

Local economic development programs are intended to resolve important local economic development issues in areas such as *agriculture, industry, communication, and transport.*

Local ecological programs are aimed at raising awareness of environmental issues among the local population and addressing these issues. In particular, such programs focus on those issues that complement or are not in the State's ecological programs. These programs can include *maintaining the ecological balance in the local area, cleaning and improving the territory of the municipality, collecting and recycling waste materials, protecting water, air and land from pollution, and implementing ecological measures in conjunction with neighboring municipalities or with State institutions.*

In case if legislative and executive bodies grant additional functions to municipalities, they shall be provided with financial means necessary to implement these functions. If the expenses of a municipality increase and/or the income decreases due to decisions approved by executive bodies of the Republic of Azerbaijan, these bodies shall pay compensation to the municipality. The amount of compensation shall be determined by the time of relevant decree's approval. The municipality shall implement the decisions of the state bodies, which caused additional expenses, within the limits of the compensation granted.

In theory, municipalities have extensive authority in providing public services as well. According to legislation, municipalities may adopt programs of public service delivery and create municipal entities to implement them in the following areas: education, health care, culture, municipal housing and other buildings, sanitation, water supply and sewerage, local transport and communication, cemeteries and funeral services, public catering and consumer services.

Some strategic services such as education, culture, public health services, communications, public catering and other services, are carried out by local divisions of the relevant state structures. Management and control over public service delivery are performed by central executive bodies, such as ministries, committees and the local state administration. These services are financed from the state budget.

All public services are jointly provided by the state administration and municipalities with domination of the state. There is no delegation of responsibility in this direction. Capital investments are financed from local excom budgets or directly from the state budget.

The executive branch of the municipality reports to the local council on the performance of these services, which must correspond to the standards determined by the state. Municipalities have complete autonomy in determining the *method of public service delivery* and may take local conditions into account in order to determine exemptions and other special features.

Certain public services may also be delivered by the private sector (local, joint and foreign organizations) on a contractual basis. Private companies may engage in any public service where not explicitly prohibited, provided that they meet the standards established by the state. The role of the private sector is substantially increasing in this field, especially in public health care, education, transport, communication, trade and public catering. This is an undoubtedly positive trend, which leads to increased quality of public services at reduced cost. However, in the absence of quality control, certain negative phenomena emerge, such as inconsistency or division of services.

Share of local budget revenues and expenditure in overall state budget revenue and expenditure (%)

Years	Share of local budget revenues in overall state budget revenue (%)	Share of local budget expenditure in overall state budget expenditure (%)
2002	1.4	1.37
2003	0.91	0.90
2004	1.16	1.17
2005	1.18	1.13
2006	0.85	0.87
2007	0.83	0.82
2008	0.40	0.40
2009	0.26	0.25
2010	0.25	0.24
2011	0.22	0.22
2012	0.21	0.21
2013	0.24	0.25

Expenditure 2013: (Aggregate)

Operational/maintenance	39.5 %
Education	0.7 %
Health	0.1 %
Social protection	3.4 %
Culture, art, sport	1.3 %
Communal services	36.3 %
Transport	7.4 %
Others	10.3 %
Total	100 %

Chapter 3

Local government own and shared revenues

Annex 1. Summary of the proposed benchmarking areas: local own source and shared revenues

The Law on Municipal Finance defines the following sources of income for the local budget:

Tax revenues:

- land tax from natural persons;
- property tax from natural persons;
- tax on the use of natural resources upon building materials of local importance;
- municipal enterprise profit tax;

Non-tax revenues:

- fees for advertising on municipal property;
- hotel fees, parking fees and other local taxes or duties stipulated by the law;
- payment for fixed or mobile trade, catering and other services on specific sites allocated by municipalities
- revenue from privatization or lease of municipal property;
- income from lotteries or other municipal activities;

Transfers

- financial aid from private entities and international organizations or funds;
- compensation from the state for expenses incurred due to state decisions.
- subventions from the state budget

Table 3. Local government revenues in 2013

Land tax:	14.1 %
Property tax:	9.1 %
Mine tax:	1.1 %
Enterprise profit tax:	0 %
Tax revenues	24.3%
AD tax:	0.5 %
Land and asset sale	48.8 %
Land and asset lease	8.8 %
Non-tax revenues	58.1
Aids	2.2 %
Transfers	11.2 %
Others	4.2 %
Total	100%

Source: Statistical Committee of the Republic of Azerbaijan

3.1. LOCAL TAX REVENUES

Local (municipal) taxes rates shall be established within limits stipulated by the tax legislation. In accordance with the tax legislation, municipalities shall be entitled to make decisions on complete or partial tax release or decrease of tax levels for certain categories of taxes paid by taxpayers in their areas.

Rates of municipal taxes are determined within the limits specified in the tax legislation. In accordance with the tax legislation, municipalities may adopt decisions to fully or partially exempt specific categories of taxpayers from local taxes or reduce tax rates in their territories.

Land Tax. Natural persons and enterprises who own or use land plots in the territory of the Republic of Azerbaijan are payers of tax on land. Land owners and users are liable to pay tax on land irrespective of results of economic activity, and land plots granted to their ownership or use is the taxable base. Tax rates for *agricultural lands* are calculated for each hectare of such lands based on conventional points determined with consideration of the purpose, geographical location and the quality of agricultural lands. The price of one conventional point is 0.06 manats. The land tax is established on the basis of documents that confirm the right of ownership and use of lands.

The land tax is also paid for lands located under structures, buildings and facilities as well as plots necessary for sanitary protection of facilities. Physical entities and municipal enterprises must register at municipalities within 1 month after obtaining the documents proving their right to own or use land plots.

The rates specified in the next tables are applied for every 100 square meter plot of land with the exception of agricultural land:

Table 4. Land tax rates

Settlements	Lands of industry, construction, transport, communication, commercial and trade services and other lands with special designation (in manats)	
	Up to 10000 m ²	For the area of more than 10000 sqm m ²
Baku	10	20
Ganja, Sumgayit cities and Absheron district	8	16
Other towns (except for regional subordination), regional centers	4	8
In towns, districts and villages of regional subordination (except for districts and villages of Baku and Sumgayit cities and Absheron district)	2	4

Settlements	Settlements of courtyards lands and land in garden plots of citizens (in manats)	
	Up to 10,000 m ²	more than 10,000 m ²
Baku	0.6	1.2
Ganja, Sumgayit cities and Absheron district	0.5	1
Other towns (except for regional subordination), regional centers	0.3	0.6
In towns, districts and villages of regional subordination (except for districts and villages of Baku and Sumgayit cities and Absheron district)	0.1	0.2

Physical entities' taxes on land are calculated by municipalities by **1 July** every year, and the payment notification containing the amount of the land tax is delivered to them not later than **1 August**.

For land plots owned or used by several legal or natural persons separately for the placement of structures or for service, the tax is calculated proportionally to areas of the structure owned by such parties. The cal-

culated tax on land is paid by physical persons to the local (municipal) budget in equal sums not later than **15 August** and **15 November**. If the land tax was not paid by the previous owner of the land, it must be paid by the new owner by the date established by the legislation.

The amount of land tax calculated for the land used by natural persons for purposes of entrepreneur activities is considered as deductions from profit.

Tax relieves

The amount of tax on residential land (not commercial) owned by the following natural persons is reduced by **10 manats**, which is an annual flat reduction:

- National Heroes of the Republic of Azerbaijan;
- Heroes of the Soviet Union and Social Labor;
- disabled war participants;
- widowed wives (husbands) of war participants who were killed at war or died later;
- persons who were awarded orders and medals for heroic labour in the war during the years **1941-1945**;
- persons who received the status of war veterans in accordance with legislation;
- persons who acquired radiation and radiation sickness or had these diseases as a result of the accident at Chernobyl AES, radiation accidents in civil or military atomic facilities.

Natural persons – residents of the industrial or technological parks founded by the decision of the President of the Republic of Azerbaijan are released from paying tax on land for the territories used in the *business parks for 7 years* starting from their reporting registration year. These are industrial and technological parks founded by the government in order to stimulate the growth of non-oil industry. They are supported through different stimuli which also involve tax reliefs.

Property tax

Resident and non-resident natural persons are payers of property tax. The buildings and their parts as personal property of natural person in the Republic of Azerbaijan, as well as any water and air transport facility owned by a natural person, irrespective of where they are located and whether they are used or not, are considered taxable units for the property tax. Natural persons pay the property tax in following order and rates:

Table 5. Property tax rates

Settlement	Residential and non-residential areas owned by a natural person (AZN/m ²)
Baku (0.7-1.5)	0.4
Ganja, Sumgayit cities and Absheron district	0.3
Other towns (except for regional center subordination), regional centers	0.2
In towns, districts and villages of regional subordination (except for districts and villages of Baku and Sumgayit cities and Absheron district)	0.1

The rates specified in the table above are applied (if the building is situated in Baku, coefficients not lower than 0.7 and more than 1.5 as determined by the Cabinet of Ministers are applied) per square meter area of the buildings in their ownership (with respect to residential areas – their parts larger than 30 sqm in section). The property tax for premises owned by natural persons is calculated by the municipality of the area where they are located. Property tax on a building with several owners is calculated in accordance with the share of each owner in that building. The area of the property can be estimated by independent professional assessors, upon the initiative and at the expense of each individual or by the municipality.

Tax authorities calculate tax on water and air transport facilities **as of 1 January** of each year on the basis of the relevant information submitted by authorities registering such facilities. In the absence of such registration, the owner of such property provides the relevant authorities with documents that include all nec-

essary data (year of manufacturing, price at the moment of purchase and technical characteristics) on all water and air transport facilities owned each year **before 1 January**. Tax on a water or air transport facility that has several owners is withheld from the person who has registered such facility under his own name. Municipalities must submit tax payment notifications to taxpayers **not later than 1 August**. The annual tax amount is paid in equal portions **before 15 August and before 15 November**. If property tax was not paid by the previous owner of the property it shall be paid by the new owner within timeframes stipulated by this article. Property tax from natural persons is paid to the local (municipal) budget.

Tax relieves

The property tax on buildings is to be paid by aforementioned natural persons who are granted tax privileges *on tax on land*, as well as people on retirement or obligatory military service and their family members for the period of such service reduced by the amount of **30 manats**, except the cases of their leasing, rent or use for entrepreneurial or other commercial activity. Buildings of art workshops or parts of buildings where such workshops are located, which belong to natural persons involved in entrepreneurial activity without establishing legal entity on craft production of copper, tin and pottery products, house appliances, gardening instruments, national music instruments, toys, souvenirs, house appliances made of reeds and cane, involved in embroidery and production of house appliances from wood, are not taxed.

Natural persons – residents of the industrial or technological parks founded by the decision of the President of the Republic of Azerbaijan are released from paying property tax for their property in the parks for 7 years starting from their reporting registration year. Natural persons involved in the production of agricultural products (including production by industrial methods) are exempt from property tax on objects used during the process of activity up to **1 January 2019**.

Municipalities have some discretion over tax reliefs (full or partial reduction) but they should abide by the tax law. They can include different categories that fall under the groups mentioned in the law.

Mining tax

The tax paid for the use of subsurface resources in the territory of the Republic of Azerbaijan is called mining tax and natural and legal entities extracting minerals from subsurface strata of the Earth are payers of the mining tax. The mining tax on the following construction materials of local importance is paid to the municipal budget:

- brick-tile clays
- mortar sand
- raw materials for gravel

Natural persons and enterprises pay the mining tax on these construction materials at the rate of **0.5 manat per cubic meter** of extracted material. For the purposes of mining tax, the time of taxable operation is the time when minerals are extracted. The tax period for the mining tax is the calendar month. Mining taxes must be paid **before the 20th day of the month** following the month of extraction of the product. Payers of mining taxes must submit tax returns on mining tax to the municipalities **no later than the 20th day of the month** following the accounting month.

Profit tax from municipal enterprises

Enterprises and organizations owned by municipalities pay the profit tax to the municipal budget. The profit tax rate is **20 percent**.

Hotel tax

According to the effective legislation, municipalities shall charge payment - no more than one equivalent to percent of conditional monetary unit (i.e. 1.1 manats) - from the facilities in the municipal territory delivering hotel, resort, sanatorium, inn and touristic services to people. These payments shall be withheld from the registered entities/individuals, and paid to the relevant municipalities by the 5th of the next month.

3.2. NON-TAX REVENUES

Advertising fees

Enterprises or persons wishing to advertise on municipal property have to pay pre-specified fees to municipal budgets. The amount of fees is mutually agreed and put on the contracts.

Payment for either qualified parking spaces that belong to individuals and legal entities within municipal territories, or other permanent or temporary parking spots, specified by municipal resolutions, for all kinds of vehicles is another source of income. Such payments shall be defined as not exceeding 0.1 manat per vehicle per day and shall be withheld from each payer, and paid to the municipalities in manners and within dates defined by the municipalities.

In the manner specified by law, municipalities may resort to legal entities and individuals for one-time optional payment for the purpose of financing targeted projects carried out as a result of local public opinion surveys. Such payments should be used for the intended purpose only.

Taxes are collected either directly from the source (deducting tax prior to gaining income or profit), upon declaration (deducting tax after gaining income or profit), or upon notification (payment of the tax by the taxpayer on the basis of payment notice, issued for the sum, calculated by the taxation authority of the municipality on the basis of cost of the taxation object and area).

3.3. LOCAL TAX ADMINISTRATION

Municipalities are to set up their **own tax authorities** to deal with issues of local taxation. Neighbouring municipalities can jointly organize their tax administration to efficiently deal with local taxation. It's within their own competence to calculate, notice and collect local taxes. That is accurate calculation and complete timely payment of taxes and fees in compliance with the law shall be controlled by the tax service agencies of municipalities. The registration of payers of local (municipal) taxes shall be conducted by the municipal tax authority. Control over calculation in accordance with the legislation, as well as complete and timely payment of local taxes (municipal taxes) are conducted by municipal tax authorities. They are free to apply to courts in case their rights are violated. In cases where tax payments are based on the declaration principle such as hotel fees or mining taxes, in order to control the correctness of the tax calculation and payments, municipalities can participate in regular controls held by state tax authorities. *They have to apply to central tax authority and express their willingness to take part in controls.*

Municipal property

Municipal property shall consist of assets of the local budget created from local taxes and payments; municipal non-budget funds; municipal property as well as municipal land; municipal enterprises and organizations; municipal apartment stock and buildings other than dwellings; roads that do not belong to the state or are personal property; municipal education, health, culture and sport organizations; other movable and fixed property.

According to the law, municipalities may have the right to assign structures of municipal property to physical and legal entities for permanent or temporary use, lease them, privatize municipal property in accordance with the rules defined by the law, conclude deeds relating to municipal property, define terms on usage of the privatized and utilized property in agreements and contracts. Municipalities may define, for the local population's benefit, terms on use of land which is within the borders of the municipality, in accor-

dance with the law. According to the law, municipalities may create legal persons for economic and other activity not prohibited by the law, and may resolve the issues related to their re-organization or termination. Municipalities shall define the aims, terms and rules of activity of legal persons; regulate prices and tariffs of goods (services); approve their charters; appoint and release their managers; listen to the reports on their activity.

Local governments are obliged to present results of their budgetary activities to the statistical body, which is the State Statistical Committee, on quarterly and yearly basis. The Committee releases the yearly bulletin reflecting data regarding income and expenditure of local governments. Consequently the main source of information is the database of the Statistical Committee.

The Tariff Council (central government agency) regulates tariffs, user charges, service fees for water sewage, waste management, public transportation.

Chapter 4

Intergovernmental transfers, fiscal equalization

According to the legislation, municipalities have the right to receive allocations from the state budget during the process of regulation of the local budget.

Article 32.2.2 of the Law on “Budgetary System” provides that in the event of inability to finance local socioeconomic development programs through local budget resources, the state budget allocates subsidies and subventions.

According to the Law on the budget system of Azerbaijan, **funding from state budget** takes the following forms:

- **Budgetary loan** — funds allocated from the state budget to the local budgets to be repaid in a certain period of time;
- **Donation** — unearmarked funds donated to the local budgets *to regulate* their incomes and expenditures;
- **Grant** — earmarked funds donated at the expense of internal and external sources;
- **Subvention** — earmarked funds allocated from the state budget to the local budgets for specific purposes – mostly *capital investments* - being repaid if not used for those purposes or in a certain period;
- **Subsidy** — *unearmarked funds* donated from the state budget to the local budgets.

Among the above mentioned types of transfers only DONATIONS (unearmarked transfers) have been effective up to date. However they comprise very tiny portion of local budget revenues. Only lately there has been legal clarification on how LGs should apply for subventions (earmarked transfers) (explained below). Once the donations have reached to municipalities, they can be used. The volume of donations is defined arbitrarily by the Ministry of Finance based on information (necessary documentation presented by LGs on an annual base). There aren't usually any negotiations between LGs and MoF.

Municipalities requesting financial support from the state budget should submit the following documents and materials to the Ministry of Finance by 1 May of the current year:

- Reference of the budget outcomes actual in the previous year and expected in the current year;
- Incomes and expenditures of the local budget for the next budget year, substantiation of the volume of donations and other funds to be allocated from the state budget;
- Auditor's opinion on the execution of local budget in the previous year;
- Other materials upon request of Ministry

Proposals are formulated in person by municipalities requesting donations and submitted to the MoF. There is no specific formula applied in the calculation of donations. Ministry of Finance directly defines the volume of overall donations. Donations are transferred to the local offices of MoF to be delivered to individual municipalities.

According to recent amendments to the Budget Law during the calculation of donations, the following criteria are to be considered. There is no specific formula yet applied in the calculation of donations. The volume is defined by the central government (Ministry of Finance) directly.

- Size of municipal population
- Its share in the formation of financial resources of the country
- Revenue and expenditure capacity of municipalities
- Location in high mountainous region

- Location in the frontier or country borders
- Living standards of the people within municipal borders.
- Socio-economic projects planned for implementation

Also municipalities requesting earmarked grants (subventions) for specific projects should apply to the Ministry of Finance no later than 15 March. The Ministry must respond within 30 days. In case the proposal is accepted, municipalities should present the above mentioned documents no later than 1 May. Subventions are delivered to the municipalities no later than 15 February of the following budget year.

Chapter 5

Local borrowing

In fact there is no legal restriction for the municipal borrowing. However borrowing is not easy for municipalities with low fiscal capacity. Municipalities are not commercial entities and cannot get loans under commercial terms. Cooperation between municipalities and credit and insurance organizations is implemented on the basis of contracts. Municipalities shall have the following rights, in accordance with the rules defined by the legislation:

- to choose an authorized bank for their accounts and cash operations, and to create a treasury, or implement cash realization via the state treasury, in accordance with the legislation;
- to take short-term and long-term credits from the bank and other credit organizations which are residents of the Republic of Azerbaijan;
- to contract the insurance of objects which are part of the municipal property, and of municipal officials.

The government is not responsible for municipal borrowing.

Although municipal borrowing is not prohibited by laws, it is not common in practice. LGs are not capable of borrowing because of low credibility and lack of sustainable financial management. There is no specific law regulating the process.

Chapter 6

Local financial management

A local budget is a municipal budget and it is not a part of the state budget. The local budget is a financial resource created and used for realization of self-governance principles in accordance with the status of municipalities and the implementation of powers of municipalities defined by the Constitution and Laws of the Republic of Azerbaijan. Local budgets are prepared on an annual basis and the budget year begins on 1 January and ends on 31 December. Local budget is independent and this independence is ensured by the existence of its own income sources and its right, without exception, to give directions about the municipality's local budget funds. Legislative and executives bodies of the Republic of Azerbaijan are not allowed to interfere with municipalities' budget activities.

Municipalities independently make arrangements for any balance of the local budget accumulated at the end of the financial year. A municipality independently prepares, discusses, approves, and implements the local budget, and controls its implementation in accordance with the requirements of the laws on the economy.

The government guarantees the independence of local budgets and it is not responsible for their undertakings. State guarantees are based on the following:

- to create conditions for the development of production and service areas;
- to determine additional income sources or allocation of subsidies and subventions during the fiscal year for meeting a deficit in a local budget, taking into account the finance available from the state budget, when it is not possible to finance local social or economic development programs from the local budget.

When legislative and executive authority bodies give additional responsibilities to a municipality, they provide the municipality with the necessary funds to implement these powers. If income to the local budget is reduced or expenses are increased as the result of decisions adopted by the executive authorities, the amount reduced or increased is provided by the bodies that made such a decision. The municipality submits information on the local budget to the statistical agencies and the relevant executive power body, in accordance with the rules defined by legislation.

The amount and types of expenses of the local budget are defined by the municipality. The local budget is formed on the basis of the standard expenses defined by the municipality, taking into account the expenses on managing the municipality, and on maintaining social-welfare, living, cultural and sport buildings, streets, yards and gardens for common use.

Expenses to finance social protection, social and economic development, and ecological programs can also be determined by local budgets. Necessary expenses shall be secured in the local budget for assisting the organization of burial and mourning ceremonies of the diseased people from needy families living in the municipality, and shall be spent for such purposes only.

Draft local budget shall be developed on the basis of assessment of economic activities of municipal enterprises and other legal entities, including individuals operating within the municipality, as well as socio-economic forecasts and special-purpose programs. *Municipalities must submit the required documents to the Ministry of Finance relevant executive authorities, by 1 May, in order to receive a subsidy allocated from the state budget.*

The drafting of local budget shall start 11 months prior to the next fiscal year and will continue until the draft budget is submitted for consideration at the municipal meeting. Drafting and submission of the draft budget shall be the liability of the Municipality Chairperson, and s/he can decide whether to involve standing and other commissions of the municipality, municipal servants and experts for such purposes.

The draft decision on local budget for the next fiscal year shall be, along with the relevant papers, submitted for discussion and approval at the municipality meeting, not later than 15 October of the current year. The draft local budget shall be published within 10 days from the date of its submission to the municipal meeting, to be introduced to the municipality population. The draft local budget for the next fiscal year shall be approved at a municipality meeting, not later than 20 December of the current year. The draft local budget for the next fiscal year that includes a subsidy from the state budget shall be approved by decision of the municipality, not later than 25 December of the current year. The approved local budget can be specified by a decision of the municipality.

Municipalities can make changes in income and expenditure line items during the implementation of the local budget, within the limit of loans approved in accordance with the budget classification, except for specific purpose funds received from the state budget. Operations on commitments incurred from the implementation of the local budget shall be finalized upon the end of the fiscal year, and unused funds shall remain at the municipality's disposal. Municipalities shall approve annual reports on the implementation of the local budget and inform the local population about it.

If income received during the implementation of the local budget is reduced, and if this causes debts greater than the limits, a mechanism to reduce expenses can be used. Reduction of expenses consists of proportional reduction of expenses in each article of the budget, except for those articles protected against reduction such as expenditure for basic public service provision or wages. However this is not common in practice.

The municipality shall control the implementation of the local budget and the expenditure of funds in accordance with the budget, and has the right to invite independent auditors not less than once a year.

Legislative and executive bodies control the usage of funds allocated for the implementation of functions they have given to municipalities. Municipalities organize their finance within the territory of the municipality, as well as in cooperation with credit organizations located outside the territory of the municipality and which are residents of the Republic of Azerbaijan.

According to Article 34 of the Law of the Azerbaijan Republic on the Status of Municipalities dated 2 July, 34 local governments in Azerbaijan have the *right to form legal entity*. There are no limitations on state registration of municipal entities and companies: they can start the delivery of services, having been registered in a corresponding state office in compliance with general procedures applied to other enterprises and organizations regardless of property, organizational and legal forms. And the legislation does not stipulate any limitation or restrictions on the profile of the municipal enterprises/companies, so they can be engaged in all kinds of activities unrestricted by the Azerbaijan legislation.

Under Article 35 of the said Law, the activity of municipal companies is based on the following principles and conditions:

- Municipal companies are independent legal entities, their relations with municipalities are provided by the labor and civil legislation;
- The objectives and conditions of municipal companies and enterprises are defined by municipalities;
- Prices (tariffs) of their goods (services) *are adjusted by municipalities*, and the heads are appointed and released by municipalities.

Municipalities shall observe national accounting standards. The Law on municipal finance requires the publication of the draft budget within 10 days after submission to the municipal council; the same law requires that municipalities shall report on the budget realization to the municipal council on a yearly or 6 months basis and the report must be approved by the council within 15 days. Later these reports are disseminated via different sources (bulletins, leaflets, internet, etc).

The Law on local taxes and payments stipulates that the supervision of implementation of the local budget shall be realized by relevant municipal commissions and committees comprised of members elected by the local community.

Under Article 39.1 (*Supervision over the local budget*) of the Law of Azerbaijan Republic on Budget System, as well as Article 12.2 of the Law on “Local (Municipal) Taxes and Payments”, the municipality shall supervise the local budget execution, including the correspondence of the spent resources with the approved budget indicators and with this purpose has the right to involve independent auditors.

Article 13.1 of the Law on financial bases for municipalities stipulates that municipal bodies control the local budget execution. Under Article 12.1 of the Law on local (municipal) taxes, the financial activity of municipalities shall be scrutinized by Review Commissions comprised of community members who are subject to approval in municipality meetings. There is no professional audit in municipal bodies, but purely community audit.

In Azerbaijan, the external audit is carried out by two bodies:

- 1. The Chamber of Accounts of the Azerbaijan Republic;**
- 2. The Chamber of Auditors of the Azerbaijan Republic.**

The Accounts Chamber is a state-run legal entity, while the Chamber of Auditors, being a financial institution, is an independent audit body. In addition, the Azerbaijan’s Finance Ministry has the right to control the use of State Budget subventions to local governments. Therefore, it is essential to clarify the principles and duties of financial audit in local governments provided by the Finance Ministry.

Article 35 of “The Law on the Status of the Municipalities” provides that municipal companies, first of all, shall report to municipalities. The reports must cover both the company’s production (service) activity and the financial results. Municipal enterprises shall submit quarterly and annual reports on local budget execution to the State Statistics Committee of the Azerbaijan Republic, while quarterly and annual financial reports to local structures of the Finance Ministry. The financial reports shall reflect the prognosis for local budget receipts and expenditures as well as the present state of affairs on them.

Municipal company audit is voluntary. The audit can be conducted at the initiative of the municipal company or the municipality.

Chapter 7

Implementation of LFB

The main data source is from the Statistical Committee. However the Centre for Work with Municipalities and Associations of City, Settlement and Village Municipalities may serve as a data source to a certain extent. Individual city municipalities may be referred for specific data. Laws, rules and regulations regarding local governments are all accessible.

Municipalities (primarily the bigger ones) would be interested in participating in LFB. Essentially the Centre for Work with Municipalities and Associations of City, Settlement and Village Municipalities is possibly interested in hosting the program. Larger local governments do have their internet sites where they publish the necessary information. Further information can be obtained upon request. Parliamentary elections are to be held in the country in November 2015. However it doesn't seem to hinder the program in any way.

The Center for Work with Municipalities under the Ministry of Justice not only implements administrative control over local governments but also provides the methodological support to municipalities, as well as carries out educational programs to develop institutional capacity of LGs in Azerbaijan. This Centre and the Associations of Municipalities seem to be the main actors for raising central and local government public interest for LFB.

Latest reforms in the sphere of local governance are the amalgamation of many small village municipalities into bigger ones. Now altogether 1607 (formerly 1718) municipalities exist in Azerbaijan. There are 73 city, 147 settlement and 1387 village municipalities. Another reform was the amendment to the Law on Budget regarding the criteria for donations (unconditional transfers) as well as the procedure for receiving subventions (conditional transfers). City municipalities are potential partners for hosting the future LFB programme.

ANNEXES

Annex 1. Summary of the proposed areas of benchmarking: local own source and shared revenues

National systems, level of decentralization: with references to Rec (2005) No. 1.-36.; 68.-72.	
General principles	
Area No. 1.....	Rec (2005). No
Local taxation	
Area No. b	Rec (2005). No
Local governments: with references to Rec (2005) No. 9.-31.	
General principles	
Area No. 1.....	Rec (2005). No
Local government possess financial resources commensurate with their competences	Rec (2005). No. 3 Local authorities should, within the framework of the national economic policy, be entitled to their own resources, which should be adequate, and of which they may freely dispose, in the exercise of their powers and responsibilities, within the limits of the law (financial autonomy).
Local governments freely dispose of their revenues	
number of local taxes	
ratio of local taxes to current and total local government revenues	
Local governments have discretion over local tax base and tax rates	Rec (2005). No. 4 Where taxes are assigned to local authorities, they should also be given some power to intervene in their administration in order to improve their efficiency and to appropriate their proceeds (fiscal autonomy).
Local taxes are administered by LGs	
Standards and procedures of local tax administration	
Methods of paying local taxes	
Share of local taxes and miscellaneous revenues compared to expenditure by functions	Rec (2005). No. 4 To the greatest extent possible, each local authority should finance, from its own resources, the expenditure it decides on (fiscal equivalence at the local authority level).
Local taxation	
Area No. a. Fiscal Decentralization	Rec (2005). No
Significant proportion of the costs incurred are funded through own resources	Rec (2005). No 13 Financial autonomy of local authorities implies that local authorities have sufficient own resources to fund a significant proportion of the costs incurred in the discharge of their responsibilities, as defined in the Constitution or by law. This proportion should be sufficiently large to allow for and encourage substantial room for manoeuvre and accountability on the part of local authorities when they determine the expenditure to be incurred in the discharge of these responsibilities.
This proportion is sufficiently large to allow for and encourage substantial room for manoeuvre and accountability of LGs	
local tax revenues are directly connected to local functions	
local governments' autonomy in	
defining tax base, exemptions - setting tax rate (regulation allows: 0, minimum, maximum, range)	
tax collection is locally administered	
local taxes are more levied on voters	
Inter-budgetary relations allow to support LGs	Rec (2005). No 16 When the degree of fiscal decentralisation is considered low on the basis of the parameters, the central authorities should consider, in conjunction with the local authorities, means of increasing the proportion of local authorities' own tax revenues and tax revenues transferred under a permanent law, without necessarily increasing overall tax pressure.

LGs and their associations are negotiated when limitations on financial autonomy of LGs are imposed Limitations are proportionate to objectives pursued	Rec (2005). No 20 Limitations on the financial autonomy of local authorities should not be disproportionate to the objectives pursued, and should be discussed with local authorities or associations of such authorities, provided for by law and lifted as soon as possible.
Compensation provided for decisions of higher authorities	Rec (2005). No 21 In general, when higher authorities take decisions that reduce the local authorities' tax base, compensation should be provided.
Area No. b. Structure of local taxation	Rec (2005). No
proportion and type of local tax revenues collected from – residents	Rec (2005). No 24 The tax revenues of a local authority should come from resident individuals or property or businesses on the territory of the local authority in question
balanced (diverse) local tax structure local taxes supplement national tax structure avoiding tax exportation differences in setting local tax base and rate overall local tax wedge on residents local scope of manoeuvre in tax policy design	Rec (2005). No 30 Local taxes should be neutral and create little negative economic distortion (minimum impact on growth and the economic structure of the municipality), demographic distortion (so as not to prompt people to migrate) and social distortion (so as not to cause further problems for social groups in difficulty).
national regulations on local tax relieves and exemptions Regulations on local taxes and tax administration Cooperation with higher authorities collecting information, relevant for local tax administration	Rec (2005). No 31 The central authorities should be able to help local authorities draw up local tax regulations. The establishment of a single database (or a single access point) for all local taxation can make for greater openness.
Fees and charges	
Area No.	Rec (2005). No
Local authorities are free to charge for services they render	Rec (2005). No 9 Local authorities should be entitled to decide what to charge for the services they provide according to the situation and local preferences.
Other resources	
Area No.	Rec (2005). No. y

Annex 2. Summary of the proposed areas of benchmarking: fiscal equalization and grants

National systems, level of decentralization: with references to Rec (2005) No.37.-67.	
Financial equalization	
Area No.	Rec (2005). No. z 39
LGs have the right to receive financial aid from central governments Financially weaker LGs are compensated for lower financial capacity. Equalization is in place for LGs suffering from geographical location, demographic situation or other factors	The equalisation system should compensate, at least in part, for differences in authorities' financial capacity (so as to provide more resources to financially weaker authorities) and spending needs (so as to provide more resources for authorities that either have additional responsibilities or, by virtue of their geographical location, demographic situation or other factors, are obliged to spend more in order to discharge their responsibilities). It should not compensate for differences in managerial efficiency or differences in cost stemming from the adaptation of service levels to local preferences.

Grants to local authorities	
Area No a. General grants	Rec (2005). No.
The grants are usually general with no strings attached	The higher authorities' contribution to local budgets should mainly take the form of general grants.
Criteria for allocation are transparent and formula based LGs are able to calculate the amount of transfers before the budget year	Criteria to allocate general grants should be clearly defined by law, or at least in accordance with the legal framework, on a non-discretionary basis. This should enable local authorities to calculate in advance the amount of the grants they will receive and adopt their budgets accordingly.
Area No b. Specific grants	
Criteria for allocating specific grants are objective and transparent	Specific grants should generally be awarded on the basis of objective, transparent criteria related to spending needs. All the authorities eligible for such grants should be informed about the availability of funds and the relevant criteria, and should be able to submit applications for such grants, which should be compared by means of transparent procedures.
LGs are fully informed about the availability of funds	
Procedures for grant applications are transparent	

Annex 3. Summary of the proposed areas of benchmarking: local borrowing

National systems, level of decentralization: with references to Rec (2005) No. 73.-76	
Borrowing	
Area No.	Rec (2005). No.
LGs have free access to capital market	Rec (2005). No 73
Different forms of loans available for local governments	Local authorities should be able to borrow in order to finance their capital expenditure projects. Such projects are intended to benefit future generations, and recourse to borrowing may therefore make it possible to spread the burden fairly among generations. As future generations do not have a say in the choice of projects to be financed, however, financing through borrowing is mainly suitable for services for which the loan will be repaid by means of charges to users.
Guarantees issued by national government/budget	
Local authorities are fully answerable for their decisions to resort to borrowing	Rec (2005). No 76
Central government does not offer guarantee for loans raised by local governments	In order to make decision-makers more accountable, local authorities should be held fully answerable for their decisions to resort to borrowing. The central authority should not offer guarantees for loans raised by local authorities, save in exceptional circumstances.
Local governments: with references to Rec (2005) No. 30.-31.	
Borrowing	
Area No.	Rec (2005). No.

Annex 4. Summary of the proposed areas of benchmarking: financial and budgetary management

National systems, level of decentralization: with references to Rec (2004) No. 1.-43	
General principles	
Area No.	Rec (2004). No.
	Rec (2004). No 1
	The local or regional authority should be entitled, within the framework of national economic policy, to foreseeable resources commensurate with its competences and responsibilities that would allow it to implement these competences effectively and of which it may dispose freely.

Central governments cover additional costs incurred by LGs as a result of central decisions	Rec (2004). No 3 Higher-level authorities whose decisions impose additional costs on local and regional authorities should ensure that these costs are covered by new financial resources such as additional fiscal resources, evolving financial transfers or other financial means.
Public access to local budget documents Public is involved in local budget design Forms of local budget presentation support easy access to relevant information on revenues Diversity of methods for disseminating information on local budgets	Rec (2004). No 4 The legislation should establish rules for drawing up, approving and implementing local and regional budgets and for the supervision of their implementation, as well as for their healthy, balanced management in the long term.
Approval of the accounts, other than the elected deliberative body at local level.	Rec (2004). No 5 It should not be possible to delegate the adoption of the budget and the approval of the accounts to a committee or a body other than the elected deliberative body of the local or regional authority.
LGs independently adopt their budgets	Rec (2004). No 6 Within the limits of the legislation, the local or regional authority should be able to independently adopt its budget and to adapt the operational rules applicable to its budget and to apply them to its specific situation.
Objectivity and transparency of criteria for limitations imposed by the state on the financial autonomy of LGs	Rec (2004). No 10 The limitations which may be imposed by the state on the financial autonomy of local and regional authorities should be established by law. Limitations should be based on objective, transparent and verifiable criteria, applied fairly and in such a way as to avoid accounting devices that obscure the truth.
Limitations on financial autonomy	
Area No.	Rec (2004). No.
	Rec (2004). No 8 The state or the legally established supervisory authority may take measures to restrict the financial autonomy of a local or regional authority or to limit or reduce the amount of funding transferred to it. Such measures should be taken within the framework defined by the statute and should not be excessive or threaten the principle of local autonomy.
Fiscal estimation methods	
Area No.	Rec (2004). No.
....	
Financial risk management	
Area No.	Rec (2004). No.
....	
Local elected representatives and employees	
Area No.	Rec (2004). No.
The mayor is responsible for quality and accuracy of the financial and budgetary information issued by LG	Rec (2004). No 25 The quality and accuracy of the financial and budgetary information issued by the local or regional authority should be guaranteed by the mayor, the chief executive or any other elected representative or executive body designated by law, who assumes responsibility.

Number of training courses organised locally for municipal servants	Rec (2004). No 27
Staff days spent at training courses in a year	The central authority should ensure that local or regional officers and elected representatives receive appropriate professional training. If such training is not provided by the local or regional authority itself or its association, the central authority could, for example, set up standards in this respect, organise such training and help the local or regional authority and its association to organise training for their elected representatives and officers.
Control	
Area No.	Rec (2004). No.
The extent of the supervisory authority's intervention is proportional to the magnitude of the interests which the authority wishes to preserve.	Rec (2004). No 28
Supervision is neither political nor punitive and applied to LGs based solely on objective factors connected with the situation of the authority concerned.	The external supervisory procedure should be laid down by law and should be balanced and fair. The procedure should be limited to an examination of the legality of decisions. In case of disagreement, the procedure should provide the supervising authority with the possibility of recourse to the competent jurisdiction.
Possibility to delegate the adoption of the budget	Rec (2004). No 31
Approval of the accounts, other than the elected deliberative body at local level.	There should be a legal deadline for the adoption of local and regional budgets and mechanisms to ensure the continuity of public services if the budget is not adopted in due time, or if the local or regional authority fails to fulfil its obligations
statistical and comparative analysis of budget implementation,	Rec (2004). No 32
spending and the rate of spending in order to detect any anomalies and	There should be statistical and comparative analysis of budget implementation, spending and the rate of spending in order to detect any anomalies and trigger the relevant warning procedures, rather than a series of successive authorisations that provide no dynamic overview.
trigger the relevant warning procedures in the general financing system	
Recovery of local authorities in financial difficulty	
Area No.	Rec (2004). No.
Guarantees issued by the national government/budget	Rec (2004). No 34
	As a general principle, the central authority should not guarantee the borrowings of a local or regional authority.
Reporting on implementation of budget by LGs on a quarterly or yearly basis	Rec (2004). No 36
Participation at public (committee, council) meetings	The state or the supervisory authority should establish procedures for monitoring the financial situation of local and regional authorities by gathering financial information and making it public. This information should enable citizens, the local and regional authority and the government to be aware of the financial situation of a given authority, to compare it with that of other authorities with similar characteristics and to take appropriate measures, where necessary and according to law, to avoid any financial difficulties arising.
Intervention at public meetings	
Media reporting on local budgets	
Forms of targeting specific groups (e.g. large taxpayers, vulnerable groups)	
Channels to communicate with the public	
Local governments: with references to Rec (2004) No. 44.-87.	
General principles	
Area No.	Rec (2004). No.
Involvement of in-house experts and outside opinions in the process of public debates	Rec (2004). No 46
	Budget projections and proposals should be prepared with the involvement of in-house experts (for example, receiver, treasurer, internal auditor) and outside opinions (such as economists, independent auditors, etc.), particularly in the event of public debate (hearings before the relevant committees, the local or regional council, etc.).

	Rec (2004). No 47 Whenever a decision is taken by the executive or the local or regional council, the budgetary expenditure for the current year and the following financial years should be clearly explained
Dissemination of the proceedings of committees dealing with budget matters	Rec (2004). No 48 As a general rule, the proceedings of committees dealing with budget matters should be open to the public and their documents should be published and accessible to the public.
Information and openness	
Area No.	Rec (2004). No.
Official manuals, training materials, which explain the framework of local reporting system to be easily readable, providing both a clear and comprehensible overview of the budget, sufficient details to analyze the budget and to make comparisons. It includes some examples to understand the way of analysis and to recover risks. The manuals contain ideas how to involve citizens to recover budget needs, to justify investment programs, and their participation in budget debate.	Rec (2004). No 51 Budget and accounting documents should be easily readable, providing both a clear and comprehensible overview of the budget (including main balances, issues and priorities, key data, etc.) and sufficient detail to analyse the content of the budget and make relevant comparisons (with other financial years, other authorities, etc.)
Accessibility of published documents via Internet with explanation	Rec (2004). No 52 Published documents, for example via the Internet, should be accompanied by a suitable explanation making them more easily comprehensible to a lay public.
Budgets consist of both expenditure and receipts by type and function The expenditure in the draft budget (within functions, groups and activities) is clearly and comprehensively presented and explained.	Rec (2004). No 53 Expenditure and receipts should be presented by type and by function in budget documents, identifying as far as possible the different sectors of local and regional government involved so that the sharing of resources between fields of activity may be gauged.
Participation at public (committee, council) meetings Budget documents are open to scrutiny by the public and public comment is welcomed and taken into account.	Rec (2004). No 55 The local or regional authority should stimulate participation of citizens and social partners in public affairs by regularly consulting them and should ensure that objective information is provided on the financial aspects of the issues under consultation.
Draft council budget documents are made public and put on the website All the budgetary documents are accessible to citizens, and published before the debates	Rec (2004). No 56 The local or regional authority should make it possible for citizens to be informed of draft budgets as soon as these are forwarded to local or regional councillors for final approval. When a budget has been adopted, its outlines and consequences for the community should be made public; for example by explaining changes in taxation or priority allocation of the authority's funding, and mentioning the services ready to provide the public with further details.
Budget preparation	
Area No.	Rec (2004). No.
Preparation of the budget is the responsibility of a specialised unit of the local or regional authority	Rec (2004). No 57 Preparation of the budget should be the responsibility of a specialised unit of the local or regional authority with a good knowledge of the authority's operational departmental costs and budget consumption so that it can propose different options to the executive and prepare internal arbitration before arbitration at a later stage.
Budget proposals are discussed by responsible persons, and those responsible for finance	Rec (2004). No 58 Budget proposals should be discussed by the authorities and the persons responsible for the domain concerned and then by those responsible for finance, who should consider overall balances, overall income, borrowings and any problems raised.

Financial risk management	
Area No.	Rec (2004). No.
....	
Budget approval	
Area No.	Rec (2004). No.
Both elected representatives and the public hold a discussion on the main thrusts of the budget,	Rec (2004). No 73 A budget strategy debate should be organised at the beginning of the budgetary procedure, allowing initial discussion of the overall objectives to be adopted for the year and possibly the years to come
Budget preparation staff obtains useful information on the major projects to be launched, the level of services, the local or regional authority's priorities and other assumptions to be adopted for preparation of the budget.	
The practice of presenting only a final draft budget to the council and public is avoided.	
Time allocated for councilors to read and analyse the budget documents	Rec (2004). No 74 The local or regional authority should set sufficient time limits in which councillors may read and analyse the budget documents issued.
Rules should be made at local and regional authority level so that elected representatives can have access to information, especially financial, but also in order to ensure that certain elected representatives do not convert their right to information into a weapon for harassing the executive or local or regional officials.	Rec (2004). No 75 If the elected representatives consider the information received to be inadequate or unclear, they - individually or collectively (for example in the competent committees) - should be able to request further information, question the relevant officers and, where necessary, hear the experts of their choice.
Budget implementation	
Area No.	Rec (2004). No.
Debates on the implementation of the budget are held mid-year	Rec (2004). No 76 Where appropriate, a debate on the implementation of the budget should be held mid-year, in order to put budget changes into perspective and to review the changes in the economic, budgetary and social context, and after the end of the financial year.
Council receives regular updates on the monitoring of the budget	Rec (2004). No 77 The council should receive regular updates (for example, every three or four months) on the monitoring of the budget. If budget adjustments prove necessary, it would be advisable to group them in one or two "sets" per annum, accompanied by an overview or even a debate on the state of budget spending.
Budget accounts	
Area No.	Rec (2004). No.
Municipal councillors receive in due time full information on the budget draft	Rec (2004). No 79 The accounts (for financial year n) should be submitted to the council within a reasonable time and certainly before holding the debate on budget implementation for the following year (n + 1) and before the budget for the year after that (n + 2) is drawn up.
Both an outside technical opinion and the involvement of elected representatives in discussing and adopting budgetary accounts is obtained	Rec (2004). No 80 Approval of the accounts should be properly debated, in committee and then in the council, in the light of an outside opinion (for example an external audit).
The reports of the council and committee concerning the budget are published	Rec (2004). No 81 The executive of the local or regional authority should ensure that the reports of committees and the council concerning the budget are published (allowing public access or online consultation).
Recovery of local authorities in financial difficulty	
Area No.	Rec (2004). No.
....	

Annex 5. Availability of information and data on local governments

Aggregate data of local (subnational) finances	
Current expenditures	available through statistical bulletins online
Capital expenditures	available through statistical bulletins online
Expenditures by functions (service areas)	available through statistical bulletins online
Total revenues	available through statistical bulletins online
Local own source current revenues	
local taxes	available through statistical bulletins online
dues, fees	not common
user charges, tariff revenues	not common
Local capital revenues	
Shared revenues: • origin based • allocated by formula	it is not the case for Azerbaijan
Grants, transfers, donations, subventions, etc.	available through statistical bulletins online
Local debt (stock)	not available
Annual net borrowing	not available
Disaggregated data (by municipalities/local governments)	
Total revenues (current and capital)	available through statistical bulletins online
Local own source current revenues	available through statistical bulletins online
Local own capital revenues	available through statistical bulletins online
Shared revenues	not is the case
Grants, transfers, donations, subventions, etc.	available through statistical bulletins online
Annual net borrowing	not available
Classification of local governments: • administrative status (region, city, town, village, commune) • regional position • population number • area, etc.	available

References, further readings, websites

1. On local governments, intergovernmental finances, local public financial management
2. Government statistics, Reports by NGOs, individual municipal reports, laws, regulations, a few websites reflecting some aspects of LGs
3. https://en.wikipedia.org/wiki/Administrative_divisions_of_Azerbaijan
4. <http://files.preslib.az/projects/azerbaijan/eng/gl2.pdf>
5. <http://abma.az/uploads/docs/bulletenbelediyye.pdf>
6. [http://www.venice.coe.int/webforms/documents/?pdf=CDL-REF\(2014\)018-e](http://www.venice.coe.int/webforms/documents/?pdf=CDL-REF(2014)018-e)

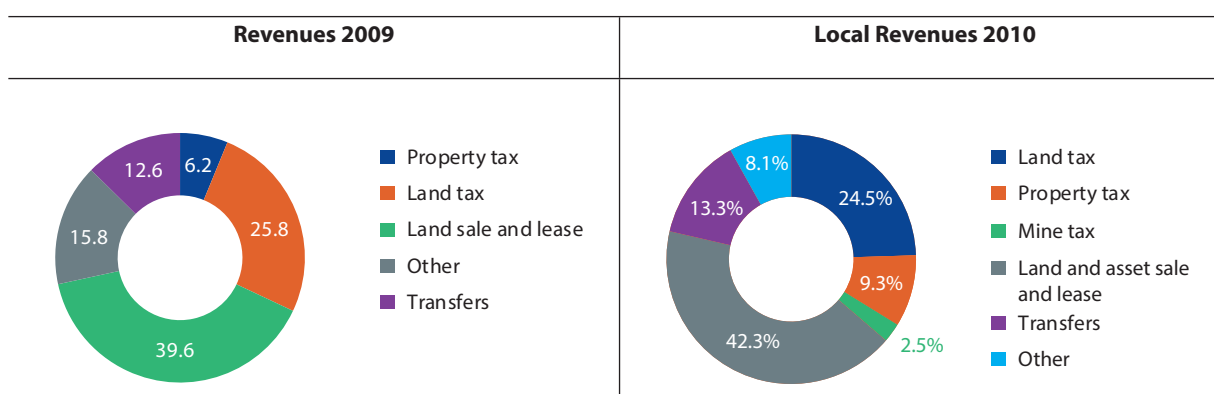
Recent trends

Volume of transfers to LGs (mln manats)

Years	Transfers to LGs	Share of transfers in total budget expenditure %	Share of transfers in GDP, %
2000	3.6	0.47	0.07
2001	2.1	0.26	0.07
2002	5.0	0.54	0.06
2003	1.0	0.30	0.05
2004	2.0	0.13	0.04
2005	2.0	0.10	0.03
2006	3.0	0.08	0.02
2007	3.5	0.06	0.01
2008	3.5	0.03	0.01
2009	3.5	0.03	0.01
2010	3.5	0.03	0.01
2011	3.5	0.03	0.01
2012	4.7	0.028	0.02
2013	5.3	0.03	0.02

Share of Local Government budget revenues and expenditures in total state budget revenues and expenditures, in %

Years	Share of LG budget revenues in total state budget revenues, in %	Share of LG budget expenditure in total state budget expenditure, in %
2002	1.4	1.37
2003	0.91	0.90
2004	1.16	1.17
2005	1.18	1.13
2006	0.85	0.87
2007	0.83	0.82
2008	0.40	0.40
2009	0.26	0.25
2010	0.25	0.24
2011	0.22	0.22
2012	0.21	0.21
2013	0.24	0.25



Revenues 2012: (Aggregate)

Tax - 36.1 %		Non-tax 61.3 %	
Land tax:	55.1 %	Land and asset sale	55.8 %
Property tax:	31.3 %	Land and asset lease	20.3 %
Mine tax:	5.4 %	Aids	2.5 %
Enterprise profit tax:	0 %	Transfers	21.6 %
AD tax:	0 %	Others	2.6 %
Others	8.2 %	Land and asset sale	55.8 %

Expenditure 2012: (Aggregate)

Operational\ Maintenance	47.7 %
Social protection	6.1 %
Communal services	27.5 %
Transportation and road maintenance	10.4 %
Others	8.3 %

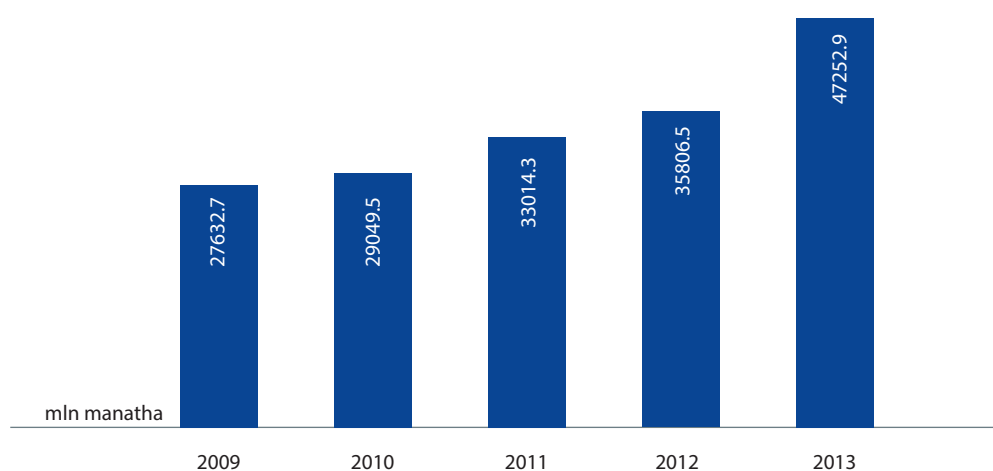
Revenues 2013: (Aggregate)

Tax - 26.8 %		Non-tax 71.1 %		Others
Land tax:	14.1 %	Land and asset sale	48.8 %	2.1 %
Property tax:	9.1 %	Land and asset lease	8.8 %	
Mine tax:	1.1 %	Aids	2.2 %	
Enterprise profit tax:	0 %	Transfers	11.2 %	
AD tax:	0.5 %			

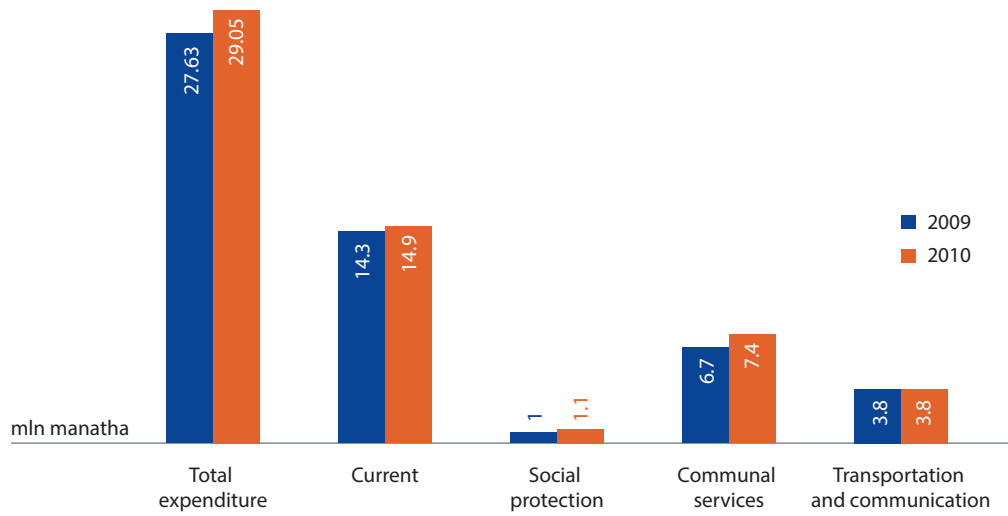
Expenditure 2013: (Aggregate)

Operational\ Maintenance	39.5 %
Health	0.1
Social protection	3.4 %
Culture, art, sport	1.3 %
Agriculture and environmental	1.4 %
Communal services	36.3 %
Transportation and communication	7.4 %
Others	10.7 %

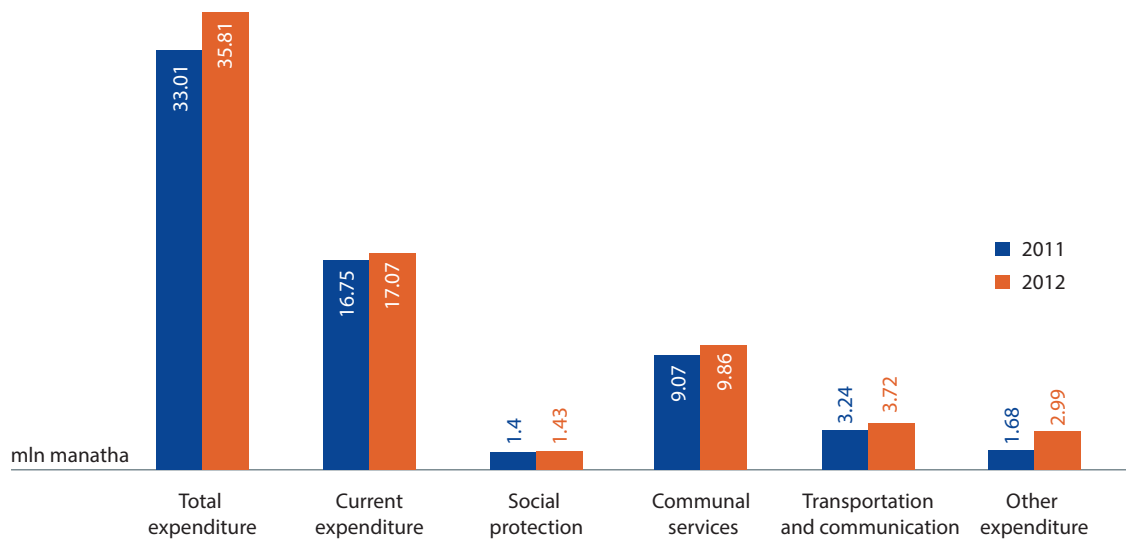
Local government expenditure 2009 – 2013 (in AZN) – 1.08 AZN = 1 Euro



Local expenditure by source 2009-2010 (mln AZN)



Local expenditure by source 2011-2012



Local Finance Benchmarking in Georgia

Author:
Irakli KHMALADZE

September 25, 2015

Chapter 1

Political and administrative structure

1.1. FORMS AND TYPES OF ELECTED LOCAL GOVERNMENTS

Apart from occupied territories (Abkhazia and South Ossetia) there are 76 self-government units in Georgia, out of which 12 are self-governing cities and 64 are municipalities. Local governments are elected every 4 years in Georgia, the latest election being organized in 2014. Elections are conducted throughout the country simultaneously, in autumn.

1.2. LOCAL ADMINISTRATIVE UNITS OF THE STATE

Ministries and state agencies do not have representation at the municipal level. Territorial branches of the state are established at the (historical) regional level. Eight out of 18 line ministries (education, agriculture, environmental protection, healthcare, refugees and accommodation, internal affairs and finance) have regional representation. Provision of services is administered from the center, however regional branches perform monitoring activities.

1.3. LOCAL GOVERNMENT TIERS, ADMINISTRATIVE STRUCTURE

From 2006, there is a single tier of local self-government in Georgia. Municipalities consist of villages, boroughs and towns. Self governing cities are divided into districts. Local governments' independence is guaranteed by the Constitution.

Local self-government has two branches. The representative body - Sakrebulo - is formed through direct elections (both from majoritarian and proportional voting system). In LSGs that have more than 70 thousand inhabitants 15 members of representative body are elected through proportional vote and 10 members through majoritarian vote. In smaller LSGs Sakrebulo consist of 15 members (10 elected through proportional and 5 through majoritarian vote). Sakrebulo is headed by the chairman and deputy chairman(men)¹ who are elected from its members. Not more than five committees shall be established within the representative body. Temporary commissions can be formed with the period of 3 month. Political parties form fractions.

The executive branch of LSG is headed by Mayor in self governing cities and by "Gamgebeli" in municipalities. Mayor/Gamgebeli is elected directly from 2014. Even though Mayor/Gamgebeli is elected, he/she represents the head of the local administration. The Mayor/Gamgebeli is free to form the executive body, by nominating deputy Mayors and defining the administrative structure of the office. The Mayor/Gamgebeli appoints representatives in LSG districts.

1.4. POPULATION SIZE OF ELECTED LOCAL GOVERNMENT UNITS

According to the 2015 census, the population of Georgia has decreased by 700 thousand compared to 2004 and amounts 3.7 million persons. The average number of inhabitants per municipality is 49 thousand. If we exclude the capital Tbilisi, which has 1.12 mln. population, the average number will amount only 34 thousand. There are only 7 LSGs that have more than 100 thousand citizens.

1. In LSGs with population above 100 000, municipality Sakrebulo chairman has two deputy chairmen.

Table 1. Local Self Governments according to size of population²

	Number of local governments	Population number (1,000)
1,000-4,999	2	8
5,000-19,999	13	182
20,000-49,999	30	942
50,000	18	1,480
capital city	1	1,118
Total	64 (76)	3,730

1.5. CENTRAL GOVERNMENT AGENCIES, RESPONSIBLE FOR LOCAL GOVERNMENTS

There are two entities established at state level in charge of local government affairs.

The Ministry of Regional Development and Infrastructure (MRDI) was formed in 2010. The ministry is responsible for providing legal and administrative support to LSG units. It also manages the regional development fund - the budget line in the State Budget that finances projects in regions/municipalities. Another entity, the Municipal Development Fund, is under MRDI's supervision and implements infrastructure projects, which are financed from external investment credits and grants.

The unit for communication with the regional and local authorities is established under the Prime Minister's office. The unit does mostly coordination and analytical activities.

Status, size, significance of the autonomous entities within the territory of the country

There are two autonomous republics - Abkhazia and Adjara - established by the Constitution. Georgian authorities are exercising control only in Adjara Autonomous Republic, Abkhazia is occupied by Russia. Five local-self governments are established within Adjara, including the self-governing city of Batumi, the third largest in the country. The competences of the autonomous republic are set in the areas of education, culture and sport, agriculture, economy, environment. Competences of LSG units functioning in Adjara are identical to those of the rest of Georgia. The only exception from the rule is the construction and maintenance of local roads, which is organized at the autonomous republic's level.

There are five LSGs de-jure: one LSG under the Abkhazia Autonomous Republic and four under the temporary administration of South Ossetia. These LSGs receive transfers from the state but do not possess revenues as do not exercise control in "Occupied Territories".

2. Source: Statistics Service of Georgia-Geostat

Chapter 2

Local government functions

Locally provided public services:

Services provided to local population by LSGs are of two types i) exclusive, that fall in their competence according to the law; and ii) delegated from the state.

A. State functions delegated to local units of administration

The legislation does not define the spheres to be delegated to LSG units. However, state bodies can delegate functions in two ways: 1) by making amendments to the legislation (requiring approval by the Parliament); 2) by signing contracts with LSGs.

The legislation obliges the state to allocate respective financing to LSGs for executing delegated responsibilities.

The most common practice used for delegating competences is putting the respective item in the annual state budget. The same document defines the amount allocated for delegated functions by each municipality. According to the 2015 State Budget, State delegated functions relate to public health, compulsory military recall, provision of certain communal services to internally displaced persons, commemoration of heroes fallen in war. Financial data demonstrate that delegated responsibilities do not put burden on LSGs, having limited number of beneficiaries. The total amount of transfers for all LSGs is around 11 million GEL, approximately 0.01% of the state budget (not more than 5% per LSG budget).

B. Services devolved to elected municipalities (exclusive)

The law defines the following exclusive competences for LSG units:

- Spatial and urban planning
- Taking care of municipal amenities (cleaning parks and roads, planting greenery, street lighting)
- Garbage collection,
- Provision of water (including technical); Development of local melioration system
- Establishment of pre-school education centers and their maintenance
- Construction and maintenance of municipal roads; regulating local traffic and parking
- Organization and provision of local public transport service
- Organization of markets, exhibitions and trading
- Establishing cemeteries and their maintenance
- Preservation and promotion of local folklore and heritage
- Providing social housing to homeless and their registration

Municipalities spend 85%-90% of their budget for financing exclusive competences

C. Voluntary responsibilities

Local self governments have the right to provide services to the local population, which are not defined by the legislation as competence of the State. Under “voluntary” responsibilities, LSGs provide discrete cash transfers to vulnerable groups of population. Financially strong municipalities also provide SME support services.

LSGs spend from 15% to 10% of their budget on financing voluntary services.

In 2014, local governments spent approximately 17% of the consolidated budget expenses that amounts around 5.4% of Gross Domestic Product.

2.1. MAIN FORMS OF LOCAL SERVICE MANAGEMENT

Services are provided to citizens through 1) outsourcing - shall follow public procurement procedures (tendering and/or single source procurement), 2) LSG owned Non-commercial Legal Entities (NLE), or 3) LSG owned Commercial Entities.

Spatial and urban planning: In almost all LSGs, there is no practice of spatial planning and development. Taking into consideration the inadequate capacity of local public servants in this area, the service has to be outsourced when LSGs start developing spatial plans.

The table below shows the service delivery practices in Local Self Governments in Georgia

Table 2. Service delivery practices across LSGs in Georgia

Type of Service	Outsourcing	LSG owned Non-commercial Legal Entities	LSG owned Commercial Legal Entities
Cleaning parks and roads	X (mostly developed in self-governing cities)		
Planting greenery	X (mostly developed in self-governing cities)		
Street lighting	X (mostly developed in self-governing cities)		
Garbage collection			X
Water provision	In municipalities Tariff ceilings are set by the (state) commission for electricity, gas and water		In self-governing entities Tariff ceilings are set by the (state) commission for electricity, gas and water
Pre-school education		X	
Municipal roads construction and maintenance	X		
Local public transport	X (mostly in large self-governing cities)		
Organization of markets and trading	X		
Cemeteries			X
Local folklore and heritage		X	
Social Housing		X (only in Tbilisi and Batumi)	

Chapter 3

Local government own and shared revenues

3.1. SCOPE AND TYPES OF LOCAL OWN SOURCE REVENUES: TAXES, USER CHARGES, FEES

According to legislation, LSGs are entitled to the following revenues:

“Own” revenues

- Property tax (taxation objects are land and property)
- Local fees (Gambling fee, construction, garbage collection, urban development, rehabilitation of cultural heritage area)
- Income for property (including from shares)
- Administrative fines

“Shared” revenues

- Fee for using natural resources (100%), e.g. mining, mineral waters, forestry
- Fee for postponement of military service (10%)
- Fines (Traffic police fines (60%), breaching construction rules, pollution fines)

Capital revenues (from selling municipal property)

Table 3. consolidated LSG revenues by revenue types (2014 data)

	mIn GEL	%
“Own” revenues	534.77	33.4
Property tax	245.87	15.3
Local fees	129.88	8.1
• Gambling fee	64.91	4.1
• Construction permission fee	4.18	0.3
• Garbage collection fee	47.36	3.0
• Urban Development	9.52	0.6
• Other fees	3.91	0.2
Income for property (including from shares)	42.63	2.7
Municipal Administrative fines	21.87	1.4
“Shared” revenues	64.66	4.0
• Fee for using natural resources (100%), e.g. mining, mineral waters, forestry	32.93	2.1
• Fee for postponement of military service (10%)	0.13	0.0
• Fines (Traffic police fines (60%), breaching construction rules, pollution fines)	31.6	2.0
Capital revenues (from selling municipal property)	29.86	1.9
Transfers from the State	1067.80	66.6
Total	1602.57	100.0

3.2. LOCAL AUTONOMY IN TAX POLICY DESIGN: SETTING BASE, RATE, EXEMPTIONS

Property tax

Property tax is defined as a local tax by the Tax Code. Georgia has a liberal tax legislation having only 6 types of taxes (VAT, excise, personal income tax, profit tax, tax on import and property tax).

Property tax is set on property (buildings) and land (that is separated from property). Land is divided between agriculture and non-agriculture types.

The tax is paid by legal persons (both residents and non-residents) and by individuals.

The Tax Code sets maximum and minimum thresholds for property tax (from 0 to 1% of the value). LSGs have the right to introduce the tax within the given limits.

Tax on property (buildings and land) for legal persons is set for not more than 1% of the value.

Individuals pay tax on property based on their annual income:

- Persons whose family members earn not more than 100 000 GEL (about 45 000 USD) should pay minimum 0.05% and maximum 0.2% of the property value.
- Persons whose family members earn more than 100 000 GEL should pay minimum 0.8% and maximum 1% of the property value.

The Tax Code also sets fixed tax rate (in GEL) for agriculture land across municipalities. The minimum amount of the tax is 5 GEL (for mountainous regions) and the maximum is 1000 GEL per hectare.

There are significant exemptions set by the Tax Code to land owners. This shrinks the tax base significantly. Namely,

- Individuals whose family earns less than 40 000 GEL (17 000 USD, four times more than GDP per capita) annually are exempted from paying the property tax.
- Individuals who owned less than 5 hectares of land before 1.01.2005 are exempted from property tax. Taking into consideration the land fragmentation in Georgia, most of the individuals holding the land are exempted from paying tax.

Local self-governments introduce tax rates with the consultation of the Ministry of Finance. Usually they set the maximum rates.

Local fees

The following activities are taxed by local fees: gambling, construction, garbage collection.

The Law on Local Fees defines fee types and sets maximum rates.

- Gambling fee: levied on casinos, gambling machines, lotteries. This source of revenue is mainly generated by large self-governing cities (Tbilisi, Batumi, Rustavi, Kutaisi). The fee rates shall be set by LSGs within the following limits:

On each table in casino	from 15000 to 30 000 GEL
On each gaming machine	From 1500 to 3000 GEL
On lotteries	20% of profit
On each table for gaming clubs	From 3000 to 10000 GEL

- Construction permit fee: maximum rate established by the legislation: 1 Lari per sqm in urban areas, 5 lari per sqm in resorts.
- Garbage collection fee: maximum rate per natural person: 3 Lari, for legal person - 25 Lari.
- Urban development fee: maximum rate per sqm is 400 Lari
- Fee for rehabilitation of cultural heritage area: 1.5 Lari per sqm

The representative body of the LSG introduces local fees by its statute. Factors that determine the amount of the fee: the level of urbanization, the local economic potential (for tourism, industry), the quality of infrastructure. Fees are higher in self-governing cities (Tbilisi, Batumi) than in municipalities.

Income from property

Income from property renting is a significant source of revenue, especially for self-governing cities. 100% of revenues from renting municipal property go to the LSG budget.

Large municipalities and self-governing cities also benefit from the income generated by LSG established commercial entities.

Another important source of revenue for LSGs is the interest earned on the current account held in commercial banks.

Administrative Fines

The Law on administrative fines defines the status of local fines and sets fixed amounts for each type.

Fines that generate local revenues are as follows:

Type	Amount
Illegal occupation of land	2000 GEL, repetitive action 3500 GEL
Not taking after for pets	20 – 50 GEL
Illegal organization of local transport routes	100 GEL
Dropping out construction materials	200 GEL for individuals; 1000 GEL for legal persons
Illegal reconstruction of buildings, facades	From 1000 to 5000 GEL
Damaging the greenery	From 500 to 1000 GEL
Illegal trading	From 20 to 100 GEL

In addition to local fees, 60% of traffic police fines go to local budgets. The fine amount depends on the type of offense and is set by the legislation.

It should be noted that fines are insignificant in rural municipalities because most of them address infringement of the urban style of living.

3.3. CAPITAL REVENUES (ASSETS SALE)

Selling property is a source of capital revenues for local-self government units. Public property can be owned by the State, by the Autonomous Republic or by the Municipality. LSGs get 65% of the price of municipality owned property that is sold and 35% of the price of the state owned property that is sold.

3.4. TAX SHARING: ORIGIN OR FORMULA BASED; SET RATIO OR ARBITRARY ALLOCATION RULES

Currently, there is no practice of sharing taxes with the LSGs. The mechanism for sharing personal and corporate income taxes was abolished in 2006.

The fee on using natural resources is a state fee by its nature, but is channeled to local budgets by 100%. The following resources are subject to the fee:

- Oil and gas
- Minerals and metals
- Construction materials
- Mineral water
- Wood
- Animals (hunting)
- Fishery

There are few local self-governments (Bolnisi-gold, Borjomi-mineral waters) in Georgia that benefit from the fee on usage of natural resources. This source of revenue for Bolnisi municipality amounts up to 70% of its budget revenue.

Apart from the fee from natural resources, the State shares 10% of the fee for postponement of the Military Service: 2000 GEL for one year

3.5. TAX AND TARIFF COLLECTION, PAYMENT SYSTEMS, MANAGING ARREARS, ENFORCEMENT, ADMINISTRATIVE CAPACITY

Property tax, like all taxes, is administered by the State. The Revenue Service of the Ministry of Finance is in charge of this matter. LSGs have almost no competence to interact with the taxpayers.

In addition to property tax, the national tax authorities administer gambling and natural resource usage fees.

The rest of local fees and fines are collected by local self-government units.

LSG units are not entitled to conduct enforcement activities by themselves. The decisions are enforced on voluntary basis or through the Law Enforcement Bureau (LEB). The latter is subordinated to the Ministry of Justice.

If a person does not fulfill the decision on administrative fine, the executive body of the Local Self Government sends a letter to the Law Enforcement Bureau. LEB has the right to take the hold on property (bank account) of the person who has committed administrative infringement. After LEB enforces the decision, it transfers the fine amount to the LSG account (keeps 7% of the amount as a service fee).

Information on tax collection targets (plans) and rates is available on a quarterly basis in MoF's reports. However, the data are consolidated for all LSGs.

Property tax (in mln GEL)

	2012	2013	2014
Target	232	232	275.0
Actual	230	230.9	245.8
Difference	-2.0	-1.1	29.1

As we can see from the table, tax collection rate was almost 100% during 2012-2013, however it decreased to 89% in 2014. In 1st quarter of 2015 tax authorities mobilized only 85% of the target. One of the reasons for such decline of the tax collection ratio could be over-optimistic planning of the Property Tax base. Due to economic crises in Georgia region the value of property has not increased (declined in certain areas).

3.6. LOCAL PROPERTY MANAGEMENT

The legislation defines two types of LSG property: indispensable – that is vital for functioning of LSGs, and dispensable - that can be sold.

There is a special unit established in the executive branch of the LSG dealing with property management. Property management units are usually dealing with property registration and then renting or selling. Most of LSG units do not apply modern methods of property management, and the database is also incomplete or inexistent.

The Local Self Government Code grants to the state government the right to define the rules for municipal property management.

According to the government statute, the property can be rented or sold in two ways:

1. through electronic E-auctioning on the designated website www.e-aucation.ge. Access to the website (which is bilingual - Georgian and English) is free of charge for all.
2. through direct negotiation with third parties. In case of direct negotiations, the representative body of LSG should grant the rights to the executive.

The second option is not competitive and is subject to criticism from NGOs. The defensive argument coming from the LSGs is the opportunity to attract investors in a prompt way. The fact that the representative body makes decision on direct negotiation should prevent the possibility of corruption. The watchdog organizations however claim that the representative body of the LSG often does not have the capacity and competence to properly oversight the process.

3.7. INFORMATION SOURCES, PUBLIC AND AVAILABLE DATABASES ON COLLECTED LOCAL AND SHARED TAXES

The main source of information is the Ministry of Finance and the Statistics Office of Georgia. The cumulative financial data are available in Georgian on the websites: www.mof.ge, www.treasury.gov.ge and www.geostat.ge. Some of the general information is in English too.

Some of the LSG units run their own websites that are updated regularly (Tbilisi, Batumi). The annual budget laws and execution reports are uploaded on the websites too.

LFB topics/areas

Vertical fiscal balance

Changes in service standards are compensated by higher local revenues – one can use the example of 2012 when LSGs have been obliged to provide pre-school education service for all, for free.

Horizontal fiscal balance

Ratio of per capita municipal expenditure in the richest and poorest municipalities – interesting to measure the difference between the self-governing cities and municipalities (costs vs. quality of service)

Own revenue raising capacity

- Ratio of own source revenues in the total revenue
- Autonomy in setting local own source revenue base and rate
- Right to collect taxes and fees
- Stability\ and continuity in local tax revenues

Tax sharing

- Types and significance of taxes shared
- Methods of sharing

Chapter 4

Intergovernmental transfers, fiscal equalization

4.0. SIZE AND FORMS OF INTERGOVERNMENTAL TRANSFERS

There are four types of intergovernmental transfers that the State allocates to local budgets:

Equalization transfer: formula based, general purpose, unconditional

Transfer for delegated responsibilities: discretionary, matching, earmarked

Special transfer: discretionary, earmarked

Capital transfer: discretionary, earmarked

Transfers are reflected in the State budget and calculated during the budget preparation phase in August-September, each year.

The table below summarizes the types of transfers and the number of local self-governments that receive financial assistance in 2015.

Transfer type	Equalization	Delegated responsibilities	Special	Capital
Number of LSGs receiving the transfer	74	70	0??	Not defined
% of total	98.5%, 835 mln GEL	1.5%, 1.6 mln GEL	0	

Transfer (total)	Equalization	Delegated responsibilities	Special	Capital
1065.38	776.14	11.25	6.65	271.3
%	72.85	1.0	0.5	25.65

4.1. Equalization transfer

According to the Budget Code, the objective of the equalization transfer is to converge socio-economic development among local self-governments.

The equalization procedure and formula are defined by decree of the Ministry of Finance that is usually amended every year.

During the initial stage of the equalization formula calculation, the Ministry of Finance defines the consolidated amount of municipal expenses that should not be less than 4% of GDP³. The MoF also defines the ratio for self-governing cities and municipalities. The usual practice is around 2/3 for cities and 1/3 for municipalities. For 2015, the total amount of expenses for self-governing cities (12, including the capital) is 69%, for municipalities only 31%. Pre-determination of shares of expenses in the total amount for cities and municipalities undermines the objective of the transfer - the equalization of socio-economic conditions.

During the second stage, the total amount of expenses is calculated per LSG. There are two coefficients used for calculations: i) the statistical coefficient; and ii) the equalization coefficient. The combination of these coefficients per LSG defines the share of expenses in the total LSG expenses.

The statistical coefficient is calculated based on population density, as well as the number of population below age 6, the number of population between 6-18 years and the total length of municipal roads.

The equalization coefficient is the sum of status coefficient and equalization scores.

3. According to the Law on Economic Freedom, the total amount of consolidated budget (state, autonomous republics and local governments) should not exceed 30% of the Gross Domestic Product.

The status coefficient for Tbilisi and Batumi is high: 2.8. For mountainous municipalities the status coefficient is 1.1. For the rest of local self-governments it is 1.0⁴.

Equalization scores are defined per LSG as the sum of arithmetic average and equalization score. Equalization score is calculated based on LSG revenue. LSG revenues are calculated based on the analysis of the current and previous three years data. The analysis uses the Microsoft Excel function "Trend".

The equalization transfer is defined per LSG as the difference between total expenses (calculated total LSG expenses multiplied by status and equalization coefficients) and LSG revenues (estimated with inflation rate and/or estimated GDP growth rate). Almost all LSG units receive the equalization grant that is 30-70% of their budget.

Exception is for those municipalities that have high revenue from fee on usage of natural resources. To calculate the equalization transfer for 2015, the MoF decided not to decrease the absolute amount of equalization transfer compared to previous year for each municipality.

The equalization transfer is unconditional and is used to finance exclusive and "voluntary" responsibilities.

4.2. TRANSFER FOR DELEGATED RESPONSIBILITIES

As already noted above, the State is allocating transfer to LSGs for delegated responsibilities, annually. During the initial phase of transfer design, the Ministry of Finance notifies local self-governing units regarding the amount of transfer. This should be done before the 5th of October each year, which gives LSGs 40 days to identify service beneficiaries and reflect the amount in the draft budget. The draft municipal budget is submitted to the representative body before the 15th of November.

The transfer for delegated responsibilities is conditional and can be used only for pre-defined services (public health, compulsory military recall, provision of certain communal services to internally displaced persons, commemoration of heroes fallen in war).

4.3. SPECIAL TRANSFER

It is worth noting that the scope of the transfer was completely changed after 2014. According to the Budget Code of Georgia, special transfer currently can be allocated to LSGs for mitigating damage caused by natural disasters, wars, pandemics and other emergency cases. The special transfer can still be used for "other", not specified purposes. As the starting point, the local self-government unit should request the State to allocate the special transfer. The request should contain the amount and a justification. There is no time defined for sending such request, therefore it can be submitted during the budget preparation as well as during budget execution periods.

4.4. CAPITAL TRANSFER

The capital transfer was introduced in 2014, after the new Code on Local Self Government was enacted. It is allocated to local self-governments for capital/infrastructure projects. The mechanism for transfer allocation is similar to that of the special transfer; the LSG should submit the request, containing the required amount and a justification. It is again assumed that the request can be submitted during budget preparation and execution phases.

4.5. SPECIAL FUNDS OF THE STATE BUDGET

There are three funds in the budget that may provide funding to local-self governments during the budget execution period: i) the reserve fund of the President, ii) the reserve fund of the government, iii) the fund for implementation of projects in regions.

The reserve fund of the Government and of the President should not exceed together 2% of the State budget. The total amount of the fund for implementation of projects in regions is formed during the budget preparation period. It varies from 5 to 8% depending on the macroeconomic performance of the country and the election cycle.

4. As a temporary measure for five newly established self-governing cities, the status coefficient is 0.5. For LSGs that exist de jure (occupied territories) the status coefficient is 1.5.

Allocation of funding from special funds is done by decision of the President and the Government. If the amount is less than 100 000 GEL, the Prime Minister can authorize the allocation by consulting the Ministry of Finance.

It has to be highlighted that funds allocated to LSGs from special funds during the year are added to the initial amount of “special” and “capital” transfers.

4.6. DISPARITY AMONG SELF-GOVERNING CITIES AND MUNICIPALITIES IN TERMS OF FINANCIAL RESOURCES

The main purpose of all types of transfers in Georgia is to match the spending needs of LSGs. Studies conducted by NGOs and think-tanks have shown that more funding and services are available for inhabitants in self-governing cities than in municipalities. The reasons for positive discrimination of cities are twofold.

Firstly, the majority (more than 57%) of population lives in cities, therefore the government wants to target the larger group of persons. Thus, construction and maintenance of infrastructure in urban areas is more costly and the demand of the population is higher.

The second argument often quoted is the promotion of economic “enclaves”. Fostering targeted cities and settlements that have touristic or other potential for development requires heavy investments from the State. The targeted investment and economic revival shall trigger the neighbouring settlements and municipalities in the future. This approach was used for developing Batumi as a touristic destination during 2009-2012. This increased Georgia’s touristic capacities significantly and promoted foreign direct investments and touristic inflows in the country.

4.7. CAPITAL INVESTMENT: LOCAL RESPONSIBILITIES, SOURCES OF FINANCING, PLANNING AND MANAGING INVESTMENTS.

Capital investment projects in regions are managed directly by the State (through the municipal development fund) or by LSGs. In almost all cases, financing is coming from the state budget (even though in some cases the initial source is an external donor).

LSG units are involved in the planning process and their voice is not neglected. However, modern practices of capital budgeting and investment project management are not introduced in Georgia.

4.8. INFORMATION SOURCES AVAILABLE AND PUBLIC DATABASES ON INTERGOVERNMENTAL TRANSFERS

The information on intergovernmental transfers is available in the annual state budget law and in quarterly budget execution reports. The budget documents and execution reports are published online on the website www.mof.ge, in Georgian, in PDF format. The information on transfers is available in disaggregated form.

Areas/topics for benchmarking

Fiscal equalization

- Objectives of equalization - factors of inequalities taken into consideration
- Share of equalization grant in total amount of transfers
- Local spending autonomy in service areas eligible for transfers

Stability and predictability of equalization transfer amount, equalization formula

Quality of data: local government information vs. State statistics

State policy towards non-equalization grants

- Transparency of decision making
- Bargaining power
- Institutions involved in grants design process

Chapter 5

Local borrowing

5.1. SIGNIFICANCE OF RAISING DEBT

There is a limited practice of LSG borrowing. As the financial market is underdeveloped in Georgia, the only source of borrowing is commercial banks. Only large self-governing cities occasionally use the practice of borrowing from banks. Most of the loans are short term (within one year). During the last three years, there has been no case of loan taken from commercial banks (with one year or longer maturity period)⁵.

Multi-year borrowing is possible if it is related to investment projects. Investment projects funded from the international donors (World Bank, Asian Development Bank investment credits, European Union Neighbourhood Investment Facility) are reflected in the State or LSG budgets. Donor funded investment projects are managed through the MoF and debt service is reflected in intergovernmental transfers.

5.2. AUTONOMY IN BORROWING: DEBT LIMITS AND NATIONAL REGULATIONS

According to the Law on Public Debt, local self-government units are not allowed to borrow without the consent of the Ministry of Finance. Having the opportunity to apply for special or capital transfers, LSGs are reluctant to apply for lending to the banks. Lending became also more difficult after 2013, when the Law on Economic Liberty entered into force. The Law provides that national public debt should not be more than 60% of GDP.

5.3. INFORMATION SOURCES, DATASETS ON LOCAL BORROWING, DEBT STOCK, DEBT SERVICE

The Ministry of Finance maintains information only on the State debt; the Ministry updates the database on a monthly basis and it is also available on the website (www.mof.ge) in English and Georgian. The data on LSG debt are not available publicly. The National Bank of Georgia publishes information on total public debt on its website (www.nbgf.gov.ge). However, the data contain info on debt of State, LSGs and State owned enterprises.

The investment projects financed through donors do not pass through the Treasury Single Account. Therefore, the Treasury and MoF do not possess up-to-date database on local-self government debt. However, the information on LSG debt is available in municipal budget documents (approved budgets and budget execution reports). The budget format, which is universal for all levels of the government, requires reference on total debt as well as annual targets. For example, the annual budget of self-governing city of Tbilisi (the capital) projects the total debt by the end of 2015 as 2009.8 mln GEL. The debt consists of:

- 95.1 mln GEL as World Bank loan for municipal development
- 808.7 mln GEL as Japanese project loan
- 1106 mln GEL as Kuwait fund investment credit

To collect the data on local-self government debt, one should read annual budgets and quarterly execution reports for all 76 entities. The information could be available in the Budget Department of the MoF that collects and analyses the LSG financial data regularly.

Areas/topics for benchmarking

Freedom to borrow

Forms of loans available to LSGs

Availability of Central Government guarantees

5. Source: State Treasury

Chapter 6

Local financial management

6.1. BUDGET CLASSIFICATION

1. Separation of current and capital budget, balancing local budgets

IMF's Government Financial Statistics Manual 2001 (GFSM 2001) is applied in Georgia from 2009. The information on current and capital budgets is available since 2010. The budget revenues are grouped and presented under four headings:

Income: taxes, non-tax revenues and grants.

Decrease of financial assets: leftovers from bank account

Decrease of non-financial assets: selling the municipal property and shares

Increase of liabilities: loans, mostly investment credits from the WB, ADB, etc.

Budget outlays are grouped under four headings:

Expenditures: salaries, procurement of goods and services, subsidies, subventions, taxes, interest payments on loans

Increase of financial assets: providing loans to businesses (only large self-governing cities run SME development programmes)

Increase of non-financial assets: investing in infrastructure that can be considered as the capital budget

Decrease of liabilities: repaying investment credits

The Budget Code sets the requirement that the budgets shall be balanced. LSG units have limited source of deficit financing. In order to shadow the deficit, usually they make optimistic projections of the revenue item "decrease of non-financial assets".

The legislation requires two type of information presented in the budget: i) financial; and ii) programme.

Financial information is presented according to economic, functional and organizational classification. Economic classification groups expenses according to cost types (salaries, procurement of goods and services, etc). Functional classification groups expenses according to functions (general government expenses, economic activities, agriculture, healthcare, environment, etc.). Organizational classification groups expenses according to entities that are under the LSG (Mayor's office, representative body, other municipal entities).

The programme information, introduced from 2013, requires the local self-governments to develop the programme budget format. Even though the programme budgeting is in its initial phase of development in Georgia, LSGs have to design four types of programmes:

- Administrative programmes: related to management of the municipality
- Service programmes: related to service provision
- Subsidiary programmes: related to financing of municipality owned non-commercial entities
- Infrastructure programmes: related to capital investment

Each programme should have defined objectives, expected results and measurement indicators as well as costed activities that are linked to the financial part of the budget. Even though most of the LSG programmes follow the required structure, objectives, expected results and indicators are of poor quality. Infrastructure programmes not often contain full information on projected constructions, costs per activity and per unit.

6.2. PLANNING AND BUDGETING

2. Strategic planning, multiyear budgeting

Strategic planning and medium term budgeting are introduced in LSGs from 2013. The planning horizon is four years. The multi-year planning has two stages.

During the first stage, LSG units are required to elaborate the Priorities Document (PD). PD should have a number of sections. In the first part of the document, LSGs should outline main figures on income, expenditure, financial and non-financial assets and liabilities for current, past and future four years. The source of the information is usually the Ministry of Finance of Georgia. Fiscal targets for future years are very tentative due to weak macro-fiscal forecasting and the fragility of Georgia's economy.

In the second part of the document LSGs should analyse the financial trends of the last and the current year. This information is usually taken from the budget execution reports that are prepared on a quarterly basis.

In the third section medium-term priorities should be indicated. Priorities shall be derived from the needs of the local population and be in line with the mandate of the LSG. It is worth noting that needs are almost identical in each municipality. These are mostly infrastructure (roads, water, sewage), pre-school education, health and social issues, cultural heritage, etc. The priorities document should also contain preliminary information on budget programmes, their objectives, expected outcomes and indicators.

The annual budget document is the second stage of budgeting. It is developed based on the Priorities Document. During budget preparation an update on macro-fiscal targets is done and more precise projections are made on programme objectives, activities, outputs, results as well as activity costs.

Programmes (objectives, results, indicators) should be projected for the next four years. The municipalities should design programmes that derive from their mandate and have a permanent nature. Activities under the programme can be grouped into sub-programmes. Similar to programmes, sub-programmes have objectives, results and indicators. However, the duration of sub-programmes shall be designed for shorter periods than programmes (around 1 year).

The Priorities Document and the annual budget are considered as one package and should be consistent with each other.

3. Annual fiscal planning, budgeting: responsibilities, methods, timing, planning municipal subsidiaries, openness and publicity

The management of the whole budget cycle is the responsibility of the LSGs. The executive body Mayor's office/Gamgebeli is responsible for budget planning, submission, execution and reporting. The representative body (Sakrebulo) is in charge of budget approval and financial oversight.

The budget planning starts in March each year and takes 9 months. The financial unit of the executive coordinates the preparation of the Priorities Document. All structural units of the executive, as well as subordinated agencies should be involved in the document preparation process. Most of the LSGs conduct public consultations in order to identify the needs. The consultations are held in April-May through public meetings, interviews and opinion surveys.

During May-July, LSGs get the preliminary data from the Ministry of Finance regarding macro-fiscal projections and the functions that will be delegated from the State. As most valuable sources of LSG finances are collected or allocated by the MoF (taxes and fees and transfers), LSGs depend on the information coming from the centre. During August-September, local budgets are prepared with informal consultations with the MoF. The latter notifies LSGs regarding the state transfers before the 5th of October. After that date, municipalities have 40 days to make final changes to the draft budget and submit it to the representative body no later than 15th of November.

As macro-fiscal planning is still weak, incremental budgeting is the most common method to project the revenues. Taxes and fees are projected based on inflation and GDP growth expectation. Sale of assets is projected case by case.

Expenditures are projected based on inflation. Any major increase in expenditure items is consulted with the MoF. A major increase of the budget can be caused by an investment loan coming from donor funding or by the decision of the State to allocate funding to a specific subject (infrastructure, pre-school education, etc). A major increase of expenses is usually reflected in state transfers. The last example of this was the decision of the state to increase pre-school education coverage for all.

The budget (both revenue and expenditure side) covers only partial information regarding subsidiaries. The resources transferred to commercial and non-commercial entities are reflected in the expenditure item "subsidiaries", without further breakdown of expenditure types (salaries, goods and services, etc). Revenues generated by subsidiaries are not consolidated in the LSG budget too. A similar type of practice exists at the state level too. During the current year, the MoF initiated a number of actions to integrate the subsidiaries in the respective budgets. However, opponents of the reform argue that the integration of semi-governmental institutions into the budget would limit their revenue generating independence directly linked to service efficiency.

The representative body of the LSG has 45 days for budget scrutiny and approval. Sakrebulo should provide its comments to the executive regarding the draft within 10 days, which is relatively short period. The Budget Code requires that the draft budget is published as well.

The executive body has another 10 days to accommodate the comments issued by the representative. The budget discussion process should be public and be completed before the end of the year.

The approved budget is published in the local newspaper and uploaded on the website of the LSG. LSGs do not prepare citizen's budget and because the information is technical, it does not get high attention from the public. However, the formal requirement of the legislation regarding the budget transparency and publicity is met.

6.3. BUDGET IMPLEMENTATION

4. Budget implementation, local spending autonomy: supervision and control over approved budgets, carry forward leftovers, intervention rules in emergency cases

The executive branch of the LSG is responsible for budget execution and reporting. The fiscal year is similar to the calendar year. The approved budget is broken down into quarters and executed according to the public procurement plan. The procurement system is fully electronic in Georgia and obliges all procuring entities to place their requests in the system (procurement.ge). The procurement is open to national and international bidders and is bi-lingual (Georgian and English).

The Executive is allowed to spend the money strictly according to the approved budget. Deviations are allowed within the 5% margin. Thus, the Mayor/Gamgebeli has a reserve fund that should not exceed 2% of the municipal budget. Even though the reserve fund is intended for unforeseen expenses, it should be spend according to public procurement rules (competitive tendering). The only exception is Tbilisi municipality, which most of the LSGs find unfair.

Reallocation of costs from one programme to another (or from one budget organization to another) above 5% should be done through budget amendments. Amendments are quite frequent and occur a number of times during the year, mostly in mid-year and late autumn.

Apart from the weak capacity to project expenses, the reason for budget amendments is the state transfers coming during the year. As noted above, special and capital transfers can be allocated during the budget execution period and their reflection and execution in the LSG budget requires the consent of the representative body.

The unspent funds that are accumulated in the LSGs accounts at the end of the year can be carried over to the next year's budget.

5. Agreement, contract with and control of service organizations

Cultural, sports and primary education services are implemented through municipality established non-commercial legal entities.

The garbage collection is managed through LSG established companies.

The rest of the services (road construction and maintenance, street lighting, greenery, look after cemeteries) is outsourced or provided through municipal companies.

The contract on service delivery is signed only in case of outsourcing. In the other cases, the statute of the LSG defines the terms of service provision.

Relevant departments of the LSG are in charge of monitoring the service delivery. Monitoring is done through regular reporting from subsidiary agencies and from contractors.

6.4. INFORMATION AND AUDIT

6. Fiscal information system, accounting rules, practices, transparency of budget and reports

The cash based accounting is used during the budget execution. Certain items are also recorded through accrual. The budget execution reporting is done on a cash basis. Apart from financial data, LSGs provide some information regarding service delivery (number of beneficiaries, geographical mapping of provided services). Most of the service related information is focused on inputs (rather than on outputs).

According to the Budget Code of Georgia, all budget data and reports should be open to public. Therefore, LSGs provided financial data to stakeholders if requested.

7. Budget monitoring, supervision, independent and external audit

The representative branch of the LSG is responsible for budget execution monitoring. This is done through the Budget and Finance Commission that is formed in all LSGs. The Commission has the right to conduct hearings on budget execution and recall respective documents from the executive as well as from subsidiary agencies.

The representative body should approve the annual budget execution report not later than May of the next year. If the execution report is not approved the "vote of no confidence" to the executive is declared.

In addition, the representative body has the right to contract an independent auditor to verify the annual financial statements produced by the Executive.

The State Audit Office, that is the supreme audit institution, is independent from the government and has the right to conduct audit (financial and performance) of LSGs. The audit is done usually once in 3-5 years, as the budget of LSGs is relatively small compared to the State budget.

Line Ministries have the right to monitor the implementation of functions/activities delegated from the state. However, the monitoring is always coordinated with the Ministry of Regional Development and Infrastructure (MRDI), which provides technical and methodological guidance to LSGs.

The Governor's offices established in regions have the right to monitor the compliance of legal documents issued by LSGs with the national legislation. They also have a function to provide inputs to the Priorities Documents that are produced by municipalities. This should allow the alignment of national priorities in regions with local needs.

8. Conflict of interest regulations, transparency

The Law on Civil Service defines the conflict of interest for public officials. Civil servants have the obligation to submit annual income statement/declaration to the Civil Service Bureau that monitors the potential cases of misconduct.

6.5. LOCAL FINANCIAL MANAGEMENT CAPACITY, TRAINING OF MUNICIPAL ADMINISTRATION AND ELECTED OFFICIALS

The capacity of local financial managers is still weak. Only large local-self governing cities have the ability to attract most qualified personnel. The knowledge of elected members of Sakrebulo regarding budget and financial oversight issues is very poor in most of the LSGs.

The Ministry of Finance provides trainings through its financial academy related to newly adopted regulations. The target audience of MoF trainings is the executive.

International donors and local NGOs provide training in municipal finance, including for elected officials, but this is not done on a regular basis.

From 2015, LSGs are required to allocate 1% of their budget for capacity development of local civil servants. More systemic approach for capacity development of municipal civil servants will be coordinated by the Ministry of Regional Development and Infrastructure.

Potential areas, topics for benchmarking

Involvement of the public in budgeting (planning, execution, monitoring and evaluation) - accountability channels

Framework of budget preparation and approval

Multi-annual budget plans

Explanations of performance: quality of programme budgets

Involvement of elected bodies in the budgeting process (including the right to amend the proposal)

Rules and frequency for budget adjustments

Financial monitoring system of local budgets

Transparency of budget documents

Chapter 7

Implementation of LFB

7.1. INFORMATION, DATASETS FOR COMPARISON (ANNEX 1)

A. Potential sources of aggregate data and statistics needed for the LFB surveys

Ministry of Finance, State Treasury database; the budget department of the MoF is regularly monitoring the LSGs budget. Thus, the LSGs regularly submit detailed financial data (draft and enacted budget, execution reports) to the MoF.

B. Disaggregate information and data on local government budgets, revenue sources

From 1st January 2015 all local government accounts are closed and banking operations are done through the Treasury. Thus detailed info per income/expenditure type can be collected from the treasury in PDF or Microsoft Excel format. Thus, the interested person should submit an official request for info.

7.2. PROBLEMS AND OBSTACLES IN LFB IMPLEMENTATION

A. National government incentives for comparison, competition;

The state is interested to measure the efficiency of LSGs. The Ministry of Regional Development and Infrastructure, who is in charge of LSG coordination, is considering establishing the model/standard for measuring the performance of sub-national governments.

In addition, the experience of the Easter Partnership countries and the comparison with existing practices will be valuable information for policy makers at national level.

B. Willingness of local governments to participate in the future LFB programme

Large self-governing cities, including the capital, will be eager to participate, with the support of the Ministry of Regional Development and Infrastructure.

C. Government units, national agencies, independent bodies, civic organizations possibly interested in hosting the benchmarking programme

Ministry of Regional Development and Infrastructure, National Association of Local Governments of Georgia (NALAG); Centre of Effective Local Governance and Territorial Arrangements (CEGSTAR: <http://www.lsg.gov.ge/>).

D. Availability of information, disaggregated data

Already noted above

E. Publicity of and access to local internal documents (rules and procedures, resolutions, decrees, budgets, audit reports, etc.)

Rules and regulations issued by LSGs are public. Legal acts are registered in the Ministry of Justice database that maintains the database of legal acts. The legal documents are available on the designated website: www.matsne.gov.ge. Internal documents and procedures that are not publicly available can be obtained

from LSG. In this case the fee for provision of public information has to be paid (covering the costs of photo-copy). Audit reports are available on the State Audit Office website: www.sao.ge

F. Local technical capacity to manage external evaluation of local finances

All LSGs can temporarily designate one or two persons for external evaluation. For local public servants it is an opportunity to get acquainted with international practice.

G. Election years (parliamentary, local)

Parliamentary elections will be organized in 2016. Presidential and LSG elections will be in 2018.

7.3. GUIDANCE AND PROGRAMME FOR ADAPTING THE (NATIONAL AND LOCAL) LFB TOOLKIT

A. Options for raising central and local government public interest for LFB

Fiscal benchmarking is an opportunity to take stock of implemented reforms in this area. The Council of Europe, which has contributed to the establishment of standards in this area, is highly respected in Georgia. The cross-country data and comparisons will allow supporters (Ministry of Regional Development and Infrastructure) of LSG reform to increase awareness on the subject.

B. Major ongoing local government reform and modernization programs

Currently fiscal decentralization is on the agenda of authorities. It is widely recognized that LSGs do not have enough capacity to cope with the assigned responsibilities. However, Georgia is a developing country with high level of unemployment and social needs. High expenditure needs at the State level, coupled with economic crisis in the region do not allow the government to allocate more funds to sub-national governments. In order to foster development in regions, the state plans to introduce economic stimulation (smaller taxes and communal service fees and exemptions; more state subsidies) measures in depressed and mountainous regions. The Parliament already passed by the second reading the Law on Mountains (regions) that envisages the above noted economic activity stimulation measures.

C. Potential partners for hosting the future LFB programme (national, local)

Potential counterparts can be the Ministry for Regional Development and Infrastructure and the Centre for Effective Governance and Territorial Arrangements. The Association for Local Authorities of Georgia could also be partner in the LFB.

At local level the relevant self-governments should provide their contribution.

D. Potential local sources of financing the LFB programme

A number of international organizations, such as European Union, USAID and its projects, UNDP, Swiss Agency for Development, that are active in the local governance/decentralization field should be willing to finance the study. The Government of Georgia may be interested in co-funding the project.

ANNEX

Annex 1. Availability of information and data on local governments

Aggregate data of local (sub-national) finances in mln GEL (2.25 GEL = 1 USD)

Item	2012	2013	2014
Current expenditures	1123.4	1246	1306.9
Capital expenditures	586.6	291	295.7
Expenditures by functions (service areas)			
Total revenues	1710	1537	1602.6
Local own source current revenues	424.1	453.7	534.8
• local taxes	230	230.7	245.9
• dues, fees	194.1	223	288.9
• user charges, tariff revenues			
Local capital revenues			
Shared revenues:			
• origin based	0.1	0.1	0.1
• allocated by formula	0.1	0.1	0.1
Grants, transfers, donations, subventions, etc.	1285.9	1083.3	1067.8
Local debt (stock)	8.8	12.3	9
Annual net borrowing			

References, further readings, websites

1. Constitution of Georgia
2. Budget Code of Georgia
3. Local Self Government Code of Georgia
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9. Decree of the Ministry of Finance defining the fiscal equalization transfer allocation mechanism
10. State budget for 2015 of Georgia
11. 2015 budget of self-governing city Tbilisi
12. Web-pages:
 - a. www.mof.ge
 - b. www.treasury.gov.ge
 - c. www.geostat.ge
 - d. www.sao.ge
 - e. www.matsne.gov.ge
 - f. www.procurement.ge
 - g. www.e-auction.ge

Local Finance Benchmarking in Moldova

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Executive Summary

Until 2014, the local authorities in Moldova had limited fiscal autonomy and fiscal potential. The budgets of lower levels were strictly dependent on higher levels of governments (matryoshka), while the transfer system was highly inefficient, unpredictable, and non-transparent, providing little if any incentives for fiscal responsibilities to local authorities (i.e. the transfers were reduced if the municipality collected more local revenues). LPAs were highly dependent on the state budget (70% excluding Chisinau and Balti municipalities), making them financially weak in performing their responsibilities. As of 2014, the old system of local finances has been improved and implemented in three pilot districts or rayons (Basarabeasca, Ocnita, and Rascani) and in the Chisinau Municipality. The improvement aims at ensuring a fiscal and budgetary autonomy of local authorities, maximizing efficiency and equity in allocation of resources while maintaining fiscal discipline. As of 2015, the new system of local finances is being implemented across the entire country. This report summarizes the current situation and identifies key areas for local finance benchmarks implementation.

The administrative territorial division of Moldova could be considered as very fragmented and the average population size of local governments in Moldova is rather small. Territorial fragmentation is usually pointed out as one of the key barriers to a qualitative provision of public services. The current small size of many villages (communes) is considered not economically viable in terms of self-governing units due to the narrow economic base and lack of economies of scale in terms of service production and provision. Furthermore, a large number of villages (communes) implies lower efficiency - high cost for administration, technical support, capacity building - as it promotes stronger supervision of local governments from the higher level of public administration and central government. While the decentralization reform has been adopted and implemented across the entire country as of 2015, a territorial-administrative reform of Moldova is a must for the authorities in the period to come.

The actual structure of local government functions is more or less a "classical" one for the transition countries, even the assignment of all the local functions is dissipated among a lot of normative acts (laws, government decisions, or other regulations). A critical feature of the assignment process of functions to local government in Moldova stands out, namely the assignment is very fragmented, a lot of sub-functions, arbitrary separated from the main functions, being transferred to local government units by a lot of normative acts in a very un-systemized way.

In terms of local budgets, transfers stand out as the largest component of revenues at about 70% in 2014 for both level 1 and 2 local governments. Own revenues are at 13% and 6%, respectively. As there are no preliminary data for 2015, a recent report, which analyzed the effect of fiscal decentralization in the pilot regions, shows that the new reform generated a number of interesting trends where shared taxes decreased significantly while transfers increased in the pilot regions. This tendency is primarily due to the modified inter-budgetary relations where income tax of legal entities is no longer shared. Public institutions are now financed via special transfers, which were introduced with the new law.

Revenues from sale and privatization of public property are predominantly used by LPAs to cover budget deficits when necessary. These have accounted for over 236 mln MDL. Over 62.7% have been collected by LPA I while the rest by LPA II. Revenues from local property management are relatively evenly distributed throughout the country. While in rural areas revenues from land taxes are dominant, in urban areas building taxation is the main revenues driver. It is important to note that local tariffs and user charges are set based on political, rather than economic principles. These, in most cases, do not cover expenses and as such most of the service provision enterprises risk bankruptcy.

Management of public property is characterized by a medium level of inventory and registration of public property. Most public land and real estate are inventoried by municipalities at a rate of 60-80%, but their cadastral registration body records a much smaller proportion. The entire public patrimony is managed by the City Hall and its subordinate institutions. Public tenders are organized for sale of municipal heritage.

The resources obtained from auctions are usually used to cover the budget deficit. Records show low recovery of public assets through investment projects.

Special means represent revenues obtained by public institutions, under conditions approved by the regulatory acts, from the works undertaken and services delivered, as well as donations, sponsorships and other funds properly come into possession of the public institution. These financial means represent up to 5% in total revenues of local governments. Financing through grants (see chapter 400 of the budgetary classification of revenues) is generally considered as being unfavorable to local autonomy in that local governments remain dependent upon the authority allocating these grants. However, transfers from the central government form the largest share of grants received by local governments. So not the mere size of central budget grants, but more the methods of allocation define the local fiscal autonomy. Finally, loans as one of sources for local government capital investments are virtually inaccessible to local public administrations.

To better align the local government functions as well as compare these on a regional, national, but also international level, this report also proposes a comprehensive list of local finance benchmarking areas. Particularly, the report recommends that benchmarking own revenues, shared revenues, municipal property management, intergovernmental transfers and grant allocations, as well as local borrowing are required to fasten growth at local and regional level in Moldova. However, benchmarking these areas might also face a number of obstacles, among which lack of incentives at local and national levels, lack of competence of civil servants, and limited public interest are critical.

On the one hand, local civil servants might have *insufficient competences and skill* to fully understand the complexity of LFB implementation and as such the benefits it might bring to local and national development. On the other hand, not being fully aware of the benefits and the essence of LFB implementation might minimize the incentives local governments have to fully adhere to for an objective local, national, but also international comparison.

These problems could be overcome by increasing the public awareness of the population about the LPA's activities. However, as a recent UNDP survey shows, while a vast majority of population (around 70%) knows their rights to be informed about the LPA's activities, only about 10% of the population actually does so. Thus, more intense policy initiatives are required to facilitate citizens' involvement in the local government's activities. Building comprehensive benchmarks and overcoming these obstacles is a challenge to be addressed in a follow up report.

Chapter 1

Political and administrative structure of the Republic of Moldova

1.1. GENERAL DATA

Republic of Moldova:	Parliamentary Republic
Population:	2.913 million, excluding Transnistria (2014 census)
Territory:	33,843 sq. km
Borders with:	Ukraine, Romania
Capital City:	Chisinau (population 761.9 thousand)
Currency:	Moldovan Leu (MDL); 1 MDL=0.048 EUR; 1 EUR=20.78 MDL (as of 31 July 31, 2015)
Language:	Romanian

1.2. ADMINISTRATIVE-TERRITORIAL DIVISION AND LOCAL GOVERNMENTS

Local governments in Moldova are organized in a two level (tier) system. According to the Constitution of the Republic of Moldova (Article 110) the territory of the Republic of Moldova from the administrative point of view is structured in districts, towns and villages. Certain towns may under the law be declared municipalities.

The administrative-territorial unit is a legal entity of public right and it disposes of property separated from that of the state and of other administrative-territorial units, according to the law.¹ The first level (primaria) local governments are represented by local governments in cities and villages. There are 896 first level administrative-territorial units – cities and communes (comprised of more villages) - in Moldova.

The second level local governments are the 35 administrative territorial units - 32 districts (rayon), two municipalities – Chisinau and Balti, and one autonomous territorial unit - Gagauzia. The average number of population in the first level local government is 2,850². The largest by population local government is the capital city Chisinau (761.9 thousand), but the smallest local governments have less than five hundred residents (Ochiul Ros, Anenii Noi) and many have fewer than 1,000 inhabitants.

Table 1. Number of first level local governments and population by size (2014)

Population number	Number of primaria*	Number of primaria, %	Population	Population, %
<500	4	0.4	1552	0.05
501-1,000	96	10.7	76,058	2.23
1,001-2,000	328	36.5	482,299	14.13
2001-5000	365	40.6	1,085,019	31.79
5001-10000	69	7.7	439,410	12.87
10001-20000	27	3.0	370,290	10.85
20001-50000	7	0.8	196,260	5.75
>50,000	2	0.2	762,338	22.33
Chisinau Municipality			761,9	
Total	898	100	3,556,000**	100

Source: Elaborated by author according to the report on the execution of administrative-territorial units budgets in year 2014*including Chisinau and Balti, **including Transnistria

1. Law on Local Public Administration, No.436, Article 4.

2. Osoian I., Sirodoev I., Veverita E., Prohntitchi V. Analytical Study on Optimal Administrative – Territorial Structure for Republic of Moldova. Chisinau, 2010.

Although the Law on Administrative - Territorial Organization sets the minimum required number of residents of the administrative territorial unit – 1,500³, there are less than 1,500 residents in almost one third from total local governments. Significant part of those “exceptional cases” in Moldova are geographically rather close or even adjacent, and could be merged.⁴

The rayon (or district) is an administrative and territorial unit, which includes villages (communities) and cities that are territorially bound by economic, social and cultural connections. The average district size by population is 77.3 thousand inhabitants. The largest by population districts are UTA Gagauzia (141.7 thousand), Orhei (115.5 thousand), Cahul (111.5 thousand), Hincesti (110.4 thousand), Ungheni (103.5 thousand), while the smallest districts have less or about 40 thousand residents (Basarabeasca (26.9 thousand), Dubasari (33.9 thousand), Soldanesti (40.3 thousand)), which is closer to the population number of some towns or rayon centers (Cahul, Ungheni, Soroca). Average area of district is 890 sq.km, the largest district (Cahul, 1545 sq.km) is 5.2 times larger as compared with the smallest district (Basarabeasca, 290 sq.km).⁵

The capital city, Chisinau, is both a second level and a municipality level administrative-territorial unit. The Chisinau city is divided in administrative-territorial subdivisions named sectors, while the municipality is comprised of towns and villages (communes) which are LPA level 1. The Law regarding the status of the Chisinau municipality no. 431 of 19.04.1995 is outdated and does not meet the current conditions and institutional framework. As such this law needs urgent amendment. The Law on Local Public Administration contains a special chapter (VII) about public administration of Chisinau municipality. Not all provisions of the Capital City Law are fulfilled in fact⁶.

Besides the local government administrative territorial units there are six development regions in Moldova: North, Center, South, Chisinau, Gagauzia and Transnistria (based on the Law on Regional Development No. 438-XVI of 28.12.2006).

In general, the administrative territorial division of Moldova could be considered as very fragmented and the average population size of local governments in Moldova is rather small. Territorial fragmentation is usually pointed out as one of the key barriers to a qualitative provision of the public services. The current small size of many villages (communes) is considered not economically viable in terms of self-governing units due to the narrow economic base and lack of economies of scale in terms of service production and provision. Furthermore, a large number of villages (communes) implies lower efficiency - high cost for administration, technical support, capacity building – as it promotes stronger supervision of local governments from the higher level of public administration and central government. The fragmentation of administrative territorial division of Moldova does not promote the decentralization and development of financial autonomy of local governments. While the decentralization reform has been adopted and implemented across the entire country as of 2015, a territorial-administrative reform of Moldova is a must for the authorities in the period to come.

1.3. POLITICAL STRUCTURE

Moldova is a democratic and unitary republic. The political system is mixed (parliamentary-presidential), with the Parliament (one hundred and one members) and the President. While the Parliament is elected by population for a four year period, the President is elected by the Parliament for the same length of mandate. The Prime Minister is appointed by the President only after he/she and his or her cabinet have received a vote of confidence from the parliamentary majority. The rights of the President to dissolve the Parliament are very restricted. Some executive powers are vested in the President's hands: he or she can issue decrees and has special powers in defense and foreign policy. The delicate balance of power between Parliament, Government, and President is held to be responsible for the relatively high level of democracy as well as the blocking of important reform projects. Consequently, there have been discussions aimed at strengthening the powers of the President. Judicial powers are vested in the courts.

3 Chapter III, Article 7 (3)

4 Osoian I., Sirodoev I., Veverita E., Prohntitchi V. Analytical Study on Optimal Administrative – Territorial Structure for Republic of Moldova. Chisinau, 2010.

5 Osoian I., Sirodoev I., Veverita E., Prohntitchi V. Analytical Study on Optimal Administrative – Territorial Structure for Republic of Moldova. Chisinau, 2010.

6 To be more precise, the law on the capital city dated on 1994 provides some baseline legislation for the capital city, but this law is not in accordance with the legislation of the Republic of Moldova.

Chapter 2

Local government competences

2.1. LOCAL GOVERNMENT FUNCTIONS, RESPONSIBILITIES AND RIGHTS

The Constitution (Article 109, (1)) states that "... public administration as manifested in the administrative-territorial units is based on the principles of local autonomy, of decentralization of public services, of the eligibility of local public administration authorities, and of consulting the citizenry on local problems of special interest." The responsibilities for providing local government services are stipulated in two laws: The Law on Administrative Decentralization and the Law on Local Public Administration."

The Law on Administrative Decentralization (Article 3, a-e) defines the following principles that are connected with the competence of local governments: (i) *principle of local self-government*, which implies guaranteeing the right and effective capacity of local public authorities to regulate and manage, under the law, in their own responsibility and in the interests of local population, an important part of public affairs; (ii) *principle of subsidiarity*, which implies the exercising of the public responsibilities by the lowest level authorities that are closest to the citizens, excepting the cases when the intervention of the high level authorities has obvious benefits that proceed from the volume and nature of the responsibilities and the need to assure the efficiency of the public action; (iii) *principle of equity*, which implies guaranteeing some equal conditions and opportunities to all local public authorities with the aim to achieve their objectives in carrying out their duties; (iv) *principle of integrity of competences*, which supposes that any competence assigned to local public authorities shall be full and exclusive, and its exercising cannot be challenged or limited by another authority, except in cases provided by law; and (v) *principle of correspondence of the resources with the competences*, which implies the correspondence of the financial and material resources allocated to the local public authorities with the volume and nature of the competences that are assigned to them in order to assure their efficient fulfilment.

According the Law on Local Public Administration (Article 10), local public authorities organize their activity in the fields established by the Law on Administrative Decentralization (see Appendix 8.1 for local government functions and Appendix 8.2 for local government domain of activity), being granted, for this purpose, full competences which shall not be undermined or limited by any public authority, unless the requirement of the law. The competences of the local public authorities are strictly defined, under this law, between the deliberative and executive public authorities of first and second levels. The central public administration authorities cannot assign or impose any competences to the local public authorities without a prior assessment of the financial impact that these competences may generate, without consulting the local authorities of the appropriate level, and without providing the local communities with the necessary financial resources.

The actual structure of local government functions is more or less a "classical" one for the transition countries, even the assignment of all the local functions is dissipated among a lot (too many) normative acts (laws, government decisions, or other regulations). A critical feature of the assignment of functions to local government in Moldova stands out, namely the assignment is very fragmented, a lot of sub-functions, arbitrary separated from the main functions, being transferred to local government units by a lot of normative acts in a very un-systemized way. The above classification is a strong rationalization and consolidation of the actual situation.

Some of the major problems in the assignment of functions to local governments are:

- a) Unclear assignment of functions among different administrative tiers: central, rayon and primaria, due to the high number of normative acts; a fragmented core responsibility in many sub-functions without any managerial or technical rationality; the lack of unique set of technical criteria to be used for any assignment of functions to local governments; as well as a vague juridical language in the normative acts;

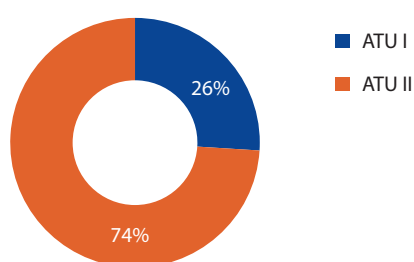
- b) The assignment of responsibilities is not coherent and uniform: many responsibilities are transferred through normative acts dealing with another subject, just like some auxiliary or connected provisions, with no details, without implementation and financial mechanisms, without respecting the general rules of decentralization;
- c) Generally the assignment is not correlated with the financial envelope – many reports and local authorities associations claim that the transfer of new responsibilities is done by the central administration without enough financial resources necessary to provide them. Moreover, the assignment of functions to one or other of local government tier ignores their fiscal and management capacity, jeopardizing the efficient and effective provision of public services;
- d) The assignment process is not correlated with the ownership of the infrastructure necessary to provide the transferred functions. Moreover, for many decentralized responsibilities, the investment decision power remains at the central level, disconnected from the local authority which provides the service and decides on operational costs;
- e) Many local government units of the first level (primarias) complain against the permanent intervention (paternalism) of the central public administration or rayon (second level of the local government) on direct management of public service provision or in budgetary management. Partially, this paternalistic approach is justified by the lack of administrative and professional capacity at the level of primarias. It is expected that this issue will dissipate as the new law on fiscal decentralization is better understood by current public servants. Once fiscal decentralization is fully implemented, local public administrations will attain a greater financial autonomy. As such, their degree of responsibility will increase as well, which will undoubtedly improve their professional and administrative capabilities.

With respect to item (e) above, some clarifications are required. After approval of the Law on Local Public Finances, dual subordination has been virtually ruled out. In fact, until then double subordination was not legally stipulated. The law stipulated however that LPAs were skewed to provide services to CPA without them covering with the required finances. Nevertheless, dual subordination has been manifested through:

- Budgeting: LPA II budgets have been formed in stipulation with the Ministry of Finance, which settled expenditure norms by domains, and then supplemented these with budgetary corrections in case of insufficiency of funds (ex. Ministry of Finance sent a letter of cost cutting by 20% to an LPA in 2008); LPA 1 budgets have been formed in concordance with LPA 2, which could redistribute transfers towards LPA 1 (more LPA 1 taxes would decrease general transfers by said amount);
- Investment planning: the annual national budget contained an appendix that stipulated investments for LPAs; these were distributed according to political discretion after parliamentary approval;
- Personnel employment: central governments would establish the structure and employment limits; although these had a character of recommendation, they were still considered in budgetary planning.

Currently, the local public authorities of first and second levels, as well as the central ones, may cooperate, under the law, with the aim to assure the accomplishment of some projects or public services that require joint efforts of these authorities⁷.

Figure 1. Ratio of ATU I and ATU II budget



Source: Author calculations

⁷ Law on Administrative Decentralization, No.435, Article 5 (1).

2.2. INSTITUTIONAL STRUCTURE OF LOCAL GOVERNMENTS

The Constitution (Article 112) provides the following provisions on first level local government institutional structure:

1. At village and town level the public administration authorities through which local autonomy is executed are represented by the elected local councils and mayors.
2. The local councils and the mayors operate under the law as autonomous administrative authorities and are assigned the task of solving public affairs in villages and towns.
3. The ways of electing local councils and mayors, as well as their powers and competences shall be established by law.

The Law on Local Public Administration determines the number of local council members, but the election process is set in a special law – the Elections Code. The number of councillors depends on the number of residents in the municipality and it varies from 9 (in municipalities with less than 1,500 inhabitants) to 43 in municipalities with population over 200,000, but in Chisinau the council is composed of 51 councillors⁸.

Councils as representative authorities establish executive bodies to fulfil local government's tasks. The mayor is the chief of the local public administration. The vice mayors are elected by the council upon the mayor's proposal. The mayor proposes and the council approves under the law the organizational and employees' chart, the salary plan.

The structure of Chisinau municipality differs from other local governments. The public administration of Chisinau municipality is implemented by the municipal council, town councils and village (commune) councils, as deliberative authorities, and by the General Mayor of Chisinau municipality, and the mayors of the villages (communes) and towns, as executive authorities. The Law on Local Public Administration provides the requirement on position of secretary of local council and its duties, provisions on mayoralty.

The Constitution (Article 113) provides the following on districts:

1. The district council coordinates the activity of the village and town councils to achieve public service at district level.
2. The district council will be elected and will work in accordance with the law.
3. The interrelationships of public authorities are based on the principles of autonomy, legality and cooperation in solving common problems.

The rayon (district) council is the representative authority of the district's population. The district council is composed of councillors, elected according to the provisions of the Elections Code⁹. Depending on the number of population the number of district councillors varies from 27 to 35. The district council elects the district president with the vote of the majority of councillors. The district president may be the only person that has access to the state secrets. The district president is assisted by the vice presidents. The staff of the district president's office is organized and functions based on a regulation approved by the district council. The secretaries of the district council, of the Chisinau Municipal Council and of the sector council of Chisinau municipality are considered civil servants.

To fulfil their functions, local governments establish administration and institutions and manage municipal enterprises (companies). According to the law the local councils are obliged to elaborate and approve the statute of the respective administrative-territorial unit, which contains specific data and elements that are designed to individualize them compared to other similar units. The Assessment Report on Administrative Capacity of Local Public Administration Authorities (2010) reflects that significant number of local governments (districts, cities, municipalities) do not have such document¹⁰.

Moldovan local public administration is influenced by both European models and principles and by Soviet vestiges, with the latter seemingly having a bigger influence on it¹¹. The centralized model of administra-

8. Last local elections in Moldova were held in June 2011

9. Law No.436 on Local Public Administration, Article 41.

10. Assessment Report. Administrative Capacity of Local Public Authorities. Prepared by Popa V., Bulat V., Barbu D. for UNDP, Chisinau, 2010.

11. Osoian I., Sirodov I., Veverita E., Prohntichi V. Analytical Study on Optimal Administrative – Territorial Structure for Republic of Moldova. Chisinau, 2010.

tion was reinforced and replicated, especially in the period between 2003 and 2009, when the government took great efforts to strengthen the verticality of the power¹².

The Law on Local Public Administration sets out the full right of the local and rayon councils to determine the necessary staff in institutions. The Government Decision no. 688 (dated 10.06.2003) "On structure and staff of local administration of cities and villages" (abolished in 2013) and the Government Decision no. 689 (dated 10.06.2003) "On structure and staff of district administration" (also abolished in 2013) have determined the necessary staff positions and the number of loads according to the number of population in the administrative territorial unit. Those acts were obsolete and were abolished because the structure and the staff shall be approved only by the Council (proposed by mayor or president), under the Law on Public Administration in force from 2006. The Government Decision No. 525 (16.05.2006) „On the remuneration of civil servants and persons performing technical service" that determines the local government staff salaries was abolished in 2012.

2.3. LOCAL GOVERNMENTS SUPERVISION

Until 2006 there was the prefects' system as state representatives in the territory of districts in Moldova. During the period 2006 - 2009 the LG supervision was ensured by the Ministry of Local Public Administration. It had 10 Territorial Administrative Control Subdivisions. In September 2009 the Ministry was abolished and its functions were transferred to the State Chancellery. The State Chancellery and the Ministry of Finance are the main organizations that define the local government's sector policy and ensure supervision of local governments.

In the State Chancellery, the divisions responsible for local governments are:

- Decentralization Policies Division;
- Relations with Local Public authorities Division;
- Administrative Control Division.

In the Ministry of Finance, the divisions that deal with local government issues are:

- Division on Budget of Administrative - Territorial Units;
- Financial inspection.

Also other ministries and state institutions have close relations and have shared public services with local governments, such as:

- Ministry of Regional Development and Construction;
- Ministry of Education;
- Ministry of Interior Affairs;
- Ministry of Agriculture and Food Industry;
- Agency for Land Relations and Cadastre, etc.

The State Chancellery has competence and responsibility on the development and implementation of the administrative decentralization policy. The State Chancellery is responsible for organizing the administrative control of the local public authorities' activity (including legality control), implemented directly by the State Chancellery or by its territorial offices, ruled by the Government representatives in the territory.

The Ministry of Finance and/or Finance department is authorized to screen the budgets of administrative territorial units for accuracy of their preparation and execution. Revision to the execution of the budgets of administrative-territorial units is carried out by Financial Inspection under the Ministry of Finance, periodically, every two years.

In exercising its powers, the Court of Accounts audits the local authorities on formation and implementation of the budget of administrative-territorial unit. In the Parliament, the Public Administration and Regional Development Committee deals with the local government issues. Above mentioned state institutions, local governments and their organizations form the range of main Moldova's stakeholders of decentralization and finance decentralization process. They have different interests and perceptions. Involvement of all of them in the process of finance decentralization planning and implementation is crucially important and must be done in the earliest possible stage.

12. Popa V., Bulat V., Barbu D. Administrative Capacity of Local Public Authorities. Assesment Report. UNDP, Chisinau, 2010.

Chapter 3

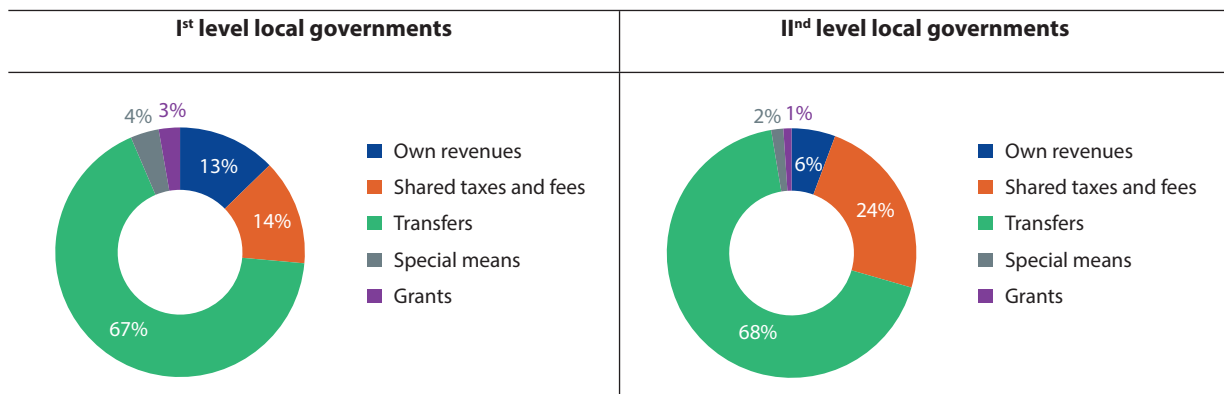
Local government own and shared revenues

According to the Law No. 397-XV on Local Public Finance, Article 4(1), the revenues of the administrative-territorial unit's budget consist of:

- Own budget revenues that consist of local taxes and fees, property tax and other fiscal and non-fiscal revenues;
- Shared tax and fees;
- Special means/special funds
- (General and special) Transfers from the state budget;
- Grants/Borrowings.

Figure 2 presents the share of revenue components in total revenues in year 2014 for I and II level local governments.

Figure 2. The share of revenue components in total revenues, year 2014, %



Source: Elaborated by author according to the Ministry of Finance report on the execution of administrative-territorial units budgets in year 2014. Note that the ATU I budget is calculated separately from the ATU II budgets.

As there are no preliminary data for 2015, a recent report which analyzed the effect of fiscal decentralization in the pilot regions shows that the new reform generated a number of interesting trends. As such, shared taxes decreased significantly while transfers increased significantly in the pilot regions. This tendency is primarily due to the modified inter-budgetary relations where income tax of legal entities is no longer shared. Public institutions (such as preschool, primary, secondary, special, and complementary education, as well as other delegated powers) are now financed via special transfers, which were introduced with the new law.

3.1. OWN REVENUES

The budget classification does not contain such category as own revenues, and usually they are calculated as sum of local taxes and fees, property tax and other fiscal and non-fiscal revenues, and are transferred in whole and directly to the local government's budget.

Local taxes and fees are stipulated in Chapter VII of the Tax Code, and every year the local government must establish these taxes/fees according to the Tax Code. This category of own revenues represents about 30-40% from the amount of own revenues. Chapter VII of the Tax Code defines local fees as being "an oblig-

atory payment made to ATU budget¹³. Article 288 states a number of definitions establishing the subjects and objects of local fees' imposition. In 2014, the Tax Code (article 289(2)) stipulates 14 types of local taxes:

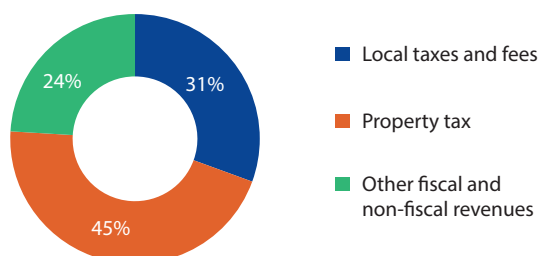
- a) Fee for land management (territory accomplishment tax);
- b) Fee on auctions and lotteries organized on the territory of the administrative territorial unit;
- c) Advertisement fee (on placement of advertisement);
- d) Fee for application of local symbols;
- e) Fee for commercial and/or social services units;
- f) Market fee;
- g) Lodging fee;
- h) Resort fee;
- i) Fee on passenger auto-transport services in the territory of municipalities, cities and villages (communes);
- j) Parking lots' fee (for physical or legal persons rendering such service);
- k) Dogs owners' fee;
- l) Parking fee;
- m) Fee for solid waste removal;
- n) Fee on publicity devices.

While property tax (land and real estate tax) is also a local own source revenue, it is regulated in a different chapter of the Fiscal Code (namely Chapter VI, Articles 276-287). Local taxes, on the other hand, are regulated in Chapter VII of the Fiscal Code (art. 288-298). Figure 2 presents the share of revenue components in total own revenues.

Figure 3 shows the structure of the total own revenues of the 1st level local government. Property tax is also regulated by Chapter VI of the Tax Code. Property tax is divided in tax on land and tax on real estate. First level local governments, Chisinau and Balti collect the property tax. According to the Tax Code property tax represents "local tax which is an obligation towards the budget deriving from the value of real estate goods." The Tax Code sets the objects, subjects and tax rates for the purposes of property taxation. Real-estate tax objects are land, houses, buildings, apartments, etc., including buildings in process of finishing the construction (50% and more) and in construction for more than 3 years. Subjects of real-estate taxation are both physical and legal persons.

Tax is calculated from estimated cadastral value of the property. Territorial cadastral administrations are responsible for property evaluation and re-evaluation according to unified methodology. The Law stipulates that territorial cadastral administration every three years makes re-evaluation of property. In fact the situation is different. Actual evaluation of cadastral value of property is done mostly in the cities and rayon centers and did not cover most of the villages and individual housing (which include expensive villas as well).

Figure 3: The share of revenue components in total own revenues, year 2014, %



Source: Elaborated by author according to the report on the execution of administrative-territorial units budgets in year 2014

13. A.Secieru, A.Casian, A.Petroia. Local public finance through the perspective of financial decentralization in Moldova. Chisinau, 2010. pp. 21

The Law establishes a minimum and a maximum tax rate. At the same time local public administration authorities can establish their property tax rate within the limits set by the Tax Code. It is a custom to set property tax rates at the minimum in villages and communes, while in cities these are slightly higher but not at the maximum. The Law envisages tax exemptions. At the same time the Law regulates tax exemptions awarded by LPA authorities¹⁴.

Article 280 of Chapter VI of the Tax Code sets the following minimum and maximum tax rates:

- In municipalities and towns: min 0.05% - max 0.3% from the taxable value of the real estate;
- For agricultural land with constructions on it – min 0.1%– max 0.3% from the taxable value;
- For other real-estate objects – 0.1% from the taxable value.

Under the category of *non-fiscal own revenues* (about 20-30% from the amount of own revenues) related to local budgets are assigned:

- other income from entrepreneurial activity and property (such as: payments for rent of natural resources, for agricultural land and land for other purpose than agriculture, rent of public assets, other property income, etc.);
- administrative taxes and payments (includes revenues received from collection of the state fee, local fees and other charges and administrative payments);
- fines and administrative sanctions (this chapter includes income received as fines, penalties and administrative remedies imposed by courts and other competent bodies in supervision and regulations. Fines and penalties related to the calculation of certain tax or fee are included in the record together with the tax or fee to imposing the fine);
- other unidentified receipts.

Revenues from sale and privatization of public property are predominantly used by LPAs to cover their budget deficits when necessary. Over 62.7% have been collected by LPA I while the rest by LPA II. Revenues from public property rent are part of the own revenues.

Revenues from local property management are relatively evenly distributed throughout the country. While in rural areas revenues from land taxes are dominant, in urban areas building taxation is the main revenues driver. Unlike many other European countries, Moldova does not face the problem of the concentration of property tax revenues in urban regions. With the increase in revenues from real estate tax, there is an increased risk of territorial concentration of such income in urban areas where property value is greater. However, special equalization transfers, which are already part of the Moldovan system of local finances, should offset this development.

3.2. SHARED TAXES AND FEES

The system of shared general state taxes (duties) and fees to the local government budgets includes: income tax and fees to the Road Fund.

Until 2014, the income taxes (personal and corporate taxes) were shared in the local budgets in different proportions established by Ministry of Finance. In 2013 were operated some changes in the Law on local public finance no. 397/2003. The changes provide that the corporate income tax will be transferred in whole and directly to the state budget, but personal income tax will be transferred in proportion of 75% to first level local governments and 25% to the second level of local government from the total amount of income tax collected in the territory of the administrative territorial unit. For Chisinau and Balti municipalities it was established a proportion of 50% respectively 45%, and for residence towns (towns where the rayon council is located) a proportion of 20% from the total amount of personal income tax collected in their territories. Therefore, clear proportions were established in legislation for tax breakdown of individuals. As of 2015 the breakdown of taxes to businesses flows 100% towards the state budget, while until 2014 these were transferred only partly (shares set by Ministry of Finance). These were replaced by special transfers to

14. A.Secieru, A.Casian, A.Petroia. Local public finance through the perspective of financial decentralization in Moldova. Chisinau, 2010. pp. 20

finance preschool, primary, secondary, special and complementary education, as well as other delegated powers.

According to the Law no. 435 on administrative decentralization and local autonomy, local authorities are entitled to manage and regulate under their own responsibility and in the interest of the local population an important part of public affairs. Financial and budgetary autonomy is the right of local authorities to have sufficient own financial resources and use them freely, under the law, by adopting their own local budgets and setting taxes, tariffs and user charges.

It is important to note that local tariffs and user charges are set based on political rather than economic principles. These, in most cases, do not cover the expenses and as such most of the service provision enterprises risk bankruptcy.

Most municipalities registered a satisfactory level of collection of taxes in the local budget, however they face some difficulties in forecasting and collecting taxes. Some LPAs recorded a collection level higher than planned while others - lower than planned in the initial budget as approved. In recent years, there was a tendency for collection rate of taxes to reach 100%. Weaknesses are caused in particular by the lack or poor quality databases of individual taxpayers and businesses, which would allow better forecasting of income taxes. At the same time mayors do not use sufficient means of disseminating information on tax liabilities, which would contribute to an effective local budget collection.

Management of public property is characterized by a medium level of inventory and registration of public property. In most municipalities there is a specialist or service responsible for managing public property and records. In about half of the LPAs there is compliance with a set of procedures for recording public property and a local register of public property has been developed. The registry contains annual reports, collected until April 15, on public property under the administration of the Public Property Agency. Most public land and real estate are inventoried by municipalities at a rate of 60-80%, but their cadastral registration body records a much smaller proportion. The entire public patrimony is managed by the City Hall and its subordinate institutions. Public tenders are organized for sale of municipal heritage. The resources obtained from auctions are usually used to cover the budget deficit. Records show low recovery of public assets through investment projects.

Following our analysis above, we present the areas of local own source and shared revenues benchmarking at international and local level in Appendix.

Chapter 4

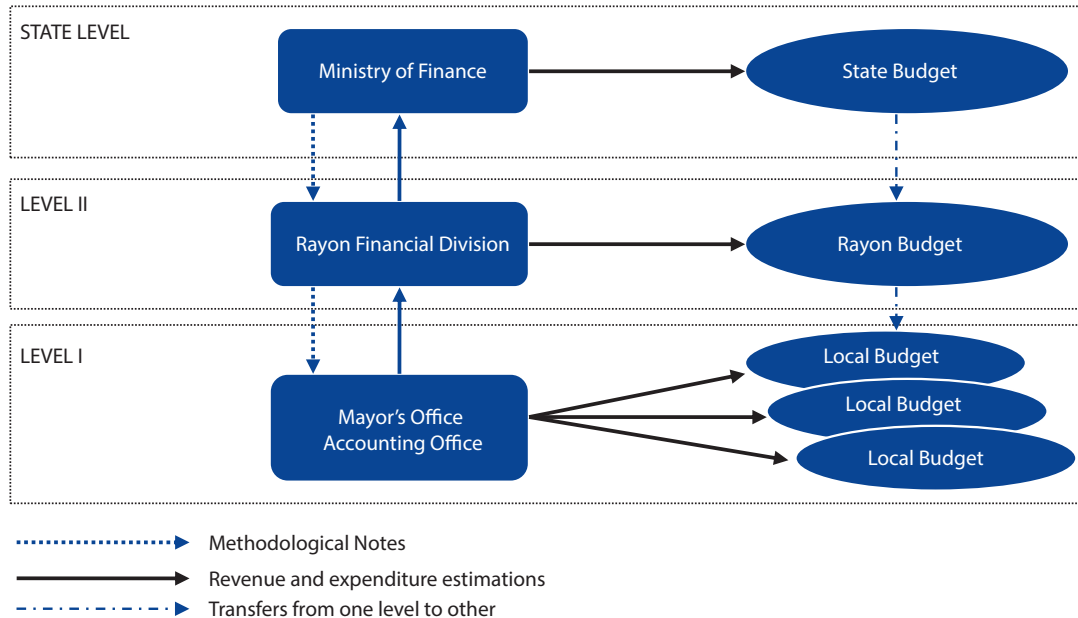
Intergovernmental transfers, fiscal equalization

Central government transfers are the main source of revenue for local government. The analysis of the current system of local finances proved that the financing of local public tasks is dependent on major transfers from the state budget (in 2014 - 64% of total local revenues, including Chisinau and Balti, and 68%, excluding these two municipalities), making them financially weak in performing their responsibilities.

The Law on Local Public Finance (Article 1) defines that transfers as financial resources allocated, with final claim and absolute amount, as provided by law, from the state budget to the administrative territorial unit budgets, for levelling the financial possibilities of administrative-territorial units for the purpose of performing the established public functions, financing the activities performed by local public authorities, or for other special purposes.

Until 2014, the transfers were shared in the II level local government budgets in different proportions established by the Ministry of Finance. The amount of funds received by first level local governments from intergovernmental transfers and shared revenues was solely determined by second level local governments. It was a process of negotiations between 1st and 2nd local governments, before the transfers were made and it was highly dependent on political colour of the mayor of I level local government and unclear rules rather than on objective criteria.

Figure 3. Transfers system before changes in the Law on local public finance

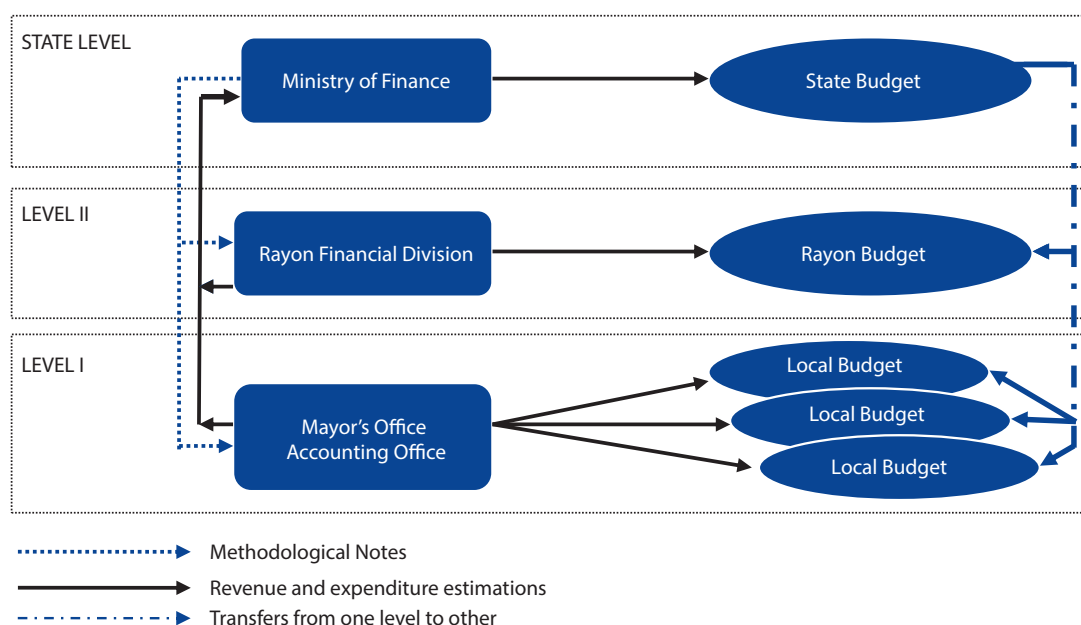


Source: Intermediary progress report on Moldova Intergovernmental Fiscal System, page.40

In 2013 were operated some changes in the Law on local public finance no. 397/2003. In 2014, the ATUs from 4 rayons (about 78 LPAs) implemented the new system of local public finance. From 2015, the system is implemented across all LPAs from the Republic of Moldova. The operated changes established a new formula for the calculation of general transfers, which represents the financial resources allocated with final claim and absolute amount from the state budget to the rayon's budgets, to finance their own spheres

of activities¹⁵. Therefore the 1st level local governments can easily calculate the amount of transfers they must receive. In addition, the new Law on local public finance defines a new category of transfers – special transfers. Special transfers are transfers of financial resources allocated, with final claim and conditioned amount, as provided by law, from the state budget to the administrative territorial unit budgets to ensure the exercise of public functions or for other special purposes delegated by the state.

Figure 4. Transfers system after changes in the Law on local public finance



Source: Intermediary progress report on Moldova Intergovernmental Fiscal System, page 40

To be more precise, general transfers (equalization) for the LPAs of level I are based on three indicators, namely: (i) fiscal capacity per capita (measured as revenue collected from tax deductions on personal income per capita), (ii) area of the LPA, and (iii) population. Moreover, the new equalization formula also relies on a number of relative indicators. These are presented along the corresponding formulae in Appendix 7.3.

4.1. SPECIAL MEANS

Special means represent revenues obtained by public institutions, under conditions approved by the regulatory acts, from the works undertaken and services delivered, as well as donations, sponsorships and other funds properly come into the possession of the public institution. These financial means represent up to 5% in total revenues of local governments.

The Appendix summarizes the main benchmarking areas in fiscal equalization and grant allocation.

4.2. LOCAL BORROWING

4.2.1 Grants

Grants are financial flows that are allocated to local governments, most often by the central governments. They can also come from federal states in federally-structured countries, from other local governments or from foreign or international sources. According to the law grants are resources allocated for the budget

¹⁵ To be more precise, until 2014, transfers were calculated not only based on the local taxes (listed above) on which the LPA has decision powers. Any increase in property or other fiscal and non-fiscal revenues would diminish the transfer flows. As such, LPAs had no incentives to facilitate own revenue increases. The new law, on the other hand, creates incentives to LPAs to identify new revenue sources as the more revenues are collected the more LPAs can spend on service provision and infrastructure improvements. The transfers are stipulated by law and are unaffected by collected revenues. These changes have increased the fiscal autonomy of an LPA by 6-8 times due to increased flexibility in setting rates and fees on income and property taxes for individuals.

support and for projects financed from external sources. Several types of grants exist however, which have a more or less limiting effect on local autonomy. These grants are currently distributed through funds from various international donors into, for example, Regional Development Fund, National Environment Fund, Energetic Efficiency Fund, etc.

However, transfers from the central state form the largest share of grants received by local governments. So not the mere size of central budget grants, but more the methods of allocation define the local fiscal autonomy.

4.2.2 Borrowings

Loans are one of the sources for local government capital investments. However, access to the borrowing by the local governments has not yet evolved very much in Moldova. Table 2 summarizes the borrowing levels across ATUs of level 1 and 2.

Table 2. Borrowing for Local Public Administrations in Moldova (2014, in thousand MDL)

	Total ATU level 1	Total ATU level 2	TOTAL
Internal Financing Sources (Internal Borrowing)	(7,325.04)	(1,435.48)	218.05
External Financing Sources (External Borrowing)	-	3,072.52	3,072.52
Public Property Sale and Privatization Proceeds	148,000.02	88,252.58	236,252.60
Account Balancing	45,880.92	(65,458.65)	(19,577.73)
Temporary Financing from the Budget	673.65	742.15	1,415.80
TOTAL	95,467.71	156,090.41	260,536.69

Source: Elaborated by author according to the report on the execution of administrative-territorial units budgets in year 2014

The Law on Local Public Finance (2003) determines the rights of local governments to take long-term or short term loans or float bonds for capital expenditures upon the decision of the corresponding representative and deliberative authorities. This applies to loans from domestic or foreign financial institutions. The law specifies that within the loan agreement revenues to repay the interest and principal must be identified from the jurisdiction's own fiscal revenues. The law is also clear that the central government may not act as a guarantor of loan repayment. Article 14 specifies that the loan may not exceed 20 per cent of the total annual revenues, what is often recognized as a requirement in other countries, too. Contrary, for current expenditures, LPAs can borrow up to 5% of the approved revenues for the given year. The maturity of these loans is by law within the same year of the said budget.

Access to the borrowing by the local governments has not yet evolved very much in Moldova. Considering the large number of the village (commune) local governments in the rural areas, their low revenue potential for some time in future, the lack of administrative capacity and the mere absence of financial and capital markets, it appears that the borrowing option is far from reality for the local governments. As a result, they may have to continue depending on central transfers to bridge the fiscal gap. The situation with municipalities (in particular in Chisinau), where the residents' awareness and ability to pay for services is relatively high, might be different.

Article 13 of the Local Public Finance Law no. 397 stipulates that executive authorities, on the basis of the representative and deliberative decisions, have the right: to borrow loans for current expenses with maturity in the same budgetary year, from financial institutions and other creditors both in country and abroad, and the total volume of loans for current expenses due in the same budget year should not exceed 5% of total revenues approved (corrected) of the administrative-territorial unit budget, which is a prerequisite. However, Article 14 of the same law states that executive authorities, under the representative and deliberative decisions, have the right to borrow short-term and long-term capital expenditure from financial institutions and other creditors both from our country and abroad, may contract by issuing bonds, short-term loans and long-term capital expenditures if the total amount of annual payments (repayment of principal, interest and other payments related payment) related to debt servicing in the budgets of territorial administration to contracted or guaranteed loans and/or to be contracted or guaranteed shall not exceed 20% of total annual revenue of the respective budgets.

Chapter 5

Local financial management

Presently in Moldova the practice of negotiations is not an established element in the relations between central government and LPAs. Such practice could be introduced in the decentralization reform process. At the same time the practice of consultations is rather common and has different informal forms.

Subjects of consultation and agenda of those consultations depend on existing legislation and existing budget creation practice.

5.1. BUDGETARY CONSULTATIONS

Until 2013, LPAs had discretion over spending the income from local taxes only. Therefore local autonomy in public spending was limited. In 2014, after the implementation of a new fiscal system in 78 pilot LPAs, this autonomy has increased. As the law has been implemented as of 2015 throughout the entire country, it is expected a similar trend nationwide. In the new system, the local autonomy increased significantly. LPAs now have decision-making power over collected revenues from: property taxes, income from lease of public property, deductions from citizen's income tax and on transfers of general purpose, which can be calculated unaided by LPA according to a formula specified in the legislation. The LPAs have greater resources to fulfil their competences and establish priorities for independent choices over the use of public funds. Control and monitoring of budgets is carried out by preparing and submitting quarterly reports of the budgets and annual presentation of reports on budget implementation.

Municipal enterprises providing public services recorded a low level as regards the organizational and financial management. The delegation of powers of public services is carried out by signing a contract on delegation of powers between LPA and municipal enterprises. Usually businesses are not generating profits and LPAs do not have sufficient human resources to monitor their activity. Currently in Moldova there are inter-municipal cooperation initiatives between several locations, which improve public services (utilities) to citizens and provide economies of scale.

Information on tax liabilities is not sufficiently disseminated to ensure an adequate level of information for citizens on tax obligations. The most used methods of disseminating this information are: Mayorality panels, City Hall's website (if any), TV, newspaper or local radio. Most municipalities use all budgetary classification (functional, economic and organizational) required by law in the budgetary process. But not all LPAs take into account all budget documentation (macroeconomic indicators, inflation, currency, economic development and social assumptions, previous budget, the amount of debts, estimating the impact) in the drafting, approval and execution of the budget. The transparency of the budget process record is low. The budget documents required by law to be presented to the public include: the village budget, the annual report on budget execution, quarterly reports on budget implementation and external audit reports on public procurement. The most frequently presented documents to the public are: the village budget and annual report on budget implementation. The remaining documents should be available to the public. The methods of presenting such information are panels in the City Hall, City Hall's website (if any), public debate. According to a previous survey, 5% of citizens know which the village budget is and how public money is spent.

In most LPAs, the budget is running at a rate higher than that originally approved. Municipalities record deficiencies in budgetary expenditure control and budgetary planning and execution. Municipalities allow offsetting main categories of expenditure at the expense of others and allow arrears for goods and services. The Auditor's Court is the only authorized public institution that controls the formation, administration and use of public funds and public property management by providing external audit in the public sector as a supreme audit institution. The Auditor's Court work program is planned independently by it for a period of 1 and/or 3 years.

Resolving conflicts of interest is a huge issue for local governments in Moldova. Conflicts of interest and incompatibility are regulated by the Law on Conflict of Interest No. 16 of 15.02.2008. According to the General Investigations Division of the Prosecutor General of the Republic of Moldova, during the checks it was brought to light an enormous number of cases of incompatibility for public office, when the leaders of local government occupied also other functions and carried out other activities, including holding positions in management bodies of commercial structures. In the old system of formation of local budgets, budgets of LPAs of level I were dependent enormously on the second level budgets. Given that the share of transfers in the budget of LPA level 1 is on average 60% of own resources, independent decisions could not be exercised. Therefore, this has created a huge dependency towards level II ATUs. Thus to obtain benefits and advantages, not the personal need for the community was relevant, but the strong connections within the party or special personal relations with people who are political decision makers. So getting these benefits was depending on political affiliation and relationships with party leaders. Under the new fiscal system of local budgets, LPA's can obtain general transfers calculated by the formula stipulated in the law and the subordination to LPA's of level II would disappear. Thus transparency in the allocation of transfers has increased considerably compared to the old system.

Most LPAs have a very low financial management capacity, particularly towns/villages. Towns recorded a higher capacity compared to towns / villages in 2014. Most municipalities in cities have a person/department responsible for project writing and management with internal and external financing. In the mayoralities of villages the situation is worse, but there are a few exceptions as some villages record-high skill levels of financial management. Major issues recorded in project writing and management are the lack of trained personnel in the field, lack of knowledge, lack of partners, the language barrier, too large proportion of co-financing. Most villages do not have sufficient investment opportunities. As such, they start cooperation initiatives and public-private partnerships, by creating new services for localities.

Chapter 6

Implementation of LFB

Local Finance Benchmarking is designed to facilitate comparison between decentralized local governments. By definition, the more decentralized an LPA is, the easier the implementation of LFB is and the more benefits it could potentially have on national and local governments activities. To better understand the process of LFB implementation in Moldova we summarize below the main issues related to data sources, potential problems and obstacles at national and local levels

6.1. INFORMATION, DATASETS FOR COMPARISON

A summary of information and datasets for analysis and comparison of local authorities' activities is presented in a report on the Assessment of the available municipal level data and information sources by Gabor Peteri and Ana Popa. Appendix 7.9 summarizes the available data sources with appropriate additions where necessary.

6.2. PROBLEMS AND OBSTACLES IN LFB IMPLEMENTATION

While the benefits of LFB implementation are straightforward for a decentralized government, there are still obstacles that might minimize the expected effect of such a policy design. In Moldova, the main obstacles are related to: (i) lack of incentives, (ii) lack of competence, and (iii) lack of public interest.

While fiscal decentralization is now fully functioning in Moldova (as of 2015), the full potential of this reform is yet widely misunderstood by many local civil servants. A recent study in the pilot regions shows that although local budgets face some improvements, the benefits of fiscal decentralization have not been fully taken advantage of by the local governments. This leaves two potential issues that might be related to LFB implementation as well.

On the one hand, local civil servants might have *insufficient competences and skill* to fully understand the complexity of LFB implementation and as such the benefits it might bring to local and national development. On the other hand, not being fully aware of the benefits and the essence of LFB implementation might minimize the incentives local governments have to fully adhere to for an objective local, national, but also international comparison.

These problems could be overcome either by organizing special training programs that would develop the required skills and understanding related to the benefits of local finance benchmarking or by creating incentives for civil servants via increasing the public awareness of the population about the LPA's activities. However, as a recent UNDP survey shows, while a vast majority of population (around 70%) knows their rights to be informed about the LPA's activities, only about 10% of the population actually does so. Thus, more intense policy initiatives are required to facilitate citizens' involvement in the local government's activities.

Appendix

1. LOCAL GOVERNMENT FUNCTIONS

According to the Law on Administrative Decentralization (Article 4) the first level local governments are responsible for:

- a) urban planning and management of green spaces of local interest;
- b) household waste collection and management, including the sanitation and maintenance of lands for its storage;
- c) distribution of drinking water, construction and maintenance of the sewerage systems and of wastewater and rainwater treatment systems;
- d) construction, maintenance and lighting of streets and local public roads;
- e) local public transport;
- f) planning and maintenance of the cemeteries,
- g) administration of local public and private assets;
- h) building, management, maintenance and equipping of preschool and extra-school institutions (crèches, kindergartens, art schools, music schools);
- i) development and management of the urban networks for gas and heat distribution;
- j) cultural, sports, recreation and youth activities, as well as planning, development and management of the infrastructures needed for these types of activities;
- k) planning of the agricultural markets, of the trading spaces, accomplishment of any other measures necessary for the economic development of the administrative-territorial unit;
- l) setting up and management of the municipal enterprises and organization of any other activity necessary for the economic development of the administrative-territorial unit;
- m) building of houses and providing of other types of facilities for the socially vulnerable people, as well as for other categories of people;
- n) organization of the fire services.

The Law also provides that second level local governments are responsible for:

- a) administration of the public and private assets of the district;
- b) planning and administration of the construction, maintenance and management works of some public units of local interest;
- c) construction, management and repair of the roads of district interest, as well as of the road infrastructure;
- d) organization of the passenger road transport, management of the bus stations and stops of district interest;
- e) establishment of the general framework for the territory development at district level and protection of forests of district interest;
- f) support and stimulation of the initiatives referring to the economic development of the administrative-territorial unit;
- g) development and implementation of projects for the construction of interurban gas pipelines (including the gas pipelines of medium pressure), of other thermal power units of local destination;
- h) administration of cultural, tourism and sports institutions of district interest, of other activities with educational, cultural and sports character of district interest;
- i) administration of the municipal enterprises of district interest;
- j) administration of the social assistance units of district interest;
- k) development and management of the community social services for socially vulnerable people, monitoring of the quality of social services.

2. DOMAINS OF LOCAL GOVERNMENT FUNCTIONS

The main domains of local government functions are summarized below:

Communal services:

- 1) Production, transport and distribution of drinking water; management of sewage systems, including water treatment plants;
- 2) Collection, transport and disposal of garbage, including the management of landfills;
- 3) Management and maintenance of public parks, green areas and cemeteries;
- 4) Public lighting.

Public transport and local/rayon roads:

- 1) Management of the public transport system within locality and/or rayon;
- 2) Maintenance of locality and rayon roads (streets).

Territorial and urban planning:

- 1) Designing, updating, implementation, monitoring urban plans;
- 2) Territorial planning;
- 3) Public constructions/social houses.

Local economic development and management of the public property:

- 1) Design and implementation of local economic development strategies;
- 2) Organizing and managing local public enterprises;
- 3) Management of the public property in the ownership of local government units, including renting and concession.

Public utilities:

- 1) Management, maintenance and development of heating systems;
- 2) Participation to the development of gas networks;
- 3) Participation to the development of electricity networks.

Pre-university education:

- 1) Maintenance of the buildings and facilities of pre-school education;
- 2) Maintenance of the buildings and facilities for extra-school activities;
- 3) Delegated function from the state to finance pre-university education.

Social services:

- 1) Planning, financing and providing community social assistance services at primaria level;
- 2) Planning, financing and providing specialized social assistance services at rayon level.

Public health services:

- 1) Public health education;
- 2) Participation to the development of public health network;
- 3) Designing and implementing local strategies in the field of public health.

Human rights, gender equality and social inclusion of vulnerable groups:

- 1) Implementing at local level the national policies regarding human rights, gender equality and vulnerable groups' protection.

Marital status services:

- 1) Issuing, recording, modifying, annulment of marital status documents;
- 2) Managing the database and the archives of marital status documents.

Civil defense and emergency situation services:

- 1) Implementing the national policies referring to civil defense and emergency situations;
- 2) Public information activities in this field.

Environment protection:

- 1) Implementing the national standards of environment protection referring to drinking water supply and sewage, garbage collection and disposal, landfill management;
- 2) Ecological reconstruction of damaged areas under local government ownership;
- 3) Implementing the national policies referring to protected areas.

Public order:

- 1) Cooperation with the national police – establishing an administrative commission in this domain.

Agriculture and veterinary consultancy services:

- 1) Cooperation with deconcentrated services in the field of food safety activities and epizootics.

Culture, youth, sport and leisure services:

- 1) Management and financing the local/rayon cultural institutions: libraries, museums, theatres;
- 2) Building and maintenance of sport and leisure facilities/infrastructure;
- 3) Planning and financing the sport and youth activities.

National defense:

- 1) Responsibilities in preparing the territory for defense;
- 2) Financing the recruitment centre

3. GENERAL TRANSFERS (EQUALIZATION)

In Moldova, by the amendments to the Law no. 397-IV of October 16, 2003 on Local Public Finance and the Tax Code 1163-XIII of April 24, 1997, there have been significant changes in the way of budgeting administrative units, both for income formation in ATU budgets and the expenses. Completely new is the method of calculating equalization transfers and transfers for special purpose. The new vision creates real opportunities for strengthening the financial autonomy and fiscal decentralization.

The transition to the new formula of budgeting the administrative units has started by drafting ATU budgets for fiscal year 2014. For this purpose, all administrative-territorial units of the Republic of Moldova received indications from the Ministry of Finance to prepare draft budgets for fiscal year 2014 in two variants: Variant I - the existing formula, and variant II - by the new funding formula. Distinct budgeting for administrative-territorial units highlights new conditions determined by the new method of calculating general transfers (equalization) and special transfers for both: level I and level II.

- When talking about calculating the general transfers (equalization) for administrative-territorial units (ATU) of first level it is noted that for the calculation of equalization transfers three financial indicators are counted, such as: Fiscal capacity per capita (measured as revenue collected from income tax deductions of individuals and number of inhabitants of ATU);
- Concrete land area;
- Number of population of a specific territory.

These indicators find expression in the new formula for calculating general transfers (equalization). In addition to these "local" indicators in the formula, there are weighted indicators specified as:

- PS_{CFL}^1 - specific weight indicator per capita of fiscal capacity;
- PS_p^1 - specific weight of the population indicator;
- PS_s^1 - specific weight of the area indicator;
- P_e - supraunitar parameter.

where $PS_{CFL}^1=60\%$, $PS_p^1=30\%$, $PS_s^1=10\%$, and $P_e=1.3$.

Below we present the method of calculating equalization transfers for ATU level I (A); level II (B) and special purpose transfers (C).

A. Calculation of general purpose transfers (equalization) for ATU of first level:

$$TE_i = FEB_1 + \left[\left(PS_{CFL}^1 + \frac{P_e \times CFL_n - CFL_i}{\sum_i P_e \times CFL_n - CFL_i} \right) + \left(PS_p^1 \times \frac{P_i}{P_n} \right) + \left(PS_s^1 \times \frac{S_i}{S_n} \right) \right],$$

where

- TE_i - balancing transfer for some ATU of first level;
- FEB_1 - budget fund balance of the first level ATU;
- CFL_i - per capita fiscal capacity of some first level ATU;
- CFL_n - the national average per capita of fiscal capacity;
- P_i - population of a certain ATU of first level;
- P_n - total population of administrative-territorial units of the first level;
- S_i - particular area of the first level ATU;
- S_n - total area of the administrative units of the first level;
- PS_{CFL}^1 - specific weight of indicator per capita of fiscal capacity;
- PS_p^1 - specific weight of the indicator population;
- PS_s^1 - specific weight of the indicator area, and
- P_e - is the supraunitar parameter.

B. Transfers of budget balancing for ATU of second level

FEB_2 is intended to balance budgets of ATU of second level and is distributed according to the following indicators:

- population;
- the area of ATU, according to the formula:

$$TE_j = FEB_2 \times \left(\frac{PS_p^2 \times P_j}{P_n} + \frac{PS_s^2 \times S_j}{S_n} \right)$$

where

- TE_j - balancing transfer for some ATU of second level;
- FEB_2 - budget fund balance of the second level ATU;
- P_j - population of a certain ATU of second level;
- P_n - total population of the second qualifying assignment;
- S_j - particular area of the second level ATU;
- S_n - total area of the second qualifying assignment;
- PS_{CFL}^1 - specific weight of indicator per capita of fiscal capacity;
- PS_p^1 - specific weight of the indicator population;
- PS_s^1 - specific weight of the indicator area.

Calculation of general purpose transfers (equalization) for ATU of second level is directly proportional to the population and ATU area, balancing local budgets being qualified to the second level, with the exception of municipal budgets of Chisinau, Balti and the budget of autonomous territorial unit (ATU) with special legal status.

C. Special purpose transfers

Special purpose transfers from the state budget are allocated to ATU budgets for funding:

- a) primary, secondary, general, special and (extracurricular) education;
- b) the power delegated to LPA by the Parliament on the Government's proposal.

Information on special purpose transfers from the state budget to local budgets for financing primary, secondary, general, special and (extracurricular) education for 2014 and estimates for the years 2015 and 2016 are presented in Appendix. 2.2. with notes about the development projects of ATU budgets for 2014 and estimates for 2015 and 2016.

At present, when establishing relations between the state budget and local budgets, transfers to finance powers delegated to LPA are considered the following:

- a) social transfer payments;
- b) transfers to compensate for the difference in tariffs for electricity and natural gas (used by residents of towns Dubasari and Căușeni and Varna village from Anenii Noi district);
- c) transfers to compensate for lost revenues of ATU budget (... compensation of local budget income, budget of state social insurance and mandatory health insurance funds, funds missed by exempting landowners located on the route Râbnița - Tiraspol;
- d) transfers from the republican fund of social support for the population.

4. SUMMARY OF THE PROPOSED BENCHMARKING AREAS: LOCAL OWN SOURCE AND SHARED REVENUES

Scope of fiscal decentralization: national systems	Local government financial resources, financial management
Fiscal equivalence: scope of own revenues; diversity of tax base	Local taxes: significant, stable, simple
Tax decentralization: autonomy in rate setting and defining tax relief	
Autonomy in own revenue raising: regulatory methods, stability of national tax policies	Tax system audited: collection rate, coverage of taxpayers
Procedures of national tax policy design: openness, consultation	Local tax policy design: sound, open, legal (approved by elected bodies)
Economic impact: neutral, limited distortions	Capital revenues: separated, used for capital investments
User charges: scope, limits on access to services, local autonomy in charge setting	User charges are comparable to costs, support to disadvantaged users
Tax administration: local vs. central, administrative capacities, standard litigation procedures	Local tax administration: collection is effective, costs of tax administration
	Local records on assets and liabilities
	Organizational forms and management of local property
Tax sharing is origin based, supporting local tax efforts to increase the tax base	
Transparent sharing rules are set by law for a longer period	
Shared taxes are not earmarked	

5. SUMMARY OF THE PROPOSED BENCHMARKING AREAS: EQUALIZATION, GRANT ALLOCATION AND LOCAL BORROWING

Scope of fiscal decentralization: national systems	Local government financial resources, financial management
Complexity of intergovernmental transfer: expenditure and revenue based equalization	
Characteristics of grant allocation: <ul style="list-style-type: none"> rule based or arbitrary; transparent, understandable or too complex and managed internally by the administration, stable, predictable for the local governments or often changing 	
General grants vs. specific, earmarked grants	
Objective measures are used for calculating expenditure needs and local fiscal capacity	
Incentives created by the intergovernmental transfers: savings on expenditures, increasing revenues	
Loans are used for capital investments	Loans are used for financing capital investments
Loans are repaid by local revenues, user charges generated by the project	Short term borrowing for cash flow management only
No national government guarantees	Compliance with the national borrowing limits
Regulations on local borrowing limits are set	

6. SUMMARY OF THE PROPOSED BENCHMARKING AREAS: LOCAL FINANCIAL AND BUDGETARY MANAGEMENT

Scope of fiscal decentralization: national systems	Local government financial resources, financial management
Budgeting process, budget approval and implementation is regulated by law	Local strategies, multi-annual budget plans exist
Basic budget requirements are set and they operate effectively: balanced budget, separate current and capital budget	Budgeting methods support council decisions by providing analytical sheets, service performance information, consolidated reports on satellite organizations
Commercial activities of local governments are limited	Budgeting process is open and participatory, allowing sufficient time for review
National government intervention in local budget planning and implementation is indirect, proportional and not excessive	Budget implementation is monitored and regularly evaluated.
Rules and procedures of financial recovery are in place and operate effectively	Budget report is independently audited.
Reliable budgetary information is available for the local administration and the general public	Internal audit system is in place and used.
Monitoring system of local finances is in place.	Relationship with the service organizations, commercial entities
Human capacity development needs are identified continuously	

7. SUMMARY OF AVAILABLE DATA SOURCES AND INFORMATION AVAILABLE

Information	Size, number	Level of disaggregation	Source
1. Revenues			
local taxes	60	rayon, primaria	The rate of local taxes is available at http://www.fisc.md/CodulfiscalalRM.aspx
shared revenues	4	rayon, primaria	Ministry of Finance (MoF)
transfers, grants	app. 20	rayon, primaria	MoF
2. Expenditures			
administrative categories	4 levels, 475 entries	rayon, primaria	http://minfin.md/ro/BOOST/
functional classification	Main groups: 42 entries Level 2: 232 items		
economic classification	Main groups: 52 items Level 2: 311 items		
programs	Level 1: 109 Level 2, sub-programmes: 243		
3. Balance sheet			
	assets: 91 liabilities: 65 extra balance: 23	Rayon, primaria	For rayons available at MoF, for primaria available at rayon level
4. ATU budget execution reports			
		rayon, city, villages	Form No. 524 Available at MoF
5. Special reports			
		Rayon, primaria	For rayons available at MoF, for primaria available at rayon level
staff			
use of special funds			
external funds for projects			
use of assets			
6. Utility companies			
		41 water companies MSW Public cleansing	Asociatia Moldova Apa-Canal (AMAC), Min. of Environment, Min. of Construction NBS
7. Housing stock			
		Primaria	NBS
8. Area			
		rayon, primaria	Cadastral Agency, 2009
9. Urbanization level (share of urban population, population density)			
		Rayon, primaria	NBS, can also be calculated based on NBS and Cadastral Agency data
10. Length of roads			
		Rayon, primaria	NBS Ministry of Economy

Source: Peteri and Popa, Assessment of the available municipal level data and information resources

Local Finance Benchmarking in Ukraine

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Executive Summary

Political and administrative system of Ukraine

Ukraine is a unitary, sovereign, independent, democratic, social and legal state, a parliamentary-presidential republic. The bearer of sovereignty and the only source of power in Ukraine is the people. The people exercise power directly and through bodies of state power and local self-government.

The power in Ukraine is exercised on the principles of separation of legislative, executive and judicial branches. The executive power in the country belongs to the Cabinet of Ministers and the legislative power belongs to the Parliament (the Verkhovna Rada of Ukraine). The highest body of judicial power in Ukraine is the Supreme Court of Ukraine. The President of Ukraine has the ability to influence the operation of all three branches of government: executive, legislative and judicial, in accordance with the Constitution of Ukraine, he is required to terminate any of their actions that violate the Constitution of Ukraine.

Functions of Local Self-Government

The Constitution of Ukraine envisages local self-governance at local level. The following areas of responsibility are implemented through the local self-government functions: ensuring integrated development of the territory of the community; planning; budget and financial; management of communal property and local finances; ensuring the needs of the population in housing, transport, trade and communal services; social protection of population; external economic activity; promoting the defense of the state; development of healthcare, education, culture and sports; environmental protection; regulation of land relations; accounting; licensing and registration; and informational. These functions are performed through a number of own and delegated powers.

One of the crucial elements for local self-governance is financial sustainability. Unfortunately, the situation is currently emerging where local governments receive less financial resources from the State budget than the amount required for implementation of delegated powers, and there is a significant underfunding or lack of any funding altogether for some part of delegated powers. That makes local budgets drastically dependent on assistance from the central authorities. The indicator of local budgets' dependence on transfers from the State budget exceeded 50% of all local budget revenues and showed an upward trend in recent years.

Own and delegated to local government revenues

One of the problems with local finances is the lack of reform in the part of local taxes. Local taxes and fees are established according to the list and within the size limits of rates prescribed by the Tax Code of Ukraine, decisions of village, town and city councils within their authority and are mandatory for payment on the territory of the municipalities. Local taxes include property tax and single tax. Local fees include fee for vehicle parking and tourism fee.

The composition of local revenues in the main portion is common to the budgets of republican (the Autonomous Republic of Crimea) and regional significance, the cities of Kyiv and Sevastopol, district budgets, budgets of combined territorial communities, villages, towns and cities of district significance. Village, settlement and city councils, within their powers, make decisions on the establishment of local taxes and fees, in the manner prescribed by the Tax Code of Ukraine.

Aside from setting local taxes and fees, local government may not influence the taxation system.

Inter-budget transfers, fiscal equalization

Thus, the significant part of the local finance constitutes the intra-budgetary transfers. The State Budget of Ukraine may provide the following kinds of transfers to local budgets: basic subsidy; additional grants;

subventions to implement the government programs of social protection; additional subsidy for compensation of lost revenues in local budgets due to provision of benefits established by the state; subvention to implement investment projects; educational subvention; subvention for working staff training; medical subsidy; subvention for providing medical activities of individual government programs and comprehensive measures of programmatic nature; subvention to finance social and economic measures on risk compensation of the population living in the territory of the monitoring zone; subvention for projects to liquidate the enterprises of coal and peat industry and the maintenance of drainage facilities in safe mode by co-financing (50 percent); other additional subsidies and other subventions.

The amount of inter-budget transfers is approved in the State Budget of Ukraine separately for each of the local budgets, if there are grounds for giving and receiving relevant inter-budget transfers. Any decisions on the amount of transfers, their allocation and structure (within the scope established by the Budget Code) shall be made by the Verkhovna Rada in the Law on the State budget of Ukraine for the respective years.

The transfers are allocated according to a number of principles stipulated by law. In particular, the horizontal fiscal capacity equalization of oblast budgets is carried out separately by income from the enterprise profit tax and from the PIT (personal income tax), taking into account some parameters: 1) number of population; 2) income from the corporate profit tax; 3) income from the PIT (personal income tax); 4) fiscal capacity indexes of the relevant oblast budget, determined separately by income from the corporate profit tax and from the PIT (personal income tax).

The fiscal capacity indicator of the relevant oblast budget is the coefficient that determines the level of the fiscal capacity of such a budget, in comparison with the similar average indicator for all oblast budgets in Ukraine, calculated per person. In the event that the indicator is within 0.9-1.1 - equalization is not carried out; less than 0.9 – basic subsidy is granted to appropriate budget in amount of 80 percent of the amount needed to achieve the value of the security indicator of the corresponding budget - 0.9; more than 1.1 - reverse subsidy is transmitted from the respective budget in amount of 50 percent of the amount that exceeds the value of 1.1.

Local borrowing

To provide for better financial potential, the law allows local borrowing. Local borrowing represents a part of revenues of local budgets, therefore borrowing implementation is a part of the local debt management process. Local borrowing is recognized as source of financing the relevant budget.

In order to ensure the compliance with the limit values of the local debt and local guarantees, the Ministry of Finance of Ukraine keeps the Register of local borrowings and local guarantees.

Local borrowing is included in the budget revenues of the local budget development. The amount and terms of local borrowing implementation and local guarantees provision are agreed with the Ministry of Finance of Ukraine.

In the event that, in the process of local debt repayment and payments of its maintenance, stipulated by the agreement between the lender and the borrower, the repayment schedule is disrupted by the fault of the borrower, the Verkhovna Rada of the Autonomous Republic of Crimea or the relevant city council are not entitled to carry out new local borrowing over the next five years.

Management of local finances

Management of local finances is regulated by a number of laws and by-laws and stipulates all stages of budget process, monitoring and audit, structure and functioning of fiscal information system, accounting rules, as well as local budgets reporting system and availability of fiscal data.

Chapter 1

Political and administrative system of Ukraine

The political and administrative system of Ukraine is formed under the influence of two components - administrative and territorial structure and state structure.

The internal structure, the territorial structure of Ukraine, is determined by the system of administrative and territorial structure of our country, based on which the public authorities and local government bodies are being established and operate.

The administrative and territorial structure of Ukraine consists of administrative and territorial units of three levels: 1) the Autonomous Republic (*avtonomna respublika*) of Crimea, oblasts and cities with special legal status - Kyiv and Sevastopol; 2) *raions* (districts), cities of republican (ARC) and regional significance; 3) towns of *raion* (district) significance, settlements, and villages. These units are classified on several grounds.

Due to the annexation of Crimea and the war in the east of Ukraine, some parts of the Ukrainian territory are currently occupied and not under the control of the Ukrainian government. Those include the territory of the Autonomous Republic of Crimea and the city of Sevastopol, and inland waters of Ukraine in these territories. In addition, on 17 March 2015, the Verkhovna Rada also recognized certain raions of the Donetsk and Luhansk oblasts¹ as temporarily occupied territories. The legal status of the temporarily occupied territory is regulated by the Law of Ukraine "On Assuring the Rights and Freedoms of Citizens and the Legal Status of the Temporarily Occupied Territory of Ukraine"².

1) by geographical grounds, they are divided into regions (ARC, oblasts, *raions* (districts), cities-regions in case of Kyiv and Sevastopol) and populated places (towns, settlements, and villages);

2) by their status, they are divided as follows: administrative and territorial units (oblasts, *raions* (districts)), self-governing territorial units (towns, settlements, and villages). In addition, ARC has a particular status of territorial autonomy, and urban districts are characterized both by administrative and territorial features and self-governing units' features);

3) by the place in the system of administrative and territorial system of Ukraine, they are divided into the primary level territorial units (towns without district division, districts in the cities, settlements, and villages), the average level (*raions* (districts), towns / cities without district division) and the higher level (the Autonomous Republic (*avtonomna respublika*) of Crimea, oblasts, and the cities of Kyiv and Sevastopol).

Article 133 of the Constitution of Ukraine defines the exclusive composition of administrative and territorial units of the first-level administrative and territorial structure of Ukraine as follows: ARC, Vinnytsia Oblast, Volyn Oblast, Dnipropetrovsk Oblast, Donetsk Oblast, Zhytomyr Oblast, Zakarpattia Oblast, Zaporizhia Oblast, Ivano-Frankivsk Oblast, Kyiv Oblast, Kirovohrad Oblast, Luhansk Oblast, Lviv Oblast, Mykolaiv Oblast, Odesa Oblast, Poltava Oblast, Rivne Oblast, Sumy Oblast, Ternopil Oblast, Kharkiv Oblast, Kherson Oblast, Khmelnytskyi Oblast, Cherkasy Oblast, Chernivtsi Oblast, Chernihiv Oblast, and the cities of Kyiv and Sevastopol.

1. The Decree of the Verkhovna Rada of Ukraine of 17 March 2015, No. 254-VIII "On Recognizing Certain Raions, Cities, Settlements, and Villages of the Donetsk and Luhansk Oblasts as Temporarily Occupied Territories"

2. The Law of Ukraine of 15 April 2014, No. 1207-VII "On Assuring the Rights and Freedoms of Citizens and the Legal Status of the Temporarily Occupied Territory of Ukraine"

Table 1. The Administrative and Territorial System³

	2013	2014	2015 (as of 1 January)
Autonomous Republic	1	1	1
Oblasts	24	24	24
Cities total	460	460	460
including			
special status cities	2	2	2
cities with population over 1 million, thou persons			
Kyiv (capital city)	2845	2869	2888
Odesa	1015	1017	1017
Kharkiv	1451	1451	1453
Raions	490	490	490
Urban-type settlements	885	885	885
Rural settlements, thou	28.4	28.4	28.4

According to its state system Ukraine is a unitary, sovereign, independent, democratic, social and legal state, a parliamentary-presidential republic. The bearer of sovereignty and the only source of power in Ukraine is the people. The people exercise power directly and through bodies of state power and local self-government.

The power in Ukraine is exercised on the principles of separation of legislative, executive and judicial branches. The executive power in the country belongs to the Cabinet of Ministers and the legislative power belongs to the Parliament (the Verkhovna Rada of Ukraine). The highest body of judicial power in Ukraine is the Supreme Court of Ukraine. The President of Ukraine has the ability to influence the operation of all three branches of government: executive, legislative and judicial, in accordance with the Constitution of Ukraine, he is required to terminate any of their actions that violate the Constitution of Ukraine. The President is elected by popular vote for a five-year term. Upon the recommendation of the President, the Verkhovna Rada of Ukraine appoints the Prime Minister of Ukraine and the other members of the Cabinet of Ministers of Ukraine. The Verkhovna Rada consists of 450 deputies, elected for a five-year term.

The Cabinet of Ministers of Ukraine is the highest body within the system of executive government bodies. Central executive bodies include government ministries, State committees and executive government bodies with a special status (such as the SBU [Security Service of Ukraine], Antimonopoly Committee and others). Activities of the Cabinet of Ministers are regulated by the Constitution and laws of Ukraine, as well as by edicts of the President of Ukraine and decrees of the Verkhovna Rada of Ukraine adopted according to the Constitution and laws of Ukraine. The Cabinet of Ministers of Ukraine is accountable to the President of Ukraine and Verkhovna Rada of Ukraine; it is controlled by and is reporting to the Verkhovna Rada of Ukraine within the scope envisaged by the Constitution.

Local executive government bodies include local State administrations whose activities are regulated by the Constitution and the Law of Ukraine "On Local State Administrations" of 9 April 1999, No. 586-XIV.

The composition of local State administration is formed by heads of local State administrations. The heads of local State administration are appointed and dismissed by the President of Ukraine upon proposal of the Cabinet of Ministers of Ukraine. In the exercise of their powers they are accountable to the President of Ukraine and the Cabinet of Ministers of Ukraine, they report to and are controlled by executive government bodies of higher levels. In addition, local State administrations report to and are controlled by councils within the scope of the powers delegated thereto by respective raion or oblast councils.

The local State administrations ensure the following in their respective territories:

- execution of the Constitution and laws of Ukraine, acts of the President of Ukraine, the Cabinet of Ministers of Ukraine and other executive government bodies;
- law and public order; observance of citizens' rights and freedoms;

3. According to the data on the official web-portal of the Verkhovna Rada of Ukraine

- implementation of national and regional socioeconomic and cultural development programs, environmental protection programs, and also ethnic-cultural development programs for native peoples and ethnic minorities in the areas of their compact settlement;
- preparation and execution of respective oblast and raion budgets;
- a report on execution of respective budgets and programs;
- interaction with local governments;
- implementation of other powers granted by the State and delegated by respective councils.

The judicial branch of power represents a system of established by law bodies, having the exclusive authority to review legally significant cases, by using a special procedure.

Chapter 2

Functions of Local Self-Government

Under the provisions of the European Charter of Local Self-Government, the major powers of local self-government are established by the Constitution or by law. In Ukraine, they are enshrined in general form in Art. 143 of the Fundamental Law, and their details are contained in the Law "On Local Self-Government in Ukraine", "On the capital of Ukraine - Hero City of Kyiv" as well as in sectoral legislation and in the Budget Code, the Land Code, the Forest Code and the Water Code of Ukraine, and in other legal acts.

Chapter 3 of the Law of Ukraine "On Local Self-Government in Ukraine", through the articles from 27 to 41, defines the areas of responsibility of local self-government, dividing each of them in their own and delegated powers. Own (or self-governed) powers are the rights and responsibilities of local government entities that are recognized by the state and provide independent decision on local issues by the population. Delegated powers – the powers of executive power bodies, granted to local authorities by law, with simultaneous transfer of the necessary material and financial resources, the realization of which is controlled by executive authorities.

Areas of responsibility are implemented through the local self-government functions: ensuring integrated development of the territory of the community; planning; budget and financial; management of communal property and local finances; ensuring the needs of the population in housing, transport, trade and communal services; social protection of population; external economic activity; promoting the defense of the state; development of healthcare, education, culture and sports; environmental protection; regulation of land relations; accounting; licensing and registration; and informational.

These functions are performed through a number of own and delegated powers in the following areas and sectors:

- Social and economic as well as cultural development, planning and accounting;
- Budget, finance and prices;
- Management of municipal property;
- Housing and Municipal Economy, consumer services, trade services, public catering establishments, transport and communications;
- Construction;
- Regulation of land relations and environmental protection;
- Social protection of population;
- Foreign economic activity;
- Defense Activities;
- Resolving issues of administrative and territorial structure;
- Providing free primary legal aid;
- Awarding with state awards of Ukraine.

The own powers mean the rights and responsibilities recognized by the State for local government entities and those providing for autonomous resolution of any local significance issues by the population. The delegated powers mean the powers of executive government bodies granted to local governments by law, with simultaneous transfer of the required material and financial resources, and exercise of such powers being controlled by State executive bodies.

According to the latest amendments to the Budget Code of Ukraine dated 28 December 2014, No.79-VIII, the division into Basket One and Basket Two revenues has been abolished. These provisions came into force as of the outset of 2015.

In particular, the functions in the fields of budget, finance and prices are implemented by the local self-government through the following powers:

A. Own (or self-governed) powers:

1) the local budget drafting, its submission for approval to the relevant council, ensuring the implementation of the budget; quarterly submission of written reports on the progress and results of the budget implementation to the council; preparation and presentation of the required financial performance, in accordance with local or regional council's suggestions and drafting of district and regional budgets;

2) establishment, in the manner and within the limits set by the legislation, of the tariffs on household utilities (except for tariffs for thermal energy, centralized water supply and sanitation, recycling and disposal of household waste, centralized heating, etc.), transportation and other services (for repayment of any debt due to difference in tariffs for thermal energy, centralized water supply and sanitation services, which were produced, transported, and delivered to the population, which difference emerged due to a mismatch between the actual cost of thermal energy or services of centralized water supply and sanitation and the tariffs approved and/or agreed by State authorities or local governments, an annual State budget subvention is provided);

The Law of Ukraine "On the Housing and Communal Services" dated 24 June 2004, No.1875-IV, is the key document, which determines the relations between participants on the housing and communal services market. This law subdivides the housing and communal services into three groups, based on the procedure of price/tariff approval. Group one comprises the housing and communal services the prices/tariffs of which are approved by specially authorized central executive bodies; group two includes the housing and communal services the prices/tariffs of which are approved by local governments in the territories where such services are provided; and group three comprises the services whose prices/tariffs are determined on a contractual basis.

At present, the powers of setting tariffs for communal services are divided between the National Communal Services Regulatory Commission (the "Commission") and local governments.

According to requirements of the Law of Ukraine "On State Regulation in the Communal Services Sector" of 9 July 2010, No.2479-VI, the Commission shall set tariffs for communal services (tariffs for heat energy, transportation of heat energy by main and local/distribution heat networks, supply of heat energy, as well as tariffs for services of centralized water supply and water removal) only for those natural monopolies and economic entities in adjacent markets, whose activities it is licensing.

In turn, local governments set the tariffs for communal services for the rest of the enterprises, which are outside the Commission's regulation, and also set the tariffs for the services of district heating and hot water supply to end users based on the tariffs approved by the Commission.

Setting of tariffs for the services of maintenance of buildings and structures and adjacent territories, and removal of municipal waste is within the exclusive responsibility of local governments.

3) establishing, according to the approved decision of the respective councils, the order of funds use and other assets that are jointly owned by local communities;

4) implementation of the established order to finance expenditures from the local budget;

5) on a contractual basis, raising funds of enterprises, institutions and organizations, irrespective of ownership (e.g., conclusion of Public Private Partnership contracts), located on the respective area, and fundraising from the public, as well as budget funds for construction, expansion, maintenance on share basis of social and industrial infrastructure and on measures for the environment protection;

6) on a contractual basis, the funds consolidation of the relevant local budget and of other local budgets to implement joint projects or to jointly finance municipal enterprises, institutions and organizations, other issues relating to the common interests of local communities;

7) conclusion of contracts with legal entities and individuals on collecting local fees, which is mandatorily established by law;

8) preparation and approval of the list of specially designated parking spaces for vehicles;

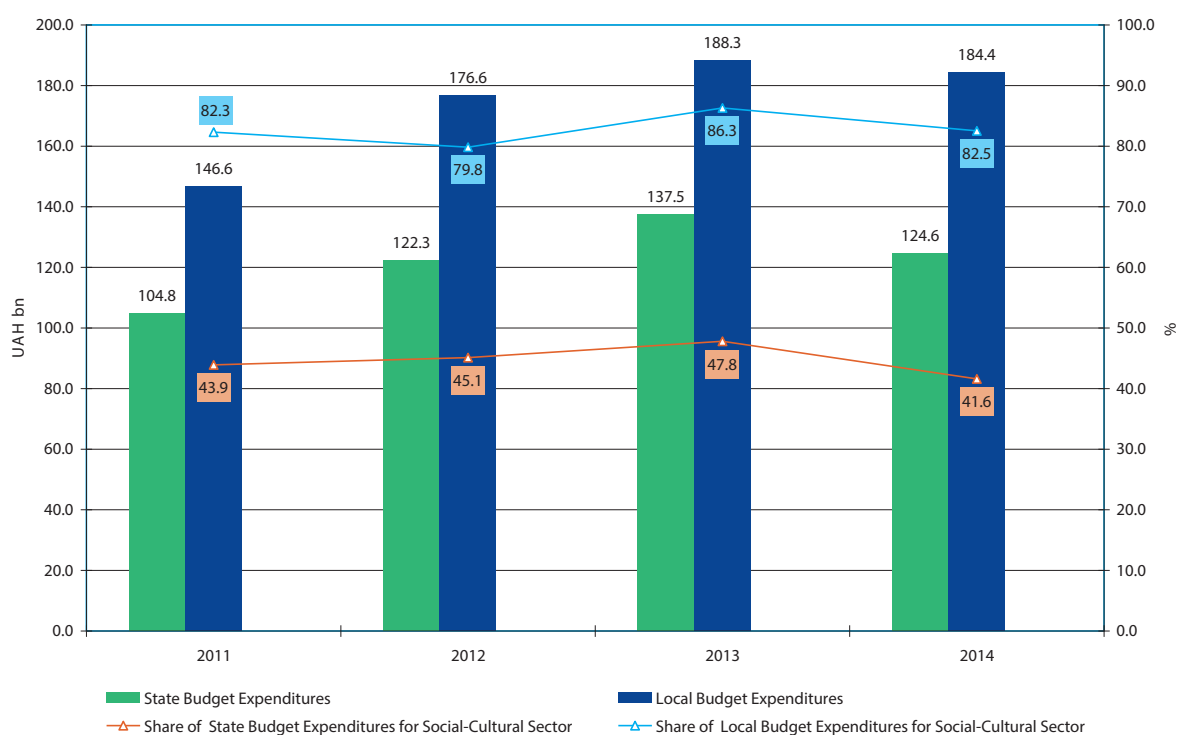
B. Delegated powers:

- 1) according to the law, exercising control over the compliance with the obligations concerning payments to the local budget by the enterprises and organizations, irrespective of ownership;
- 2) according to the law, exercising control over the compliance with the prices and tariffs;
- 3) promotion of investment activity in the relevant territory.

The situation is currently emerging where local governments receive less financial resources from the State budget than the amount required for implementation of delegated powers, and there is a significant underfunding or lack of any funding altogether for some part of delegated powers.

Local budgets are allocating a significantly greater portion of expenditures for the social and cultural sphere compared to the State budget. This is explained by the structure of expenditures of local budgets pursuant to the Budget Code of Ukraine.

Fig. 1. Financing of Social and Cultural Sphere Expenditures in 2011-2014

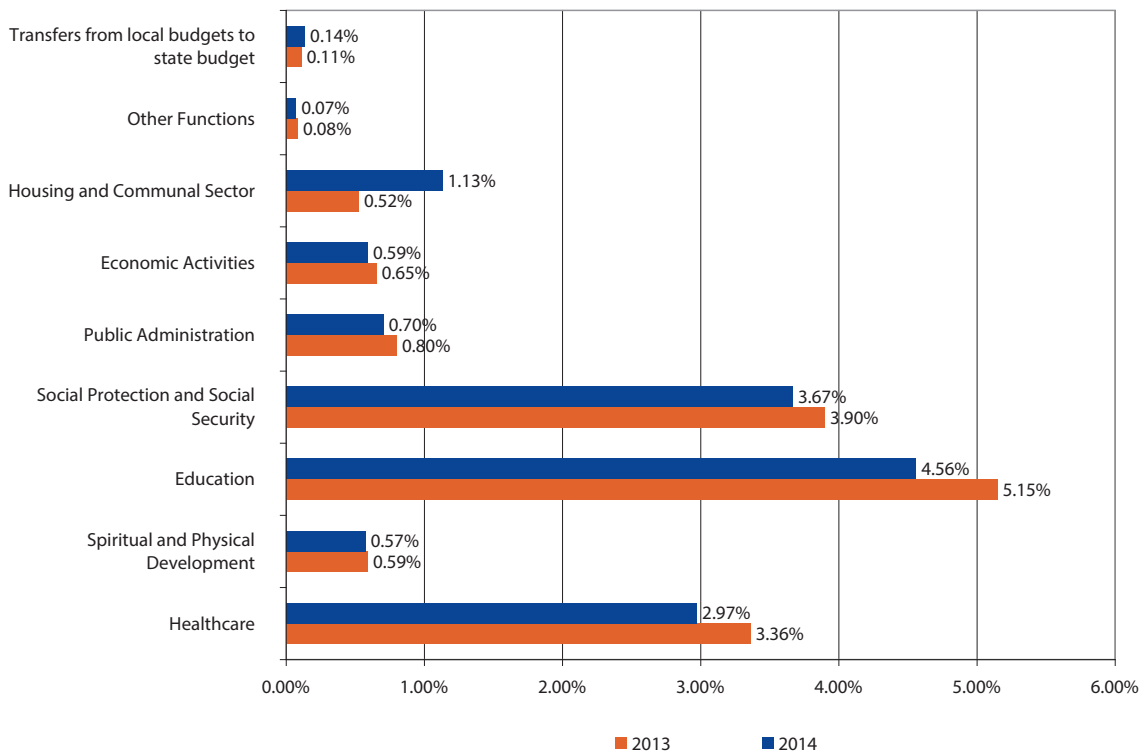


The indicator of local budgets' dependence on transfers from the State budget is a good illustration of financial system's centralization. This indicator exceeded 50% of all local budget revenues and showed an upward trend in recent years.

The level of GDP redistribution via the local budgets in Ukraine⁴ amounted to 14.27% according to the 2014 data, which is 0.79 ppt less than last year. The highest growth of this indicator is observed in expenditures for the housing and communal services sector (+0.61 ppt). The greatest decline of the share occurred in the expenditures for education (by 0.59 ppt), healthcare (by 0.39 ppt), and social protection and social security (by 0.23 ppt).

4. The share of local budgets in the GDP.

Fig. 2. Shares of Local Budget Expenditures in GDP in 2013-2014



Chapter 3

Own and delegated to local government revenues

Local taxes and fees are established according to the list and within the size limits of rates prescribed by the Tax Code of Ukraine, decisions of village, town and city councils within their authority and are mandatory for payment on the territory of the municipalities. Local taxes include property tax and single tax. Local fees include fee for vehicle parking and tourism fee.

Local councils establish obligatorily a single tax and property tax (in terms of vehicle tax and land tax). They also decide on issues for the property tax setting (in terms of real estate tax, other than land) and on setting the fee for vehicle parking and tourism fee. Setting of local taxes and fees not provided for by the Tax Code is prohibited. Transfer of local taxes and fees to the relevant local budgets is performed according to the Budget Code of Ukraine. On its basis, a part of national taxes paid (credited) in the respective territory is included to the local budget revenues (excluding local taxes and fees). Thus, the state supports the fiscal autonomy of local government. According to the latest amendments to the Budget Code of Ukraine dated 28 December 2014, No.79-VIII, the division into Basket One and Basket Two revenues has been abolished. These provisions came into force as of the outset of 2015.

The amendments associated with the entry into force of the Law of Ukraine No. 157-VIII "On voluntary association of communities", dated 05.02.2015, as well as of the Law of Ukraine No. 176-VIII "On Amendments to the Budget Code of Ukraine and some other legislative acts of Ukraine", dated 10.02.2015, have been currently introduced to the Budget Code of Ukraine. These laws, through clarifications and amendments to 23 articles of the Budget Code of Ukraine, have made coordination and implementation of the budget legislation norms with the norms of modern legislation concerning reforms of the state system of Ukraine. The distribution system of intergovernmental fiscal transfers has been replaced by a more progressive system of horizontal fiscal equalization of territories. Therefore, the revenues of local budgets are no longer divided into own and delegated, they are uniform by their managerial essence and economic content.

Budget revenues are classified according to the following sections: 1) tax revenues, 2) non-tax revenues, 3) income from capital operations, 4) transfers.

Tax revenues mean the national taxes and fees (compulsory payments), established by the laws of Ukraine on taxation, and local taxes and fees (compulsory payments).

Non-tax revenues mean as follows: 1) revenues from property and business activity; 2) administrative charges and fees, income from non-profit entities; 3) other non-tax revenues.

Transfers mean funds received from other state authorities, authorities of the Autonomous Republic of Crimea, local governments, other countries or international organizations on free and irrevocable basis.

Composition of revenues in the main portion is common to the budgets of republican (the Autonomous Republic of Crimea) and regional significance, the cities of Kyiv and Sevastopol, district budgets, budgets of combined territorial communities, villages, towns and cities of district significance (Appendix 1). Before these changes were introduced, separate revenue baskets had been assigned for each level of local budgets: those taken into account and disregarded when calculating inter-budget transfers. Redistribution of PIT revenues is one of the key changes.

Table 2. Changes in Standard Ratios for Personal Income Tax

	Old Budget Code version		New Budget Code version	
	Standard ratios	Forecast for 2015 (UAH bn)	Standard ratios	Forecast for 2015 (UAH bn)
Budgets of villages, their associations, settlements, raion-significance cities (amalgamated communities)	25 %	4.4	60 %	9.4
Budget of oblast-significance cities	75 %	25.4	60 %	17.9
Kyiv city budget	50 %	8.0	40 %	6.4
Raion budgets	50 %	8.2	60 %	8.7
Oblast budgets	25 %	22.0	15 %	9.0
State budget	50 % of revenues collected in the Kyiv city territory	8.0	60 % of revenues collected in the Kyiv city territory and 25% of revenues collected in all other budgets	24.6
TOTAL		76.0		76.0

However, according to Art. 64 of the Budget Code of Ukraine, the communities, which are combined in accordance with the Perspective Plan (territorial communities association plan), receive a significant additional resource in the form of 60% of PIT (personal income tax), in addition to the revenue base, common to all rural budgets. Therefore, if amalgamated communities (raion-significance cities, villages, and settlements) could change into direct inter-budget relations with the State budget and obtain the powers of oblast-significance cities (commensurate increase in the financial resource, in particular, crediting of 60% of PIT collected in the community's territory), PIT is payable at the place of company registration.

To standardize the process of association of territorial communities, the Law of Ukraine "On Voluntary Association of Territorial Communities" was adopted on 5 February 2015, No.157-VIII, as well as the Decree of the Cabinet of Ministers "On Approving the Methodology of Formation of Capable Territorial Communities" of 8 April 2015, No.214. According to these documents, the formation of capable territorial communities will be carried out pursuant to the Perspective Plan.

A Draft Perspective Plan shall be approved by the Verkhovna Rada of the Autonomous Republic of Crimea, respective oblast council, and confirmed according to the established procedure by the Cabinet of Ministers of Ukraine.

Communities of the rural (of the towns of *raion* (district) significance) area, which are not combined (or combined outside the Perspective Plan) do not receive this type of income.

The composition of budget revenues of the city districts (in case of their creation) is determined by the city council, in accordance with the powers assigned to city district councils. In the event the other cities, settlements or villages are subordinated administratively to a city district, the composition of budget revenues of such cities, settlements or villages is determined according to the procedure approved by the city council, taking into account the respective powers of local councils.

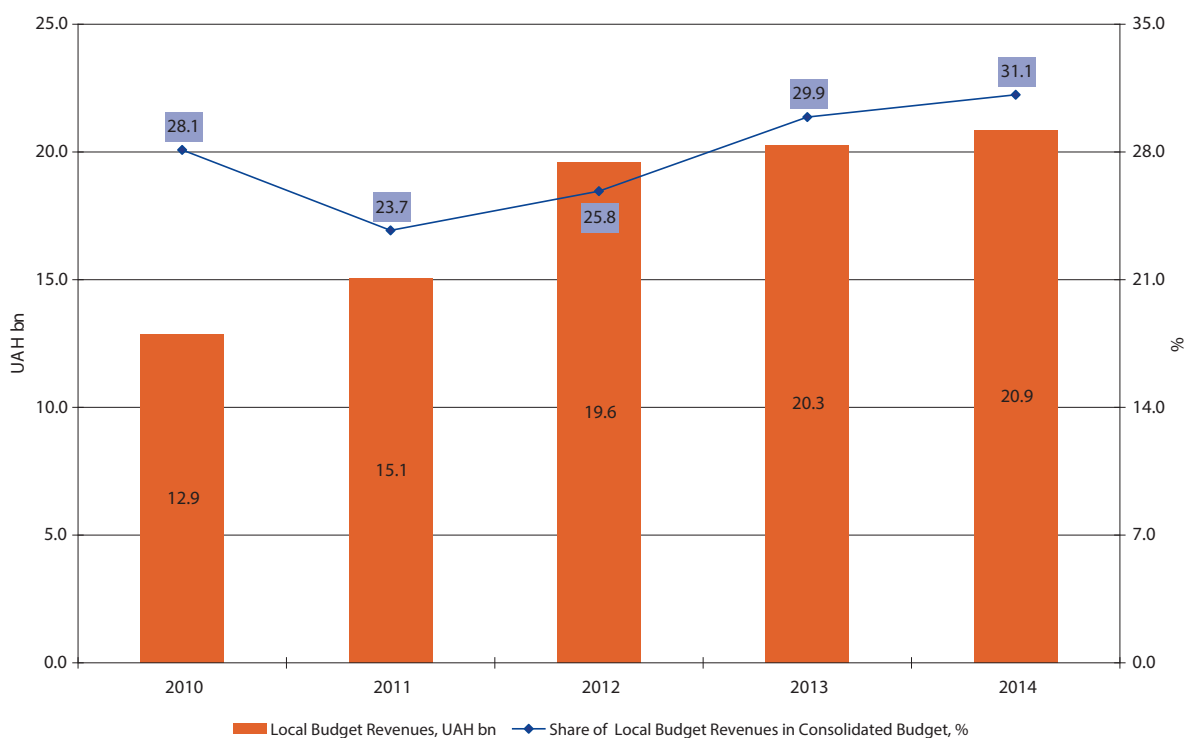
The composition of the general budget fund of the Autonomous Republic of Crimea and oblast budgets is given in Annex 2. The data on the revenue of local budgets of different levels are not public. Only the aggregate data for all local budgets combined are made public.

The General Fund serves for financing the budget expenditures against all the revenues, other than those intended for being credited to the Special Fund. This Fund provides for financing the implementation of State's and territorial communities' key functions and tasks.

The Special Fund envisages targeted use of budget funds. The Special Fund comprises budget appropriations for expenditures against specifically designated sources of revenues received by spending units for a specific purpose. The budget subdivision into the General Fund and Special Fund, sources of formation of the Special Fund, decisions on setting up a Special Fund within a local budget, and transfers of funds between the General Fund and Special Fund are all carried out exclusively according to laws.

According to the existing Budget Code, Special Fund revenues of local budgets are presented in Annex 3. The amounts of revenues of the Special Fund of local budgets remained virtually unchanged and amounted to about UAH 20 bn in recent years.

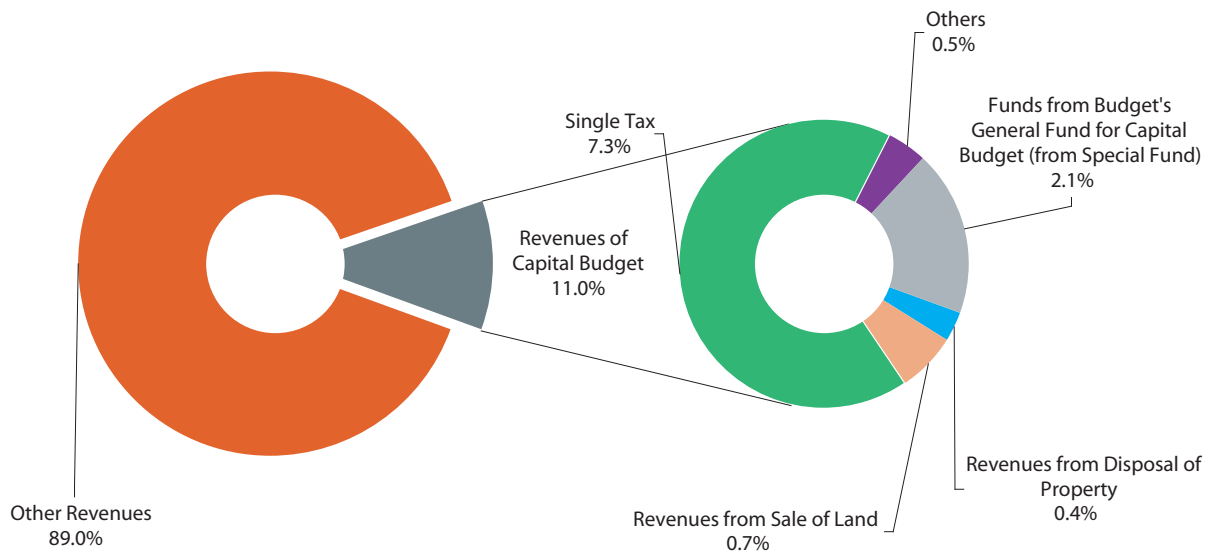
Fig. 3. Dynamics of Special Fund Revenues of Local Budgets in 2010–2014



Budget revenues of local development budgets (capital income) are outlined in Annex 4.

The development budget revenues of local budgets (including the funds received from the budget's General Fund into the development budget) totaled UAH 11.1 bn in 2014, which is 15.9% less year-on-year.

Fig. 4. Share of Development Budget Revenues in Local Budget Revenues (without Inter-Budget Transfers) in 2014



According to the old version of the Budget Code of Ukraine, the proceeds from administration of the single tax shall be remitted to the development budget as of 1 January 2011 to 1 January 2015. Based on the 2014 results, these proceeds have become the main source (at 66.6%) of all development budget revenues. A significant drop in the amount of development budget revenues occurred in 2015 due to exclusion of the single tax from its replenishing sources.

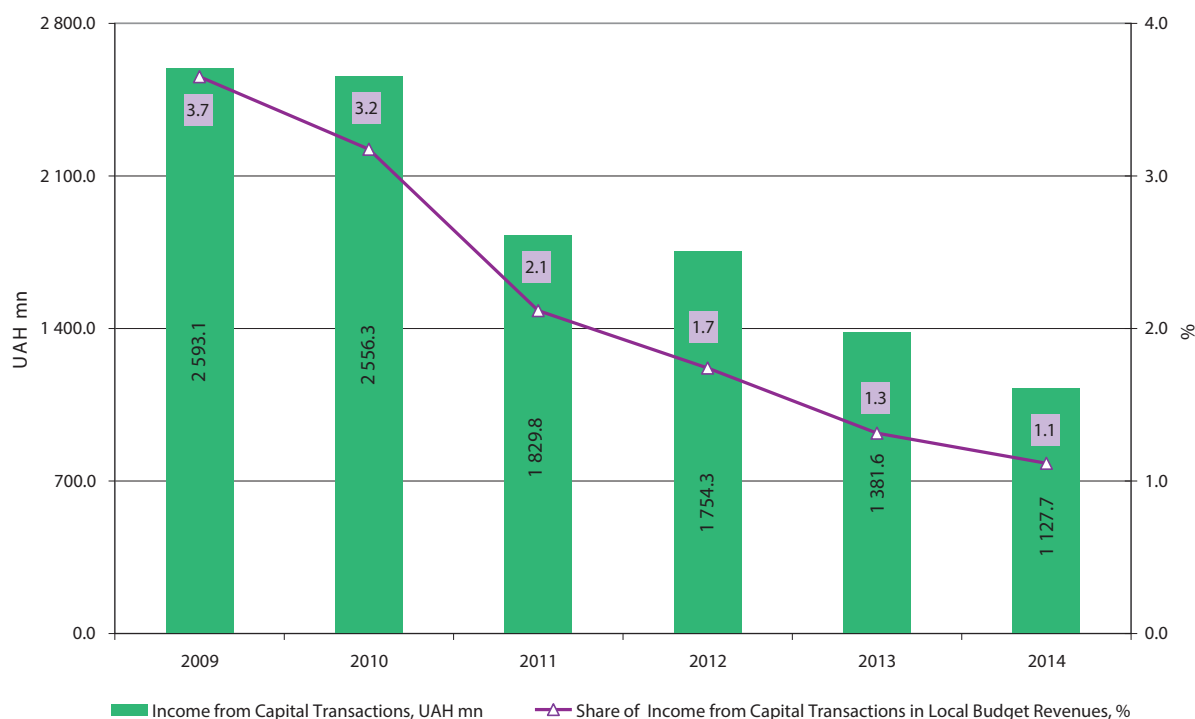
The second and third most important sources of revenues are the funds remitted from the budget's General Fund into the development budget (UAH 2.1 bn or 18.6%) and the proceeds from sale of land (UAH 0.7 bn or 6.6%).

The proceeds from the disposal of municipal property totaled UAH 0.4 bn, which amounts to 3.4% of all development budget revenues.

The proceeds from other sources amounted to 4.8% of all development budget revenues of local budgets.

The income from capital transactions decreased in 2014 compared to last year. It totaled UAH 1.1 bn, which is 18.4% less than in 2013. This has decreased the share of said income in the local budget revenues by 0.2 ppt down to 1.1%.

Fig. 5. Dynamics of Income from Capital Transactions in 2009–2014



If the law establishes a new type of local budget revenues, its crediting is determined by the State Budget of Ukraine through the appropriate amendments to the Budget Code.

Village, settlement and city councils, within their powers, make decisions on the establishment of local taxes and fees, in the manner prescribed by the Tax Code of Ukraine. A copy of the decision on the establishment of local taxes or fees is sent within ten days from the date of its promulgation to the supervisory authority in which the payers of relevant local taxes and fees are registered. The decision on the establishment of local taxes and fees is officially promulgated by the relevant local authority before 15 July of the year preceding the budget period in which the application of the established local taxes and fees or amendments thereof is planned (planning period). Otherwise, the norms of relevant decisions shall apply until the beginning of the budget period following the planned period.

In the event that the village, settlement or city council has not taken a decision on the establishment of appropriate local taxes and fees, as well as the excise tax in the implementation of the undertakings of retail trade of excisable goods, that are mandatory under the rules of this Code, such taxes, before taking the decision, are imposed on the basis of norms of this Code with the use of minimum rates, and the land fee is levied using rates that have been enacted by 31 December of the year preceding the fiscal period in which it is planned to use land fees.

Aside from setting local taxes and fees, local government may not influence the taxation system. Administration of taxes and fees is conducted at the level of cities, raions and oblasts. The rates of local taxes and fees are set for each village, settlement and city separately.

It should be said something about the tax on real estate other than land plot. Its parameters are standardized by Art. 265 of the Tax Code of Ukraine. Taxpayers are individuals and legal entities, including non-residents, who own residential real estate.

The object of taxation is residential real estate, including its share.

The taxable base of residential real estate objects, including their shares, which are owned by individuals, is calculated by the supervisory authority based on the data of the State Register of rights to immovable property, provided free of charge by the bodies of state registration of rights to immovable property.

The taxable base of residential real estate objects, including their shares, which are owned by legal entities, is calculated by such entities independently based on the living space of each taxation object, on the basis of documents confirming the ownership of such an object.

In the event of more than one taxation object in the ownership of a taxpayer - individual, including different types of objects (apartments, residential buildings or apartments and residential buildings), the taxable base is calculated based on total living space of all the objects.

The taxable base of the residential real estate object / objects, including their shares, owned by an individual – taxpayer, is reduced:

- a) for an apartment / apartments, regardless of their number – by 120 square meters;
- b) for residential building / residential buildings, regardless of their number – by 250 square meters;
- c) for residential real estate objects of different types, including their shares (in case of simultaneous ownership by the taxpayer of apartments, residential buildings or apartments and residential buildings, including their shares) - by 370 square meters.

Such reduction is provided once for each basic tax (reporting) period (year).

The tax exemptions are not provided on taxation objects used by their owners in order to obtain revenues (rented, leased, used in entrepreneurial activities).

City, settlement and village councils may establish additional tax exemptions payable in the respective territory on residential real estate objects owned by religious organizations of Ukraine, the charters (regulations) of which are registered in accordance with the law and used for activities provided by such charters (regulations). Until 1 February of the current year, local self-government authorities submit to the relevant supervisory authority at the location of residential real estate objects the information concerning the benefits provided for them in accordance with the first unnumbered paragraph of this subparagraph.

The tax rates are established by the decision of village, settlement or city council as a percentage of the minimum wage established by law on 1 January of the reporting (tax) year, for 1 square meter of taxation base. The tax rates for individuals are established in the following amounts:

- a) less than 1 percent - for apartment / apartments, the living area of which does not exceed 240 square meters, or residential building / buildings, the living area of which does not exceed 500 square meters;
- b) 2.7 percent - for apartment / apartments, the living area of which exceeds 240 square meters, or residential building / buildings, the living area of which exceeds 500 square meters;
- c) 1 percent - for different types of residential real estate objects owned by one taxpayer, the total living area of which does not exceed 740 square meters;
- d) 2.7 percent - for different types of residential real estate objects owned by one taxpayer, the total living area of which exceeds 740 square meters.

The tax rates for legal entities are established in the following amounts:

- a) 1 percent - for apartment / apartments, the living area of which does not exceed 240 square meters, or residential building / buildings, the living area of which does not exceed 500 square meters;
- b) 2.7 percent - for apartment / apartments, the living area of which exceeds 240 square meters, or residential building / buildings, the living area of which exceeds 500 square meters.

The tax liability for the reporting year is payable: a) by individuals - within 60 days from the date of delivery of tax notification-decision; b) by legal entities – quarterly, in advance payments until the 30th day of the month following the reporting quarter, which is displayed in the annual tax return.

The sources of information on local budget revenues are as follows: the Resolution on the local budget, the explanatory note to it, reports on the implementation of these decisions, analytical and calculation tables (not unified, formed by each local budget, if necessary), financial, treasury and tax statements.

The list of public databases is determined on the basis of requirements of Art. 28 of the Budget Code of Ukraine. In particular, they include as follows:

- Information on the state (local) budget implementation should include indicators for the general and special funds on revenues (broken down by types of revenues that provide income not less than 3 percent of total revenues of the relevant budget). Such indicators are given compared with those of the corresponding period of the previous budget period, indicating the dynamics of their changes.
- The Verkhovna Rada of the Autonomous Republic of Crimea, the Council of Ministers of the Autonomous Republic of Crimea, local state administrations and local self-government authorities ensure publication of information on local budgets, including decisions on local budgets and quarterly reports on their performance. The decision on the local budget should be published no later than ten days after its adoption in the newspapers set by the Verkhovna Rada of the Autonomous Republic of Crimea, by the corresponding local councils.
- Information on local budget implementation (except for the budgets of villages and settlements) shall be published no later than on 1 March of the year following the year of the report in the newspapers set by the Verkhovna Rada of the Autonomous Republic of Crimea and by the corresponding local councils.
- Public presentation of information about the local budget implementation (except for the budgets of villages and settlements), according to the indicators, on which the budgetary appropriations have been approved by the local budget, is carried out by 20 March of the year following the reporting one.
- Public presentation of information about the implementation of budgets of villages and settlements is carried out in the manner determined by the relevant local council.

This Budget Code provision is fully respected; however, these data are insufficient for a full analysis. In particular, the data on execution of local budgets by region and by budget level are not made public.

Strong and missing areas of local own and divided revenues			
National systems, level of decentralization, with reference to the Rec (2005) No. 1.-36.; 68.-72.		Local self-government authorities: with reference to the Rec (2005) No. 9.-31.	
Area No. 1.....	Rec. (2005). No. x	Area No. 1 Tax revenues of the local budgets must be considerable	Rec. (2005). No. 9
Area No. 2.....	Rec. (2005). No. y	Area No. 2 Prevention of tax evasion	Rec. (2005). No. 18
.....		Area No. 3 Identification of the taxpayers and the scope of tax payments, effectiveness of tax administration	Rec. (2005). No. 25

Chapter 4

Inter-budget transfers, fiscal equalization

In accordance with Art. 2 of the Budget Code of Ukraine, the inter-budget transfers mean funds donated and permanently transferred from one budget to another.

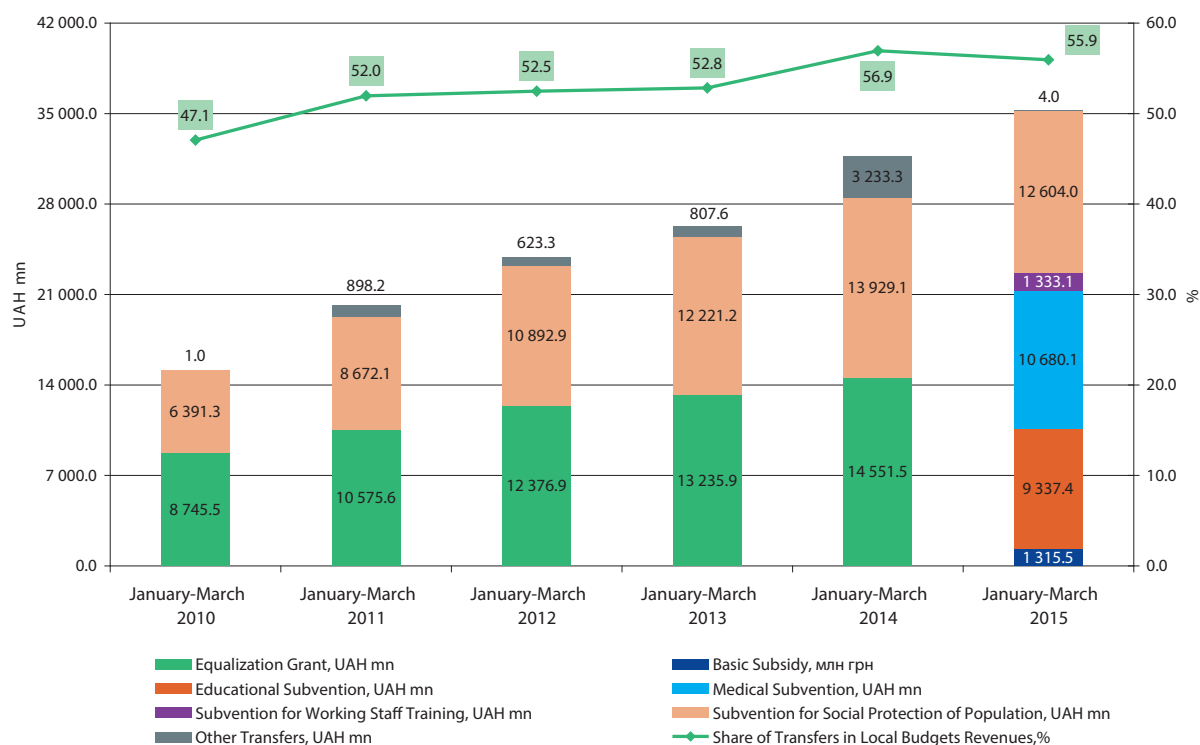
Chapter 16 of the Budget Code of Ukraine regulates the relations on the formation and distribution of inter-budget transfers, which are divided as follows:

1) basic subsidy (transfer provided from the state budget to local budgets for horizontal fiscal capacity equalization of the territories); 2) subventions; 3) reverse subsidy (funds transferred to the state budget from local budgets for horizontal fiscal capacity equalization of the territories); 4) additional subsidies.

The State Budget of Ukraine may provide the transfers to local budgets as follows:

- 1) basic subsidy;
- 2) additional grants;
- 3) subventions to implement government programs of social protection;
- 4) additional subsidy to compensate lost revenues of local budgets due to provision of benefits established by the state;
- 5) subvention for investment projects implementation;
- 6) educational subvention;
- 7) subvention for working staff training;
- 8) medical subsidy;
- 9) subvention for providing medical activities of individual government programs and comprehensive measures of programmatic nature;
- 10) subvention to finance social and economic measures for the risk compensation of the population living in the territory of the monitoring zone;
- 11) subvention for projects to liquidate enterprises of coal and peat industry and maintenance of drainage facilities in safe mode in co-financing (50 percent);
- 12) other additional subsidies and other subventions.

Fig. 6. Dynamics of State Budget Transfers to Local Budgets in Q1 2010-2015



The procedure and conditions for granting subventions from the state budget to local budgets, first defined by the State Budget of Ukraine, shall be approved by the Cabinet of Ministers of Ukraine no later than 30 days from the date of entry into force.

The distribution of additional subsidies between local governments is carried out on the basis of criteria set by the Cabinet of Ministers of Ukraine.

The amount of inter-budget transfers is approved in the State Budget of Ukraine separately for each of the local budgets, if there are grounds for giving and receiving relevant inter-budget transfers. Any decisions on the amount of financing of transfers, their allocation and structure (within the scope established by the Budget Code) shall be made by the Verkhovna Rada in the Law on the State budget of Ukraine for the respective years.

4.1. BASIC SUBSIDIES

The horizontal fiscal capacity equalization of oblast budgets is carried out separately by income of the enterprise profit tax and of the PIT (personal income tax), taking into account some parameters as follows: 1) number of population; 2) income of the corporate profit tax, specified in paragraph 1.1 of Article 66 of this Code for the last budget reporting period; 3) income of the PIT (personal income tax), specified in paragraph 1 of Article 66 of this Code for the last budget reporting period; 4) fiscal capacity indexes of the relevant oblast budget, determined separately by income of the corporate profit tax and of the PIT (personal income tax).

The fiscal capacity indicator of the relevant oblast budget is the coefficient that determines the level of the fiscal capacity of such a budget, in comparison with the similar average indicator for all oblast budgets in Ukraine, calculated per person. In implementing the equalization, the fiscal capacity indicator of the relevant regional budget is taken into account.

In the event that the indicator is within 0.9-1.1 - equalization is not carried out; less than 0.9 – basic subsidy is granted to appropriate regional budget in amount of 80 percent of the amount needed to achieve the value of the security indicator of the corresponding budget - 0.9; more than 1.1 - reverse subsidy is transmitted from the respective regional budget in amount of 50 percent of the amount that exceeds the value of the indicator - 1.1.

So this is different from the oblast level equalization discussed in the previous paragraph. The horizontal fiscal capacity equalization of oblast-significance cities, raions, and combined territorial communities is only performed for PIT. The horizontal fiscal capacity equalization of the cities of regional significance, *raions* (districts) and of combined territorial communities, created under the law and perspective plan of formation of the communities' territories, is carried out taking into account some parameters as follows: 1) number of population; 2) income of the PIT (personal income tax), specified in paragraph 1 of Article 64 of this Code for the last budget reporting period; 3) fiscal capacity indexes of the relevant budget. The fiscal capacity indicator is the coefficient that determines the level of the fiscal capacity of the consolidated budget of the city of regional significance, *raion* (district) or a combined territorial community, created under the law and perspective plan of formation of the communities' territories, in comparison with the similar average indicator for all consolidated budgets of the cities of regional significance, *raions* (districts) and combined territorial communities, created under the law and perspective plan of formation of the communities' territories in Ukraine, calculated per person. In implementing the equalization, the fiscal capacity indicator of the relevant budget is taken into account.

In the event that the indicator is within 0.9-1.1 - equalization is not carried out; less than 0.9 – basic subsidy is granted to appropriate budget in amount of 80 percent of the amount needed to achieve the value of the security indicator of the corresponding budget - 0.9; more than 1.1 - reverse subsidy is transmitted from the respective budget in amount of 50 percent of the amount that exceeds the value of the indicator - 1.1.

The fiscal capacity indicators of local budgets cannot be amended and reviewed more often than once a year, except for some cases as follows: allocation of new or amendments to the status of existing administrative and territorial units; amendments to location of business entities - taxpayers; adjustment of tax legislation. Change of the amount of revenues collected from the corporate profit tax and the PIT (personal income tax) for the relevant fiscal period should be confirmed by the tax enforcement office.

2. The Verkhovna Rada of the Autonomous Republic of Crimea and the local councils (oblast, raion, city, settlement, and village councils) can provide the following types of inter-budget transfers in the relevant budgets: 1) subventions for the maintenance of common amenities or liquidation of negative consequences of common amenities; 4) subventions for investment projects implementation, including the construction or reconstruction of common amenities; 5) subsidies and other subventions.

The terms of granting subventions mentioned in this section are defined by the relevant contract between the parties.

4.2. SUBVENTIONS FOR SOCIAL PROTECTION

Parameters and indicators of subventions granted from the state budget to local budgets for the implementation of public social protection programs are provided in Annex 5.

Provision of state tax exemptions that reduce the incomes of local budgets should be accompanied by additional subsidies from the state budget to local budgets for appropriate compensation of losses of local budgets.

4.3 EDUCATIONAL SUBVENTION

Educational subvention is directed to pay current expenditures of the following types of educational institutions:

- 1) general educational institutions of all levels;
- 2) school divisions of educational and pedagogic systems "preschool educational institution - general educational institution", "general educational institution - preschool educational institution";

- 3) specialized schools (boarding schools), including boarding schools with advanced study of certain subjects and courses for children depth training in science and arts, physical culture and sport and other branches, lyceums with intensive military and physical training; lyceums (lyceums – boarding schools); gymnasiums (gymnasiums – boarding schools); colleges (colleges – boarding schools);
- 4) evening (shift) schools;
- 5) general educational institutions for citizens requiring social assistance and rehabilitation: general educational boarding schools, general sanatorium boarding schools; special boarding schools; general educational institutions for orphans and children deprived of parental care, children's homes (excluding orphanages and foster families);
- 6) special general educational institutions for children requiring correction of physical and / or mental development, training and rehabilitation centers.

In the event of covering in full the need of current expenditures for the budget period by the said subvention and in the absence of overdue debts on protected budget expenditures in the specified schools, this subvention may be directed to their capital expenditures.

The specified subvention may be directed for implementation of measures to optimize the network of the specified schools.

The Law on State Budget of Ukraine approves the educational subsidy amounts separately for the budget of the Autonomous Republic of Crimea, oblasts budgets and *raions* (district) budgets, as well as of the city budgets (in case of the cities of Kyiv and Sevastopol, the cities of Republican and regional significance) and the budgets of combined territorial communities created under the law and perspective plan of formation of the communities' territories.

The educational subvention is distributed among the respective budgets, based on the formula developed by the central executive body, to form and implement the national education policy, and is approved by the Cabinet of Ministers of Ukraine Resolution No. 6 "Some Issues of education subventions provision from the state budget to local budgets", dated 14 January 2015, and should take into account, in particular, the following parameters: 1) the number of pupils in general educational institutions in urban and rural areas, as well as in mountainous settlements; 2) class sizes; 3) revaluation adjustment coefficients applied to the number of pupils of different types of general educational institutions and depending on the area in which the institution is located.

At the same time, the reserve funds, the amount of which cannot exceed 1 percent of the total subvention amount, are assumed as part of the specified subvention for expenditure execution that could not be taken into account, when applying the formula.

4.4. SUBVENTION FOR WORKING STAFF TRAINING

The subvention for working staff training is directed to pay current expenditures of vocational and technical schools and other state and municipal property, which provide services on training skilled workers in terms of the state order. In the event of ensuring in full the need for the current expenditures for the budget period at the expense of the specified subvention and in the absence of overdue indebtedness under protected budget expenditures of the specified educational institutions, this subvention may be directed to their capital expenditures. The specified subvention may be directed for implementation of measures to optimize the network of the specified educational institutions.

The subvention for working staff training is distributed among the respective budgets, based on the formula developed by the central executive body, to form and implement the national education policy, and is approved by the Cabinet of Ministers of Ukraine Resolution No. 7 dated 14 January 2015, and should take into account, in particular, the following parameters: 1) the number of pupils, including pupils in mountainous settlements, orphans and children deprived of parental care; 2) revaluation adjustment coefficients applied to the number of pupils of different types of general educational institutions and, depending on the area in which the institution is located.

At the same time, the reserve funds, the amount of which cannot exceed 1 percent of the total subvention amount, are assumed as part of the specified subvention for expenditure execution that could not be taken into account, when applying the formula.

4.5. MEDICAL SUBVENTION

Local budgets expenditures on health care are conducted at the expense of a medical subvention. The specified subvention may be directed for implementation of measures to optimize the healthcare facilities network. The Law on State Budget of Ukraine approves the medical subvention amounts separately for the budget of the Autonomous Republic of Crimea, oblasts budgets and *raions* (district) budgets, city budgets (in case of the cities of Kyiv and Sevastopol, the cities of Republican and regional significance) and the budgets of combined territorial communities created under the law and perspective plan of formation of the communities' territories.

The medical subvention is distributed among the respective budgets, based on the formula developed by the central executive body, to form and implement the national policy in the field of healthcare, and is approved by the Cabinet of Ministers of Ukraine Resolution No. 11 dated 23 January 2015, and should take into account, in particular, the following parameters: 1) number of population of the corresponding administrative and territorial unit; 2) adjustment coefficients, which take into account the differences in the cost of medical care provision; 3) peculiarities of medical care provision in mountainous settlements.

At the same time, the reserve funds, the amount of which cannot exceed 1 percent of the total subvention amount, are assumed as part of the specified subvention for expenditure execution that could not be taken into account, when applying the formula.

The balances of funds for the medical subvention and for the subventions for working staff training, as well as the subvention for providing medical activities of individual government programs and comprehensive measures of programmatic nature at the end of the budget period are kept in the accounts of local budgets and can be used in the next budget period, taking into account the subvention purpose, including for upgrading the material and technical base of facilities.

The subvention for providing medical activities of individual government programs and comprehensive measures of programmatic nature is used to implement the government programs and comprehensive measures in the field of healthcare, following the directions defined by the Cabinet of Ministers of Ukraine. The subvention for providing medical activities of individual government programs and comprehensive measures of programmatic nature is distributed among the respective budgets, based on the formula developed by the central executive body, to form and implement the national policy in the field of healthcare, and should take into account, in particular, the following parameters: 1) number of patients; 2) number of population of the corresponding administrative and territorial unit.

4.6. LIQUIDATION OF NEGATIVE CONSEQUENCES OF COMMON AMENITIES

The subventions for the maintenance of common amenities or the liquidation of negative consequences of common amenities are granted from one local budget to another to compensate for the expenditures. The conditions of the maintenance of common amenities or liquidation of negative consequences of common amenities and the subvention granting are determined on contractual basis between the subvention grantor and its recipient.

4.7. CAPITAL INVESTMENT GRANTS

The subvention granted for investment projects implementation is based upon the following basic principles: 1) the principle of objectivity and openness – the subvention recipient is determined by transparent procedures; 2) the principle of unity – the funds distribution should ensure the implementation of national values and objectives of innovation development and contribute to reducing differences in living standards in different regions of the country; 3) the principle of sustainable development – the state support provided for the territories in view of their potential; 4) the principle of targeted use of funds – the subven-

tion is used exclusively for the purpose specified by its grantor, subject to forecast and program documents of economic and social development of the country and of the relevant territory, government programs, the budget forecast for the next two budget periods following the planned budget period.

The subventions for investment projects implementation are granted from the state budget to local budgets taking into account such basic principles: 1) the economic efficiency of the objectives of the investment project, involving the minimum amount of budgetary funds for the investment projects implementation; 2) the subvention direction exceptionally to create, increase or upgrade fixed assets of the municipal pattern of ownership (primarily, on the completion of construction and reconstruction of objects with the degree of construction readiness over 70 percent); 3) the financial security of investment projects whose implementation period is longer than the budget period with necessary financial resources of local budgets, credits (loans), attracted under the state and / or local warranty, and the subvention on their implementation throughout the implementation period; 4) the level of provision with facilities of production, communication and social infrastructure, which increases the investment attractiveness of the territory; 5) budget participation of the subvention recipient: - for budgets of villages and their associations, settlements and towns of *raion* (district) significance - not less than 1 percent of such subvention amount;

- for the budget of the Autonomous Republic of Crimea, oblast and *raion* (district) budgets, budgets of the city of Sevastopol, of the cities of republican (the Autonomous Republic of Crimea) and oblast significance, and the budgets of combined territorial communities, created under the law and perspective plan of formation of the communities' territories - not less than 3 percent of such subvention amount;
- for the budget of the city of Kyiv - not less than 5 percent of such subvention amount;

7) substantiation of capacity for further financing from local budgets for objects of municipal property.

The distribution of the subvention for investment projects implementation carried out in the manner determined by the Cabinet of Ministers of Ukraine Resolution No. 520 "On Approval of the Procedure and Terms for granting subventions from the state budget to local budgets for investment programs (projects) implementation", dated 18 May 2011, taking into account the tasks and activities of the state strategy on regional development, regional development strategies based on the formalized parameters, which are based on actual and forecast indicators of economic and social development of the relevant territory (the main ones are the indicators of industrial production, volume of gross agricultural production, investment in fixed assets, level of population density, unemployment rate of the population, income of the population per person and the average monthly wage of employees).

All the above mentioned transfers from the state budget to local budgets are transferred from the accounts of the state budget by the Treasury of Ukraine to the budget of Autonomous Republic of Crimea, oblast budgets, budgets of the cities of Kyiv and Sevastopol, of the cities of republican (the Autonomous Republic of Crimea) and oblast significance and the *raion* (district) budgets, other local self-governments budgets, for which the inter-budget transfers are determined in the state budget.

The procedure for the transfer of the inter-budget transfers from the state budget to local budgets, reverse subsidies, as well as the procedures of transfer of the inter-budget transfers between local budgets, are determined by the Cabinet of Ministers of Ukraine and should ensure timeliness, uniformity, guarantee and completeness of transferring. According to the prescription of the State Budget of Ukraine, the Treasury of Ukraine carries out the transfer of basic subsidies and reverse subsidies each decade, and the transfer of the educational subvention, the subvention for working staff training and the medical subvention is carried out twice a month.

The Cabinet of Ministers of Ukraine in coordination with the Budget Committee of the Verkhovna Rada of Ukraine can perform the distribution and redistribution of subventions and additional subsidies from the state budget to local budgets among local budgets within the limits of total amount of the relevant subventions and additional subsidies. Thus, the amount of subventions from the state budget to local budgets for the implementation of public social protection programs can be transferred in accordance with part six of Article 102 of this Code, and the amount of subventions from the state budget to local budgets for holding elections for deputies of the Verkhovna Rada of the Autonomous Republic of Crimea, local coun-

cils and village, settlement and city mayors are distributed in the manner prescribed in Article 61 of the Law of Ukraine "On the Election of Deputies of the Autonomous Republic of Crimea, local councils and village, settlement and city mayors."The peculiarities of distribution of the amounts of the educational subvention, the subvention for working staff training and the medical subvention concerning the funds reserve and redistribution of such subvention amounts among local budgets may be determined by the State Budget of Ukraine.

The local State Administration may decide on the distribution and redistribution of the transfer amounts from the state budget to local budgets between sessions of the respective local council, provided the delegation of such powers by it to the local State Administration with subsequent amendments to the decision on the local budget. Such allocation or reallocation of transfers is carried out within the amounts approved by the Law on the State Budget for the respective year. Local authorities may not either increase or decrease the transfer amounts set by the Law.

The sources of information on inter-budget transfers are as follows: the Law on State Budget of Ukraine, the Resolution on the local budget, the explanatory note to it, reports on the implementation of these decisions, analytical and calculation tables (not unified, formed by each local budget, if necessary), financial, treasury and tax statements. All the information envisaged by Article 28 BCU is public information and is promulgated.

Strong and missing areas of fiscal equalization and subsidies			
National systems, level of decentralization, with reference to the Rec (2005) No. 37.-67.		Local self-government authorities: with reference to the Rec (2005) No. 9.-31.	
Area No. 1.....	Rec. (2005). No. x	Area No. 1 Dependence of local budgets on intergovernmental transfers	Rec. (2005). No. 9

Chapter 5

Local borrowing

The significance of local borrowing is determined by currently existing objective limitations of budgetary resources and systemic crisis of the state and regional institutions, which resulted in falling of economic indicators of communities in Ukraine. In this vein, the local borrowing represents an innovative tool of state administration that can reinforce the local governments' autonomy, as well as the processes of fiscal decentralization, which is the basis of modern domestic reforms.

The regulatory acts, which determine the legitimization and procedures of local borrowing include the Budget Code of Ukraine and the Cabinet of Ministers of Ukraine Resolution No. 110 "On Approving the Regulation on Local Borrowings Implementation", dated February 16, 2011, issued pursuant to the provisions of Art. 74 of the Code.

Paragraph 33 of Art. 2 of the Budget Code provides the following definition: Local borrowings mean operations on credits (loans) obtained to the budget of the Autonomous Republic of Crimea or a local budget on terms of repayment and maturity in order to finance the budget of the Autonomous Republic of Crimea or a local budget.

Local borrowing represents a part of revenues of local budgets, therefore borrowing implementation is a part of the local debt management process. Local borrowing is recognized as source of financing the relevant budget.

The right to local borrowings implementation within the limits prescribed by the local budget decision belongs to the Autonomous Republic of Crimea, the city's territorial community, represented by the local financial authority on behalf of the Autonomous Republic of Crimea and the city council.

The local external borrowings can be implemented only by the Verkhovna Rada of the Autonomous Republic of Crimea, Kyiv, Sevastopol city councils and city councils of regional significance. At the same time, the local external borrowings by obtaining credits (loans) from international financial institutions can be implemented by all the city councils.

In the event of the involvement of funds from local borrowings to the development budget, the local budget can be approved with a deficit, since local debt arises from local borrowings – the total debt of the Autonomous Republic of Crimea or of the territorial community with the return of received and outstanding credits (loans) as of the reporting date.

In order to ensure the compliance with the limit values of the local debt and local guarantees, the Ministry of Finance of Ukraine keeps the Register of local borrowings and local guarantees. The Register of local borrowings and local guarantees is an information system that provides information on the implemented local borrowing and the provided local guarantees. All local borrowing agreements and contracts, for which the fulfillment of obligations is provided with local guarantees, and the agreements on local budget reimbursement, as well as the essential amendments of conditions of such agreements, are registered in it.

Based on the provisions of Art. 71 of the Budget Code of Ukraine, local borrowings are included in the budget revenues of the local budgets development. They are implemented in order to finance the development budget of the Autonomous Republic of Crimea or of the local budgets and are used for the creation, increase or upgrading of strategic assets of durable strategic objects or objects that ensure the compliance with the objectives of the Autonomous Republic of Crimea and local councils, aimed at meeting the interests of the Autonomous Republic of Crimea and of the territorial communities of the cities.

The amount and terms of local borrowing implementation and local guarantees provision are agreed with the Ministry of Finance of Ukraine. The amount and terms of local borrowing implementation by obtaining credits (loans) from international financial institutions and local guarantees provision in order to ensure full or partial implementation of debt obligations of business entities, arising under the credits (loans) from

international financial institutions, shall be deemed to be agreed if the Ministry of Finance of Ukraine takes no decision within one month from receipt of documents for approval.

In the event that in the process of local debt repayment and payments of its maintenance, stipulated by the agreement between the lender and the borrower, the repayment schedule is disrupted by the fault of the borrower, the Verkhovna Rada of the Autonomous Republic of Crimea or the relevant city council are not entitled to carry out new local borrowing over the next five years.

It is prohibited to implement local borrowing and provide local guarantees until making the decision on the local budget for the current budget period. It is also prohibited to implement borrowing in any form to individual budget institutions.

Long term debt should not exceed 200% of the annual development budget in the next two years (400% in the case of City of Kyiv) and the debt service should be below 10% of the general fund during the entire debt service period.

At the end of the budget period, the total amount of local debt and a debt guaranteed by the Autonomous Republic of Crimea or a territorial community of a city (less the guarantee obligations emerging under credits/loans from international financial institutions) may not exceed 200% (400% for the city of Kyiv) of the average annual indicative projected amount of development budget revenues (without the amount of local borrowing and capital transfers/subventions from other budget), as determined by the forecast of the respective local budget for the two budget periods following the planning period.

Strong and missing areas of regulatory acts on local borrowing

National systems, level of decentralization, with reference to the Rec (2005) No. 73.-76.		Local self-government authorities: with reference to the Rec (2005) No. 73.-76.	
Area No. 1.....	Rec. (2005). No. x	Area No. 1 Local borrowings must take place to finance development budget of the ARC and town budgets	Rec. (2005). No. 73
		Area No. 2 Discussion of the strategically documents	Rec. (2005). No. 73

Chapter 6

Management of local finances

Among the laws of Ukraine containing provisions that regulate local finance issues, a special place is occupied by the Law of Ukraine "On Local Self-Government in Ukraine", dated 1997, which is the basic law on these issues. On the basis of this law draft laws have been developed and laws have been adopted that govern separate issues of functioning of local government, in particular the Law of Ukraine "On elections of local councils and village, settlement and city mayors", "On citizens' appeals", "On bodies of self-organization of population", "On Associations of Citizens", "On national and local referendums" and "On voluntary association of territorial communities in Ukraine." The need for the adoption of these laws is expressly provided for in the Law of Ukraine "On Local Self-Government in Ukraine" or follows from its final and transitional provisions.

In addition, the package of legislation that makes up a system of legislative support of local self-government development, of course, includes the Budget Code of Ukraine, the Economic Code of Ukraine the Tax Code of Ukraine and others.

The existence of municipal property, local budgets and local finances requires appropriate legal regulation and the presence of certain self-regulatory regime for financial and economic relations at the local level. For this purpose, various material and financial resources are at the disposal of local self-government authorities in Ukraine. Through these resources, the specified authorities ensure the provision of the whole complex of public services.

6.1. BUDGET PROCESS

The budget process is aimed for budget implementation, which has the following stages: 1) drafting of the budgets projects; 2) consideration of the draft and adoption of the Law on State Budget of Ukraine (the decision on the local budget); 3) budget implementation, including amending the Law on State Budget of Ukraine (the decision on the local budget); 4) preparation and consideration of the budget implementation report and making the decision on it. The monitoring of compliance with budget legislation, audit and evaluation of budget funds management in accordance with the legislation are carried out at all stages of the budget process.

The participants of the budget process are the authorities, institutions and officials endowed with budgetary powers (rights and responsibilities of budget funds management).

The participants of the budget process, within their powers, carry out an evaluation of the budget programs efficiency, at all stages of the budget process, which provides measures for monitoring, analysis and control over the targeted and efficient use of public funds. The evaluation of the budget programs efficiency is based on the analysis of performance indicators for budget programs, as well as on other information contained in the budget requests, cost estimates, budget program passports, reports on the budgets implementation and reports on the budget programs implementation. Organizational and methodological principles of evaluating the effectiveness of budget programs are determined by the Ministry of Finance of Ukraine.

The evaluation of the budget programs efficiency, including the conclusions of executive authorities authorized to implement financial control on the compliance with budget legislation, is the basis for making decisions on introduction, in the prescribed manner, of the amendments to the budget allocations of the current budget period, corresponding proposals to the draft budget for the planned budget period and the forecast budget for two budget periods following the planned budget period, including the suspension of the implementation of relevant budget programs.

At present, strategic planning has been started at the level of local budgets. Thus, in accordance with the Budget Code of Ukraine, the Council of Ministers of the Autonomous Republic of Crimea, the local State

Administrations and the executive bodies of local councils draw up and approve local budget forecast for the next two budget periods following the planned budget period, in accordance with forecast and program documents of economic and social development of the country and the relevant territory, state targeted programs, based on a forecast of the State Budget of Ukraine for two budget periods following the planned budget period.

The local budget forecast for two budget periods following the planned budget period includes indicative projected implementation of the local budget by main types of income, financing, expenditures and lending, indicative forecast figures of the local debt and of the debt, guaranteed by the Autonomous Republic of Crimea or a territorial community, and indicative figures for the forecast budget programs that provide a few years of implementation of investment projects.

The local budget forecast for two budget periods following the planned budget period is submitted to the Verkhovna Rada of the Autonomous Republic of Crimea, the corresponding local councils together with the draft decision on the local budget, specified on the basis of the forecast of the State Budget of Ukraine for two budget periods following the planned budget period, approved by the Cabinet of Ministers of Ukraine, and on the basis of the adopted decision on the local budget, as well as it should be approved by the Council of Ministers of the Autonomous Republic of Crimea, local state administrations and executive bodies of local councils.

Indicators of the draft local budget for the budget period following the planned, forecasted are based on indicative figures of the local budget for two budget periods following the planned budget period.

As for the budget programs which provide implementation of investment projects for several years, including those carried out with the assistance of state credits (loans) from foreign states, banks and international financial organizations, and identified by the State Budget Law of Ukraine (the decision on the local budget), the Cabinet of Ministers of Ukraine (Council of Ministers of the Autonomous Republic of Crimea, the local state administration, the executive body of the respective local council) takes measures to prioritize the budget predictions for the next budget period in the draft State Budget of Ukraine (the draft decision on local budget) for the continuation of such investment projects with the need of a phased completion and implementation of the relevant facilities.

The participants of the budget process, within their powers, carry out an evaluation of the budget programs efficiency, at all stages of the budget process, which provides measures for monitoring, analysis and control over the targeted and efficient use of public funds. The evaluation of the budget programs efficiency is based on the analysis of performance indicators for budget programs, as well as on other information contained in the budget requests, cost estimates, budget program passports, reports on the budgets implementation and reports on the budget programs implementation. Organizational and methodological principles of evaluating the effectiveness of budget programs are determined by the Ministry of Finance of Ukraine.

6.2. MONITORING AND AUDIT

The monitoring of compliance with budget legislation, audit and evaluation of budget funds management in accordance with the legislation are also carried out at all stages of the budget process.

Monitoring of compliance with budget legislation is aimed at ensuring efficient and effective budget funds management and is carried out at all stages of the budget process by the participants in accordance with this Code and other legislation and also provides:

- 1) assessment of the budget funds management (including carrying out public financial audit);
- 2) accuracy of accounting records and the reliability of financial and budget reporting;
- 3) achievement of budgetary savings, intended use of budget funds, effectiveness and efficiency in the activities of budget funds managers, by taking reasonable management decisions;
- 4) carrying out of analysis and assessment of financial and economic activities of the budget funds managers;

- 5) prevention of violations of budget legislation and ensuring the state interests in the management of state property objects;
- 6) justification of planning the budget revenues and expenditures.

The budget funds managers, represented by their directors, organize internal control and internal audit, as well as ensure their implementation in their institutions and in subordinate budget institutions. The internal control is a set of measures applied by the director to ensure the compliance with the law and effectiveness in the use of budget funds, achievement of results, in accordance with the established goals, objectives, plans and budget requirements of the institution and budget institutions subordinate to it. The internal audit lies in activities of the internal audit unit in the public institution, aimed at improving the management system, preventing the facts of illegal, inefficient and ineffective use of budget funds, occurrence of errors or other defects in the activities of the budget institution and budget institutions subordinate to it, improving internal controls. The basic principles of internal control and internal audit and the procedures for establishing internal audit units are determined by the Cabinet of Ministers of Ukraine.

The powers of state financial control bodies to monitor compliance with budget legislation include the control over:

- 1) targeted and efficient use of local budgets (including carrying out the state financial audit);
- 2) targeted use and timely repayment of credits (loans) obtained under local warranty;
- 3) reliability of determining the need of budget funds in the preparation of the planned budget indicators;
- 4) compliance of budgetary commitments undertaken by the budget funds managers with the corresponding budget appropriations, the budget program passport (in case of program budgeting in the budget process); compliance of long-term commitments undertaken by the budget funds managers for the energy services with the terms of energy services purchase, approved in established order;
- 5) maintaining accounting records and preparation of financial and budget reporting, budget program passports and reports on their performance (in the case of program budgeting in the budget process), cost estimates and other documents used in the implementation of the budget;
- 6) state of internal control and internal audit at the budget funds managers.

6.3. FISCAL INFORMATION SYSTEMS, ACCOUNTING RULES

The total sum of national and local taxes and charges levied according to the procedure established by the Tax Code of Ukraine makes up the tax system of Ukraine.

The tax system of Ukraine could be represented as three main subsystems:

- subsystem for taxation of legal entities
- subsystem for taxation of individuals
- charges of State targeted funds.

All these subsystems are closely interrelated. They consist of the same structural elements: direct taxes; indirect taxes; and other taxes and charges.

A new Tax Code of Ukraine was enacted on 1 January 2011 (dated 2 December 2010, No. 2755-VI). It has significantly changed the system of taxation in Ukraine. The new Code voided a number of Laws of Ukraine, Decrees of the Cabinet of Ministers of Ukraine, Resolutions of the Verkhovna Rada of Ukraine, and Edicts of the President of Ukraine. The new Code has changed the number and makeup of national and local taxes and charges. According to the Tax Code, there are 11 taxes and charges, including seven national and four local ones levied in Ukraine today.

The national taxes include:

- corporate profit tax;
- personal income tax;
- value-added tax;

- excise tax;
- ecological tax;
- rent payment;
- duty.

The local taxes and charges include:

- property tax;
- single tax;
- motor vehicle parking charge;
- tourist charge.

Implementation of the national tax policy and State customs policy is entrusted to the State Fiscal Service of Ukraine (SFS). In its activities, SFS is working with the civil society institutions, ensures public participation in implementation of the State policy in the SFS activity areas, and informs the public about its operations. The SFS official website (<http://sfs.gov.ua/>) publishes information about all aspects of Ukraine's fiscal system, rules, procedures, forms, and clarifications regarding their use.

The main statutory document, which regulates the procedure of book-keeping in Ukraine, is the Law "On Accounting and Financial Reporting in Ukraine", No. 996-XIV adopted on 16 July 1999. The principles and methods of accounting and financial reporting in Ukraine have been approved by the national accounting provisions/standards (AP/S). The Ukrainian standards are not contrary to international standards, and present, essentially, their individual case adapted to the specific national features of conducting business in Ukraine. These standards are intended for designating the procedure of accounting transactions of all legal entities registered in Ukraine, irrespective of their organizational and legal form and the form of ownership, as well as representative offices of foreign companies, which are required to keep accounts based on the national standards. The national accounting standards have been in use in Ukraine as of 1 January 2000. There are two National Accounting Provisions/Standards and 29 Accounting Provisions/Standards approved in Ukraine today.

The Methodological Accounting Board, an advisory body to the Ministry of Finance of Ukraine, is responsible for the development of accounting standards in Ukraine.

The developed standards are approved by the Ministry of Finance, while the standards related to accounting in banks are approved by the National Bank of Ukraine.

The key documents in the system of accounting regulation in Ukraine also include a chart of accounts and its use instructions. The Methodological Accounting Board under the Ministry of Finance has approved the following:

- Chart of accounts for book-keeping of assets, capital, obligations, and business transactions of enterprises and organizations;
- Instructions for use of the Chart of accounts for book-keeping of assets, capital, obligations, and commercial transactions of enterprises and organizations;
- Chart of accounts for book-keeping of government-funded institutions;
- Procedure for use of the Chart of accounts for book-keeping of government-funded institutions;
- Regulation on the procedure of accounting of individual assets and transactions of State-owned and municipal enterprises and other organizations, which own and/or use State-owned or municipal facilities;
- Chart of accounts for book-keeping in Ukrainian banks;
- Chart of accounts for book-keeping of assets, capital, obligations, and commercial transactions of small business entities.

Transparency of budgets, reports, availability of fiscal data

The legislative framework for ensuring budget transparency and engagement of citizens in Ukraine is represented by the following legislative and regulatory acts:

- Constitution of Ukraine (Articles 34, 95, 97)
- Budget Code of Ukraine (Articles 7, 28)
 - According to Article 7 of the Budget Code of Ukraine, the core principles of the budget system of Ukraine include the principles of openness and transparency;
 - Article 28 of the Budget Code of Ukraine guarantees the availability of budget information.
- Law of Ukraine of 2 October 1992, No. 2657-XII “On Information”;
- Law of Ukraine of 21 May 1997, No. 280/97-BP “On Local Self-Government” (Articles 3, 13, 42);
- Law of Ukraine of 13 January 2011, No. 2939-VI “On Access to Public Information”.

To meet the Budget Code requirements vis-à-vis availability and transparency of budget information, as well as for promoting citizen participation in the budget process, the following methods are used in Ukraine today:

- providing information about the budget and budget issues in mass media outlets;
- posting information about the budget on websites, including on official websites of the Verkhovna Rada of Ukraine, Ministry of Finance of Ukraine, Accounting Chamber of Ukraine and State Treasury Service of Ukraine.

In addition, a Draft Law “On Openness in Using Public Funds” No. 0949 of 27 November 2014 was developed, which envisages the creation of a single web portal on the use of public funds.

This legislative draft proposes to require that the spending units of the State and local budgets, State and municipal economic entities, funds of mandatory State insurance and Pension Fund offices shall make public on a quarterly basis, on a special unified web portal dedicated to highlighting the use of public funds, the information about any planned and actual use of public funds, in particular, under contracts and for official travel. The format for such information shall be approved by the Cabinet of Ministers of Ukraine.

A unified web portal on using public funds shall be set up for the promulgation of said information; such web portal shall be an official State information Internet resource, which will publish information according to this Law. The information published on the unified web portal on using public funds shall be State property and shall be available to the general public free of charge.

Local financial management capacity

Within the scope of their competence, local governments have the right to independently decide on any issues of local significance in order to ensure socio-economic development of their territories, with the State guaranteeing the realization of those rights by allocating financial resources for that purpose. The decisive place among the financial resources accumulated in the respective territory shall be granted to the centralized pool of funds, i.e., the local budget, whose amount directly determines the real scope of powers of local governments, which could be realized within the current budget period.

Local governments have their dedicated financial base. Article 142 of the Constitution states that the material and financial base of local governments shall include movable and immovable property, revenues of local budgets, other funds, land and natural resources owned by the territorial communities of villages, settlements, cities, city districts, as well as their joint properties managed by raion and oblast councils.

Therefore, local government responsibilities include: management of the property owned by the territorial community; development, approval, and execution of its budget based on the unified tax and budget policy of Ukraine; development, approval, and implementation of local programs on issues of socioeconomic and cultural development, rational use of natural resources, and environmental protection in accordance with national programs, etc.

The Constitution grants to local governments the right to approve the budgets of relevant levels, establish local taxes and charges according to the law, etc. Local councils also have the authority to approve their own budgets, which are made up of resources of the State Budget of Ukraine for their appropriate distri-

bution among territorial communities or for implementation of joint projects, and the funds attracted on contractual basis from local budgets for implementation of joint socioeconomic and cultural programs, and to supervise their implementation.

Strong and missing areas of the management of local finances			
National systems, level of decentralization, with reference to the Rec (2004)		Local self-government authorities: with reference to the Rec (2004)	
Area No.1.....	Rec. (2004). No. x	Area No. 1 Technical capacities for the budget drafting procedure	Rec. (2004). No. 46, 57, 58
		Area No. 2 Analytic data make the budget more understandable (transparent)	Rec. (2004). No. 47
		Area No. 3 Discussion on the preparation of decisions on implementation of investment projects and other important programs	Rec. (2004). No. 50, 59, 71

Chapter 7

Implementation of local finances benchmarking

7.1. INFORMATION, DATA FILES FOR COMPARISON

A. Potential sources of aggregate data and statistics needed for local finances benchmarking research is contained in the following sources and are not limited to:

a) Normative sources of the state level:

- Legislation on legislative activities;
- Legislation on local self-government bodies activities;
- The Tax Code of Ukraine;
- The Budget Code of Ukraine;
- Other legislation on local budgets;
- Regulations concerning local taxation;
- Regulations concerning pricing;
- The program of social and economic and cultural development of Ukraine for the planned and forecast periods;
- Regulations governing the sale of land;
- Regulations governing procurement agreements with private investors and business partners;
- CMU Resolutions, presidential decrees, orders of ministries and departments;

This information is public information.

b) Normative legal acts of the local level:

- Decisions on local budgets;
- Decisions on amendments to the budget;
- Decisions of the local council concerning rates of local taxes and fees, as well as benefits;
- Regulations on the target funds establishment;
- Decision on approval of the local target and complex programs;
- Procedures and acts of local self-government bodies on issues of information technologies and their implementation;
- Programs of social, economic and cultural development
- Strategy of the region, territory development;
- Foundations and principles of local strategies and policies;
- Regulations on the activities of local executive bodies;
- Decisions of the local council concerning the allocation of funds.

The majority of this information is public information.

B. Disaggregated information and data on the budgets of the local self-governments, revenue sources are contained in the following sources and are not limited to:

- Audit reports and inspection acts of supervisory bodies and the Accounting Chamber;
- Local tax statistics;
- Indicators of service quality;
- Budget requests of the main managers and of the local budgets managers;

- Budget program passports and reports on their implementation;
- Documents on budget issues, approved at the local level (other than regulatory acts);
- Minutes of meetings;
- National and local information systems;
- Ways and means of public information;
- Reports of the State Treasury of Ukraine, a report on the network, staff and contingents of budgetary institutions;
- Agreement on co-financing;
- Monthly budget drafting;
- Long-term financial plan;
- Minutes of meetings of advisory committees, working groups, etc.
- Instructions for completing the budget documents for managers;
- Information on budget issues for the deputies;
- Procedure for initiating and holding consultations concerning budget hearings;
- Minutes and resolutions of public hearings;
- Suggestions and calculations of financial needs for implementation of Public Private Partnership (PPP);
- Projects and reports on the implementation of PPP agreements;
- Plans for local economic development;
- Contracts with business partners in support of the infrastructure development in the region and territory;
- Educational materials that explain, in particular, the questions of conflict of interest, issues of civil servant ethics, etc.
- Provisions and reporting on the presence of conflict of interest;
- Manuals on issues of problematic situations of public procurement, accounting and reporting, with illustration of the typical situations;
- Media reviews (local publications, local television and radio broadcasting);
- Internet publication;
- Digests and publications of local means of public relations;
- Records and phonograms of public discussion on the draft budget.

This information is not public information. To obtain it one will need to submit additional inquiries, which might be processed. There is a possibility that such data will not be provided.

7.2. PROBLEMS AND OBSTACLES ON THE WAY OF THE IMPLEMENTATION OF LOCAL FINANCES BENCHMARKING

1. Despite the ongoing preparatory work before the direct site visits (analysis of the Internet resources of cities and filling of the statistical tables, developed by them), the representatives in the majority of cities are not prepared in full (no information on certain parameters). The absence of such information in one administration / department is caused by the fact that the evaluation system of local finances encompasses almost all areas of the activities of local self-governments and, accordingly, branching of their structural subdivisions responsible for one or another indicator led to delays in time in completing the questionnaire.

2. For some research indicators, there may be observed a certain lack of identity of their understanding of each region or territory. At the same time, there are indicators that illustrate significant differences and are able to distort the results of research (i.e. among them can be named "Average annual revenues from parking fees for one parking place", "The volume of tax on personal income per 1 resident of working age population, compared to the national average", "Percentage of employees of a local self-government body and its structural subdivisions, who were trained in the previous year", "Investments amount in the main capital per resident", "A set of the budget tables with an explanation in the explanatory memorandum to the draft budget and a report on the local budget implementation", "Availability of programs to support

entrepreneurship, business incubator”, etc.). Such differences are characterized by the construction of a system of relations between the state and local budgets and the centralization of powers that takes a sufficient place in Ukraine.

3. According to results of evaluation and scoring, there is a threat of getting not sufficiently objective information that generally is caused by the imperfect criterial parameters of benchmarking.

4. The general principles of the methodology and the adaptation programs (national and local) of the set of tools of local finances benchmarking should be implemented in the most appropriate method of questioning, according to the following form:

7.3. FURTHER QUESTIONS

A. Government units, national agencies, independent bodies, civic organizations possibly interested in hosting the benchmarking programme.

The parties interested in LFB at the central level may include the Ministry of Finance of Ukraine, the Ministry of Economic Development and Trade of Ukraine and the Ministry of Regional Development, Construction and Housing and Communal Services of Ukraine. As regards civic organizations, the results of LFB implementation will be useful for the Association of Ukrainian Cities and the Association of Ukrainian Towns.

B. Availability of information, disaggregated data

The summarized statistical information is published on the website of the State Statistics Service of Ukraine (<http://www.ukrstat.gov.ua/>). Its territorial offices could provide more disaggregated statistical information.

All the information on budget execution envisaged by Article 28 BCU is public information and shall be published. At the same time, the data on execution of local budgets by region and by level of budget are not made public. To obtain information for a specific local budget one will have to approach the respective local financial authority or a local office of the Treasury Service of Ukraine.

C. Publicity of and access to local internal documents (rules and procedures, resolutions, decrees, budgets, audit reports, etc.)

This information is not public information. To obtain it one will have to make additional inquiries, which might be processed. It is possible that such data will not be provided.

D. Local technical capacity to manage external evaluation of local finances

According to the existing legislative provisions, local authorities may conduct their own evaluation and analysis of the status of local finance. At the same time, the obligation to conduct such a procedure and its clear rules are not set by legislation. External evaluation is only carried out by supervisory bodies (State Financial Inspectorate of Ukraine, Accounting Chamber of Ukraine, etc.). There is practically no independent evaluation on the status of local finance in Ukraine (individual instances of conducting audit of local budgets are possible, however, only “rich” cities can afford to implement such procedures).

E. Election years (parliamentary, local)

The next presidential election is scheduled for 31 March 2019.

The next election to the Verkhovna Rada of Ukraine will take place in 2019.

The next local election is scheduled for late October 2015. However, it is not yet decided whether the election will be held according to the current law on the mixed election system or a proportional system will be introduced with open lists, or the election will be moved to next spring altogether. Besides, the constitutional reform could influence the timeline and choice of the election system. For example, according to the Draft Law on amending the Constitution of Ukraine (regarding decentralization of government) No.

2217 of 1 July 2015, the next scheduled local election (the election of community chairpersons, deputies of community councils, raion and oblast councils) will take place on the last Sunday of October 2017.

Guidance and programme for adapting the (national and local) LFB toolkit

- options for raising central and local government public interest for LFB

It is necessary to conduct a powerful information campaign regarding the opportunities and benefits of LFB implementation. Roundtables and trainings on LFB will need to be conducted at the central level and support secured from top officials of central government agencies. Without such support it will be difficult to implement a full-scale LFB implementation in Ukraine.

- major ongoing local government reform and modernization programs

Implementation of the constitutional reform with regard to decentralization of government, administrative-territorial reform (consolidation and creation of territorial communities), budget reform (a new system of inter-budget relations and distribution of powers between levels of the budget system, decentralization).

- potential partners for hosting the future LFB programme (national, local)

Such partners could include the Ministry of Finance of Ukraine, the Ministry of Economic Development and Trade of Ukraine and the Ministry of Regional Development, Construction and Housing and Communal Services.

- potential local sources of financing LFB programme

Local budgets in Ukraine are very limited in their financial resources at present. It will be very difficult for them to find an opportunity of financing the LFB. Grant support by international donors will need to be provided for LFB implementation. If LFB demonstrates its efficiency and usefulness, then legislative provisions could be subsequently adopted to mandate LFB implementation with appropriate financing from local budgets. However, we would like to reiterate that LFB financing from local budgets in the present environment will be very difficult (virtually impossible).

ANNEXES

Annex 1. Composition of general fund revenues of the budgets of the cities of republican (the Autonomous Republic of Crimea) and regional significance, the cities of Kyiv and Sevastopol, district budgets, budgets of combined territorial communities, villages, towns and cities of district significance

A) Taxes:

40 percent of tax on personal income paid (transferred) in the territory of the city of Kyiv and credited to the budget of Kyiv; 100 percent of tax on personal income, paid (transferred) in the territory of the city of Sevastopol and credited to the budget of Sevastopol;

The excise tax on implementation by business entities of retail trade of excisable goods, payable to the budget of the combined territorial communities and city budgets;

0 percent of corporate income tax (other than income tax of state-owned enterprises and tax under paragraph 18 of this Article, paragraph 1-2 of Article 66 and paragraph 2 of Article 69 of this Code), which is credited to the budget of the city of Kyiv;

Corporate Income Tax and financial institutions of municipal property. Corporate income tax and financial institutions of municipal property, founded by the district and city councils, combined territorial communities, credited, respectively, to regional, municipal budgets, and the budgets of combined territorial communities;

Property tax, payable to local self-government budgets;

Harmonized tax, credited to local self-government budgets;

25 percent of the environmental tax that is paid (transferred) in the respective territory and credited to the budgets of the cities of republican (the Autonomous Republic of Crimea) and regional significance, to the budgets of combined territorial communities; 80 percent of the environmental tax that is paid (transferred), according to the Tax Code of Ukraine, in the cities of Kyiv and Sevastopol and credited, accordingly, to the budgets of Kyiv and Sevastopol;

B) Non-tax revenues:

State fee, payable to local self-government budgets at the location of committing acts and issuing documents;

Funds from the sale of ownerless property (including such property, which has been refused by its owner or recipient), findings, inherited property (in the absence of heirs by will and by law, of removal of their right to inheritance, of rejection of their heritage, and of rejection of acceptance), property obtained by a territorial community by inheritance or gift, as well as currency values and funds, the owners of which are unknown;

Part of the net income (profit) of municipal unitary enterprises and associations, being expropriated to the budget in the manner specified by relevant local councils;

Penalties for violation of legislation on the patenting;

Administrative fines and penalties for violation of legislation on production and turnover of alcohol and tobacco products payable at the location of committing the violation;

Administrative penalties imposed by the local executive authorities and executive bodies of local councils or formed by them in the established order by the administrative commissions;

Penalties due to non-fulfillment of contracts with business entities for the purchase of goods and services at the expense of local budgets, concluded with the manager of budget funds;

Funds received from bidders, according to procurement procedures, to ensure their competitive bidding proposals that are not subject to return to these bidders in cases provided by the Law of Ukraine "On public procurement", in terms of implementation of procurement from the budgets of the combined territorial communities, district and city budgets;

Funds received from the winning bidder of the procurement procedure at the conclusion of the purchase agreement, as the enforcement of this agreement, that are not subject to return the winning bidder, in terms of implementation of procurement from the budgets of the combined territorial communities, district and city budgets;

80 percent of funds received by enterprises, institutions and organizations, kept by budgets of the combined territorial communities, district and city budgets, in gold, platinum, platinum group metals, precious stones, deposited in the form of scrap and waste, and 50 percent of funds received by those enterprises, institutions and organizations for silver deposited in the form of scrap and waste;

C) Payments and fees:

50 percent of rent payments for special use of forest resources in form of timber, harvested in the procedure of final felling, credited to the municipal budgets of Kyiv and Sevastopol cities;

50 percent of rent payments for special use of water resources (excluding rent payments for special use of water from water bodies of local significance), credited to the budgets of Kyiv and Sevastopol cities by users of water at the place of its intake;

25 percent of rent payments for the use of subsoil for extraction of mineral resources of national importance (excluding rent payments for use of subsoil for the extraction of oil, natural gas and gas condensate) that are included to the budgets of Kyiv and Sevastopol cities;

Fees for the use of other natural resources, credited to the budgets of Kyiv and Sevastopol cities;

Fees for parking vehicles, credited to the budgets of local self-government;
Tourist tax, credited to the budgets of local self-government;
Fees for licenses for certain types of entrepreneurial activity and certificates issued by the district state administrations, executive bodies of local councils, which are credited, respectively, to regional budgets and the budgets of local self-government;
Fees for licenses and certificates, credited to the budgets of Kyiv and Sevastopol cities by the licensees at the location of activity implementation;
Fees for the license to manufacture ethyl, cognac and fruit alcohol, rectified ethyl grape alcohol, rectified ethyl fruit alcohol, grape crude alcohol, fruit crude alcohol, alcoholic beverages and tobacco products, credited to the budgets of Kyiv and Sevastopol cities by the licensees at the location of activity implementation;
Fees for licenses for the right to import, export and wholesale trade of ethyl, cognac and fruit alcohol, rectified ethyl grape alcohol, rectified ethyl fruit alcohol, grape crude alcohol, fruit crude alcohol, credited to the budgets of Kyiv and Sevastopol cities by the licensees at the location of activity implementation;
Fees for licenses for the right to import, export of alcoholic beverages and tobacco products, credited to the budgets of Kyiv and Sevastopol cities by the licensees at the location of activity implementation;
Fees for state registration (except the administrative fee for the state registration of legal entities and individuals - entrepreneurs), credited to the budgets of Kyiv and Sevastopol cities;
Fees for licenses for the right to the wholesale trade of alcoholic beverages and tobacco products, payable to the budgets of Kyiv and Sevastopol cities by the licensees at the location of activity implementation;
Fees for licenses for the right to the retail trade of alcoholic beverages and tobacco products, credited to the budgets of Kyiv and Sevastopol cities by the licensees at the location of activity implementation;
Revenues from rent for the use of property complexes and other property that is in municipal property, founded by the district and city councils and combined territorial communities;
Rent payments for the use of subsoil for extraction of mineral resources of local importance; rent payments for the use of subsoil for purposes not related to extraction of mineral resources; rent payments for special use of water from water objects of local importance; rent payments for special use of forest resources. Such payments are credited to the local budgets at the location (placement) of the natural resources or water bodies - the place of registration of the rent taxpayer;
Fees for placement of temporarily free funds of local budgets (excluding the funds received by higher and vocational education institutions from depositing temporarily free budget funds received for providing paid services, if such institutions legally have the corresponding right);
Rent payments for the water bodies (or parts thereof) provided for use under lease by the district, Kyiv and Sevastopol city state administrations, local councils, credited accordingly to district budgets, local self-government budgets;
Concession fees for municipal property objects founded by the district and city councils and combined territorial communities;
Fees for the provision of other administrative services, charged at the place of service provision.

Annex 2. Composition of general fund revenues of the budget of the Autonomous Republic of Crimea and oblast budgets

A) Taxes:

15 percent of tax on personal income paid (transferred) in the relevant territory;

10 percent of corporate income tax;

Corporate Income Tax and financial institutions of municipal property. Corporate income tax and financial institutions of municipal property, founded by the Verkhovna Rada of the Autonomous Republic of Crimea and oblast councils, credited, respectively, to the budget of the Autonomous Republic of Crimea and oblast budgets;

The excise tax on excisable goods (products) manufactured in Ukraine, which is paid by taxpayers registered in the Autonomous Republic of Crimea to the budget revenues of the Autonomous Republic of Crimea;

55 percent the environmental tax;

B) Non-tax revenues:

Part of the net income (profit) of municipal unitary enterprises and associations, being expropriated to the budget in the manner specified by the Verkhovna Rada of the Autonomous Republic of Crimea and oblast councils;

Administrative penalties imposed by the local executive authorities and executive bodies of local councils or formed by them in the established order by the administrative commissions;

Penalties, due to non-fulfillment of contracts with business entities for the purchase of goods and services at the expense of the budget of the Autonomous Republic of Crimea and oblast budgets, concluded with the manager of budget funds;

Revenues from rent payments for the use of property complexes and other property that is in municipal ownership founded by the Verkhovna Rada of the Autonomous Republic of Crimea and oblast councils;

Concession fees for communal property founded by the Verkhovna Rada of the Autonomous Republic of Crimea and oblast councils (except for concession fees referred to in paragraph 3 of Article 69-1 of this Code);

Funds received from bidders, according to procurement procedures, to ensure their competitive bidding proposals that are not subject to return to these bidders in cases provided by the Law of Ukraine "On public procurement", in terms of implementation of procurement from the budget of the Autonomous Republic of Crimea and oblast budgets;

Funds received from the winning bidder of the procurement procedure at the conclusion of the purchase agreement, as the enforcement of this agreement, that are not subject to return the winning bidder, in terms of implementation of procurement from the budget of the Autonomous Republic of Crimea and oblast budgets;

80 percent of funds received by enterprises, institutions and organizations, kept by the budget of the Autonomous Republic of Crimea and oblast budgets, in gold, platinum, platinum group metals, precious stones, deposited in the form of scrap and waste, and 50 percent of funds received by those enterprises, institutions and organizations for silver deposited in the form of scrap and waste;

C) Payments and fees:

50 percent of rent payments for special use of forest resources in form of timber, harvested in the procedure of final felling;

50 percent of rent payments for special use of water resources, credited to the budget of the Autonomous Republic of Crimea and oblast budgets by users of water at the place of its intake;

25 percent of rent payments for the use of subsoil for extraction of mineral resources of national importance;

Fees for the use of other natural resources, credited to the budget of the Autonomous Republic of Crimea and oblast budgets;

Rent payments for the water bodies (or parts thereof) provided for use under lease by the Verkhovna Rada of the Autonomous Republic of Crimea and oblast state administrations, credited, accordingly, to the budget of the Autonomous Republic of Crimea and oblast budgets;

Fees for placement of temporarily free funds of the budget of the Autonomous Republic of Crimea and oblast budgets (excluding the funds received by higher and vocational education institutions of depositing temporarily free budget funds received for providing paid services, if such institutions legally have the corresponding right);

Fees for licenses for certain types of entrepreneurial activity and certificates issued by the Verkhovna Rada of the Autonomous Republic of Crimea and oblast state administrations, which are credited, respectively, to the budget of the Autonomous Republic of Crimea and oblast budgets;

Fees for licenses and certificates, credited to the budget of the Autonomous Republic of Crimea and oblast budgets by the licensees at the location of activity implementation;

Fees for the license to manufacture ethyl, cognac and fruit alcohol, rectified ethyl grape alcohol, rectified ethyl fruit alcohol, grape crude alcohol, fruit crude alcohol, alcoholic beverages and tobacco products, credited to the budget of the Autonomous Republic of Crimea and oblast budgets by the licensees at the location of activity implementation;

Fees for licenses for the right to import, export and wholesale trade of ethyl, cognac and fruit alcohol, rectified ethyl grape alcohol, rectified ethyl fruit alcohol, grape crude alcohol, fruit crude alcohol, credited to the budget of the Autonomous Republic of Crimea and oblast budgets by the licensees at the location of activity implementation;

Fees for licenses for the right to import, export of alcoholic beverages and tobacco products, credited to the budget of the Autonomous Republic of Crimea and oblast budgets by the licensees at the location of activity implementation;

Fees for state registration (except the administrative fee for the state registration of legal entities and individuals - entrepreneurs), credited to the budget of the Autonomous Republic of Crimea and oblast budgets;

Fees for licenses for the right to the wholesale trade of alcoholic beverages and tobacco products, payable to the budget of the Autonomous Republic of Crimea and oblast budgets by the licensees at the location of activity implementation;

Fees for licenses for the right to the retail trade of alcoholic beverages and tobacco products, credited to the budget of the Autonomous Republic of Crimea and oblast budgets by the licensees at the location of activity implementation.

Annex 3. Composition of special fund revenues of local budgets

Budget development revenues of local budgets (are defined by Part 1 of Art. 71 of the Budget Code);

Funds from the compensation of loss of agricultural and forestry production, payable at a rate of 100 percent - to the budgets of Kyiv and Sevastopol cities, 25 percent - to the budget of the Autonomous Republic of Crimea and oblast budgets, 75 percent - to the budgets of the cities of republican (the Autonomous Republic of Crimea) and regional significance, to the budgets of combined territorial communities created under the law and the perspective plan of formation of the communities' territories, 15 percent - to the *raion* (district) budgets, 60 percent - to the budgets of towns of district importance, settlements and villages;

Concession fees for municipal property objects that have targeted use according to law;

70 percent of monetary penalties for damage caused by violation of the law on environment protection as a result of economic and other activities, including: to the village, settlement and city budgets, to the budgets of combined territorial communities created under the law and the perspective plan of formation of the communities' territories - 50 percent, to the oblast budgets and to the budget of the Autonomous Republic of Crimea - 20 percent, to the budgets of Kyiv and Sevastopol cities - 70 percent;

Deduction of 10 percent of the cost of drinking water by the subjects of entrepreneurial activity who carry out drinking water through centralized water supply system with deviation from the relevant standards, which are credited to the budgets of cities, settlements and villages, to the budgets of combined territorial communities created under the law and the perspective plan of formation of the communities' territories;

Own revenues of budgetary institutions financed from the relevant local budget;

Targeted and voluntary contributions of enterprises, institutions, organizations and citizens in the Autonomous Republic of Crimea and local funds of environmental protection;

Revenues of the target funds, established by the Verkhovna Rada of the Autonomous Republic of Crimea and the local councils;

Subventions provided from other budgets at the expense of specifically identified revenues of the special fund of such budgets;

Repayment of loans granted from local budgets;

Revenues as part of aid programs and grants from international financial institutions and the European Union.

Annex 4. Budget development revenues of local budgets (capital income)

Dividends (income) accrued on shares (participatory interests, equity units) of economic companies, which have in their share capital the property of the Autonomous Republic of Crimea or municipal property;

Charges for provision of local guarantees;

Costs of share participation to develop the infrastructure of a populated place;

10 percent of funds from the use (sale) of manufactured products, which remain in the state property under production sharing agreements, and / or funds in the form of monetary equivalent of such a state part of production, distributed between local budgets of administrative and territorial units on whose territory the relevant subsoil area is situated, in the following proportions: 5 percent - to the budget of the Autonomous Republic of Crimea or oblast budgets; 3.5 percent - to the *raion* (district) budgets; 1.5 percent – to the city, settlement or village budget. If the subsoil area is located on the territory of several administrative and territorial units, the costs between respective local budgets are distributed within the specified ratio according to the procedure established by the Cabinet of Ministers of Ukraine;

Proceeds from the sale of property belonging to the Autonomous Republic of Crimea, and property located in the municipal property, including funds from the sale of non-agricultural land or rights to ownership to them;

90 percent of funds from the sale of non-agricultural land or rights to ownership to them, which are in state ownership prior the separation of state and municipal property (other than non-agricultural land in state ownership, on which the facilities subject to privatization are located), while, from the sale of land plots located on the territory of the Autonomous Republic of Crimea, 35 percent are credited to the budget of the Autonomous Republic of Crimea, 55 percent - to the village, settlement and city budgets of the Autonomous Republic of Crimea;

Capital transfers (subventions) from other budgets;

Funds from the repayment of loans granted from the corresponding budget and interest paid for their use;

Local borrowings;

Funds transferred from another part of the local budget by decision of the Verkhovna Rada of the Autonomous Republic of Crimea, of the corresponding local council (regarding funds of the reserve fund of the local budget in terms of budget expenditures - by decision of the Council of Ministers of the Autonomous Republic of Crimea, local state administration, the executive body of the relevant local council).

Annex 5. Local budget expenditures envisaged in the legislation on social protection of population carried out at the expense of subventions from the state budget to local budgets for the implementation of government programs of social protection.

At the expense of subventions from the state budget to local budgets for provision of benefits and housing subsidies for purchasing solid and liquid household fuel and liquefied gas, privileges are granted on the basis of calculating the cost of one ton of solid fuel and a cylinder of liquefied gas per household per year, and for the persons who have such a right under Article 48 of the Mining Law of Ukraine, an estimated cost of 3.1 tons of coal or peat briquettes for household needs per household per year. Threshold value of solid and liquid household furnace fuel and liquefied gas in the context of the Autonomous Republic of Crimea, Kyiv and Sevastopol are determined by the Cabinet of Ministers of Ukraine.

The local executive authorities and the local self-government bodies have the rights as follows:

To establish standards for increased purchase of solid and liquid household fuel and liquefied gas to persons who are entitled to benefits and housing subsidies in accordance with the legislation at the expense and within the funds of local budgets; to provide privileges for solid and liquid household furnace fuel and liquefied bottled gas in its natural form or in cash.

Natural norms of providing the population with solid and liquid household furnace fuel and liquefied gas, according to which the population will be provided benefits and housing subsidies to reimburse the expenses for their acquisition, shall be approved by the Council of Ministers of the Autonomous Republic of Crimea, oblast, Kyiv and Sevastopol city state administrations within minimum norms and their value thresholds established by the Cabinet of Ministers of Ukraine, based on the amount of funds allocated for this purpose.

At the expense of subventions from the state budget to local budgets for provision of benefits and housing subsidies for electricity, natural gas, heat, water supply and drainage, rent (maintenance of houses and buildings and houses adjoining areas), removal of domestic waste and liquid sewage, housing subsidies are provided to the population and benefits to War Veterans; to persons who are under the scope the Law of Ukraine "On Status of War Veterans, guarantees of their social protection"; to persons who have special merits before the Motherland; to widows (widowers) and parents of perished (died) persons having special merits before the Motherland; to persons with special labor merits before the Motherland; to widows (widowers) and parents of perished (died) persons having special labor merits before the Motherland; to victims of Nazi persecution; to Military Service Veterans; to Veterans of Internal Affairs; to Tax Police Veterans; to Veterans of the State Fire Service; to Veterans of the State Penal Service; to Veterans of Civil Protection Service; to Veterans of the State Service for Special Communications and Information Protection of Ukraine; to widows (widowers) of perished (died) Military Service Veterans, Veterans of Internal Affairs, Tax Police Veterans, Veterans of the State Fire Service, Veterans of the State Penal Service; Veterans of Civil Protection Service; Veterans of the State Service for Special Communications and Information Protection of Ukraine; to personnel of the Security Service of Ukraine dismissed from service due to age, illness or superannuation, to militia officers, to persons of commanding structure of the Tax Police, to ordinary staff and officers of the State Penal Service; to persons dismissed from the Civil Protection Service due to age, illness or superannuation, and who became disabled while performing official duties; to pensioners from among the investigating prosecutors; to children (under the age of majority) of militia personnel, officers of the Tax Police, to ordinary staff and officers of the State Penal Service, killed or died while performing official duties, to disabled family members who were dependent on them; to persons discharged from military service who became disabled during military service; to parents and family members of military personnel, military personnel of the State Service for Special Communications and Information Protection of Ukraine, who perished (died) or went missing during military service; to parents and family members of the persons of ordinary staff and officers of the State Penal Service who perished (died) or went missing while performing official duties; to rehabilitated citizens who have become disabled as a result of repression or are pensioners; to citizens affected by the Chernobyl disaster; to wives (husbands) and guardians (at the time of guardianship) of children of the deceased citizens whose death is related to the Chernobyl catastrophe; to pensioners from among the Plant Protection specialists under part four of Article 20 of the Law of Ukraine "On Plant Protection"; to citizens in accordance with paragraph "i" part one of Article 77 of the Fundamentals of Legislation of Ukraine on Health Care, part five of Article 29 of the Law of Ukraine "On Culture", part two of Article 30 of the Law of Ukraine "On Libraries and Librarianship", unnumbered paragraph one part four of Article 57 of the Law of Ukraine "On Education"; to children of war; to large families, family-type orphanages and foster families, in which, accordingly, three or more children have been living for at least one year and families (except for large families), in which, accordingly, three or more children have been living for at least one year, including those under established tutelage or guardianship.

At the expense of subventions from the state budget to local budgets for provision of benefits and housing subsidies to purchase solid and liquid household furnace fuel and liquefied gas, housing subsidies are provided to the population and benefits to War Veterans; to persons who are under the scope the Law of Ukraine "On Status of War Veterans, guarantees of their social protection"; to persons who have special merits before the Motherland; to widows (widowers) and parents of perished (died) persons having special merits before the Motherland; to persons with special labor merits before the Motherland; to widows (widowers) and parents of perished (died) persons having special labor merits before the Motherland; to victims of Nazi persecution; to Military Service Veterans; to Veterans of Internal Affairs; to Tax Police Veterans; to Veterans of the State Fire Service; to Veterans of the State Penal Service; to Veterans of Civil Protection Service; to Veterans of the State Service for Special Communications and Information Protection of Ukraine; to widows (widowers) of perished (died) Military Service Veterans, Veterans of Internal Affairs, Tax Police Veterans, Veterans of the State Fire Service, Veterans of the State Penal Service; Veterans of Civil Protection Service; Veterans of the State Service for Special Communications and Information Protection of Ukraine; to personnel of the Security Service of Ukraine dismissed from service due to age, illness or superannuation, to militia officers, to persons of commanding structure of the Tax Police, to ordinary staff and officers of the State Penal Service; to persons dismissed from the Civil Protection Service due to age, illness or superannuation, and who became disabled while performing official duties; to pensioners from among the investigating prosecutors; to children (under the age of majority) of militia personnel, officers of the Tax Police, to ordinary staff and officers of the State Penal Service, killed or died while performing official duties, to disabled family members who were dependent on them; to persons discharged from military service who became disabled during military service; to parents and family members of military personnel, military personnel of the State Service for Special Communications and Information Protection of Ukraine, who perished (died) or went missing during military service; to parents and family members of the persons of ordinary staff and officers of the State Penal Service, who perished (died) or went missing while performing official duties; to rehabilitated citizens who have become disabled as a result of repression or are pensioners; to citizens affected by the Chernobyl disaster; to wives (husbands) and guardians (at the time of guardianship) of children of the deceased citizens, whose death is related to the Chernobyl catastrophe; to pensioners from among the Plant Protection specialists under part four of Article 20 of the Law of Ukraine "On Plant Protection"; to citizens in accordance with paragraph "i" part one of Article 77 of the Fundamentals of Legislation of Ukraine on Health Care, part five of Article 29 of the Law of Ukraine "On Culture", part two of Article 30 of the Law of Ukraine "On Libraries and Librarianship", unnumbered paragraph one part four of Article 57 of the Law of Ukraine

“On Education”; to children of war; to large families, family-type orphanages and foster families, in which, accordingly, three or more children have been living for at least one year and families (except for large families), in which, accordingly, three or more children have been living for at least one year, including those under established tutelage or guardianship, to persons who have such a right under Article 48 of the Mining Law of Ukraine; compensation to persons who, in accordance with Articles 43 and 48 of the Mining Law of Ukraine, have the right to free coal or peat briquettes for domestic needs, but live in homes with central heating.

At the expense of subventions from the state budget to local budgets for provision of benefits for communication services, other statutory benefits (except benefits to obtain drugs, prosthetic dentistry, for electricity, natural and liquefied gas for domestic purposes, solid and liquid household furnace fuel, heat, water supply and drainage, rent (maintenance of houses and buildings and houses adjoining areas), removal of domestic waste and liquid sewage to compensate the loss of income due to the abolition of tax on vehicle owners and other self-propelled machinery and a corresponding increase in excise tax on fuel and to compensate price reductions of individual categories of citizens, benefits are provided to War Veterans; to persons who are under the scope of the Law of Ukraine “On Status of War Veterans, guarantees of their social protection”; to persons who have special merits before the Motherland; to widows (widowers) and parents of perished (died) persons having special merits before the Motherland; to persons with special labor merits before the Motherland; to widows (widowers) and parents of perished (died) persons having special labor merits before the Motherland; to victims of Nazi persecution; to Military Service Veterans; to Veterans of Internal Affairs; to Tax Police Veterans; to Veterans of the State Fire Service; to Veterans of the State Penal Service; to Veterans of Civil Protection Service; to Veterans of the State Service for Special Communications and Information Protection of Ukraine; to widows (widowers) of perished (died) Military Service Veterans, Veterans of Internal Affairs, Tax Police Veterans, Veterans of the State Fire Service, Veterans of the State Penal Service; Veterans of Civil Protection Service; Veterans of the State Service for Special Communications and Information Protection of Ukraine; to persons discharged from military service who became disabled during military service; to disabled persons, to disabled children and to persons who accompany disabled persons of the 1st group, or disabled children (no more than one accompanying person); to pensioners from among the investigating prosecutors; to rehabilitated citizens who have become disabled as a result of repression or are pensioners; to citizens affected by the Chernobyl disaster; to wives (husbands) and guardians (at the time of guardianship) of children of the deceased citizens, whose death is related to the Chernobyl catastrophe, to large families, family-type orphanages and foster families, in which, accordingly, three or more children have been living for at least one year and families (except for large families), in which, accordingly, three or more children have been living for at least one year, including those under established tutelage or guardianship, as well as compensatory payments are provided for the preferential fares of individual categories of citizens.

The Cabinet of Ministers of Ukraine may redistribute subventions from the state budget to local budgets for the implementation of public social protection programs among their types and among local budgets, based on actual volumes of relevant accrued benefits and subsidies to the population within the total amount of subsidies.

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Local Finance Benchmarking in Belarus

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Chapter 1

Political and administrative structure

1.1. FORMS AND TYPES OF ELECTED LOCAL GOVERNMENTS

In Belarus there is one form/type of the elected local authority only. It is the Local Council as representative body of the power. The Executive Committee or executive local power is not elected. The Chairman of the Executive Committee is appointed by the President of Belarus. However, local executive committees have supremacy in local government and overwrite the elected councils' powers. Belarus accounts 118 rayons, 113 cities, 90 urban settlements, 1159 rural settlements, 23251 villages. This is illustrated in Table 1.

Table 1. Administrative and territorial units' structure

Regions/Oblasts	Administrative and territorial units						
	Rayons	Cities	incl. oblasts submission	districts in cities	urban settlements	rural settlements	villages
Brestskaya oblast	16	21	3	2	8	190	2161
Vitebskaya oblast	21	19	2	3	24	191	6262
Gomelskaya oblast	21	18	1	4	16	240	2296
Grodnenskaya oblast	17	15	1	2	16	163	2296
Minskaya oblast	22	24	1	-	18	219	5203
Mogilevskaya oblast	21	15	2	4	8	156	3015
Minsk city (capital)	-	1	-	9	-	-	-
Total:	118	113	10	24	90	1159	23251

Source: Compiled by expert on the basis of the State Committee of property of the Republic of Belarus as of 1 January 2014

In recent years the quantity of administrative and territorial units is reduced due to reduction of rural settlements, which are integrated with other municipalities of this level. Since 2008 until now the number of rural settlements is reduced to 452 units.

The Belarusian sub-national government is structured on three governmental tiers. On the first tier are six oblast governments (Brestskaya, Vitebskaya, Gomelskaya, Grodnenskaya, Minskaya, Mogilevskaya) and Minsk (capital of Belarus) city government. The second tier comprises 118 rayons and ten cities with oblast submission and finally, the third level consists of 1,351 units, including cities with rayon submission, as well as urban and rural settlements.

Table 2. Population size of elected local government units (fragmentation)

Belarus regions (oblasts)	Population size in local government units (number of local government units)						
	Less than 499	500-999	1000-4999	5000-19999	20000-49999	More than 50000	Total
Brestskaya	1	11	208	4	12	3	239
Vitebskaya	2	17	180	20	3	5	227
Gomelskaya	4	53	204	6	10	5	282
Grodnenskaya	-	7	183	6	9	3	208
Minskaya	2	28	263	15	3	4	315
Mogilevskaya	1	24	162	10	9	2	208
Minsk city (capital)	-	-	-	-	-	1	1
Total:	10	140	1200	61	46	23	1480
The share in total units (per cent)	0.7	9.5	81.1	41.1	3.1	1.6	100.0

Source: Compiled by authors on the basis of oblasts executive committees by the data of the population census of 2009

Central government agencies, responsible for local governments, are: Ministry of Economy, Ministry of Finance, Ministry of Industry, Ministry of Agriculture and Forestry.

Line and branch ministries actively participate in local government development. For example, the budgetary process for local budgets begins with the Ministry of Economy (MoE) and the Ministry of Finance (MoF). MoE develops macroeconomic indicators for regions and then transfers them to MoF for the total sub-national budget planning or the combined local budgets. The MoF sends target figures to regional finance departments, which are subordinated to MoF for oblasts budget planning. After that, oblast financial departments establish target figures for rayon local budgets planning and the cities of oblast status. In turn, rayon executive committees, together with the rayon financial department, establish parameters for local budgets of rural and urban settlements.

MoF also participates in municipalities' control. In its structure there are control - auditing divisions, which provide audits and inspections of budgetary funds used by municipalities.

Besides, oblast's financial departments can perform checks on different local finance issues and local financial management. Besides MoF and its division's inspections regarding local government finance, inspections and audits can be made by the Committee of state control. They generally are performed on all issues connected with the local government development. The Ministry of Housing, Utilities and Communal Services establishes the indicators for local budgets expenditures in the sphere of housing, utilities and communal services and then transfers them to oblast associations of housing and communal services. In turn, oblast associations of housing and communal services together with oblast financial departments are planning expenditures on housing, utilities and communal services. The Ministry of Industry, and the Ministry of Agriculture and Forestry are similarly planning expenditures on industry and agriculture purposes with the oblast financial department.

Chapter 2

Local government functions

Local government functions and responsibilities are presented below in Table 3

Table 3. Local government functions/ responsibilities in Belarus:

Local government levels:	Functions:
Cities with rayon status, rural and urban settlement municipalities (local governments of primary level)	State and local administration in settlements and cities; <i>Accomplishments (Improvement in settlements and villages);</i> Social protection: <i>social assistance</i>
Rayons and cities with oblast status (local governments of base territorial level)	State and local administration in rayons; Transport (within rayon borders) Agricultural production, fishing, and processing of agricultural production development: <i>maintenance of inter-district veterinary laboratories; maintenance of regional veterinary stations; maintenance of technical supervision bodies.</i> Maintenance of fuel and energy in the rayon; Maintenance of other economic branches and sectors; Housing, utilities and communal services: <i>street lighting; water supply; sewerage; waste removal; garbage collection; maintenance of treatment facilities; gasification (maintenance of gas pipeline networks within rayon); cleaning of streets, accomplishment in the rayon cities; maintenance and repair of housing stock; service of heating networks, capital repairs of infrastructure objects.</i> Health care: <i>out-patient clinics; polyclinics in rayon centres (rayon cities); inter-district hospitals.</i> Physical culture, sport, culture and mass media: <i>physical culture and sport development; cultural and art development; mass media; cinema.</i> Education: <i>pre-school education (kindergartens); elementary (basic) schools; secondary schools; secondary schools for children who need social assistance; boarding schools</i> Social policy: <i>social protection; youth policy;</i> Protection against emergency situations (fire protection); Public safety (within the rayon); National defense (functioning of military commissaries in rayons for recruiting)

Local government levels:	Functions:
Oblast Government (Local governments of oblast level)	State and local administration in oblasts; Transport (all types within the oblast borders); Roads maintenance of oblast submission; Agricultural production, fishing, and processing of agricultural production development; <i>melioration; processing of agricultural production.</i> Industry, energy, construction, architecture: development of fuel and energy in the oblast; maintenance of other economic branches and sectors of the national economy Housing, utilities and communal services (inter oblast utilities): <i>construction of new objects for utilities and communal services (equipment procurement); construction of treatment facilities; gasification (main gas pipelines within oblast); electrification (main power supply networks within oblast)</i> Health care: <i>oblasts hospitals; medical centres</i> Physical culture and sport development in oblasts; Cultural and art development in oblasts; Mass media; Accomplishment in cities; Environmental Education: <i>professional education (professional colleges); medium vocational education (colleges); production - technical schools; special educational institutions; cadet schools; lyceums; hospices; out-of-school education;</i> Social protection: <i>employment assistance; assistance in the provision of housing</i> Protection against emergency situations (fire protection); Public safety; National defense (functioning of military commissaries in oblasts for recruiting); Environmental

Source: Expert's list produced from the Law on Local Government and Self-Government and Minsk oblast financial department.

All Local government functions indicated here correspond to local budget expenditures. Delegation of public functions from the central government to local authorities isn't stated in the Belarusian legislation. So, in local government legislation there is no concept of delegated functions in local government practice.

All local service management belongs to the State and is regulated by organizations of the Ministry of Housing, Utilities and Communal Services. In Belarus, there are no contract forms, leasing, and concession ones. Exceptions are some condominiums in houses as the non-governmental activity for communal service provision. Services devolved to elected municipalities are absent.

The Belarusian public sector is showing high indicators, quite comparable with ones in the EU countries. For example, in 2014 the share of local government expenditures in GDP reached 18.2% and in total (consolidated) public expenditures – 62.0%. The share of local government revenues in total (consolidated) budget revenues reached 63.2%. In comparison with some Central and Eastern European and Baltic countries these indicators look higher in Belarus.

Chapter 3

Local government own and shared revenues

3.1. SCOPE AND TYPES OF LOCAL OWN SOURCE REVENUES: TAXES, USER CHARGES, FEES.

In accordance with the Budget Code local revenues are divided in two parts: tax revenues and non-tax revenues, which contain own and ceded revenues, as well. This is shown in Table below.

Types of own and ceded revenues of local governments¹

Own and ceded revenues:				Own non- tax revenues:			
Types of taxes and fees	Local budgets			Types of taxes and fees	Local budgets		
	OLB	RLB	SLB		OLB	RLB	SLB
Personal income tax (PIT);		X	X	Bank deposit interests;	X	X	X
Land tax;		X	X	Dividends;		X	X
Real estate tax;		X	X	Revenues from land sale;		X	X
Real estate tax on incomplete construction objects		X		Revenues from land rental;		X	X
Taxes on revenues:				Revenues from other property sale and rental;		X	X
• tax on lottery activity;		X	X				
• tax on revenues of foreign organisations		X					
Other taxes from sales (except VAT):				Expenditure compensations from the State;	X	X	X
• uniform tax from entrepreneurs and other individuals;	X	X	X				
• uniform tax from agricultural producers;	X	X	X				
• tax on simplified system of taxation for businessmen;	X	X	X				
Taxes and fees from separate activity:				User charges;	X	X	X
• tax on royalty;		X					
• collection from suppliers;		X	X				
• uniform trade collection;		X					
• unify imputed income tax;		X					
• charges for use of goods;	X	X	X				
Tax for possession of dogs;		X	X	Revenues from property sale;		X	X
Ecological tax;	X			Advertising fee;		X	X
Tax on production of natural resources;	X	X		Penalties;	X	X	X
Resort duty;			X				
State fee;	X	X	X				
Contributions to innovative funds	X						

Source: Compiled by expert based on the Budget Code

1. The table shows taxes and fees that are directed in local budgets: OLB – oblast budget; RLB – rayon budgets+ budgets of cities with oblast submission; SLB – rural budgets + urban budgets + budgets of cities with rayon submission.

By the assessment of local budgets in 2014, the main part of own revenues is tax revenues – 90 per cent, non-tax revenues is 10 per cent. An essential part of own tax revenues is PIT – about 70 per cent, taxes from sales - 11.3 per cent, real estate tax and land tax – about 6.5 per cent. The share of other own taxes occupies 12.2 per cent from own tax revenues.

Among the own non-tax revenues the essential ones are interests and dividends – 41 per cent, revenues from land sale and rental, property sale and rental – 22.8 per cent, and from expenditure compensations made by the State – 19.5 per cent;

The share of own revenues in sub-national budget and oblasts consolidated local budgets for 2011-2013 is shown in the following Table 4.

Table 4. Local budget financial sources' structure (in percentage)

Sub-national government budget/oblasts budgets	2011			2012			2013		
	Own and ceded taxes and fees	Shared taxes	Transfers, grants	Own and ceded taxes and fees	Shared taxes	Transfers, grants	Own and ceded taxes and fees	Shared taxes	Transfers, grants
Total Sub-national government budget	29.39	35.19	35.42	30.89	37.61	31.50	40.54	29.02	30.45
from which budgets of:									
Brestskaya oblast	29.07	24.86	46.07	31.62	25.32	43.06	34.46	22.55	42.99
Vitebskaya oblast	23.12	29.49	47.39	31.71	28.15	41.14	35.52	24.59	39.89
Gomelskaya oblast	32.29	27.61	40.10	32.62	25.99	41.39	32.88	25.12	41.99
Grodenskaya oblast	28.17	22.45	49.38	31.95	22.49	45.56	34.05	21.47	44.48
Minskaya oblast	30.16	33.20	36.64	38.66	33.88	27.46	45.47	30.22	24.30
Mogilevskaya oblast	28.45	21.32	50.23	32.40	21.51	47.09	32.97	20.15	46.88
Minsk city capital	52.52	44.97	1.51	52.40	46.18	1.42	54.84	43.92	1.25

Source: Own expert's calculations based on reports of the Ministry of Finance of the Republic of Belarus.

As Table 4 shows, the share of own and ceded taxes and fees in the analyzed period has risen from 29.39% to 40.54 and the share of transfers and shared taxes has totally decreased from 70.61% to 59.47%. Among oblast budgets the same tendency was observed as well.

3.2. LOCAL AUTONOMY IN TAX POLICY DESIGN: SETTING BASE, RATE, EXEMPTIONS

Our researches on decentralization development in Belarus allowed making a conclusion about the absence of local financial autonomy and the existence of an essential restriction in the fiscal capacity of local authorities.

As an example may be the situation in the Minsk oblast, where the regional authorities use the practice to restrict some own revenues for subordinate budgets of rayons and budgets of cities with oblast status. For example, in 2013, the assignment for personal income tax in budgets of oblast and the cities of regional status was limited by the regional authorities for local budgets of the Minski rayon, the Soligorski rayon, Soligorsk city, in size of 50 per cent from their collection in the respective territory, while for other rayon budgets and city budgets with the oblast status this normative remained at a rate of 100 per cent, i.e. this tax was completely included in the local budget. Fiscal capacities of local authorities regarding a tax on real estate, which should remain in local budgets (rayons and the cities of oblast status), were similarly limited. So, assignments from tax on real estate in the budget of the Minski rayon, Zhodino city and Soligorsk city were at a rate of 40 per cent, and in budgets of Borisov city, Zaslavl city, Molodechno city, Slutsky rayon, Soligorski rayon - at a rate of 50 per cent.

Restrictions of fiscal capacities took place on target charges, which should completely (100 per cent) be enlisted in local budgets of rayons and budgets of the cities with oblast status. In fact, assignments to local budgets of rayons and budgets of the cities with oblast status were limited up to 40 per cent for Soligorsk city and Zhodino city, 50 per cent for Minski rayon and Nesvizhsky rayon, 75 per cent for Borisov city.

3.3. CAPITAL REVENUES (ASSET SALE, RENT, PROFITS, ETC.)

In the Belarusian local budgeting practice there is no division in current budget and capital one. Capital revenues and expenditures and current ones are reflected in one budget. However, land sale and land lease, property sales, sale of the rights for rent and other capital operations take place in one budget. The capital revenues are illustrated in Table 5.

Table 5. Revenues of Belarus sub-national budgets from land sale, land rental and sale of other property in 2013 (in percentages)

Indicators:	2013
Revenues from leasing of land plots	0.21%
Revenues from leasing of other property	0.06%
Revenues from property sale, property rights on objects of intellectual property	0.37%
Revenues from sale of land plots in private ownership, non-governmental legal entities and in ownership of foreign international organisations	0.07%
The share of capital revenues in the Belarusian sub-national budgets	0.71%

Source: Own expert calculations based on reports of the Ministry of Finance of the Republic of Belarus.

As Table 5 shows, the share of capital revenues is less than 1 percent into the Belarusian sub-national budgets.

3.4. TAX SHARING: ORIGIN OR FORMULA BASED; SET RATIO OR ARBITRARY ALLOCATION RULES

In the structure of financial sources of local budgets there are shared taxes. Their existence in local financial management is inherited from the former Soviet financial system. Existence of the shared taxes is connected with the dependence of local taxes from economic conjuncture and degrees of unevenness of tax base placement of local own taxes on territories. Now, the shared taxes are used for regulating vertical and horizontal imbalances.

The shared taxes are national taxes, which share the central budget and subnational ones in portions determined by the Law on the Republican Budget. According to the Budget Code the shared taxes are: value added tax (VAT) and income tax (PT). Standards of contributions from these taxes to sub-national budgets are determined by the annual Laws on the Republican Budget. So, for 2013 the following standards of assignments from PT and VAT were established:

- PT: 50% go to sub-national budgets (the budget of the Brestskaya oblast region, the budget of Vitebskaya oblast, the budget of the Gomelskaya oblast, the budget of the Grodnenskaya oblast, the budget of the Minskaya oblast, the budget of the Mogilevskaya oblast). The other 50% go to the Central (Republican) Budget.
- VAT: 30% go to sub-national budgets, from which in the budget of Brestskaya oblast – 4.41%, in the budget of Vitebskaya oblast – 3.84%, in the budget of Gomelskaya oblast – 4.53%, in the budget of Grodnenskaya oblast – 3.36%, in the budget of Minskaya oblast – 4.47%, in the budget of Mogilevskaya oblast – 3.42%). The other 70% go to the Central (Republican) Budget. The portions / normatives of sharing are established as stable on the long term. The shared taxes (PT and VAT) received from the central budget to the oblast budgets may be distributed to the lower local budgets (rayon budgets and budgets of cities oblast submission).

In Belarus tax sharing is determined by the Budget Law annually. The sharing normatives for PT and VAT prescribed by the Budget Law are used by the oblast government in the local budget process. The shared taxes concentrate in oblast budgets and then they are sent to the rayon budgets as transfers from oblast government.

3.5. LOCAL TARIFFS, USER CHARGES:

All local tariffs are established by the central government. Communal tariffs for the local governments are developed and established by the Ministry of Housing, Utilities and Communal Services and the Ministry of Economy. Local authorities have no independent rights in the establishment and regulation of communal / municipal tariffs.

3.6. LOCAL PROPERTY MANAGEMENT

An important underlying notion, which is basic in the process of assets management, is that a communal ownership is fixed in the Belarusian legislation. However, its only type is State ownership. In Belarus, therefore, municipalities are functioning within the framework of a State ownership. For the local government it means that municipalities are subordinated to a so-called rigid “presidential” vertical hierarchy and function far from being within the framework of fiscal decentralization. So, it is worth to imagine that municipalities have no their own assets and the State has transferred to municipalities their property for operative management and economic conduct.

The Belarusian Constitution (Article 13) states that ownership can be both state and private (Konstitutsia Respubliki Belarus, 2004). On the other hand, the Constitution (Article 121) also states that the competence of Local Council of deputies is to manage and conduct the communal ownership in limits defined by the Law (Konstitutsia Respubliki Belarus, 2004). So the concepts of state, private and communal ownership are stated in the Constitution. The Belarus Civil Code (Article 215), however, classifies communal ownership as a state one (Grazhdanski Kodeks Respubliki Belarus, 1998). It very seriously confuses the situation in the regulation of fundamental relations. However, the aspiration to reduce the number of independent patterns of ownership up to the state and private ones into the Belarus Civil Code can be recognized as a contradiction of common sense. Thus the local governments have no municipal/communal ownership by the nature and use the state ownership transferred to them for operative management [*operativnoe upravlenie*]².

In Belarus the so-called municipal ownership or state ownership transferred for operative management to municipalities may include: state property structures of a corresponding administrative and territorial unit, local budget’s financial sources, available housing and communal services of subordinated territory, and also the industrial, building, agricultural enterprises, trading enterprises, transport and public consumer services, other enterprises, organisations, establishments of public health services, culture, physical training and sports, social protection and other property necessary for functioning and developing the territory. Besides, the property transferred to the municipal ownership gratuitously by the state, other proprietors, and also the property created by Local Councils, other local governments, executive committees and local administrations, can be attached to the municipal ownership.

3.7. INFORMATION SOURCES, PUBLIC AND AVAILABLE DATABASES ON COLLECTED LOCAL AND SHARED TAXES

Information resources and publicly available databases on collected local and shared taxes are very poor, limited and need special permission for their receiving from officials. The existing statistical yearbooks give very brief information about the dynamics of revenues and expenditures of the consolidated local budget (sub-national budget.) Financial reports on the governmental tiers aren’t published; there are no suitable information bases on local finance in Internet. For receiving information sources according to local budget revenues it is necessary to get a special office access to the Ministry of Finance and its structures. Information sources received aren’t transparent.

2. Operative management means that the state assets or property are ceded by the central government to local governments for use on the free of charge base. Operative management or administration is the way of management (legal regime of using) of municipal ownership. It should be understood, however, that transferred property isn’t fixed to municipal ownership by Law.

Chapter 4

Intergovernmental transfers, fiscal equalization

The transfer and grant system in Belarus is designed to equalize the financial conditions for local governments and additionally to fund public sector expenditures. In other words, it is designed to equalize budgetary security (expenditures on welfare sphere) and balance local budget revenues and expenditures. The full set of transfers used in the local government financial system of Belarus is presented below in Table 6.

Table 6. Central government transfers for sub-national governments in Belarus, fiscal year 2009-2013

Types of transfers assigned from the Central (Republican) budget	Years				
	2009	2010	2011	2012	2013
Donations to the welfare branches (donations to the <i>[neptoizvodstvennyaya sfera]</i> for equalization)	59.8	72.65	75.7	82.53	83.5
Subventions for funding of agricultural and fishing expenditures	8.6	5.8	4.2	1.56	2.66
Subventions for funding the expenditures to overcome the Chernobyl catastrophe	13.1	6.65	6.2	7.7	8.3
Funds received from the State off-budget fund of social protection of the population to provide the funding of employment	1.9	1.1	0.7	0.7	0.77
Subventions for covering housing construction cheques <i>[zhil'e]</i>	1.9	1.7	1.1	0.9	0.57
Other inter-budgetary transfers	4.3	0.8	0.6	0.01	-
Capital transfers from other budgets of the fiscal system of the Republic of Belarus	10.4	11.3	11.5	6.6	4.2
Total:	100.0	100.0	100.0	100.0	100.0

Source: Author's own calculations based on the Ministry of Finance reports

The share of central government transfers and grants in sub-national government budgets fluctuated from 30.45% to 35.5% in 2011-2013. In some oblast budgets this indicator has fluctuated from 39.89% to 50.23% (see Table 3). This is explained by shortages of own taxes and fees collected and the subsidized nature of these regions.

All central government transfers and grants are strictly programmed as established in the annual Budget Law adopted by the Belarusian Parliament. It is worth mentioning that the grants and transfers of the medium level (oblasts) governments are not applied. Instead, the method of shared taxation is used. The shared and ceded taxes – including the value added tax, the profit tax, the shared portion of the personal income tax and the real estate tax – are balanced in the budgets of the rayons, cities with oblast status, cities with rayon status and the urban and rural settlements.

The most important central government transfers targeted at the welfare *[neproizvodstvennyh]* sectors include expenditures for education, public health, culture, fitness and sport, mass media and social care, payments of communal services, and purchases of stock and equipment. Such transfers may be granted in the event of shortfall of own taxes, shared taxes, and of local taxes, fees and duties, which lead to the inability to cover the planned expenditures. These transfers are implemented from the *special fund for financial support of administrative-territorial units* (FFSATU) into the Central (Republican) Budget. This size fluctuates within 23-25% of the Central Budget expenditures. The equalization of local government budgets is made on the expenditure side of local budgets through the simple method of vertical equalization. In other words, transfers based on equalizing according to the expenditure needs and not taking into account the revenue possibilities.

In Belarus the equalization scheme is based on discretion approach or calculations, which include the following components: a normative of per capita budgetary security as specified in the annual Republican

Budget Law; the number of inhabitants in the oblast or city; a correction coefficient taking into account the non-uniformity of welfare sector [*neproizvodstvennyh*] organisations and units located in the regions. They are established for each social-cultural/welfare sphere. For example, in the capital, Minsk city, and in regional cities it is higher than in the countryside. By multiplying these components, the size of expenditure needs on welfare [*neproizvodstvennyye*] programs are determined. If revenue shortages occur with respect to the size of expenditures calculated, the central government is to draw from the fund for financial support of the administrative-territorial units for that purpose. Since 2002 the Belarus Ministry of Finance has introduced some corrective elements into the equalization procedure, which are now incorporated into the Budget Laws. Now for the calculation of expenditure needs both separate normatives/norms and social standards in the welfare sphere are used. There are two separate normatives / norms in health care and in education used in calculations: the normative per inhabitant for health care and the normative per inhabitant for education. Both normatives and norms are differentiated for the oblasts and Minsk city. Social standards for expenditure needs' calculation in other welfare sectors (culture, fitness, sport, mass media) are used as well.

The budgets of rayon and cities with oblast status as base local budgets are balanced after the equalization procedure is finished, with grants (subventions) provided from the Central Budget for funding of expenditures to overcome the Chernobyl catastrophe, for covering housing construction cheques [*zhil'e*], funding of agricultural and fishing expenditures in regions, capital expenditures.

It should be mentioned that in practice the methods of equalizing and balancing local budgets create unequal conditions for rayons and cities which use their own revenues to help fund their own needs and those which do not, but which receive significant grants from the central budget. It should be apparent that this allocation of Central Budget funds does not motivate sub-national governments to perform the necessary tasks to increase their own financial sources and reserves. The main problem is that the bulk of grants allocated does not take into account the tax efforts of local authorities. As a result, the tax efforts of local authorities do not correlate with the level of social and economic development of their communities. The following principle of transfer allocations should, therefore, be realized: more effective local tax efforts should result in greater financial support from the Center.

The size of transfer allocation is performed by the old Soviet approaches based on funding of protected expenditure items of municipal enterprises, which under the Budget Law are: expenditures on salary, charges on salary, food, medicines, various transfers to the population, reimbursement of housing and communal services' costs [*zatrat zhilishchno – communalnyh uslug*] to the population. It would be important to note that the process of transfer passing is performed not directly to the concrete local (rayon) budget and through the higher regional (Oblast) budgets, which doesn't provide efficiency and creates opportunities for further redistribution of funds based on subjective approaches.

4.1. EQUALIZATION OF REVENUES AND SPENDING NEEDS

In Belarus the equalisation process is performed based on expenditure needs of rayon municipalities and cities with oblast status municipalities only. Expenditure needs are determined by standards or normatives of the budgetary security per inhabitant by the items: health care, education and culture. By multiplication of these standards or normatives with the number of inhabitants in rayon and cities, the sum of expenditure needs is defined. It should be noted that budgets of lower municipalities (rural, urban, cities with rayon status municipalities) do not participate in the equalisation process. Equalizing the revenue possibilities isn't applied. Instead of revenue possibilities the revenue basket³ is used.

The revenue basket for equalization is defined proceeding from the taxes which are administered by the municipality. As a rule, it is all planned taxes which can be collected by the municipality except for the shared and ceded taxes and fees. So, the revenue basket should be equal to own taxes, fees and shared taxes to be collected in the rayon municipality budget.

So, transfer = expenditure needs - revenue basket.

³. Revenue basket serves as an alternative to revenue capacity

It should be noted that all equalization procedures are not transparent also any of them isn't registered in the Budget Code and in other legislative acts.

4.2. CAPITAL INVESTMENT

Capital expenditures occupy more than 20 per cent of total consolidated local budget expenditures, which are distributed: on capital investments in fixed assets; land purchase and intangible assets and capital transfers. It is illustrated in Table 7.

Table 7. Capital expenditures in consolidated sub-national government budgets in 2014 (in percentage)

Sub-national budgets (consolidated oblast budgets)	Expenditures on							
	Total capital expenditures	of which:		of which:			Land purchases	Capital transfers
		Capital investments in fixed assets	Purchases of equipment	Capital construction	Capital repairing			
Brestskaya	22.85	20.75	1.37	17.16	2.22	-	2.1	
Vitebskaya	15.02	13.19	0.55	9.93	2,71	-	1.83	
Gomelskaya	20.24	18.2	0.62	14.43	3.15	-	2.04	
Grodnenskaya	21.21	18.95	1.35	13.95	3.65	-	2.16	
Minskaya	20.3	17.85	1.04	14.42	2.39	-	2.44	
Mogilevskaya	17.54	15.84	0.86	11.26	3.72	-	1.7	
Minsk city	29.35	25.44	0.49	22.86	2.10	0.002	2.51	
Total consolidated local budgets	21.94	19.43	0.84	15.85	2.74	0.002	2.51	

Source: Author's own calculations based on the Ministry of Finance reports

Capital investments are funded by the oblasts budgets and covered mainly by the shared taxes and central government transfers. Capital investments in local governments are planned on the basis of general plans of social and economic development of regions and should be coordinated with the central government. The line ministries might play an important role, as well.

Chapter 5

Local borrowing

The significance of debt rising is connected with the global financial crisis of 2008-2010, which touched Belarus as the other European countries. In the conditions of the financial crisis, municipal borrowing, as a new form of the local governments' financial support, has been found in Belarus. Since July 2009 local executive bodies and administrative ones have acquired the right to issue their bonds. Thereby local authorities had a tool to attract additional financial resources. By this time some local executive bodies and administrative ones have already taken advantage of this tool and issued the bonds. The State bank of SB "Belarusbank" has become buyer of these bonds. Local executive committees were authorized to issue their bonds without security as the borrower has been the State in this case. Bond issues of the local executive bodies and administrative ones were carried out within the size of a debt defined in the local budgets for the next fiscal year. Thus, for the purpose of attractiveness of these bonds, the income received at bond repayment by local authorities was released of profit taxation. According to data at the beginning of August 2009, a portfolio of redeemed SB "Belarusbank" of bonds of legal bodies has reached 327 bn. Belarus rubles, or 0.24% of GDP and 1.42% of total sub-national expenditures. 90% of the portfolio (more than 290 bn. Belarus rubles) belonged to the local authority securities.

The time of bond circulation has not exceeded one year, i.e. debt repayment was made no later than one year after the bond circulation. The first bonds issuers among local authorities were the Brest and Minsk regional executive committees, Pruzhansky and Kamenetsky rayon executive committees, the Brest city executive committee. By this time the local authorities listed above have been issued their own bonds until their closed sale to SB "Belarusbank".

For the regulation of borrowing process, for the first time a debt limit indicator of the guarantees and guarantees provided by local authorities on loans issued by banks to legal entities of Belarus ⁴ has been introduced by the Budget Law on 2006 and later it entered into the Budget Code. Now this indicator can't exceed 20% of the total amount of expenditures of oblast budgets, rayon ones and city budgets except for the credits issued for development of housing construction in villages and the investment projects implementation which passed the state complex examination ⁵.

Another restriction for local governments is the limit of *debt services, which should not exceed 15%* of local budget revenues. In other words, local government borrowings aren't allowed if the sum of the planned payments on debt services in the current year exceeds 15% of the budget revenues gained without taking into account transfers and grants.

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4. Local authorities can issue guarantees for legal entities which are in the boundaries of their jurisdiction. But in fact it isn't used in practice.
 5. Guarantees on housing construction in rural areas aren't taken into account for this indicator

Chapter 6

Local financial management

6.1. SEPARATION OF CURRENT AND CAPITAL BUDGET, BALANCING LOCAL BUDGETS

In the Belarusian local budgeting practice, there is no division of local budget in current budget and capital one. Capital revenues and expenditures and current ones are reflected in one budget.

6.2. STRATEGIC PLANNING, MULTIYEAR BUDGETING

Strategic planning of local budgets by local authorities in Belarus isn't applied. Multiyear budgeting is also not formed due to economic instability and high inflation in the country. In the best case, the planning of sub-national budgets is made only for one year ahead.

6.3. ANNUAL FISCAL PLANNING, BUDGETING

Annual fiscal planning and budgeting is carried out by finance departments in municipalities. Responsibility for fiscal planning and budgeting is born by the head of the finance department and the Chairman of the executive power of municipality. Planning methods are based on old Soviet techniques to form the local budget, i.e. a method based on summation of all budget expenditures. Program budgeting isn't applied.

A prominent feature of the budget process in local financial administration is that the formation of local budgets occurs within the framework of a uniform State budget process. It imposes certain specificity in local budget formation. First, local budgets are included in the system of the State budget. Second, local budgets should be corrected on the basis of the macroeconomic parameters and indicators of Belarus economy by the Ministry of Economy and the Ministry of Finance.

Budget planning example: The local budget planning procedures start in September and finish in the mid of December. A starting point in rayon local budget planning is GRP growth indicator (Growth Regional Product, an analogy of GDP indicator for regions), which oblast committee of economy brings to rayon finance department for budget planning. This indicator then is used to determine the local budget size for the next year. By multiplication of the total budget sum on current year with GRP growth coefficient / indicator on next year, the size of planning local budget on next year is defined.

After that the expenditure side of budget is defined. The local government executive committee gives an assignment for all organisations funded by the local budget to present all calculations for expenditure side projection. Allocations on expenditure items should be calculated from network and volume indicators and calculations for the forms enclosed for formation of the budget draft. Allocations should take into account the planned growth or reduction in next year, as well. Calculations for all other indicators should be made from real requirements and concrete expenditure features, namely: equipment of establishments by stock and equipment, need of current and capital repairs, number of vehicles, telephone numbers, plans of the direction for advanced training courses and other. Calculations are formed on separate funded organisation with granting the arch according to the paragraph, subsection, the section of the budgetary classification. Together with expenditure, written explanations are submitted.

After that the revenue side of the budget is defined. Revenue items of the budget are generally defined in proportion to coefficient / indicator of GDP growth. The financial department is defining the opportunities to collect own revenues to supplement the shared taxes. Then the expenditure side of the budget for standard items is defined. Priority to determination of expenditure sums on concrete items can be given.

The planned revenues and expenditures are submitted to the higher financial body - the Oblast financial department. At this stage, the amounts of central transfers and grants (donations, subventions and subsi-

dies) to be included into the local budget are clarified and updated. Later the oblast financial department determines the sums of shared taxes to be directed for local budget balancing.

The planned local budget is adopted and approved by the Local deputies at the plenary session. Then the budget approved by local deputies is transferred to the oblast financial department for consolidation and reporting. After that the central and sub-national budgets are considered by the National Government and the President of Belarus in the preparation process to adopt the State Budget.

The local budget approved on the next year is published in rayon newspapers and mass media without any comments. The local population isn't allowed to participate in the discussion of budget items at the plenary session. At hearings of the budget in a session, local citizens are not accepted, as a rule. Inhabitants aren't interested in drawing up the local budget as their opinion will not be considered.

Allocations according to items of expenditure have to pay off proceeding from network, volume indicators and to calculations for the enclosed forms for the formation of the draft budget. Allocations according to items of expenditure calculate proceeding from the existing network indicators taking into account the planned gain (reduction) in 2003.

6.4. BUDGET IMPLEMENTATION

Budget implementation of local budgets is carried out by the following bodies: Executive committees, local financial departments, tax collections departments. Local budget implementation is made through the automated state system of treasury within the actual existence of budgetary funds. The report on budget implementation is formed in accordance with the budgetary classification. The report is discussed at the Local Council session by the local deputies.

Budget implementation is monitored by the head of the executive committee of municipality and the financial department of municipality quarterly. Monitoring is also exercised by local tax administration, which supplies reports on taxes and fees collected quarterly. As a rule, the sums on revenue side and expenditure one are equal in local budgeting and deficit or surplus doesn't happen. In case of budget revenue decrease to the level which can lead to reduction of expenditure funding from the budget compared with the planned volume for a year more than 10%, the local financial department should urgently inform about it the local executive bodies. Local executive bodies should present the draft decision on reduction or blocking of budget expenditures on the current fiscal year to Local Councils of deputies for its consideration in urgent manner.

Intervention rules in emergency cases may be applied by the following bodies: Committee of the State control of the Republic of Belarus, Ministry of Finance, Ministry of Taxes and Fee Collection, Local Councils of deputies. They can apply the following measures: stopping or restriction of expenditure funding from budgetary funds; collecting budgetary funds; stopping bank transactions for treasury; imposing a fine, charge and collecting penalty fees.

Agreements with service organizations are signed by the local executive committee. All service organisations are the state-owned enterprises of housing, utility and communal services. The private public utilities aren't used in practice. Contracts, leasing and concessions aren't applied, as well. All public utilities with contracts signed are strongly subordinated to the center - the Ministry of Housing and Public Utilities. All utilities are located in rayons, but they belong to the Ministry of Housing, Utilities and Communal Services, which has a representative body in oblasts – Oblast association of housing, utility and communal services.

6.5. FISCAL INFORMATION, ACCOUNTING AND AUDIT

The fiscal information system is very poor. The general information on the fiscal system can be received from the statistical yearbook published by the Committee of Statistics and from the website of the Ministry of Taxes and Tax Collection. To obtain fiscal information on local budgets the special permission from the Ministry of Finance and the Ministry of Taxes or / and Tax Collection is required.

In Belarus there are no specific rules of book-keeping for sub-national governments. Local authorities use the common rules of accounting applied in all government tiers. Local authorities do not draw up and pub-

lish accounting balances (reports) by these standards. It should be noted however, that there is a special plan of accounts for organisations funded from budgets.

The bodies exercising control over the local budgets: Committee of the State Control of the Republic of Belarus, Ministry of Finance, Ministry of Taxes and Fee Collection, Local Councils of deputies. The supervision and control system over the activity of sub-national governments is basically implemented by external and internal control bodies. The external control bodies are implemented by the Committee of State Control bodies, the Ministry of Finance's control bodies, the tax administrations of all levels, and the Committee of Economic Control in the regions. The basic internal body for controlling and supervising local government is the commission on budget and finance of the local council, which oversees the implementation of the local budget for a fiscal year. Independent audit organisations are not admitted to the process of control and supervision of the financial activities of local governments. Because state power is omnipresent in local governments, external State control is dominating in the Belarus system of local financial management.

The process of financial management of local government is very complicated and non-transparent.

The complexity of local financial management is connected with the fact that local finance is subordinated to state finance, and local budgets are branches of the Central Budget in localities.

The central power, however, wishes to show that in Belarus there is a fiscal decentralization, but actually provides a fiscal centralization policy, submission of local finance to State finances. In reality, the Central Government wishes to keep all financial flows of sub-national level under the State control.

That's why many topics of local financial management (expenditure functions and responsibilities, formation of own revenue base, tax sharing, equalization procedures) remain non-transparent and closed subjects for discussion by the population.

6.6. LOCAL MANAGEMENT CAPACITIES

In Belarus there is a good potential for local financial management. First of all, there are financial experts and specialists with higher education, practical experience and skills in local finance departments. An experience of local financial management legislation is saved up as well. In Belarus there is high degree of tax collection and high tax culture. There is an experience of many methodical documents development according to standards of tax sharing, borrowing and tax administration. The Belarusian local financial management is characterized by the high organization of control over the financial processes at all levels.

An essential part of experts and specialists is able to be retrained in the direction of fiscal decentralisation. Thus, Belarus has big abilities in local financial management. Only the political will of the top management of Belarus is necessary.

Financial administration staff, especially young financial specialists and experts, is ready to perceive the new in local financial management, get trainings and have abilities in financial development.

The Belarusian financial experts will be able quickly to adapt to the demanded standards of local financial management if the political decision on transition to real local government and decentralization at the highest level of the power will be accepted.

Chapter 7

Implementation of LFB

7.1. INFORMATION, DATASETS FOR COMPARISON

Database of the Ministry of Finance and regional finance departments:

- Dynamics of local budgets by the sub-national governmental tiers (levels); local budget's revenue sources by the sub-national governmental tiers (levels); local budget's expenditures by the sub-national governmental tiers (levels); expenditures by the functional and economic classification;
- Intergovernmental transfers (structure of transfers); funds allocated for equalization (the equalizing transfers); dynamics and sizes of municipal loans by the sub-national governmental tiers (levels);

Database of the Ministry of Taxes and Tax Collection: data on the actual sums of taxation and payments in the local budgets by the oblasts and rayons;

Data of rayon executive committees, rayon finance departments and rayon tax administrations: total revenues (current and capital); local own source current revenues; local own capital revenues; shared revenues; grants, transfers, donations, subventions, etc.; annual net borrowing; data of rayon's executive committees and rayon finance departments; data on implementation of the revenue plan (on quarters); sheet of the revenue movement; data on receipt of revenues in budgets of rural and urban councils and cities with rayon status; data on shortages in the budget; classification of local governments: (administrative status (region, city, town, village, commune; regional position; population number; area, etc.).

7.2. PROBLEMS AND OBSTACLES IN LFB IMPLEMENTATION

Practically, local authorities have no incentives for comparison and competition because there is no local financial autonomy and financial competition between municipalities. A fiscal capacity and expenditure abilities of the local governments are limited by the higher governmental authorities. In this case there is no competition between municipalities for public goods and services. So, it is very difficult to show the existence of local incentives for competition.

With all probability, local authorities' participation in future LFB program is extremely small, though their experience, skills and knowledge potential are not bad, they are well prepared and could participate in this program. But there are some reasons. As local authorities are strictly subordinated to the central government and they are central government's representatives at the local levels, there is no need to perform LFB as local budgets completely enter into the state budget. Thus, there is no sense for local authority's representatives to participate in this program. In addition, there is no political will and political decision on the issue of power decentralization and local government development in Belarus. Recently the President of Belarus, Alexander Lukashenko, said in the mass media that decentralization and self-government will ruin Belarus. It is the reply to challenges of local government development in Belarus. Therefore both the central and local authorities won't be able to become allies and participants in a future LFB program.

LFB program allies and participants can become independent bodies: civil organizations and institutions, public and non-government organizations (NGO) and others. For example, NGO "Lev Sapieha Foundation", whose experts are scientists and specialists in the field of local government and local finance, can become participant of the benchmarking program.

Availability of information on participation in a future LFB program is limited to special permissions for obtaining information. If we want to get any information from ministries and local government bodies we should apply for what information we need. Very often we are getting negative response with the motivation "it is closed information" and it requires a special permission. It can be received, however, by the

channels of personal contacts and communications. For example, I am receiving information by my own channels, based on personal contacts and reference on university studies in field of public finance.

Publicity of and access to local documents require the allowing procedures. For receiving information on the studied object one needs to provide: the purpose of obtaining information, what kind of organization you represent and where information will be used. Even if a positive permission will be obtained, local authorities try to provide as little as possible information on the required subject (audit report, budget figures, etc).

Nevertheless, there are good technical capabilities to operate an external assessment of local finance. First of all, the Internet is well developed in Belarus, there is software and there are possibilities to create special websites for a future LFB program. Experts and specialists are able to use well the software products.

The election years for central and local governments and President are the following:

Parliament elections: every 4 year (2000, 2004, 2008, 2012, next elections in 2016); Local elections: every 4 year (2002, 2006, 2010, 2014, next elections in 2018); Presidential elections: every 5 year (2000, 2005, 2010, next elections in October 2015)

7.3. GUIDANCE AND PROGRAM FOR ADAPTING THE (NATIONAL AND LOCAL) LFB TOOLKIT

Opportunities for rising public interest in the central and local governments consist in the creation of pre-requisites for maximum approach of inhabitants to local finance management. It is necessary to show more advantages in the approach of local management of local finance from the experience and practice of the European countries. It is necessary to bring in the consciousness of people that the benefits of decentralized management are more than of the centralized one.

The main difficulty in an explanation of decentralization advantages is the following argument of official authorities: "Look at the Belarus public administration. Here everything works well. Public transport works well, there is light on the streets, there are no problems in water supply and the sewerage, streets are purely cleaned, there is no crime, good safety, high employment and isn't present unemployment. What still you need? If we introduce decentralisation, we will lose everything that we have now". Decentralization, as official authorities say, it is chaos, a disorder and ruin. Therefore, the strong counterargument in favour of decentralization and local government development has to be found in Belarus. Only then it will be possible to find allies, represented by the central and local governments, for a rise of public interest in LFB.

A specific argument of authorities is the reply to the question why in Belarus the public sector reforms aren't carried out. Instead of public reforms implementation, some cosmetic measures and imitation of reforms are performed to get the next loan from the international financial organizations. Modernization programs don't concern fiscal and budgetary reforming, and they are directed to attract foreign investments only.

The international financial organizations (IMF, World Bank), the European Union structures (Council of Europe, European Commission), the European foundations, NGOs and other non-governmental organization can be potential partners for rendering hospitality of a future LFB program. Potential local sources for funding the LFB program in Belarus are absolutely absent.

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